



Issue Date

March 13, 2012

Audit Report Number

2012-LA-1005

TO: William Vasquez, Director, Los Angeles Office of Community Planning and Development, 9DD

*Tanya E. Schulze*

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The City of Los Angeles, CA, Did Not Expend Brownfields Economic Development Initiative and Section 108 Funds for the Goodyear Industrial Tract Project in Accordance With HUD Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the City of Los Angeles' Community Development Department as a result of a complaint, which alleged that U.S. Department of Housing and Urban Development (HUD) funds were misused for the development of the Goodyear Industrial Tract project. The City was awarded Brownfields Economic Development Initiative grant funds and Section 108 loan guarantee funds for the development of this project. Our audit objective was to determine whether the City expended Brownfields and Section 108 funds for the development of the project on eligible activities and within required deadlines in accordance with HUD requirements.

### **What We Found**

The City did not expend Brownfields and Section 108 funds awarded for the development of the project in accordance with HUD requirements. Specifically, the City used loan and grant funds for an ineligible project and

expended grant funds after the grant deadline. As a result, it expended (1) \$3.8 million in loan funds on an ineligible project, (2) \$625,000 in grant funds on an ineligible project after the grant expenditure deadline, and (3) an additional \$897,821 in grant funds after the grant expenditure deadline. As a result, the City did not ensure that HUD funds were disbursed in accordance with HUD rules and regulations and used on approved projects intended to meet the programs' national objectives.

### **What We Recommend**

We recommend that the Director of the Los Angeles Office of Community Planning and Development require the City to (1) repay \$3.8 million from non-Federal funds for the use of Section 108 loan funds for an ineligible project, plus any interest due, to HUD's Section 108 loan account; (2) reimburse \$625,000 from non-Federal funds for the use of Brownfields funds for an ineligible project after the grant agreement deadline, plus any interest due, to HUD's Brownfields account; (3) reimburse \$897,821 from non-Federal funds for use of the funds after the grant agreement deadline, plus any interest due, to HUD's Brownfields account; and (4) establish and implement policies, procedures, and controls to ensure that grant and Section 108 loan funds are used for eligible project activities and expended within applicable deadlines in accordance with HUD rules and regulations.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided the City a discussion draft report on February 7, 2012, and held an exit conference with City officials on February 15, 2012. The City provided written comments on February 22, 2012. It generally disagreed with our findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report. Attachments to the auditee's response will be made available upon request.

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## **BACKGROUND AND OBJECTIVE**

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The Brownfields Economic Development Initiative grant is designed to stimulate and promote economic and community development. It is intended to assist cities with the redevelopment of abandoned, idled, and underused industrial and commercial facilities, the expansion and redevelopment of which is burdened by real or perceived environmental contamination (brownfield sites). The Brownfields grant funds are primarily targeted for use with particular emphasis upon the redevelopment of brownfield sites in economic development projects and the increase of economic opportunities for low- and moderate-income persons as part of the creation or retention of businesses, jobs, and increases in the local tax base. All grants must be used in conjunction with a new Section 108 loan guarantee commitment.

The Section 108 loan guarantee program is a provision of the Community Development Block Grant (CDBG) program. Section 108 loans provide grantees with a source for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. For purposes of determining eligibility, the CDBG rules and requirements apply. All projects and activities must meet one of the following three U.S. Department of Housing and Urban Development (HUD) national objectives: (1) benefit low- to moderate-income persons, (2) prevent or eliminate slums or blight, or (3) meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health and welfare of the community.

HUD emphasizes the use of Brownfields and Section 108 loan guarantee funds to finance projects and activities that will provide near-term results and demonstrable economic benefits. HUD does not encourage site acquisition or remediation (land banking) when there is no immediately planned redevelopment. Brownfields funds are used to enhance the security or to improve the viability of a project financed with a new Section 108 loan.

The City of Los Angeles' Community Development Department was awarded \$1.7 million in Brownfields grant funds and \$10.4 million in Section 108 loan guarantee funds for the development of the Goodyear Industrial Tract project. Specifically, the funds would be used for the remediation of three locations within the project: (1) Slauson Central Retail Plaza (Slauson and Central Avenues), (2) Apex Patterns (McKinley Street), and (3) United L.A. Alloys (Slauson Avenue). The Brownfields grant agreement was effective on December 21, 1998; however, it was signed on July 14, 2004. The grant stipulated that funds must be expended and withdrawn by August 31, 2005. There were two contracts for the Section 108 loan funds—the first, dated July 14, 2004, for more than \$6.5 million, and the second, dated September 27, 2004, for more than \$3.8 million—totaling \$10.4 million. The Section 108 loan agreement stipulated that funds must be expended and withdrawn by September 30, 2004.

The objective of the audit was to determine whether the City expended Brownfields and Section 108 funds for the development of the Goodyear Industrial Tract project on eligible activities and within required deadlines in accordance with HUD requirements.

## RESULTS OF AUDIT

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### Finding: The City Did Not Expend Section 108 Loan and Brownfields Grant Funds in Accordance With HUD Requirements

The City did not expend Section 108 loan and Brownfields grant funds in accordance with HUD requirements. Specifically, it used loan and grant funds for an ineligible project and expended grant funds after the grant deadline. This condition occurred because the City did not have sufficient policies and procedures for monitoring its HUD loans and grants. It expended (1) \$3.8 million in loan funds on an ineligible project, (2) \$625,000 in grant funds on an ineligible project after the grant expenditure deadline, and (3) an additional \$897,821 in grant funds after the grant expenditure deadline. As a result, funds were not available for the City to use on approved projects intended to meet the programs' national objectives.

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#### **The City Used Section 108 Loan Guarantee and Brownfields Grant Funds for an Ineligible Project**

The City used \$3.8 million in Section 108 loan guarantee funds and \$625,000 in Brownfields grant funds for an ineligible project. It used the funds for the interest repayment, acquisition, loan fees, and interest reserves for the Avalon Park Plaza project.

Section 2 of the grant agreement requires grant funds to be used in connection with the development of the Goodyear Industrial Tract project to specifically develop or expand the following businesses: (1) Slauson Central Retail Plaza, (2) Apex Patterns Company, and (3) United L.A. Alloys Company. Section 8 of the grant agreement states the agreement may only be amended with prior written approval from HUD. Further, section 15(i) of the Section 108 loan guarantee contract requires that a lien be placed on the real property that will be funded with the loan funds. The legal descriptions detailed in attachment 3 of the Section 108 loan guarantee contract do not include the Avalon Park Plaza project. Section 15(j) of the Section 108 loan guarantee contract incorporates the entire grant agreement into the Section 108 loan guarantee contract. In addition, 24 CFR (Code of Federal Regulations) 570.704(a)(i)(B) states that activities that will be funded with HUD funds must be described in the application for loan guarantee assistance in detail. The City provided HUD with a status report on the progress of the grant and loan funds and its related projects. However, it did not request approval for the use of grant and loan funds for the Avalon Park Plaza project. The City stated that since it did not receive a response from HUD regarding the status report, it

believed that it was able to use the funds on the Avalon Park Plaza project. Section 11 of the grant agreement specifically states that all amendments must be in writing and executed by both HUD and the recipient.

Since the project was not part of the Section 108 loan or Brownfields grant agreements, the City used \$4.4 million in loan and grant funds for ineligible purposes. We attribute this deficiency to the City's lack of policies and procedures to ensure that Section 108 and Brownfields funds were monitored and expended on approved projects and activities in accordance with HUD rules and regulations. Since the City used the funds for an unapproved project, funds were not available for eligible projects to meet the national objectives of the loan and grant programs.

### **The City Used Brownfields Funds After the Grant Expenditure Deadline**

The City withdrew more than \$1.5 million in Brownfields funds after the deadline set forth in its contract with HUD. Section 6(c) of the grant contract entered into with HUD states that funds must be entirely withdrawn and expended for approved uses for the applicable approved project(s) on or before August 31, 2005. As documented in the table below, the City requested only three withdrawals from HUD before the deadline for a total of \$177,179. The balance of the \$1.7 million grant was requested after HUD's deadline.

<b>Drawdowns of the City's Brownfields grant</b>		
<b>Date requested</b>	<b>Project</b>	<b>Amount</b>
01/08/05	Slauson Central	26,782
05/09/05	Slauson Central	17,816
07/29/05	Slauson Central	132,581
<b>Subtotal amount drawn before contract expenditure deadline</b>		<b>177,179</b>
10/31/05	Slauson Central	68,563
02/14/07	Slauson Central	654,554
12/06/07	Slauson Central	174,704
10/29/08	Avalon Park Plaza	625,000
<b>Subtotal amount drawn after contract expenditure deadline</b>		<b>\$1,522,821</b>
<b>Total amount drawn from HUD for Brownfields grant</b>		<b>\$1,700,000</b>

Of the \$1.5 million, the City withdrew \$897,821 in grant funds after the deadline and \$625,000<sup>1</sup> for an ineligible project after the expenditure deadline. The City confirmed that it did not have specific policies and procedures for its

<sup>1</sup> Ineligible use of \$625,000 is described in previous section.

Brownfields funds. Additionally, the City did not properly monitor these funds. Consequently, it did not ensure that HUD funds were disbursed within the applicable deadlines in accordance with HUD rules and regulations to ensure that it met the national objectives of the grant program.

## **Conclusion**

The City withdrew more than \$5.3 million in Brownfields and Section 108 funds in violation of its agreements with HUD and HUD rules and regulations. We attribute this deficiency to the City's lack of policies and procedures for the use of Brownfields and Section 108 funds. As a result, funds were not available for eligible projects and activities. These funds could have been made available to other eligible grantees and helped maximize the effectiveness of the programs by helping to ensure that the programs' national objectives were met.

## **Recommendations**

We recommend that the Director of the HUD Los Angeles Office of Community Planning and Development require the City to

- 1A. Repay \$3,817,000 from non-Federal funds for the use of Section 108 loan funds for an ineligible project, plus any interest due, to HUD's Section 108 loan account.
- 1B. Establish and implement policies, procedures, and controls to ensure that Section 108 funds are used only for eligible projects and activities in accordance with its Section 108 loan guarantee agreement and HUD rules and regulations.
- 1C. Reimburse \$625,000 from non-Federal funds for using Brownfields grant funds for an ineligible project after the grant agreement deadline, plus any interest due, to HUD's Brownfields account.
- 1D. Establish and implement policies, procedures, and controls to ensure that Brownfields grant funds are only used for eligible projects and activities in accordance with its grant agreement and HUD rules and regulations.
- 1E. Reimburse \$897,821 from non-Federal funds for using Brownfields grant funds after the grant agreement expenditure deadline, plus any interest due, to HUD's Brownfields account.

- 1F. Establish and implement policies, procedures, and controls to ensure that Brownfields grant funds are expended within the applicable deadlines in accordance with its grant agreement and HUD rules and regulations.



## SCOPE AND METHODOLOGY

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We performed our onsite audit work at the City's offices, located in Los Angeles, CA, between August and October 2011. Our audit scope covered the period December 1998 through September 2011.

To accomplish our audit objective, we

- Reviewed applicable HUD regulations, the Code of Federal Regulations, and other requirements and directives that govern the Brownfields and Section 108 loan guarantee programs.
- Reviewed the City's grant agreements.
- Reviewed HUD files and correspondence for the City's Brownfields and Section 108 loan programs.
- Reviewed the City's applicable policies and procedures used to administer its Brownfields and Section 108 loan activities.
- Interviewed City personnel responsible for administering the City's Brownfields and Section 108 loan programs.
- Reviewed all HUD disbursements for the Brownfields and Section 108 loan programs for the Goodyear Industrial Tract project.
- Reviewed all expenditures for the Brownfields and Section 108 loan programs, along with supporting documentation for the Goodyear Industrial Tract project.

We conducted the review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Policies and procedures to ensure that HUD funds are withdrawn and expended in accordance with HUD requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The City did not have adequate policies and procedures in place to ensure compliance with Brownfields and Section 108 loan program requirements (see finding 1).

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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Recommendation number	Ineligible <u>1/</u>
1A	\$3,817,000
1C	\$625,000
1E	\$897,821
Total	\$5,339,821

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. These costs consist of Section 108 loan guarantee and Brownfields grant funds used for an ineligible project and grant funds expended after the grant deadline.


## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments

<p>RICHARD L. BENBOW GENERAL MANAGER</p>	<p><b>CITY OF LOS ANGELES</b> CALIFORNIA</p>  <p>ANTONIO R. VILLARAIGOSA MAYOR</p>	<p>COMMUNITY DEVELOPMENT DEPARTMENT 1200 WEST 7TH STREET LOS ANGELES, CA 90017</p>
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February 22, 2012

Tanya E. Schulze  
Regional Inspector General for Audits  
U.S. Department of Housing and Urban Development  
Office of Inspector General, Region IX  
611 West Sixth Street, Suite 1160  
Los Angeles, CA 90017-3101


**CITY OF LOS ANGELES RESPONSE TO DRAFT AUDIT REPORT GOODYEAR  
TRACT INDUSTRIAL PARK PROJECT**

Dear Ms. Schulze:


This letter provides the comments of the City of Los Angeles, Community Development Department (CDD), to the draft audit report regarding the use of U.S. Department of Housing and Urban Development (HUD) funds for the development of certain projects within the Goodyear Industrial Tract (Goodyear Tract). The draft audit report was provided to CDD on February 7, 2012, and a meeting was held with you and other representatives of the Office of Inspector General (OIG) and Department of Housing and Urban Development (HUD) on February 16, 2012 to discuss the findings contained in the draft report.

The draft audit report makes three findings regarding CDD's use of Brownfields Economic Development Initiative (BEDI) grant funds and Section 108 loan guarantee program (Section 108) funds: (i) CDD withdrew and expended BEDI funds of \$1,522,821 after the program deadline of August 31, 2005, (ii) CDD expended BEDI funds of \$625,000 on an "ineligible" project—a project not identified in CDD's BEDI application nor in the grant agreement, and (iii) CDD expended Section 108 funds of \$3,817,000 on that same "ineligible" project. The draft audit report recommends, among other things, that CDD repay/reimburse HUD in the amount of \$5,339,821 with non-Federal funds.

CDD is mindful of its obligations under Federal statutes, the Code of Federal Regulations (CFR) and the BEDI and Section 108 agreements, and, as demonstrated in the comments below, acted in good faith at all times in its use of Federal funds. Generally, CDD's comments to the proposed findings are:



AN EQUAL EMPLOYMENT OPPORTUNITY - AFFIRMATIVE ACTION EMPLOYER



**Comment 1-3**

- CDD requested an extension of the BEDI expenditure deadline by letter dated August 31, 2004, but HUD failed to comply with the requirements of the grant agreement by not preparing an amendment to the grant agreement prior to the expiration of the deadline.

**Comment 4-7**

- A HUD official, with apparent contract authority, informed CDD in writing in May 2005 that the BEDI expenditure deadline has been extended. CDD relied on that representation, and HUD performed thereafter as if the deadline had been extended.

**Comment 8-9**

- Although the Avalon Park Plaza project was not specifically identified in the grant or Section 108 agreements, HUD tacitly consented to the funding of the project because (i) HUD approved the Section 108 contract with the understanding that two of the projects were not ready for funding and may be replaced, (ii) the Avalon Park Plaza project is within the Goodyear Tract and was otherwise eligible for funding, and (iii) CDD specifically notified HUD in writing that the Avalon Park Plaza project was to be funded and HUD never objected to its funding.

**Comment 10**

- CDD's use of the BEDI and Section 108 funds were used for eligible activities in meeting national objectives. CDD should not be required to repay the funds for mere procedural errors, if any.

**Comment 1-5**

CDD requests that the finding in regard to the drawdown of BEDI funds after the expenditure deadline be revised to indicate that CDD did not violate the grant agreement deadline, but rather complied with its requirements and relied on the written representation made by a HUD official. CDD also requests that the finding in regards to the use of BEDI and Section 108 funds on an "ineligible" project be revised to indicate that the Avalon Park Project, although not specifically identified in the applications or agreements, was within the scope of the Goodyear Tract funding, and that HUD officials were informed of the substitution of projects and tacitly approved funding for the project.

**Background - Chronology****Comment 8-9**

The following chronology of key dates and communications with HUD in connection with the development of the Goodyear Tract project provides background for CDD's comments. Please note that CDD has located two additional documents related to the project which are identified below and are attached hereto for OIG review.

August 7, 1998

CDD submitted a \$1,700,000 BEDI grant application for the Goodyear Tract Industrial Park Project -Slauson Central Retail Plaza (Slauson Central), Apex Patterns Expansion (Apex) and United LA Alloys Expansion (United Alloys).

December 21, 1998	HUD approved the BEDI grant application with expenditure deadline date of August 31, 2005 (the grant agreement was not fully executed until July 14, 2004).
March 30, 1999	CDD submitted a \$10,400,000 Section 108 Loan application for the Goodyear Tract Industrial Park Project - Slauson Central, Apex and United Alloys.
July 16, 1999	HUD approved the Section 108 Loan application with an expenditure deadline date of September 30, 2004 (the first agreement was fully executed on July 14, 2004, while the second agreement was fully executed on September 27, 2004).
June 4, 2003	CDD letter to HUD advising that the United Alloys and Apex projects were not ready to be funded. [This letter has not been reviewed by OIG and is attached hereto.]
October 22, 2003	CDD executed the BEDI Grant Agreement and the \$6,583,000 Section 108 Loan Contract.
July 14, 2004	HUD executed the BEDI Grant Agreement and the \$6,583,000 Section 108 Loan Contract
August 31, 2004	CDD letter to HUD to (i) state CDD's understanding from HUD officials that there was no deadline for the expenditure of BEDI funds and requesting that HUD amend the grant agreement to set an expenditure deadline date of no earlier than August 31, 2008, and (ii) request a Section 108 contract, note and drawdown by September 30, 2004 for the remainder of 108 funds which would continue to meet the project implementation objectives with respect to developing the Goodyear Industrial tract. [This letter has not been reviewed by OIG and is attached hereto.]
September 24, 2004	CDD executed the \$3,817,000 Section 108 loan contract.
September 27, 2004	HUD executed the \$3,817,000 Section 108 loan contract.
September 30, 2004	Expenditure deadline for Section 108 loan proceeds.
February 25, 2005	CDD informed HUD during the monthly status conference call of negotiations to replace Apex with the GE site within the Goodyear Tract.

March 17, 2005	CDD informed HUD during the monthly status conference call that the United Alloys site had been purchased by an adjacent business for expansion, and that negotiations for a replacement project within the Goodyear Tract were underway.
May 31, 2005	HUD Economic Development Specialist [REDACTED] sent e-mail to CDD stating that there was no expenditure deadline for BEDI grant funds.
August 31, 2005	BEDI expenditure deadline.
October 31, 2005	HUD approved CDD BEDI drawdown of \$68,563 for the Slauson Central project.
December 20, 2005	CDD informed HUD during the monthly status conference call that the GE site was being considered for the Apex site.
May 15, 2006	CDD notified HUD during the monthly status conference call that the United Alloys may be replaced with American Apparel.
February 14, 2007	HUD approved CDD's BEDI drawdown of \$654,554 for the Slauson Central project.
October 1, 2007	CDD informed HUD during the monthly status update conference call that American Apparel had been dropped as a prospect for the United Alloy site, and that CDD was seeking a replacement project.
December 6, 2007	HUD approved CDD's BEDI drawdown of \$174,704 for the Slauson Central project.
February 5, 2008	CDD informed HUD during the final monthly status conference call that Avalon Park Plaza had been identified for the United Alloys site.
September 30, 2008	CDD letter to HUD affirming the addition of the Avalon Park Plaza project, and stating that the project was within the same proximity of the other funded projects and conforms to the overall project scope of the original application.
October 29, 2008	HUD approved CDD's BEDI drawdown of \$625,000 for the Avalon Park Plaza project.

Names have been redacted for privacy reasons

Comments**A. Expenditure of BEDI Grant Funds After Deadline Date:**

1. *CDD, in compliance with the requirements of the BEDI agreement, requested HUD to amend the agreement to extend the expenditure deadline. HUD, however, failed to prepare the agreement amendment.*

**Comment 1**

CDD, in its August 31, 2004 letter to HUD, expressly and specifically requested HUD to amend the BEDI agreement to extend the expenditure deadline date to at least August 31, 2008. HUD, in reviewing the request under Sections 8 and 11 of the grant agreement, was to review, among other things, whether the amendment would impact the original ranking of the application, and whether the amendment is consistent with Federal statutes, the CFR and the NOFA. Any increase in the BEDI grant amount must be documented by "formal amendment" to the grant agreement executed by authorized officials of each of the parties.

**Comment 2**

CDD's proposed amendment met the requirements of Sections 8 and 11 because (i) extension of the expenditure deadline would not have changed the substantive contents of CDD's application and therefore would not have impacted the original ranking of that application, and (ii) there do not appear to be any express statutory or regulatory deadlines for the expenditure of BEDI funds. HUD, in good faith and fair dealing, was required to approve CDD's request and amend the grant agreement.

**Comment 3**

However, HUD never prepared a written amendment to the agreement, never formally responded to CDD's request, and never indicated to CDD that its request was not in compliance with the grant agreement. If HUD had prepared the amendment and extended the expenditure deadline to the requested date of at least August 31, 2008, then three of the four post-August 31, 2005 drawdowns would have been within the new deadline. CDD should not be penalized for its performance under the BEDI agreement.

2. *A HUD official, with apparent contract authority, informed CDD in writing that the expenditure deadline of August 31, 2005 had been extended and that there was no deadline for the expenditure of BEDI funds.*

**Comment 4**

CDD's primary HUD contact for the administration of the BEDI agreement was Economic Development Specialist [REDACTED] (CDD notes that the BEDI agreement provides that, for notice purposes, the contact is [REDACTED] of the Financial Management Division, Washington D.C.) CDD, after receiving no response from [REDACTED] in regards to the August 31, 2004 letter, requested [REDACTED] to confirm the expenditure date for the BEDI funds for the Goodyear Tract project. [REDACTED] responded to CDD on May 31, 2005, by writing "No expenditure deadline."



**Comment 4**

CDD relied on the representation from the HUD official, continued to make drawdowns of the grant funds, and provided those funds to the redevelopment agency, which expended the funds on eligible project activities. CDD's reliance was reasonable and it should not now be penalized for the representations of a HUD official with apparent contract authority.

**Comment 5**

Further, [REDACTED] e-mail arguably constitutes an amendment to the BEDI agreement since it meets the requirements of Sections 8 and 11 – it was in writing, it was prior to the expenditure deadline date of August 31, 2005, and it was approved by a HUD official with apparent authority. Although the e-mail may not be a "formal amendment" to the grant agreement, Section 8 implies that a formal amendment is only required for "new grant obligations," such as an increase in grant funding.

Pursuant to [REDACTED] representation, all four of the post-August 31, 2005 drawdowns are in compliance with the grant agreement expenditure deadline.

3. *HUD performed under the BEDI agreement as if the expenditure deadline date had been extended and it was only until the OIG audit that the expenditure drawdowns were invalidated.*

**Comment 6**

Section 6(a) of the grant agreement provides that CDD must obtain HUD's approval for the release of grant funds. In carrying out the BEDI grant, CDD submitted drawdown requests to the HUD regional office, which reviewed the requests and informed CDD of its approval to proceed with the withdrawal.

As noted in the draft audit report, CDD made seven drawdown requests, three before the August 31, 2005 expenditure deadline and four afterwards. All such requests, including the four after the expenditure deadline date, were approved by HUD. If HUD believed that the expenditure deadline date had not been extended, then it could not have approved CDD's four post-August 31, 2005 drawdown requests.

**Comment 7**

Further, HUD never informed CDD that the four post-August 31, 2005 drawdowns were not in compliance with the requirements of the grant agreement, and HUD never exercised the default provision (Section 9) of the grant agreement. Had HUD taken such action after the first post-August 31, 2005 drawdown, then CDD would have been prevented from seeking the three other drawdown requests.

**B. Funding of "Ineligible" Project:****Comment 8**

1. *HUD tacitly approved the funding of the Avalon Park Plaza project because it had knowledge that two of the projects identified in the Section 108 contract and BEDI agreement were not ready for funding, that CDD intended to replace those*

*projects with other projects, and that CDD notified HUD of the replacement of one of the projects with the Avalon Park Plaza project.*

**Comment 8**

Although CDD identified three projects - Slauson Central, Apex and United Alloys - in its BEDI and Section 108 applications, it was the expressed intent of CDD that, due to the variable nature of the development environment, the funding would be used for eligible projects within the Goodyear Tract. CDD advised [REDACTED] Deputy Director, Financial Management Division, by letter dated June 4, 2003 - about 13 months prior to HUD's execution of the BEDI agreement, and over 15 months prior to HUD's execution of the second Section 108 agreement - that the Apex and United Alloys projects were not ready for funding.

**Comment 8**

Following the execution the BEDI agreement and the Section 108 contract, CDD kept HUD regional staff apprised of its efforts to replace the Apex and United Alloys projects with other projects that were ready for development and funding. Specifically, during at least six of the monthly status conference calls between CDD staff and HUD regional staff held between February 25, 2005 and February 5, 2008, CDD informed HUD of its efforts to identify eligible projects within the Goodyear Tract for funding under the grant agreement and loan contract.

**Comment 8**

At the final monthly status conference call on February 5, 2008, CDD informed HUD that the Avalon Park Plaza project had been identified to replace the United Alloys project. By letter dated September 30, 2008 to [REDACTED] CDD informed HUD that it intended for the Avalon Park Plaza project to receive the remaining Section 108 loan amount of \$3,817,000 for acquisition and predevelopment costs for the project.

**Comment 8**

At no time during the monthly status conference calls, nor in response to CDD's letters of June 4, 2003 or September 30, 2008 letters did HUD indicate that the BEDI agreement or Section 108 contract would need to be formally amended to provide that other projects within the Goodyear Tract would be funded. To the contrary, HUD executed both the BEDI agreement and the Section 108 loan contract knowing that two of the identified projects were not ready for funding, and approved the October 29, 2008 BEDI draw down for the Avalon Park Plaza project.

**Comment 9**

24 CFR Section 570.704(c)(5) provides that amendments to the Section 108 contract must be approved by HUD, but does not otherwise specify the nature of amendments - that it be "formal", that it be in writing, or that it be prior to the relevant activity. As noted above, it was always the intent of CDD that the identified projects to be funded would change, that HUD approved the Section 108 contract with that knowledge, and that HUD tacitly approved the amendment to the contract to include the Avalon Park Plaza project through its receipt of the September 30, 2008 letter and its non-response.

**C. All Federal funds expended were for eligible activities to meet a national objective:**

All the expenditures for both Slauson Central and Avalon Park Plaza projects are eligible under HUD regulations, and will create full-time equivalent jobs to meet national objective 24 CFR 570.208(a)(4) – Activities benefiting low-and moderate-income persons by job creation or retention.

In conclusion, CDD should not be penalized for procedural errors when it acted in good faith and used the Federal funds for eligible activities to meet a national objective. CDD, therefore, requests OIG to withdraw Recommendations 1A, 1C and 1E. Regarding Recommendations 1B-1D-1F to establish and implement policies, procedures and controls to ensure that Section 108 and BEDI grant funds are only used for eligible projects and activities in accordance with their agreements and HUD rules and regulations, and in a timely manner, CDD is pleased to inform the OIG that such policies and procedures have been established by the City since 2008. CDD will continue to adhere to, and comply with, HUD's rules and regulations and deadlines.

Sincerely,



RICHARD L. BENBOW  
General Manager

**Attachments (2)**

cc: William Vasquez – HUD Los Angeles Office  
Robert Ilumin – HUD L.A. Office  
Wayne Itoga – HUD Los Angeles Office  
Robert L. Sainz – CDD, City of Los Angeles  
Rhonda B. Gaston – CDD, City of Los Angeles  
Manuel Chavez – CDD, City of Los Angeles  
Ninoos Y. Benjamin – CDD, City of Los Angeles  
Catherine Bondoc – CDD, City of Los Angeles  
Jeffery Whitmore – CDD, City of Los Angeles

**Comment 10**

**Comment 11**

## **OIG Evaluation of Auditee Comments**

- Comment 1** We acknowledge that the City requested an extension of the BEDI expenditure deadline. However, HUD and the City did not execute an amendment to the grant agreement. Paragraph 11 of the BEDI grant agreement specifically states “this Agreement constitutes the entire Agreement between the Recipient and HUD, and it may not be amended except in writing and executed by authorized officials of both HUD and the Recipient.” Since an amendment was not executed, the deadline stated in the grant agreement is binding. Further, HUD complied with the agreement as there is no requirement that HUD must approve and incorporate all amendment requests by the City.
- Comment 2** We acknowledge that HUD never formally responded to the City’s amendment request and never indicated to the City that its request was not in compliance with the grant agreement. However, HUD is not obligated to approve all amendment requests and evaluates several factors when considering proposed amendments. Paragraph 8(a) of the BEDI grant agreement states that in considering proposed amendments to the grant agreement or the approved application HUD “shall review, among other things, whether the amendment would have affected the ranking of the application in the year it was approved sufficiently to have resulted in the application not ranking high enough for funding, and whether the amendment is otherwise consistent with the Act, the Regulations, and the NOFA.” As a result, HUD is not required to approve all amendment requests.
- Comment 3** Since HUD and the City did not execute an amendment to the agreement, the City was required to follow the BEDI grant agreement deadline. We acknowledge that if HUD and the City had agreed to extend the expenditure deadline, three of the four drawdowns in question would have been within the new deadline. However, an extension was never approved and incorporated into the BEDI grant agreement.
- Comment 4** The OIG acknowledges that the City did not receive a response of its request to extend its BEDI grant funds expenditure deadline from HUD. The OIG also acknowledges that the City received an email from a HUD employee in May 2005 that stated there was no deadline for the expenditure of BEDI funds. We disagree with the City that it was reasonable to rely on the HUD e-mail because paragraph 6(c) of the grant agreement specifies an expenditure deadline of August 31, 2005. In addition, it is not reasonable to believe that there is no expenditure deadline and that the agreement can continue indefinitely.
- Comment 5** We also disagree with the City that formal amendments to the agreement are only required for “new grant obligations” and that the email constituted an amendment to the agreement. Paragraph 11 of the BEDI grant agreement

clearly states that amendments must be in writing and executed by authorized officials of both HUD and the Recipient. Further, Paragraph 8(a) of the grant agreement states “to request approval of an amendment, the recipient shall attach the proposed revisions to the applicable pages of this agreement...to a cover letter addressed as required below (see paragraph 11)...signed by the recipient’s official representative for this grant.” Paragraph 11 of the agreement also requires that all notifications to HUD (which would include proposed amendments) be addressed to the Director of HUD’s Financial Management Division in Washington, DC. The May 31, 2005 email provided does not meet the requirements for an amendment to the agreement. As a result, an amendment was never executed to extend the expenditure deadline.

**Comment 6** The OIG agrees that Paragraph 6 (a) of the grant agreement states that the City must obtain HUD’s approval for the release of the grant funds. However, Paragraph 6 (a) is in reference to environmental review procedures only. Paragraph 6 (c) of the grant agreement states that the funds “must be entirely withdrawn and expended for Approved Uses for the applicable Approved Project on or before August 31, 2005.” The City submitted seven drawdown requests to HUD that only stated the grant number. The requests were signed by an official from the City that certified all information provided on the request was true and accurate. HUD approved and processed the disbursements for the intended purposes of the grant, as stated in the BEDI grant agreement, with the assurance that the City certified that it was in compliance with its BEDI grant agreement.

The OIG recognizes that HUD never informed the City that the four drawdowns after August 31, 2005 were not in compliance with the requirements of the grant agreement. However, HUD processed the disbursements for the intended purposes of the grant, as stated in the BEDI grant agreement and certified by the City to be true and accurate. HUD approved the drawdown requests made by the City with the assurance that the City certified it was in compliance of its BEDI grant agreement.

**Comment 7** The fact that HUD did not take action at the time of the drawdowns does not permit the City to violate its BEDI grant agreement with HUD. The City is required to comply with its BEDI grant agreement. The default provision (Paragraph 9) of the agreement specifies that HUD can take remedial or corrective action for violation of the agreement. The agreement further states “No delay or omission by HUD in exercising any right or remedy under this Agreement shall impair HUD’s ability to exercise such right or remedy or constitute a waiver of, or acquiescence in, any Recipient default”. This permits HUD to enforce the default provision (Paragraph 9) and take corrective action at any time.

**Comment 8** We acknowledge that the City identified three specific eligible projects within the Goodyear Industrial Tract: (1) Slauson Central Retail Plaza, (2) Apex

Patterns Company/General Electric Site, and (3) United L.A. Alloys Company in its BEDI grant and Section 108 loan applications. Further, 24 CFR Section 570.704 (a)(i)(B) requires that each activity proposed to carry out with the Section 108 loan funds “must be described in sufficient detail, including provision of Section 570.703 under which it is eligible and the national objective to be met, amount of guaranteed loan funds expected to be used, and location, to allow citizens to determine the degree to which they will be affected.” HUD approves BEDI grant and Section 108 loan funds based on the information provided on the applications submitted and certified to be true and correct by the applicant. Approval for funding is based on the specific projects identified in the applications. Additionally, the BEDI grant agreement and Section 108 loan contract require that all BEDI grant and Section 108 loan funds be used for approved projects only. Therefore, the use of these funds for other projects located within the Goodyear Industrial Tract not identified in the applications, BEDI grant agreement, and Section 108 loan contract are not eligible for funding with these funds.

The City informed HUD in a letter dated June 4, 2003, that two of the three projects approved for funding were not ready for funding at that time. One year later, July 14, 2004, the City executed a Section 108 loan contract with HUD for the Slauson Central project. Two months later, September 27, 2004, the City and HUD executed a contract for the remaining Section 108 loan funds. Both contracts (paragraph 15(c)(i)) stated that the loan funds must be used to acquire specific eligible projects within the Goodyear Industrial Tract. The July 14, 2004 contract required use of funds for property described as the Kramer Parcels. The September 27, 2004 contract required use of funds to acquire four parcels for the Slauson Central Retail Center, one parcel for United Alloys, and one parcel for the General Electric Site. Paragraph 7 of both contracts also states that the City may not use Section 108 funds for other purposes without prior written approval from the Secretary. Avalon Park Plaza is not included in either of the contracts and the contracts do not contain any provisions that would permit the City to substitute projects or parcels without an amendment to the contract.

The City submitted a letter, dated September 30, 2008, informing HUD that \$6.6 million in Section 108 funds had been used on the Slauson Central project. The remaining \$3.8 million in Section 108 loan funds would “likely be allocated” to the Avalon Park Plaza project and did not state the funds would be used on the project. The letter was not a request for an amendment to the current Section 108 contract and it only provided HUD with an update of the project progression. In addition, all contracts with HUD are binding and any departure requires a formal amendment to the contract.

**Comment 9** We agree that all amendments to the Section 108 loan contract must be approved by HUD. 24 CFR Section 570.704(c)(5) refers to the amendment requirements of Section 108 loan funds. It does not specify the terms of

Section 108 loan contracts. Nonetheless, all amendments must be approved by HUD and follow the citizen participation requirements for amendments in 24 CFR 570.704(a)(2). The City did not provide sufficient support that HUD approved any amendments to the Section 108 loan application or contract. Further, the BEDI grant agreement and Section 108 loan contracts were approved for the specific projects described within them. The OIG acknowledges that HUD did not provide a response to the City's letter dated September 30, 2008; however, an amendment was not approved by HUD with its nonresponse. Discussions and letters to HUD do not equate to HUD approval. In addition, paragraph 15(j) of the contracts incorporated the entire BEDI grant agreement into the Section 108 loan contracts. Therefore, the amendment requirements in paragraphs 8 and 11 of the grant agreement identified previously in comment 2 and comment 4 apply. The documentation provided by the City did not meet these requirements.

**Comment 10** The City submitted applications for both BEDI and Section 108 funding for three specific project activities. HUD approved funding for the three specific projects to help maximize the effectiveness of the program by helping to ensure that the programs' national objectives were met. The City violated its grant agreement and loan contracts by changing projects without HUD approval.

**Comment 11** We disagree with the City and are not removing the recommendations from the report. We also disagree that the City had sufficient policies and procedures in place to ensure BEDI and Section 108 loan funds are used for eligible activities. The City did not follow its BEDI agreement and Section 108 loan contracts with HUD. The City needs to establish sufficient policies and procedures to ensure that Section 108 loan and BEDI grant funds are only used for eligible projects. The City will provide these policies and procedures for HUD review during the audit resolution process.

## Appendix C

### CRITERIA

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#### **24 CFR 570.704, Application Requirements**

- (a) Presubmission and citizen participation requirements. (1) Before submission of an application for loan guarantee assistance to HUD, the public entity must:
- (i) Develop a proposed application that includes the following items:
- (A) The community development objectives the public entity proposes to pursue with the guaranteed loan funds.
- (B) The activities the public entity proposes to carry out with the guaranteed loan funds. Each activity must be described in sufficient detail, including provision of Section 570.703 under which it is eligible and the national objective to be met, amount of guaranteed loan funds expected to be used, and location, to allow citizens to determine the degree to which they will be affected. The proposed application must indicate which activities are expected to generate program income. The application must also describe where citizens may obtain additional information about proposed activities.

#### **24 CFR 570.705, Loan Requirements**

- (b) Security requirements. To assure the repayment of debt obligations and the charges incurred under paragraph (g) of this section and as a condition for receiving loan guarantee assistance, the public entity (and State and designated public agency, as applicable) shall:
- (1) Enter into a contract for loan guarantee assistance with HUD, in a form acceptable to HUD, including provisions for repayment of debt obligations guaranteed hereunder;

#### **24 CFR 570.208, Criteria for National Objectives**

The following criteria shall be used to determine whether a CDBG-assisted activity complies with one or more of the national objectives as required under section 570.200 (a) (2):

- a) Activities benefiting low- and moderate-income persons. Activities meeting the criteria in paragraph (a)(1), (2), (3), or (4) of this section as applicable, will be considered to benefit low and moderate income persons unless there is substantial evidence to the contrary. In assessing any such evidence, the full range of direct effects of the assisted activity will be considered. (The recipient shall appropriately ensure that activities that meet these criteria do not benefit moderate income persons to the exclusion of low income persons).

#### **Brownfields Economic Development Grant Agreement (B-98-BD-06-0034), Executed July 14, 2004**

##### **2. Approved Grant Amount, Projects, and Uses of Funds**

- c. The grant funds shall be used in connection with the Approved Project for the following specifically Approved Uses ("Approved Uses"):



Environmental clean-up and site preparation of parcels in the area known as the “Goodyear Industrial Park Tract” for an economic development purpose pursuant to 24 CFR 570.703(f)(2), specifically relating to the development and/or expansion of the following businesses:

- 1) Slauson Central Retail Plaza
- 2) Apex Patterns Company – expansion
- 3) United L.A. Alloys Company – expansion

6. Release, Deposit, and Timing of Expenditure of Grant Funds and Program Income

c. This BEDI [Brownfields] Grant must be entirely withdrawn and expended for Approved Uses for the applicable Approved Project on or before August 31, 2005.

8. Amendment; Record-Keeping

a. This Agreement or the Approved Application may be amended only with the prior written approval of HUD.

11. General

...This Agreement constitutes the entire Agreement between the Recipient and HUD, and it may not be amended except in writing and executed by authorized officials of both HUD and the Recipient.

**Contract for Loan Guarantee Assistance Under Section 108 of the Housing and Community Development Act of 1974, September 24, 2004 (B-99-MC-06-0523)**

**PART II**

**1. Receipt, Deposit and Use of Guaranteed Loan Funds**

...The Borrower shall make withdrawals from said account only for payment of the costs of approved Section 108 activities.

7. Use of CDBG or EDI [Economic Development Initiative] Funds for Repayment

Any funds specifically available to the Borrower [City] for such payments or as a debt service reserve under an EDI Grant Agreement pursuant to Section 108(q) of the Act which supports the eligible project(s) and activities financed by the Note may also be used therefore; any other use of Section 108(q) funds for such purposes shall require the prior written approval of the Secretary.

15. Special Conditions and Modifications

(b) Guaranteed Loan Funds shall be used by the Borrower [City] to make a loans to one or more developers, to assist in acquisition or real property, and the development of commercial/industrial projects at the Goodyear Industrial Tract, pursuant to 24 CFR 570.703(i)(1).

(c) In order to secure the payment and performance of the secured obligations of the Obligors to the Borrower, the Borrower shall obtain the following collateral (collectively, the “Collateral”):

(i) A lien on the real property described in Attachment 3 hereof. Established through appropriate and properly recorded mortgage.

(j) The Grant Agreement, dated July 14, 2004 for the grant made to the Borrower pursuant to Section 108(q), under grant number B-98-BD-06-0034, is hereby incorporated in this Contract and made a part hereof.

### **Attachment 3**

#### **Legal Descriptions**

##### *Slauson Central Retail Center*

###### **PARCEL 1:**

THAT PORTION OF SECTION 20, TOWNSHIP 2 SOUTH; RANGE 13 WEST, SAN BERNARDINO MERIDIAN, IN THE CITY OF LOS ANGELES, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA, ACCORDING TO THE OFFICIAL PLAT OF SAID LAND, DESCRIBED AS FOLLOWS:

BEGINNING AT THE INTERSECTION OF THE WEST LINE OF CENTRAL AVENUE, (100 FEET WIDE), AS NOW ESTABLISHED, WITH THE SOUTH LINE OF SLAUSON AVENUE (40 FEET WIDE) AS NOW ESTABLISHED, WHICH INTERSECTION IS SOUTH 0 DEGREES 05 MINUTES 20 FEET AND SOUTH 89 DEGREES 17 MINUTES 50 SECONDS WEST 50 FEET FROM THE NORTHEAST CORNER OF SAID SECTION 20; THENCE ALONG THE SOUTH LINE OF SLAUSON AVENUE, SOUTH 89 DEGREES 17 MINUTES 50 SECONDS WEST 344.75 FEET; THENCE SOUTHEASTERLY ON A CURVE CONCAVE TO THE SOUTHWEST, HAVING A RADIUS OF 397.96 FEET AND WHOSE RADIAL LINE BEARS SOUTH 31 DEGREES 18 MINUTES 10 SECONDS WEST A DISTANCE OF 408.27 FEET; THENCE TANGENT TO SAID CURVE SOUTH 0 DEGREES 05 MINUTES WEST 40539 FEET; THENCE SOUTH 89 DEGREES 25 EAST 153.05 TO A POINT IN THE WEST LINE OF CENTRAL AVENUE; THENCE ALONG SAID WEST LINE NORTH 0 DEGREES 05 MINUTES, 748.68 FEET TO THE POINT OF BEGINNING.

###### **PARCEL 2:**

PARCEL "A", IN THE CITY OF LOS ANGELES, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA, AS SHOWN UPON PARCEL MAP L.A. NO. 875, FILED IN BOOK 8 PAGE 38 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY.

###### **PARCEL 3:**

PARCEL "B", IN THE CITY OF LOS ANGELES, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA, AS SHOWN UPON PARCEL MAP L.A. NO. 875, FILED IN BOOK 8 PAGE 38 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY

###### **PARCEL 4**

PARCEL "C" AS SHOWN ON PARCEL MAP LOS ANGELES NO. 875, IN THE

CITY OF LOS ANGELES, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA,  
AS PER MAP FILED IN BOOK 8 PAGE 38 OF PARCEL MAPS, IN THE OFFICE OF  
THE COUNTY RECORDER OF SAID COUNTY  
EXCEPTING THEREFROM ALL RIGHTS, TITLE AND INTEREST IN AND TO  
SUBSURFACE MINERAL RIGHTS, INCLUDING, BUT NOT LIMITED TO OIL,  
MINERALS, GAS AND OTHER HYDROCARBON SUBSTANCES, WITHOUT THE  
RIGHT OF SURFACE ENTRY, AS RESERVED BY GEORGE H. NIQUETTE AND  
RUTH E. NIQUETTE, HUSBAND AND WIFE, IN DEED RECORDED OCTOBER 30,  
1972 AS INSTRUMENT NO. 1495, OFFICIAL RECORDS.

***United Alloys***

LOT EX OF R/W COM S 8925' W 919.84 FT FROM NW COR OF 59 ST AND  
CENTRAL AVE

***General Electric Site***

DE CANTILLON TRACT LOT EX OF R/W COM E 695 FT AND N 699.86 FT FROM  
S 114 COR