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OFFICE OF INSPECTOR GENERAL
Office of Audit

May 22, 2002

Memorandum No:
2002-NY-1802

MEMORANDUM FOR: Nelson Bregón, Deputy Assistant Secretary for Grant Programs, DG

Alexander C. Malloy

FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: Interim Report on Community Development Block Grant
Disaster Assistance Funds
New York, New York

The Congress tasked¹ the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG) to audit the Community Development Block Grant (CDBG) Disaster Assistance Funds provided to the State of New York resulting from the September 11, 2001, terrorist attack on New York City. The Governor of the State of New York authorized Empire State Development Corporation (Empire State) to administer the Disaster Assistance funds. We recently started our audit of those funds and expect to issue a report in November 2002. During our initial interviews with representatives of Empire State, we quickly realized that this is a fast moving operation. Each week, hundreds of applications are processed and millions of dollars are disbursed. Also, Empire State changes its processing procedures as needed. With this in mind, we noted two concerns that we believe warrant immediate attention. These concerns pertain to: (1) duplication of grants and loans from various sources, and (2) the applicant's economic loss amount.

First, Empire State may be awarding CDBG disaster grants to applicants that have already received Small Business Administration (SBA) Disaster Loans. In some instances, applicants may not be eligible to receive both a CDBG grant and a SBA loan. Second, Empire State requires applicants to estimate the amount of their economic loss. This estimate is a key component of the calculation that is used to determine whether an applicant is eligible for a grant. Until recently, an applicant was not required to provide any details showing how the amount of the estimated loss was derived. It should be noted that in some instances, the amount of the estimated loss is in the millions of dollars.

¹ Conference Report to Accompany H.R. 3338 (Report Number 107-350, page 456)

BACKGROUND

The Congress has authorized HUD to provide the State of New York \$2.7 billion of Community Development Block Grant Assistance. The first congressional appropriation was in the amount of \$700 million, which was awarded by HUD to the State of New York on February 13, 2002, through Empire State for the properties and business damaged by, and economic revitalization related to the September 11, 2001, terrorist attacks on the World Trade Center in New York City. Regarding the additional \$2 billion in assistance, Lower Manhattan Development Corp (LMDC), a subsidiary of Empire State, has been designated as the entity that will distribute those funds for the State of New York. Currently, LMDC is finalizing an action plan that will show how those funds will be allocated.

With respect to Empire State's Action Plan, which is dated January 30, 2002, it describes how the \$700 million is allocated among various categories. Pursuant to that Plan, the \$700 million has been allocated as follows:

Compensation for Economic Losses, \$401 million
Technical Assistance for Small Businesses, \$5 million
Retention and Attraction Assistance, \$250 million
Business Information, \$5 million
Infrastructure Rebuilding-Initial Planning and Design, \$25 million
Administration, \$14 million

Regarding the Compensation for Economic Losses, this category consists of three sub-programs: applicable to small businesses. They are as follows: the Bridge Loan Program, the Business Recovery Loans, and the Business Recovery Grant Program. Empire State budgeted \$396 million² for these sub-programs, with \$331 million of this amount allocated for the Business Recovery Grant Program.

As of April 30, 2002, Empire State had disbursed about \$110 million to 4100 applicants, who applied for Business Recovery Grants. Empire State expects to process over 19,000 applications through December 2002, under its Business Recovery Grant Program. Empire State had not disbursed any Federal funds under the Business Recovery Loans Program or the Bridge Loan Program at April 30, 2002.

Because the Business Recovery Grant Program is the only program currently in operation, our audit efforts have been concentrated on understanding this Program. In doing so, we noted two issues that we believe need immediate attention. They pertain to the alternative requirement pertaining to duplication of benefits, and the manner in which the amount of an applicant's economic loss was determined. The two issues are discussed in the next section of this report.

² *The Compensation for Economic Losses includes \$396 million for small businesses and \$5 million for compensation to other businesses.*

RESULTS OF REVIEW

DUPLICATE BENEFITS

When Congress authorized the funds for the CDBG Disaster Assistance, it directed the Secretary of HUD to either waive various requirements or specify alternative requirements. In January and February 2002, HUD published various waivers and alternative requirements. One of the alternative requirements pertained to duplication of benefits. The Federal Register³ provided that “CDBG funds appropriated under the Emergency Response Fund⁴ may not be used to provide funds for the same specific uses as disaster loans made available by the Small Business Administration (SBA) in compliance with 15 U.S.C. 636 (b)(1)(A). If the needs for assistance are more than the SBA disaster amount, CDBG assistance may be used to fund such additional need. New York State should encourage the use of SBA physical damage and economic injury disaster loans; they offer low interest rates and favorable terms.”

As mentioned in the above background part of this memorandum, Empire State is administering New York State’s CDBG Disaster Assistance Program. As part of our audit of the Business Recovery Grant Program, we held various discussions with Empire State’s management. During these discussions, Empire State representatives indicated that they do not believe that any duplication exists with SBA loans. Empire State management believes that SBA loans focus on the need to meet working capital needs; whereas, the funds disbursed regarding the Business Recovery Grant Program are for economic losses resulting from the disaster. The HUD Senior Program Officer responsible for monitoring the New York State’s CDBG Disaster Assistance Program agrees with Empire State’s management.

However, our discussions with the Deputy Area Director for SBA, who is located in Niagara Falls, indicated that duplication of benefits could exist if the benefits provided by the Business Recovery Grant and the SBA loan are in excess of the amount of an applicant’s net economic loss. Furthermore, the application form for the Business Recovery Grant states: “Note to SBA Borrowers and Applicants: Grant assistance provided under this program may not be used for the same specific purposes as disaster loans made by the Small Business Administration.” Inasmuch as there appears to be a difference of opinion, we believe that HUD needs to clarify this issue.

In connection with the issue discussed above, we noted that one of the Senate Reports⁵ that accompanied the various public laws pertaining to the CDBG disaster funds, indicates that any payments made from the CDBG funds should be reduced by paid or projected insurance policy payments, as well as, benefits under the public assistance program, individual assistance program, or other Federal programs.

³ Docket No. FR 4732-N-01, dated January 28, 2002 and Docket No. FR4732-C-02 dated February 7, 2002

⁴ CDBG funds used for the New York State’s economic recovery were initially authorized by Public Law 107-38, Emergency Response Fund

⁵ Senate Report 107-109, page 206

Because disaster funds under the Business Recovery Grant Program are expected to be disbursed until the end of December, 2002, we believe that HUD should resolve this issue as quickly as possible. This is important because Empire State only requires the applicant to provide information on insurance proceeds and two non-Federal grants⁶. Empire State does not require the applicant to provide information on other grants or loans that the applicant may have received, such as SBA loans, etc.

ECONOMIC LOSS AMOUNT

An applicant must certify to the accuracy of the total amount of the economic loss reported on the application. Also, an applicant must provide such documentation as a Federal tax return for the most recent fiscal year prior to September 11, 2001. Depending upon the location of an applicant's business, an applicant may receive up to 4 percent of the amount of income identified on the Federal tax return. The grant amount is essentially a calculated amount. However, Empire State reduces the grant amount if it exceeds the applicant's net economic loss. Until recently, Empire State only required an applicant to provide an estimated loss amount. The applicant was not required to provide any details showing or describing how the estimated loss was derived. In some instances, the amount of the estimated loss is in the millions of dollars.

During our review, representatives of Empire State told us that Empire State recently instituted a procedure whereby an applicant is required to complete a form, itemizing the economic loss, if the amount of the estimated economic loss appears unusual. However, this only started recently, and is done on a judgmental basis. Empire State management believes that the applicant's signature certifying the economic loss is sufficient.

Our non-representative selection of six completed applications indicated that one of the applicants estimated the amount of the economic loss to be in the millions of dollars. Because public funds are involved, we believe that, at a minimum, Empire State should require applicants to at least provide detailed information explaining how the amount of their economic loss was determined. We noted that one of the Senate Reports⁷ that accompanied the various public laws pertaining to the CDBG disaster funds gives guidance to HUD regarding economic losses. The Senate Report recommends that when calculating business interruption losses, the manual prepared by Price Waterhouse Coopers for the Cerro Grande fire claims should be used. We observed that claimants for the Cerro Grande fire had to provide detailed explanations explaining how they estimated their losses.

Further, we discussed this issue with Empire State's internal auditors. The internal auditors explained that they plan to verify the amount of the economic loss identified by the applicant on the itemized form mentioned above. We explained to the internal auditors that Empire State just started this procedure, and that it is only used on a judgmental basis. The internal auditors said that where the itemized form is not available, they plan to contact the applicant and ask for the information.

⁶ *New York City's Lower Manhattan Business Recovery Grant and New York State's Retail Recovery Grant*

⁷ *Senate Report 107-109, page 206*

On May 20, 2002, we met with HUD officials at HUD Headquarters, Washington, D.C., to discuss these issues. At the meeting we learned that on May 16, 2002, Empire State revised its application regarding the Business Recovery Grant Program. The new application requires applicants to provide the details as to how their economic losses were determined. We followed up at the two locations in New York City where an applicant can apply for a grant and determined that the new application is being utilized. In this regard, the new application should eliminate our concern regarding the economic loss amount for future applicants. However, we believe that Empire State should request the same data from the 4100 applicants who have already received a Business Recovery Grant so that the application process is consistent.

ACTION NEEDED

We recommend that you:

- 1A. Consult with appropriate SBA officials and determine whether duplication of benefits could exist if the benefits provided by a Business Recovery Grant and a SBA loan are in excess of the amount of an applicant's net economic loss. This may necessitate a legal interpretation of the alternative requirements pertaining to duplication of benefits. If you determine that duplicate benefits could exist, notify Empire State of the determination and direct that its processing procedures be revised to request applicants to provide appropriate details on SBA assistance.
- 1B. Ensure that Empire State is complying with Congressional intent and the Federal Register notices dated January 28, and February 7, 2002 (as referred to above) regarding the reduction of CDBG disaster grants by any other public benefits that an applicant may have received.
- 1C. Require Empire State to obtain from the applicants who have already received a Business Recovery Grant, the details as to how the amount of their estimated economic loss was determined.

Within 30 days please provide us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any issued correspondence or directives related to this audit.

Should you or you staff have any questions, please contact me or William H. Rooney, Assistant District Inspector General for Audit, at (212) 264-8000, extension 3976.

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