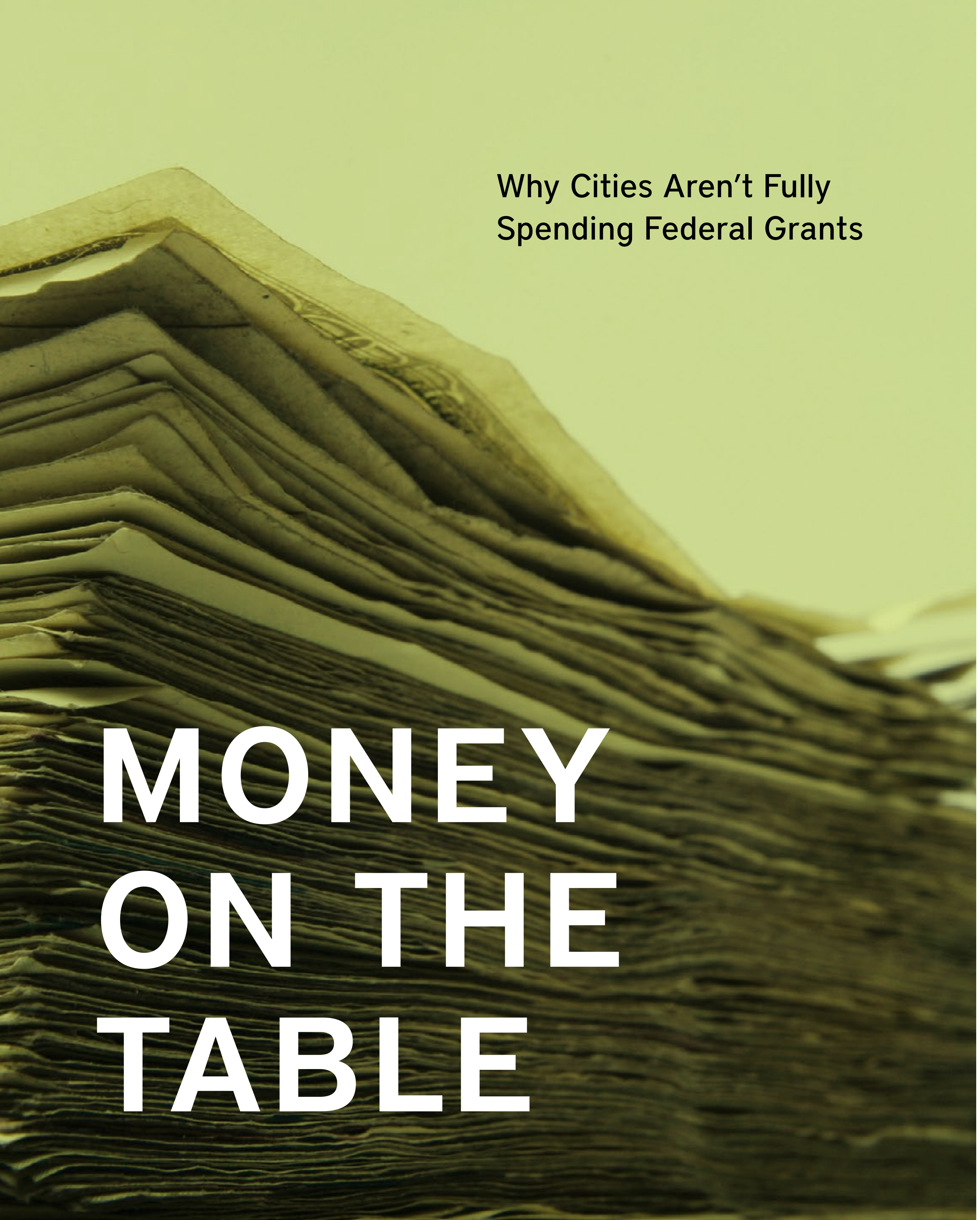


MONEY ON THE TABLE

Why Cities Aren’t Fully Spending Federal Grants

By Loren Berlin

EVERY YEAR, U.S. STATE AND LOCAL GOVERNMENTS ARE LEAVING HUNDREDS OF MILLIONS OF FEDERAL GRANT DOLLARS ON THE TABLE. The national government allocates these funds to states and municipalities, frequently on a competitive basis, to help pay for many of a community’s most basic and critical local services, including education, transportation, and public safety. In fiscal year 2015 alone, the U.S. Government Accountability Office (GAO) identified roughly $994 million in undisbursed funds—money that had been allocated but not yet drawn down by recipients—in expired grant accounts in the Payment Management System, the nation’s largest platform for dispensing federal grant monies, responsible for making about 77 percent of all federal civilian grant payments. More than half of the accounts were at least one to three years past their expiration date (U.S. GAO 2016).

This trend would be perplexing in the best of circumstances, but it’s confounding in the current environment, when so many U.S. communities are struggling economically. More than 50 municipalities have filed for bankruptcy since 2010. Chicago Public Schools are in such tight financial straits that Moody’s Investors Services recently downgraded the district’s debt to B3, which is “six notches below investment grade,” said Moody’s Vice President Rachel Cortez in an interview with *Marketplace* (Scott 2016). In Petersburg, Virginia, a community of 32,000 located fewer than 30 miles from Richmond, the city is so far behind on its debt payments that fire and rescue equipment has been repossessed, lenders have stopped making loans to the city, and officials have approved measures to both cut public services and raise taxes.

These dollars are a critical funding stream for state and local governments. Absent federal grant funds, states and localities may have to withhold essential goods and services, secure loans, or cover costs by increasing taxes and fees for their residents, thus diminishing the pool of available local dollars to pay for a community’s critical needs.

In fiscal year 2015 alone, the U.S. Government Accountability Office identified roughly $994 million in undisbursed funds—money that had been allocated but not yet drawn down by recipients—in expired grant accounts in the Payment Management System.

“Counties and cities are limited by state mandates in how they can raise revenue. While they can collect property taxes and potentially income or sales taxes, it’s not a free-for-all where they can do whatever they want to get the money they need,” says Jenna DeAngelo, a program manager at the Lincoln Institute of Land Policy. “Federal funds are essential to help fill in that funding gap, to pay for the services that make up the fabric of a community, such as bridges, teachers’ salaries, fire departments, pothole repairs. The list goes on and on.”

Intergovernmental Grants

In 2016, the U.S. government allocated approximately $666 billion in federal grants to support state and local programs. Funded with federal tax dollars, these intergovernmental grants are designed to promote economic efficiency, redistribute resources, stabilize the economy, and foster innovation. There are grants to incentivize local governments to invest in infrastructure and other goods and services that benefit residents beyond their jurisdiction, grants to assist in the adoption of federal policy priorities, and grants to pilot initiatives that would be difficult to test in a single national program. In other words, the federal government uses the money to assist states and localities to build strong, vibrant communities that can attract and retain residents and, in turn, establish their own thriving local tax bases.

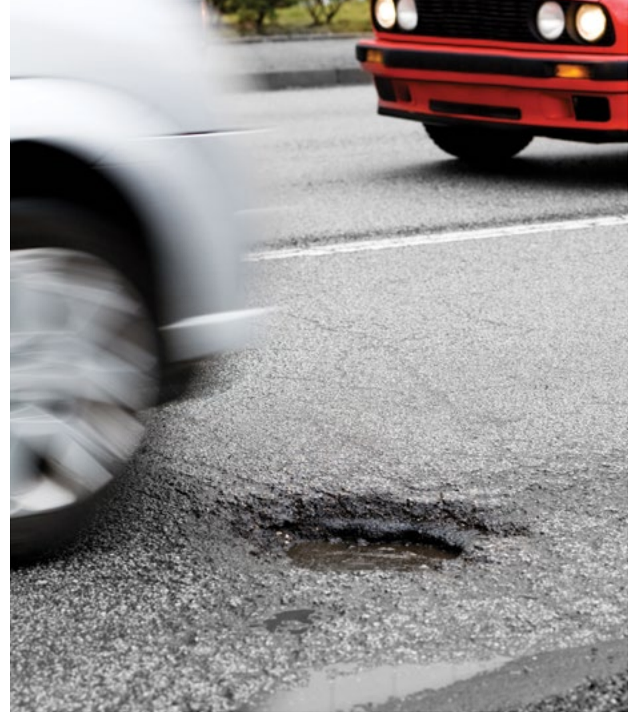
Navigating the landscape of federal grants can be complicated. There are more than 1,700 intergovernmental grant programs and two primary types of grants.

Categorical grants constitute the bulk of federal grants and can be used only for a specific purpose. Some are distributed on a formula basis, such as the Federal Transportation Administration's Urbanized Areas Formula Grant, which provides funding to urban communities for transportation-related planning activities based on population density. Others are distributed through a competitive application process, such as the Department of Transportation's Transportation Investment Generating Economic Recovery Program (TIGER), a $5 billion initiative that funds transportation projects most likely to produce significant economic and environmental benefits to a metropolitan area, a region, or the nation.

The other primary type of grant is block grants, which are pegged to broadly defined functions such as community development or social services, and afford state and local recipients more flexibility in how to use the funds to meet the program goals. An example of a prominent block grant is the Department of Housing and Urban Development's Community Development Block Grant (CDBG), which supports affordable housing, job creation, and the provision of services to vulnerable populations. As of 2014, the federal government has awarded $144 billion in CDBG funds to cities, counties, and states.

"Federal funds are essential to help pay for services that make up the fabric of a community, such as bridges, teachers' salaries, fire departments, pothole repairs."

Dozens of federal departments and independent agencies administer the grants, but the largest is the Department of Health and Human Services (HHS), which is responsible for 22 percent of the grants and hosts the Payment Management System (PMS), which is used primarily by HHS but also by the departments of Labor, Agriculture, Homeland Security, and the Treasury, among others. There's no centralized system across agencies and programs for



Federal grants help cities pay to fix potholes and other street damage in U.S. municipalities. Credit: Justin Sullivan/ Getty Images

reporting and tracking grant allocations against outlays, so it's virtually impossible to know precisely what percentage of intergovernmental transfers remain unspent in a given year. The GAO and other researchers can illuminate only disparate pieces of the puzzle.

What happens to unused funds is also unclear, as it depends on the parameters of the grant program. "Unlike federal contracts, federal grants aren't governed by a single set of rules when it comes to the question of 'clawbacks,'" explains Robert Cramer, managing associate general counsel at the GAO, referring to the recovery of funds that have already been disbursed. "The terms vary depending on how the grant is structured. One grant may allow for provisions that another does not. What is ultimately done with the funds that are not spent by a grantee and recovered by an agency can vary as well." In some instances, money must be returned to the Department of the Treasury, which maintains a database of allowable uses for spending it. In other cases, it can be redeployed by the original grant-making agency. Some funds can remain unused for decades if they were allocated without an expiration date.

Many government officials are reluctant to publicly disclose challenges they face in using their federal grants, which muddies the picture further. "No one wants to appear incompetent," explains George W. McCarthy, president and chief executive officer of the Lincoln Institute.

According to McCarthy, a city's failure to spend federal dollars can result in an increase in local taxes. Local governments commonly use the property tax as a "residual" source of revenue, meaning once they have collected all other revenues, including federal grant funds, they set their property tax rates to make up the difference between what they've collected and the total revenues needed. Thus, any revenue source that is not collected and deployed additionally burdens property tax payers. "If beleaguered taxpayers hear that their local government isn't using all of its available funding and conclude that they're making it up by increasing property tax rates, they are likely to get very angry and express it in the polls," says McCarthy. "It also translates to decisions by local governments to defer maintenance of infrastructure, rather than raising property taxes, which will eventually translate to lower property values or much higher property tax burden when the inevitable crisis occurs in the form of some sort of infrastructure failure."

But bureaucratic dysfunction or even corruption are inadequate explanations for the preponderance of unused federal funds, says Erika Poethig, director of urban policy initiatives at the Urban Institute and a leading architect of President Obama's Strong Cities and Strong Communities initiative, which seeks to help struggling localities to better utilize their resources, including federal grants. "There is an array of reasons, good and bad, why a state or local government leaves federal money on the table. And sure, there's no question that there are other issues that come with bureaucracy. But generally these are well-meaning people trying to do the right thing with programs that may not necessarily be attentive to community differences. Fundamentally, the primary driver is that federal policies are not necessarily as adaptable to the full range of cities and their status on a continuum from healthy to recovering to deeply distressed."

Program Design and Management

In order to deploy intergovernmental funds effectively, both the grant-making agencies and the grant recipients have to do their part. The federal government needs to design programs that grantees can use on the ground. State and local governments need to comply with the grant requirements. All parties need to diligently track and manage the funds. While the vast majority of federal grant dollars are successfully deployed, there nonetheless are instances when this all proves easier said than done.

FLAWED PROGRAM DESIGN

For starters, it's complex to create a grant program that works well. In February 2010, President Obama established the Hardest Hit Fund (HHF), a $7.6 billion initiative to fund foreclosure prevention programs in 18 states and the District of Columbia by providing assistance to struggling homeowners. Designed to leverage the expertise of state and local partners, the HHF aimed to support solutions that were tailored to a community's specific situation. As a result, it relied on a massive network of state and local partners to administer the program, which not only decentralized operations but also created tremendous red tape. The HHF and participating partners had to execute the program in a complicated framework of a half-dozen federal, state, and local laws, some of which varied by state or community. The U.S. Treasury was also responsible for negotiating individual agreements with each housing authority that was a partner in the program. Against this backdrop, the HHF was slow to gain momentum. Nearly two years after its creation, only three percent of the available funds—$217.4 million—had been used, despite good intentions and obvious need.

The HHF's early failure is not a secret. "At various junctures of the program, the Office of the Special Inspector General found that there were no centralized goals or targets for measuring the HHF program's effectiveness. Various reports noted that this lack of metrics resulted, in part, due to fears of impacting the 'dynamic nature' of the program. Instead, it led to a lack of accountability, effectiveness, and underutilization of the grant funds," says Lourdes Germán, director of International and Institute-Wide Initiatives at the Lincoln Institute. In an unusual move, the Department of the Treasury implemented changes to course correct, including introducing blight remediation as an allowable program activity. Since then, the HHF has become a primary source of federal funds for blight remediation and has proven so effective that in 2016 an additional $2 billion was allocated to participating HFF states.

"The story of the HHF illustrates the crux of the problem," says McCarthy. "To the extent that unused grants are an artifact of defects in program design, there are few ways to bring these defects to light and address them because there is no forum for it. That's what is so unusual about the HHF. Extremely slow deployment of funds opened an opportunity for communities to relate to the Treasury why it was so hard to use money that was not fit for purpose. The Treasury used its regulatory discretion to make the program more useful and usable to the communities. But improving program design through regulatory discretion is rare. Instead, what usually happens is that programs remain as conceived whether or not they are effectively designed. The onus for program success rests with communities, and they are rarely asked whether the programs work for them."

POORLY MANAGED CLOSEOUTS

Yet it's not enough to design an effective program. It must also be managed correctly throughout the four-step life cycle followed by most federal grants: the pre-award stage, when the program is announced and applications are received and reviewed; the award stage, when parties agree on the terms of the grant, including the length of time the recipient has to deploy the funds; the implementation phase, when the recipient spends the money; and the closeout stage, when final reports are received and evaluated once funds have been deployed and/or the grant's end date has arrived. The "closeout" procedures are designed to ensure that the grantee has satisfied all financial requirements, submitted all required reports, and returned any unused money to the agency.

These closeout procedures are critical to maximizing available grant dollars, as this is the agency's opportunity to redirect unspent funds toward other projects or new grants, or to return the money to the Treasury, depending on the unique terms of the individual grant program. Failure to close out a grant in a timely manner can create opportunities for waste, fraud, or mismanagement by allowing grantees to continue drawing down the funds past the grant's end date or by leaving unspent funds idling in accounts and accruing administrative fees.

Nevertheless, grant making agencies sometimes fail to close out grants as soon as they should, jeopardizing hundreds of millions of dollars. In September 2011, the GAO reported $794.4 million in unspent grant funds from almost 400 different programs in PMS—approximately 3.3 percent of the total funds made available for these grants—and an additional $126 million in a second payments system. According to the GAO, this represents an improvement from fiscal year 2006, when the GAO last gathered comparable data. The unspent balances are more than $200 million less than the nearly $1 billion found in PMS in 2006, even as grant disbursements through PMS increased by roughly 23 percent, from $320 billion in 2006 to $415 billion in 2011 (U.S. GAO 2012). However, when the 2011 data is broken down by the individual agencies or by agencies' specific programs, the total amount of unused money can represent anywhere from 2.7 percent to a whopping 34.8 percent of the agency's or program's grant funding for the period.

At a variety of agencies, obstacles to correctly closing out grants include inadequate systems and policies for reconciling accounts, low prioritization of grant management processes, and unnecessary delays in making available the unused funds, according to independent reports by the GAO as well as the Inspectors General at the departments of Agriculture, Education, Energy, Health and Human Services, Homeland Security, and Labor.

In 2015, the U.S. Department of Transportation announced that more than 61,000 bridges are structurally deficient and need significant repair—work that is partially funded by federal grants (U.S. DOT 2014). Credit: Spencer Platt/Getty Images

LOCAL LACK OF CAPACITY

But the federal government is not solely responsible for ensuring federal grant dollars are used. The states and localities receiving the funds play an equally large role in determining outcomes. While there's a tendency to assume that only localities in fiscal distress fail to use the entirety of their grant allocation, this is not the case, says McCarthy. "You would be surprised by some of the cities that leave federal funds on the table. It's easy to think it's mostly an issue with distressed cities because they may have had to lay off staff or may lack other resources necessary to effectively administer the grants. But actually we've had numerous conversations with officials not only in distressed cities but also in thriving ones who report challenges in using their federal grant monies. The estimates we've received are that anywhere from 9 to 20 percent of allocated grant money goes unspent in any given year."

There are many reasons a locality may or may not succeed in spending federal grant money. A community may voluntarily forgo funds due to a philosophical disagreement with the policy priority that underlies the grant program. In response to President Donald J. Trump's assertion that he will withhold federal funds to so-called "sanctuary cities" (communities that choose not to prosecute undocumented immigrants solely for violating federal immigration laws), numerous cities and states have declared that they will risk losing the money rather than revise their policies—including New York City, which could lose nearly $10.4 billion, and Santa Fe, which stands to lose $6 million, roughly 2 percent of its annual budget.

Or a community may end up leaving money on the table due to changing circumstances, says McCarthy. "Sometimes the way the locality intended to use the money has changed. They received money for a project they are no longer undertaking, for example. Or the locality's financial position has changed. In such instances, it is perfectly legitimate not to spend the money."

Other times, the forfeiture of funds is unintentional, frequently due to errors related to the use or management of the monies. To successfully use a federal grant, the community must not only deploy the funds in accordance with the program guidelines but also provide consistent, accurate, and timely reports on how the money is being used. Failure to do so can result in an "audit finding," the term used to describe significant issues identified during an audit. Grant dollars affiliated with an audit finding are at risk of being clawed back by the federal government. To help avoid these sorts of mistakes, communities must invest in reliable reporting systems and staff with specialized grants management skills.

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Localities grappling with financial challenges frequently lack at least some of these resources. In the face of shrinking budgets and accumulating debts, they may be forced to reduce staff, which can significantly diminish their grants management capacity. This was the case in Detroit, which became the nation's largest municipal bankruptcy when it filed in 2013. In the years leading up to the bankruptcy, Detroit's ability to access and utilize federal grant funds plummeted. Between 2008 and 2013, the city's federal award spending dropped by more than 30 percent, even as the nation's federal grant spending increased by almost 20 percent over the same period. During roughly this same time, the city lost 34 percent of its full-time employees—about 4,500 people—including a third of its planning and development department staff, which administered the roughly $265 million in the Department of Housing and Urban Development's (HUD) CDBG and HOME Investment Partnerships Program grants received by the city during the period.

The staff reductions meant a loss of not only employees but also of critical knowledge, compounded by a lack of documented policies and procedures, says John Hill, the chief financial officer for the City of Detroit. "At the time, Detroit didn't have a good system for reporting and tracking grants," says Hill, who first began working in Detroit in September 2013 as part of a team tasked with assisting the city to clean up its grants management. "Had the city implemented a tracking and reporting compliance group, it could have helped guard against leaving grant money on the table and failing to close out old projects, for example. As it was in the past, when someone left, all that institutional knowledge left with her, because there were no documented policies and procedures that would allow us to transition the grants management duties to another staff member."

Information technology (IT) systems also play a critical role in preserving this kind of institutional knowledge and in successfully tracking and reporting grant funds. In the years preceding the bankruptcy filing, senior officials in Detroit "did not know the total amount of grant funds Detroit received from the federal government, because their various IT systems did not communicate with one another. . . . Grant account information appeared in numerous makeshift spreadsheets that did not necessarily match the city's central accounting system. And Detroit's general ledger did not update automatically with grant payroll or budgeting data . . . [making] it impossible for Detroit to capture reliable financial information," according to a 2015 GAO report on the impact of fiscal challenges on grants management in Detroit and Flint, Michigan; Camden, New Jersey; and Stockton, California (U.S. GAO 2015). The city failed to complete basic accounting practices, resulting in inconsistent records and funds that were at risk of expiring. These and other IT deficiencies led to audit findings that required Detroit to compensate for the errors with money from its already-strained general funds.

A basic lack of capital can compound these problems, limiting a municipality's ability to apply for federal grants, creating a negative feedback loop in which communities most in need of the funds can't access them. Officials in the city of Flint postponed for three years their application to the Department of Transportation for a competitive Transportation Investment Generating Economic Recovery (TIGER) grant, which is evaluated in part by the amount of nonfederal money the municipality can invest in the proposed transportation project, because they were doubtful they could provide the local funds in the near term. They also declined to apply for some federal grants that included "maintenance of effort" provisions, which would have required the city to maintain local investments in the project at a designated amount for a specific number of years, over concerns they may not be able to satisfy the requirement.

Detroit: Hard Times Demanded Solutions

Once the poster child for ineffective grants management, Detroit is now the model for other communities. When Hill and his team began their work in Detroit in the fall of 2013, every federal grant dollar the city received that year—more than $200 million—was potentially at risk of being clawed back due to a lack of effective grants management controls and procedures. Fast forward three years to today, and only $214,000 of funds are at risk at the end of the City's fiscal year 2015. Hill is quick to add that he thinks his team will be able to take the necessary steps to resolve the outstanding audit findings, reducing the total funds at risk to zero.

"When we first arrived, the controls were so lax that any grant we were dealing with had the potential for problems, and we would risk having to give grant funding back. Now there's less risk because we have better controls and a better understanding of the grants management process. We have fewer questioned costs and steps we can take when there is a questioned cost to gather the documentation so that we can resolve it," explains Hill.

To make fuller use of its grant monies, Detroit invested in a modern, centralized IT system, a centralized Office of Grants Management (OGM), and a chief development officer who coordinates efforts with staff across all city departments. Credit: ManaVonLamac

Once the poster child for ineffective grants management, Detroit is now the model for other communities.

According to Hill, rebuilding the city's approach to grants management was very similar to developing a corporation's 'go to market' strategy. "You want to go to market or, in this case, ask for funding in a way that shows that the entire organization, including the mayor, supports the project at all levels. When I first got here, it was clear that our 'go to market' strategy, so to speak, was not at all cohesive. It was very disjointed. There were instances when we were competing with ourselves for grants because various divisions were applying for the same funds."

To better coordinate Detroit's approach to identifying and using grant monies, Hill invested in a modern, centralized IT system. He also created a centralized office of grants management (OGM). Whereas individual departments such as health and human services, workforce development, and public safety had previously relied on their departmental staff to identify, secure, and manage grants, all grant-related activities would now be the responsibility of, or done in coordination with, the centralized OGM. In this way, Detroit began to build subject matter expertise in grants management among OGM staff, who could then partner with program staff as needed throughout the grant life cycle.

Hill and his team also created a new position—chief development officer—to coordinate efforts with staff across all city departments, including the director of the centralized OGM and the office of the mayor, to help contextualize the work within the city's larger financial position. Integrating grant activities into the city's broader financial infrastructure has been critical to its success, says Hill. "There's a connection among grants, budgeting, procurement, et cetera. If you just implement a grants management office and still have an ineffective back of the house, you might get a couple of wins; but in terms of planning, procurement, budgeting—the strategic things that need to happen to support the mayor's agenda—you'd still have big holes."

As an example, he offers how the city handles the issue of securing local funds to match grant dollars, as required under certain grant programs. "In the past, we would receive a grant and have no knowledge of where the funds would come from to match it. Eighty percent of the money to fund a project would go away, because we couldn't identify the funds to contribute our 20 percent. Now, before we even apply for a grant, we identify where the matching funds would come from as part of our planning process and set those funds aside."

If Detroit is the model for a successful reboot, that may be due in part to the city's unusual access to financial resources. While Detroit is infamous as the country's largest municipal bankruptcy, it is also beloved as the birthplace and epicenter of the nation's automobile industry and a major driving force behind the country's postwar economic boom. Mindful of—and grateful for—the city's place in history, private and public organizations have poured approximately $331 million into Detroit in the wake of the bankruptcy filing to assist in its recovery.

CONTINUED ON P 36

Money on the Table
CONTINUED FROM P 25

"In addition to restructuring grants management, we restructured the entire financial management organization. We identified the skills and competencies we needed and hired qualified new or existing people into new jobs. We now have more people in grants and financial management positions, and they possess the skills and competencies to do the jobs and are compensated accordingly. Having the authority to completely restructure an operation from top to bottom is a luxury I don't take for granted, and I know other cities might benefit from a similar approach," admits Hill.

Municipalities with less money have to address grant management challenges in less expensive ways. Many turn to partnerships with state and local organizations in an effort to streamline the process and offload some of the responsibility. For example, Flint, in Genesee County, looks to the Genesee County Land Bank to manage the demolition of blighted structures with state and federal funding. "It's a huge load off of the city," explains Christina Kelly, the land bank's director of planning and neighborhood revitalization. "In the past, the city had to do its own demolition, which is a major undertaking when state and federal grants are involved. They had their own demolition department and their own demolition crews. Now we manage the state and federal demolition grants and the demolition process instead." The land bank is also managing more than $6 million in federal grant funds tied to the redevelopment of a former General Motors manufacturing site in downtown Flint that is being cleaned up and converted into green space. "The city is still at the table," says Kelly. "We are following their master plan, and they give input into the decision making process. But the day-to-day grants management is off their shoulders, as is project management."

The federal government is also working to help grant recipients to more fully utilize the funds. In 2011, President Obama announced Strong Cities, Strong Communities (SC2), an interagency initiative to increase the capacity of local governments "to develop and execute their economic visions and strategies" by providing technical assistance across a wide range of areas, including grants management. "The idea behind SC2 is for the federal government to identify ways to have a more flexible relationship with local governments—one that is responsible and accountable but acknowledges that different communities may need different things," says Poethig. "For example, maybe the community has received a grant but doesn't quite have the full matching funds yet that the grant requires. We can look at that and ask if perhaps there are ways we can be flexible so that they can still use the grant money as they assemble the matching funds."

Additionally, some federal agencies are reviewing and revising their procedures to reduce the amount of funds that remain unspent. But efforts appear piecemeal. Individual entities—including the departments of Commerce, Justice, and Health and Human Services, along with the National Aeronautical and Space Administration (NASA) and the National Science Foundation (NSF)—have implemented policies to "elevate the issue of timely grant closeout internally," according to a 2016 report by the GAO. However, there's currently no movement toward introducing a single set of tracking, reporting, and closeout procedures that could be applied across all federal grants and granting agencies to streamline and standardize these critical activities.

More remains to be done, says McCarthy, who is especially interested in the question of program design. "If the federal government persists in concluding that the failure to use allocated funding is a local pathology, nothing will ever be done to address systemic defects built into the programs or policies," he says. "It's like a dysfunctional family. How do the problems get fixed if the parents claim that the dysfunction resides with the children, who are often the victims of the dysfunction? Someone else needs to intervene to get the parents to see their role in creating the dysfunction. Organizations like the Lincoln Institute can play the intervening role if they are able to use their access to policy makers and their convening power to create the forum for helpful discussion."

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