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[JOINT COMMITTEE PRINT]

SUMMARY OF THE REVENUE PROVISIONS OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1993 (H.R. 2264)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

AUGUST 23, 1993

U.S. GOVERNMENT PRINTING OFFICE

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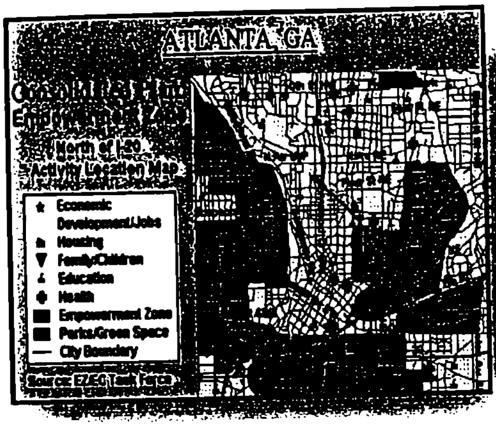
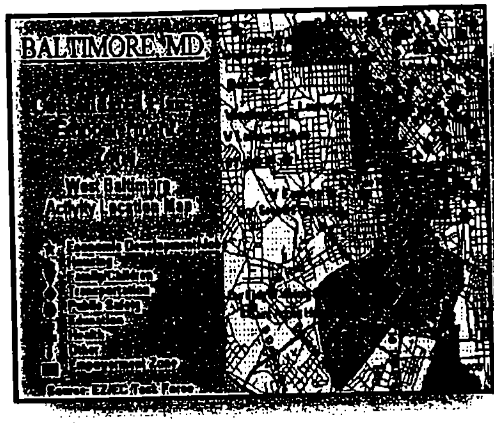
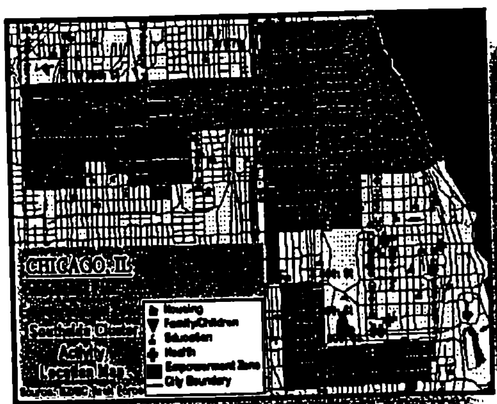
	effective (millions)	1994	1995	1996	1997	1998	1994-98
2. Extend 25% deduction for self-employed health insurance for individuals through 12/31/93	7/1/92	−566	....	....	....	....	−566
G. Empowerment Zones and Enterprise Communities [17]	1/1/94	−276	−459	−539	−583	−635	−2,492
1. Provide tax incentives for businesses on Indian reservations	1/1/94	(18)	(18)	(18)	(18)	(18)	(18)
Subtotal: Investment and Training Provisions		−7,605	−5,785	−5,263	−4,954	−4,746	−28,354
III. Other Revenue Provisions							
A. Disclosure Provisions							
1. Extend tax information access for Department of Veterans Affairs (through 9/30/98)	DoE	....	....	....	....	....	....
2. Access to tax information by the Department of Education (through 9/30/98)	DoE	....	....	....	....	....	....
3. Access to tax information by the Department of Housing and Development (through 9/30/98)	DoE	....	....	....	....	....	....
B. Increase in Public Debt Limit	DoE	....	....	....	....	....	....
C. Vaccine Provisions							
1. Permanent extension of vaccine excise tax	DoE	142	137	137	135	134	684
2. Excise tax for non-continuation of coverage under group health plans of cost of pediatric vaccines	pyba DoE	(19)	(19)	(19)	(19)	(19)	(19)
D. Other Provisions							
1. Extend Trade Generalized System of Preferences (GSP) [2]		−791	....	....	....	....	−791

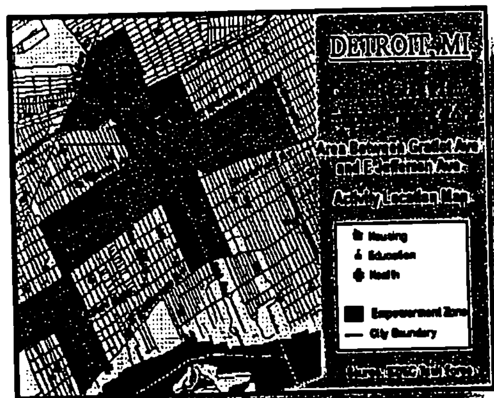
The Urban Empowerment Zones:

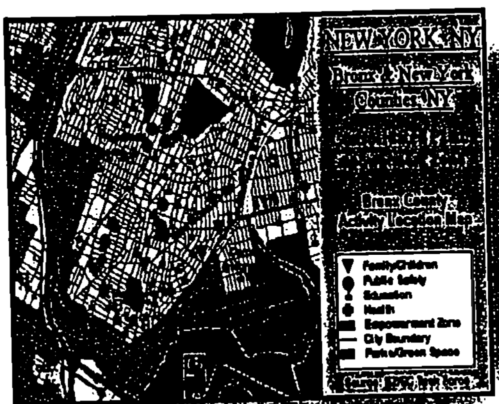
Highlights from the First 18 Months

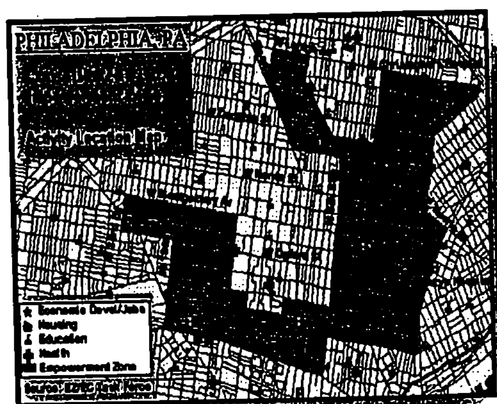












September, 1996

The Urban Empowerment Zones: Highlights from the First 18 Months

President Clinton's Empowerment Zone/Enterprise Community (EZ/EC) initiative, headed by Vice President Gore, marks the most significant effort launched by the federal government in decades on behalf of the Nation's distressed inner cities.

In December 1994, six distressed urban communities, Atlanta, Baltimore, Chicago, Detroit, New York, and Philadelphia/Camden were designated urban Empowerment Zones, receiving a combination of tax incentives and block grants to implement ten-year community-wide strategic plans to promote overall revitalization.

Empowerment Zones have begun to translate the goals articulated in their strategic plans into specific strategies. The investment strategies are focused primarily on economic opportunity and sustainable community development. In a departure from traditional government approaches, the selected mechanisms are production oriented - they seek to import capital and income into the Zone in the short run and then provide an increased demand for goods and services created by local business establishments in the long run.

Empowerment Zones were awarded $100 million each in Title XX Social Service Block Grant funds. Expenditures to date have been utilized primarily as seed money to leverage additional private resources.

- Since designation of the six urban Empowerment Zones in December, 1994, the total of public and private investment activity commitments exceeds $2.6 billion.

- More than $2 billion in private investment has been made, indicating that capital investors perceive future opportunities for investment returns in the zones to be equal to or greater than in other metropolitan locations. For every $1 in EZ funds obligated, $18 of private investment are leveraged.

- The overwhelming focus of the new investment-- $1.7 billion-- is targeted toward economic opportunities. The focus of economic opportunity investment activities includes: business related job retention, expansion, relocation and creation; investment pools for capital access and innovative financing needs; job and occupational skills training; and entrepreneurial and business support services and assistance.

Within the first 18 months of the program, Empowerment Zones have made significant strides in utilizing Title XX Social Services Block Grant funds and tax incentives to attract notable private sector investment, generate job growth, stimulate new business openings and expansions, construct new housing, expand homeownership opportunities, and stabilize deteriorating neighborhoods.

This summary presents selected highlights from the hundreds of economic opportunity success stories taking place in the six urban Empowerment Zones.

Community and Individual Investment Corporation

The Atlanta Empowerment Zone has established a Community and Individual Investment Corporation (CIIC) in which residents own shares in the investments made in their communities. Initial capitalization of approximately $30 million will increase the availability of development credit and encourage capital formation and savings among the target area residents. As shareholders, residents will have a direct economic stake in investments made in their community. Atlanta is the first city in the nation to introduce this kind of free market device into an inner-city area.

Fulton Bag and Cotton Mill

The Atlanta Empowerment Zone Corporation approved a $1 million loan of Title XX funds leveraged with $4.2 million in private equity to refurbish this formerly abandoned 550,000 square feet mill site of 11 buildings in Cabbagetown into corporate offices, retail outlets, and residential lofts. The developer, Winter Properties, has committed to set aside some retail outlets and offices for EZ residents and businesses. In addition, lofts will be set aside for a few low-income residents and a fund for future community economic development will be established from the developer's profits. The plan also includes hiring approximately 300 construction workers from the EZ to help develop this project. Phase I of the project will consist of 175 loft apartments.

> **"Fulton Bag Mill is synonymous with the neighborhood. It was once the catalyst of the neighborhood - it was for some time. The rebirth of the mill is definitely symbolic."** *Marc Steinberg, Cabbagetown resident.*

Renewal Atlanta

Renewal Atlanta is a new recycling business established on a formerly unused industrial site. The newly purchased facility will create up to 65 full-time jobs for EZ residents and 200 temporary jobs for youth. Renewal Atlanta, in conjunction with other local businesses, will offer Zone youth two-year internships in various recycling enterprises. Internships will each receive stipends of $4,000 for every year of participation. Over $3.5 million in private financing is committed to this initiative.

Empowerment Zone Spin-Off Business Project

The large health care institutions and universities in the Empowerment Zone area have partnered with the Empower Baltimore Management Corporation to develop EZ-based suppliers of products and services. The effort involves contributions from Empowerment Zone funds, Johns Hopkins University, the University of Maryland Medical Systems and Liberty Health Systems. The current target is to establish two new supplier firms in the Empowerment Zone and add 10 existing suppliers in the Zone to these institutions' supplier network.

Baltimore Mayor Kurt Schmoke is pleased with the Zone's economic development: **"There is indeed a competitive advantage to doing business in the inner city, and more people are learning that."**

Business Empowerment Center

The Business Empowerment Center (BEC) will provide access to capital and specialized training and technical assistance (i.e. marketing, entrepreneurship training, etc.) specifically for EZ-based businesses and residents. The $2.9 million project will be funded in part by an EZ grant of $1.35 million with the remainder from the U.S. Small Business Administration, the Minority Business Development Agency, NationsBank, Bell Atlantic, and several local colleges and universities. A Small Business Administration sponsored One-Stop Capital Shop and an Employ Baltimore Satellite office will co-locate in the Center. The BEC will reach 300 businesses and entrepreneurs in the first two years of operations. The Business Empowerment Center opened in August 1996.

Fairfield Ecological Industrial Park Development

The objective of this industrial park is to attract environmentally sensitive business processes through an incubator arrangement using a closed loop production system linked to resource recovery technology. When the project reaches its full potential, more than 1,500 jobs will be available to EZ residents. The project is a collaboration of the Empower Baltimore Management Corporation, the Baltimore Development Corporation, Cornell University Work and Environment Initiative, the City of Baltimore, and the State of Maryland. By the end of 1996, it is anticipated that 10 businesses will have located within the park.

Homeownership Assistance Pilot Project

A partnership between Chicago Mayor Richard Daley, the First National Bank of Chicago and several city-wide nonprofit organizations has created a pilot program to help families purchase their first homes in Chicago's Empowerment Zone. The $100,000 pilot project will assist 75 to 100 qualified families buy their first home in the EZ by giving them grants up to $1,500 for single family homes and up to $2,000 for two-unit properties. The home ownership grants are expected to generate mortgages totaling $5 million. The first two families used the pilot program to purchase condominiums in the West Garfield Park neighborhood.

> **"This is just the beginning of some really positive work. We're establishing a business incubator to help aspiring entrepreneurs, especially those in public housing, to create businesses and jobs."** *Pat Dowell-Cerasoli, Mid-South Planning and Development Commission.*

Brownfields

Through the Brownfields Initiative, the city has begun to recycle existing industrial land once deemed unusable due to varying degrees of environmental hazards. In 1994, the city dedicated $2 million to restore five South and West Side industrial sites; and in 1995, the city spent $10 million to clean up a dozen more sites. Early successes include:

Faced with the need to expand its facilities, **Scott Peterson Meats** was considering relocating out of its city location because the only nearby property was an environmentally unsafe abandoned bus barn. But under Brownfields, the city demolished and cleaned up the site, and Peterson Meats then spent $5.5 million to expand into the adjacent property. This retained existing jobs, and created 80 additional full-time jobs. **Madison Equipment** similarly was ready to relocate its facilities to meet expansion needs. However, the company chose to build a facility on a restored property, which retained existing jobs, and added seven new jobs initially.

Forty-Seventh Street and Lake Park Shopping Center

This project provides $6.4 million for the pre-development costs associated with the revitalization of a 75,000 square feet shopping center anchored by a 40,000 square feet grocery store. This project is expected to create 150 construction related jobs, and 200 permanent jobs in the shopping center. Empowerment Zone funding provides $475,000 toward this project; private sources provide nearly $6 million.

Empowerment Zone Financial Institutions Consortium (EZFIC)

Eight Detroit Banks and two financial intermediaries have formed the Empowerment Zone Financial Institutions Consortium (EZFIC) to fund loans to Zone residents and businesses. This consortium has pledged $100 million a year over a 10-year period, to be lent in the Zone, for a total of $1 billion, as an underpinning for the city's Empowerment Zone application. The EZFIC exceeded its original $76 million lending target for the 1995 calendar year, approving loans totaling $286 million in the Detroit Empowerment Zone. Mid-size and small businesses were the primary beneficiaries.

> **"Detroit's economic engine is running better because President Clinton's Empowerment Zone gave it a jumpstart."** *Dennis Archer, Mayor of Detroit*

Detroit Works

Mayor Archer describes Detroit Works as a program which brings new investment into Detroit so that the citizens of this city and their Detroit-based businesses can participate in the economic development throughout the city. The program builds on the Empowerment Zone designation with $110 million in private capital pledged over five years. These funds will be used to place 1,000 people in work within five years, train 500 apprentices in the same time period, construct 350 units of housing, and expand access to contractor bonding.

New Way Material Handling

Frank Harden, founder of New Way, spent more than $1 million to transform an abandoned building into his place of business. New Way is an automotive metal fabricating supplier which employs 50 people. Chrysler Corporation helped Harden locate and renovate his facility. Chrysler offered no direct financial assistance, but has contracted with the company. New Way was the first minority supplier to relocate to the Zone.

Ace-Tex Expansion

This 100,000 square feet, $5.5 million expansion will result in 100 new jobs over the next two years. All of the new hires will be Zone residents. The company manufactures tack rags, supplies, linens, and rents uniforms. It also washes 250,000 industrial floor mats weekly. The expansion was underwritten by $3 million in tax exempt Empowerment Zone facility bonds.

> **"What we are talking about here is changing people's lives, by giving them the chance to earn a livable wage. We're talking about putting people to work and teaching them a trade. Nothing can change your life quicker than that."** *Kenny Stewart, Carpenters District Council*

> "We're committed not just to the funding of it but to doing everything we can to make sure that this partnership with the 200,000 people in this Empowerment Zone works for everyone in the Zone, for everyone in this great city, for everyone in this great state." *George E. Pataki, Governor of the State of New York*

Business Resource and Investment Service Center (BRISC)

BRISC is designed to stimulate economic growth by providing capital and business expertise to small and/or growing ventures in the Zone using the One Stop Capital Shop model. The center comprises bank lenders, the Small Business Administration, and equity and technical assistance equity providers. BRISC is funded by leveraging Title XX funds against other public, private, and non-profit resources.

Entrepreneurial Training

The South Bronx EZ has set out to use Title XX funds to create micro and small business enterprises by providing training and one-on-one consultation in business plan development, cash flow management, market assessment, and other basic business practices. This program seeks to provide secure financing for program graduates as well. The initiative's immediate plans target 30 new micro and small businesses for assistance.

Harlem USA

Walt Disney Company's Disney Store is anchoring Harlem USA, a $56 million retail and entertainment complex scheduled to open in 1998. *Gap* Inc. has signed a letter of intent to open a store in the 275,000 square feet complex. The entertainment complex will also house an ice rink, jazz club, sports facility, a 12-screen movie theater and a children's recreation program. Offering 500 jobs, it promises to be one of the biggest commercial employer's in the Upper Manhattan EZ.

Community Development Lending Institutions

The Philadelphia Empowerment Zone is creating a community development finance institution to package small and micro business loans in EZ neighborhoods. Over the ten year period of designation, the loan funds will be capitalized with $21 million in Title XX funds and leveraged with an estimated $40 million in private resources. The first financing package, in the amount of $100,000, has been made to Sea Change Environmental Services. Sea Change will employ 25 Zone residents in lead abatement activities and other environmental remediation occupational skills.

Rite-Aid Drug Store

New construction of a 10,000 square feet Rite Aid at 13th Street and Girard Avenue to house a pharmacy is completed. The $1.5 million project includes parking spaces for 60 cars. The store involves a unique partnership with North Philadelphia Health Systems which will direct its $100,000 prescription business to the EZ Rite Aid store.

Kaighn Point Construction - Camden

Construction is scheduled to begin in August on a new marine terminal for commercial vessels. In addition, 371,000 square feet of refrigerated warehouse space for perishable cargo will be constructed. The $33 million project, a combination of private money with public support, is the first major commercial expansion investment in the Camden Empowerment Zone.

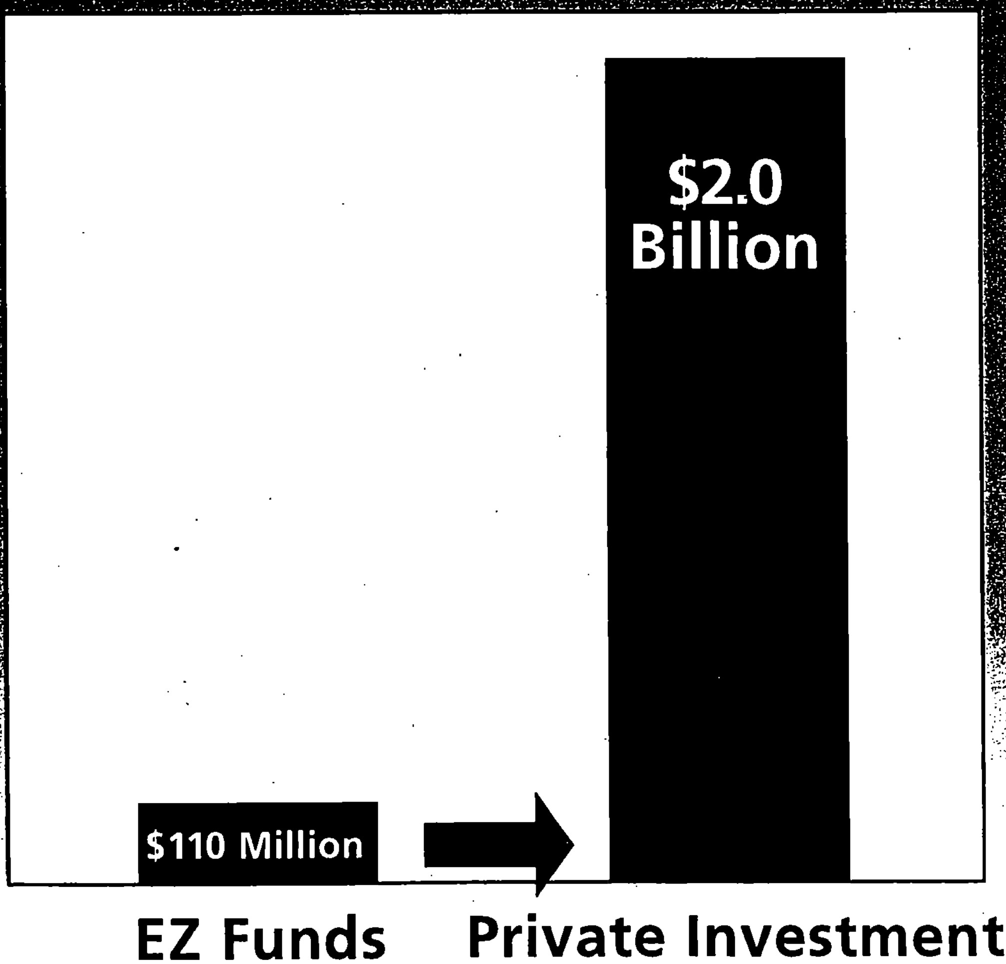
New Manufacturing and Distribution Businesses

Redring Solder, a Malaysian metal alloys producer, and *Graboyes Commercial Windows* will soon become tenants in a new 25,000 square feet manufacturing facility to be constructed in the American Street neighborhood. *Redring Solder* is making its North American headquarters in the Philadelphia EZ. The firm manufacturers solder and alloy products used in the production of circuit boards. *Graboyes Commercial Windows* is the largest distributor of Traco Windows in the United States. Together both businesses bring 80 new jobs to the American Street EZ neighborhood.

> **"We can't just leave things to market forces. If we do, cities will not survive ...Philadelphia is one of the few cities that, along with Camden, got an Empowerment Zone."**
> *Rick Santorum, U.S. Senator from Pennsylvania*

PRIVATE INVESTMENT LEVERAGED

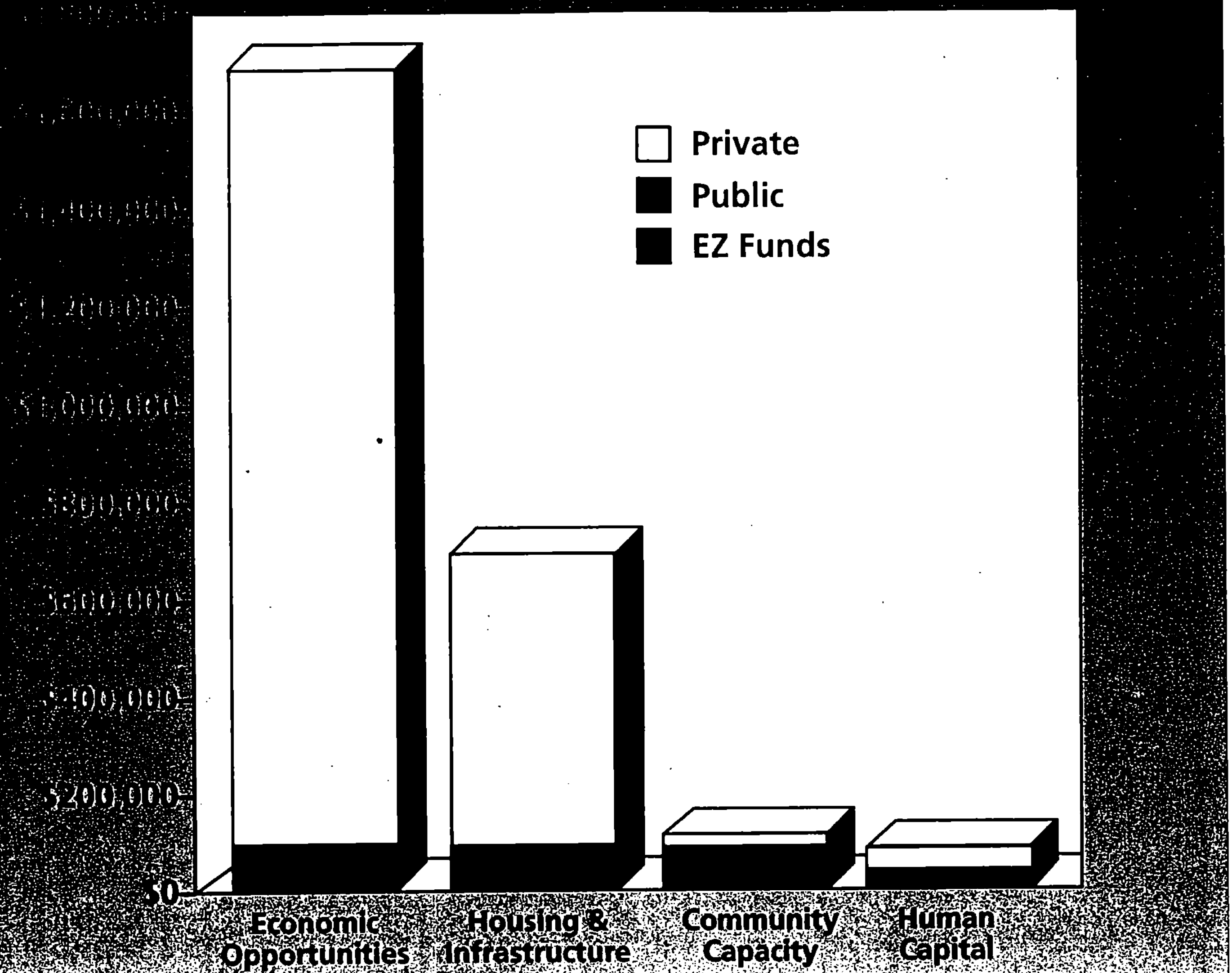
The First 18 Months in the Urban Empowerment Zones



For every dollar of EZ Funds, 18 dollars of private investment are leveraged.

TOTAL FLOW OF INVESTMENT ACTIVITY

The First 18 Months in Urban Empowerment Zones



	EZ FUNDS	Public	Private	Total
Economic Opportunity	$40,062	$71,997	$1,592,412	$1,704,471
Housing and Infrastructure	$23,498	$305,804	$379,586	$708,888
Community Capacity/Environment	$20,979	$39,971	$19,937	$80,887
Human Capital/Education	$25,665	$13,353	$83,561	$122,579
Total Investment Flow	$110,204	$431,125	$2,075,496	$2,616,825

Source: Price Waterhouse LLP
Empowerment Zone Performance Review Reports
Empowerment Zone governance entities
U.S. Department Housing & Urban Development

DAILY NEWS
$1.00
NEW YORK'S HOMETOWN NEWSPAPER

Harlem renaissance

Harlem's famed 125th St. is regaining its luster. The latest to join the revival is St. Luke's-Roosevelt Hospital, long criticized for ignoring the neighborhood's residents.

The hospital's planned outpatient facility at 125th St. and Morningside Drive will replace a garbage-strewn lot with a 50,000-square-foot facility housing pre-natal care and preventive medicine clinics plus moneymaking, job-generating retail and commercial space. Hospital officials estimate that 20,000 to 25,000 Harlem residents will avail themselves of the center's doctors and a wide range of specialist services.

Years ago, 125th St., always the spiritual heart of Harlem, ceased being its economic engine. But that is changing. Thanks to city development efforts and federal Empowerment Zone tax-breaks, officials estimate that more than $1 billion will be invested in Harlem over the next 10 years; 125th St. is getting back on the economic map.

Strawberry's department store, Duane Reade and two McDonald's Express restaurants already have opened their doors, and by October, famed Crispy Cream doughnut shop will open on the corner of Frederick Douglass Blvd. By the end of the year, the Harlem USA project plans to open off St. Nicholas, featuring a Disney store and a Cineplex Odeon multiplex. There is even talk of a fancy hotel. St. Luke's-Roosevelt hopes to break ground early next year. Welcome aboard!

DAILY NEWS • Tuesday, August 27, 1996

DRAFT

Estimating the Economic Effects, Consequences, and Impacts of President Clinton's Empowerment Zone Program: An Analysis Using the Economic Impact Forecasting System

by

John I. Gilderbloom, Ph.D.

Center for Sustainable Urban Neighborhoods

University of Louisville

September 11, 1996

Special thanks to Ron Webster and Wayne Hamilton, U. S. Army Corps of Engineers, Economic Impact Forecast System; Wayne Hamilton, U.S. Army Corps of Engineers, Economic Impact Forecast System, for giving us special permission to use their highly sophisticated computer. Dr. John Markham played a critical role in helping to analyze and write up portions of this report. Several individuals played critical roles in helping to gather data and review portions of this report: Tom Lyons, Tom Lambert, La tondra Jones, Muthsami Kumaran, and Susan Sullivan of University of Louisville Center for Sustainable Urban Neighborhoods; Garret Knapp, University of Illinois at Urbana-Champaign; Perry Pockros and Susan Harper of Price-Waterhouse; and Marilyn Melkonian of Telesis Corporation. This analysis represents the contributions of the author.

ABOUT THE AUTHOR

John I. Gilderbloom, (Ph.D 1983, University of California — SB), is Associate Professor of Urban Policy and Economics in the College of Business and Public Administration. He currently directs two research centers: Center for Sustainable Urban Neighborhoods and the Urban Center on Aging at the University of Louisville. In the past thirteen years, Gilderbloom's housing and economic development research has appeared in nineteen scholarly (refereed) journals, sixteen chapters in edited books, eleven monographs and twenty-five opinion pieces in newspapers and magazines. He is editor of a book on housing policy; co-author of *Rethinking Rental Housing* (Temple-1988) and co-author of *Community Versus Commodity: Tenants and the American City* (SUNY 1992). His book *Rethinking Rental Housing*, was declared "the most significant piece on housing policy written in the last 30 years" by the ***Journal of the American Planning Association***. A survey of college housing courses by the National Housing Institute found it to be one of the most widely used books in graduate courses. *Community Versus Commodity: Tenants and the American City* has been hailed as "fascinating. . . a model of qualitative research. . . nearly flawless. . . a masterful combination of historical information, fieldwork and theoretical analysis. . . it is worthwhile reading for urban scholars, social movement scholars, and methodologists." according to the ***American Journal of Sociology***.

As an undergraduate, Gilderbloom graduated at the top of his class at the University of California at Santa Barbara with a straight A average. Gilderbloom has received honors for his research on public policy from the American Society of Landscape Engineers, Western Governmental Research Association, American Planning Association Chapter Award, Journal of Applied Behavioral Science, Mayor of Houston and Louisville and American Institute for Architects. In 1987 and 1990, he received two "teacher-of-the-year" awards at the University of Houston and University of Louisville respectively. In 1993 Gilderbloom was awarded outstanding researcher award for the College of Business and Public Administration. In 1994 Governor (Brereton) Jones commissioned him the status of "Kentucky Colonel." Gilderbloom has provided research assistance for National Urban League, Urban Coalition, PBS/Frontline, City of Houston, City of Los Angeles, City of Louisville, Social Science Research Council, Shatil of Israel, Ontario-Canada, United States Congress, United States Department of Housing and Urban Development (President Bush and Clinton administrations) and State of California Department of Housing and Community Development. He has lectured at Harvard, Stanford, Cornell, University of California (Los Angeles, Berkeley and Davis), University of Virginia and Michigan.

INTRODUCTION

President Clinton's Empowerment Zone/Enterprise Community (EZ/EC) initiative, headed by Vice President Gore, marks the most significant effort launched by the federal government in decades on behalf of the Nation's distressed inner cities. The program is notable as an innovative approach to building partnerships and community capacity; for fostering reform in the relationship between citizens and their government, and among levels of government; and for insisting on a new level of accountability, with visionary goals connected to measured results. Although these principles are central to a number of recent federal initiatives, including the National Performance Review effort, the Department of Housing and Urban Development's Consolidated Plan, and Homeless Continuum of Care, they find their fullest expression in the Empowerment Zone/Enterprise Community (EZ/EC) program. In December, 1994, 105 distressed urban and rural communities around the country received a combination of tax incentives and block grants to implement ten-year community-wide strategic plans to promote overall revitalization.

What are the economic effects, consequences, and impacts of the Empowerment Zones in America's economically depressed inner cities? The purpose of this study is to calculate the total economic impact of the six urban empowerment zones. To accomplish this, we calculated the sales and the jobs created by the public and private investments in the Empowerment Zones. A key focus is how federal funds have steered private funds to invest in the inner cities. While no study can prove causation between public and private investment strategies, the two are clearly correlated. In order to determine these effects, the authors used the United States Army Corps of Engineers' Economic Impact Forecast (EIFS) program.

METHODOLOGY

EIFS is the most comprehensive, rigorous, and sophisticated model for short-run forecasts and estimation. Because of its ability to generate multipliers for any county or metropolitan area in the nation, EIFS is one of the most far-reaching economic modeling programs ever created. EIFS provides a standardized model that allows for comparisons across cities, counties, and regions in the United States. The EIFS provides a consistent estimate which is an improvement over existing customized economic forecasting. Moreover, the comprehensiveness of the model far exceeds the local models; depending on the county, the number of variables put into the model ranges from 600 to 2,000, with larger metropolitan areas having more variables. EIFS uses both governmental and privately generated data like the Census Bureau's County Business Patterns, Census of Population and Housing, and other current data. EIFS is able to provide as good an approximation of new jobs created or new money put into circulation into a local economy as a non-survey model possibly can.

For this study, EIFS was utilized to estimate the sales volume generated and the number of jobs created. The EIFS model identifies and then quantifies economic activities in a regional economic area which are basic, in the sense that their performance leads and determines the region's overall economic development.[1]

For example, the construction of housing in an area would create a certain number of new construction jobs. Contractors who work on the project would also place orders with suppliers and manufacturers who would be considered in a basic industry. Orders placed with local suppliers would be expected to increase the sales and subsequently the employment of those suppliers. Since these suppliers are part of a basic industry, economic base theory predicts that there will be additional hiring in nonbasic industries. The employment impact of the expenditures on the new construction project should go beyond those of just building housing.

Central to EIFS is the multiplier effect. The multiplier effect refers to how many times one dollar is circulated. That is, when one dollar is spent by a consumer, a portion of that dollar is in turn spent by other persons. The EIFS model quantifies this effect and thereby determines the direct, indirect, and total effects of an external infusion of funds. By using the information in the database on each city and by entering the amount of the Empowerment Zone award into this database as an external influx of funds, the sales volume and jobs generated are determined.

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[1]These estimates, however, are conservative compared to local official estimates. Local estimates on job generation can average three times higher than EIFS. Local estimates tend to be based on "guestimates" based on simplistic assumptions. The high estimates are driven by competition of other cities trying to demonstrate the biggest "bang for the buck."

EMPOWERMENT ZONE AND ENTERPRISE COMMUNITY INITIATIVE

Introduction

The Empowerment Zone and Enterprise Community Initiative (EZ/EC) was established in law on August 10, 1993, when President Clinton signed the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66). Provisions of the Act authorize the federal government to designate up to 104 communities throughout the country as Empowerment Zones or Enterprise Communities, enabling these selected communities to benefit from the incentives and regulatory flexibility, block grants, and other favorable treatment, provided to attract private investment and stimulate community revitalization.

The EZ/EC initiative is not typical as a federal program. Unlike most traditional federal programs that are administered by a single department or agency, the EZ/EC initiative involves three federal cabinet departments in lead roles (Departments of Agriculture, Health and Human Services, and Housing and Urban Development). These line departments are further under direction of the President's Community Empowerment Board, chaired by Vice President Gore, comprising domestic cabinet secretaries and representatives of agencies.

Application and Designation

Just as the structure of the EZ/EC initiative is not typical for a federal program, it did not have a conventional application process. The application process was designed to capture the spirit and philosophy of the EZ/EC initiative by fostering community building and resident empowerment. It was modeled, in part on the comprehensive, community-based strategic planning initiatives (CCI) underway in many cities -- some of which were locally driven and others that were stimulated and supported by national foundations and community development intermediaries. For many cities, strategic planning represents a new undertaking different from the type of planning they have engaged in for previous federal grant applications.

To have been considered for Empowerment Zone and Enterprise Community designation, a community must meet stringent criteria to establish its relative needs, involving pervasive poverty, unemployment, and general distress. The heart of the community's application was a strategic plan that:

* describes the coordinated economic, human, community, and physical development and related activities proposed for the nominated area;

* describes the process by which members of the community, local institutions and organizations are involved in, and have contributed to, the process of developing and implementing the strategic revitalization plan;

* Specifies needed waivers or other changes sought in federal, state and local governmental programmatic regulations, to facilitate better coordination and delivery; and

* identifies the state, local, private, and nonprofit resources that will be leveraged against federal resources in the nominated area.

The proposed designated area must also have been nominated by the state and local government, putting these other partners in the position of assuring their own commitment to resources and reinvention. The strategic community revitalization plan is the cornerstone of the application for EZ or EC designation.

More than 500 applications were submitted for designation including 292 applications from urban communities and 229 applications from rural communities. On December 21, 1994, 105 communities were designated -- 72 urban and 33 rural Empowerment Zones and Enterprise Communities. The Department of Housing and Urban Development (HUD) also utilized additional funding under the Economic Development Initiative and Section 108 Loan Guarantee program to designate two Supplemental Empowerment Zones and four Enhanced Enterprise Communities.

The designation of urban EZ/ECs was made by HUD Secretary Cisneros following review by an interagency task force comprising nearly 100 senior executives from 11 different agencies. Further reviews of the applications were conducted by the departments and agencies comprising the Community Empowerment Board, each in their own respective area of jurisdiction and expertise.

Empowerment Zones

Six urban Empowerment Zones (abbreviated as EZs) were designed, comprising census tracts within the cities of Atlanta, Baltimore, Chicago, Detroit, New York, and Philadelphia/Camden. Each designated city receives up to $100 million in federal Title XX Social Services Block Grant (SSBG) funds for comprehensive community revitalization. In addition, businesses located in Empowerment Zones are eligible to claim a wage tax credit on each employee who resides within the Zone and undertakes a substantial portion of business within the Zone of up to 20% of the first $15,000 in wages. Qualified Empowerment Zone businesses are also eligible to receive additional allowances ranging from $10,000 to $20,000 for expenses on depreciable property in the first year of acquisition. States and localities are eligible to issue tax-exempt facility bonds for certain business activities within Empowerment Zones. Finally, Empowerment Zones are granted preferential status in the competition for certain federal grant programs and special consideration for waivers of federal regulations. The wage tax credits, known as the Empowerment Zone Employment Credit, may prove to be an important influence on program outcomes. The cost of credits has been estimated by the U.S. Treasury to amount to $1.5 billion or roughly $250 million per Empowerment Zone over the 10 year life of the program.

Supplemental Empowerment Zones

Two Supplemental Empowerment Zones (abbreviated below as SEZs) were designated comprising parts of the cities of Los Angeles and Cleveland. In addition to receiving $2.95 million in Title XX Funding granted to other FCs, the Cleveland EZ is to receive $87 million in Economic Development Initiative (EDI) grants from HUD; Los Angeles is to receive $125 million in EDI grants from HUD. EDI funds are further matched with an equal amount of federally guaranteed Section 108 economic development loan authority.

Enhanced Enterprise Communities

Four Enhanced Enterprise Communities (abbreviated below as EECs) have been designated among the ECs, comprising parts of Boston, Houston, Kansas City and Oakland. In addition to receiving $2.95 million is Social Service Block Grant funds, each EEC is to receive $2 million in EDI grants from HUD matched with an equal amount of federally guaranteed Section 108 economic development authority.

Enterprise Communities

Urban Enterprise Communities (abbreviated below as ECs) -- 65 of which are authorized in the statute -- are eligible to receive $2.95 million in Social Services Block Grant funds to implement their comprehensive community revitalization plans. In addition, each designated EC is eligible for tax-exempt facility bonds for certain private business activities and special consideration for requested waivers of federal regulations and preferential treatment in the competition of numerous federal grant programs.

Measures of Distress

The areas selected as Empowerment Zones and Enterprise Communities are among the most distressed communities in the nation by almost any measure. Poverty rates are roughly four times higher in the Empowerment Zones and Enterprise Communities than in the surrounding metropolitan areas, with most ranging over 40% poverty to more than 50% in the Atlanta and Philadelphia Empowerment Zones. At least 45 percent of the working age population was not in the labor force in the six empowerment zones, with three of the six zones over 50% for 16-19 year olds, the proportion of persons neither working nor in school is 80% higher than in the surrounding metropolitan areas. Less than half the population of the zones has a high school diploma.

SUMMARY OF FINDINGS

Using data collected from Price Waterhouse, we were able to calculate sales and jobs created by public and private investment in the Empowerment Zones. The total Empowerment Zone funding for these cities was $110,204,000.

Private Investment Leveraged (See Table 1)

* Since designation of the six urban Empowerment Zones in December, 1994, the total public and private investment activity commitments exceeds $2.6 billion.

* More than $2 billion in private investment has been made, indicating that capital investors perceive future opportunities for investment returns in the zones to be equal to or greater than in other metropolitan locations.

* The overwhelming focus of the new investment -- $1.7 billion -- is targeted toward economic opportunities. The focus of economic opportunity investment activities include: business-related job retention, expansion, relocation and creation; investment pools for capital access and innovative financing needs; job/occupational skills training; and entrepreneurial and business support services and assistance.

New Economic Activity and Empowerment in Empowerment Zones (Sales)

EIFS estimated that the Empowerment Zone funds will generate $4.640 billion dollars in sales. This represents the sum of direct and indirect spending due to the multiplier effect in the six cities. This represents a spectacular return on generation of sales from such a relatively small federal investment that helped encourage private and public investment at the local level.

Job Creation in Empowerment Zones (See Table 2)

Increased sales result in new job generation. EIFS estimates that a total of 30,154 jobs were generated in five of the six Empowerment Zone cities.[2] This number was determined by adding the total number of jobs created in each of the Empowerment Zone cities. The total number of jobs generated in each city is the sum of the number of direct jobs as an immediate result of the Empowerment Zone funding and the number of indirect jobs created due to the multiplier effect. The average cost per job created is the total federal funding, or $110 million, divided by the total number of jobs. We estimate that the overall cost per job is $3,655.

[2]Due to a dispute between the City and State of New York, no Empowerment Zone activities have been approved by the New York City Empowerment Zone Corporation Board for the Upper Manhattan or South Bronx portions of the New York Zone. Although the federal government has obligated $100 million for the New York Zone, matching commitments by the City and State have not yet been obligated. In addition, while private sector investment and activity has been integrated into the implementation of the other five Empowerment Zones, no corresponding effort has been made to date in the New York Zone.

Conclusion

Using state-of-the-art methods and statistics, this report finds that economic empowerment programs have caused a dramatic increase in sales and jobs. Moreover, the cost of producing each job is minimal because President Clinton's programs rely on leveraging local funds, creating innovative partnerships and maximizing citizen participation in the development of plans. Given welfare reforms, the need is great to create job opportunities in the inner city. Empowerment Zones provide an exciting model of how new jobs can be created leading to the rebirth of inner cities.

Table 1. EZ Investments/Economic Activities/Jobs Created

DRAFT

	Investments				Economic Activity			Jobs Created 1)		
	Title XX $	Public	Private	Total	Direct Sales	Induced Sales	Total Sales	Direct	Indirect	Total
Atlanta	25,373,000	152,427,000	90,747,000	268,547,000	170,072,000	293,724,000	463,796,000	867	1,498	2,365
Baltimore	12,451,000	107,173,000	45,928,000	165,552,000	107,948,000	202,288,000	310,236,000	969	1,817	2,786
Chicago	37,000,000	62,629,000	135,132,000	234,761,000	171,468,000	464,523,000	635,991,000	989	2,681	3,670
Detroit	13,786,000	64,637,000	1,723,063,000	1,801,486,000	1,114,630,000	1,808,819,000	2,923,449,000	7,281	11,814	19,095
New York	not available	not available	not available					na	na	
Philadelphia/Camden	21,594,000	44,260,000	80,626,000	146,480,000	99,163,000	207,821,000	306,984,000	723	1,515	2,238
TOTAL	110,204,000	431,126,000	2,075,496,000	2,616,826,000	1,663,281,000	2,977,175,000	4,640,456,000	10,829	19,325	30,154

1) Jobs created were etermined us ing the U.S. A rmy Corps of E ngineers Econo mic Impact Fo recast System (EIFS)

Table 2. Cost Per Job in the Empowerment Zones.

DRAFT

	EZ Funds (Title XX $)	Job Creation/ Retention	Cost per Job
Atlanta	25,373,000	2,365	10,729
Baltimore	12,451,000	2,786	4,469
Chicago	37,000,000	3,670	10,082
Detroit	13,786,000	19,095	722
New York	not available	not available	
Philadelphia/Camden	21,594,000	2,238	9,649
TOTAL	110,204,000	30,154	3,655

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AUDIT REPORT

OFFICE OF INSPECTOR GENERAL
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT

REVIEW OF EMPOWERMENT ZONE, ENTERPRISE COMMUNITY, AND ECONOMIC DEVELOPMENT INITIATIVE GRANT SELECTION PROCESSES

95-HQ-154-0002

AUGUST 31, 1995

OFFICE OF AUDIT
PROGRAM RESEARCH AND PLANNING DIVISION
WASHINGTON, D.C.

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-4500

OFFICE OF INSPECTOR GENERAL

August 31, 1995

MEMORANDUM FOR: Henry Cisneros, Secretary, S

Andrew Cuomo, Assistant Secretary For Community Planning and Development, D

Chris Greer

FROM: Chris Greer, Assistant Inspector General for Audit, GA

SUBJECT: Audit of Empowerment Zone, Enterprise Community and Economic Development Initiative Grant Selection Processes (Audit Case No. 95-HQ-154-0002)

INTRODUCTION

This report presents the results of our audit of the Empowerment Zone (EZ) and Enterprise Community (EC) designation process. We also included the Economic Development Initiative (EDI) grant award process in our audit, because of its close ties to the EZ/EC designation process. Our primary objective was to determine if fair and equitable processes were developed and followed in making all EZ/EC designations and awards of EDI funds in accordance with statutory requirements. The audit was initiated at the request of Senator Bond, Chairman of the Senate Appropriations Subcommittee on Veterans Affairs, HUD and Independent Agencies, and Senator Mack, Chairman of the Senate Banking, Housing and Urban Affairs Subcommittee on Housing Opportunity and Community Development.

In conducting the audit, we flowcharted the EZ/EC application review and designation process (Attachment 1), and assessed the adequacy of the Office of Community Planning and Development's (CPD) management controls over the process. We interviewed EZ/EC Task Force staff, including application review team members and review panel members, as well as CPD's legal advisors, the Assistant Secretary for CPD and the Secretary of HUD. The scope of our audit included all activities related to the EZ/EC designation process, from the June 30, 1994 application receipt deadline through the final designation date on December 21, 1994. Similar audit steps were performed for the EDI grant application selection process, which took place between December 7, 1994 and December 21, 1994.

The below captioned sections present: a summary of our audit results, program background information, detailed descriptions of the EZ/EC and EDI selection processes, and our recommendations for needed corrective actions. Our audit, which was performed during the period January 4, 1995 through May 12, 1995, was conducted in accordance with generally accepted governmental auditing standards. We considered and have attached HUD management comments on our draft report, which were transmitted by the Secretary.

SUMMARY OF RESULTS

The processes used in making EZ/EC designations and EDI grant awards did not provide reasonable assurance that the best eligible applications were selected for benefit designations and funding awards. The original process designed for making EZ/EC designations was not fully followed, and the nature of alternative procedures used was not described in writing. More importantly, assessments of the eligibility, as well as an application's relative rating and ranking against other applications, were inadequately documented to enable an independent reviewer to determine the bases for decisions made. As a result of these process weaknesses, we were unable to satisfy ourselves as to the basis for or reasonableness of:

- The final designation of 6 EZs from a total of 22 EZ applications which were generally categorized as "strong" by the application review process,
- The final selection of 14 EC applications which were categorized as "weak" or no longer under further consideration by the application review process, and
- A decision to limit EDI grants to 6 strong rated EZ applicants who did not receive EZ designations.

The CPD staff responsible for the EZ/EC application review process advised us that they avoided detailed written rating, ranking and decision processes -- in favor of group discussions and general consensus ratings -- given the newness and complexity of the EZ/EC program concept, and their perceived need to maintain an openness and flexibility in the decision process. The Secretary informed us that he used the CPD staff's general input, as well as his personal knowledge and perspectives on individual community needs, commitment and leadership, in making the final designations and award decisions. He indicated he had been advised by senior CPD program staff that he had the legal authority to make decisions in this manner. While the Secretary had the authority to make the final EZ/EC designations, the basis for selections should have been limited to the application of the specific selection criteria provided in the program statute and published in the Notice Inviting Applications. It is not evident that this occurred in each of the final 71 EZ/EC designations made by the Secretary.

Given the significant staff commitment to the application review process -- a 5-month, 90-person, Federal task force to review 290 proposals -- the Secretary's final decision making process could have been better served with more diligent staff work to present him with more objective information on application eligibility and comparative strengths and weaknesses. However, given that there is a degree of subjectivity in any competitive selection process, and given that 57 of the Secretary's 71 EZ/EC designations were from the EZ/EC Task Force's final recommended list of 90 applications for selection, we have only questioned the 14 EC designations that were not recommended by the extensive application review process.

The basis for the selection of these 14 lower rated EC applicants was undocumented. In the case of some of the 14 questionable EC designations, we believe the eligibility of the application's designated zone is in question, and in need of clarification. Furthermore, we believe the stated reliance on unspecified "needs" and "geographic diversity" selection criteria was unfair to applicants that were previously determined to have better met the defined statutory and regulatory selection criteria through an extensive review process. In this regard, the final selections do not logically flow from the defined application review process, giving the appearance that the process was open to favoritism.

With respect to the EDI awards, the Secretary's reliance on the completed EZ application review process for final selections ran contrary to EDI's separately published Notice of Funding Availability (NOFA) requirements, and is in our opinion a violation of HUD Reform Act requirements for competitive grant awards. In response to our draft audit report, CPD obtained a formal legal opinion from HUD's Office of General Counsel to support prior verbal legal advice that HUD Reform Act requirements did not apply to EDI funding. Notwithstanding this opinion -- with which we disagree -- we still contend that the manner in which HUD solicited and selected applications was unfair to potential or actual applicants.

Our draft audit report contained recommendations that the eligibility and quality of the questioned 14 EC and 6 EDI cases be reassessed, with changes to the status or conditions of their designations or awards, as appropriate. Given HUD management's stated disagreement with the nature of our concerns and the need to address them (see Attachment 5), we have deleted these recommendations to HUD from our final report. We will, however, distribute this report to HUD's Congressional Oversight Committees for their consideration of whether HUD has acted in accordance with Congressional intent. We are also retaining our recommendations that HUD assure adequate documentation of the basis for all future selections and awards, and formally condition any EC designations where changes to proposed zone boundaries were necessary to meet eligibility criteria.

BACKGROUND

Title XIII of the Omnibus Budget Reconciliation Act of 1993 (the Statute) authorized HUD to designate six Empowerment Zones and up to 65 Enterprise Communities in urban areas. The Department of Agriculture was likewise authorized to designate three rural EZs and 30 rural ECs. The program is intended to combine the resources of the Federal government with those of State and local governments, educational institutions, and the private and non-profit sectors to implement a comprehensive Strategic Plan to revitalize distressed areas. Communities must meet certain eligibility criteria regarding size, poverty, unemployment and general distress.

A Strategic Plan, developed with the input of community residents, is required to describe the community's vision for the future and how the vision will be implemented. The Strategic Plan is judged on the basis of four principles: economic opportunity, sustainable community development, community-based partnerships, and strategic vision for change. While the basic eligibility criteria are important for identifying the needs of the communities, it is the Strategic Plan that describes how the communities will implement corrective actions to address the identified needs.

The EZ/EC selection process and program are administered by an interagency task force consisting of approximately 90 individuals. CPD's Office of Economic Development oversees the task force. All final EZ/EC designations were to be made in consultation with the Community Enterprise Board, which the President established on September 9, 1993. The board is comprised of 17 executives from Federal Agencies and chaired by the Vice President.

Each EZ and EC designation is to be given special consideration for various Federal programs and other assistance, including HHS

Social Service Block Grants, tax exempt Facility Bonds, tax incentives for zone employees, and other special consideration for existing Federal programs and future Federal awards. These incentives make the program extremely advantageous for the designated communities.

Section 232 of the Multifamily Housing Property Disposition Reform Act of 1994 authorized the Economic Development Initiative (EDI) Grant Program. The program was intended to increase economic development activities in communities by augmenting the use of CPD's Section 108 Loan Program. The Section 108 Loan Program allows Community Development Block Grant (CDBG) recipients to borrow against future block grant awards for economic development activities. The types of activities financed with Section 108 loans are often high risk activities. The enactment of the EDI grant program was intended to lower a community's risk by providing grant funds to buy down the interest on these loans. The EDI grant is intended to supplement the Section 108 Loan Program by making it less risky and therefore more desirable.

EZ/EC APPLICATION SELECTION PROCESS

The Notice Inviting Applications for Designation of Empowerment Zones and Enterprise Communities was issued on January 18, 1994, with applications due by June 30, 1994. Two hundred and ninety urban communities submitted proposals for EZ/EC designations as follows:

TYPE OF DESIGNATION	APPLICATIONS RECEIVED	SELECTIONS TO BE MADE
Empowerment Zones	78	6
Enterprise Communities	212	65

The original documented design of the EZ/EC Task Force review process called for a rating of each application on a relative point scale, where points would be awarded for specific criteria such as the strategic plan, the level of innovation, community partnerships, and need. Before the application review process began, CPD officials decided that applications would not be numerically scored.

According to panel members, the EZ/EC selection process was thought to be unique from most other HUD competitions in that it included: unprecedented complex and comprehensive applications, reviewers with different experience levels from 11 Federal agencies, and a variety of evaluation factors not easily susceptible to simple numerical scores. At the request of the Assistant Secretary for CPD, one panel member conducted a comprehensive analysis of other competition formats used at HUD. This analysis, which was not documented, reportedly led to the revised EZ/EC review process actually used in making final designations. The revised process was not established in writing. However, Attachment 1 provides a flowchart of the actual process, which was constructed during our audit.

After receipt of applications, interagency EZ/EC task force members were assigned to provide narrative assessments of applications, noting their strengths and weaknesses. This interim record was used in making oral presentations to a "review panel," consisting of three senior CPD officials. At least one member of the review panel was to read the application in advance of it being presented. We were told by review panel members that no final rating decisions were made until all applications were reviewed, offering the presenters and review panel the broadest possible perspective on application quality.

The review panel categorically rated the applications as strong, medium, weak, or under further consideration (UFC). In effect, the UFC designation meant the application was no longer under consideration because it was poorly developed in comparison to other applications. According to one panel member, the UFC category was created to guard against the premature release of a list that would reveal to outsiders which cities had been preliminarily **eliminated** from the competition. A total of 164 of the 290 applications received were categorized as UFC.

While the review panel members expressed their beliefs that every application received a thorough written and oral review, the review panel did not provide for distinctions within each rating category, e.g., the strongest of the strong. This general categorical rating system gave the Secretary great responsibility and flexibility in making the final designations.

On December 5, 1994, the review panel gave the Secretary a final referral list of 13 "strong" rated EZ applications for the selection of the 6 EZ designations. No written information was provided to allow the Secretary to distinguish among these applications. Furthermore, the review process had resulted in a total of 22 EZ applications in the "strong" category, but there was no record as to how that number was reduced to the 13 on the referral list to the Secretary. The applications were never placed in any rank order and the panel did not identify any preferences for one application over another. While some discussions were held between the Secretary, Assistant Secretary and/or panel members in identifying the best applications, it appeared as though the Secretary was largely left on his own to make these decisions, without the full benefit of input from the staff intensive EZ/EC application screening process.

There is no written documentation as to the factors the Secretary used in making each final EZ selection. There was a series of telephone calls to the final 13 EZ applicants in the running to update the application's standing in case there had been any changes. Again, there was no documented analysis or conclusions from this update process. Since there was no individual scoring of the applications, and the basis for final selections was not documented, we could not readily determine if the final six designations were the best of the 13 strong applications referred to the Secretary. The Secretary advised us that he consulted with the Assistant Secretary for CPD and review panel members to assess the strengths of his 6 finalists, and that it was their assessment that the 6 stood well above the other applicants.

On December 5, 1994, the review panel also referred 77 EC applications to the Secretary for his consideration in making the final 65 EC designations. This list consisted primarily of the EC applicants rated as "strong" and "medium" by the panel. The list also included 23 "alternate" selections because the Secretary asked the panel to include at least one jurisdiction for every state, regardless of general rating, for possible consideration in providing greater geographic diversity. The Secretary's final selections included 14 weak and UFC applications not among the 77 referred applicants. These 14 low rated applications were selected over eight "strong" and 21 "medium" rated applications. Attachment 2 identifies the 14 weak or UFC applicants that were not on the review panel's referral list, as well as the referred stronger rated applications that were not selected.

The Statute permitted the Secretary to identify additional selection factors that he could use in the designation of EZs and ECs, subject to publication in the interim and final program rule and Notice Inviting Applications. An additional selection factor was established for "geographical diversity," but the meaning and intended application of this general factor was never clearly established for the benefit of potential applicants or application reviewers. The Secretary indicated that the geographic diversity factor was intended to allow him to disperse the designations if the review panel's recommendations were too clustered in specific areas of the country.

As an example, the Secretary used geographical diversity to spread out designations within a State. However, there was no consistency in the manner in which geographical diversity was applied between States. For example, Los Angeles received a supplemental EZ of $125 million, yet the Secretary wanted an EC near the Los Angeles area and selected Huntington Park. On the other hand, New York City received an EZ designation and the Secretary decided that the other strongly rated EC applicants in the vicinity of the designated EZ were too close, resulting in the selection of lower rated applications in other parts of New York. Attachment 3 shows the distribution of the final EZ, EC and EDI selections resulting from these processes.

In providing for greater geographical diversity, the Secretary also decided to select at least one EC for each State where jurisdictions applied, regardless of the application's rating by the review process. Had a clearer definition of geographic diversity been made known in the EZ/EC application solicitation, it may have changed who applied for designations and how applications were evaluated and screened by the review panel. For example, five States had only one jurisdiction applying. These jurisdictions could have been quickly checked for eligibility since the quality of their applications was ultimately not a factor in their selection for geographic diversity. Yet, effort went into the application evaluation process by the EZ/EC review team and the panel. In addition, seven States had no jurisdictions applying for EZ/EC designations. Jurisdictions in these States may not have applied because they felt that their chances of designation were remote. Had they known that the Secretary would interpret geographic diversity to allow the selection of at least one EC from each State, they may have applied.

The interim rule indicated that other selection factors could be identified by the Secretary, if the factors were published in a Federal Register notice. In our discussions on actual factors used in the selection process, "need" was described as an additional factor that was used by the Secretary in making his final selections. The element of need was a built-in, quantifiable selection criterion, given that the statute and regulations specified required levels of poverty for areas to be eligible for designation as an EZ or EC. Furthermore, the extensive application review process considered other required quantifiable needs information, such as unemployment rates, in determining the best applicants for referral to the Secretary. Nevertheless, CPD staff interpreted Section 597.301(a)(4) of the interim rule as giving authority for the Secretary to select based on "additional" needs criteria without a Federal Register notice defining such criteria. We believe the Secretary had no authority to select lower rated applications based on additional need or other factors, because applicants were not given notice of any such criteria in the Federal Register.

The Secretary advised us that he considered his personal knowledge of communities in making final EC designations. In each case where a lower ranked application was brought up, the Secretary told us that he asked the Task Force Director to re-examine these applications and determine if they were strong enough to compete. In our earlier discussions with the Task Force Director, he indicated he provided no additional application information to the Secretary after the panel recommendations were submitted on December 5, 1994. The Task Force Director did indicate he was aware that some additional communities were under consideration by the Secretary and the Task Force verified the basic eligibility of those applications. Some examples of the Secretary's deviations from the recommendations of the application review process are as follows:

- Charlotte N.C. - The Review Panel rated Charlotte weak based on the merits of their application. The Secretary indicated he selected Charlotte because of their strong community leadership and their former successes in other HUD programs.

- Rochester N.Y. - The Review Panel rated this application UFC because of limited community participation and the lack of a time line for achieving results. The Secretary indicated he chose Rochester because they had a great need based on the recent downsizing of a major corporation in the city.

- East St. Louis, IL - The Review Panel rated this application UFC based on no private commitments and a lack of detail on how Federal funds would be spent. The Secretary indicated he selected East St. Louis because he knew they had great need and also he wanted to add geographical diversity within the State.

Overall, the Secretary indicated he had a great knowledge of many communities and their needs based on personal visits. In some cases, the Secretary felt his knowledge was greater than that of the panelist and task force members. His stated criteria for selection were leadership, public/private initiatives, need and geographical diversity.

EC ELIGIBILITY CONCERNS

The basic eligibility of some of the EZ and EC areas designated by the Secretary is in need of clarification. The eligibility requirements for an EZ or EC are prescribed in the Statute. A jurisdiction must demonstrate in its application that the nominated area meets minimum poverty levels. Nominated areas are identified by census tracts. The nominated area may contain up to 3 non-contiguous areas but each area must separately meet the eligibility requirements. For each non-contiguous parcel all census tracts must have 20% plus poverty, ninety percent of the census tracts must have 25% plus poverty and fifty percent of the census tracts must have 35% plus poverty. The Bureau of the Census 1990 Data is used to measure population and poverty levels for each census tract.

A Management Information System (MIS) was developed to aid the EZ/EC task force members in evaluating applications. The MIS was loaded with 1990 Census information. The Census information in the application was then compared to the MIS. Problems with the MIS program caused a high rate of rejections which required applications to be manually checked against Census information available in the HUD library. Consequently, most eligibility checks were made late in the review process.

The Statute allowed EC applicants to request exemptions from certain poverty thresholds in order to qualify for designation. Both the statute and the interim rule contain the same unclear language regarding exemptions from poverty requirements. With regard to the adjustment of census tract data, the statute and rule state:

> "the Secretary may reduce by 5 percentage points one of the following thresholds for not more than 10 percent of the population census tracts (or, if fewer, 5 population census tracts) in the nominated area....."

In the parenthetical note above, it is unclear what "if fewer," references. The EZ/EC team members interpreted the language to permit either a 10 percent exemption <u>or a reduction of 5 tracts</u>. This interpretation was used in the application guidelines and throughout the evaluation process. One panel member stated that much discussion was generated over the exemption requirements and that the Office of General Counsel was consulted on how to interpret this provision.

We reviewed the Statute's conference report to determine whether exemption language may have been incorrectly drafted into the legislation. In the conference report the parenthetical note reads:

> "... the appropriate Secretary may reduce one of these poverty criteria by five percentage points for not more than 10 percent of the population tracts (up to a maximum of five population census tracts) in the nominated area."

This conference report language should govern since the statutory language is unclear. In other words, if a nominated parcel contained less than 10 census tracts, no exemptions are permitted by Statute. Yet, the Task Force permitted up to 5 exemptions, no matter how small the parcel. The task force interpretation of the exemption language resulted in 3 EC designations where applicants did not meet statutory requirements.

The Albany, Schenectady, and Rensselaer, NY designation is one example where too many exemptions were granted. This application contained three separate parcels and each must separately meet the eligibility requirements. Albany sought an exemption for one of six census tracts in their parcel and Schenectady sought an exemption for one of three census tracts in their parcel. The Rensselaer parcel contained an ineligible Central Business District tract (24% poverty). Exemptions were granted although technically not permitted by the Statute. We noted similar problems with the Huntington Park, CA and Manchester, NH EC designations.

After exemptions were granted, some applicants still had census tracts remaining that could not meet statutory requirements. The task force dropped ineligible census tracts from the nominated area for these designated EZ or ECs. Such modifications are permitted in the designation process under Section 597.300(d) of the Interim Rule. The language requires modifications to strategic plans or boundaries to be "reasonable."

In the modification for the Kingston/Newburgh, NY EC, two of three parcels were dropped leaving only the Newburgh parcel. The remaining part of the EC is one third the original size and two thirds the original population. We question whether such a major modification can be considered reasonable.

In addition, if the statutory requirements for exemptions were properly interpreted for the Albany, Schenectady and Rensselaer, NY EC, five of the 11 census tracts would be ineligible (32% of the population and 53% of the area served.) We believe such a modification would be unreasonable.

We also found that eight designated ECs and one designated EZ with census tracts removed were not notified in writing of their new boundaries. Formal notification should be required to assure that benefits associated with designations are restricted to eligible areas. The EZ/EC Task Force Director indicated that EZ/EC applicants were verbally informed of the revised nominated areas and that he was not concerned that such notification was not formalized. We did not find any written documentation that HUD staff reviewed the strategic plans in these modified applications to assure that a jurisdiction's intended goals were still achievable.

ECONOMIC DEVELOPMENT INITIATIVE AWARD CONCERNS

Six EZ applicants were effectively awarded a total of $300 million in Economic Development Initiative Grants, in lieu of an EZ designation. The non-competitive manner in which these EDI grants were awarded is in our view a violation of Section 102(a) of the HUD Reform Act of 1989.

The 1993 statute limited the number of urban EZ designations to six. HUD was seeking other funds to further support designated EZ/ECs, and to further advance the EZ/EC concept. HUD's Fiscal Year 1995 authorization bill proposed $500 million in grants to EZs and ECs to be used in conjunction with CPD's Section 108 Loan Program. When the bill was not enacted, CPD staff began exploring alternative ways to fund additional highly ranked zones beyond the six formal EZ designations.

HUD's Fiscal Year 1995 Appropriation Bill provided $400 million in funding for new programs, but the accompanying authorizing legislation for these new programs was never enacted. After the 1994 elections, it became evident that HUD's authorizing legislation would not pass. CPD sought and received an opinion from the HUD General Counsel that it would be appropriate to use the "new programs" funding in the appropriation bill for previously authorized programs such as EDI.

A reprogramming request letter was sent to the Congressional staff members on HUD's Appropriations Committees in late November 1994. The letters asked for authorization to use $350 million of the funding designated for new programs for EDI grants. HUD requested a rapid response as HUD wanted to announce the EDI awards at the same time as the EZ/EC designations on December 21, 1994. The November 30, 1994 response from the Senate Committee authorized the use of $300 million for EDI grants for communities that did not receive the EZ designation.

A Notice of Funding Availability was published on December 7, 1994, inviting all 78 previous EZ applicants to apply for $300 million in EDI funds. The NOFA explicitly stated that the awards would be non-competitive and restricted to the 78 EZ applicants. The NOFA required a 1:1 match of EDI with Section 108 loan authority. Consequently, only entitlement communities with outstanding Section 108 loan authority could apply. The NOFA had a 2-week response time, and 45 communities applied by the December 17th deadline. The Secretary made the final EDI award announcements at the same time as the EZ designation announcements, on December 21, 1994.

At the time of the issuance of the EDI NOFA, 13 communities were under consideration for final EZ designations by the Secretary. Only six of these 13 could receive EZ awards, as authorized by Statute. From our interviews with those involved in the EDI review and selection process, it appeared that EDI funds were only intended for 7 of the final 13 strong rated EZ applicants that would not receive EZ designations. In this regard, it is our opinion that the targeting of the EDI NOFA to all 78 original EZ applicants was unfair. The disposition of the 13 EZ application finalists is shown in Attachment 4.

The authorization to use the $300 million for EDI awards in early December, and the desire to announce EDI awards at the same time as EZ/EC designations in late December, left little time for a competitive NOFA. A number of questions centered around whether or not the HUD Reform Act applied to this designation of EDI funds. Section 102(a) of the HUD Reform Act would require establishment of and adherence to a more formal competitive selection process than that used for the EZ/EC designations, with a minimum 30-day announcement period. CPD obtained verbal assurances from their legal counsel that the EDI program could be considered a non-demand program that makes assistance available without a competition. Therefore, it is exempt from the requirements of Section 102(a) of the HUD Reform Act.

We disagree that EDI could be considered a non-demand program that makes assistance available without competition. The Statute sets out specific criteria for the selection of EDI grants. Moreover, the legislative history for EDI reflects Congress' expectations that HUD will design "a method of selecting [EDI] grant recipients that is based on competition," including "a quarterly competition for funds." The EDI NOFAs preceding and following this EDI funding round were both competitive and expressly recognized the applicability of Section 102(a) of the HUD Reform Act. No change in the law occurred which would have justified CPD's failure to comply with the HUD Reform Act in its December 7, 1994 EDI NOFA.

The December EDI NOFA's required 1:1 leveraging of Section 108 loans was different from the previous August EDI NOFA, which advocated close to a 10:1 leveraging. The previous NOFA and the legislation identified the need to use EDI to maximize the use of 108 loans through leveraging. It appears from the legislative history that Congress intended the EDI leveraging ratio to be much larger than one to one. The EDI could be used to lower the cost of borrowing to make the economic development project less risky. Several billion dollars of 108 loan authority was available and not being used. The EDI was intended to be a marginal part of the overall loan package. Congress was hopeful that every dollar of EDI could leverage 10 dollars of Section 108 loans. In the December awards the leveraging ratio was 1:1. In other words, there is no leveraging as the EDI grant is sufficient to pay off the Section 108 loan.

After receiving the EDI applications, CPD reviewed the applications for eligibility. The final list of eligible applicants was forwarded to the Secretary who selected 6 EDI awards. The final EDI awards were made to 6 of the 13 EZ finalists that did not receive an EZ designation. The Secretary indicated he limited the EDI awards to only six communities because smaller dollar awards would be ineffective, and the seventh community on the final EZ selection list, Miami, had received considerable Federal funding in recent years. Two EDI selections received a $100 million and $87 million grant, respectively, and were designated by HUD as "Supplemental Enterprise Zones." Four other selectees were awarded EDI grants for $22 million and were designated by HUD as "Enhanced Empowerment Communities." Aside from public relations value, these HUD designations had no programmatic meaning or statutory basis.

ANALYSIS OF HUD COMMENTS

On July 10, 1995, we provided a draft audit report to the Secretary and Assistant Secretary for CPD for review and comment. Management's response to the draft report is provided in Attachment 5, and the referenced attachments are available under separate cover upon request. The response generally disagreed with our depiction of the selection process and our recommendations to address perceived weaknesses. Our analysis of the response concluded that it: (1) failed to address our primary concern over management's failure to provide reasonable support and justification for all selections made; (2) misconstrued the nature of many of our other concern issues; and (3) portrayed process information and events in a manner which is contradicted by evidence obtained during our audit. For these reasons, the substance of our draft report remained unchanged in this final report.

In management's view, "The most serious allegations in the Draft center on the applicability of the HUD Reform Act to the Economic Initiative grant awards, the interpretation of the Federal register notice of selection factors for EZ/EC designees, and the interpretation of certain eligibility provisions." As a matter of general response, HUD management took the position that its actions were consistent with the opinions of HUD's Office of General Counsel, and that the OIG's questioning of reliance on such opinions was an "ill-advised-- departure from the system of institutional checks and balances governing program office management." During the course of our audit, we were told differing stories as to what legal opinions were sought and provided on the EZ/EC and EDI selection processes. However, it was an objective of our audit to independently assess management's compliance with statutory requirements governing the EZ/EC and EDI selection processes. A discussion of the OIG's mandate for reviewing program compliance with statutory requirements is contained in the Inspector General's August 31, 1995 memorandum to the Secretary (see Attachment 6).

The following captioned sections provide our analysis of each of the 15 specific draft report issues to which HUD management took exception in its response.

1. Interpretation of the Application of the HUD Reform Act to EDI Awards - In response to our draft report, HUD's General Counsel issued a July 18, 1995 legal opinion to formalize its prior oral advice to CPD Officials that Section 102(a) of the HUD Reform Act did not apply to the December 1995 NOFA for EDI Grants. The opinion noted that HUD's references to the HUD Reform Act for previous and latter EDI Grants was a matter of "programmatic choice." The opinion also noted "The touchstone for mandatory application of the Section 102 procedures has therefore been whether something exogenous to Section 102 itself -- a statute, regulation, or other requirement -- provides for the competitive distribution of the funding."

The preamble to the HUD rule implementing Section 102 of the HUD Reform Act identifies those programs excluded from the Statute's coverage. These include 1) formula programs, 2) demand programs and 3) programs that distribute assistance on a discretionary (non-formula, non-demand) basis. OGC opined that EDI Grants fall in the last category. However, the HUD rule identifies the specific programs that fall within category three above. It also states that HUD will add other programs as appropriate. EDI Grants are not a listed program.

Additionally, there are many other HUD program statutes that do not expressly prescribe "competition" in the language of the statute. Yet, HUD has interpreted Section 102(a) of the HUD Reform Act to apply to funding under these statutes. Some examples include: Innovative Project Funding under the Innovative Homeless Initiatives Demonstration Program, Youth Development Initiative under PIH Family Investment Centers, Family Investment Centers and Community Outreach Partnership Centers. Our position remains that the HUD Reform Act provisions for competitive award processes should have applied to EDI grants, too.

2. Interpretation of the Use of Need as a Selection Factor - HUD's response misconstrues our concern, which is limited to the Secretary's authority to use "additional" needs criteria not already considered by the review process, as a basis for his final selections. We fully acknowledge that the EZ/EC application evaluation process took into consideration a community's "need" for an EZ/EC designation by virtue of the basic poverty level eligibility criteria, as well as requirements to spell out specific community needs as an integral part of a community's strategic plan. These clearly established needs factors were reviewed and rated by the task force and the review panel. We believe the interim rule requires that any "other factors" the Secretary would use (need was cited as an example), required Federal Register notification.

Counsel staff concerning Section 597.301(a)(4) of the interim rule. CPD staff expressed a belief that the interim rule permitted the Secretary to use "need" as a selection factor. We were told by General Counsel staff that CPD staff had not consulted them on this matter, and that additional needs factors not already stipulated in the statute or interim rule would require a Federal Register Notice. In a subsequent August 17, 1995 legal opinion to the Assistant Secretary for CPD, HUD's General Counsel noted "...a construction of the quoted text so as to permit need as a criterion could raise a question of interpretation. It is not, however, an impossible interpretation." While not an impossible interpretation, we continue to believe it was an unfair interpretation to apply any other selection criteria without defining it and allowing all applicants to respond to it.

3. Interpretation of Eligibility Requirements - HUD's response generally questions OIG's role in matters of legal interpretation, and contends its interpretation of EC eligibility requirements was consistent with HUD's legal counsel and a newly introduced legal opinion from the U.S. Department of Agriculture (USDA). We found the language in the Statute and Regulation ambiguous and unclear as to when exemptions to poverty eligibility levels could be granted. During our audit, CPD staff indicated that they relied on HUD Counsel for an interpretation of this language. HUD Counsel told us that they were not consulted on this matter, and their advice to us was consistent with basic principles of statutory construction. These principles permit resorting to extrinsic aids, such as legislative history, to discern Congressional intent.

We found that the conference report for this statute clearly indicates how exemptions can be applied. Notwithstanding that HUD's response to our draft report introduced a USDA legal opinion which supports their position, our position remains that the correct procedures were not used in determining the eligibility of EC applications.

4. Leveraging of EDI Grants with Section 108 Loans - HUD's response misconstrued our draft report language. We did not recommend that the leveraging ratio in the December 1994 EDI awards be 10 to 1. We did point out that Congress was hopeful that EDI dollars would be used to leverage Section 108 loan activities, and cited the 10 to 1 ratio used in other EDI funding rounds as an example. We did express our opinion that a 1 to 1 ratio does not do much to leverage funds. However, a lower ratio requirement would open the limited competition to more applications, and allow more flexibility in the EDI selection process.

5. Documentation of the EZ/EC Application Review Process - HUD's response does not accurately reflect the extent to which the "actual" process used in making EZ/EC selections was documented. The original documented review process procedures provided to us by CPD staff included a process where applications were to be numerically scored and ranked. The review panel later changed the process to eliminate the scoring and ranking of applications, in favor of a revised process using categorical groupings of applications from strong to weak. The intended functioning of the "revised" selection process was not documented.

6. Documentation of the EZ/EC Application Reviews - Our draft report did not criticize the EZ/EC task force staff efforts to assess the strengths and weaknesses of applications. Our issue pertained to the failure to adequately use the results of this effort as a basis for some of the Secretary's final selections.

7. Composition of the Review Panel - Our draft report did not question the composition of the Review Panel, only its effectiveness in preparing the Secretary for making sound and supportable selections.

8. Information Provided to the Secretary - While we agree with HUD's response that considerable information was generally "available" for the Secretary's review and analysis in making his final selections, we continue to question the extent to which the information was actually used, and why the information was not better summarized to support the Secretary's final selection process.

9. Documentation of Additional Review Information - While we agree that additional information was assembled on the top 13 EZ applicants, we are unsure as to the extent that this additional information was made available to the Secretary. The review panel did not analyze or summarize this additional information.

10. Initial Screening Process - HUD's response indicates that the review panel presentations provided to the auditors were preliminary characterizations and not determinative of the final recommendations of the review panel. This response contradicts the information we were provided during the audit. Furthermore, no other information has been provided as the basis for the final determinative results of the application review process.

11. Definition of Geographic Diversity - The response indicates that the audit misconstrues the intent and actual application of the geographical diversity criteria. We disagree. The draft report identified instances where geographical diversity was inconsistently applied and where it could have been better used to solicit additional applicants. In effect, the decision to award at least one EC to each State, regardless of the quality of the State's applications, created an "entitlement" process which

HUD's response indicates it did not want to create.

12. Timing of Eligibility Checks - Our draft report did not question the timing of the eligibility checks.

13. Modifications to Boundaries - HUD's response indicates that they did not negotiate boundary modifications. The draft report noted that the regulation only permits reasonable modifications of proposed zones. We pointed out instances where compliance with statutory requirements would require major modifications of zones, and in turn make the application ineligible. Our position on this issue remains unchanged by HUD's response.

14. Notification of Census Track Eligibility - HUD's response indicates that applicants were notified in writing of ineligible census tracts. The sample notifications provided in the response do not cite the specific ineligible tracts, and do not clearly define the actual final zone designated for benefits under the program. This issue should be brought to closure by HUD.

15. EDI NOFA Eligibility - We interpret HUD's response as supporting our contention that the EDI grants were predetermined to be awarded to the 13 EZ finalists that did not receive an EZ designation. We still contend that this was contrary to the EDI NOFA and unfair to the 45 applicants that applied under the NOFA.

RECOMMENDATIONS

On the basis of the above discussed results of our audit of the EZ/EC and EDI grant selection processes, and in full consideration of HUD's response to our draft report, we recommend that the Assistant Secretary for CPD take the following actions:

1. Review all EZ/EC selections to identify any waivers of eligibility criteria which impact the boundaries of proposed benefit zones, and assure that those boundary changes are formally acknowledged as part of the designation so that future benefits are directed to the proper areas.

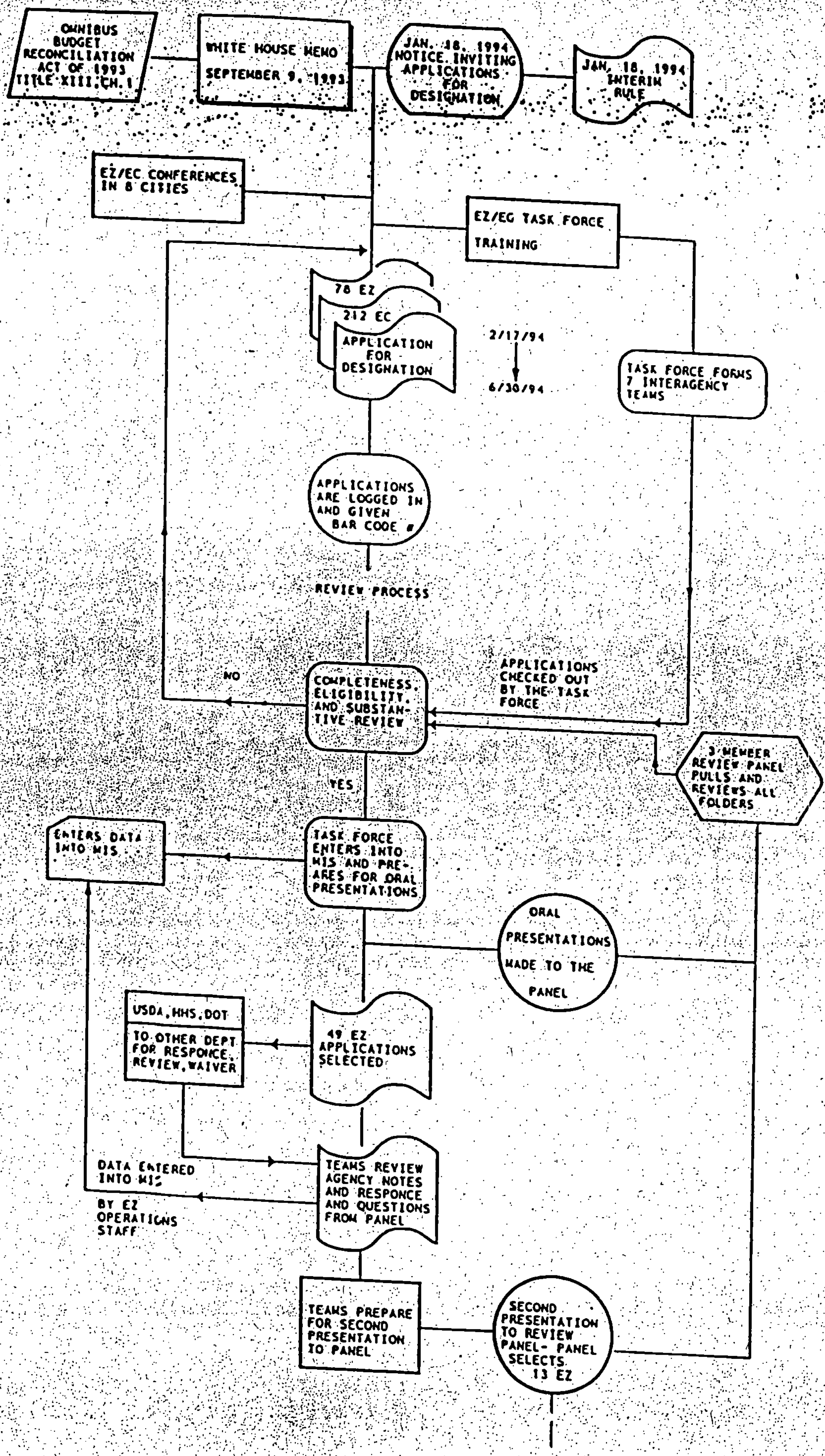
2. Require that any future EZ/EC, EDI or other program selection processes be governed by written processing instructions which assure a fair and equitable application review with sufficient documentation to support the basis for selections made.

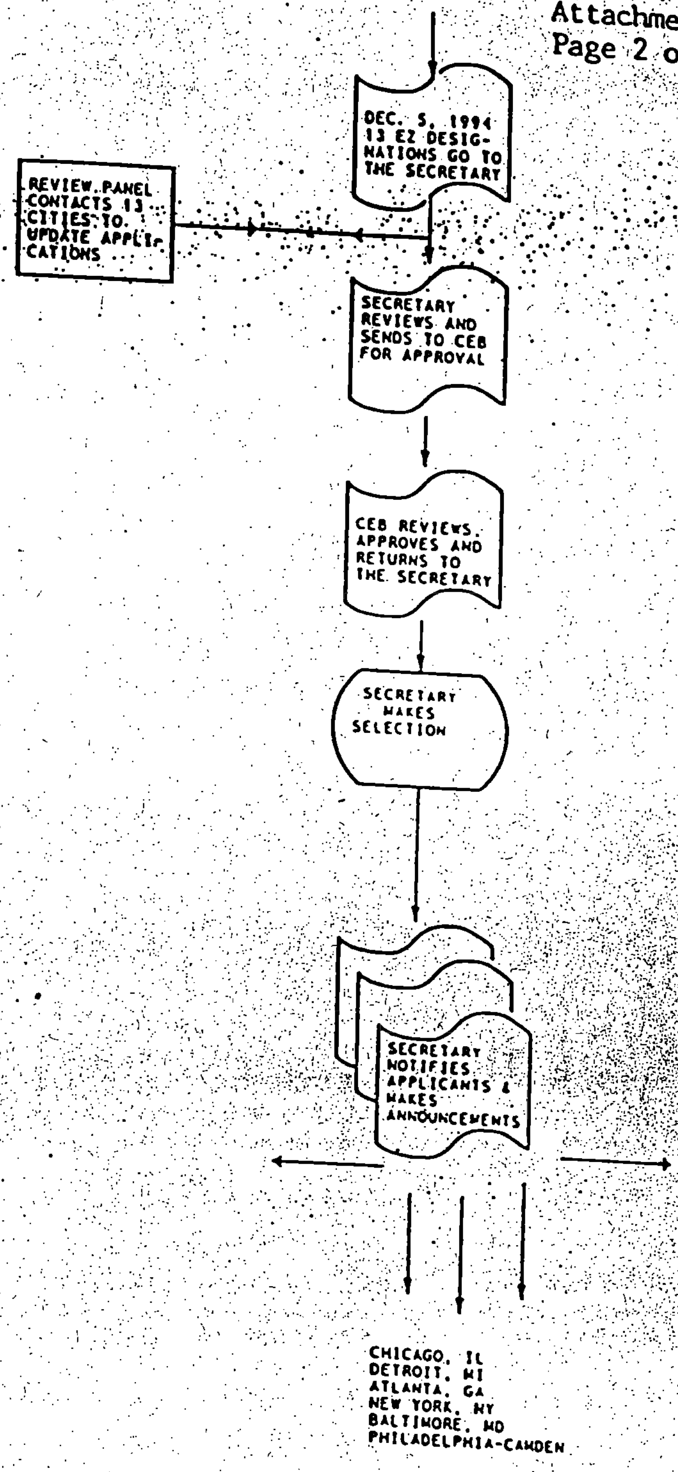
Within 60 days, please provide us a status report, for each recommendation, which indicates: (a) the corrective action taken; (b) the proposed corrective action and the date to be completed;

or (c) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions on our report, please contact me, or James M. Martin, Director of Program Research and Planning, on (202) 708-2306.

EMPOWERMENT ZONE/ENTERPRISE COMMUNITY APPLICATION PROCESS FLOW CHART




DEC. 5, 1994 13 EZ DESIGNATIONS GO TO THE SECRETARY
REVIEW PANEL CONTACTS 13 CITIES TO UPDATE APPLICATIONS
SECRETARY REVIEWS AND SENDS TO CEB FOR APPROVAL
CEB REVIEWS, APPROVES AND RETURNS TO THE SECRETARY
SECRETARY MAKES SELECTION
SECRETARY NOTIFIES APPLICANTS & MAKES ANNOUNCEMENTS
CHICAGO, IL
DETROIT, MI
ATLANTA, GA
NEW YORK, NY
BALTIMORE, MD
PHILADELPHIA-CAMDEN

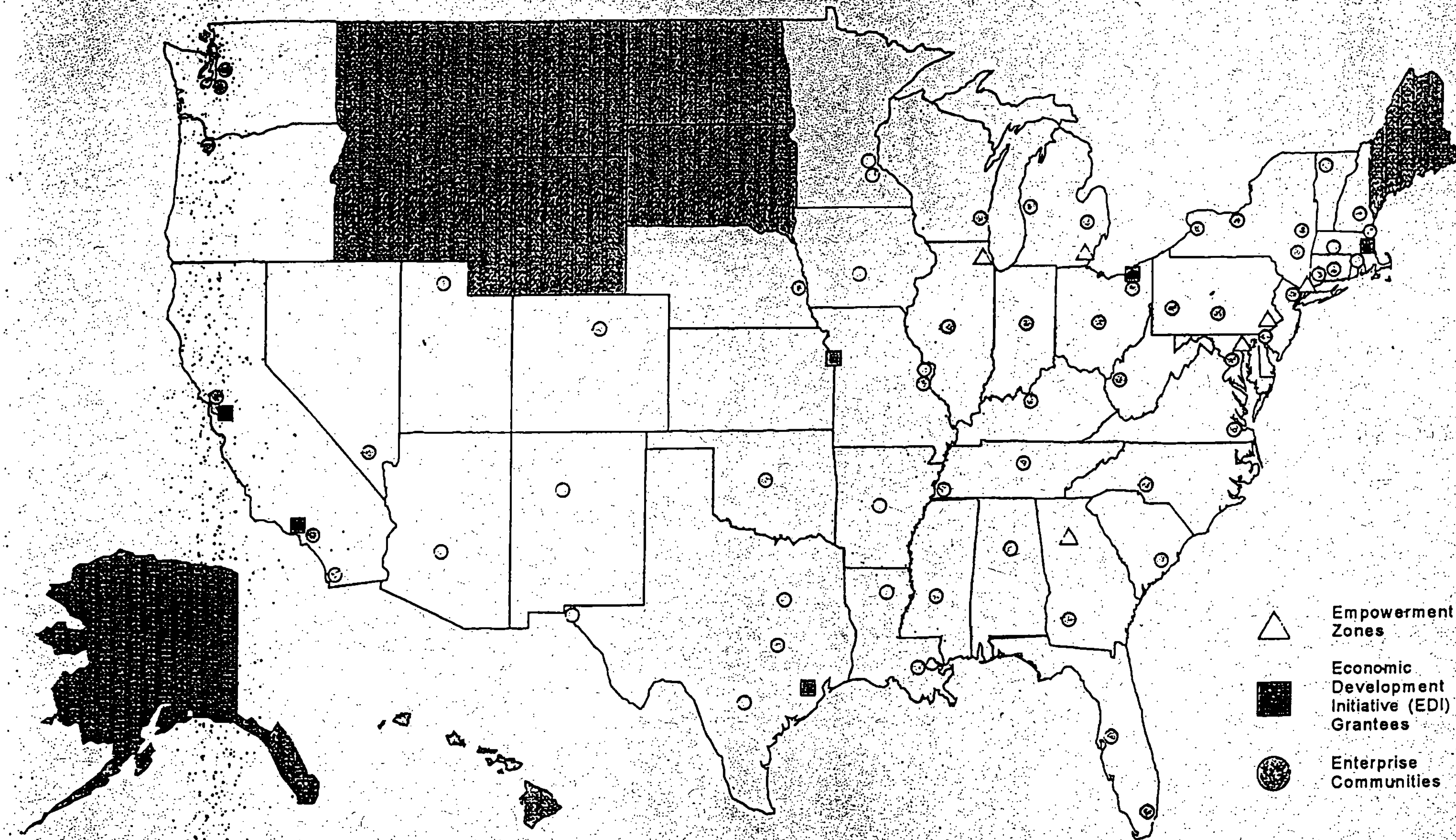
SECRETARY'S FINAL SELECTIONS INCLUDED FOURTEEN WEAK AND UFC APPLICATIONS NOT ON REFERRAL LIST

	STATE	EZ/EC	CITY	PANEL RATING	PANEL RECOMMENDATIONS: EZ FINALISTS	PANEL RECOMMENDATIONS: EC FINALISTS	PANEL RECOMMENDATIONS: ALTERNATE COMMUNITIES	SECRETARY'S SELECTION
1	CALIFORNIA	EC	HUNTINGTON PARK	UFC				X
2	ILLINOIS	EZ	EAST ST. LOUIS	UFC				X
3	ILLINOIS	EC	SPRINGFIELD	UFC				X
4	INDIANA	EC	INDIANAPOLIS	UFC				X
5	NO. CAROLINA	EC	CHARLOTTE	EC(W)				X
6	NEW HAMPSHIRE	EC	MANCHESTER	UFC				X
7	NEW YORK	EZ	BUFFALO	EC(W)				X
8	NEW YORK	EZ	ROCHESTER	UFC				X
9	NEW YORK	EC	ALBANY	EC(W)				X
10	NEW YORK	EC	KINGSTON	UFC				X
11	PENNSYLVANIA	EC	HARRISBURG	UFC				X
12	SO. CAROLINA	EC	CHARLESTON	EC(W)				X
13	TENNESSEE	EZ	MEMPHIS	UFC				X
14	VIRGINIA	EZ	NORFOLK	EC(W)				X
			TOTALS	14				14

STRONG AND MEDIUM RATED APPLICATIONS RECOMMENDED BY THE PANEL NOT SELECTED BY SECRETARY

STATE	EZ/EC	CITY	PANEL RATING	PANEL RECOMMENDATIONS: EZ FINALISTS	PANEL RECOMMENDATIONS: EC FINALISTS	PANEL RECOMMENDATIONS: ALTERNATE COMMUNITIES	SECRETARY'S SELECTION
ORNIA	EC	RICHMOND	EC(S)		X		
ORNIA	EC	SACRAMENTO	EC(S)		X		
ORNIA	EC	SAN FRANCISCO/CHINATOWN	EC(S)				
LAND	EC	HAGERSTOWN	EC(S)			X	
GAN	EC	KALAMAZOO	EC(S)		X		
ROLINA	EC	COLUMBIA	EC(S)		X		
SSEE	EZ	KNOXVILLE	EC(S)		X		
SSEE	EC	CHATTANOOGA	EC(S)		X		
RNIA	EC	RIVERSIDE	EC(M)		X		
RADO	EC	PUEBLO	EC(M+)		X		
IDA	EC	ST PETERSBURG	EC(M)			X	
RGIA	EC	ATHENS, CLARK COUNTY	EC(M)			X	
IANA	EC	FT. WAYNE	EC(M)		X		
NTUCKY	EC	LEXINGTON-FAYETTE	EC(M)		X		
ENTUCKY	EC	RICHMOND	EC(M)		X		
UISIANA	EC	BATON ROUGH	EC(M)			X	
SSACHUSETTS	EC	CAMBRIDGE	EC(M)			X	
SACHUSETTS	EC	LYNN	EC(M)			X	
IGAN	EZ	BENTON HARBOR; BENTON	EC(M)		X		
IGAN	EZ	GRAND RAPIDS	EC(M)			X	
AROLINA	EC	RALEIGH	EC(M)			X	
AROLINA	EC	WILMINGTON	EC(M)		X		
AROLINA	EC	WINSTON-SALEM	EC(M)			X	
JERSEY	EC	TRENTON	EC(M)			X	
W YORK	EC	BROOKLYN NAVY YARD	EC(M)		X		
EW YORK	EC	NYC/SW BROOKLYN	EC(M)		X		
	EC	DAYTON	EC(M)		X		
	EC	TOLEDO	EC(M)		X		
NIA	EC	PORTSMOUTH	EC(M)		X		
NIA	EC	ROANOKE	EC(M+)		X		
		TOTALS	30		19	11	0

Geographic Distribution of All Designated Jurisdictions



NOTE: No designated jurisdictions within shaded States.

Attachment 4

DISPOSITION OF 13 EZ APPLICATION FINALISTS

EMPOWERMENT ZONE DESIGNATIONS
ATLANTA, GA
BALTIMORE, MD
CHICAGO, IL
DETROIT, MI
NEW YORK, NY
PHILADELPHIA, PA/CAMDEN, NJ
SUPPLEMENTAL ENTERPRISE ZONES
LOS ANGELES, CA ($125M EDI Grant)
CLEVELAND, OH ($87M EDI Grant)
ENHANCED EMPOWERMENT COMMUNITIES
BOSTON, MA ($22M EDI Grant)
HOUSTON, TX ($22M EDI Grant)
KANSAS CITY, MO/KANSAS CITY, KS ($22M EDI Grant)
OAKLAND, CA ($22M EDI Grant)
EC DESIGNATION
MIAMI, FL

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY
WASHINGTON, D.C. 20410-0001

DATE: August 24, 1995

MEMORANDUM FOR: Susan Gaffney, Inspector General, Z

FROM: Henry G. Cisneros, S Henry Cisneros

SUBJECT: Response to Review of Empowerment Zone, Enterprise Community and Economic Development Initiative Grant Selection Process

Thank you for the opportunity to respond to your draft July 10, 1995 review of the Empowerment Zone, Enterprise Community and Economic Development Initiative Grant Selection Process ("the Draft").

The Office of the Inspector General (OIG) has reviewed several Community Planning and Development (CPD) competitions over the years. Although CPD has not always agreed with the recommendations generated by these reviews, we have generally found these reviews to be helpful tools in improving the management of CPD programs. However, the current Draft departs from the usual helpful nature of OIG reviews.

As outlined in the attached comments, the Draft OIG report establishes an entirely novel set of standards for CPD and other HUD program offices to follow. The essential role of the program office is to manage programs in accordance with the law. Effective management requires the program office to identify ambiguity in the law, and seek opinion of the Department's Counsel prior to taking program action. The Draft recommends a fundamental change to this traditional approach to program management. Throughout the Draft, the Inspector General implies that the program office should not rely upon the opinion of the Department's Counsel. This represents a substantial --and I believe, ill advised-- departure from the system of institutional checks and balances governing program office management.

The most serious allegations in the Draft center on the applicability of the HUD Reform Act to the Economic Development Initiative grant awards, the interpretation of the Federal Register notice of selection factors for EZ/EC designees, and the interpretation of certain eligibility provisions. Each case involves CPD actions which are consistent with the opinions of the Office of General Counsel. By implication, the OIG Draft report seeks either to change the laws Congress passed or the interpretation of those laws by HUD's Counsel. Neither is appropriate.

Again, I appreciate the opportunity to transmit this response to you, and request that it and the accompanying documentation be included in your published report.

As always, I look forward to working with you to continue to make the CPD competition process as effective as possible.

Attachment

The Empowerment Initiative application review process represented a unique, interagency approach to the review of Empowerment Zone and Enterprise Community Application submissions. During the review process, beginning July 5, 1994, almost one hundred senior executives from eleven different federal agencies ("the EZ/EC Task Force") thoroughly analyzed the 74 urban Empowerment Zone and 219 urban Enterprise Community applications. Individual reviewers worked in teams managed by leaders from five separate federal agencies. Team leaders and members received extensive training prior to the start of the review process, and followed a carefully designed and well documented review process.

The interagency team reviews resulted in extensive written and oral presentations to a three member Review Panel, composed of a majority of federal career executives. The work of the review panel and assessment teams resulted in rough preliminary divisions of the EZ and EC applications on the basis of relative quality.

Concurrently with the interagency team reviews, most of the agencies of the President's Community Enterprise Board ("CEB") conducted additional reviews of the applications. For example, a large team from the Department of Health and Human Services reviewed applications for Title XX funding eligibility and assessed the quality of social service components. The Department of Justice examined the public safety segments of the applications, and the Departments of Labor and Education, the Environmental Protection Agency and other CEB agencies also reviewed the EZ and EC applications.

In the second stage of the review process, the interagency EZ/EC Task Force reviewed over 3500 waiver and program funding requests contained in the applications. The review panel and review teams then conducted a second round of written and oral presentations. These presentations included the input of the federal agencies regarding application quality, the results of federal waiver and program funding requests, and additional analysis by the review teams. The second round presentations, made by the same reviewers and team leaders who managed the first round of presentations, led to the review panel's final, broad recommendations of the relative quality of the applications.

During the week of December 5, 1994 the agencies of the CEB received a list of EZ applications under serious consideration by the HUD Secretary for final EZ designation. Concurrently, the Office of Inspector General conducted a review of potential designees to determine if there were outstanding audit findings for any HUD programs. Federal agencies then completed their last evaluations of the EZ finalist applications.

On December 21, 1994, President Clinton and Vice President Gore announced the designation of 72 urban and 33 rural Empowerment Zones and Enterprise Communities. HUD obtained additional funding from its Economic Development Initiative for two Supplemental Empowerment Zones and four Enhanced Enterprise Communities.

The Empowerment Initiative review process may well have been the most thorough interagency effort of its kind ever undertaken by the federal government. The process was extensively documented every step of the way, from program design to the final recommendations of the review panel. The end result of this unprecedented collaboration was a group of high quality finalists presented to the HUD Secretary. These applications represented a series of blueprints for the revitalization of some of America's most distressed communities unsurpassed in their degree of community participation, potential private investment, local government commitment, and strategic planning for the future.

The OIG's Draft Report contains numerous incorrect interpretations of how the above selection process was implemented. This attachment addresses the misinterpretations contained in the Draft.

II. Responses to Specific OIG Comments

As outlined in this memorandum, CPD sought and relies upon legal interpretations provided by OGC on the major issues raised in the Draft. On these issues --applicability of the HUD Reform Act, interpretation of eligibility provisions, and interpretation of the use of "need" as a selection criterion-- the Draft offers a different interpretation than that provided by OGC, and suggests that CPD be held not to OGC's legal opinion, but to the retrospective interpretation of OIG. This presents the program office with an impossible dilemma. Either the program office must disregard the opinion of Counsel in favor of its own legal judgments, or it must try to predict how OIG might retrospectively interpret the issue. Since, as discussed herein, the Draft even takes positions at odds with OIG's own earlier reviews on the same issues, it is simply impossible for a program office to guess how OIG will come out on any given question. A program office cannot function in this manner.

The implication of the OIG report is that CPD should disregard the interpretations provided by HUD Counsel and substitute its own judgment. That was not an appropriate role for CPD during the application review process. Nor is it proper for OIG to now step in, one year later, to substitute its judgment on matters of legal interpretation for that of the Office of General Counsel.

These issues, along with others presented by the Draft, are examined in detail in this section.

Interpretation of the Application of the HUD Reform Act to the Economic Development Initiative Awards

- <u>OIG Comment:</u> The draft review states that the non-competitive manner in which Economic Development Initiative ("EDI") grants were awarded is a violation of the HUD Reform Act. Draft, page 3, 12.

<u>Response:</u> The award of the EDI grants was administered according to legal advice provided by the Office of General Counsel. Prior to taking any action, CPD consulted with

counsel and obtained an opinion regarding applicability of the HUD Reform Act, which it then relied upon. The NOFA, drafted with the assistance of and signed off by OGC, explicitly states:

"This NOFA is not subject to Section 102 of the Department of Housing and Urban Development Reform Act (42 U.S.C. 3545) because funds under this NOFA are not being awarded on a competitive basis. The applications will not be reviewed by reviewing panels, nor will applications be rated or ranked. The award of funds will be made by the Secretary". Fed. Reg., Vol. 59, No. 234, Wednesday, December 7, 1994.

Under OGC's interpretation, section 102 of the HUD Reform Act does not compel a competitive selection of grantees under the EDI program. This interpretation was provided to OIG on two occasions prior to the OIG publication of the draft review. A formal legal opinion detailing OGC's conclusion that the competitive distribution of EDI grants is a programmatic choice for CPD is attached. See attachment 2.

At a minimum, the report should clearly state that this is OGC's opinion, and that CPD reasonably and properly sought and relied on OGC's opinion in choosing to award EDI grants non-competitively. For OIG to say otherwise is to force CPD to ignore the opinions of HUD Counsel and instead try to predict how OIG staff might interpret a statute. In effect, CPD would be substituting its own judgment for that of HUD counsel. This is untenable from the standpoint of program management. More importantly, this approach undermines the very integrity of the system of Departmental checks and balances.

Interpretation of The Use of "Need" as a Selection Factor

- <u>OIG Comment:</u> The Draft review states that CPD staff improperly interpreted section 597.301(a)(4) of the interim rule as authorizing the Secretary to select on the basis of "need" without a Federal Register notice. Draft, page 7.

<u>Response:</u> First, CPD staff does not interpret any statute, rule or regulation. All interpretations of any statute, rule or regulation are made by the Office of General Counsel and relied upon by CPD staff. At a minimum, the report should state that CPD at all times acted reasonably and properly in relying on the rule OGC drafted, and that OIG now chooses to interpret the rule in opposition to OGC's interpretation.

Second, the Office of General Counsel has stated that "need" was an available criterion. As OGC concluded, Federal Register, Vol. 59, No. 11, page 2709 did in fact contain an explicit notice that need was a basis of selection. Section 597.301 (a)(4) Selection Factors clearly states:

In choosing among nominated urban areas eligible for designation, the Secretary shall consider:

(4) Such other factors established by HUD. Such factors include, but are not limited to, the degree of need demonstrated by the nominated area for assistance under this part. (emphasis added)

"Need" was thus explicitly and properly noticed in the Federal Register. This interpretation is provided in the HUD General Counsel's August 17, 1995 memo. See attachment 2.

Third, applicants clearly understood that "need" was one factor upon which selection would be based. The Application Guide identified "need" as one element to be addressed in the application. See Application Guide, pp. 23, 27, attachment 3. Moreover, CPD held eight informational forums around the country during February 1994 at which the inclusion of need as a factor was discussed. Every application received by the Task Force did, in fact, address "need". And, information about "need" was explicitly captured during the evaluation process. See Sections 1, IV of the Presentation Outline, attachment 4. There was no confusion or mystery surrounding the use of "need" as an evaluation element.

At every step of the way --drafting and publication of the interim and final rule, distribution of application materials, technical assistance to applicants, the submission of applications, and the review process-- all of the parties involved in the application process, including the applicants themselves, acted on the assumption that need was a factor in selection. That the OIG staff involved in preparing the Draft conclude otherwise is irrelevant, since CPD relies upon OGC's guidance on this issue.

Finally, it should be noted that the Department of Agriculture, which shared responsibility with HUD for the EZ/EC application review and selection processes, also employed "need" as a criterion in the evaluation and selection process after consulting with USDA legal counsel. In short, both HUD OGC and USDA's counsel settled on the same interpretation of the role of need in this process. HUD and USDA strove to be completely consistent in the interpretation and application of the statute and rules. The interim and final rules were jointly drafted and published. It would have made a shambles of the interagency cooperation promised by the Empowerment Initiative for the two agencies to apply different criteria to the EZ/EC application process.

Since "need" was properly noticed in the Federal Register as a selection criterion, the final report should delete the discussion of need on page 7 of the draft. In the alternative, the report should note that:

--CPD staff at all times acted reasonably and properly and relies on OGC's interpretation of the interim rule and final rule drafted by OGC;

--No applicant was prejudiced by what OIG --and OIG alone-- interprets as a failure to properly notice "need" as a selection factor in the Federal Register;

--It would not have been a good policy choice for HUD to apply a different set of selection criteria than USDA.

Interpretation of Eligibility Requirements

OIG Comment: On the issue of exemptions for certain poverty thresholds in order to qualify for designation, the Draft contends that the Statute may have been "incorrectly drafted" and that the conference report should therefore have governed the issue of exemptions. As a result, the Draft concludes that three EC designations failed to meet the statutory eligibility requirements. Draft, page 9.

Response: It is clearly beyond the authority of CPD staff --and for that matter the Inspector General-- to determine whether Congress has "incorrectly drafted" a piece of legislation. CPD's duty was to implement the legislation, and to seek advice of HUD counsel where the legislation was not clear. All decisions regarding the application of exemptions were made pursuant to interpretation of the statute by HUD counsel and upon the advice of HUD counsel. That OIG has a different interpretation of the statute than OGC is simply not relevant to whether CPD reasonably relied on legal advice provided by OGC. At a minimum, the report should state that CPD did reasonably rely on the interpretation provided by OGC of a statutory provision the OIG draft report itself admits was "unclear".

Moreover, as with all matters concerning statutes, rules and regulations governing the Empowerment Initiative application process, HUD sought to administer the program in a manner consistent with the Department of Agriculture. It would have been patently unfair to applicants to apply two distinct eligibility standards to rural and urban applicants, some of whom were located in the same state. Sec. 1332(b)(2) of the statute and 597.103(b)(3)(iii) of the interim rule were the focus of substantial discussion by the staffs and legal counsels of HUD and USDA from the inception of the program. There was considerable confusion expressed about this provision at the eight regional information workshops conducted in February, 1994. HUD and USDA worked collaboratively to ensure that a uniform interpretation of the provision would be followed. After consultation with HUD OGC, and prior to receipt of any application, the Acting Assistant General Counsel for USDA issued a decision memorandum that USDA would follow an interpretation of the statute which would permit a reduction of up to five census tracts. See USDA Memo of May 5, 1994, attachment 5. The final regulations for both agencies contain the same language relative to the poverty exception allowance for Enterprise Communities.

In reaching its decision, USDA relied on the clear intent of the exemption provisions to expand, not limit, eligibility. The OIG interpretation runs counter to the spirit and intent of the waiver provisions, which were designed to qualify more communities for Enterprise Community designation, not to restrict them.

Of the sixty-five designated Enterprise Communities, the interpretation of this provision affected three designees. The Draft states that under its theory of interpretation, these three communities, Huntington Park CA, Albany NY, and Manchester NH would be ineligible. However, the issue is not whether OIG can imagine alternative interpretations of the provision, but whether CPD properly sought and reasonably relied upon a legal interpretation provided by Counsel. Since it is undisputed that CPD did so, the Draft's entire discussion of the alternative legal theory and its consequences is irrelevant. The exemptions granted for the three applicants were in total compliance with the Counsel's interpretation of the statute and rule governing poverty exceptions.

This section should be deleted from the Draft.

Leveraging of EDI Grants with Section 108 Loans

- OIG Comment: The Draft states that the 1:1 leveraging ratio of EDI grants to Section 108 loans was inadequate, and suggests that CPD should have employed a 1:10 ratio. Draft, page 12.

Response: The action recommended by the Inspector General is illegal.

It should be noted at the outset that the statute does not address the question of leveraging. It simply provides that grants may be made "in connection with" Section 108 loan guarantees. Section 108 (q), Housing and Community Development Act of 1974, as amended. The amount of leverage is a programmatic decision. Moreover, this use of EDI funds was specifically approved by HUD's Appropriation Committee in November, 1994.

More important, the OIG suggestion would result in violation of at least two statutory provisions.

First, the Department's authority to issue loan guarantees is capped at \$2 billion. See Section 108(a), Housing and Community Development Act of 1974, as amended. The December EDI Notice of Funds Availability ("NOFA") announced that the Department would award \$300 million in EDI grants. Had the Department applied the ten-to-one ratio favored by the Inspector General, the total amount of loan guarantees issued under this single NOFA would have been \$3 billion. *Under the Inspector General's approach, the Department would have exceeded its statutory authority by \$1 billion.*

Second, the maximum aggregate amount in Section 108 loan guarantees which can be awarded to any single grantee is limited to five times the amount of the grantee's annual Community Development Block Grant (CDBG). Section 108(b). Due to the size of the EDI grants made under this competition, application of a ten-to-one ratio would have violated this provision. For example, the City of Boston's CDBG allocation is approximately \$25 million. Under the statute, the City is limited to approximately \$125 in Section 108 loan guarantees. The City received a \$22 million EDI award in the December competition. Applying the ten-to-one ratio recommended by the Inspector General would result in a Section 108 award of $220 million, exceeding the statutory cap by $95 million. Similar results would have been reached for each EDI award recipient if the Inspector General's formula was followed.

On this issue it would be inappropriate and wrong to hold CPD to the OIG, rather than the Department's interpretation of the law, as provided by its legal Counsel.

Aside from the legal issues, the Draft's statement that "there is no leveraging as the EDI grant is sufficient to pay off the Section 108 loan", page 12, is incorrect. The EDI grants are not used to pay off the loan guarantee. While in some cases a small amount of EDI funds might be used to establish a loan loss reserve, the vast bulk of EDI funds are invested in local development activities. In fact, the EDI grants leveraged approximately $650 million in Section 108 loan guarantees, since several communities applied for loan guarantees significantly in excess of a one-to-one ratio. The combined EDI/108 investment in the six cities receiving EDI grants approaches $1 billion.

Finally, OIG's current interpretation is at odds with its own earlier review of the EDI NOFA prior to its publication. CPD sought and received from the Office of the Inspector General its concurrence with the substance of the NOFA at the time it was circulated for Departmental clearance. No comment was made with respect to any concern with the leverage issue. See attachment 6. In fact, the Inspector General also concurred on a subsequent March, 1995 EDI NOFA, which --like the December NOFA-also contained the requirement of at least a one-to-one EDI/108 leverage ratio. For OIG to clear the NOFA in December, and again in March, and then reverse itself in July, is inconsistent and undermines program office reliance on OIG clearances. CPD cannot manage its programs effectively by being forced to guess what opinion OIG will take in any given month on the same issue.

This section of the Draft should be deleted.

Documentation of the EZ/EC Application Review Process

• <u>OIG Comment:</u> The Draft states that the Empowerment Zone review process was not established in writing. Draft, pp. 2, 5.

<u>Response:</u> The Draft is simply wrong. The review process was extensively documented in a series of materials, including:

-- Manual of Policies and Procedures. See attachment 7.
-- Summary memo to the Community Enterprise Board. See attachment 8.
-- Training materials for EZ/EC review teams. See attachment 9.
-- Evaluation instructions. See attachment 10.
-- Evaluation criteria review sheets. See attachment 11.
-- Application Review Flow Chart. See attachment 13.
-- EZ/EC Presentation Outline. See attachment 4.

-- EZ/EC MIS Users' Guide. See Sample reports: attachment 14.
-- Review Panel Report. See attachment 23.

Each of these materials was prepared and distributed prior to the beginning of the competition. The policies and procedures established in these documents were rigorously adhered to throughout the duration of the review process. Although these materials were provided to OIG for assistance in preparing the Draft, the Draft incorrectly and repeatedly states that the review process was not documented. The final report should delete these comments and state that the EZ/EC review process was thoroughly and extensively documented, and that the policies and procedures which were established were carefully followed.

Documentation of the EZ/EC Application Reviews

• <u>OIG Comment:</u> The Draft states that reviewer assessments and the relative strengths and weaknesses of applicants were inadequately documented. Draft pages 2, 5, 6.

<u>Response:</u> CPD strongly dissents from this conclusion. The task force reviewers produced over 3000 pages of comments assessing the strengths and weaknesses of each application. A written assessment was prepared *for each and every applicant*. Two hundred and ninety written assessments were prepared by the interagency review team addressing in detail thirty-six review criteria for each application. The format for the written assessments is found at attachment 4. An example of a written review can be found at attachment 15.

These in-depth analyses served as the basis for presentations to the review panel. The review panel also read each and every application. The review panel then added 900 pages of its own notes. The reviews and the notes were made available to the Secretary to assist the selection process. These materials, which filled ten large document binders, were also made available to the Inspector General's staff for its review. The Draft's conclusion that more detailed information on each application should have been collected, see Draft p. 3, is perplexing. We question whether the Inspector General's staff took adequate notice of the voluminous assessment materials made accessible to them. In any event, we strongly disagree with any suggestion that either the review process or the review assessments were inadequately documented. The facts indicate otherwise. Pages 2, 3, and 5 of the Draft should be revised to indicate that the written assessments of EZ/EC applications generated by the review process were exemplary in their depth and quality of analysis.

Composition of the Review Panel

• <u>OIG Comment:</u> The draft review states that the EZ/EC review panel was composed of three senior CPD officials. Draft, page 5.

<u>Response:</u> For clarity's sake it should be noted that two of the three senior officials were career executives; only one panel member was a political appointee. This is consistent

with the CPD Competition Manual, see attachment 12, which requires that a majority of the panel reviewing applications in any CPD competition be comprised of career civil servants. The purpose of this provision is to avoid politicizing the review process.

Information Provided to the Secretary

- <u>OIG Comment:</u> The draft review states that no written information was provided to the Secretary to allow him to distinguish between applications, and that it appeared as though the Secretary was largely on his own to make final distinctions within the strongest category of applications (page 6, first paragraph).

<u>Response:</u> The Draft is factually incorrect. The Secretary had extensive discussions with senior staff and had full access to the applications themselves, briefing materials, as well as the voluminous written reviews described above. Indeed, a substantial exchange of information took place during the final phase of the review process. The final report should delete this comment or take note of this interchange.

The Office of Inspector General also faults the Secretary for use of his own "personal knowledge" of communities in the designation process. See Draft, page 8. But it does not state how that personal knowledge was used or even what the term "personal knowledge" means in this matter. The operative regulatory criteria are set out at 24 CFR 597.301. It is within these criteria that the Secretary's decisions were to be made. According to the HUD General Counsel, the application of the Secretary's knowledge within the regulatory selection criteria would pose no problem. Each of the examples of "personal knowledge" cited in the OIG Draft on page 8 clearly fall within the regulatory criteria of need and geographic diversity. The Secretary's designations were thus in full compliance with applicable statutory and regulatory requirements.

Documentation of Additional Review Information

- <u>OIG Comment:</u> The Draft correctly notes that there was a series of phone calls to the final 13 EZ applicants for the purpose of updating the application's standing in case there had been any changes. Draft, page 6. The Draft states that there were no documented analysis or conclusions from this update process. Draft, page 6.

<u>Response:</u> In fact, two notebooks full of additional material were assembled from these calls and made available to OIG as part of the 17 volumes of documentation provided for this review. Key information from those calls was made available to the Secretary. The final report should delete this comment or state that this information was collected and utilized.

• <u>OIG Comment:</u> The Draft places a great deal of emphasis on the fact that applications were categorically rated as strong, medium, weak or under further consideration (UFC). The Draft suggests that the UFC category was created to guard against the premature release of a list that would reveal to outsiders which cities had been preliminarily eliminated from the competition. Draft, page 5.

<u>Response:</u> The Draft misstates both the purpose of the initial ratings, and the use of these ratings. These ratings were designed and used only as a preliminary screening device. Indeed, the alternative --sending every application to the other federal agencies for complete review-- would have created an impossible and wholly unnecessary workload. The initial distinctions drawn by the panel narrowed the number of applications to be considered by other federal agencies. This made the heavy workload at least manageable for these other agencies. When the review panel reconsidered applications that had been classified UFC's, those applications were then forwarded to the other federal agencies for review.

Moreover, under the CPD Competition Manual, no final ratings are assigned prior to the conclusion of the review of all applications. The purpose of this policy is to ensure that the review panel has reviewed a sufficient number of applications to form an accurate impression of relative strength, weaknesses and quality. This approach protects against inconsistent evaluations of the relative quality of applications.

The EZ/EC application review process is consistent with the Competition Manual. The ratings assigned by the EZ/EC review panel during the first panel presentation -including the UFC rating-- were preliminary characterizations and not determinative of the final recommendations made by the panel. These characterizations existed only in the informal notes of one panel member and were never intended nor used as a final ranking system. After these notations were recorded, additional evaluations received by the panel from the agency reviews were factored into the final recommendations of the panel. In addition, the panel reconsidered applicants originally evaluated as EZ's for EC status. This additional information was documented in the second round of review panel presentations. See attachment 19. As a result of this further consideration, a number of applications initially characterized "weak" or "UFC" were included in the final recommendation lists. These applicants included:

Pulaski County, Arkansas
Denver, Colorado
Peoria, Illinois,
Lowell, Massachusetts
Springfield, Massachusetts
Oklahoma City, Oklahoma
Chester, Pennsylvania
Ogden, Utah

Burlington, Vermont
Tacoma, Washington

"Under Further Consideration" thus meant just that. The section of the Draft which purports to describe the rating process is misleading and inaccurate and should be revised or deleted.

Definition of Geographic Diversity

- <u>OIG Comment:</u> The Draft suggests that the selection factor "geographic diversity" would better have been defined in advance of the application solicitation. Draft, page 7.

<u>Response:</u> The Draft misconstrues the application of the geographic diversity criterion. During the review process, the review team makes an independent evaluation of each applicant without regard to geographic distribution of the applicants. The selecting official may then review the geographic distribution of the finalists, and in his discretion, select applications "in order to increase the level of geographic diversity of designations". 597.301(b).

The Draft's misunderstands the purpose of the "geographic diversity factor." Because the geographic distribution of the pool of finalists must be known before this particular "selection factor" can be intelligently applied, it makes little program sense to rank on that factor in advance. Moreover, the approach advocated by the Draft would undermine the integrity of the competitive process. If geographic allocations of grants are announced in advance, the grant process begins to resemble an entitlement program rather than a competition.

Moreover, the application of the factor is consistent with the opinion of the Office of General Counsel. See attachment 2.

Finally, OIG reviewed the definition of geographic diversity contained in the interim rule <u>prior to publication</u> and had no objection at that time. See attachment 16. CPD relied on the Inspector General's concurrence with the rule when it was published. CPD should not be held to OIG's later inconsistent interpretations of rules and regulations.

This section of the Draft should be deleted.

Timing of Eligibility Checks

- <u>OIG Comment:</u> The draft review states that most eligibility checks were not made until late in the review process. Draft, page 9.

<u>Response:</u> Final eligibility decisions were made in the latter stage of the review process because there was no reason to do comprehensive checks on weak applications which

were not likely to be selected. Similarly, the Office of the Inspector General did not conduct audit reviews until the pool of applicants had been screened. See attachment 20. As a practical matter, it would have created a tremendous workload to check all applicants for either eligibility or audit findings prior to this stage of the review process. The final report should delete this comment or note that this was a reasonable management choice.

Modifications to Boundaries

- OIG Comment: The Draft questions whether modifications made to boundaries of certain Enterprise Communities were "reasonable". Draft, page 10.

Response: Under Section 597.300(d) of the interim rule, HUD may "negotiate reasonable modifications of the strategic plan, the proposed boundaries of a nominated urban area, or the term for which a designation is to remain in full effect, to ensure maximum efficiency and fairness in the provision of assistance to such areas". Although HUD held several negotiation sessions to discuss modifications to several strategic plans, HUD did not negotiate any boundary modifications in these sessions, nor at any other time. Since HUD did not negotiate any boundary modifications, this section does not apply.

The only instances in which boundaries of nominated areas changed were those mandatory modifications that occurred as a result of the application of the statutory census tract criteria which rendered certain census tracts ineligible. There was simply no discretion exercised by HUD in this matter. This section of the Draft, including the references to the Albany and Newburgh/Kingston census tract eliminations, should be deleted.

Notification of Census Tract Ineligibility

- OIG Comment: The Draft states that designees were not notified in writing that census tracts were ineligible. Draft, page 10.

- Response: The Draft is factually incorrect. All designees with census tract changes were notified in writing in February, 1994. A follow-up letter was sent in April, 1994. Procedures and sample letters and are attached as Attachment 17. This comment should be deleted.

EDI NOFA Eligibility

- OIG Comment: The draft review states that the targeting of the EDI NOFA to all original applicants was unfair because EDI funds were only intended for 7 of the final 13 strong rated EZ applicants that would not receive EZ designations. Draft, page 12.

Response: It was not clear that all 13 of the finalist applications would apply or even be eligible for the EDI award, or submit properly completed applications. Had finalists chosen not to apply (as several so indicated to HUD), or been ineligible, or made non-curable errors in their applications. CPD would have had to move further down the list of original EZ applicants. Since this was a reasonable administrative decision, this reference should be deleted from the final report.

III. Recommendations

1. OIG Recommendation: The Draft recommends that CPD perform an assessment of the eligibility of the 14 designated EC's that were not recommended by the application review process, and make necessary changes to the status or conditions of those designations as a result of any problems found.

Response: Eligibility checks were run on the 14 EC's during December 1994. See sample, attachment 18. No problems requiring a change in designation resulted.

2. OIG Recommendation: The Draft recommends that boundary changes resulting from ineligible census tracts be formally acknowledged.

Response: All designees with ineligible census tracts were notified verbally in January, 1994, and in writing in February, 1994. A follow-up letter was sent in April, 1994. Procedures and samples of the letters are attached; see attachment 17.

3. OIG Recommendation: The Draft recommends that CPD request and act on a formal legal opinion concerning the applicability of the HUD Reform Act on the EDI grant selection process.

Response: CPD requested and received an opinion from HUD Counsel prior to the publication of the EDI NOFA concerning the applicability of the HUD Reform Act. The opinion of the Office of General Counsel was that the Reform Act did not apply. This opinion was delivered to OIG by the General Counsel at a meeting with Inspector General Gaffney on May 11, 1995, and in writing on May 24, 1995, six weeks prior to the issuance of the Draft. An additional memorandum from the General Counsel containing this opinion is attached; see attachment 2.

4. OIG Recommendation: The Draft recommends that CPD require any future EZ/EC or EDI competitions be governed by written processing instructions which ensure a fair and equitable application review, with sufficient documentation to support the basis for selections made.

Response: All CPD competitions are governed by the CPD Competitions Manual, written guide to CPD competition policies. See attachment 12. The Manual ensures that CPD competitions are managed according to principles which ensure fairness and openness, comprehensive and accurate evaluations of each application, and program awards that exemplify innovation and maximum possible effectiveness. In addition, a comprehensive policy and procedures manual was established specifically for the EZ/EC competition.

As described in this memorandum, the documentation for the EZ/EC application review process was extensive and thorough, consisting of over 3000 pages of reviewer assessments.

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-0000

Attachment 6

August 31, 1995

MEMORANDUM FOR: Henry G. Cisneros, Secretary, S

FROM: Susan M. Gaffney, Inspector General, G

SUBJECT: Response to Review of Empowerment Zone, Enterprise Community and Economic Development Initiative Grant Selection Process

Thank you for your August 24, 1995 response to the Office of Inspector General (OIG) draft report titled "Review of Empowerment Zone, Enterprise Community and Economic Development Initiative Grant Selection Process."

As I understand it, your response is grounded in a belief that, if program managers act in conformance with Office of General Counsel interpretation of laws, it is inappropriate for the OIG to question the Department's compliance with those laws. Much to the contrary, the OIG has a statutory responsibility to independently assess the Department's compliance with laws and regulations -- whether or not the Department's actions are based on legal advice from the Office of General Counsel.

I sincerely regret the existence of such a fundamental misunderstanding about the role of the OIG. My purpose in writing this memorandum is to set the issue straight in both legal and practical terms, through the following discussions of the Inspector General Act of 1978 as amended (IG Act), HUD's history, and the role of OIG Counsel. Your specific comments on the OIG draft report are addressed in the attached final audit report.

The Inspector General Act of 1978 as amended

The purpose of the IG Act is to create independent and objective units to conduct audits and investigations; provide leadership in promoting economy, efficiency, and effectiveness and in preventing and detecting fraud and abuse; and keep the Secretary and the Congress fully and currently informed about problems and the progress of corrective action. Two aspects of this statement of purpose deserve your special attention.

- First, to ensure OIG independence and objectivity, the IG Act provides an extraordinary range of safeguards. Among these are the requirement that OIGs report directly both to the Congress and the head of the agency, and the statement that "Neither the head of the establishment nor the officer next in rank below such head shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, or from issuing any subpena during the course of any audit or investigation..."

- Second, the OIG mission as defined in the IG Act is extraordinarily broad. A significant portion of the HUD OIG's work -- e.g., Operation Safe Home, our report to you on "Opportunities for Consolidating, Streamlining, and Terminating HUD Programs," and our participation in numerous Department task forces -- falls within the "providing leadership" mandate in the IG Act. These are not traditional OIG activities, but we have undertaken them because we share your commitment to bringing about positive change in HUD, as well as improving the quality of life for HUD beneficiaries. These activities, however, do not relieve the OIG of its statutory responsibility to conduct traditional audits and investigations.

With respect to audits, the IG Act stipulates that the OIG shall "comply with standards established by the Comptroller General of the United States for audits of Federal establishments, organizations, programs, activities, and functions...." Under these standards (see "Government Auditing Standards, 1994 Revision"), the auditor is required to assess compliance with laws and regulations in any case where laws and regulations are significant to the audit objective. The standards further require that:

> "In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free from personal and external impairments to independence, should be organizationally independent, and should maintain an independent attitude and appearance."

Thus, it is abundantly clear that i) the OIG has an obligation to independently assess HUD's compliance with relevant laws and regulations; and ii) in making such assessments, the OIG's accepting Office of General Counsel legal opinions without question would negate the OIG organizational independence required by the Comptroller General and mandated by the IG Act.

Lest any doubt remain about the OIG's statutory obligation to conduct independent reviews of laws and regulations, I call your attention to section 4(a)(2) of the IG Act:

> "It shall be the duty and responsibility of each Inspector General, with respect to the establishment within which his Office is established...to review existing and proposed legislation and regulations relating to the programs and operations of such establishment and to make recommendations in the semiannual reports required by section 5(a)

concerning the impact of such legislation or regulations on the economy and efficiency in the administration of programs and operations administered or financed by such establishment or the prevention and detection of fraud and abuse in such programs and operations...."

HUD's History

In a very practical sense, both you and the Congress are well served by an OIG that reports independently and objectively on the full gamut of HUD activities. Because we are independent and objective doesn't mean that you will always agree with our findings or follow our recommendations, but it does mean that you have a highly effective internal control device that should alert you to problems.

Permit me to give an example of how this issue of legal opinions is relevant to HUD's troubled history. The HUD "Mod Rehab" scandal was assisted by a verbal opinion of a former General Counsel construing the applicable law to allow the use of informal and undocumented discretionary methods to allocate funding. In the audit report that led to a congressional probe of the scandal, the OIG reported and expressly disagreed with the General Counsel's opinion. I think we can all agree that the interests of HUD and the general public were well served by this OIG reporting.

In another instance in the early 1990s, an OIG audit revealed that a recipient of a CDBG Entitlement Program made loans of the grant funds for purposes that were subsequently determined to be ineligible under the CDBG program. HUD's Office of General Counsel opined that interest earned on the unauthorized loans was program income that could be kept by the grantee for its own use. The OIG audit took the position that the interest should be treated as grant advances belonging to the U.S. Government. The issue was referred to the Comptroller General, who rejected the Office of General Counsel argument and ruled for the OIG. HUD then required the grantee to return the interest earned to the U.S. Treasury.

Role of OIG Counsel

The IG Act authorizes OIGs to select, appoint, and employ such officers and employees, including attorneys, as are necessary to carry out their duties and responsibilities. During the Congressional hearings on the HUD scandals, the OIG was repeatedly criticized for not having its own counsel. Last year, you allocated an SES slot to the OIG so that I could establish an Office of OIG Counsel. As I advised you at the time, one of the reasons for employing counsel was to avoid the problem of divided loyalties and the inherent conflicts of interest arising from the OIG's reliance on the Office of General Counsel for legal advice.

The establishment of OIG Counsel in no way infringes on or diminishes the role of HUD's General Counsel as the legal advisor of the Secretary and the HUD program offices. The OIG Counsel's role is essentially limited to advising OIG managers, auditors, and investigators. In its March 1995 report titled "Inspectors General: Independence of Legal Services Provided to IGs," the General Accounting Office described the roles of OIG Counsel and the General Counsel as follows:

> "The General Counsel serves as an agency's chief legal official and, as such, advises the agency head and articulates the agency's positions on legal matters. The IG serves as an independent evaluator of the agency's programs and operations and reports on the evaluations to the agency head and the Congress. Occasionally, attorneys advising the agency head and those advising the IG may view legal issues differently. As a result, the IG's attorneys may be placed in the position of offering legal advice or preparing opinions that differ from those of senior OGC officials, including the General Counsel. When the differences cannot be resolved by the staffs, or by the General Counsel and IG themselves, the IG may elevate them to the agency head during the audit resolution process and require further legal assistance."

I trust that this memorandum is a sufficient exposition of the OIG's obligation to question the Department's compliance with laws and regulations, even when the Department's actions are based on Office of General Counsel legal advice. Should any questions remain to be answered, however, I would be most happy to discuss them with you.

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