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TO: Maria Cremer, Acting Director, Community and Planning Development
Division, 9AD

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: City of Fresno, Neighborhood Stabilization Program

HIGHLIGHTS

What We Audited and Why

We completed a capacity review of the City of Fresno's (City) Neighborhood Stabilization Program (program). We performed the audit because Housing and Economic Recovery Act of 2008 (act) reviews are part of the Office of the Inspector General's (OIG) annual audit plan and the program was identified as high risk. In addition, the City was awarded a \$10.9 million program grant.

Our objective was to determine whether the City had sufficient capacity and the necessary controls to manage and administer program funds provided by the U.S. Department of Housing and Urban Development (HUD) under the act.

What We Found

The City has sufficient management controls to ensure that grant funds are used for eligible purposes and disbursements are fully supported. However, it may not be capable of obligating program funds for eligible activities within 18 months as required. It took the City more than more than four months after selection of the sub recipients and seven months after receiving the grant to execute the contracts. Further, the program requires grantees to set aside 25 percent of grant funds to benefit individuals and families that earn no more than 50 percent of area median income. As of the end of November 2009, the

City had not developed an action plan, nor had it selected a subgrantee for this activity. Program activities were delayed for several reasons, including lengthy procedures that the City imposed upon itself, a decision to have two departments coordinate on the program, and difficulty in reaching an agreement with one subrecipient on an eligible action plan.

What We Recommend

We recommend that the Director of the San Francisco Office of Community Planning and Development provide the City with technical assistance and HUD oversight to ensure that program funds are obligated within 18 months.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided the City a discussion draft report on January 5, 2010, and held an exit conference with the City's officials on January 14, 2010. The City provided written comments on January 19, 2010, and had some disagreements with our findings.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (program) was authorized under Title III of the Housing and Economic Recovery Act of 2008 (act) and provides grants to every State and certain local communities to purchase foreclosed or abandoned homes and rehabilitate, resell, or redevelop them to stabilize neighborhoods and stem declining values of neighboring homes. The act calls for allocating funds “to states and units of general local government with the greatest need,” and in the first phase of the program, the U.S. Department of Housing and Urban Development (HUD) allocated more than \$4 billion in program funds to assist in the redevelopment of abandoned and foreclosed homes.

The City of Fresno (City) was allocated \$10.9 million in program funds, and HUD executed the grant agreement on March 17, 2009. The City selected four entities, to include two nonprofit developers, the Redevelopment Agency, and the Housing Authority of the City of Fresno (Authority) to carry out program activities consisting of the purchase, rehabilitation, and resale of foreclosed properties with home-buyer assistance.

The City was incorporated in October 1885. It became a HUD entitlement jurisdiction in the 1980s. HUD provides the City with more than \$7.5 million in Community Development Block Grant funds and more than \$3.5 million in HOME Investment Partnerships Program (HOME) funds annually.

Our objective was to determine whether the City has sufficient capacity and adequate controls to implement program requirements in accordance with HUD rules and regulations.

RESULTS OF AUDIT

Finding: The City May Not Have the Capacity to Complete Program Activities within Statutory Timeframes

The City may not have the capacity to successfully complete program activities within required timeframes. This condition is due to delays in selecting subrecipients and executing contracts. Without HUD's oversight and technical assistance, we are concerned that the City may not complete program activities and funds could be returned to the Federal Government without achieving intended relief for the neighborhoods affected by the foreclosure crisis.

The City Moved Slowly To Select Subrecipients and Execute Contracts

HUD executed the City's \$10.9 million program agreement on March 17, 2009, and more than seven months passed before the City executed contracts with the four entities it selected to carry out the purchase, rehabilitation, and resale of foreclosed single-family homes. In addition, the City still had not selected a subrecipient or planned an activity for the 25 percent of its grant funds that must be used to benefit residents making 50 percent or less of the area's median income.

Program regulations require all grant funds to be obligated for eligible activities within 18 months of HUD's execution of the grant agreement. In addition, all funds must be expended within 48 months.

We spoke with the City officials responsible for the program to determine why it had taken so long for the City to start program activities. The reasons cited by officials included the City's lengthy process for public information and comment and that two departments, Housing and Budget, had to learn how to coordinate and work together on one program. During the on-site review, the auditors observed that the City and one of its subrecipients did not communicate effectively to quickly finalize an eligible activity plan and execute a contract (after the City determined that the initial proposal from the subrecipient was ineligible). Although the other three entities had acceptable action plans, it took the City more than four months after selection of the sub recipients and seven months after receiving the grant to execute the contracts. The City's 68-page contracts took excessive time to write, review, and revise before approval by the City's and subrecipients' attorneys and governing boards.

The City Has Not Published a Request for Proposals to Select a Subrecipient for the Set-Aside

Due to the problems in executing the first four contracts, the City delayed developing an action plan and advertising for a subrecipient for the 25 percent set-aside for very low-income residents. As stated in its substantial amendment to the annual plan, the City will use \$2.7 million for acquisition and rehabilitation of rental properties for very low-income residents (see appendix C). At the beginning of November 2009, City officials told the auditors that they would publish a request for proposals before the end of the month to find a developer/subrecipient to carry out this activity. As of the second week in December, the request had not been published.

Conclusion

Despite good controls over expenditures and extensive experience with HUD programs, the City will need HUD oversight and technical assistance to ensure that funds are obligated for eligible activities by September 17, 2010, the date of the 18-month obligation deadline. It is important that the purchase, rehabilitation, and resale of foreclosed homes to eligible participants go forward without additional delays and essential that the City quickly develop an action plan and select a subrecipient to carry out acquisition, rehabilitation, and rental of an eligible foreclosed or abandoned property to very low-income residents.

Recommendations

We recommend that the Director of the San Francisco Office of Community Planning and Development

- 1A. Provide technical assistance and oversight to ensure that the City continues without further delays and obligates all grant funds for eligible activities before the deadline of September 17, 2010.

SCOPE AND METHODOLOGY

The period covered by the audit was from July 1, 2007, through June 30, 2009. Our review was performed at the City and the Authority, both located in Fresno, CA. We performed our audit work from September through December 2009.

To perform our audit, we

- Reviewed applicable laws, regulations, and guidance issued by HUD.
- Reviewed HUD monitoring reports and interviewed HUD officials in the San Francisco office.
- Reviewed pertinent records on administration and procurement maintained by the City and the Authority, including records from HOME program activities and other, similar rehabilitation and home-buyer assistance programs.
- Interviewed staff responsible for program activities at the City and the Authority.

Specifically, our review included the City's and the Authority's financial records and accounting systems, policies, and procedures. We reviewed transactions from the City's fiscal years 2007 and 2008 and tested several HOME program activities for compliance with HUD requirements.

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

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

- Administering the program's operations in compliance with applicable laws and regulations,
- Maintaining complete and accurate records, and
- Safeguarding the program's resources.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we did not find any weaknesses in the internal controls.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



Andrew T. Souza
City Manager

January 20, 2010

U.S. Dept. of Housing & Urban Development
Office of Inspector General, Region IX
611 W. Sixth Street, Suite 1160
Los Angeles, CA 90017-3101

SUBJECT: HUD Audit- City of Fresno's NSP Program

The City of Fresno received the audit response from the U.S. Department of Housing and Urban Development – Office of Inspector General (HUD OIG) regarding the recently completed monitoring of the Neighborhood Stabilization Program (NSP). The City, through its NSP partners, has acquired 23 houses; obligated/expended \$1.67 million of NSP funds at 15.2% of the entitlement; with another \$490,000 of expenditures pending approval. Because the partners have been setting up their own internal processes in anticipation of receiving the funds and their vast experience; program outlays are occurring at a very fast pace. The NSP outlays were \$1.67 million for a four week period of time that included the holiday season. This expenditure rate exceeds the NSP national average of 10%.

After reviewing the draft audit report and completing the exit interview with HUD OIG the City provides this statement and alternative resolutions to the HUD OIG recommendations.

Finding:

The City may not have the capacity to complete program activities within statutory timeframes

The City of Fresno is the recipient of \$10.969 million of NSP funds and annually administers \$11.7 million of HUD federal entitlement funding. Through HUD programmatic reviews and the current HUD OIG audit it is firmly established that the City possesses good internal controls and extensive experience with HUD programs. HUD OIG supported the finding with the following assertions:

1) The City moved too slowly to select subrecipients and execute contracts; and 2) The City has not published a Request for Funds Proposal to select a subrecipient for the set-aside.

The City Moved Too Slowly

As did most jurisdictions, the City of Fresno received its NSP agreement at the end of March 2009. The City had completed a comprehensive citizen participation process to: obtain the views of the target population; hear from non-profit and for-profit developers; and to receive NSP proposals. This process occurred October 2008 through March 2009. The City conducted a proposal review process April and May 2009, with final selection occurring June 2009. Contracts were released by the City Attorney's Office in August 2009 and contract negotiations occurred September/October 2009. Final signing of the contracts occurred in October and November. Two contracts were dated for October 1 and two were dated for November 1, 2009.

City of Fresno
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Comment 1

Comment 2

The City was very methodical in its approach to ensure that due diligence was performed in developing this many nuanced program. This due diligence sought to ensure that when audited, the City had addressed every regulatory issue. It appears HUD OIG did not consider the time it takes to develop the foundation for an \$11 million program. The time to identify viable and experienced NSP partners; develop policies and procedures; develop contracts that need to be adopted by the NSP partners governing boards; and the three months of intensively working with HUD OIG to provide information daily and being available to explain the programming. The City has reviewed the statute and regulation and do not see the justification for "moved too slowly." Rather the City abided by the edict set forth by HUD at the July 2009 NSP Conference whereby HUD specifically stated that if the programs were not run according to the statute then HUD OIG would audit the jurisdiction. The timing of a 3-month audit while establishing procedures for a new HUD program impeded the City's NSP development process.

The City has not published a Request for Proposals for the Set-Aside

Comment 3

HUD OIG auditors were provided the plan of action for the set-aside funds. The City anticipated using the set-aside funds for two projects. Once reviewed, staff reviewed the feasibility and it was determined that one of the projects did not meet NSP criteria and the City awaits the Notice of Default for the second project. The second project will be an outlay of \$545,000 of NSP to acquire the structure and a yet to be determined amount for the extensive rehabilitation that will need to occur. Additionally, City staff is currently identifying small and large-scale multi-family foreclosed upon housing to address the set-aside. One project currently being reviewed is a 108-unit apartment-condo conversion whereby 98% of the units have been foreclosed upon.

Comment 4

What concerns the City is that we are being evaluated for a non-regulatory requirement and for conducting due diligence in determining project feasibility.

Specifically the City seeks to remove the following inaccurate information from this public record:

Comment 5

1) References that the City made a first-time decision in having two departments work together. This is inaccurate, the Budget and Housing divisions work together daily for 4 years on HUD programming, reporting, and CDBG/HOME/ESG funding.

Comment 6

2) References that the City delayed executing three contracts with acceptable action plans to process the contracts at the same time. This is inaccurate; HUD OIG received two executed contracts prior to their departure.

Comment 7

3) The 68-page contract took excessive time to write. This is inaccurate. The NSP contract was based upon an existing HOME contract and was returned in a month's time from the City Attorney. Additionally, the City was unprepared for this comment as the City reserves the right to conduct due diligence and protect its self from liability through effective contracts.

Comment 8

4) The City has not published an RFP for the set-aside. The regulations do not require the City to prepare an RFP for the set-aside funds. The regulations state the Grantee is able to select a developer/subrecipient/for-profit/non-profit without going through the full procurement process.

Comment 9

5) Throughout the process to date the City has been unable to meet its self-determined deadlines. The auditor provided two examples for a statement that was made about the entire program. One of the examples was not driven by regulation and was a result of the City conducting due diligence, and the second example provided by the auditor were for contracts that were provided prior to their departure and date back to October 1st and the second that dates back to November 1st.

Comment 10

6) Strike the reference to HUD CPD to reallocate the funds prior to the statutory deadline. The recommendation appears inaccurate as it is not supported by the regulation.

HUD OIG Recommendations

The Office of Inspector General provides actionable items to HUD Community Planning and Development.

- 1) Provide technical assistance and oversight. If it "appears" the City is unable to meet the deadline HUD CPD should consider reallocating the funds to another grantee.
 - a. City Response – The City welcomes technical assistance from HUD CPD. All learning opportunities are seen as an overall benefit to the program. However, the City does not believe that HUD OIG justified its supposition for oversight. The audit letters speak highly of the City's internal controls and experience with HUD programs, which when making determinations of oversight it would seem a lack of internal controls is integral to that decision. Additionally, it does not appear the recommendation to the City of Fresno is equitable when compared with other audit recommendations. A County within Region IX was audited and HUD OIG determined that, "...the County operated its Program within a weakened control environment, increasing the risk of waste, fraud, and/or abuse." Yet OIG did not recommend oversight. Other jurisdictions outside of Region IX had conflicts of interest and low expenditure rates, yet there were not any recommendations for oversight or for the CPD office to consider reallocating the funds.

Comment 11

Additionally, the recommendation for HUD CPD to consider reallocating the funds if it "appears" the City is not going to meet the deadline is not in keeping with the regulation. While the City of Fresno will meet its programmatic requirements we seek to have this public document accurately reflect the program requirements. Specifically, Federal Register Volume 73, No. 194, I (B) 2a affords the City 18 months. Only after the first day after the deadline has passed does the statute allow HUD to restrict the amount of unused funds. Once the deadline is reached, the statute affords jurisdictions 30 days to submit information to HUD regarding any additional use of funds.

Comment 10

The City appreciates the time HUD's Region IX Office of Inspector General took to review and discuss the City's Neighborhood Stabilization Program. The City will meet the expenditure/obligation deadline and seeks any technical assistance HUD Community Planning and Development has available. Because this is a public document, it is imperative the City addressed each inaccurate or ambiguous statement.

Respectfully submitted,



Bruce A. Rudd
Assistant City Manager

OIG Evaluation of Auditee Comments

- Comment 1** The City informed the auditors of recent property acquisitions during the exit conference on January 14, 2010. Although the City stated it has made progress, we have concerns regarding the City's capacity to complete activities within the required deadlines. For the October through December 2009 quarterly reporting period and as of January 27, 2010, the City has not entered any obligations or expenditures into HUD's Disaster Recovery Grant Reporting system (DRGR).
- Comment 2** Actual dates on executed contracts provided to OIG for review were:
2M Development Corporation, Inc. - October 9, 2009
Coalition for Urban Renewal Excellence (CURE) - October 9, 2009
Fresno Redevelopment Agency (RDA) - October 28, 2009
The Housing Authority of the City of Fresno - October 29, 2009
- Comment 3** Although City officials informed auditors that they were evaluating possible projects for the set-aside funds, no specific plan of action for the funds was provided. The City's response to the discussion draft report indicates that the City is still evaluating possible projects and has yet to commit specific projects.
- Comment 4** We evaluated whether the City has the capacity to obligate and expend grant funds within statutory timeframes. Based on our review, we concluded that the City may not have the capacity.
- Comment 5** The explanation that two departments, Housing and Budget, had to learn to coordinate and work together on one program, was given by a City official, therefore it was included in the report.
- Comment 6** We removed the explanation that the contracts were delayed in order to process all contracts together. This does not change the fact that contract execution took more than four months.
- Comment 7** Based on the work we have done, it took more than four months from selection and approval of developers and subgrantees to execute contracts. This was an excessive amount of time, considering the statutory timeframes for obligation and expenditure of grant funds.
- Comment 8** It is correct that an RFP is not required and the auditors discussed this fact with City officials, who stated that they had chosen to issue an RFP and were in the process of writing one. As of the latest update, officials told auditors the RFP would be issued in November 2009.
- Comment 9** We removed the references to missed self-imposed deadlines from the report.
- Comment 10** HUD is required to reallocate funds if the grantee fails to meet the deadline for obligation of funds; therefore, we have removed this recommendation.

Comment 11 Every audit report is based on unique circumstances as are recommendations.

Appendix B

CRITERIA

1. Public Law 110-289 (Housing and Economic Recovery Act of 2008), Title III, Section 2301(c)(1)
 - (c) USE OF FUNDS.—
 - (1) IN GENERAL.—Any State or unit of general local government that receives amounts pursuant to this section shall, not later than 18 months after the receipt of such amounts, use such amounts to purchase and redevelop abandoned and foreclosed homes and residential properties.
2. Public Law 110-289 (Housing and Economic Recovery Act of 2008), Title III, Section 2301(f)(3)(A)
 - (f) AUTHORITY TO SPECIFY ALTERNATIVE REQUIREMENTS.—
 - (3) LOW AND MODERATE INCOME REQUIREMENT.—
 - (A) IN GENERAL.—Notwithstanding the authority of the Secretary under paragraph (1)—
 - (i) all of the funds appropriated or otherwise made available under this section shall be used with respect to individuals and families whose income does not exceed 120 percent of area median income; and
 - (ii) not less than 25 percent of the funds appropriated or otherwise made available under this section shall be used for the purchase and redevelopment of abandoned or foreclosed upon homes or residential properties that will be used to house individuals or families whose incomes do not exceed 50 percent of area median income.
3. Federal Register Volume 73, Number 194, I(B)2
 - I. Formula: Reallocation B. Formula: Reallocation
 2. If any jurisdiction, state, insular, or local area fails to meet the requirement to use its grant within 18 months of receipt of the amounts, as required, HUD, on the first business day after that deadline, will simultaneously notify the grantee and restrict the amount of unused funds in the grantee's line of credit. HUD will allow the grantee 30 days to submit information to HUD regarding any additional "use" of funds not already recorded in the Disaster Recovery Grant Reporting system (DRGR). Then HUD will proceed to recapture the unused funds. HUD will reallocate these unused funds in accordance with 42 U.S.C. [United States Code] 5306(c)(4).
4. Federal Register Volume 73, Number 194, II(M)
 - II. Alternative Requirements and Regulatory Waivers
 - M. Timeliness of Use and Expenditure of NSP Funds. On consideration, the Department [HUD] chose to implement the use test based on whether the state or unit of general local government has expended or obligated the NSP [program] grant funds and program income in an aggregate amount at least equal to the NSP allocation. HUD is also imposing a deadline for expending NSP grant funds because the intent of these grants clearly is to quickly address an emergency situation in areas of the greatest need.

Requirements:

1. Timely use of NSP funds. At the end of the statutory 18-month use period, which begins when the NSP grantee receives its funds from HUD, the state or unit of general local government NSP grantee's accounting records and DRGR information must reflect outlays (expenditures) and unliquidated obligations for approved activities that, in the aggregate, are at least equal to the NSP allocation. (The DRGR system collects information on expenditures and obligations.)
2. Timely expenditure of NSP funds. The timely distribution or expenditure requirements of sections 24 CFR [Code of Federal Regulations] 570.494 and 570.902 are waived to the extent necessary to allow the following alternative requirement: All NSP grantees must expend on eligible NSP activities an amount equal to or greater than the initial allocation of NSP funds within 4 years of receipt of those funds or HUD will recapture and reallocate the amount of funds not expended.

Appendix C

GRANT AGREEMENT

FUNDING APPROVAL AND GRANT AGREEMENT FOR NEIGHBORHOOD STABILIZATION PROGRAM (NSP) FUNDS AS AUTHORIZED AND APPROPRIATED UNDER THE HOUSING AND ECONOMIC RECOVERY ACT OF 2008 (PUBLIC LAW 110-289, JULY 30, 2008)

NSP GRANTEE: City of Fresno

NSP GRANT NUMBER: B-08-MN-06-0003

NSP GRANT AMOUNT: \$10,969,169

NSP APPROVAL DATE: January 15, 2009

DATE HUD SIGNED THE AGREEMENT: March 17, 2009

DATE CITY OF FRESNO SIGNED THE AGREEMENT: March 31, 2009

PROVISIONS:

- The Grantee shall have 18 months from the date of HUD's execution of this Grant Agreement to obligate the NSP Grant Amount pursuant to the requirements of HERA and the Notice.
- The Grantee shall have 48 months from the date of HUD's execution of this Grant Agreement to expend the NSP Grant Amount pursuant to the requirements of the Notice.
- The Grantee agrees to assume all of the responsibilities for environmental review, decision making, and actions, as specified and required in regulations issued by the Secretary pursuant to Section 104(g) of Title I of the Housing and Community Development Act, as amended (42 U.S.C. 5304) and published in 24 CFR Part 58.
- The Grantee further acknowledges its responsibility for adherence to the Grant Agreement by sub-recipient entities to which it makes funding assistance hereunder available.
- The Grantee shall submit information on performance measurement as established by the Secretary for activities undertaken with NSP grant funds.

PROPOSED ACTIVITIES

Activity 1: Acquisition/Rehabilitation and Resale with a Financing Mechanism
 Description: The activity is acquisition/rehabilitation and resale to first time Low, Moderate and Middle Income homebuyers and will occur in phases starting in neighborhoods with block groups having higher foreclosure, abandonment, and subprime mortgages risk scores as established by HUD data and the Home Mortgage Disclosure Act. The City expects activity/rehabilitation and resale activities to produce 100 units that will benefit low, moderate, and middle income households. The tenure of beneficiaries will be homeownership with the term of assistance dependent upon the subsidy provided and the debt capacity of the household. If an affordability gap exists after NSP assistance, then a portion of NSP funding will remain in the property as a silent second. The silent second will carry no monthly payments and a proportionate equity-share mechanism in lieu of interest, to be repaid upon change of title or status as primary residence. Continued affordability will be ensured through affordability covenants recorded against the property for a minimum of 30 years and an annual monitoring process by City staff.

Projected Start: October 1, 2009
 Projected End: Obligation/Expenditure of funds ends August 30, 2010 with use of funds ending February 1, 2013.

Total Budget

The City has appropriated \$7,100,000 of NSP funding for activities as indicated in the table.

| Agency | Acquisition | Rehabilitation | Financing Mechanism | Total Contract Amount |
|----------------------|-------------|----------------|---------------------|-----------------------|
| Housing Authority | \$5,000,000 | \$0 | \$0 | \$5,000,000 |
| Redevelopment Agency | \$480,000 | \$210,000 | \$110,000 | \$800,000 |
| CURE | \$600,000 | \$0 | \$200,000 | \$800,000 |
| 2M Corporation | \$500,000 | \$0 | \$0 | \$500,000 |

Performance Measures

Income Group & Units Produced

51 to 80% of Area Median Income: 30 Units
 81 to 120% of Area Median Income: 70 Units

Activity 2: Acquisition/Rehabilitation and rental or resale to individuals and families making less than 50 percent of area median income.

Total Budget: \$2,742,292 ($\$10,969,169 \times 25\%$)

The City has not submitted a specific action plan for this activity.

Activity 3: Administration

Total Budget: \$1,126,877 ($\$10,969,169 - \$7,100,000 - \$2,742,292$)