STATE OF MINNESOTA
Department of Energy and Economic Development
Community Development Division

In the Matter of Proposed Adoption of Amended Rules of the Department of Energy and Economic Development Governing the Community Development Block Grant Program

Statement of Need and Reasonableness

General Statement - Statutory Authority

The Department of Energy and Economic Development (hereinafter DEED) is proposing to adopt the above-referenced rule amendments as a permanent rule, as authorized in Minnesota Statutes, sections 116J.401(2) and 116J.403.

Background

This proposed rule amendment will modify a portion of existing rules codified in Chapter 4300 of Minnesota Rules. These rules establish standards and procedures to govern the administration of the federal Small Cities Community Development Block Grant program. These rules were initially adopted when the State assumed the responsibility for awarding and administering these grants to local units of government throughout Minnesota. Two years later, these same rules were applied to the administration of the state-funded Economic Recovery Grant program. The authorizing legislation for this program, Minn. Stat. section 116J.873 (1986), specifically stated that the rules adopted for economic development grants in the Small Cities Community Development Block Grant Programs be used to govern the administration of the new state-funded Economic Recovery Grants Program.

Small Business/Commissioner of Finance Considerations

The grants made pursuant to the rules proposed for amendment may only be provided to county, township, and city governments; and, therefore, the proposed amendment will have no effect on small businesses. The proposed amendments to the rules will not modify a fee charged and, therefore, does not require the approval of the Commissioner of Finance.

Need and Reasonableness

There are several subparts of the rules which would be modified by the proposed amendments. Those subparts are:

- 4300.1100, Types of Grants Available

  Subp. 2 Comprehensive Grants
  Subp. 3 Previous Grant Commitments

- 4300.1200, Application Process and Requirements

Subp. 1 Grant Application Manual

- 4300.2000, Determination of Grant Awards

  Subp. 1 Funds Available for Grants
  Subp. 2 Division of Funds
  Subp. 6 Grant Ceilings

- 4300.3100, Grant Agreements

  Subp. 3 Use of Program Income

- 4300.3200, Recordkeeping and Monitoring

  Subp. 2 Audits

The subparts proposed for revision will be identified in the following manner: Deletions will be characterized by strikeouts (-), while additions are characterized by underlining (_). An explanation of need and reasonableness will follow each amended subpart.

4300.1100, Subpart 2, Comprehensive Grants

> The office shall approve comprehensive grants for two or more projects which constitute a comprehensive program as described in Part 4300.0100. ~~Comprehensive grants shall be approved for funding from one, two, or three grant years. In the case of grants approved for funding from more than one grant year, the office shall make funds available to the grant recipient in the second or third year only after the recipient submits an approved application. Approval shall be subject to a finding by the office that the grant recipient has made normal progress and is in compliance with this chapter.~~

The following discussion is intended to illustrate that the original concept and mechanics of approving comprehensive grants from two or three grant years is cumbersome, unnecessary, and should be eliminated. This discussion is not intended, however, to suggest that the $1.4 million comprehensive grant ceiling should be reduced. For a further explanation on grant ceilings, please see the discussion of the proposed amendments to Minn. Rule pt. 4300.2000, subp. 6.

First, this amendment is necessary because comprehensive grants approved from more than one grant year requires unnecessary paperwork. Pursuant to OMB Circular A-102, Attachment G, grant recipients must establish separate account records for each grant award and pursuant to OMB Circular A-102, Attachment H, grant recipients must provide separate reports for each grant award. Pursuant to current rules, grant recipients must submit, for approval, a separate application for each grant award. Of course, DEED staff must analyze each set of account records, each report, and each application submitted by grant recipients. Thus, comprehensive grants approved for funding from two or three grant years require two or three sets of accounting records,

two or three sets of reports, and two or three applications, plus attendant analyses. In order to be competitive and ultimately receive grant money, a prospective comprehensive grant recipient must establish, in the **first** application, the interrelated nature of the project, the project need, the project impact, and the project cost effectiveness. In essence, the applicant must establish that the application represents one project, albeit a comprehensive project. Yet, by financing the project over two or three grant years, DEED and the grant recipient must treat the comprehensive project like two or three separate projects. As a result, unnecessary duplication or triplication occurs at both the state and local levels.

Second, the method of approving comprehensive grants for funding from two or three years can artificially and unnecessarily cause projects to take a long time to complete. Currently, if a grant recipient completes activities funded in their first grant year before they have received approval to begin their second grant year, the grant recipient must stop work and wait for application approval, grant agreement execution and environmental clearance. When those steps are completed, the grant recipient may resume work on the project. Thus, under the present rules, DEED is penalizing those grant recipients who can efficiently execute their projects. A grant recipient certainly cannot spend any grant money until a grant agreement is formally executed. As a result, instead of encouraging a grant recipient to expediently initiate and complete a comprehensive project based on their own administrative capabilities, DEED requires each comprehensive grant recipient who is awarded funds for two or three grant years to follow a prescribed schedule which is based solely on the timing of grant awards. In many cases, grant recipients could progress at a faster rate. Moreover, because some activities (like low-income housing rehabilitation) naturally take a long time to initiate and complete, project agreement periods are frequently written with $1\frac{1}{2}$ to $2\frac{1}{2}$ year durations. Therefore, if a grant recipient schedules a time consuming activity to be conducted with the second or third year award, a multiple year comprehensive project can easily take four to five years to complete.

Third, comprehensive grants approved for funding from two or three years can be complicated further by changes in laws and/or regulations which apply to a specific fiscal year. A grant recipient may have to administer activities funded in their first grant year differently than they administer identical activities funded in their second or third grant years. This situation can lead to unnecessary confusion and/or noncompliance with laws or regulations.

Fourth, approval of comprehensive grants for funding from two or three grant years substantially reduces future grant pools and inhibits the State's ability to finance future comprehensive projects. By permitting funding of comprehensive projects from two or three years, DEED originally hoped to spread each year's allocation to as many grant recipients as possible. In practice, the opposite has occured. Under current rules[1], the State may approve a $700,000 grant for the first year of a comprehensive project and **obligate** up to $700,000 to the second- or third-year phase from future grant pools. For example, in FY'85, DEED approved eleven comprehensive projects which were designed to require funds from the FY'86 grant pool. Those eleven comprehensive projects obligated nearly $6.0 million from the FY'86 competitive grant cycle before the cycle had even begun. Based on program rules and the dollar amount of the FY'86 allocation, only $9.0 million was available for all comprehensive projects. Because the FY'85 multi-year comprehensives required $6.0 million from the FY'86

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[1]Minn. Rule pt. 4300.1100, subp. 2, states, in part, "the office shall make funds available to the grant recipient in the second or third year only after the recipient submits an approved application." Minn. Rule pt. 4300.2000,

pool, there was only $3 million left to finance first year FY'86 comprehensive projects. In FY'86, only 8 new comprehensive projects could be funded, even though the average cost of the FY'86's was significantly less than the FY'85's. The reason for so few FY'86 approvals is that the eleven FY'85 comprehensives used nearly two thirds of the FY '86 comprehensive project allocation. On the surface, it appeared that DEED awarded 19 comprehensive grants in FY'86 (eleven from '85 and eight from '86), but FY'86 applicants knew they were competing exclusively for the '86 money that had not previously been reserved for FY'85 projects. Thus, in reality, by reducing the annual grant maximum and making funds available to approve comprehensive grants from two or three grant years, DEED really only spread the money around to more grant recipients in the **first year of program management.** After the first year, DEED was awarding more grants pursuant to 4300.1100, Subp. 2; but as the FY'85/86 example illustrates, DEED was making awards to **fewer** new grant **recipients.** Again, FY'85 comprehensive projects were not inherently superior to FY'86 comprehensive applications. Yet, because of previous commitments, the FY'85 comprehensive projects received nearly two thirds of the FY'86 comprehensive allocation. Moreover, the problem illustrated by the FY'85/86 example is further aggravated by steady, yearly reductions in congressional appropriations. Some local government officials have recognized the problem and have suggested, via grant cycle public hearings, that the multi-year award aspect of comprehensive projects be eliminated.

Finally, it is important to note that pt. 4300.10100, subp. 2, which states that approval of a second- or third-year grant, "shall be subject to a finding by the office that the grant recipient has made normal progress and is in compliance with this chapter," is not needed to give grant managers the authority to stop a mismanaged project. There are other provisions in the rules which provide DEED said authority. Minn. Rule pt. rules, 4300.3100, subp. 5, now states: "If it is determined that an improper use of funds has occurred, the office will take whatever action is necessary to recover improperly spent funds." So, DEED has the authority to demand refunds, if necessary. DEED also has the authority to hold future payments on mismanaged grants. Minn. Rule pt. 4300.3100, subp. 6, states that DEED, "shall suspend payments of funds to grant recipients that are not in compliance with applicable state and federal laws, rules, and regulations." These rules implement the provisions of OMB Circular A-102, Attachment L, which require the State to develop and follow procedures for termination of a grant, "when a grantee has failed to comply with the grant award stipulations, standards, or conditions." Briefly stated, there are two types of grant terminations. Termination for cause may occur at the grantor's discretion upon a determination that a grant has been mismanaged. Termination for convenience may occur when both the grantor and the grant recipient determine that the project should be discontinued. Thus, because other sections of the rules implementing OMB Circular A-102, Attachment L, gives DEED the authority to stop payments, recover improperly spent grant funds or even terminate a project, there are adequate safeguards short of awarding grant money from two or three grant years to ensure proper local management of grant money.

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subp. 2, states, in part, "...55 percent shall be reserved by the office to fund comprehensive grants, including the second and third years of comprehensive grants approved for funding under parts 4300.1100 and 4300.1900." Further, part 4300.2000, subp. 6, states, in part, "No comprehensive grant may be approved for an amount over $700,000 from any single grant year or for more than a total of $1,400,000 over three grant years."

Thus, in summary, comprehensive grants approved for funding from two or three grant years require unnecessary duplication of effort, can unnecessrily increase project duration, are difficult to manage when laws or regulations change, and arbitrarily reduce future grant pools before actual application quality can be determined. As a result, it is necessary and reasonable that Minn. Rule pt. 4300.1100, subp. 2, be amended.

4300.1100, Subpart 3, Previous Grant Commitments

~~Subp. 3. Previous Grant Commitments. The provisions of Subp. 2 apply to three-year comprehensive grant commitments made by the United States Department of Housing and Urban Development in 1981 under United States Code, title 42, section 5306 (1980).~~

When DEED assumed the program's administrative responsibilities in 1983, there were a few local governments who had received assurance from HUD that their comprehensive projects would receive awards in FY'81, '82, and '83. Minn. Rule pt. Chapter 4300.1100, subp. 3, commits DEED to funding the 1983 portion of those comprehensive grants. It is reasonable to repeal subpart 3 because it has been obsolete since FY 1984. The program rules will be more clear and understandable if obsolete material is removed.

4300.1200, Subpart 1, Grant Application Manual

Subp. 1. Grant Application Manual. The office shall prepare a manual for distribution to eligible applicants no later than 120 days before the application closing date. The manual must instruct applicants in the preparation of applications and describe the method by which the office will evaluate and rank applications. ~~If this chapter is not adopted before September 15, 1982, the 120-day period is waived for the 1983 grant year but the office shall make the manual available no later than 60 days before the application closing date.~~

The original purpose for this segment of the rules was to enable DEED to begin the 1983 grant cycle while the formal rules were going through the final stages of adoption. DEED has just begun the FY'87 grant cycle. It is reasonable to repeal this segment of the rules because it has been obsolete for four years. The program rules will be more clear and understandable if obsolete material is removed.

4300.2000, Subpart 1, Funds Available for Grants

Subp. 1. Funds Available for Grants. The amount of funds available for grants shall be equal to the total allocation of federal funds made available to the State under United States Code, title 42, section 5306 (1981), after subtracting an amount for costs ~~incurred by~~ available to the office for administration of the program, as allowed by that law. The office is not liable for any grants under this chapter until funds are received from the United States Department of Housing and Urban Development.

The necessity of this amendment stems from a HUD monitoring report of September 5, 1985. An excerpt of the HUD report is attached as Appendix A. The HUD report

states, "First, in discussing the amount of funds available for grants (10 MCAR 1.550 A)[2], you note you will be 'subtracting an amount for costs incurred by the office for administration of the program as allowed by law.' Actually, the amount subtracted was the amount available for administration. Very little, if any, administrative expenses had actually been incurred." HUD went on to direct the State to better describe future actions to avoid this finding in the future. The only way to avoid a future finding is to amend Minn. Rule pt. 4300.2000, subp. 1, to delete the phrase "incurred by" and add the phrase "available to."

It is necessary to make this change because we have been directed by HUD, an agency with direct oversight authority over the Small Cities Development Program, to make the change. It is reasonable to make the change because the change will allow DEED to comply with the HUD request without changing program administraiton in any way. The change will not affect the manner in which administrative costs are calculated or the manner in which the State received administrative funds from HUD. The change is merely intended to more accurately reflect the manner in which administrative funds are actually received.

4300.2000, Subpart 2, Division of Funds

> **Subp. 2. Division of Funds.** Of the funds available for grants in each grant year, 30 percent shall be reserved by the office to fund single-purpose grants, 15 percent shall be reserved for economic development grants, and 55 percent shall be reserved by the office to fund comprehensive grants~~, including the second and third years of comprehensive grants approved for funding under Parts 4300.1100 and 4300.1900~~. However, the office may modify the proportions of funds available for single-purpose and comprehensive grants if, after review of all applications, it determines that there is a shortage of fundable applications in either category.

It is both necessary and reasonable to delete the above-referenced segment of subp. 2 in order to be consistent with the proposed amendments to Minn. Rule pt. 4300.1100, subp. 2, which eliminates the concept of approving grants for funding from more than one grant year.

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[2]10 MCAR 1.550A was renumbered as Minn. Rule Pt. 4300.2000, subp. 1.

4300.2000, Subpart 6, Grant Ceilings

> Subp. 6. Grant Ceilings. No competitive single-purpose grant may be approved for an amount over $600,000. No comprehensive grant may be approved for an amount over ~~$700,000 from any single grant year or for more than a total of~~ $1,400,000 ~~over three grant years.~~ No economic development grant may be approved for over $500,000.

An amendment to this subpart is necessary for two reasons. First, subp. 6 makes reference to multi-year comprehensive grants. Proposed amendments to Minn. Rule pt. 4300.1100, subp. 2, eliminate the concept of approving grants for funding from more than one grant year. Thus, in order to be consistent with previously-mentioned amendments, the multi-year reference in subp. 6 must be eliminated.

Secondly, the purpose for amending Minn. Rule pt. 4300.1100, subp. 2, is to eliminate unnecessary protracted project duration and to avoid reducing future grant pools. It is not our intention to suggest that the ultimate amount of a comprehensive grant award should be reduced. There is no justification for reducing total comprehensive grant awards to less than $1.4 million. Comprehensive projects, by definition, are more expensive than single-purpose projects. A grant ceiling for comprehensive projects of $1.4 million is still necessary. Thus, by amending Minn. Rule pt. 4300.1100, subp. 2, and 4300.2000, subp. 6, as proposed, DEED reduces paperwork, reduces potential applicant confusion/noncompliance, encourages faster moving projects, and protects future grant pools without reducing the total amount for which a comprehensive grant may be approved.

It is reasonable to keep the grant ceiling for comprehensive projects at $1.4 million. Since the State began administering the program in 1983, there have been many multi-year comprehensive grant awards in amounts ranging from $1,131,699 to $1,400,000. Reducing the comprehensive grant ceiling to less than $1.4 million may compromise DEED's ability to help recipients alleviate community development problems in a truly comprehensive manner. In addition, although construction costs have been rising relatively slowly in recent years, there is little doubt that costs will continue to rise. Consequently, reducing the total comprehensive grant award ceiling to less than $1.4 million this year would probably necessitate a rule change in the near future to raise grant ceilings in order to keep pace with community development needs and escalating construction costs. Finally, Minn. Rule pt. 4300.2000, subp. 5, states "The office may recommend an application for funding in an amount less than requested if, in the opinion of the office, the amount requested is more than is necessary to meet the applicant's need. If the amount of the grant is reduced, the reasons for the reduction shall be given to the applicant." This section means DEED sets grant awards based on the needs and merits of specific applications, not simply on the amounts requested. As a result, the grant ceilings represent a maximum threshold. In fact, eleven of the nineteen DEED comprehensive projects funded in FY'86 were funded in amounts which were less than originally requested. Grant applicants cannot and should not apply for a comprehensive grant with the expectation of automatically receiving $1.4 million.

Thus, in summary, it is reasonable to keep the comprehensive grant ceiling at $1.4 million because many local governments will need that amount (or nearly that amount), and if they don't, DEED has the authority to reduce grant awards.

4300.3100, Subpart 3, Use of Program Income

> Subp. 3. Use of Program Income. Income from sources such as reimbursements to and interest from a grant recipient's loan program, proceeds from disposition of real property, and proceeds from special assessments must be used for ~~project-related costs within 12 months from the time it is earned.~~ eligible activities. The office shall reduce future grant payments by the amount of any unobligated income which an applicant has and shall take whatever additional action is necessary to recover any remaining amounts owed.

An amendment to this subpart is necessary for three reasons. First, grant management experience has taught DEED staff that it is not always feasible to use income, "within 12 months from the time it is earned." Grant recipients are allowed to design and establish loan programs which will reflect local needs and conditions. Many local loan programs, particularly in the early stages of projects, generate very small amounts of income. This condition exists because, in order to be grant eligible, the loan programs must be targeted to individuals and businesses who have a limited ability to repay. Frequently, within a given 12-month period, revolving loan accounts do not have sufficient cash to finance another loan. If that is the case, our rules force a recipient to move the funds out of their loan program and spend it on other "project-related costs." Moving money out of the revolving loan accounts defeats the purpose of establishing revolving loan programs in the first place. Moreover, there may not be any other "project-related costs" to consume program income. If that is the case, given the segment of subpart 3 which states, "The office shall reduce future grant payments by the amount of any unobligated program income that an applicant has...", grant recipients may conceivably be required to remove money from their revolving loan program and return it to the State. Again, that action tends to defeat the purpose of establishing revolving loan funds.

Secondly, a requirement of the grant recipient to use program income within twelve months from the time it is earned, implies that the State must monitor the grant recipients performance, vis-a-vis the requirement. In many instances, program income may be generated just prior to project closure. Minn. Rule pt. subp. 3, as written, requires DEED to monitor grant recipients' disposition of program income after projects are closed. Obviously, the purpose of grant closeout is to establish a date when DEED oversight of projects ends. This subpart currently does not acknowledge that distinction and, thus, should be amended as proposed.

The third reason for amending Minn. Rule pt. 4300.3100, subp. 3, relates to the statement that, "Program income from sources such as reimbursements to and interest from a grant recipient's loan program, proceeds from disposition of real property, and proceeds from special assessments must be used for project-related costs..." Specifically, the phrase, "project-related costs" needs to be amended to read, "eligible activities." Again, one reason to make this revision relates to activity completion and project closure. At the closure of a grant, a grant recipient may have program income available for use. Yet, by definition, grant closure means all "project-related costs" have been incurred. Thus, there are no more "project-related costs." A strict interpretation of the rule using the above related scenario would require the grant recipient to return the income to the State. The intent of subpart 3 was to allow grant recipients to use program income, if they could. Subpart 3, as written, unnecessarily restricts their ability to do so.

It is reasonable to substitute "eligible activities" for "project-related costs" because DEED has the authority for determining which program income may be retained by the

grantee and which program income must be returned to the State. For instance, revolving loan programs must be described in a grant application. DEED's grant agreements include the grant application by reference. Therefore, income generated by the revolving loan program must be used in the manner described in the application; i.e., an eligible activity. Use of "proceeds from the disposition of real property and proceeds form special assessments" may or may not be described in the application. If they are described, to remain an eligible activity, the grant recipient must use the income as described. If they are not described in the application, the grant recipient must request an amendment to the project (Minn. Rule pt. 4300.3100, subp. 7) and describe their proposed method for use of program income. The determination of eligibility rests with the State. If the request is for an eligible activity, the grant recipient may use the income upon approval of the amendment. If the request is not eligible, DEED can recover the income pursuant to Minn. Rule pt. 4300.3100, subp. 3.

4300.3200, Subpart 2, Audits

> Subp. 2. Audits. Grant recipients must arrange for and pay for an acceptable independent audit ~~before grant closeout.~~ prepared in compliance with OMB Circular A-128, which was published in the Federal Register, Volume 50, number 188, page 39083, on September 27, 1985, and the Single Audit Act of 1984, Public Law No. 98-502, Codified as 31 U.S.C. §§ 7501-7507. ~~Audits will usually be done annually, but no less frequently than every two years. In the case of two and three year comprehensive programs, the office shall require an audit after two years;~~ Costs incurred pursuant to this requirement are eligible under this program.

The need to amend this subpart relates to the passage of the Single Audit Act and the implementation of OMB Circular A-128. Minn. Rule pt. 4300.3200, subp. 2, briefly describes the audit requirements of OMB Circular A-102, Attachment P. The Single Audit Act of 1984 and, particularly, OMB Circular A-128 (Attached as Appendix B) "supersedes Attachment P, audit requirements of OMB Circular A-102." Thus, subpart 2 is currently obsolete, in violation of federal audit requirements, and must be updated. It is reasonable to correct program rules to conform with changes in the federal law that governs grant recipient audit requirements. The proposed language properly updates Minn. Rule pt. 4300.3200, subp. 2.

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