GAO

September 2003

CAPACITY BUILDING

Section 4 Program Has Expanded and Evolved

G A O

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CAPACITY BUILDING

Section 4 Program Has Expanded and Evolved

Why GAO Did This Study

Congress recognized the importance of building the capacity of community development organizations by passing Section 4 of the HUD Demonstration Act of 1993. The act authorized the Department of Housing and Urban Development (HUD) to partner with several national nonprofit organizations that provide funding to these community groups for such things as training, staff salaries, office equipment and supplies, and management information systems. In 2002, HUD provided $31 million for capacity-building activities. To help Congress with its oversight of Section 4, we reviewed the evolution and use of Section 4 funding, the importance of Section 4 funding to private sector involvement, and the management controls and measurements that are in place to assess Section 4.

What GAO Recommends

GAO recommends that HUD take steps to recover the grant funds one Section 4 grantee used to cover a bad debt.

www.gao.gov/cgi-bin/getrpt?GAO-03-975.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Thomas McCool at (202) 512-8678 or mccoolt@gao.gov.
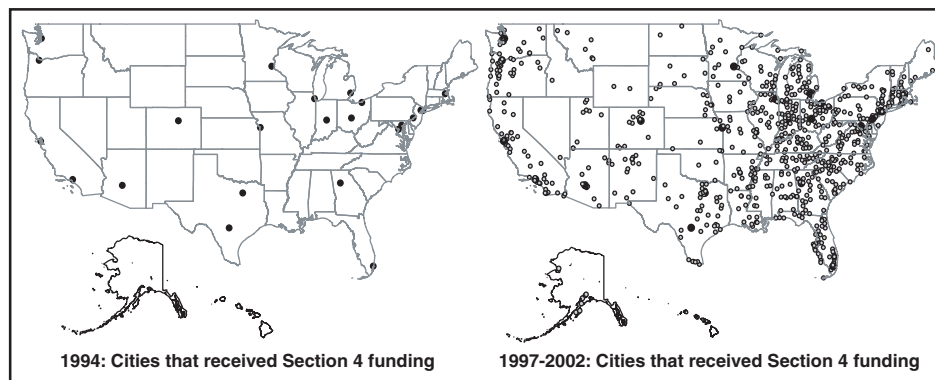
What GAO Found

We found that Section 4 has evolved from a narrowly targeted initiative that focused on providing funding for capacity building in 23 urban areas to a broader program that funds groups and activities in urban, rural, and tribal areas nationwide. The four organizations (grantees) use Section 4 funding to provide a variety of capacity-building support to their subrecipients. These subrecipients are nonprofit organizations that undertake locally targeted initiatives in areas such as economic development, low-income housing construction, and job training. The Section 4 funds that the grantees receive help leverage private sector funding and in-kind contributions such as land and equipment, pro bono legal services, office space, and voluntary labor. Since the four grantees became eligible for Section 4 funding, they have leveraged nearly $800 million in cash and in-kind contributions from the private sector.

HUD is responsible for ensuring that Section 4 funds are used according to federal law and regulations and that grantees are utilizing funds efficiently and effectively. However, HUD relies on grantees to oversee their subrecipients. The grantees had far-reaching organizational structures and processes in place to monitor and control their subrecipients. But we found that one of the seven subrecipients we tested for monitoring and control procedures had reimbursed a subrecipient for an item that was prohibited by the Office of Management and Budget (OMB). While HUD has the overall responsibility to prevent such internal control failures, the cost-effectiveness of adding additional federal controls must be weighed against the amount of the federal dollars involved. We believe that as long as HUD and the grantees remain vigilant, additional controls are not necessary at this time. HUD is taking steps to develop a framework for assessing the effectiveness of its technical assistance programs and will take part in an OMB Program Assessment Rating Tool review.

Section 4 Geographical Expansion from 1994 to 2002

1994: Cities that received Section 4 funding   **1997-2002: Cities that received Section 4 funding**

Source: GAO analysis of NCDI, LISC, Enterprise, HFHI, YBUSA data.

United States General Accounting Office

Contents

Abbreviations

CDC	Community Development Corporation
CDBG	Community Development Block Grant
CHAPA	Citizen's Housing and Planning Association
Enterprise	The Enterprise Foundation
GED	General Equivalency Diploma
HFHI	Habitat for Humanity International
HOME	Home Investment Partnerships Program
HOPWA	Housing Opportunities for Persons with AIDS
HUD	U.S. Department of Housing and Urban Development
GIS	Geographical Information Software
LISC	Local Initiatives Support Corporation
NCDI	National Community Development Initiative
OMB	Office of Management and Budget
PART	Program Assessment Rating Tool
YBUSA	YouthBuild USA

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

September 15, 2003

The Honorable Sue W. Kelly
Chairman, Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives

The Honorable Bob Ney
Chairman, Subcommittee on Housing and
Community Opportunity
Committee on Financial Services
House of Representatives

For fiscal years 1997 through 2002, the Department of Housing and Urban
Development's (HUD) budget for 20 capacity-building and technical
assistance programs was over $860 million.[1] Of these funds, almost
$150 million was specifically designated to build the capacity of local
community development and affordable housing organizations through the
Section 4 program. Since its inception in 1993, the program has provided
capacity-building funds and services to over 1,590 local organizations in
more than 783 cities nationwide, either through direct grants or substantial
technical assistance activities.

To assist you with your oversight of the Section 4 capacity-building
program, you asked us to

- describe how funding under Section 4 of the HUD Demonstration Act of
  1993 has evolved and expanded over the years, how grantees use Section 4
  funding, and what other federal funding is available for capacity building;

- determine the importance of Section 4 funding to private sector
  involvement in community development initiatives; and

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[1]Capacity building can generally be defined as strengthening the capabilities of program
recipients or providers—typically housing or community development organizations—to
build institutional knowledge within those organizations. Among other things, capacity-
building assistance can include funding for training, hiring staff, purchasing software,
obtaining expertise from outside sources, and developing accounting systems and strategic
plans. Technical assistance can generally be defined as training designed to improve
performance or management. Congress and HUD sometimes use the terms
interchangeably.

GAO-03-975 Capacity Building

- determine how HUD and Section 4 grantees control the management and measure the impact of Section 4 programs.

  To address these objectives, we reviewed public laws, federal regulations, HUD directives, budget documents, and other materials that describe the Section 4 program and authorized/appropriated funding amounts. We interviewed HUD headquarters officials and grantee and subrecipient officials at both the national headquarters and local office levels. We visited subrecipients in eight cities, and at several we conducted file reviews to evaluate grantee internal controls. Finally, we interviewed private funders that provided grants or loans to the grantees and subrecipients. We conducted our work in accordance with generally accepted government auditing standards in Baltimore, MD; Boston, MA; Cleveland, OH; Frederick, MD; Hughesville, MD; Kingston, RI; Americus, GA; and Washington, D.C. Our scope and methodology are discussed in greater detail at the end of this letter.

Results in Brief

Section 4 of the HUD Demonstration Act of 1993 has evolved from a narrowly targeted initiative that focused on providing funding for capacity building in 23 urban areas to a broader program that funds groups and activities in urban, rural, and tribal areas nationwide. Section 4 authorized HUD to become an equal partner with several private foundations and financial institutions in the already existing National Community Development Initiative (NCDI). NCDI, currently known as Living Cities, began in 1991 as a partnership of public and private, for-profit and nonprofit funders committed to revitalizing urban communities. NCDI enlisted the assistance of two nationally recognized community building organizations, the Local Initiatives Support Corporation (LISC) and the Enterprise Foundation (Enterprise) to work with local community development corporations (CDC) in 23 cities.[2] In 1997, eligibility for Section 4 funding was expanded to include Habitat for Humanity International (HFHI), YouthBuild USA (YBUSA) and activities in cities where NCDI was not active and in rural and tribal areas (fig. 1). Since then, the four designated grantees have delivered Section 4 funds and

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[2]Community development corporations are neighborhood-based nonprofit organizations that are involved in initiatives that focus on improving the economic, social, and physical condition of their communities.

services as operating support to their subrecipients (CDCs and affiliates).[3] The grantees determine their individual approaches and administer their funds in a variety of ways. Grantees can also tap into other federal funding sources such as Community Development Block Grant (CDBG) funding for capacity-building and technical assistance.

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[3]Affiliates are independent, locally run nonprofit organizations joined to national organizations by an agreement. HFHI affiliates agree to build low-income housing, while YBUSA affiliates agree to provide job training, education, counseling, and leadership development opportunities through the construction and rehabilitation of affordable housing.

Figure 1: The Organizational Structure of Section 4
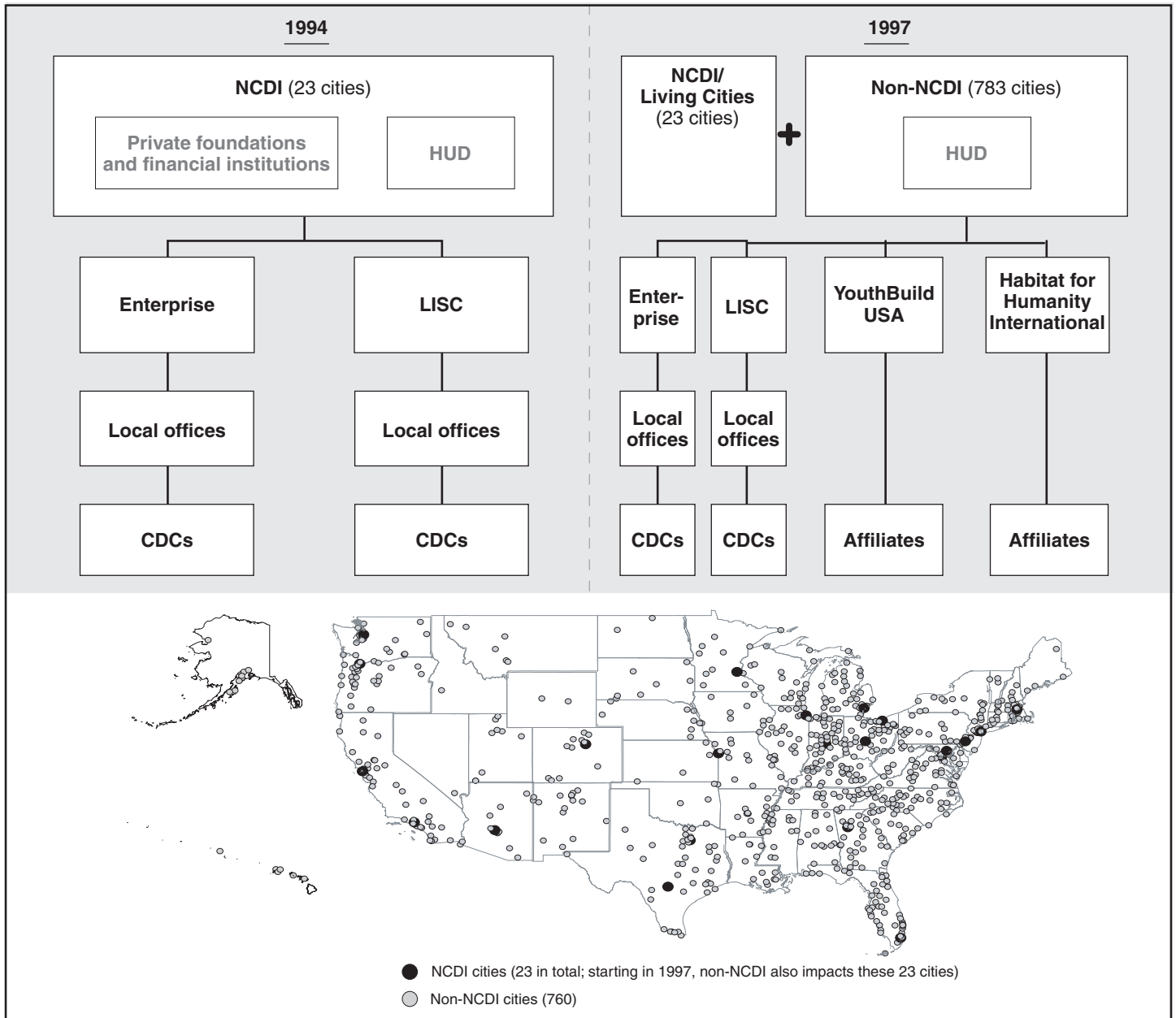
Source: GAO analysis of NCDI, LISC, Enterprise, HFHI, and YBUSA data.

While external factors such as economic trends and private sector interests made it difficult to demonstrate empirically that Section 4

funding directly influenced private sector involvement in community development initiatives, all four grantees and most of the private foundations and lenders we contacted stressed the importance of federal funding in leveraging funds from the private sector. For example, one senior executive from a major lending institution indicated that federal participation in NCDI provides funders with both a symbolic and a financial incentive to join the NCDI consortium. Symbolically, federal funding provides a sense of credibility to NCDI, as funders see federal participation as a sign of good housekeeping and reduced risk. Financially, federal participation adds more money to NCDI capacity-building initiatives, in turn enabling subrecipients to raise more private funding. In addition, Section 4 calls for significant private sector participation because every dollar that is provided to grantees must be matched with three dollars from private sources. Since federal regulations permit contributions in the form of cash or verifiable third party in-kind services, private sector involvement comes in the form of grants, loans, donated land and equipment, pro bono legal services, donated office space, and voluntary labor.[4] Although all four grantees are able to raise these required matching funds, each grantee has its own policies and may raise funds nationally, locally, or both. Since the four grantees became eligible for Section 4 funding, they have raised nearly $800 million in cash and in-kind contributions from private foundations and businesses.

HUD uses desk audits and other document reviews to assess grantees' use of funds and relies on grantees to monitor their subrecipients. However, HUD does not measure the impact of its grants. HUD is responsible for ensuring that Section 4 funds are used according to federal law and regulations and that grantees are utilizing funds efficiently and effectively. HUD carries out this responsibility through limited desk reviews of work plans that outline proposed activities and expected outcomes; quarterly and annual progress reports that determine whether grantees are achieving their stated goals; and payment vouchers and supporting documentation, which help ensure that federal funds are used only for eligible activities. HUD receives the same reports and follows the same processes for both NCDI and non-NCDI activities but reviews NCDI work plans in consort with other NCDI funders and non-NCDI activities on its own. HUD depends on grantees to provide oversight of their subrecipients.

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[4]Federal regulation 24 CFR 84.23 specifies what constitutes a matching contribution and how it is counted and reported. These contributions cannot be included to meet the matching requirements of any other federally assisted program and cannot be paid by the federal government under another award.

While it appeared that grantees maintained far-reaching organizational structures and processes to monitor and control their subrecipients, we found that one grantee had reimbursed a subrecipient for a bad debt, an activity that is prohibited by the Office of Management and Budget (OMB).[5] HUD does not currently measure the impact of Section 4 funding but relies on its grantees to measure the impact of their individual programs. However, HUD is taking steps to develop a framework for assessing the effectiveness of its technical assistance programs and will take part in an OMB Program Assessment Rating Tool review (PART) designed to help in making informed budget decisions, supporting management, identifying program design problems, and promoting performance measurement and accountability.[6]

Background

In 1991, a group of for-profit and nonprofit public and private funders started NCDI, currently known as Living Cities, to revitalize urban communities.[7] NCDI is composed of 17 major corporations, foundations, and the federal government—HUD and the Office of Community Services of the Department of Health and Human Services. In its first decade of operation, NCDI assembled a community development system composed of

- two of the largest national community-building organizations to administer the initiative—LISC and Enterprise;

- 300 CDCs in 23 cities; and

- local operating support collaboratives, which include local foundations, banks, corporations, and local governments, that identify and draw on local technical expertise and governmental and economic resources and use them to sustain and enhance the capacity of CDCs.

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[5]OMB Circular A-122 indicates that, among other things, bad debts are ineligible for federal funding.

[6]PART is a series of questions designed to provide a consistent approach to rating programs across the federal government.

[7]Prior to becoming Living Cities, NCDI was a virtual organization handled by consultants. NCDI did not have staff or occupy office space. Living Cities now has staff and oversees NCDI's operations.

As of September 1, 2001, NCDI had provided $234.8 million to its 23 cities. Of this amount, about three-quarters was for project funding and the balance, about $60 million, supported capacity building with operating grants and training.

LISC, founded in 1979 and headquartered in New York City, is the largest community-building organization. LISC's mission, involving hundreds of CDCs, is to rebuild whole communities by supporting these groups. LISC operates local programs in 38 urban program areas and 70 rural communities. According to LISC, it has raised more than $4 billion from over 2,200 investors, lenders, and donors, which has leveraged an additional $6 billion in public and private sector funds. In addition, according to LISC, it has helped 2,200 CDCs build or rehabilitate more than 110,000 affordable homes, created over 14 million square feet of commercial and community space, and helped generate 40,000 jobs.

Enterprise was founded in 1982 as a vehicle for helping low-income people revitalize their communities. Headquartered in Columbia, Maryland, Enterprise has offices in 18 communities across the nation. Enterprise works with a network of 2,200 nonprofit organizations, public housing authorities, and Native American tribes in 800 locations, including more than 100 CDCs. The Enterprise Foundation provides these organizations with technical assistance, training, short and long-term loans, equity investments, and grants. According to Enterprise, it has raised nearly $430 million to support community-based development that has helped produce 17,000 affordable homes and assisted 20,000 low-income individuals in finding employment.

HFHI, founded in 1976 and headquartered in Americus, Georgia, is a nonprofit ecumenical Christian housing ministry (faith-based organization) seeking to eliminate substandard housing. HFHI builds and rehabilitates houses with the help of homeowner (partner) families, volunteer labor, and donations of money and materials. Work is done at the local community level by affiliates that coordinate all aspects of home building, including fund-raising, building site selection, partner family selection and support, construction, and mortgage servicing. HFHI provides its affiliates with information, training, and a variety of other support services. Affiliates are primarily volunteer driven, though some have their own staff. Affiliates are monitored and supported by HFHI staff across the country. HFHI currently has over 1,669 affiliates, and in 27 years has built over 150,000 houses worldwide, including more than 40,000 homes in the United States. Figure 2 shows the 526 cities where HFHI affiliates have directly received Section 4 funds.

Figure 2: Locations of HFHI Affiliates Receiving Section 4 Funds between 1997 and 2001


● HFHI cities (526)
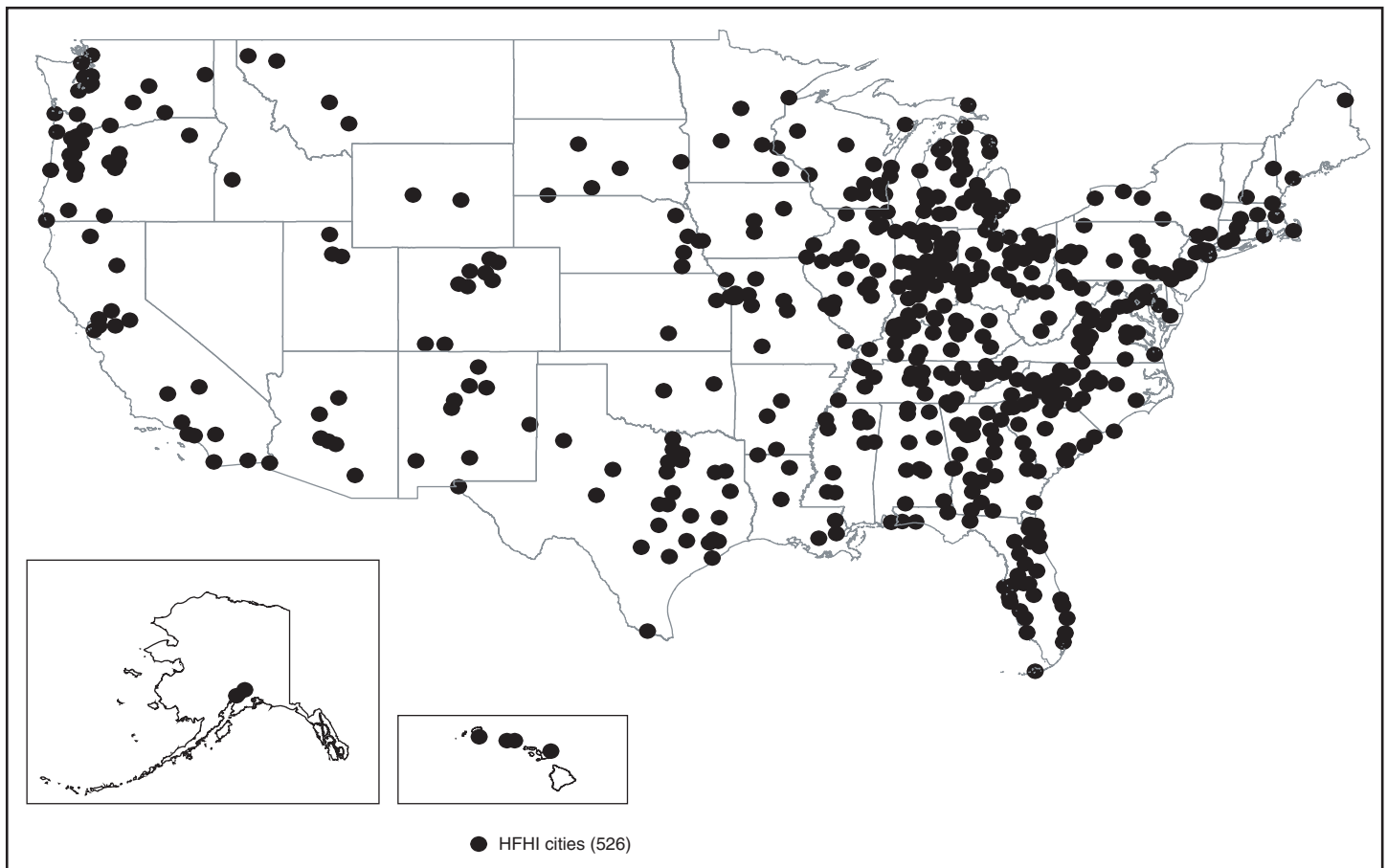
Source: GAO analysis of HFHI data.

YBUSA was founded in 1990 and is headquartered in Somerville, Massachusetts. It is a national nonprofit organization that provides capacity-building grants on a competitive basis to support the efforts of organizations that are planning to or are operating Youthbuild programs in their communities, many of which are funded by the HUD Youthbuild grant program. [8] A Youthbuild program is a comprehensive youth and community development program as well as an alternative school. Youthbuild programs, which offer job training, education, counseling, and

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[8]Under the Housing and Community Development Act of 1992, "Hope for Youth: Youthbuild," HUD awarded Youthbuild programs grants and contracts totaling $403 million for fiscal years 1993 to 2002. In addition to capacity-building funds, YBUSA has received funds from HUD to provide technical assistance to Youthbuild program recipients.

leadership development opportunities through the construction and rehabilitation of affordable housing, serve young adults ages 16 to 24 in their own communities. Participants split their time between the construction site and the classroom, where they earn GEDs or high school diplomas and prepare for jobs or college. The buildings that are constructed or rehabilitated during the program are primarily low-income housing. YouthBuild USA serves as the national intermediary and support center for over 200 Youthbuild programs. Over half of the Youthbuild programs are members of YBUSA's affiliated network. As shown in figure 3, YBUSA affiliates located in 106 cities have received Section 4 funds from 1997 to 2001.

Figure 3: Cities Where YouthBuild USA Affiliates Received Section 4 Funds between 1997 and 2001
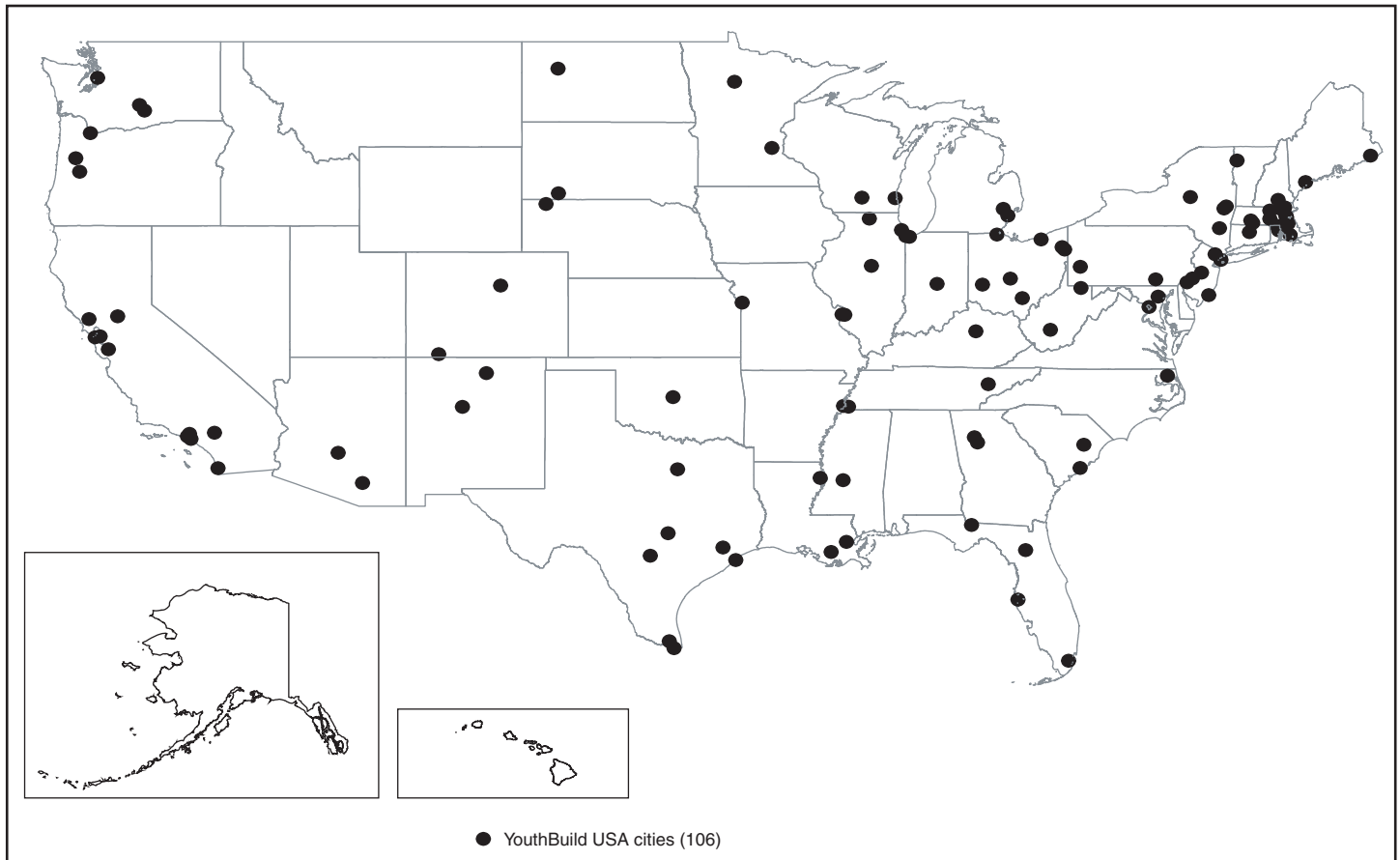
● YouthBuild USA cities (106)

Section 4 of the HUD Demonstration Act of 1993 Has Evolved and Expanded Over the Years

The scope of eligible activities funded by Section 4 of the HUD Demonstration Act of 1993 has changed over the years. Originally the act focused on providing funding for capacity building in 23 urban areas. Currently, it provides funding to groups and activities in urban, rural, and tribal areas nationwide. Section 4 authorized HUD to join other corporations and foundations as an equal partner in NCDI to develop the capacity and ability of CDCs in 23 cities. In 1997, Section 4 was expanded to include two more grantees, HFHI and YBUSA as well as more cities, and rural and tribal areas. The grantees' organizational structures and missions vary, as do their strategies for awarding Section 4 funds and the types of

activities they authorize. Each grantee has initiatives in rural and tribal areas.[9] Additional federal funding, such as Community Development Block Grants, is also available to grantees for capacity building and technical assistance.

Section 4 Provides Capacity-Building Funding to Four Organizations

NCDI in 1991 started with seven large national foundations and a major insurance company and was administered by LISC and Enterprise. This consortium of funders believed CDCs could achieve greater and more lasting success if they could count on a significant reliable commitment of multiyear operating support, project financing, technical assistance, and training. To date, NCDI has had four phases (rounds) of funding. In the first phase (1991-93), NCDI funders pledged $62.9 million (see table 1). With the enactment of Section 4, HUD joined phase II of NCDI, which also included 12 private foundations and financial institutions, as an equal partner.[10] Congress' goal in authorizing HUD to participate in NCDI was to develop the capacity and ability of CDCs to undertake community development and affordable housing projects and programs. HUD's involvement resulted in some changes to the way funds were disbursed. While the foundations provided funding through Living Cities (NCDI), which in turn distributed grant funds to LISC and Enterprise, HUD distributed its funding directly to LISC and Enterprise. In addition, unlike other NCDI funders, HUD provided funding only after expenses were incurred, monitored funding more closely, and restricted uses to capacity-building activities. In 2001, 17 foundations and corporations committed another 10 years to the initiative.

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[9]None of the grantees distinguish between rural and tribal programs.

[10]NCDI's goals coincided with HUD's program goals in the Community Development Block Grant Program and the Home Investment Partnerships Program (HOME). Both programs emphasize the use of neighborhood-based, nonprofit community development organizations to provide affordable housing and economic development in low-income neighborhoods.

Table 1: NCDI Funding, 1991-2004

Dollars in millions

Living Cities Initiative	NCDI I 1991-1993	NCDI II 1994-1997	NCDI III 1998-2001	Living Cities (Second Decade) 2001- 2004	Total
Private funder	$62.86	$67.85	$87	$93.7	**$311.41**
HUD	0	20	16	20	**56**
Total	**$62.86**	**$87.85**	**$103**	**$113.7**	**$367.41**

Source: NCDI.

Congress did not appropriate funds for HFHI and YBUSA until 1997 (see table 2).[11] At that time, LISC and Enterprise were given the option of using Section 4 funding to continue NCDI activities in the original 23 cities or to undertake new non-NCDI activities in other cities, which expanded the geographical dispersion of Section 4 funding. In addition, Congress required the grantees to set aside a portion of Section 4 funding for rural and tribal areas. Unlike the NCDI activities, whose funding objectives were determined by the responsible funders, LISC and Enterprise worked directly with HUD in creating the objectives for non-NCDI cities.

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[11]Section 4 grants cover a 4-year period. We are only providing information on the FY 1997 grant for HFHI and YBUSA because it was the only grant that had been completed at the time of our review.

Table 2: Section 4 Funding, 1994-2003

Dollars in millions

Fiscal year	Enterprise		LISC		YBUSA	HFHI	Total $ allocated for Section 4
	NCDI	non-NCDI	NCDI	non-NCDI			
1994	$10	$0	$10	$0	$0	$0	**$20**
1995	0	0	0	0	0	0	**0**
1996	5	0	5	0	0	0	**10**
1997	3	4.6	3	4.6	7.6	7.6	**30.4**
1998	0	7.5	2	5.5	0	0	**15**
1999	0	7.5	2	6	0	0	**15**
2000	0	10	2	8.2	2.5	3.8	**26.3**
2001	10	2.5	10	2.5	4	3.5	**32.5**
2002	0	12.5	1.4	11	2	4	**30.9**
2003	0	14	3	11	2	4.2	**34.2**
Total	**$28**	**$58.6**	**$37.7**	**$48.8**	**$18.1**	**$23.1**	**$214.3**

Source: HUD.

Grantees Use a Variety of Methods to Help Build Capacity

LISC and Enterprise are national organizations that use local program offices to provide financial and technical support to CDCs. The staff at the local program offices work with CDCs to achieve community-driven goals. For example, through its Boston local office, LISC provided several Section 4 grants to the Madison Park Development Corporation. A $78,000 grant was used to help the CDC improve the Dudley Square Business district in the Roxbury neighborhood of Boston. The Cleveland Enterprise office provided Section 4 funds to the Cleveland Neighborhood Partnership Program, a local support collaborative that provides organizational and real estate development and neighborhood planning for Cleveland CDCs.
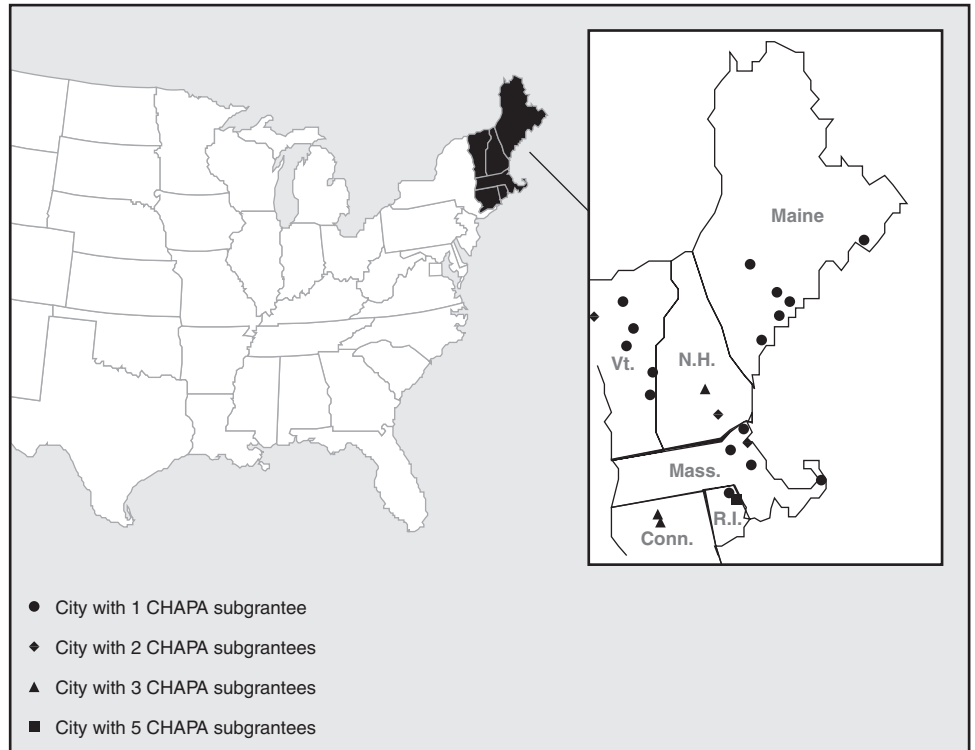
According to HFHI and YBUSA officials, these organizations provide direct grants to affiliates but operate somewhat differently. HFHI has provided grants to affiliates on a 3-year diminishing basis to hire new staff or establish warehouse facilities, with an expectation of increasing house production by at least 15 percent. In addition, HFHI has established regional support centers to bring technical assistance closer to affiliates. YBUSA uses Section 4 funds to provide a variety of grants to its affiliated network, such as operating grants, program enhancement grants, special assistance grants, and scholarships to staff and students. In addition,

YBUSA has used Section 4 funds to build its capacity to serve as a national support center and to provide technical assistance and training.

LISC and Enterprise consider the subrecipient's stage of development when making Section 4 funding decisions. For example, a new organization might receive Section 4 funds to pay for a portion of the salary of the executive director, whereas more established CDCs might receive funding to upgrade their financial management software. All grantees stressed that because capacity building takes time, they provide multiyear support to subrecipients. However, three of the four grantees indicated that they generally fund subrecipients in ways that encourage the organizations to become financially independent. Officials from LISC and Enterprise explained that although some subrecipients receive multiple grants for several years, the grants are small enough to keep subrecipients from becoming dependent on Section 4 funds for daily operations. As noted earlier, HFHI's grants, which are provided to hire new staff, diminish over a 3-year period. According to HFHI, the affiliates' gradual absorption of staff costs leads to independence from—rather than dependence on—federal funding. YBUSA, however, has provided Section 4 funding to affiliates to pay for general operations during years when they had not received funding under HUD's Youthbuild program.

Generally, Section 4 funds are used to pay for staff salaries, training, technology, and office supplies and equipment and to fund the operating support collaboratives. For example, with its 1997 funds HFHI provided direct grants to 60 affiliates to pay for staff salaries (usually an executive director). The YouthBuild Boston affiliate used Section 4 funds to hire an administrative coordinator and enhance its technological capabilities. The Washington, D.C., LISC office provided Section 4 funding to a local CDC to pay for some staff training and to purchase equipment and other supplies to outfit a homebuyer's training center. Enterprise has used Section 4 funds to develop on-line tools, such as a best practices database, and to bring current technology to CDCs. For example, Enterprise awarded one nonprofit organization, Citizen's Housing and Planning Association (CHAPA) in Boston, Section 4 funds to administer the NET-Works program, a program to enhance the technological capacity of CDCs in the New England region. As a result, 36 CDCs received computer equipment, Internet access, and assistance in developing websites. Figure 4 illustrates the broad impact that Section 4 funding had for this nonprofit organization on other CDCs.

Figure 4: Effect of Funding for CHAPA, an Enterprise Subrecipient, for Technology Improvements

● City with 1 CHAPA subgrantee

◆ City with 2 CHAPA subgrantees

▲ City with 3 CHAPA subgrantees

■ City with 5 CHAPA subgrantees

Source: GAO analysis of CHAPA data.

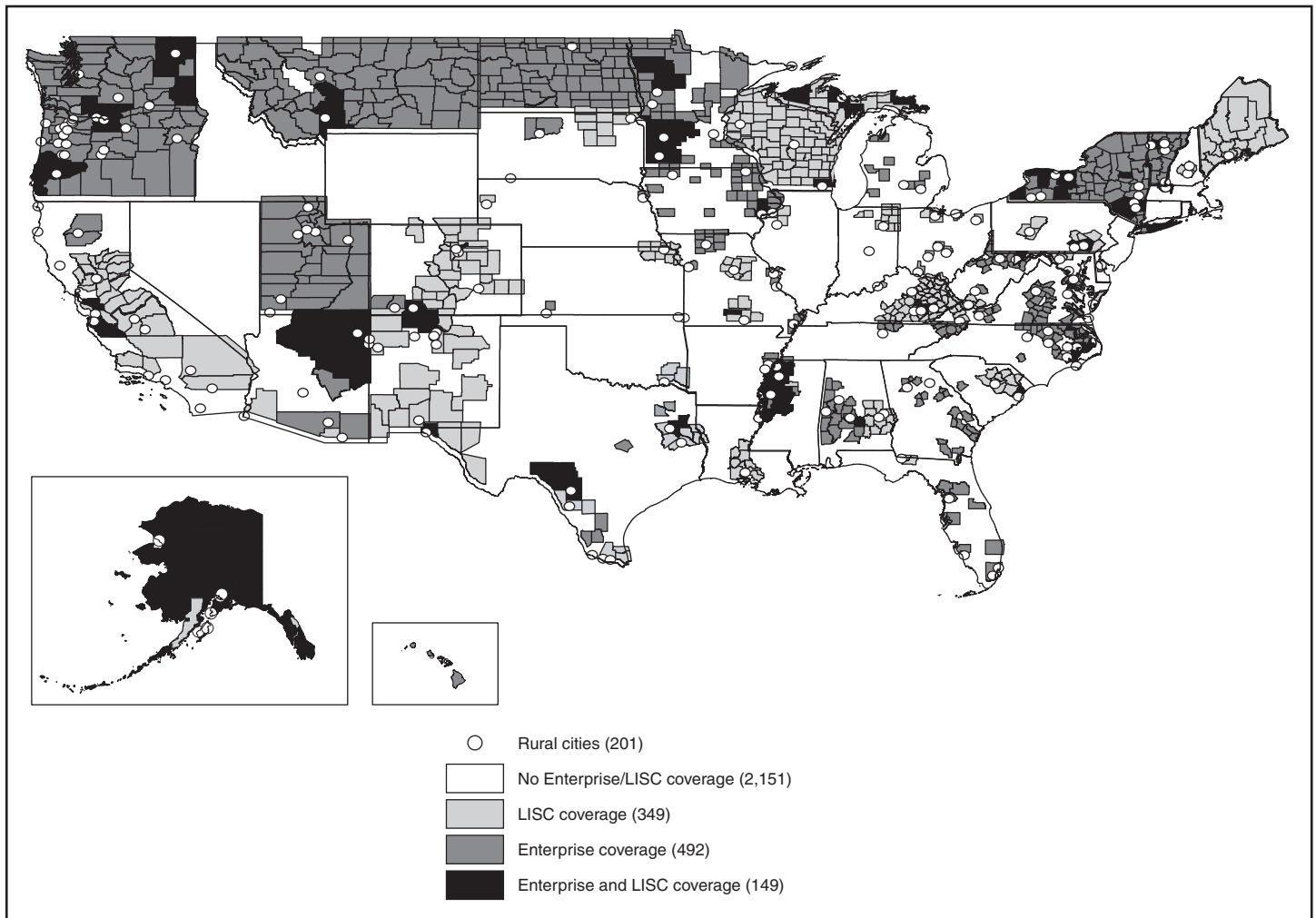## Rural Areas Now Have Access to Section 4 Funding

Congress did not require grantees to set aside Section 4 funding for rural and tribal areas until 1997.[12] All four grantees currently have initiatives that focus on these areas. For example, LISC has a rural office that supports both a national program and a program in the Mississippi River Delta Region of the United States covering 56 counties and parishes. In fiscal years 1997 through 2002, LISC awarded Section 4 grants totaling

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[12]For its rural and tribal programs, YBUSA generally follows the Rural Housing Service's requirement that most households receiving assistance be located in rural communities with fewer than 20,000 residents. HFHI classifies rural counties as those with fewer than 100,000 residents and rural cities as those with no more than 25,000 residents. LISC defines rural counties as those having no cities with 50,000 or more residents. Enterprise considers communities rural if they have fewer than 50,000 residents.

approximately $9 million to rural CDCs. Enterprise has awarded $6.2 million in Section 4 grants to rural CDCs. Unlike LISC, Enterprise does not have a rural office. Enterprise services its rural and tribal subrecipients through partnerships with other state and regional rural agencies and the Housing Assistance Council, which administers Enterprise's Rural Capacity Building Initiative, and through its regional and local office structure.[13] Although 218 of the 1,003 LISC and Enterprise CDCs provide services to rural and tribal areas, many of them cover large geographical areas. For example, 57 of the 72 rural CDCs that are funded by LISC, operate in more than one county, and 64 of the 146 rural CDCs that are funded by Enterprise operate in more than one county. Figure 5 shows the cities where LISC and Enterprise subrecipients who work in rural areas are located and the multiple counties they serve.

[13]The Housing Assistance Council is a national nonprofit corporation created to increase the availability of decent and affordable housing for rural low-income people.

Figure 5: Enterprise and LISC Subrecipient City and Rural County Coverage

Legend:
- ○ Rural cities (201)
- No Enterprise/LISC coverage (2,151)
- LISC coverage (349)
- Enterprise coverage (492)
- Enterprise and LISC coverage (149)

Source: GAO analysis of LISC and Enterprise data.

HFHI makes an effort to reserve at least one-third of its Section 4 funding for its rural affiliates. HFHI awarded $4.6 million of its fiscal year 1997 Section 4 funds to 60 affiliates of which 33 were rural. According to YBUSA officials, meeting the required set-aside has been a challenge. YBUSA's outreach efforts have included encouraging rural affiliates to apply for planning, operating, and program enhancement grants and for specialized technical assistance. According to a YBUSA official, over the course of the 1997 grant, about $2.5 million of YBUSA's $7.6 million allocation was focused on rural and tribal and partly rural and tribal programs. Of this amount, about $1.3 million was for direct grants to sites and about $1.2 million was for services to sites. A YBUSA official told us

that as of July 2003, 84 of the 203 operating Youthbuild programs were rural and partly rural.

Grantees Receive Capacity-Building Funding from Other Federal Programs

LISC, Enterprise, HFHI, and YBUSA also receive capacity-building and technical assistance funds from other HUD programs (table 3). The primary difference between Section 4 funding and other federal funding is that the other federal funding for capacity-building and technical assistance is generally awarded competitively, while Section 4 funding is noncompetitive. Several federal programs offer capacity-building funds: CDBG, HOME, and Housing Opportunities for Persons with AIDS (HOPWA). All grantees' Section 4 capacity-building funds exceed those received from other federal programs.

Table 3: Additional Federal Funding for Capacity-Building and Technical Assistance

Dollars in millions

Intermediary	Total other federal funding	Federal program
LISC	8.6	CDBG Technical Assistance
		HOME Technical Assistance (1994-2002)
Enterprise	13.1	CDBG Technical Assistance
		HOME Technical Assistance
		HUD Technical Assistance /Capacity Building
		HOPWA Technical Assistance (1995-2002)
YBUSA	20.2	Youthbuild program (1997-2002)
		Corp. for National and Community Service for AmeriCorps (1997-2003)
		U.S. Dept. of Labor for Welfare to Work (1998-2001)
HFHI	7.5	Self-help Homeownership Opportunity Program (1999)

Source: LISC, Enterprise, YBUSA, and HFHI.

Federal Funding Has Encouraged Private Sector Involvement in the Section 4 Grantees' Community Development Initiatives

While it was difficult to demonstrate empirically that Section 4 directly influenced private sector involvement in community development activities, funders and grantees said that federal involvement served as a catalyst for private fund-raising and provided credibility to subrecipients in terms of their ability to comply with the requirements that are associated with federal funding. Some local funders of CDCs and affiliates were not aware of the specific Section 4 funding the subrecipients received but indicated that both federal funding and diverse funding streams are important. Since matching funds can be raised either nationally, locally, or a combination of both, each grantee employs its own matching policy and raises funds from foundations, corporations, banks, individual donors, and nongovernmental sources. Since the creation of Section 4, grantees have raised nearly $800 million from the private sector, in matching and other cash and in-kind contributions.

Grantees and Private Contributors Generally Believe that Federal Funding Is Important to Private Sector Participation

The grantees and nearly all of the private lenders and foundations we contacted stressed the importance of federal funding in leveraging funds from the private sector. For example, officials from LISC, Enterprise, and Living Cities indicated that private funding and lending have increased since HUD's involvement. In addition, Enterprise officials indicated that the private sector believes that federal funding provides an incentive to work in areas and projects that would be less likely to receive funding without federal involvement. HFHI officials said that federal funding is imperative because it is the only way for all-volunteer organizations to transition into staff-managed, volunteer-based organizations. YBUSA officials said that federal funding, especially funding that leverages private funding, has enabled YBUSA to be proactive in assisting Native American and rural programs.

NCDI lenders and funders indicated that Section 4 funding had both a psychological and a real impact on private sector involvement in the initiative. For example, one senior executive from a major lending institution indicated that federal participation in NCDI provided funders with a symbolic and financial incentive to join the NCDI consortium. Symbolically, federal funding provides a sense of credibility to NCDI, as funders see federal participation as a sign of good housekeeping and reduced risk. Financially, federal participation adds more money to NCDI capacity-building initiatives, in turn enabling subrecipients to raise more private funding. Another lender said that HUD's participation in a CDC through Section 4 funding served as an indication of good management and internal controls. An insurance company also noted that Section 4 funding showed that the federal government was strongly committed to a

coordinated effort to build CDC capacity, and a foundation told us that the federal presence legitimized NCDI as the CDC capacity-building vehicle with the greatest payoff. Furthermore, nearly all of the YBUSA and HFHI private funders that we interviewed said that federal funding was an incentive for their participation in the program. For example, one funder said that federal support was like a "seal of approval." Another funder said that Section 4 funding created a positive incentive because the availability of invaluable hard-to-get federal funding increased the viability of any project.

Most funders and lenders that provide funding directly to CDCs and affiliates stressed that federal funding was beneficial, but some of those local funders were not aware that subrecipients received Section 4 funds. Some LISC and Enterprise subrecipient funders explained that federal funding and diverse funding streams were characteristics of a viable organization. One funder suggested that public funding was critical, since private philanthropy could only do so much. Another foundation indicated that it looked to organizations that had a diversified funding structure, since it could not provide sole support for an organization.

The four funders we spoke with that provided funding directly to the YouthBuild Boston affiliate were split on whether federal participation was an incentive to their involvement. Two said that federal participation was an incentive; while the other two said their decision to provide funding was based solely on the affiliate's mission.

Officials from most of the five organizations we spoke with that provided funding to an HFHI affiliate in Rhode Island indicated that federal participation was not an incentive, but two said that having other sources of funding encouraged them to participate. An official from one organization indicated that while federal funding indirectly provides an incentive for participation, the organization provided funding primarily based on the affiliate's reputation and mission.

Cost Sharing Requirements Are Specified in Law and Grantee Policies

Section 4 funding calls for significant private sector participation in community development initiatives because Section 4 requires that grantees match each dollar awarded with three dollars in cash or in-kind contributions from private sources. Matching funds are raised nationally and locally and come from nongovernmental sources including private foundations, corporations, banks, and individual donors. Each grantee has its own matching policy and procedures for complying with the matching requirement.

LISC and Enterprise generally meet their matching requirement at the national level but encourage CDCs to seek private contributions to aid in the match. However, LISC requires subrecipients in rural areas to raise at least $1 for each $1 they receive; the remainder of the match is raised nationally. Conversely, HFHI and YBUSA require their affiliates to raise at least $3 for every dollar of Section 4 funding they receive. While both HFHI and YBUSA impose this requirement on all of their affiliates, including those in rural and tribal areas, if YBUSA rural and tribal affiliates cannot raise the 3 to 1 match, the national organization will provide the difference. Officials from the four grantees told us that raising the private matching funds had not been a problem. For example, for the 1997 grant HFHI and its 60 affiliates that received Section 4 funding raised almost $155.6 million in private contributions. YBUSA and its affiliates raised $26.6 million in private contributions to match its $7.6 million grant.

Grantees Have Raised Significant Amounts of Private Sector Funding and Other Resources

Since the four grantees became eligible for Section 4 funding, they have raised nearly $800 million from the private sector in matching funds and other cash and in-kind contributions. However, we could not demonstrate empirically that Section 4 funding influenced the grantees' fund-raising owing to external factors such as economic trends and private sector interests. Between 1994 and 2001, LISC and Enterprise raised $457 million, and from 1997 to 2002, HFHI and YBUSA raised $341 million (see table 4).

Table 4: Private Sector Funding

Dollars in millions

Grantee	Private sector funding	Time period
LISC	$319.9[a]	1994-2001
Enterprise	136.7	1994-2001
YouthBuild USA	26.6[b]	1997-2001
HFHI	314.5	1998-2002
Total	**$797.7**	

Source: LISC, Enterprise, YBUSA, and HFHI.

[a]LISC private sector grants for 1994 and 1995 contain government funding due to different accounting practices at that time.

[b]This number only includes YBUSA's matching funds and not all private sector funding.

In addition to providing funding, the private sector has contributed in-kind services to CDCs, including managerial skills, mentoring, and volunteer labor. For example, representatives from the private sector serve on

LISC's local advisory boards to help local program offices make funding decisions and are members of operating support collaboratives in several cities. HFHI's local affiliates use volunteers for office and construction work and for their boards of directors.

HUD's Grantee Monitoring and Oversight Is Limited

HUD monitoring is limited to desk reviews of the grantees' compliance with their grant agreements. In general, the grant agreements require several kinds of reporting information including work plans, semiannual or quarterly financial status reports, requests for grant payment vouchers, and final reports. However, HUD's involvement in reviewing grantee work plans differs for NCDI and non-NCDI activities. Since HUD does not directly monitor the subrecipients' capacity-building activities, it relies on the grantees to monitor and oversee them. The grantees have several mechanisms in place to ensure that subrecipients are complying with their individual grant agreements. However, in a subset of files we reviewed, we found that a grantee had funded an ineligible activity for one subrecipient. Also, HUD does not have specific impact measures in place for Section 4.

HUD Monitors Grantees but Not Subrecipients

HUD's efforts to monitor the grantees include desk reviews of work plans, annual performance reports, semiannual financial status reports, requests for grant payment vouchers, and final performance reports. According to HUD, the four grantees sign grant agreements that obligate them to comply with HUD and OMB requirements. For example, grantees must submit work plans that identify when and how federal funds and nonfederal matching resources will be used and present performance goals and objectives in enough detail to allow for HUD monitoring. In addition, the grant agreements require grantees to submit annual reports showing actual progress made in relation to the work plans, plus semiannual financial status reports that show private sector matches and grant expenditures to a certain date. Grantees are not permitted to begin activities or to draw down funds until HUD approves the work plans. Furthermore, the grant provisions require that in order to receive payment, grantees must submit a payment voucher with supporting invoices that provide enough information to allow HUD to determine whether the costs are reasonable in relation to the work plan's objectives. Finally, the grant agreement stipulates that within 90 days of completing the grant award, the grantee must submit a final report summarizing all the activities conducted under the award including any significant program achievements and problems reasons for the program's success or failure.

HUD officials told us that staffing constraints caused the agency to focus mostly on grantee work plans and payment vouchers. HUD reviews how

the grantees select subrecipients, set benchmarks, and plan to build capacity. HUD uses different processes to review NCDI and non-NCDI work plans. As an equal player, HUD reviews NCDI's work plans together with other funders and meets twice a year to discuss NCDI initiatives and goals for each city. However, HUD reviews and approves non-NCDI work plans by itself. A HUD official told us that HUD staff focus most of their attention on the funding aspects of the work plans. HUD officials told us that they check the semiannual financial status reports and accompanying narratives to determine whether the expended amounts are in line with the amounts stated in the work plans.

Section 4 grant funds are provided to grantees after costs are incurred, so grantees must periodically submit vouchers and supporting documentation that detail expenditures by city or project in order to receive payment. HUD staff review the vouchers and supporting documentation to ensure that funds are used for the eligible activities stated in the work plans and that expenditures such as travel and indirect costs are within HUD guidelines and do not exceed available funding. HUD has denied payments for activities not contained in approved work plans or not supported by the required documentation. For example, in March 2003, HUD withheld over $650,000 in Section 4 funding because one grantee did not submit a final report, several financial reports, a work plan, and two annual plans. In June 2003, however, the grantee provided the necessary documents and HUD released the funds.

In addition, grantees must submit financial status reports that show whether the organizations are meeting their matching requirements. However, HUD relies on the grantees to ensure that they and their subrecipients are matching funds correctly. Both LISC and Enterprise have a formal matching policy. LISC's policy explicitly states that counting the same funds as matching funds under more than one program is prohibited and requires its subrecipients to identify the sources and amounts of matching funding they have received twice a year. Enterprise's matching requirements are tracked on an ongoing basis and are certified by an Enterprise official. YBUSA requires its affiliates to submit documentation that supports the sources and amounts of matching funds committed before it will release Section 4 funding, and HFHI requires affiliates to report matching funds data quarterly.

HUD Relies on Grantees to Monitor Subrecipients

HUD does not directly monitor subrecipients' and affiliates' capacity-building activities but instead relies on the grantees for monitoring and oversight. Like HUD, grantees initiate grant agreements with their subrecipients and affiliates. These grant agreements generally include such things as the purpose of the grant, grant amount, time frame, disbursement conditions, causes for suspension and termination, restrictions on use of grant funds, and reporting and accounting requirements that describe how the grantee will monitor the grant. The grantees use the grant agreements as the basis for monitoring their subrecipients' performance.

The grantees use several mechanisms to ensure that subrecipients are complying with their grant agreements. For example, LISC and Enterprise officials indicated that throughout the grant period, local offices communicate with their subrecipients by telephone or email or in person in order to follow their progress. Similarly, YBUSA staff told us that they monitor affiliates by telephone as well as through on-site technical assistance. LISC, Enterprise, and YBUSA require each subrecipient to submit a monthly activity report, semiannual project reports and narratives, and final reports. However, the grantees have different procedures, forms, and checklists that guide their monitoring activities.

Operating support collaboratives aid LISC and Enterprise in their oversight through proposal reviews, organizational assessments, work plan reviews, on-site reviews, quarterly report reviews, and annual and 3-year evaluations. The LISC and Enterprise local offices use the collaboratives' monitoring information when making their Section 4 funding decisions.[14]

HFHI and its regional office personnel evaluate all affiliates every 3 years based on a "Standards of Excellence" program. The program has three elements: best practices, acceptable practices, and minimum standards. According to HFHI officials, continued failure to meet minimum standards will lead to probationary status and eventually disaffiliation. The program provides clear guidelines for affiliate self-assessments and HFHI evaluations as well as a systematic process for ensuring that Habitat

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[14]The operating support collaboratives vary by city. The one in Cleveland, for example, distributes money competitively each year, while the one in Washington, D.C., has a 3-year funding cycle. They may be run by an independent nonprofit organization or as an entity of Enterprise or LISC. In some instances, subrecipients that received funds from the operating support collaboratives also received Section 4 grants directly from Enterprise or LISC.

affiliates are complying with the organization's basic principles. If HFHI national or regional staff are aware of illegal activities or violations of HFHI's minimum standards, immediate action can be taken to correct the problem. The evaluation covers internal controls and audits. All affiliates with an annual income of $250,000 or more, assets of $500,000 or more, or both are required to have an independent annual audit. Affiliates are also requested to submit their annual report to HFHI.

Even with Comprehensive Controls, Problems May Still Occur

While the grantees appear to have comprehensive processes to monitor and control their subrecipients, our review of seven subrecipients' grant files identified a subrecipient that suffered from organizational and financial problems that eventually led to its demise. This subrecipient was the grantee's second-largest in terms of Section 4 funding, receiving 10 grants that totaled almost $1 million over a 7-year period. One grant for $143,000 paid for several activities, one of which was a bad debt—an ineligible expenditure according to OMB Circular A-122. Since HUD officials do not receive and review subrecipient grant agreements and payment vouchers, HUD was not aware of the ineligible cost. The grantee has since taken several steps to ensure that similar problems do not occur, including having a staff member perform increased subrecipient monitoring to verify that sufficient management controls are in place to ensure that grant funds are used appropriately and effectively. This monitoring includes a full review of the grant request and award documents, followed by a review of supporting documentation to verify compliance with allowable expenses and consistency with the work plan. In addition, site visits are made to subrecipients that have received large amounts of funding and a "watch report" is maintained to track all subrecipients that are late in responding to requests for information.

HUD Does Not Measure the Impact of Section 4 Funding

HUD has not measured the impact of Section 4 funding on improving the capacity of its grantees and subrecipients. However, HUD requires its grantees to submit annual work plans that include specific details of how federal and private resources will be used and to identify performance goals and objectives that should be attained during the grant period. In addition, OMB is currently requiring HUD and the NCDI grantees to conduct a PART review. PART assessments are used for making budgeting decisions, supporting management, identifying design problems, and promoting performance measurement and accountability. The assessment includes questions on a program's purpose and design, strategic planning, management, and results. Furthermore, in response to a GAO report recommendation that HUD require program offices to determine the

practicability of measuring the impact of technical assistance and establishing objective, quantifiable, and measurable performance goals, HUD is working with a group of national technical assistance providers to develop a framework to assess the effectiveness of its technical assistance programs. [15]

Living Cities has also contracted with a consultant to develop impact measurements for the 23 NCDI cities. Other evaluations[16] have resulted in measures that gauge the capacity-building system in NCDI cities and categorize organizational capabilities into five different stages of growth—initiation, demonstration, professionalization, instutionalization, and maturation.[17]

Conclusions

While Section 4 funds must be used for capacity-building initiatives, grantees are afforded a great deal of discretion as to how they administer, use, and oversee these funds. HUD is responsible for ensuring that grantees are utilizing Section 4 funds according to federal law and regulations and has several controls in place to ensure that they do. However, HUD relies primarily on its grantees to make certain that this responsibility is carried out at the subrecipient level. We found that grantees generally had good management systems and controls in place to monitor their subrecipients and to ensure that they carried out their work plans, met their objectives, and used federal funds legally and responsibly. However, even with good controls, problems can still occur, as we found

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[15]U.S. General Accounting Office, *HUD MANAGEMENT: Impact Measurement Needed for Technical Assistance*, GAO-03-12 (Washington, D.C.: Oct. 25, 2002).

[16]Christopher Walker and Mark Weinheimer, "Community Development in the 1990s" (Washington, D.C.: The Urban Institute, September 1998); and Weinheimer and Associates, "HUD Section 4: Building the Capacity of CDCs," (Washington, D.C.: Assessment Report, June 2001).

[17]Initiation refers to the first stage of growth, when a civic or church group forms to provide a social service or advocate on an issue. The group lacks staff or at least lacks staff trained in development. Demonstration occurs when an existing group assumes an initial program in community development. The new CDC lacks staff and relies on volunteers. In the third stage, professionalization, the CDC takes on larger projects (20-30 units) or builds several homes and is able to secure funds for staff and more projects. When a CDC reaches the fourth stage, institutionalization, the staff has developed expertise and taps into public and private sources of support that is enabling it to do one large project after another. A CDC has reached maturation when it can maintain a consistent level of staff expertise, manage multiple projects simultaneously, and move into new programs that meet community needs.

at one CDC. While HUD has overarching responsibility for detecting such internal control failures, the cost-effectiveness of adding additional federal controls at the subrecipient level must be weighed against the size of the program and the amount of federal funding involved. Given the relative size of the Section 4 program and the fact that similar problems should not recur if HUD and the grantees remain vigilant, we do not believe that additional controls are necessary at this time.

Recommendation for Executive Action

We recommend that the Secretary of HUD take steps to recover the grant funds that one Section 4 grantee used to cover a bad debt.

Agency Comments

In an e-mail dated August 7, 2003, HUD provided technical comments, which we incorporated into this report as appropriate.

Scope and Methodology

To accomplish our objectives, we reviewed public laws, federal regulations, HUD directives, budget documents and other material that described the Section 4 program, grantees' missions and organizational structures, and authorized and appropriated funding. To determine how Section 4 funding has evolved and expanded over the years and how grantees use Section 4 funding, we interviewed HUD, Living Cities, LISC, Enterprise, YBUSA, and HFHI officials in national, local, and rural offices, and subrecipients in Americus, GA; Baltimore, MD; Boston, MA; Cleveland, OH; Frederick, MD; Hughesville, MD; Kingston, RI; and Washington, D.C. We collected data from LISC, Enterprise, and YouthBuild USA showing the number of multiple grants and amounts provided to CDCs or affiliates. We selected five CDCs/affiliates from three grantees. For LISC and Enterprise, we chose the CDCs that had received the greatest number of grants and analyzed the purpose of each grant. For YBUSA, we selected the affiliates that had received the highest dollar amounts.[18] To create the maps of subrecipients and cities that received Section 4 funding, we obtained city data from NCDI, LISC, Enterprise, YBUSA, HFHI, and CHAPA and used geographical information software (GIS) to create the maps. We used the same software to create the rural

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[18]The criteria differed for YBUSA because of the shorter grant time frame. Habitat for Humanity was not included in this analysis because it does not allow affiliates to receive multiple grants in any Section 4 grant cycle.

county maps with data obtained from LISC and Enterprise that listed each CDC categorized as rural and the counties they served.

To determine the importance of Section 4 funding to private sector involvement in community development initiatives, we reviewed public laws, federal regulations, HUD directives, budget documents, and other materials. We obtained 1994 through 2001 private contribution data from LISC and Enterprise and 1997 through 2001 data from YBUSA and HFHI. We obtained matching policy information from HUD and the grantees and interviewed private funders that had provided either grants or loans to each of the grantees and subrecipients we visited in Boston, MA; Baltimore, MD; Frederick, MD; and Kingston, RI. We based our selections on the subrecipients' proximity to our offices in Washington D.C., and Boston, MA, and the amount of Section 4 funding they received.

To determine how HUD and Section 4 grantees controlled the management and measured the impact of Section 4 programs, we reviewed and analyzed HUD and grantee criteria, processes and procedures for monitoring, controlling, and measuring performance and tested grantee monitoring and control procedures at seven subrecipients. In addition, we reviewed reports prepared by Living Cities and the Urban Institute that discussed NCDI's history and accomplishments.

We conducted our work from September 2002 through April 2003 in accordance with generally accepted government auditing standards.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution of this report until 30 days from the report date. At that time we will provide copies of this report to the Chairman and Ranking Minority Members, Senate Committee on Banking, Housing, and Urban Affairs; the Chairman and Ranking Minority Member, House Committee on Financial Services; and the Ranking Minority Members of its Subcommittees on Oversight and Investigations and Housing and Community Opportunity. We will also send copies to the Secretary of Housing and Urban Development and the Director of the Office of Management and Budget. In addition, the report will be available at no charge on GAO's Web site at http//:www.gao.gov.

Please contact me at (202) 512-8678 if you have any questions about this report. Key contacts and contributors are listed in appendix I.

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Appendix I: Contact and Staff Acknowledgments

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