

THE ROLE OF NEED-BASED  
ALLOCATION FORMULAS IN  
COMPETITIVE GRANT PROCESSES:  
THE PROJECT SELECTION SYSTEM

By

ERNEST CAMERON HUFF

B.A., University of Texas at Austin  
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Department of Urban Studies and Planning  
June 18, 1981

Certified by \_\_\_\_\_

Joseph Ferreira  
Thesis Supervisor

Accepted by \_\_\_\_\_

Langley C. Keyes  
Chairman, Departmental Graduate Committee

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Submitted to the Department of Urban Studies and Planning  
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ABSTRACT

This thesis describes the evolution of the Small Cities Community Development Block Grant Program and its competitive system for selecting grantees, and then develops a framework for interpreting that evolution. The framework for analysis considers the limitations of linear weighted allocation formulas, ambiguity in program design, organizational requirements, and the role of competition in the allocation of funds.

The following trends are noted: 1) a shift away from allocation formulas based on need toward selection formulas based on program impact and quality; 2) accretion of new program and organizational goals by means of additional formula factors, with consequent "formula drift" away from the block grant concept; 3) shifting of formula design to the center, and constraint of HUD area office discretion in order to reduce unexpected outcomes and to legitimize discretionary selection of grantees; 4) a continuing process of HUD adjustment of the formal allocation process in response to the limitations of linear weighted allocation formula; and 5) responses to those adjustments based on polarities or tensions in goals, that is, program participants attempting simultaneously to pursue conflicting goals.

The thesis concludes that the Small Cities Program formal allocation process has evolved predictably and that HUD has responded to unexpected results of that process in a way that has increased its acceptability. However, while the outcomes of the Small Cities Program allocation process are progressively more predictable and acceptable, this evolution does not imply convergence toward an "optimal" allocation system. Finally, the Small Cities CDBG Program's competitive selection system is incompatible with the block grant formula allocation approach.

Thesis Supervisor: Dr. Joseph Ferreira, Jr.

Title: Associate Professor of Urban Studies and Planning

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My special thanks go to Kenneth Bleakley of Urban Systems Research and Engineering, Inc. of Cambridge, Massachusetts for the opportunity to work on the national evaluation of the Small Cities CDBG program, for his permission to draw on the preliminary results of that evaluation, and for his thoughtful comments on an earlier draft.

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CHAPTER I

INTRODUCTION

## INTRODUCTION

This thesis will examine the need-based Project Selection System (PSS) used to allocate community development aid to the nation's smaller communities and rural areas by the Small Cities Community Development Block Grant Program of the U.S. Department of Housing and Urban Development (HUD). Since the Small Cities Program's inception in 1975, HUD has made numerous adjustments to that formula allocation system.<sup>1</sup> This thesis provides a policy analysis of those adjustments. I will focus particularly on the cycle of problem diagnosis and system adjustment by the central office of the program. In doing the analysis I will consider the pursuit of multiple objectives by participants in the system, the requirements placed on the system by the block grant approach, and other demands, both internal and external, on the administering agency of this discretionary grant program. Using these elements as a framework of analysis, I will interpret HUD's adjustments to the program's discretionary allocation system, and then draw tentative conclusions about the effectiveness of these adjustments in managing the dilemmas that a competitive block grant program presents to participants in its allocation system and the extent to which such adjustment patterns are to be expected of other block grant programs using formula allocation strategies.

Why Examine Block Grant Programs?

In 1974, Congress created the Community Development Block Grant Program to replace eight categorical grant and loan programs under which

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<sup>1</sup>Prior to 1978, the program was called the general purpose discretionary grants portion of the Community Development Block Grant Program.

communities applied for funds case-by-case for project categories.<sup>2</sup> In the new program all of these are replaced by a system of block grants. As in the past, communities must apply for federal funds. For larger communities, the amount for which they are eligible, to which they are "entitled", is determined by a formula based on measures of community need. Smaller communities must compete for funds through an application process that considers community need and capacity, past performance and merit of the projects proposed. The use of need-based allocation formulas to distribute urban aid grants for physical improvements and housing development reflects a growing trend towards distributing federal aid through a block grant approach.

The analysis of block grant allocation systems is important for a number of different reasons. These programs comprise a large and increasing portion of federal aid activities both in numbers of programs and in dollars. Legislators and public administrators have increasingly relied on need-based allocation formulas to divide up limited aid dollars among competing purposes and interest groups. For 1978, the Congressional Research Service identified 107 programs that used formulas including population as a factor to allocate federal funds.<sup>3</sup>

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<sup>2</sup>Title I of the Housing and Community Development Act of 1974 (P.L. 93-383) replaced the Model Cities Program, urban renewal, water and sewer grants, grants for open-space, urban beautification, historic preservation, neighborhood facilities, and loans for housing rehabilitation.

<sup>3</sup>Subcommittee on Post Office and Civil Service, U.S. House of Representatives, "The Use of Population Data in Federal Assistance Programs", Committee Print, December 1978, cited in John Goodman, Jr., Federal Funding Formulas Population Redistribution During the 1970's and the 1980 Census, Washington D.C.: The Urban Institute: April 1980.



Some of these programs are large: General Revenue Sharing \$6.9 billion (estimated Fiscal Year 1980 expenditures), Social Services \$5.5 billion, Comprehensive Employment and Training (CETA) \$6.8 billion, Federal/State Highway Construction and Maintenance \$7.6 billion, Elementary, Secondary and Vocational Education \$7.3 billion.<sup>4</sup>

Block grant formulas are used more and more to achieve the goal of decentralization of government decision making. The Housing and Community Development Act of 1974 received its initial impetus in the decentralizing proposals of special revenue sharing by the Nixon administration.<sup>5</sup>

These block grant programs have become the focal point of the political debate on the proper way for the federal government to aid the economic and local development of the nation's states and communities. While the debate about formula allocation of grants has cut across all areas of federal aid, grants-in-aid to cities have been the object of particular controversy and continual Congressional and administrative program revision. These aid programs have become a major source of funds for public participation in the community development process. And the political debate absorbs major outlays of time and resources of legislators, program administrators and designers, and public and private evaluators of the programs.

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<sup>4</sup>The Budget of the United States Government, Fiscal Year 1981 in Goodman: April 1980.

<sup>5</sup>U.S. House of Representatives. Committee on Banking, Finance and Urban Affairs. Community Development Block Grant Program: Staff Report of the Subcommittee on Housing and Community Development. Washington, D.C.: U.S. Government Printing Office, 1977.

### Why Are Block Grant Programs Problematic?

Implementation of public programs is always a difficult task.<sup>6</sup> Yet block grant programs present special difficulties: they almost inevitably require a convenient allocation formula that focuses attention on conflicts and inconsistencies in the allocation process.

Several problematic features distinguish block grant allocations systems such as the Small Cities Program. First, the legislative mandate to the agency is complex and, when considered as a whole, vague. Not only are the program goals complex, but many take the form of constraints on agency discretion in the interest of increasing recipient's control of program aid. Since the program shifts to grantees major portions of the responsibility for the design and management of local activities funded by the program, the agency must rely on the administrative capacity and good political judgment of program grantees.

Additionally, the use of a need-based formula approach introduces new rigidities in implementation, rigidities that produce unintended errors in the distribution of aid. Also, the formula allocation process must operate in a dynamic system with changing goals, an evolving understanding of needs, and with a universe of eligible communities whose characteristics constantly shift. While all public programs operate in the context of such a system, the block grant approach particularly reduces the agency's ability to adjust to changes in its program environment.

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<sup>6</sup>For a revealing analysis of the travails of implementation in one federal program, see Jeffrey L. Pressman and Aaron Wildavsky, Implementation. Berkeley: University of California Press, 1973.

For policy makers and administrative staff in the agency, the implementation of a block grant allocation system is fundamentally an exploratory process, with imperfect knowledge of goals, uncertain means to achieve the goals, and a constantly shifting terrain. Nevertheless, the arguments used to justify specific formula choices never address this collection of issues, but look only to illusive need measures.

Legislators, public administrators, mayors, governors and citizens groups all want to select the best way to allocate federal aid dollars. In the debate over that choice, policy makers seek to discover a proper balance between legitimate need and administrative efficiency, between theoretical merit and political feasibility, between local priorities and national objectives. Formula block grants provide an increasingly popular technique to attempt to reduce the complexity of finding that proper balance.

However, in providing federal aid to local communities by means of need-based formula allocation systems, agency policy makers and staff confront an infinite series of trade-offs (choices among conflicting set of program benefits) and of dilemmas (choices among set of program costs both unattractive and unavoidable). When the agency acts to resolve one problem, they create new ones. As priorities and conditions change in a complex system, yesterday's solution to the program allocation problem no longer satisfies. For both the agency central office planner and branch office administrator, identifying the sources of dissatisfaction with program outcomes and predicting participant response to adjustments in the allocation system become critical; "making things better" means quicker, more reliable, more informed reactions to the most recently perceived problem in the allocation process.

During the last seven years of federal experience with the use of formula allocation systems to distribute block grant aid to urban and rural communities, identifying misspecification of the linear allocation formulas (the incorrect choice of the formulas' factors and weights) as the cause of misallocation (dissatisfaction with who gets how much money for what projects) has directed energy and attention away from more fundamental sources of dissatisfaction.

In particular, the interplay of three features of these systems confound facile diagnosis and treatment of their problems: first, the inevitable ambiguity and complexity in initial program purpose and design; second, the divergence between the conditions necessary for linear weighted allocation formulas by themselves to distribute aid dollars predictably and the conditions actually present in most program settings (divergence in the nature of need, in its measurement, in participant response to the formula allocation system); and third, the functional requirements of an agency such as HUD that administers a block grant aid program.

A better understanding of these features can inform agency efforts to improve program performance and manage the trade-offs and dilemmas the agency faces between need and merit, efficiency and equity, accountability and local choice, and administrative costs and the costs of administrative errors.

#### Why Analyze the Small Cities Program?

This thesis grows from preliminary work on the Small Cities Program for a national evaluation of the program by Urban Systems Research and Engineering, Inc. of Cambridge, Massachusetts. That work introduced

me to the Small Cities Program, and offered the opportunity to hear first-hand the reactions of HUD and local officials, and of program administrators, to the program's allocation process.

The Small Cities Program provides a useful case for a policy analysis of formula allocation systems: it combines elements of allocation by formula and discretionary grant award in its competitive Project Selection System; HUD was given greater discretion in design of the allocation process than in the entitlement CDBG program--the use of that discretion to make adjustments in the process provides valuable information on HUD's capacity and constraints in making such systems work better; the recent completion of the national evaluation of the program presents a rich source of data on the workings of the system; recent proposals to transfer responsibility of the program to the states and rely more on block grants to distribute federal aid make the analysis especially timely.

My approach differs from that of other analysts of the CDBG allocation process. Most have searched for the "right" formula by testing different community need measures and factor weights. Others have evaluated the outcomes of various formulas by simulating the allocation process, by comparing formula results with simple need indices, or by analyzing the role of community characteristics in the allocation process.

### Organization of the Thesis

The thesis consists of five chapters and several appendices. Chapter I has introduced the thesis. In Chapter II, I describe how the Small Cities Project Selection System has evolved. I develop my framework for analyzing the PSS in Chapter III. In Chapter IV, I use that framework to

interpret the evolution of the PSS. I conclude the thesis with Chapter V. The appendices give greater detail to diverse aspects of the Small Cities Program: characteristics of allocation formulas, legislative issues, program outcomes and evaluations.

CHAPTER II

THE DEVELOPMENT OF THE PROJECT SELECTION SYSTEM  
FOR THE SMALL CITIES PROGRAM

THE DEVELOPMENT OF THE PROJECT SELECTION  
SYSTEM FOR THE SMALL CITIES CDBG PROGRAM

In 1974, Congress set in motion a new allocation process with the passage of the Housing and Community Development Act. This thesis examines the development and implementation of the innovative hybrid allocation process for community development aid to the nation's smaller cities since the passage of that Act. This Project Selection System (PSS) combines the elements of formula allocation based on need and administrative choice of applicants in a competitive grant process for small cities and rural areas.

In this chapter, I will provide a detailed history of that allocation process. For each program year, from 1975 to the present, I will describe the adjustments that HUD has made in the Small Cities allocation system, as reflected in program regulations, annual program reports and other documents. The material in this chapter provides the primary source of data for the interpretation of those revisions in later chapters.

First, I give a brief summary of the current form of the PSS. Then, I describe the changes in the PSS since 1974, through four stages of development.

- STAGE I      A NEED-BASED SELECTION SYSTEM
- STAGE II     CENTRALIZATION OF SYSTEM DESIGN AND LEGITIMIZATION  
              OF DISCRETION.
- STAGE III    REFINEMENT
- STAGE IV     DECENTRALIZATION

I conclude by identifying the major problem areas in the allocation system and HUD's responses to those problems.



CURRENT FORM OF THE SMALL CITIES  
PROJECT SELECTION SYSTEM

The Small Cities CDBG Program provides federal aid dollars on an annual or multi-year basis to local communities for activities designed to meet community development needs, principally for the benefit of low and moderate-income persons. Those activities must be directed to the broad national objectives designated by Congress in 1974 and reaffirmed in 1977:

- 1) to eliminate slums, blight and deterioration where such conditions or needs exist;
- 2) to prevent blight and deterioration; and
- 3) to provide improved community facilities and public improvements, and supporting social services where necessary and appropriate.<sup>1</sup>

Units of local general government in urban and rural areas which are not eligible for so-called entitlement CDBG funds on a formula allocation basis may apply for Small Cities Program assistance. Generally speaking, cities that are not central cities of Standard Metropolitan Statistical Areas (SMSAs), cities with population under 50,000 and county governments not meeting the population and powers tests for entitlement status are eligible to compete for these funds.

Each year a portion of the total CDBG appropriation is set aside for rural and urban areas.<sup>2</sup> Two pools of funds, one for non-metropolitan

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<sup>1</sup>95th Congress House of Representatives. Committee on Banking, Finance and Urban Affairs. Subcommittee on Housing and Community Development, Community Development Block Grant Program: Staff Report. Washington, D.C.: GPO, February 1977, p. 5.

<sup>2</sup>Three kinds of discretionary funds have been designated: Metro and Non-Metro Discretionary Balances, considered here, the Financial Settlement Fund for urgent community development needs, and the Secretary's Fund for diverse designated purpose.

areas and the other for metropolitan small communities, are divided into state balances using needs-based allocation formulas counting extent of substandard housing, poverty and population. In 1975, the amount available for non-metropolitan areas was \$199.3 million, while the SMSA Balances Fund for metropolitan small cities was \$59.7 million. By Fiscal Year 1979, the Non-Metropolitan balance had increased to \$562.6 million, while the fund for metropolitan small cities grew to \$241.6 million.<sup>3</sup>

Within states, eligible units of local government compete for the Small Cities aid on an annual basis. Rural areas have a separate contest from urban areas.<sup>4</sup> Communities that have designed comprehensive programs to meet many needs over several years have a competition separate from communities with programs to meet a single need in one year.

HUD Area Office personnel use a nationally determined point system to rate and rank the program preapplications of communities trying to win grants in the separate contests in each state. The guidelines developed by the HUD central office for this point system instruct Area Office staff in their evaluation of Small Cities preapplications and specify:

- o threshold requirement for a community to be eligible to compete
- o preapplication contents
- o numerical weights to use in assigning points for
  - community-wide need based on census data

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<sup>3</sup>HUD. Community Development Block Grant Program: Fifth Annual Report. Washington, D.C.: GPO, no date, p. I-5.

<sup>4</sup>Rural communities and counties compete for "Non-SMSA Balance" funds, while urban small cities compete for the "SMSA Balance" for the state.

- extent of program benefit to persons of low- and moderate-income
- program impact in a target area
- related community effort to provide low-income housing and equal opportunity

o factors to consider in determining grant amounts

Thus, the Project Selection System guides HUD Area Office staff in their use of independent judgment to award scarce Small Cities CDBG funds to eligible communities in a manner consistent with the national objectives of the Housing and Community Development Act, and with HUD's administrative requirements in interpreting those objectives. The point system, with its carefully prescribed and weighted quantitative terms, is designed to balance "central office funding priorities and area office discretionary power."<sup>5</sup> The following figure and chart summarize the allocation process.

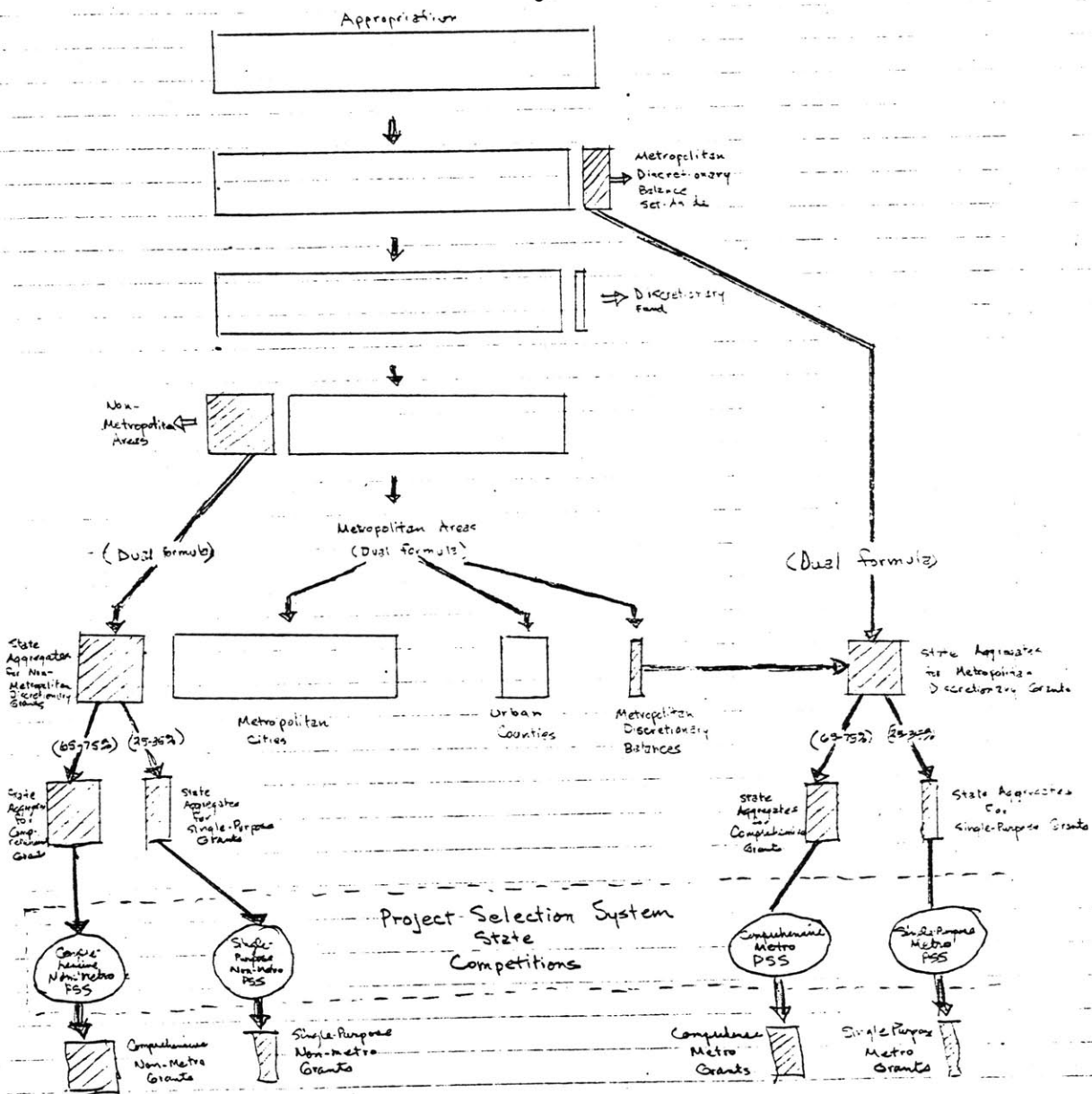
During the evolution of the system, two major legislative issues have arisen: the needs of "hold-harmless" communities and the appropriateness of the entitlement CDBG program's "dual" allocation formula for distributing Small Cities Program funds to the state pools.

The "hold-harmless" issue arose in the 1977 legislative hearings. Communities with temporary "entitlement" status wanted to retain that status rather than lose it, as provided in the 1974 Housing and Community Development Act. Congress did not extend "hold-harmless" status beyond the original schedule, but did revise the Small Cities Program to better meet the needs of "hold-harmless" communities.

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<sup>5</sup> Andrew M. Isserman, Allocation of Community Development Funds Among Small Cities: A Partial Evaluation. (Draft) p. 1.

Small Cities  
CDBG Allocation System  
Figure 1.1



Source: Robert Schaper, Alternative Formulas for Allocating Community Development Block Grants. Cambridge: Department of City and Regional Planning, Harvard University, October, 1977, p. 8 and author.

## CHART 1.1

## USE OF THE POINT SYSTEM

The point system is used to provide a yes/no decision for each applicant, to win or lose in a competition. For example, suppose five cities choose to apply for a state allotment of Single-Purpose funds of \$500,000, as determined by the formula allocation to state pools (dollars in thousands):

| <u>Cities</u> | <u>\$ Proposed</u> |
|---------------|--------------------|
| A             | 300                |
| B             | 100                |
| C             | 400                |
| D             | 250                |
| E             | 200                |

HUD Area Office staff rate the preapplications using the point system and rank the cities according to their point totals.

| <u>Cities</u> | <u>\$ Proposed</u> | <u>Points</u> |
|---------------|--------------------|---------------|
| D             | 250                | 840           |
| E             | 200                | 600           |
| C             | 400                | 450           |
| A             | 300                | 200           |
| B             | 100                | 150           |

Area Office raters determine that City E does not have the capacity or experience to administer the grant it proposes. HUD decides to award a grant half the size.

| <u>Cities</u> | <u>\$ Proposed</u> | <u>Points</u> | <u>\$ Awarded</u> |
|---------------|--------------------|---------------|-------------------|
| D             | 250                | 840           | 250               |
| E             | 200                | 600           | 100               |
| C             | 400                | 450           | 150               |
| A             | 300                | 200           | 0                 |
| B             | 100                | 150           | 0                 |

Since \$500,000 is available, City C receives only \$150,000. Cities A and B lose in this competition.

The second issue is also reflected in the current form of the PSS. In 1977, Congress revised the entitlement allocation formula for large cities, and applied that formula to the Small Cities allocation of dollars to the state pools. Opponents of that change in the program for small communities were successful in making a small revision to the "dual" formula, and also in amending the Act to require a study of small city needs, and the best measures of those needs.

HISTORY OF ADJUSTMENTS TO THE PROJECT SELECTION SYSTEM

Certain features of the Small Cities allocation system have been present from its beginnings. The system is an offshoot of the "entitlement" approach of the CDBG program. This approach allocates funds on the basis of two primary elements: (1) the use of verifiable need measures in a formula to determine the maximum grant amounts eligible communities may receive; (2) an application by eligible communities meeting certain purpose, planning and capacity requirements.

The entitlement approach, as an alternative to the problems of the previous categorical aid programs, sought to: (1) promote local flexibility in identifying needs and designing programs to meet those needs; (2) reduce the inequities of "grantsmanship", that is, the perceived preponderant influence of expertise in winning grants, rather than the level of real need, in determining who obtained federal community development aid; (3) specify a broad range of local uses of aid consistent with national objectives; and (4) provide a predictable source of community development aid to cities, in order to encourage comprehensive and integrated local planning and project implementation.

In an entitlement approach, large metropolitan cities and urban counties are eligible to receive community physical development block grants. The amount of aid per year that communities are "entitled" to is determined by formula. This formula, is a mathematical equation whose terms are objective measures of community need--population, poverty, area growth lag, overcrowded dwellings, area age of housing. In contrast, in a discretion-

ary grant approach, the amount of aid a community may receive and receipt of aid is based on the discretionary action of the Department of Housing and Urban Development.

The entitlement approach could only be partially pursued in the discretionary grant program (as the Small Cities Program was initially titled). Not enough money was allocated to the discretionary program for eligible small communities. The alternative strategy for the Small Cities Program was the formula allocation of funds to the state level and a competition among communities for funds within each state. The discretionary judgment of HUD staff has been an important element in the competitive selection of grant winners since the program's inception.



STAGE I: A NEED-BASED SELECTION SYSTEM

STAGE I

1975

HUD Area Offices apply need measures to competitive selection of grant winners.

Small, high poverty communities with no HUD grant experience win most of the discretionary grant funds.

PROGRAM YEAR ONE (1975)

In the first year, the Small Cities Program was called the discretionary grants program, with general purpose funds for metropolitan and for non-metropolitan areas. This division reflects the language of the Housing and Community Development Act of 1974 (Section 103). Both sources of funds were allocated to areas using the entitlement allocation formula: non-metropolitan funds to the state level, metropolitan funds to the SMSA level, with competitions, respectively, among eligible communities in each state and among those in each SMSA. Eligible applicants were states and units of local general governments not having CDBG entitlement status, i.e., those communities whose potential and grant amounts were not determined by a need-based allocation formula.

Program Objectives

In the regulations set forth by HUD for Fiscal Year 1975, explicit reference is made to the objectives to be accomplished in the discretionary program selection process. HUD stated that:

"The...criteria accurately reflect the Congressional intent that community development block grants be used to assist in the development of viable urban communities and expand economic opportunities principally for persons of low- and moderate-income. In addition, the Department has added another criterion to encourage the submission of joint applications between states and units of general local government or two or more units of general local government for activities designed to implement area-wide housing and community development plans.<sup>1</sup>

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<sup>1</sup>Federal Register, Vol. 40, No. 27. Friday, February 7, 1975. p. 5952.

Thus, the purposes of the program as reflected in the regulations draw from the general statement of objectives in the Act. The additional criterion reflects special Congressional intent for the program; in a report of the Committee on Banking, Housing and Urban Affairs on the Senate version of the Act, an additional purpose for the discretionary fund was mentioned:

"to encourage submission of applications from urban counties jointly with another unit of general local government in order to achieve an area-wide approach to community development."<sup>2</sup>

#### Design and Administration of Selection Systems

For the first program year, each HUD area office<sup>3</sup> developed rating and ranking systems, subject to central office review, to be used by area office staff to select grant winners in the metropolitan and non-metropolitan grant contests in each SMSA and in each state.

As stated in HUD's First Annual Report on the CDBG program, "...the general purpose fund (SMSA and non-metropolitan discretionary balances) application process (was) not a major departure from the HUD categorical grant application process."<sup>4</sup> In that categorical program process, HUD Area Offices evaluated applicant communities to determine the winners of

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<sup>2</sup>U.S. Senate Committee on Banking, Housing and Urban Affairs. Housing and Community Development Act of 1974: Report of the Committee on Banking, Housing and Urban Affairs. Washington, D.C.: GPO.

<sup>3</sup>HUD has three major levels of field offices: Regional, Area, and Service Offices. Appendix A gives a brief description of these levels with accompanying organizational charts and maps.

<sup>4</sup>HUD Community Planning and Development Office of Evaluation. Community Development Block Grant Program: First Annual Report. Washington, D.C.: U.S. Government Printing Office, no date. p. 61.

development funds. In the new CDBG discretionary grant process, as in the categorical aid programs, "funding was based upon the rank order of each application among all other applications from the particular SMSA for the SMSA general purpose funds, and from the particular state for non-metropolitan general purpose funds."<sup>5</sup>

#### Thresholds to Compete

A threshold represents a stipulation by HUD limiting entry to participate in Small Cities competitions to those eligible applicants meeting additional requirements deemed appropriate by HUD. An example of a threshold might be a requirement that eligible applicants would be rated and ranked in the competitive selection process only if the applicants had no outstanding audit findings regarding previous HUD grants. Another example of a possible threshold might be a requirement that eligible applicants would be permitted to compete only if their proposed projects provided at least 75% of their benefits to low- and moderate-income persons.

In the first program year, HUD imposed no thresholds to entry into the discretionary funds competitions. Eligibility and application standards closely followed the language of the Housing and Community Development Act of 1974.

#### Types of Grants

"Types of grants" refers to different categories of grants that may be offered by a single program. Types of grants may be distinguished by

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<sup>5</sup>HUD Community Planning and Development Office of Evaluation. Community Development Block Grant Program: First Annual Report. Washington, D.C.: U.S. Government Printing Office, no date. p. 61.

the following eligibility requirements, the range of purposes of funds, length of the period of time to be funded, application requirements, maximum grant size, or some combination of these or other well-defined characteristics.

For Program Year One, no different grant types were defined in the program regulations. Consistent with the Housing and Community Development Act of 1974, grants were to be made on an annual basis, for the general purposes authorized by the Act.

#### Selection Criteria

Area Offices were required to consider the following factors in developing their rating and ranking systems for the first program year. Priority was to be given to those applications whose proposed activities addressed the following conditions:

- (1) extent of substandard housing
  - o for metropolitan areas, the proportion and extent of overcrowded housing, expressed as a percentage of the total housing units of the applicant
  - o for non-metropolitan areas, the proposition and extent of housing units lacking plumbing, based on 1970 U.S. Census data, expressed as a percentage of the total housing units of the applicant
- (2) the proportion and extent of poverty, expressed as a percentage of the total population of the applicant
- (3) an extraordinarily high rate of growth or a severe and rapid rate of decline in population and economic activity,

arising from the impact of national policy or direct federal program decisions

- (4) conditions which represent an imminent threat to health or safety.<sup>6</sup>

Area Offices were also given authority to extend additional priority to:

- (5) applications where there are joint and voluntary cooperation agreements between states and applicants, or between two or more applicants and the activities are designed to implement Statewide or areawide housing and community development plans.<sup>7</sup>

In particular reference to the branch offices discretionary power, Area Offices were permitted to apply as "a judgmental factor" an estimate of the applicant's capacity to complete the proposed activities within the estimated cost.<sup>8</sup>

#### Other Non-Formula Provisions

Several other non-formula provisions were put forth for the first year competition: applications requirements; "hold-harmless" communities' eligibility; and grant ceilings.

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<sup>6</sup>Federal Register. op. cit. p. 5954. Section 570.402(b).

<sup>7</sup>Ibid.

<sup>8</sup>Ibid.

Preapplications were encouraged by the first year program regulations. A preapplication is a brief initial application by eligible communities which is then rated by HUD staff; applicants with winning preapplications then submit a final, full application. In the 1975 program regulations HUD specified two basic purposes of preapplications:

- o to determine how well the application compared with other applications
- o to discourage applications which had little or no chance of funding before communities spent significant amounts of money preparing full applications.

However, due to the limited amount of time available to communities to apply for assistance in the first program year, full applications were to be accepted from communities which had not submitted preapplications.<sup>9</sup>

A second non-formula provision of the first year regulations regarded "hold-harmless" communities. "Hold-harmless" status refers to the granting of temporary entitlement status to communities that had been receiving funds from the HUD categorical programs by the CDBG program. This temporary entitlement status was provided by the Act to help ease the transition to the new program--to a new level of funding for entitlement communities and to the competitive selection process of the discretionary program for non-entitlement communities. The discretionary program regulations allowed non-entitlement communities eligible for hold-harmless funds to also compete for discretionary aid.<sup>10</sup>

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<sup>9</sup>Ibid. Section 570.400(b)

<sup>10</sup>Ibid. p. 5952.

The third provision to note regards grant ceilings, i.e., the maximum amount of funds that communities may apply for in one program year. HUD Area Offices were "authorized at their discretion (but not required) to set maximum grant limits for each year", in relation to the total amount of discretionary funds available for SMSA or State competitions.<sup>11</sup>

#### Effects of the First Year Discretionary Program

As shown by Figure 2.1, the new discretionary allocation system had an immediate impact on the smallest communities, doubling the number of recipients, while reducing the average grant size. Figure 2.1 combines entitlement and non-metropolitan discretionary grant sizes. The actual discretionary grants were much smaller on average--\$87,500 for metropolitan small communities, \$168,500 for non-metro discretionary grant winners (see Appendix C, Table 2.15).

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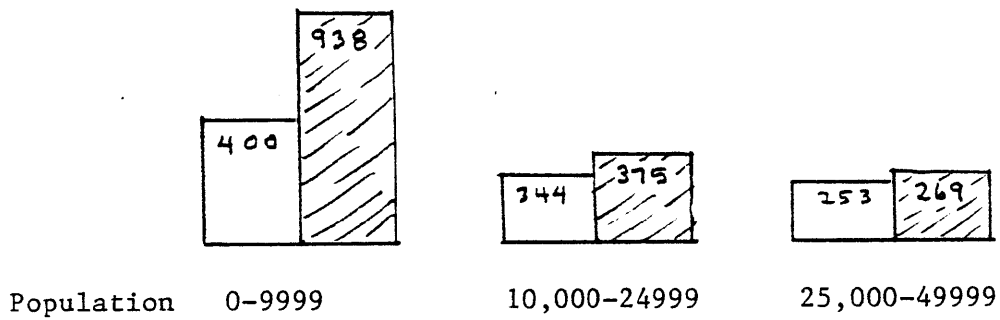
<sup>11</sup>Ibid. p. 5254. Section 570.402(b).



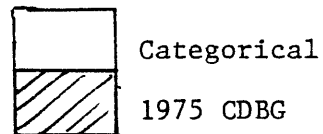
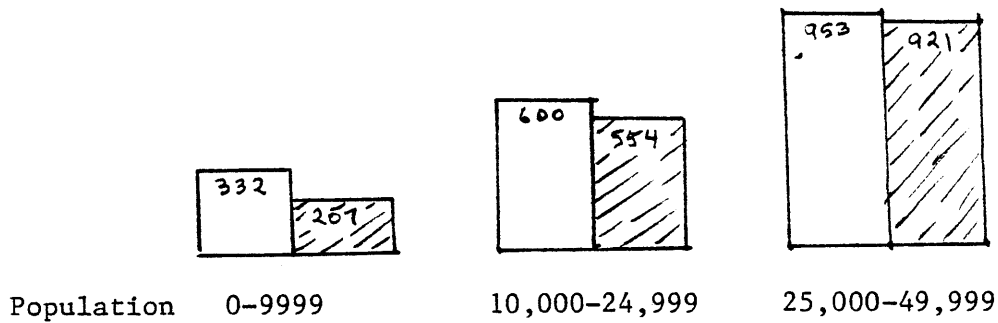
Figure 2.1

Comparison of HUD Categorical and CDBG Programs  
By City Size

Number of Cities Funded



Average Grant Size  
(\$000)



Source: Appendix C, Table 2.13.

STAGE II: CENTRALIZATION OF SYSTEM DESIGN AND  
LEGITIMIZATION OF DISCRETION

STAGE I                    1975                    HUD Area Offices apply need measures to competitive selection of grant winners.

Small, high poverty communities with no HUD grant experience win most of the discretionary grant funds.

|          |               |   |
|----------|---------------|---|
| STAGE II | 1976-<br>1978 | HUD centralizes the design of the competitive selection systems.  |
|          |               | Benefit and subjective program impact measures receive progressively greater weight than need measures.     |
|          |               | HUD refines the selection process to remove "biases" and screen out low quality projects.                   |
|          |               | Comprehensive multiyear grants are authorized to respond to the needs of the larger "hold-harmless" cities. |

PROGRAM YEAR TWO (1976)

In its Second Annual Report on the CDBG program, HUD indicated that there were no major changes in its method of determining discretionary grant winners for the second program year.<sup>12</sup> However, several changes in the regulations on selection systems and on other administrative procedures are worth noting.

Program Objectives

The program regulations for 1976 did not further clarify or mention the objectives set forth in 1975.

Design and Administration of Selection Systems

For the second program year, HUD transferred the responsibility for design of project selection systems. In 1975, Area Offices had been given this task; in 1976, Regional Offices gained this responsibility.

Each HUD Regional Office was directed to "establish a review and rating system for evaluating preapplications from communities within its jurisdiction."<sup>13</sup> Separate selections systems could be designed for each Area Office; copies of the systems were to be made available to communities

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<sup>12</sup>HUD Community Planning and Development Office of Evaluation. Community Development Block Grant Program: Second Annual Report. Washington, D.C.; U.S. Government Printing Office, no date.

<sup>13</sup>Federal Register. Vol. 40, No. 21. October 30, 1975. p. 50667. Section 570.402(c).

before they submitted their preapplications. According to HUD officials, the latter was an effort "to inform applicants of the specific weights to be used to rank order applicants."<sup>14</sup>

#### Thresholds to Compete

No definite thresholds were required in Fiscal Year 1976. However, the review systems were to "give consideration to the capacity of the applicant to complete the proposed activity within a reasonable period of time and within the estimated cost."<sup>15</sup> In contrast, in Fiscal Year 1975, Area Offices were given the option to assess applicant capacity as "a judgmental factor". According to HUD central staff, Area Office officials were also to consider the sources of first year grantees' delays in expending their discretionary awards, such as the need for lengthy environmental reviews or other uncontrollable start-up problems.<sup>16</sup>

#### Types of Grants

The regulations for Program Year Two made no changes in the grant types offered. Communities in both the metropolitan and non-metropolitan discretionary grant competitions were eligible for annual general purpose awards.

#### Selection Criteria

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<sup>14</sup>Housing and Development Reporter. Vol. 3, No. 11. October 20, 1975. Washington, D.C.: Bureau of National Affairs. p. 488.

<sup>15</sup>Federal Register. op. cit. p. 50667. Section 570.402(c)(2).

<sup>16</sup>Housing and Development Reporter. Vol. 41, No. 3. July 12, 1976. p. 112.

Based upon experience with the program in 1975, HUD determined that "modifications from the criteria for selection used in fiscal year 1975 would substantially improve the administration of the program."<sup>17</sup>

The selection criteria to be used in the rating and ranking systems were modified. The point systems could only consider the following factors:

- o degree to which an applicant's proposed activities directly addressed the "criteria for selection", that is, the initial four selection factors designated in 1975.
  - extent of substandard housing
  - proportion and extent of poverty
  - high growth or severe decline in population or economic activity
  - imminent threats to health or safety
- o degree to which the proposed activities benefit persons of low- and moderate-income
- o consistency of the proposed activities with local and area-wide plans.<sup>18</sup>

The provision was deleted that allowed additional priority for certain cases involving joint cooperation agreements among states and communities or among different communities.

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<sup>17</sup>Federal Register. op. cit. p. 50664.

<sup>18</sup>Federal Register. op. cit. p. 50664. Section 570.402(c)(1).

Two of the selection criteria carried over from 1975 were modified. The new language was intended "to make clear that both absolute amounts and percentages of poverty and substandard housing" were to be considered in the selection systems, in order to allow HUD "to give equal consideration to applicants of all sizes in making funding decisions."<sup>19</sup> In assessing the Fiscal Year 1975 competitions, HUD central staff members reported that the funding reviews had tended to favor smaller communities with higher percentages of poverty as against larger communities with greater numbers of poor persons.<sup>20</sup>

#### Other Non-Formula Provisions

Two of the non-formula provisions mentioned for Program Year One were changed for Fiscal Year 1976, those pertaining to application requirements and to grant ceilings.

The new regulations required all discretionary grant applicants to prepare preapplications which would be rated and ranked through the review systems.<sup>21</sup> The regulations for Fiscal Year 1975 had not required preapplications. Those communities that submitted preapplications were rated and ranked, but those who had missed that scoring of preapplications were permitted to submit late full applications. These full applications were then rated and ranked against the preapplications, resulting in a new ordering

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<sup>19</sup>Ibid. p. 50664. (emphasis added).

<sup>20</sup>Housing and Development Reporter. Vol. 3, No. 11. October 20, 1975. p. 488.

<sup>21</sup>Federal Register. op. cit. p. 50665. Section 570.400(b).

of applicants. The outcome of the double round of scoring, according to HUD officials, was a disappointment for applicants who had come out winners in the first ranking, only to be later displaced by late applicants. Another outcome of the process had been "overworked HUD employees."<sup>22</sup>

The second change concerned grant ceilings. In 1975, HUD Area Offices had been given the authority to set maximum grant limits, at their option, for the discretionary competitions. This authority was withdrawn for the second program year. No explanation was offered in the regulations for that change.<sup>23</sup>

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<sup>22</sup>Housing and Development Reporter. op. cit. p. 488.

<sup>23</sup>Federal Register. op. cit. p. 50664. Part 570-8.

PROGRAM YEAR THREE (1977)

HUD continued to make adjustments in the discretionary grants allocation system for the third program year. In reviewing the history of the program in its Third Annual Report, HUD commented at length on the problematic nature of discretionary grant competitions. HUD's analysis pointed out features of the program that had a dramatic impact on the nature of the competitions for funds:

- (1) the legislatively prescribed percentage reduction of funds for small "hold-harmless" communities created a shifting focus of these communities to the discretionary program, and a concomitant increase in the intensity of competition;
- (2) communities under 5,000 population were under-represented in terms of their proportion of eligible communities, in the receipt of discretionary funds;
- (3) the program had an "inherent conflict between the large number of very small governmental units technically eligible under the CDBG legislation to compete for funding and the administrative problems of selecting and administering a large number of small grants."<sup>24</sup>

The Fiscal Year 1977 regulatory revisions made a number of substantive changes in the program's allocation process.

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<sup>24</sup>HUD. Community Planning and Development. Community Development Block Grant Program: Third Annual Report. Washington, D.C.: U.S. Government Printing Office, no date.



### Program Objectives

HUD made no explicit changes in the objectives of the discretionary program for the third program year. The last formal regulatory statement of objectives had been in 1975, when attention was drawn to Congressional intent to assist in the development of viable urban communities and expand economic opportunities primarily for low- and moderate-income persons.

### Design and Administration of Selection Systems

Regional Offices retained formal responsibility to establish preapplication review systems for the Area Offices in their jurisdictions; variations in those systems were allowed among, but not within, States.<sup>25</sup>

The new regulations regarding the specifics of the review design process were intended "to provide firm guidance to field offices on how to establish ranking systems" for picking discretionary grant competition winners.<sup>26</sup>

Prior to the Fiscal Year 1977 selection regulations (described in detail in the section Selection Criteria below), all field offices had established their own ranking systems, which were forwarded to Washington for review. Generally, the HUD central office did not revise the ranking systems or specify what HUD reviewers should look for. According to HUD central office staff, the new regulations were an attempt to "downplay...the pure numbers game of discretionary grants."<sup>27</sup>

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<sup>25</sup>Federal Register. Vol. 41, No. 158. August 13, 1976. p. 34303. Section 507.402(c).

<sup>26</sup>Housing and Development Reporter. Vol. 41, No. 3. July 12, 1976. p. 112.

<sup>27</sup>Ibid.

In the view of central office staff, some field offices had strictly interpreted HUD instructions and the statutory requirements that funds be distributed according to verifiable need, i.e., according to objective measures such as U.S. Census data on extent of poverty and substandard housing. As a result, certain types of communities were gathering in all the money in a given area because their numerical needs were greatest. Community capacity and the quality of proposed activities had not been considered in those cases.<sup>28</sup>

#### Thresholds to Compete

For Fiscal Year 1977, HUD developed well-defined threshold factors for entry into discretionary grant competition.

Area Office reviewers were to determine affirmatively that preapplicants met each of three threshold factors in order to be considered for rating:

- o Performance--satisfactorily meeting HUD's performance standards for previously approved CDBG aid, taking into account progress toward completion of approved activities, as measured by
  - expenditure of funds
  - obligation of funds
  - award of third party contracts
  - committed matching funds
  - compliance with program requirements
- o Assisted Housing Effort--appropriate local actions to provide assisted housing in accord with any HUD-approved Housing Assistance Plan<sup>29</sup> applying to an applicant's jurisdiction

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<sup>28</sup>Ibid.

<sup>29</sup>The Housing and Community Development Act of 1974 required CDBG grantees to develop a Housing Assistance Plans describing community housing needs and local plans to meet those needs.

- o Eligibility of Activities--apparent eligibility of the proposed activities.<sup>30</sup>

In contrast to the previous year, reference to consideration of community capacity by HUD reviewers was deleted.

#### Types of Grants

Program Year Three regulations made no revisions in the single grant type offered, annual general purpose grants for both metropolitan and non-metropolitan communities.

#### Selection Criteria

Several important changes were made in the selection criteria to be used by Regional Offices to design rating and ranking systems; changes were made in the factors used, in their definition, and in the weights that each factor could be given.

HUD continued to change the list of factors to be considered in rating systems as they had done in Program Year Two.<sup>31</sup> The factors for 1977 were:

| <u>Factor</u>                               | <u>Weight</u>  |
|---|--|
| Extent of substandard housing               | 10-15% $\frac{1}{2}$ percentage, $\frac{1}{2}$ absolute amount |
| Extent of poverty                           | 5-10% $\frac{1}{2}$ percentage, $\frac{1}{2}$ absolute amount  |
| Benefit to Low- and Moderate-Income Persons | 25-35%   |

<sup>30</sup>Federal Register. op. cit. p. 34303. Section 570.402(c)(1).

<sup>31</sup>Federal Register. Ibid. p. 34303. Section 570.402(c)(2), (3).

|  |               |
|--|---------------|
| Housing Efforts                        | 25-35%        |
| Imminent Threat to Health<br>or Safety | <u>10-20%</u> |
| Total Weight                           | 100%          |

A maximum of 10 additional percentage points could be awarded to communities that proposed activities which involved or matched other sources of community development funds.<sup>32</sup>

Several changes were made, compared to the previous year. Each of the factors in the above table will be considered in turn.

The manner in which extent of substandard housing was to be measured was revised. The separate use of the extent of overcrowding as a measure of substandard housing for metropolitan applicants and the extent of housing units lacking plumbing for non-metropolitan applicants was discontinued. For both types of applicants, rating systems were to measure substandard housing as the sum of crowded units and units lacking plumbing both as an absolute amount and as a percentage of total units.

The extent of poverty factor was refined. The new regulations stipulated that absolute and percentage measures be given equal weight in the selection systems devised by the Regional Offices.

The way in which the benefit to low- and moderate-income persons factor was to be scored was clarified. Raters were to designate preapplication activities as exclusively, principally or incidentally providing benefits.

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<sup>32</sup>Ibid. p. 34304. Section 507.402(c)(3).

A new factor, housing efforts, was introduced. This factor was to assess the extent to which the proposed program was designed to support the expansion of the low- and moderate-income housing stock of the applicant community.

Two selection criteria from the previous year were deleted:

- (1) a condition of high growth or serious decline resulting from national policy or federal decisions;
- (2) the consistency of the proposed activities with local and area wide plans.

The most notable change was the new requirement that the review systems developed by Regional Offices assign numerical ratings within a specified range of maximum percentage points for each factor. As indicated in the previous table, the substandard housing factor was permitted 10-15%, the poverty factor 5-10%, the benefit and housing efforts factors each 25-35%, and the health or safety factor 10-20%, for a point total of 100%.

For all the specificity of the new guidelines, it is important to note the large amount of discretion left to Area Office raters. Of the 100% points total, no more than 25% was allowed for the objective community wide poverty and housing needs measures. HUD emphasized in its comments to the new rule that "the activities or programs proposed in the preapplication (are to) receive a greater weight than the base demographic characteristics of the applicant."<sup>33</sup>

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<sup>32</sup>Ibid. p. 34304. Section 507.402(c)(3).

<sup>33</sup>Ibid. p. 34302.

Other Non-Formula Provisions

In the third program year, there were numerous minor changes in the non-formula provisions of the project selection process. Three of those changes will be noted here: purpose of preapplications, determination of grant ceilings, and determination of grant amounts.

In the first program year, two purposes had been set forth for the discretionary grant preapplication process: (1) to determine how well an application compared to other similar applications; and (2) to discourage applications which had little chance of funding.

The new program regulations refocused the purpose of preapplications. The purpose of the preapplication process for Fiscal Year 1977, was to enable HUD to make funding decisions by comparing the conditions of substandard housing and poverty of an applicant and the activities proposed by the applicant, on the basis of the new selection criteria, with similar conditions and activities from other applicant communities.<sup>34</sup>

Grant ceilings for the third program year were to be determined by the Secretary of HUD at his discretion, on a State-by-State basis, with a single maximum grant amount for each State.<sup>35</sup> The authority to set grant ceilings had been withdrawn from the Area Offices in the previous year's regulations.

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<sup>34</sup>Ibid. p. 34303. Section 507.402(b).

<sup>35</sup>Ibid.

The criteria to be used by the Secretary of HUD to determine the grant amount for which an applicant was invited to submit a full application were set forth for the first time in Program Year Three. The Secretary could ask the applicant to submit a full application for an amount less than requested in the preapplication; that determination could "take into account the level and complexity of the proposed activities and the capacity of the applicant to complete such activities within a reasonable period of time and within estimated costs."<sup>36</sup>

Two contrasts may be drawn. First, the procedure outlined above differs sharply from the manner in which grant amounts are determined for "entitlement" cities. There, the maximum possible grant amount available to an eligible community (subject to submission of an acceptable application) is determined by formula, based on community wide measures of need. Second, in the first two years of the discretionary program, community capacity had been included in the project selection criteria regulations. With the third year revisions, capacity was to be considered in the determination of grant amounts for communities with winning discretionary grant preapplications.

In assessing the third year project selection system, HUD officials made two additional points about the problematic nature of discretionary grant competitions.

The phaseout of "hold harmless" status as the CDBG program pro-

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<sup>36</sup>Ibid. p. 34304. Section 540.402(d).

gressed would affect both the entitlement and discretionary programs. As the temporary entitlement awards of "hold-harmless" communities were reduced to zero (over a six year period as provided in the Act), the discretionary fund would grow rapidly, and have the effect of shifting money from larger to smaller cities. Given the discretionary nature of selection of grantees based on the merits of the proposed activities, this shift would tend to reconvert the CDBG Program into a categorical form of assistance.<sup>37</sup> (See Figure 2.2)

HUD made an additional point about the selection criteria for discretionary grant recipients:

"The necessity of developing quantifiable measures of applicant need and potential program benefit as a basis for awarding discretionary balances grants has posed a problem in developing a HUD small communities strategy: should indices of need more heavily weight the characteristics of target area beneficiaries or the city or county-wide characteristics of the local government applying for the grant?"<sup>38</sup>

For the first three program years, measures of applicant city- or county-wide need had been applied in the selection criteria. As mentioned earlier, the decision to include "absolute amount" measures of poverty and housing need reflected HUD's concern that percentage measures of applicant need biased the selection process toward smaller communities.

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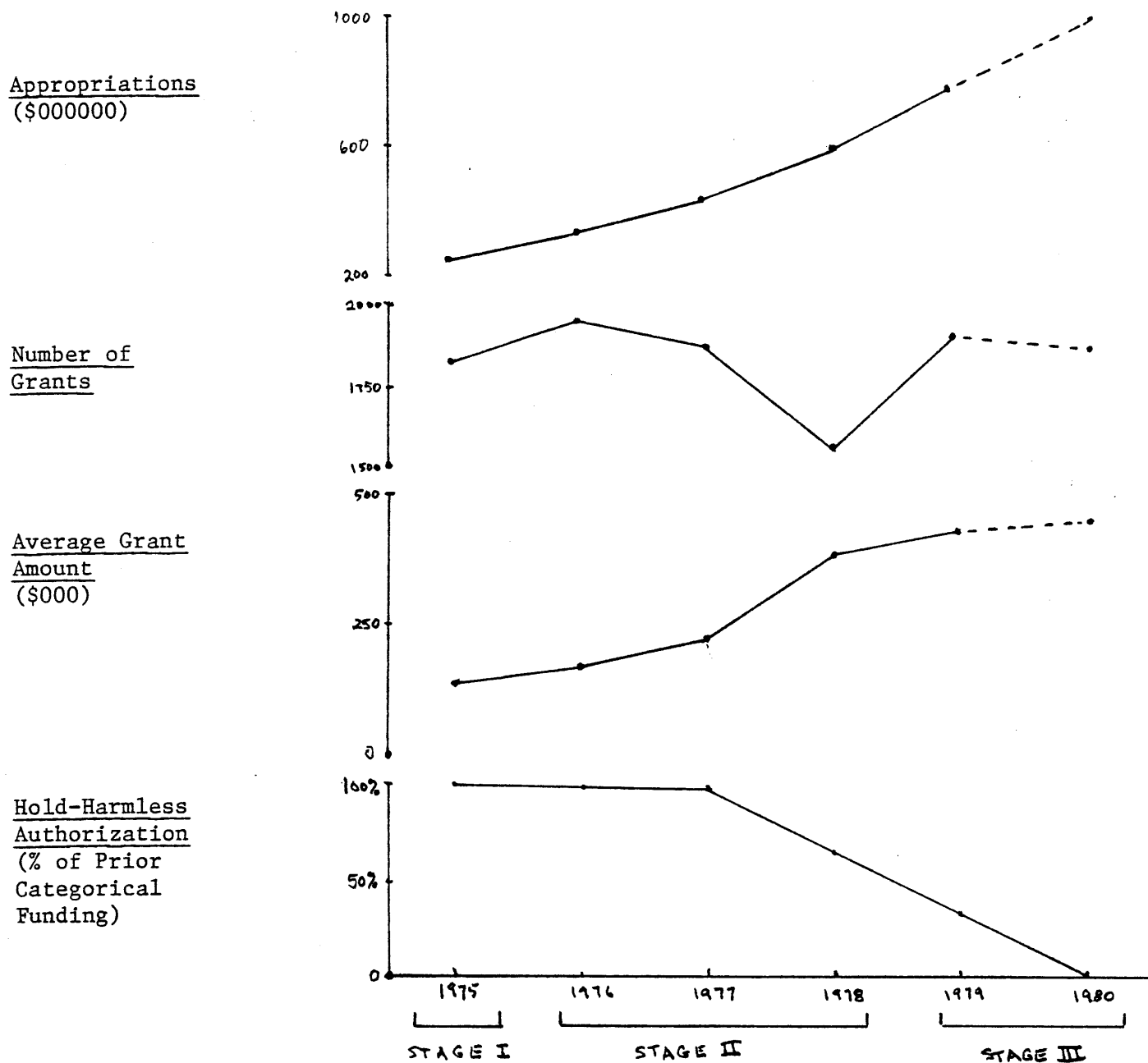
<sup>37</sup>Housing and Development Reporter. Vol. 41, No. 22. February 21, 1977. p. 889.

<sup>38</sup>HUD. Third Annual Report. op. cit. p. 282.



Figure 2.2

Changes in Small Cities Program Appropriations,  
 Number of Grants, Average Grant Amounts and  
 Hold Harmless Authorizations, 1975-1980 .



Source: Appendix C, Tables 2.15-2.17

However, concerning the outcomes of the selection process by Area Office reviewers, HUD suggested that recipient-wide need measures did not consistently affect selection decisions, whether percentage measures or measures combining percentage and absolute amounts of needs were used.<sup>39</sup> In its development of the project selection system for the subsequent program year, HUD chose to weight the impact of a community's program on a target area, and on the low- and moderate-income residents of that area, much more heavily.

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<sup>39</sup>Ibid. p. 280.

PROGRAM YEAR FOUR (1978)

The discretionary program, newly designated the Small Cities Program, was substantially revised for the fourth program year, in order to incorporate the statutory changes and new administrative initiatives consistent with the Housing and Community Development Act of 1977.

The 1977 Act refined the CDBG Program significantly. New regulations were put forth for application requirements, eligible activities, allocation and distribution of funds, and loan guarantees. HUD was required to undertake a study of small city needs. Another section of the Act made available to grantees technical assistance from the Secretary's Discretionary Fund.<sup>40</sup> Another created discretionary Urban Development Action Grants for severely distressed cities and urban counties.<sup>41</sup>

Additionally, the 1977 Act authorized HUD to make multi-year discretionary grant commitments of up to three years to small non-entitlement communities. These communities were required to have "comprehensive community development program(s) with provisions for lower income housing."<sup>42</sup>

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<sup>40</sup>The discretionary balances fund for non-entitlement cities and counties is separate from the Secretary's Discretionary Fund for diverse purposes.

<sup>41</sup>HUD. Third Annual Report. op. cit. p. 20.

<sup>42</sup>Ibid. p. 22.

Program Objectives

HUD set forth new and explicit program objectives for the Small Cities Program for Fiscal Year 1978. In its explanation of these objectives, HUD cited a rationale: while the program was to provide funds for the same community development activities as in the entitlement CDBG program, the program was competitive in nature and the demand for funds was far greater than was available; therefore, further objectives must be set forth. The communities to be selected for funding would be those which (1) had the greatest need as evidenced by poverty and substandard housing and (2) whose applications adequately addressed locally-determined needs of low- and moderate-income persons. Local Small Cities projects were required to be consistent with one or more of the following purposes:

- o Support realistic and attainable strategies for expanding low and moderate income housing opportunities;
- o Promote deconcentration of lower income housing;
- o Promote more rational land use;
- o Provide increased economic opportunities for low- and moderate-income persons;

- o Correct deficiencies in public facilities which affect the public health or safety, especially of low- and moderate-income persons.<sup>43</sup>

Of these objectives, only that relating to economic opportunities had been mentioned in the discretionary program regulations of previous years.

#### Design and Administration of Selection Systems

For the new Small Cities Program, HUD established a national project selection system that identified the criteria and rating procedures to be used by HUD Area Office staff in selecting applicants for Small Cities aid. The new national system identified both subjective and objective factors for selection. Decisions made by HUD in selecting grantees were to be documented and made available to the general public upon request.<sup>44</sup>

In the first program year, the design of project selection systems had been the responsibility of HUD's Area Offices. Regional Offices gained that responsibility in the second program year. In the third year of the discretionary grants program, HUD had revised and expanded the list of selection criteria and had specified the range of permissible points to be considered by Regional Offices in their design of ratings systems for each state. For Program Year Four, the central office of HUD assumed responsibility for design of a uniform national selection system, and provided detailed instructions to its Area Office staff in how to use the selection

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<sup>43</sup> Federal Register. Vol. 43, No. 41. March 1, 1978. p. 8482. Section 570.420(a), emphasis added.

<sup>44</sup> Ibid. Section 570.420(h).

system to select grant winners in the separate State competitions.

The new rules also specified the type of data to be submitted by communities in support of their preapplications, in order that Area Office raters might adequately assess the proposed projects.<sup>45</sup> Several commentators to the proposed rules for 1978 felt that Area Offices were given too much discretion in rejecting data submitted. The entire reference to rejection of data was omitted in the final rules.<sup>46</sup>

### Thresholds to Compete

The new Small Cities Program regulations imposed new performance thresholds for applicants who wished to compete for discretionary aid.

One new threshold set standards for prior financial management. Preapplications were not to be accepted from any community that had an outstanding audit finding for any HUD program undertaken by the community or that owed money to HUD as a result of an audit finding.<sup>47</sup>

Capacity and performance thresholds were refined. No grant was to be made to communities which did not have the capacity to undertake their proposed programs. Those communities which had previously participated in the Block Grant Program must have performed adequately, in accordance with several criteria:

- (1) community development activities
  - rate of execution of activities
  - rate of expenditure or obligation of funds

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<sup>45</sup> Ibid.

<sup>46</sup> Ibid. p. 8476.

<sup>47</sup> Ibid. p. 8482. Section 570.420(j).

## (2) housing assistance

- actual progress in meeting Housing Assistance Plan goals
- absent such progress, actions taken to facilitate the provision of housing assistance to low- and moderate-income persons

## (3) compliance with the laws and regulations applicable to the CDBG program

- compliance with laws and regulations
- resolution of HUD monitoring findings
- resolution of audit findings.<sup>48</sup>

These regulations clarified and made more specific the thresholds of the previous program year. Commentors to the proposed threshold on audit findings had charged that HUD was discriminating against small communities since no such provision was made in the entitlement program. HUD disagreed, stating that the restriction, with a provision for waivers by the Regional Administrator, was an "appropriate and useful check on past (HUD program) participants."<sup>49</sup>

HUD had set forth an additional set of capacity thresholds in its proposed regulations for Fiscal Year 1978. These thresholds were designed to condition entry into the competitions for comprehensive multi-year grants, (described in the following section), on the basis of community size and prior performance in the CDBG program.

Those tentative rules had provided for four requirements for a community wishing to apply for a comprehensive grant or a multi-year grant commitment:

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<sup>48</sup> Ibid. p. 8483. Section 570.423(c).

<sup>49</sup> Ibid. p. 8476.

- o 2,500 population (waivable)
- o previous receipt of a CDBG grant
- o adequate past performance
- o capacity to undertake the proposed program.<sup>50</sup>

The first two of these, in particular the 2,500 figure, was strongly opposed by smaller cities. The proposed "three stage approach"--first eligibility for single purpose, then for comprehensive, and finally for multi-year grants--was seen as discriminating against the smaller communities. The National Association of Smaller Communities made plans to file suit against HUD, stating that "the regulations arbitrarily prohibit many of the approximately 4,000 discretionary grantees under the first three years of the community development block grant program from applying for a multi-year commitment for three years' activities."<sup>51</sup> HUD deleted the "three stage approach" and the first two of the above thresholds in the final Small Cities Program regulations for Fiscal Year 1978.

#### Types of Grants

The new Small Cities regulations created two types of programs available to small cities--single purpose grants and comprehensive multi-year grants. This provision was made possible by the legislative revisions of the Housing and Community Development Act of 1977. In the first three years of the discretionary program, communities had been eligible to obtain annual general-purpose grants.

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<sup>50</sup> Ibid. p. 8477. Section 470.423.

<sup>51</sup> Housing and Development Reporter. Vol. 5, No. 28. December 12, 1977. p. 662-663.



The development of the new types of grants required adjustments to the allocation system. First, the metropolitan SMSA funds, for which eligible communities in each SMSA had competed, were to be aggregated into separate state pools for state-wide competitions. This revision was made in the allocation provisions of the 1977 Act.

Second, since metropolitan and non-metropolitan funds could now be used for either single-purpose or comprehensive grants, new regulations describing the division of these funds were required. In each state, 25 to 35 percent of funds in the metropolitan and in the non-metropolitan balances were to be reserved for the Single Purpose grants, with the remainder reserved for Comprehensive grants, except where the demand for Comprehensive grants was greater than 75 percent or less than 65 percent.<sup>52</sup>

The proposed rules also had provided for a 30 percent - 30 percent - 40 percent split of funds among single-purpose, one-year comprehensive, and multi-year comprehensive grants. This provision was deleted in the final rules.<sup>53</sup>

#### Selection Criteria

As mentioned earlier, the new regulations imposed a new national selection system for the separate single purpose and comprehensive, metropolitan and non-metropolitan competitions for discretionary funds in each state. The table below<sup>54</sup> summarizes the factors and points prescribed for the selection systems followed by a discussion of the factors.

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<sup>52</sup> Federal Register. op. cit. p. 8482. Section 570.420(e).

<sup>53</sup> Ibid. p. 8476.

<sup>54</sup> Ibid. pp. 8484-8485.

Small Cities Point Selection System

1977-1978 Selection System for Comprehensive Annual Grants

Applications will be rated and scored against each of the following nine factors. All points for each factor will be rounded to the nearest whole number. The maximum score possible is 200 points.

|  | Points |
|--|--------|
| a) Need - absolute number of poverty persons           | 100    |
| b) Need - Percent of poverty persons                   | 50     |
| c) Need - absolute number of substandard housing units | 50     |
| d) Need - Percent of substandard housing units         | 50     |
| e) Program factor - Impact of the proposed program     | 400    |
| f) Benefit to low and moderate income persons          | 200    |
| g) Performance:  |        |
| Housing  | 100    |
| Local equal opportunity efforts                        | 50     |
| Housing opportunity plan                               | 50     |
| Local equal opportunity plan                           | 50     |
| Housing services phase-out communities                 | 50     |

1977-1978 Selection System for Single Year Grants

Applications will be rated and scored against each of the following eight factors. All points for each factor will be rounded to the nearest whole number. The maximum score possible is 200 points.

|  | Points |
|--|--------|
| a) Need - absolute number of poverty persons           | 100    |
| b) Need - percent of poverty persons                   | 50     |
| c) Need - absolute number of substandard housing units | 50     |
| d) Need - percent of substandard housing units         | 50     |
| e) Program factor                                      |        |
| Impact of the proposed program                         | 100    |
| Benefit to low and moderate income persons             | 100    |
| f) Performance:  |        |
| Housing  | 100    |
| Local equal opportunity efforts                        | 50     |
| g) Other:  |        |
| Housing opportunity plan                               | 50     |
| Exchange position in a Federal Center                  | 25     |
| Implements State growth plan                           | 25     |
| Other Federal programs                                 | 25     |

The new project selection system differed from the 1977 system in the following ways:

- o Separate point systems for the comprehensive multi-year and single-purpose annual grant competitions.
- o A new subjective factor--impact of the proposed program--with 40% nominal weight in the comprehensive grant competitions.
- o A new performance factor, equal opportunity efforts.
- o New incentive factors for coordination with area housing and development plans.
- o A small preference factor for "hold-harmless" communities.

### Other Non-Formula Provisions

Several other changes in the program regulations for the Small Cities allocation system are noteworthy.

### Preapplications

The requirements for preapplications were expanded considerably in Program Year Four, both to fulfill legislative requirements and to ensure sufficient data for Area Office reviewers to be able to rate and rank communities using the new national project selection system. The number of items required increased, from six in the previous year, to thirteen for the Fiscal Year 1978 for Comprehensive program preapplications. Most of the additional items were for data to use in the rating and ranking process.

### Size of Grants

The new regulations provided that HUD could establish grant ceilings per applicant for the separate competition categories. Additionally, separate ceilings could be provided for comprehensive multi-year grants, for joint applications among communities, and for applications in behalf of other units of government. <sup>55</sup>

In its preface to the 1978 regulations, HUD made clear it intended that its field offices establish the ceilings. <sup>56</sup> In the first program year, Area Offices had the option to set grant ceilings. This responsibility was withdrawn in the second year. In the third program year, this responsibility had been identified with the Secretary.

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<sup>55</sup> Ibid. p. 8482. Section 570.420(f).

<sup>56</sup> Ibid. p. 8476.

The proposed rules for Fiscal Year 1978 had made provisions for grant minimums. In response to comments on the rules, these provisions were deleted in the final Small Cities regulations.

Again, as in Program Year Three, HUD provided guidelines to Area Offices on determining grant amounts for Small Cities aid. In determining an appropriate grant amount for a community, Area Offices could consider:

"an applicant's population, need, proposed activities, ability to carry out the proposed program, previous funding levels, and availability of hold harmless funds."<sup>57</sup>

#### Funding Commitments

In a related matter, funding commitments, HUD provided regulations for determining the number of years for which a comprehensive program commitment would be made. These were essentially the same as the criteria for determining the grant amount. However, consistent with the 1977 Act, special consideration was to be given to hold-harmless communities.<sup>58</sup>

#### Reimbursement for Preapplication

Several commentors to the proposed regulations had requested that reimbursements for application costs be extended to cover expenses for preapplications as well as for full applications.

HUD had considered this option for several years, but again declined to adopt it:

"Potential reimbursement would encourage the employment of outside experts and could lead to a substantial in-

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<sup>57</sup> Ibid. p. 8482. Section 570.420(f)(2).

<sup>58</sup> Ibid. p. 8483. Section 570.423(b).

crease in the costs of comparing competitive pre-applications. Such a result would be unfair to those communities not selected."<sup>59</sup>

### State Participation

HUD reserved a section of the regulations for 1978 for future rules on state participation in the Small Cities selection process. A provision of Section 104(e) of the Housing and Community Development Act of 1977 permitted the Secretary of HUD to provide States the opportunity to participate in the discretionary grant selection process.

HUD had solicited comments on "workable State roles and on criteria to be used in establishing levels of State participation" when it published proposed rules for the Small Cities Program. Final rules were to be established pending development of an urban regional strategy by the Department.<sup>60</sup>

In the proposed rule, HUD outlined the goals of State involvement: to assist small cities in meeting housing and community development needs in the context of State and regional planning strategies and to coordinate State programs with Federal programs. The degree of State participation could range from actually assisting HUD in the selection process, to providing information and advice, to providing A-95 (Areawide planning agency) comments.<sup>61</sup>

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<sup>59</sup> Ibid. p. 8481.

<sup>60</sup> Federal Register. Vol. 42, No. 223. November 18, 1977. p. 59656.

<sup>61</sup> Ibid.

In its final rules, HUD stated that it was still considering the comments received on State Participation to the request made in the proposed regulations.

#### Summary of Program Year Four

This section has analyzed the changes made in the discretionary program for the fourth program year. New program objectives were defined emphasizing the selection of the best programs that most met the needs of low- and moderate-income persons. A national selection system was designed, with administration responsibility assigned to HUD Area Offices. Two new grant types were created--single purpose grants and comprehensive multi-year grants. New selection criteria were introduced for Fiscal Year 1978, and old criteria refined. The most important of these factors were the subjective program impact factor and the benefit to low- and moderate-income persons factor. Reflecting the 1977 legislative revisions, HUD reserved a section of the rules for future provisions for state participation in the Small Cities grantee selection process.

## Effects of Stage II: Centralization of System Design

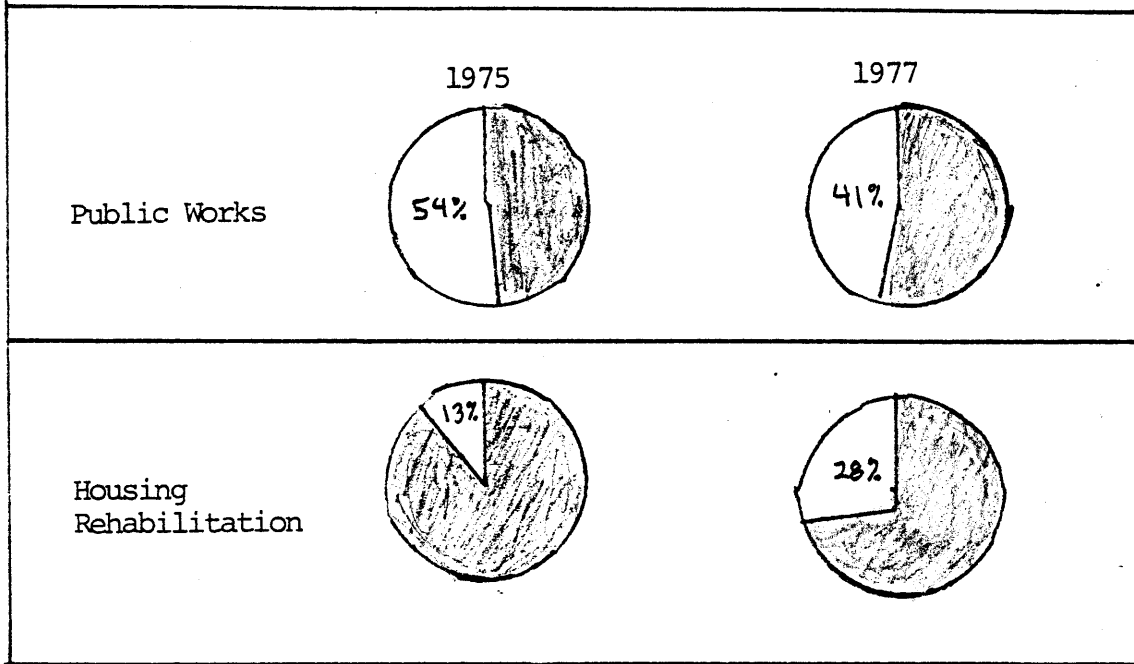
HUD efforts to deal with biases in the selection process toward certain activities had some effect by Program Year Three (1977): more funds were going to housing rehabilitation and less to public works in both metropolitan and non-metropolitan discretionary grant competitions, compared to 1975 (see Figure 2.3)

With creation of the new multi-year grants in 1978, applications for those Comprehensive grants had greater chances of winning Small Cities funds than applicants for Single-Purpose grants. (See Appendix D).

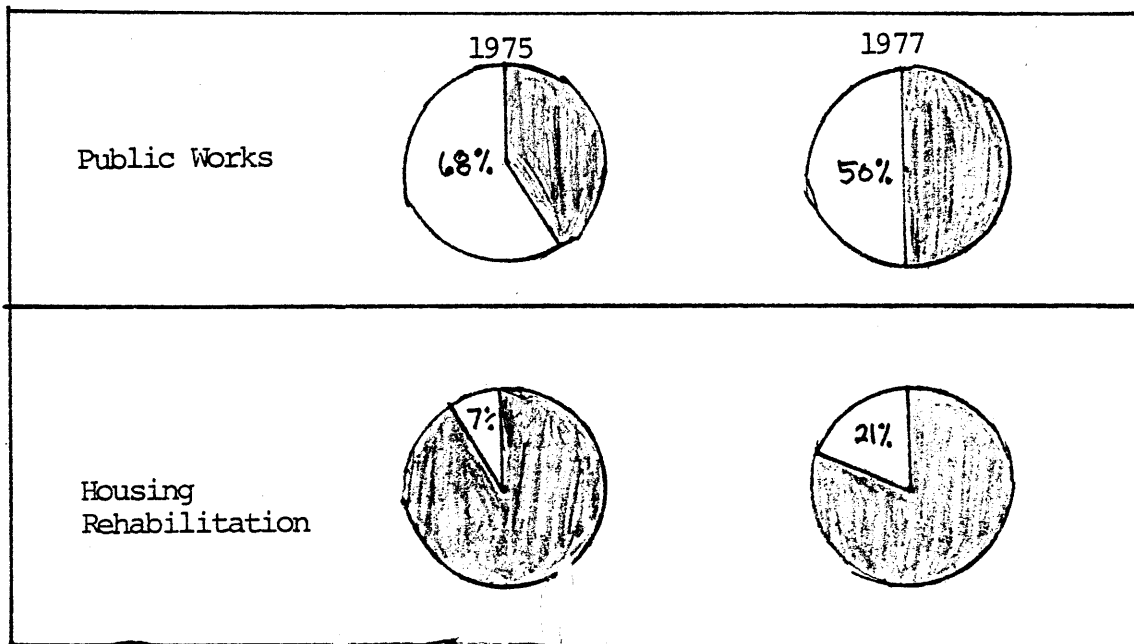
Figure 2.3

Discretionary Grant Activity Shifts  
From 1975 to 1977  
(% of dollars budgeted)

Metropolitan Small Cities



Non-Metropolitan Small Cities



SOURCE: Appendix C, Table 2.20.



STAGE III: REFINEMENT

|           |               |   |
|-----------|---------------|---|
| STAGE I   | 1975          | <p>HUD Area Offices apply need measures to competitive selection of grant winners.</p> <p>Small, high poverty communities with no HUD grant experience win most of the discretionary grant funds.</p>   |
| STAGE II  | 1976-<br>1978 | <p>HUD centralizes the design of the competitive selection systems.</p> <p>Benefit and subjective program impact measures receive progressively greater weight than need measures.</p> <p>HUD refines the selection process to remove "biases" and screen out "low quality projects".</p> <p>Comprehensive multiyear grants are authorized to respond to the needs of "hold-harmless" cities.</p> |
| STAGE III | 1979-<br>1980 | <p>HUD continues to refine the PSS to remove "biases", to add new program objectives, and to use thresholds to screen out "low quality" projects.</p>   |

PROGRAM YEAR FIVE (1979)

The Small Cities CDBG program remained essentially unchanged in the fifth year of discretionary program operations, following the extensive revisions of the previous year. No new program regulations were issued for Fiscal Year 1979.

In its Fourth Annual Report, HUD analyzed the effect and effectiveness of recent Congressional and HUD changes to the CDBG program as a whole.<sup>62</sup> This analysis is also relevant to the Small Cities Program. In particular, HUD cited four crucial methodological problems in monitoring and evaluating CDBG progress:

1. The statutory objectives associated with the CDBG program and the related statutorily-defined permissible activities are broad based. As a result they cannot easily be converted into bona fide, generally agreed-upon progress or impact measures.

Attempts to define other than very simple progress and impact indices have generated and continue to generate deep disagreements among independent analysts over specific Congressional intent. These disagreements have often led to the substitution of varied value judgments for strategic analysis.

2. The relatively limited size and scale of the CDBG program in most grantee jurisdictions makes it difficult to trace complex "cause and effect" relationships with respect to expenditures and Congressionally-defined CDBG objectives.
3. HUD's desire to respond to Congressional intent and to grant recipients flexibility

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<sup>62</sup>U.S. Department of HUD. Community Development Block Grant Program: Fourth Annual Report. Washington, D.C.: U.S. Government Printing Office, no date.

relative to the precise use of CDBG funds has led the Department to limit data collection efforts and to narrowly define data collection and related program monitoring instruments.

4. The early state of the program and frequent statutory and administrative changes in it have heightened difficulties associated with designing and carrying out progress and impact studies.<sup>63</sup>

In the Fourth Annual Report, HUD made no extended analysis of the Small Cities Program, as it had in the previous year.

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<sup>63</sup> Ibid. pp. 4-5 (emphasis deleted).

In the Single Purpose selection system, the way in which the benefit to low- and moderate-income persons factor was scored was altered.

Benefits points were now to be awarded comparatively by the problem area chosen for the program impact factor. That is, communities choosing the same problem area would be ranked together to award benefit points. HUD made this change so that:

"public facility or economic development projects, for which it is almost impossible to have 100 percent of funds benefitting low- and moderate-income persons, will still be able to achieve the maximum points."<sup>64</sup>

#### Other Non-Formula Provisions

Language was added to correct procedural errors, such as processing or mathematical errors, in the final ranking of communities for comprehensive and single-purpose grants. Applicants who would have been invited for funding in the previous year's competition, but for a procedural error, could now be invited to submit a full application for funding from the current year's funds.<sup>65</sup>

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<sup>64</sup> Ibid. p. 37479.

<sup>65</sup> Ibid.

## PROGRAM YEAR SIX (1980)

For Fiscal Year 1980, HUD retained all the essential features of the Small Cities allocation process as established by the program regulations for Fiscal Year 1978. Several relatively minor changes were made in selection criteria and other non-formula provisions.

Selection Criteria

A minor revision was made in the program impact factor. This factor assessed the relative impact of the proposed program, as subjectively determined by HUD Area Office raters, in comparing applicants along several program design or problem area criteria.

In the lowest of the four standards for which impact points were awarded, the word "insignificant" replaced the word "low". HUD clarified that "its intent (was) to achieve as much differentiation as possible on impact points and that it (expected) to award 0 to applicants on some of the criteria where appropriate."<sup>66</sup>

HUD added two more ways in which communities could earn points for performance in equal opportunity.

Communities who participated in HUD's New Horizons Fair Housing Assistance Project or who deposited local funds in minority owned banks were eligible for equal opportunity performance points.<sup>67</sup>

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<sup>66</sup> Federal Register. Vol. 44, No. 124. June 26, 1979. p. 37478.

<sup>67</sup> Ibid.

STAGE IV: REFINEMENT AND DECENTRALIZATION

|           |               |   |
|-----------|---------------|---|
| STAGE I   | 1975          | <p>HUD Area Offices apply need measures to competitive selection of grant winners.</p> <p>Small, high poverty communities with no HUD grant experience win most of the discretionary grant funds.</p>   |
| STAGE II  | 1976-<br>1978 | <p>HUD centralizes the design of the competitive selection systems.</p> <p>Benefit and subjective program impact measures receive progressively greater weight than need measures.</p> <p>HUD refines the selection process to remove "biases" and screen out low quality projects.</p> <p>Comprehensive multiyear grants are authorized to respond to the needs of "hold-harmless" cities.</p> |
| STAGE III | 1979-<br>1980 | <p>HUD continues to refine the PSS to remove "biases", to add new program objectives, and to use thresholds to screen out "low quality" projects.</p>   |

|          |      |  |
|----------|------|--|
| STAGE IV | 1981 | <p>Refinement of the system continues. HUD involves the States in selection process. The Reagan administration proposes transfer of the program to the States.</p> |
|----------|------|--|

## PROGRAM YEAR SEVEN (1981)

For Fiscal Year 1981, the regulatory revisions in the allocation system for the Small Cities Program are consistent with the changes established in prior revisions. Most of the changes related to the selection criteria. In addition, a demonstration project on State participation in the Small Cities project selection process was initiated.

Design and Administration of Selection Systems

State participation had been an issue since the beginnings of the discretionary CDBG program. The Ford Administration had suggested that states administer the program. In the first program year, additional priority could be given to proposals involving joint and voluntary agreements between states and local governments. In the 1978 program revisions creating the Small Cities Project Selection System, points could be earned by grant applicants who participated in a State growth or resource coordination plan. And a section of the 1978 regulations was reserved for State participation rules.

For Fiscal Year 1981, State participation has been increased in two ways: (1) a State rating factor; and (2) a demonstration project in which two states, Kentucky and Wisconsin, design and administer the selection systems in their state competitions.

Kentucky's system submitted to HUD in Fall, 1980 for their approval is substantially the same as HUD's.<sup>95</sup>

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<sup>95</sup>Housing and Development Reporter. Vol. 8, No. 27. November 10, 1980. pp. 499-500.

Wisconsin's selection system differs substantially from the national selection system. The Wisconsin criteria reduce the weight of the benefit to low- and moderate-income persons factor by 75%, provide bonus points to economic development projects, and introduce "distress criteria" to select the most troubled cities. In addition, the Wisconsin system permits communities to use updated locally available information and divides applicants into two groups, those with less than 5,000 population and those over 5,000, for purposes of evaluation.<sup>96</sup>

#### Thresholds to Compete

The previous section described the results of the demonstration project in state participation on the design and administration of selection systems. This section continues the description of changes in HUD's national Project Selection System for Program Year Seven.

For Fiscal Year 1981, HUD provided for new thresholds for the award of grants. These new requirements were laid out in the small cities community development block grant field manual, which guides field offices in administration of the Small Cities Program.

With a new stress on benefits to low- and moderate-income persons in the program regulations for the seventh program year, the handbook warns that "preapplications which propose less than 50 percent principal

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Housing and Development Reporter. Vol. 8, No. 40. March 2, 1981. p. 828.



benefit to low- and moderate-income persons may be funded only on an exceptional basis."<sup>97</sup>

A new set of minimum standards for several criteria was also outlined. In addition to receiving total points based on the program criteria, preapplications will be ranked in one of four categories depending on their projects' demonstrated need, low- and moderate-income benefits, likely community impact, and support from the local A-95 areawide planning agency clearing house. Preapplications falling in the lowest category won't be awarded funds, regardless of their total program score.<sup>98</sup>

Performance thresholds were also emphasized in the new regulations. According to one HUD official, the rule changes were designed to target funds to the communities with the best projects and most efficient records.<sup>99</sup>

For Fiscal Year 1981, a community's capacity and performance will be "based in part on the applicant's adherence to its own schedule."<sup>100</sup> Specifically, HUD will look at drawdown rates (the rate at which a grantee draws funds from HUD), program implementation, program compliance and housing production performance.<sup>101</sup>

In addition, regarding the award of funds, no invitations for full applications will be made to communities that score zero impact points.

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<sup>97</sup> Housing and Development Reporter. Vol. 8, No. 34. January 19, 1981. p. 689.

<sup>98</sup> Ibid.

<sup>99</sup> Housing and Development Reporter. Vol. 8, No. 12. August 18, 1980 p. 209. emphasis added.

<sup>100</sup> Housing and Development Reporter, Reference File. RF-172. September 8, 1980. p. 09:3503.

<sup>101</sup> Housing and Development Reporter. op. cit.

HUD explained:

"In previous competitions, a few applicants with zero points for program impact have been selected for funding, not because their program impacted their identified needs, but because of high scores for other selection factors."<sup>102</sup>

### Selection Criteria

The regulations for 1981 revised the project selection system factors in a number of major ways. The table below presents the criteria as revised followed by a discussion of the revisions.<sup>103</sup>

#### SMALL CITIES SELECTION POINT SYSTEM

| Factor   | Comprehensive |          | Single Purpose |          |
|--|---------------|----------|----------------|----------|
|  | metro         | nonmetro | metro          | nonmetro |
| (a) Need -- absolute number of poverty persons | 75            | 75       | 75             | 75       |
| (b) Need -- percent of poverty person          | 75            | 75       | 75             | 75       |
| (c) Program impact*                            | 400           | 400      | 400            | 400      |
| (d) Benefit to low and moderate income person  | 200           | 200      | 200            | 200      |
| (e) Performance:                               |               |          |                |          |
| Housing  | 100           | 100      | 100            | 100      |
| Local equal opportunity efforts                | 50            | 50       | 50             | 50       |
| (f) Areawide Housing Opportunity Plan (AHOP)   | 50            | —        | 50             | —        |
| (g) State's rating                             | 25            | 25       | 25             | 25       |
| (h) Energy conservation or production          | 20            | 20       | 20             | 20       |
| (i) Other Federal programs                     | —             | —        | 25             | 25       |
| TOTAL Possible                                 | 995           | 945      | 1020           | 970      |

\*Applicants cannot score zero points and still be funded.

The changes:

Reducing the weight of the needs factors and giving equal weight to the two poverty needs factors

<sup>102</sup> Housing and Development Reporter, Reference File. op. cit. 09:3502.

<sup>103</sup> Housing and Development Reporter. op. cit. p. 210.

HUD's rationale for the reduction in weight of the needs factors, which in the original system equaled 200 points, was the following:

"These factors measure the needs in the entire community, not the needs to be addressed in the proposed project. The weight of these factors, which do not directly relate to a proposed project, occasionally allowed poor quality projects to rank highly enough to be funded."<sup>104</sup>

HUD's reduction in the weight of the two need factors retained was intended to give greater weight to factors over which the applicant has more control, by means of a 25% reduction in the weight of need (from 200 points down to 150 points).

In regard to the equal weighting of the two poverty need factors, most commentors to the rule recommended such a change. HUD stated its position:

"The Department believes that the rating system is fair for all program participants because the rating system has been designed to emphasize overall grant quality. Giving equal weight to absolute and percent of people in poverty will more accurately measure the needs or distress of a community."<sup>105</sup>

It will be recalled that in Program Years Two and Three, the regulations were revised to specify that absolute and percentage need measures be given equal consideration in order that the selection system not be biased toward smaller communities.

However, in its Third Annual Report, HUD concluded that "recipient-

<sup>104</sup> Housing and Development Reporter, Reference File. op. cit. p. 09:3503.

<sup>105</sup> Ibid. p. 09:3504. emphasis added.

wide measures of need do not consistently affect the selection decisions (for the first three program years) when measures are expressed as percentages, or as a combination of percentages and actual amounts."<sup>106</sup>

Yet, in Fiscal Year 1978 (Program Year Four), HUD justified the increased weight of absolute need measures (to twice the value of percentage measures) as a way to correct an advantage toward smaller communities in Fiscal Year 1977 arising from the equal weighting of needs factors. Evidence for this advantage was the award of funds to smaller communities far in excess of their percentage of persons residing in cities under 50,000.

#### Eliminating Housing Needs Factor

The selection criteria for the Fiscal Year 1981 system delete the objective housing need criteria completely. This factor was eliminated because "it was difficult for applicants to get adequate information on housing quality."<sup>107</sup>

HUD gave a more detailed explanation in the preface to the final rules:

"In addition there are indications that the measures of housing need (the incidence of overcrowded housing and housing lacking plumbing), are declining rapidly in some areas, but not others. Therefore, the factors are becoming less useful in measuring an individual small community's relative needs, and give unfair advantage in the selection system to communities with improving housing stock. (The same is not true of larger cities and small cities in Statewide aggregates because the

<sup>106</sup> HUD. Third Annual Report. op. cit. p. 281.

<sup>107</sup> Housing and Development Reporter. op. cit. p. 209.

data base is larger and therefore more reliable.) Poverty is a stronger reflection of needs and less likely to unfairly disadvantage poorer communities.

Since the needs factors will carry a reduced weight and since the housing needs data are weak and dated with respect to individual small cities, HUD is eliminating the housing needs factors' fifty points in the selection system. The public supported this action by an almost 3 to 1 margin."<sup>108</sup>

Adding Comprehensive Grant program impact criteria dealing with economic development and energy conservation

The first of these criteria was supported by commentators to the proposed rules; this factor permits programs to attract or retain businesses that provide essential services.<sup>109</sup> The second criterion "recognizes the crucial need for energy conservation considerations in every facet of community development activities" and permits the design of programs which support energy conservation or production.<sup>110</sup>

In addition, area offices were advised "to be more broadminded about the different neighborhood conservation projects to be funded." One Small Program official said Area Offices had been limiting cities to rehabilitation projects, and the field handbook now suggests other options, such as economic development. Area Offices were also advised to be "flexible and open to innovation" in evaluating energy and economic development proposals.<sup>111</sup>

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<sup>108</sup>Housing and Development Reporter, Reference File. op. cit. p. 09:3503.

<sup>109</sup>Ibid. p. 09:3504.

<sup>110</sup>Ibid. p. 09:3505.

<sup>111</sup>Housing and Development Reporter. Vol. 3 , No. 34 , January 19, 1981. p. 689.

Increasing the weight of the Single Purpose program impact factor

Due to the relative weight of the program impact factor in the original Single Purpose selection system (less than 25% of the 875 total points),

"...projects with little significance in meeting identified needs were occasionally funded while projects with substantial impact were not."<sup>112</sup>

To correct this, the weight of this factor was increased to about 40% of the total possible points.

Replacing the two criteria about State growth and resource coordination with one factor, and upon HUD approval of a State's 701 planning strategy statement, allowing a State to award up to 25 points for the factor

This new State's rating factor was mentioned in the previous section on state participation in the project selection process.

Seven commentors to the rule, including four States, supported it, 22 opposed it, and two others expressed reservations. Opponents questioned whether the State's evaluation criteria would be publicly available, whether States have a capacity to review many preapplications, and whether State decisions would reflect political considerations. HUD felt the final rule adopted dealt with these objections.<sup>113</sup>

Other Non-Formula Provisions

Another administrative program was planned for 1980, though not a formal part of the Small Cities Program. Small city capacity to apply for

<sup>112</sup> Housing and Development Reporter, Reference File. op. cit. p. 09:3508.

<sup>113</sup> Ibid. p. 09:3507.

and administer community development and physical improvement programs had been an issue since the first years of the discretionary grant program. In 1977, the legislative revisions to the Housing and Community Development Act authorized the use of the Secretary's Discretionary Funds to provide technical assistance to CDBG grant communities.

As part of its new rural development policy, the Carter Administration announced in June 1980 its plans to ultimately have about 300 private consultants "assisting circuits of small communities with state and federal development programs." This "circuit rider" program was intended to give communities with less than 20,000 population full access to federal programs for hospitals, housing and sewer construction.<sup>114</sup>

In the 1978 Small Cities Program regulations, HUD had declined suggestions that communities who won grants be reimbursed for the costs of preparing preapplications. This was to avoid driving up the costs of competing resulting from increased use of outside consultants to prepare Small Cities project plans.

This completes the description of changes in the Project Selection System for Fiscal Year 1981. This chapter so far has described the development of the Small Cities CDBG Program Project Selection System.

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<sup>114</sup>Housing and Development Reporter. Vol. 8 , No. 53 . June 9, 1980.

HISTORY OF ADJUSTMENTS TO THE PROJECT  
SELECTION SYSTEM: THE PROBLEMS, THE RESPONSES

In discussing the major problem areas and major agency responses I will try, where possible, to identify whose problem it was, whether HUD central or Area Offices, or the major groupings of communities eligible for Small Cities aid--larger or smaller cities, metropolitan or rural communities, "hold-harmless" or non-"hold-harmless" grantees. First, I will discuss the problems identified, and then, the responses of the HUD central office.

Problems Identified

There are nine problem areas that I will describe:

- o "Bias": the selection of grant winners
- o "Bias": the selection of activities
- o Local flexibility
- o Area Office capacity
- o Area Office discretionary power
- o Community capacity
- o Needs of "hold-harmless" communities
- o Sensitivity of the selection system
- o Data



"Bias": The Selection of Grant Winners

Both the agency and eligible communities identified inconsistencies between the outcomes of the selection process and their expectations of what its outcomes should be.

In Program Years Two to Four, HUD officials felt that the Small Cities selection system had favored small, high poverty applicants. By the seventh year, HUD perceived a bias toward other types of communities.

Smaller communities felt that some features of the 1978 Project Selection System, such as performance and capacity thresholds, worked against all smaller communities.

"Bias": The Selection of Activities

Some communities believed that the national project selection system favored certain types of local development activities. In 1978, communities charged that the selection criteria revealed HUD's preference for particular community development activities.

In later years, both HUD and eligible communities saw a bias in the earlier system in favor of housing activities and against economic development projects.

Local Flexibility

Communities felt that HUD's selection process constrained local choice in setting priorities for community development activities. They felt that high priority local projects could not be pursued, because of the strictures of the selection system.

#### Area Office Capacity

HUD officials felt that the selection process, in the first three program years, created high overhead and a work overload for the Area Offices who administered the system.

#### Area Office Discretionary Power

Both HUD officials and participating communities were concerned about the use and misuse of administrative discretion by Area Offices.

HUD officials felt that initial overly strict interpretations of the regulations by the Area Offices had biased the selection system toward smaller, higher poverty communities.

When the national selection system was proposed for 1978, some communities thought that Area Offices would be given too much discretion in considering program impact, in rejecting local data, and in assessing other subjective selection factors.

#### Community Capacity

Eligible communities wanted HUD to provide more and better technical assistance to improve community capacity to compete for and administer Small Cities projects.

HUD felt that deficiencies in community capacity required capacity thresholds and performance measures to ensure that those who won grants could carry out their programs.

#### Needs of "Hold-Harmless" Communities

Both HUD officials and representatives of small hold-harmless cities

felt that the discretionary program of the first three years had failed to serve the community development needs of hold-harmless communities.

HUD justified the reshaping of the program in 1978 as a way to meet the needs of "hold-harmless" grantees--comprehensive programs, multi-year funding, larger grant amounts.

Hold-harmless communities believed that the program did not serve their needs, and that the uncertainty of the competitive selection system disrupted local development efforts.

#### Sensitivity of the Selection System

HUD felt that the selection system failed to measure need well and allowed poor quality, low need projects to win funds. They believed that community need measures did not discriminate well between needy and non-needy communities, between high quality and low quality projects. The wrong weighting of factors and the lack of thresholds reduced the ability of the system to select good projects and avoid bad ones.

#### Data

For both HUD and applicant communities, the quality and type of data required by the selection process raised difficulties. Were census data used for the need factors too outdated, too unreliable for small communities? Did the poor quality of some data flaw or bias the selection process? Was uniformly available but outdated census data better than more timely but less comparable locally- or state-produced data? Was too much or too little information required for the assessment of subjective rating factors such as program impact?

Agency Responses to Problems in the Selection System

For each generic type of agency response, I will briefly describe the nature of the response and the problem areas it addresses.

Five generic types of response by the HUD central office will be discussed:

- o Redefine objectives
- o Redistribute administrative discretion
- o Reformulate the formal allocation process
- o Provide other resources
- o Create new programs.

Redefine Objectives

HUD has redefined the formal objectives of the discretionary grant programs several times.

Specific objectives were stipulated in 1978, the fourth program year. Prior to that, HUD had restated the broad Congressional goals in the first year. In Program Year Four, HUD specified the objectives of benefit to the poor, housing opportunities, rational land use, and better public facilities. In later years, grantee program quality was stated as a specific program objective.

Primary goals were defined for the program in regulatory statements. Benefit to the poor, housing activities, program quality and economic development have been cited at various times as primary goals in the regulations and in statements by program officials.

This generic response has been a reaction to "bias" in the selection of activities.

#### Redistribute Administrative Discretion

HUD has altered the distribution of administrative discretion and program authority for the Small Cities program--who is responsible for specific aspects of administration, who reviews the decisions of each organizational level.

The central office has shifted the responsibility for design and administration of the competitive selection systems. In Program Year One, Area Offices designed the rating system; in the next two years, Regional Offices were assigned that task, and were given increasingly specific instructions; the national office designed the systems in the fourth year; for Fiscal Year 1981, in a demonstration project, States design and administer their own selection systems. Most recently, HUD under the new Reagan administration has proposed shifting primary program responsibility to the States by Fiscal Year 1983. Over several years, Area Office discretion to make grant awards and funding commitments, to waive certain requirements, has been decreased, then increased, with some responsibilities going to the Regional Offices, others to the central office in Washington.<sup>1</sup>

This redistribution has been a response to the problems of "bias" in the selection of grant winners of activities, Area Office discretionary power, and sensitivity of the system.

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<sup>1</sup>Housing and Development Reporter. Vol. 16, No. 12. August 21, 1978. p. 323.

<sup>2</sup>Housing and Development Reporter. Vol. 8, No. 42. March 16, 1981. pp. 868-869. and Vol. 8, No. 48. April 27, 1981. pp. 992-993.

#### Reformulate the Formal Allocation Process

HUD has reformulated the selection scheme in order to improve its performance in selecting grant winners.

The agency has changed the conditions for entry into the program by refining eligibility guidelines and by allowing new types of applications, such as "in-behalf-of" and joint applications, and by requiring preapplications and additional application elements. Also, the development of entry thresholds (e.g., greater than zero program impact factor scores) has changed the conditions for entry.

HUD has altered the selection criteria of the rating and ranking systems. New factors have been added, old ones deleted; the relative weights of some factors increased, others diminished. HUD has revised the procedures for assessing some factors. For example, the method of measuring benefits to the poor has been revised, and the procedures and criteria by which applicants are compared have been altered as well. The types and sources of data have been changed as the scoring criteria were altered.

Reformulation of the formal allocation process has addressed the problem areas of bias in selection of grant winners and activities, local flexibility, Area Office discretionary power, community capacity, sensitivity of the system, and difficulties with data.

#### Provide Other Resources

HUD has developed and delivered other resources to eligible communities, in particular, technical assistance to aid communities in preparing

proposals and operating their programs. Also HUD has developed data for use by applicant communities.

This agency response has addressed the problem areas of Area Office capacity and community capacity.

#### Create New Programs

HUD, with legislative assent, has created new programs, within the discretionary program and outside of it as well. The Comprehensive Grant element of the fourth program year is a new program created side-by-side with the existing program, which was retained as the Single Purpose Grant element. That the Comprehensive Program is a new program is clear, with its different funding period, eligible activities, application requirements, and separate selection system.

HUD has also created a new program outside the CDBG process. The Urban Development Action Grant (UDAG) Program provides community development aid to large and small cities in exceptional distress.

The creation of new programs has addressed the problem areas of local flexibility, needs of "hold-harmless" communities, and bias in the selection of activities.

CHAPTER III

A FRAMEWORK FOR ANALYZING  
THE SMALL CITIES PROGRAM  
FORMAL ALLOCATION PROCESS



A FRAMEWORK FOR ANALYZING THE  
SMALL CITIES PROGRAM  
FORMAL ALLOCATION PROCESS

The adjustments, evaluations and outcomes of one formula allocation system, the Small Cities CDBG Program Project Selection System, have been reviewed in Chapters One and Two. This chapter will consider the question of what is a good formula allocation system, in the context of a decentralized grant program.

The first section of this chapter will discuss the general characteristics of allocation processes that use need-based formulas, and compare the Small Cities PSS to those general features. Then, I will delineate the circumstances needed for a formula to work well in allocating aid, first for a program with a single objective, then for a program with multiple objectives. The fourth section will treat the organization's problem, i.e., the implementation problems that a formula allocation process poses for the agency that administers it. In the final section, I consider the role of competition in a need-based allocation system.

Characteristics of Grant Allocation Formulas

Allocation formulas--in general, elementary linear weighted mathematical equations--are used to distribute billions of dollars of federal funds to state and local governments, as legislatively specified. Using these formulas, the executive departments, such as the Department of Housing and Urban Development, compute entitlement grant amounts, based on quantitative measures of need, such as percentage of target population, number of eligible families and age of housing, and of performance, such as tax effort.

While the Small Cities Project Selection System (PSS) shares the linear additive form and community need factors of the CDBG "entitlement" grant allocation formula (Appendix A), it differs in key ways. Its primary purpose is to rank grant applicants to determine winners in a competitive process. Its factors include subjective merit criteria with greater weight than the objective need measures. Its purpose of ranking applicants requires a separate discretionary determination by HUD of suitable grant amounts. Its use is restricted to allocation of state pools of funds that are determined by an allocation formula almost identical to the CDBG entitlement formula.

Therefore, my analysis of what is a good formula allocation system will first consider linear weighted allocation formulas in general, and then extend the framework to include the use of organizational discretion and the role of competition in the allocation system.

Table 3.1

Characteristics of CDBG Entitlement and  
Discretionary Formula Allocation Systems

|                     | Entitlement                             | PSS                                   |
|---------------------|---|---------------------------------------|
| Purpose             | Determine grant amounts for entitlement | Rank grant applicants for competition |
| Form                | Additive                                | Additive                              |
| Factors             | Need(3)                                 | Need(2)<br>Merit(7)                   |
| Burden of Proof     | HUD                                     | Grantee                               |
| Dual Formulas       | Yes                                     | No                                    |
| Grant Maxima        | No                                      | Yes                                   |
| Thresholds          | No                                      | Yes                                   |
| Eligibility Cutoffs | No                                      | Yes                                   |
| Applicant Classes   | 1                                       | 4                                     |
| Grant Amount        | Formula Determination                   | Discretionary Determination           |

A Good Formula Allocation:  
A Single Program Objective

A good formula allocation system will predictably and understandably determine grant amounts or rank applicants in accordance with some generally accepted notion of deservedness (need and merit). To work well, community need, the measurement of need, and the responses of participants in the system must combine in a way that reflects the elementary nature of the allocation formulas. To the extent that the program setting diverges from the assumptions of the mathematical equation chosen to make the allocation decisions, the working of the system will be less predictable, less understandable, and, as a result, less satisfactory to policymakers, agency administrators and program users.

It will be useful to consider an elementary case: the use of a linear weighted sum formula to allocate a single resource (dollars) to help meet a single need (housing).

Three categories describe the program setting: who has the dollars--the funding agency; who gets the dollars--eligible states, towns, and cities; who benefits from the dollars--program beneficiaries.

Need

The illustrative allocation process will divide up resources to reduce the single need, housing. A first requirement for the formula to work well is that the funding agency, grantees, and beneficiaries share a common understanding of the nature of need. If program participants do not agree on what need is, that is, have different opinions of what aspect

of need should be addressed, then the formula allocation will always be seen as unsatisfactory by at least some, if not the majority of program participants.

Such a shared understanding is difficult to achieve. The formula will operate as a proxy for consensual decision making on the detailed aspects of need. Those aspects of need include:

- o who is needy (persons, regions, governmental units)
- o how need is created (market forces, national policy, personal efforts, natural disaster)
- o how to tell the needy from the non-needy
- o who knows best about the ways to meet need
- o how need changes over time

For example, consider a single need, housing. Is the problem bad housing or too little housing? Are some "truly needy" while others are not? Is it important to deal with absolute need (a thousand families living in substandard housing) or relative need (giving priority to the very neediest first or to areas with high concentrations of need). Is housing need a function of income, poorly built units, or regional differences in climate? When has "enough" need been met?

Lacking some unambiguous agreement as to the nature of the need to be met through the allocation process, any allocation formula will suffer an inherent lack of specificity and focus--policymakers will never find the right formula. Those whose diagnosis of the nature of the housing problem and need veers away from the diagnosis assumed in the design of the allocation formula will always perceive as faulty the allocation based on that diagnosis.

For example, small towns in the West and South may feel that their "housing problem" is due to insufficient construction. They may always consider erroneous an allocation formula that uses age of housing as a measure of need.

Or, some program participants may feel that housing need is more than a simple summation of individual needs. Perhaps housing need becomes greater when other types of need are present (for example, the effects of overcrowding may be more or less severe depending upon housing density, family composition, or age of residents). Then, an additive formula will not be seen as the right form for those who hold this view of need.

And, perceptions of need change over time. As income, personal tastes and the relative levels of need change, so too will the perception of what housing need is. Again, a formula based upon prior agreements as to the nature of housing need will be seen as providing an incorrect allocation, because the new housing need will not be distributed among eligible communities in the same way as the old housing need.

Thus, need, when considered for a single objective program is dynamic, complex and value dependent. Any single need can be thought of in several ways, and, to the degree that eligible communities are dissimilar in the aspects of need they experience, agreement among program participants will be difficult to obtain, unstable, and based upon compromises of differences in values (priorities) among the participants in the formula allocation system.

#### Measurement

Agreement may be achieved regarding the nature of need; still, an-

other requirement is necessary for a formula allocation to work well: acceptable proxy measures of need must be available.

An allocation formula requires some numerical assessment of the extent of need. The housing needs of eligible communities has to be measured --age of housing, number of substandard units, number of residential building code violations--using data that meets minimum standards of accuracy and comparability among eligible communities.

That measurement of need will always be indirect and imperfect. Need may be too dispersed or too large to measure precisely at a cost and within a period of time that we can afford: some acceptable proxy indicator or relative measure of need is necessary. If some measure of absolute need is not attainable, then measures of relative need among communities can be used in its place.

How good a need measure will be depends on how clear the definition of need is, how costly the measure, how accurately need can be assessed, how often the necessary data is collected. For the measure of need as well as for the definition of need, program participants will have to agree on how much imperfection is tolerable.

The different participants are likely to weight differently the errors introduced into the allocation process by a particular proxy measure of need. A five percent possible error from the point of view of the funding agency may represent much greater error from the program beneficiaries' point of view (for the marginal beneficiary, it may represent the difference between getting and not getting aid) or from the grantee's point

of view in the Small Cities Program (the error may switch the rankings of applications).

Therefore, the proxy measures of need must be accurate enough so that their errors fall within a range acceptable for each of the different program participants. In judging whether this is the case, several types of error need to be considered.

An error of specificity occurs if the proxy measure includes those who fall outside the accepted understanding of need. If housing need is felt to be a condition of those who live in substandard housing because they cannot and will not be able to afford decent housing, then a measure which includes the poorly housed middle class student will have an error of specificity. The measure will be seen as well functioning if its error falls within an acceptable range.

An error of sensitivity occurs if the proxy measure misses some of those who fall within the accepted understanding of need. If housing need is a condition of people, rather than structures, then a proxy measure which assesses housing need by counting substandard structures may miss those without permanent address, migrant workers, etc. Again, if the degree, or distribution, of this type of error is acceptable, then the measure will be seen as well functioning.

An error of reliability arises from imperfections in the process of measurement. A good example of this is the U.S. census undercounting of certain groups, such as young Black males in central cities. Again, if the degree of error is acceptable, or if random errors balance out, the



measure will be judged adequate.

Any proxy measure of need chosen will suffer from these types of error. The need measures may be unacceptable for other reasons as well. Decennial census measures of housing need will become increasingly outdated. Since the degree of need among communities will change at different rates, untimely data introduces new errors in the formula allocation process. Sample census data may not be reliable for small places. Local data on housing condition may be insufficiently comparable due to different definitions of need, or the quality and timing of measurement. Again, to the extent that program participants are willing to accept (even unknowingly) the error introduced by these data problems and the allocation of funds based upon such measures, the formula will be seen as working well.

While any allocation process is subject to error (and some disagreement or confusion over the nature of need and the specific program objective), formal allocation processes that depend on need-based formulas allow such errors to be easily noticed. A political or administrative discretionary allocation decision may be more subject to errors, but the criteria used to evaluate them are less stringent and explicit. Formula allocation may well be better than alternative means of dividing aid resources.

#### Participant Response

In addition to requirements for need and measurement, the nature of participant response to the formula allocation process affects how well the formula will be seen to work.

First, at the most basic level, the problem addressed must be amenable to the application of money or other resources. Program participants --the grantees--must be able to engage in activities that reduce need (in our example, that better house families as a result of the allocation process). This requirement links back to the nature of need (and potential disagreements about need). However, the response of participants may be to see flaws in the formula allocation ("the formula doesn't allot us enough resources to deal well with our needs") rather than in the diagnosis of the housing problem on which the program is based.

Second, the use of a linear weighted formula suggests that communities receiving aid have the same marginal productivity in meeting needs, and face the same processes by which need arises. A dollar spent by one community to reduce housing need will reduce the same amount of need when spent in another community. And, a dollar spent by a community with little need will have the same marginal impact as when spent by a community with great need. This requirement (arising from the linear form of the allocation equation and its restriction to need measures), when not consistent with the program context, again, may result in perceptions of error in the formula allocation--"the wrong factors were chosen", "the need measures were too imprecise," "differences in need (or deservedness) should have been taken into account." For either an entitlement or competitive allocation process, divergences in this requirement will result in perceptions of unfairness in the system.

Third, participant response also means that eligible communities will utilize the program, and that the funding agency administers the program in a way that eligible communities have access to the program (in

accordance with an accepted standard of equity). For many different reasons, that may not occur--eligible communities may choose not to participate, may fail to prepare an adequate application, or may lose eligibility for infringement of the funding agency's regulations; the funding agency may be unprepared to deal with all eligible communities, or may have regional variations in its administrative practices that affect utilization of the aid.

Fourth, a formula allocation presumes that the offer of aid or its receipt will have no unintended incentive effects, either for grantees or for program beneficiaries. Communities will not substitute the grant for housing aid for other locally financed housing activities; families will not make themselves "needy" (in accord with the definition of need and its measures) in order to take advantage of the program's benefits. To the extent these occur, the formal allocation process will be viewed as biased or faulty. When detected, these effects will create demands for adjustments in the allocation system, either through redesign of the formula, or through revision of eligibility requirements or of administrative practice.

Fifth, the minimum aid provided to a community must be sufficient to make a difference for the extent of need. That is, the minimum aid must be greater than production thresholds or trigger points. Again, exceptions to the formula allocation may be demanded to deal with any divergences. For the formula to work well, either thresholds must affect sufficiently few communities as to be considered an acceptable error, or adjustments to deal with those errors must be made.

Related to this is a requirement that the formula allocate enough

aid, but not too much, in the sense that a community may not be able to handle the scale of program consistent with the amount of aid (through wastage, "free spending", or failure to spend all the money on the program objective). While this can be diagnosed as a community capacity problem, its immediate interpretation may well be as a formula problem. (And, it's easier to alter the formula than to alter capacity).

Need, measurement and participant response will affect how well a linear weighted allocation formula will work. Even a single need is complex, dynamic and a subject of disagreement; proxy measures are subject to error and are costly--to the extent program participants do not agree on the nature of need, the errors will be weighed differently; participant response is complicated by the varieties of local need, effort and capacity and by unintended effects of the process of giving aid.

In the case of a simple program to provide local grants to deal with housing need, a formula approach will have effects other than those originally considered by its designer, effects necessitating a continual process of adjustments in the allocation system.

A GOOD FORMULA ALLOCATION:  
MULTIPLE PROGRAM OBJECTIVES

Despite the difficulties in the use of a need-based linear weighted allocation formula in the simple case of a development program with one objective, these formulas are applied most often in the more complicated case of a multiple objective program.

Instead of attempting to meet a single need, the formula allocation system apportions funds among communities that will decide how to use the funds to meet several local development needs.

In the case of the Small Cities Program, a local project may include economic development, service facilities, housing rehabilitation, public works, or some combination of these and other activities. Theoretically, communities have sole responsibility to determine priorities among local needs and to design activities to meet those needs, in accordance with limited national objectives for the program.

A typical formula designed to allocate funds for multiple purposes (or to rank applicants for multi-purpose grants) looks no different than a formula for a single objective program.<sup>1</sup>

For such a multiple need formula, all the conditions for a single need allocation formula to work well apply. However, the combination of different program objectives in the formula creates new complications and sources of error (inconsistency of outcomes with expectations).

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<sup>1</sup>For example, compare HUD's Fair Share low-income housing allocation formula with the CDBG entitlement grant formula.

Need

If an allocation formula for a multiple objective program is to work well (to predictably and understandably allocate resources in accordance with program goals), participants must share a common understanding of the various aspects of need. Again, this understanding must extend to the definition of who is needy, how the needs are created, how to tell who is needy, who knows best how to deal with the problems, and how needs change over time.

In my earlier example, this understanding was required for the need "housing". For the multiple objective case, this requirement might include the needs "housing", "economic development," and "social services."

However, in the multiple objective case, the complexity of reaching a common understanding is enormously increased. For now, the relations among the various needs must be well enough understood to separate out the diverse aspects of each need.

For example, consider the three needs mentioned above:

- o Are people with housing need the same as people with economic development need and those with social services need?
- o Is economic development a need of individuals or of communities?
- o What economic or social links exist between the different needs?
- o How will changing one affect the others?

Program participants must also agree on the relative importance of each need. Suppose participants could agree that economic development need is twice as important as housing need, and then designed a formula

that gave twice as much weight to a measure of economic development need as to a measure of housing need.

If economic development programs have no impact on housing (and vice versa), and each local area spends twice as much on economic development as on housing, then the 2 to 1 formula weights can, in some sense, be regarded as priority weights. One still might ask whether each dollar spent on economic development has as much effect as each dollar spent on housing. When the effects are not so separable, the meaning of formula weights is equally complicated.

Those who disagree with the theory of the problem (the relations between the various needs) and with the nominal relative importance of each need (the weighting of factors) will always have grounds to criticize the allocation of a particular formula system. To the extent that needs (however measured) are differently distributed among communities, the formula will not be seen as working well, unless participants agree on the national share of resources to go to each need, whatever the distribution of each need among eligible communities.

Even if program participants agree on the nature and importance of each need, such an understanding, unfortunately, will contribute little to perceptions of formula success. More likely, each community will tend to evaluate the formula allocation on the basis of the distribution of their priority needs. As a result, all communities will have some dissatisfaction with the formula allocation.

Thus, allocation formulas used for multiple objective programs are difficult to rationalize for block grant programs that emphasize local

discretion. The result is an additional layer of formal allocation rules to correct the limited scope of the formula in the allocation system.

### Measurement

As in the single need example, acceptable proxy measures must be available for a linear weighted allocation formula to work well in the case of multiple program objectives.

For example, need measures would have to be obtained for housing, economic development, and social services need, again within a range of errors of specificity, sensitivity and reliability tolerable to program participants.

However, the different kinds of need will overlap to some extent. The needs may not be defined clearly enough to find measures sensitive to just one kind of need. Since the needs are interrelated (in a way that depends upon one's view of the problem), the measures will tend to be correlated, and each measure will contribute less toward differentiating among eligible communities (with some unknown degree of error).

### Participant Response

For the case of a multiple objective program, participant response to the allocation process also affects how the formula will be seen to work.

Again, the problems that the program addresses must be amenable to the application of money or other resources. The range of problems addressed is much broader, and the mix of activities will differ from one community to another. This broader scope makes comparisons among communities more difficult.



The desire to find out how communities compare to one another, both in their productivity and in the nature of their needs, is not a bad idea. However, most practical means of comparison will result in charges of unfairness .

When some efficiency measure (such as drawdown rates), or impact measure (such as benefit to the poor), or equity measures (such as per capita allocation) is used to compare communities, and then added to the factors in the allocation formula, some communities will always charge that the allocation system results in restricted local flexibility, and that the "incentives" of the system work against local priorities.

#### Ambiguity

When Congress states a program's goals in ambiguous, vague and inconsistent ways, they serve the process of political bartering. To agree to a program only partially understood or desired may be better than to stalemate.

Block grant formulas then serve an additional function: shifting political decisions to another level of government in order to avoid stalemate, as well as dividing resources based on need, and decentralizing decisionmaking in order to get better decisions about priorities among needs.

Since reaching an agreement on need, measurement and participant response is so troublesome, ambiguity plays another important role: reducing tensions or disagreements over program objectives by reaching agreement on vague or ambiguous grounds.

The first cost of this use of ambiguity is increased perceptions of error in the system because no substantive agreement exists among program participants. The second cost of ambiguous communication is that it increases a propensity to search for the "real" meaning of the agency's directives and adjustments to the allocation process. For example, communities will question whether the deletion of a housing needs factor means that housing is no longer a priority, or that the data were so bad that the factor didn't work as intended. Deletion of the factor could be construed as refinement of the system or as unacceptable changes in priorities with little credible evidence available to choose between the two interpretations.

THE ORGANIZATIONAL PROBLEM

In this section, I extend the framework of analysis to consider organizational issues in a block grant formula allocation scheme.

Although numerous groups have a stake in the Small Cities Program, I will consider four groups in this section: the HUD central office, HUD branch offices, eligible communities, and the Congress (which fits in primarily through eligible communities).

These four groups are likely to disagree on the nature of need, its measurement, and appropriate participant responses. The main additional feature added by these groups is differing non-program purposes in implementation of the formula allocation system. All will be pursuing other organizational objectives, such as implementation of other programs, maintaining influence and power in a certain area, or maintaining internal stability and levels of funding.

As a consequence, predicting the evolution of a formula allocation system (and reducing errors) will require that these other program objectives be considered. In addition, the ability of participants to diagnose and resolve problems in the allocation system will be affected by other demands on the agency. Such demands can be deduced and predicted building on the experience of the adjustments in the formal allocation process of the Small Cities CDBG program.

For example, block grant schemes place new responsibilities on grantees and take away responsibilities previously assumed by agency branch offices. This redistribution may set off changes within the organ-

ization that affects the allocation process, as discretion is rearranged inside the agency to create a new balance. Area Offices may no longer design the selection systems, but instead are given new discretion in awarding grants without higher level authority.

In this same vein, some agency responses to problems may work better than others for reasons that are far removed from the primary program goals. Weaknesses in the formula selection system can then lead to changes that address a symptom that may or may not deal with the root problem:

- o Apparently objective procedures may be substituted for suspect staff judgment as a response to "bias" in the selection of winners when a more fundamental problem is the lack of agreement about who is neediest.
- o Responsibility to design the system may be shifted from one group to another in response to errors in the system attributed to "too strict" interpretation of the legislation when the real problem is insufficient sensitivity and specificity of the proxy need measures used.
- o New factors may be added to the formula to reflect new objectives when the real problem has been a failure to resolve the priorities among all the objectives.
- o Performance thresholds and benefit measures may be added to screen out "low quality" projects (and reduce agency workload) when a more fundamental weakness exists, the inability of the formula to link national funding priorities to how communities actually choose to spend the funds.

Understanding how participants misdiagnose problems in the system, or choose a certain solution without knowledge of its effect on other objectives, both program and organizational, will be a major part of the interpretation of the history of the Small Cities Project Selection System in Chapter IV.

THE ROLE OF COMPETITION

The primary use of block grant allocation formulas is to determine appropriate grant amounts for an eligible community, as a share of the total program appropriation based upon statistical measures of need. Such formula allocations shift the burden on HUD to provide reasons for denying funds, rather than on the applicant communities to prove the worthiness of their project proposals. In a competitive process, in contrast, the need is to choose a few winners among many applicants, where decisions on how much money to award affects the possible number of winners, and sufficiently fine criteria (even if completely subjective) are necessary to differentiate among the proposed projects.

HUD relied on its past allocation approach, the design and administration of rating and ranking system by its Area Office professional staff. These systems would need to possess a semblance of fairness and objectivity comparable to the CDBG entitlement program, even though the purpose of such systems was quite different than the entitlement allocation formula. This desire for fairness and objectivity on the part of participating communities pervades the legislative history of the CDBG program, and the later history of the discretionary grant program. Differing interpretations of what is fair or objective provide a set of values on which the performance of the allocation scheme can be judged.

Of course, a competition should be fair: the rules of the competition should be known to all potential participants; the grounds for com-

petition should be clear--if there is a generally accepted measure of need, then competitors of similar need should differ in their chances of winning only to the degree they differ in regard to some mutually agreed upon criteria of merit or performance; competitors of similar need, merit, and capacity should have similar chances of winning the same amount of funds, no matter their location or competition category; and winners should have less chance of winning in future competitions, since their program efforts will reduce their need relative to losers.

The value of equity or fairness in a competition (and the potential for disagreement about what a fair outcome is) provides insight into future errors in the system. The value is based upon agreement on the terms of the competition, in other words, on need and merit. Agency actions that treat communities differently, or that treat communities alike who perceive themselves as different, will open the door to contention about fairness in the system, and about "bias", quality of discretionary judgment, and sensitivity of the selection system.

Failure of the allocation system to meet the above conditions for fair, equitable access to discretionary aid funds (or at a more basic level, failure to operate as promised, due to unintended effects) can serve as the basis for perceptions of problems in the system, based on

selection process; redefinition of eligibility to allow redistribution of capacity (allowing some communities to take advantage of the greater capacity to compete of other communities); refinement of measures for the scoring process; increased administrative discretion to increase the sensitivity of the competitive selection process to differences not well reflected in the formal, objective rating scheme; provision of extra resources to train less able jurisdictions; decentralization to allow selection systems to be tailored to regional differences.

This initial project selection system, with its elements of need, competition and formula allotment, would then have pressures on it from eligible communities, from representatives of beneficiaries, and from HUD staff to be adjusted for greater equity by reducing discretion in the system and by equalizing treatment of applicants.

On the other hand, some participants would want a system flexible enough to promote equity in outcomes by responding to diverse needs in different areas of the country; this could be most quickly achieved by allowing Area Offices enough flexibility to adjust to those differences. Due to limited funds, these pressures would be more urgent because losers faced zero funding, rather than a smaller entitlement grant than they believed they deserved. Thus, a powerful tension in the allocation system based on equity values, the definition of eligibility, the distribution of need, and the necessity of a competitive process was already in place in the first program year.

comparisons among competitors, among contests, among different classes of communities, and among Area Offices.

The administrative actions that will be called for to correct these perceived problems can be predicted. Evaluators and eligible communities may call for uniformity of rules and administrative practices across the country. Rigid timetables and strict interpretations of rules can be seen as ways to achieve equal treatment. Increasing elaboration of scoring criteria and codification of scoring practices will seem to serve the goal of fairer competitions, by assuring equal treatment.

However, the formula allotment to State areas and to SMSA's was based upon aggregate measures of individual need, while the unit of competition was local government. Therefore, the disagreements about the outcomes of a competition would not be restricted to disagreements about need measures or about merit in the abstract. Communities can identify many factors for which there should be fair treatment or compensation in practice to make the terms of competition fairer:

- o Community size
- o Number of communities competing in each contest
- o Capacity to compete
- o Distribution and concentration of needs.

Participants who see these differences as important may call for a different set of administrative corrective actions: formula expansion to equalize allotments to States and SMSA's by incorporating capacity and community characteristics (size and number); class refinement to create separate competitions for disparate communities in order to equalize the



CHAPTER IV

INTERPRETATION OF THE EVOLUTION  
OF THE SMALL CITIES PROJECT SELECTION SYSTEM

INTERPRETATION OF THE EVOLUTION OF  
THE SMALL CITIES PROJECT SELECTION SYSTEM

The following chapter will interpret the evolution of the Small Cities allocation process, diagnosing the major problems in each program year in light of the limitations of linear weighted allocation formula, the objectives of the program and the non-program goals of the various participants.

I will look for tensions in values, conflicting but desired goals, that are revealed in the history of adjustments to the system, and partially explain the outcomes of those adjustments as a product of these tensions.

INTERPRETATION OF THE DEVELOPMENT  
OF THE PROJECT SELECTION SYSTEM

STAGE I

1975

A NEED-BASED SELECTION SYSTEM

Competitive selection required more of need-based allocation formulas than did block grants, for equity and precision.

HUD Area Offices faced different incentives in designing selection systems than did the central office.

PROGRAM YEAR ONE (1975)

The first program year provided the starting point for further development of the allocation system. As noted in Chapter I, the Community Development Block Grant program had broad and ambitious goals. The CDBG program replaced prior categorical aid programs, whose allocation process had been competitive and discretionary.

During the first year of the discretionary CDBG program, the allocation system more closely resembled that of the previous categorical grant programs than the allocation process of the entitlement block grant program.

Grant recipients had to submit applications, and winners were chosen competitively. HUD Area Office staff designed point systems which they used to rate and rank project proposals from eligible communities in each SMSA and in the non-metropolitan areas in each state. Communities could apply for single or multiple activity grants for one year project periods. As provided in the 1974 Act, a linear weighted allocation formula was used to determine the pool of funds available in each state, after a share of the total appropriation was reserved for non-metropolitan communities and funds were set aside for "hold-harmless" communities.

Several features of the initial program differentiated it from the prior categorical programs: 1) an eligibility definition that included a vastly larger number of communities; 2) allotment of funds for discretionary grants to state and to SMSA pools; 3) a clear mandate to base selection (at least in part) on community need as objectively measured,

rather than through the political process, or solely on the basis of professional staff judgment; and 4) the concurrent implementation of the entitlement CDBG program, in which receipt of funds was determined by a formula allotment and preparation of an adequate program proposal by eligible communities.

I will first consider three aspects of the initial year's formal process: the need-based formula allotment to States and SMSA's; competition among eligible communities for funds; and broad Area Office discretion in allotting discretionary grant dollars.

#### Formula Allotment to States

The formula allotment to State areas and to SMSA's was not controversial in the first program year. This feature of the allocation process was required by the CDBG legislation adopted the year before. While the need for CDBG aid to non-metropolitan areas had been disputed in the legislative consideration of the 1974 Act, the choice of the particular formula to apply to discretionary funds had not been an issue.

The formula was not seen as a problem, probably for the following reasons: First, communities that had received aid from the categorical programs were unaffected by the regional division of discretionary aid, due to the buffering effect of the hold harmless provisions. Second, the formula allotment was only one part of the allocation process; it did not apportion funds to specific, easily identifiable projects or communities. Its effects could only be judged in combination with the competitive selection process. Third, the primary constituency for aid was communities with little prior experience with HUD aid programs, and no direct experience with block grant aid.

While there was no easily available evidence that the formula allotment would be seen as good by program users and evaluators, due to its untried nature, there was no evidence it would be disliked either. Most likely, smaller communities, and groups representing them, had not engaged the issue of the adequacy of the need-based formula. In fact, given the indeterminacy of the second half of the allocation system, the grant competitions, an a priori assessment of the adequacy of the formula would have to be abstract: no one knew who the final recipients would be.

Still, the clarity of the legislative instructions on allocation of discretionary funds to State and SMSA balances may have relieved HUD of one potential administrative problem--justifying an agency-designed formula that differed from the entitlement formula. However, the second principle feature of the discretionary allocation system, a competitive grantee selection process, introduced a new source of dilemmas and potential criticism.

#### A Competitive Process

This second feature of the program is simply explained: Congress authorized too few dollars to distribute aid to all eligible communities on an entitlement basis.<sup>1</sup> Too few dollars were available to provide enough funds to all communities to undertake legitimate, effective local community development programs. Given the range of eligible activities, from housing rehabilitation to public works, and given the costs associated

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<sup>1</sup> An estimated 38,000 jurisdictions were eligible for discretionary CDBG aid.

with federal grant administration and program coordination, an entitlement formula approach was unworkable. Congress placed on HUD the responsibility of finding a practicable alternative allocation process.

However, as noted in the previous chapter, the desire for equity, the distribution of need, and the characteristics of eligible communities combine with the necessity for a competitive process to create tensions in the allocation system. While Congress provided too little money for everyone, the success of a particular competitive formula approach would depend upon communities' expectations, the nature of need, and the capacity of communities to act to meet that need.

If many communities with need lacked capacity to administer a grant program, then a selection system that ranked according to capacity criteria would be a direct, simple way for HUD to increase administrative success. Whether or not the winners would meet need well would in part depend on how HUD determined grant amounts. Three alternatives seem possible: (1) HUD uses a pro rata entitlement formula to divide dollars up among capable communities; (2) HUD gives the most capable communities what they ask for; (3) HUD tries to consider both need and capacity in setting grant amounts (and choosing winners).

The first alternative would ignore needs of less capable communities, violating communities' expectations for equity. The second alternative would concentrate funds among few, perhaps non-needy, communities. The third alternative comes closer to the form of the selection process in later program years.

But in the first stage of the program, HUD Area Offices tended to award relatively small one-year grants to the neediest communities, as measured by a particular allocation formula. Again, the decision about the most appropriate grant amount was separate from the decision to award funds. Here the degree of competition is quite small.

Criticism of this approach could come from another direction. The nature of need for some communities might require a higher threshold level of aid and a longer project period than allowed. Insufficient capacity to administer an effective program might add another incremental threshold of aid (to increase capacity).

Threshold levels of aid then will provide a different rationale for a competitive process--"not enough funds" would mean only a few effective programs to meet some need can be awarded with the available appropriation, rather than all need cannot be met with the available appropriation.

On the other hand, if capacity and threshold levels of aid were less important than the intensity and duration of need, the first year allocation process would be seen as a "problem" for different reasons. Suppose that community development need for small communities is intermittent in nature (for example, a periodic need to upgrade the water system or install new waste disposal facilities).

Then, a competitive allocation system based on infrequently measured need factors would award too much money to some communities: communities would continue to win funds after the need was not. Since this type of need is narrow, though intense, broad proxy measures of need would be less



acceptable because they would not measure brief, special needs well. Alternatively, those communities with more generalized long-term need of a type not measured well by the particular selection formula HUD used would see the competitive selection process as particularly unfair. In such a situation, the greater of HUD discretion (rather than formula determination) to choose winners and select grant amounts would seem particularly attractive.

This discussion presumes that there is meaning to the amount of money that communities ask for, that is, that HUD will control costs through monitoring or through approved rates of expenditure for different activities to ensure a reasonable relation between community need and approved grant amounts for project activities. To the extent that cost control and monitoring are missing, the competitive allocation process will have another source of unexpected (unwanted) results.

#### Area Office Discretion

It will be useful to consider the discretion given to HUD Area Offices in the first program year. Area Offices designed the point systems for

grant competitions, set grant limits if they chose, assessed applicant capacity at their own discretion. The program regulations had stipulated four factors to be incorporated into the rating schemes--percentage of substandard housing, percentage of poverty, federal impacts on community growth, and imminent threats to health and safety. The first two of these factors are also found in the entitlement program allocation formula.

With these limited instructions to Area Offices, the outcomes of the allocation process depended heavily on Area Office expertise to devise competition processes that would work well in each area, and across the country as well, although Area Offices were unlikely to be able to identify system-wide allocation objectives.

Sound organizational and programmatic reasons can be conjectured for extending broad discretionary power to HUD field offices in the initial stages of the new program.

First, the approach moved discretion away from Washington and toward the users of the program, consistent with the CDBG decentralization goal. Area Office staff were more likely to have a better understanding of local needs and capacities than the central office planners, and as a result, better equipped to produce a system satisfying program users. Second, the approach allowed variation in the allocation systems across the country, reflecting variability of need and, perhaps, blunting regional disputes that a uniform national competition might foster. Third, given the size of the Area Offices in the HUD bureaucracy, it may have been wise to allow field staff to continue with what they were used to

doing, in order to reduce the confusion in learning how to operate a new program, and dealing with the accompanying delays and errors. A marginal change in operations can seem a better way to maintain staff morale and efficiency than a change that drastically changes responsibilities and the nature of work. (But note, marginal changes in operations will work only to the extent that the program environment changes only marginally at the same time--work load won't double etc.)

Another reason for giving discretion to Area Offices in the first program year derives from the central office's lack of experience with the use of point systems in block grant programs. By giving Area Offices the responsibility to design their own selection systems, the central office would (in effect) be encouraging a range of attempts, experimentation, and useful knowledge for future improvements.

Additionally, failures and unsatisfactory outcomes would be local, rather than national, in scope. An attempt by HUD in the first program years to impose nationally rigid application criteria, to set up strict thresholds for entry into the competitions, to assess applicant capacity finely, would have risked inconsistency with the spirit of the CDBG legislation and unacceptable delays in starting up the program. Design of not one but many point systems might reduce such risks.

Therefore, decentralization of discretion can be justified in terms of internal agency requirements when faced with a new program learning task. Why then would "Area Office discretionary power" be so quickly perceived as a problem in the allocation system?

A brief answer would be that Area Offices face a different set of

incentives for action, interpret the implementation task differently, and place value on meeting the requirements of different system participants than does the central office.

Placing such discretionary power with the field offices required some major assumptions about their capacity and their priorities. First, Area Offices would recognize as error or misallocation the same outcomes that the national office would. That is, Area Offices would rank program needs and administrative priorities in the same way as the national planners. But this is unlikely, as field offices are more likely to consider workload, clear and non-contradictory instructions, and shelter by a higher organizational level for making locally unpopular decisions as more important than the interpretation of legislative goals to produce a workable program.

Second, Area Offices would comprehend the need for open and fair competitions, given the context of objectivity and entitlement of the larger CDBG allocation process. This comprehension, however, might require more distance from operations and more knowledge of the rationale for the program than Area Offices would have.

Third, Area Offices would understand the subtleties in the use of need-based formulas to determine grant winners: the need to use discretion and judgment to temper formula "errors" caused by the use of proxy factors and imperfect data; or, alternatively, the need to gain a degree of concensus among program users on what constitutes acceptable "error." Here again, the assumption could be faulty, for why use an explicit, objective formula if its results required fudging, and certainly, why ex-

pect professional staff to promote political consensus. Most likely, neither of these actions required by the nature of allocation formulas were anticipated by any of the participants in the first program year.

Finally, Area Offices would be risk-takers and innovators, rather than conservatively adhering to the sketchy national guidelines. Whether this assumption is correct depends on the incentives for taking risks that the Area Offices faced. If Area Office staff felt safe to be innovative, then they might be more likely to think about the policy implications of their actions. On the other hand, if initial errors (from the central office point of view) were punished (by taking away discretion or by reversing Area Office actions), then the merits of decentralization would be neutralized. The rational Area Office strategy in such an environment would be to check every action with headquarters.

To the extent those assumptions about the field offices were incorrect, the national officials would feel the need to act to correct errors in the allocation system: by redirecting Area Office discretion; by refining the formula scheme to automatically correct Area Office "missteps"; by giving responsibility to someone else with greater knowledge or legitimacy.

What might have been bad allocation outcomes in the first year? I have already discussed the need for a fair system of competitions, and for an equitable system; other types of agency failure, less related to the formula and point systems, were also possible: 1) excessive delay in selecting winners and obligating funds, 2) overrepresentation of some types of communities (such as large towns or towns with prior grant exper-

ience or towns who hired consultants to write their proposal); 3) funding of obviously ineligible communities or projects; 4) inappropriate grant sizes for the needs of an area, resulting in many small, ineffective programs, or in a few big winners. Of these outcomes; only the second could be the result of point system properties, while all four could be the result of misjudgment, inattention, or special priorities of an Area Office. All four could be influenced from the central office by more detailed instructions and controls, by the specification of performance standards, but only at the expense of the legitimate exercise of the specialized knowledge of the Area Offices.

#### Community Response to the System

HUD needed to put in place an acceptable allocation system--acceptable to Congress, to the Executive Office, to communities and their representatives, to advocates of the poor, to their own staff. The formal allocation system would receive pressure for change to the extent one of these groups was dissatisfied and was able to influence agency actions.

Explicit in the block grant concept was the preservation of local choice among the program's diverse goals and activities. To preserve a degree of local choice while discovering which of the goals were important to which groups was one of the major tasks HUD faced in the first years. By a combination of incentives, information, and exclusion, the system could be made workable. However, in the first year of a voluntary program, it would be difficult to know how communities would respond, and which features of the system would act as incentives.

From the communities' point of view, there were many uncertainties

as well. The legislation allowed a wide range of activities, but was vague on which goals were most important. Only with a system in place would communities learn the hierarchy of subobjectives.

For local planning purposes, communities would want to know what they could or could't do. An Area Office interpretation, even if national guidelines were later clarified or reversed, should, from the communities' point of view, be adhered to in order to avoid reversal of previous planning, with accompanying economic and political consequences.

In the first program years, communities would want to test the limits of the administrative interpretation of the program as well. The nascent administrative procedures might allow many false signals and errors. From the communities' point of view, the administration of the program should: 1) provide consistency of interpretation of policy; 2) allow enough flexibility to include their highest priority projects; 3) provide for some bargaining room to package high priority community activities with high priority HUD activities; 4) ensure fair treatment--that is, a system not biased against their own views of legislative intent and proper intergovernmental relations; and 5) permit the integration of local community development activities by means of substitution of resources.

From that point of view, a decentralized system responsive to community priorities would be preferred. But, even this breaks down if communities differ in their needs and priorities to the extent that either a decentralized, subjective or a centralized objective allocation process splits eligible communities into separate groups who make differing de-

mands on the allocation process in regard to flexibility, importance of national objectives, basis of assessment of fair treatment, and views about who knows best.

Thus there is a tension between community requirements for flexibility and administrative need for control that cannot be resolved by moving discretion among organizational levels, or by refinement of the formal allocation process but can only be managed as community responses to allocation outcomes reveal themselves.



INTERPRETATION OF THE DEVELOPMENT  
OF THE PROJECT SELECTION SYSTEM

STAGE I

1975

## A NEED-BASED SELECTION SYSTEM

Competitive selection required more of need-based allocation formulas than do block grants, for equity and precision.

HUD Area Offices faced different incentives in designing selection systems than did the central office.

STAGE II

1976-  
1978CENTRALIZATION OF SYSTEM DESIGN AND  
LEGITIMIZATION OF DISCRETION

A competition based solely on need was not a competition at all; HUD moved away from need-based selection.

HUD centrally designed the selection systems to avoid unexpected results in the competitions.

HUD legitimized Area Office discretionary power by increasingly narrow definition of the selection systems.

HUD created a new program when formula refinement could not resolve rigidities in the allocation process.

Tensions among program goals resulted in shifts in priorities by HUD.

PROGRAM YEAR TWO (1976)

In the second year, discretion in the design of selection systems was redistributed and the selection system was refined in response to several problems.

The major problem cited by HUD was the Area Office rating systems' tendency to favor smaller communities with higher percentages of poverty, as against larger communities with greater numbers of poor persons: a perceived bias in the selection process.

This outcome suggests that Area Offices, either through strict adherence to the first year point system design criteria, or through the discretionary exercise of their own priorities, had tended to produce an allocation of funds consistent with a formula approach that used percentage measures of poverty need. The evidence on the outcomes of the system in the first year indicates that winners were very small communities with no previous experience with HUD aid.

Also, the outcomes suggest that the "red tape", elaborate application processes, and grantsmanship of previous HUD aid programs had not been barriers to these communities.

Two potential sources of difficulty may explain this perception of a "problem" by HUD: first, an inconsistency of the allocation outcomes with program objectives as viewed at the national level; and second, the future demands on field offices by many small grants to communities with no previous grant experience.

#### Need Factors as A Source of Bias

In the first program year, no record of community performance or capacity was available for the untried grantees. So the test for consistency of allocation outcomes with program objectives would be to apply some need criteria. Since HUD saw the outcome as a problem, the selection criteria set forth for the first program year must not have reflected the relative priorities of poverty concentration versus poverty magnitude. Put another way, larger cities had more power to influence the system and seemed worse off as well. That would be the problem as long as there was no consensus on where the allocation system should be.

To justify a change in the system, a criterion such as grant dollars per poor person or per capita could be applied to the outcomes of the system. However, the legislation provides no specific guidance on the appropriate measure of community development need, other than the specification of the entitlement allocation formula.

To deal with the problem directly, HUD could have refined the formal allocation process, by creating separate competitions for cities of different sizes, or by introducing new selection criteria, or by leaving resolution of the issue to Area Office discretion. These solutions would require that the formal allocation mechanism, that is, the point systems, be sensitive to such explicit adjustments.

#### Lack of Community Capacity as a Source of HUD Capacity Overload

A second potential interpretation of the problem, more accurately, of the need to shift dollars to larger communities with greater absolute need could have been the excessive demands on capacity placed upon HUD

field offices by the resulting need to monitor many grants to small communities with little expertise in program administration. Field office capacity to administer many small grants, and community capacity to produce "quality programs" were an issue, as noted in HUD Annual Reports in the third and fourth program years. In the second program year, however, only the issues of size "bias" and community capacity were publicly raised by HUD officials.

But, if Area Office capacity was also part of the problem, the response of refining the formal allocation process would be indirect, however justifiable to eligible communities in terms of equity and a better interpretation of the program's priorities. More direct, but less acceptable to agency clientele, would have been responses such as establishing minimum grant sizes and imposing capacity thresholds effectively screening out smaller communities. Even more direct responses, such as increasing Area Office staff, or providing training and administrative help to small grantees, would have required external moves by HUD to increase agency resources rather than internal discretionary actions.

#### HUD's Responses: Refinement of the Formal Allocation Process

To reduce the size and poverty concentration biases of the first year's allocation process, HUD required Area Office rating systems to consider an applicant's absolute, as well as percentage, indicators of poverty and substandard housing. By continuing to include percentage amounts of need, HUD signaled that concentration of poverty was still a concern, though not the overriding one that the first year program regulations seemed to indicate.

It is important to note the double function of the rulemaking process as shown here. The official regulations inform eligible communities about the formal rules of the allocation system, as well as establishing priorities for the field offices. However, the constructions placed upon these regulations by communities and by the field offices can vary greatly from the intent of the rulemakers.

In any case, the respecification of need criteria for the selection systems was designed to favor certain types of communities over others; presumably, if the inclusion of absolute measures of need had its intended effect, smaller communities would have less chance of winning funds relative to larger communities in the second program year.

Unfortunately, a competition based solely on need criteria is not a competition at all, but instead a formula allocation with all its attendant sources of error.

First, community capacity and effort would not affect the Area Office competitions based on need measures: not directly because the point systems would not consider them; not indirectly because the links between local program activities and the proxy measures of need were too tenuous, and because measurement of even the tenuous links between need measures and project activities occurred only decennially for the data source, U.S. Census Bureau tabulations and sample estimates.

Second, the effects of altering the need factors and their weights are more unpredictable in the use of a formula to select grant winners, than in its use to allocate entitlement funds. The interaction of the

correlations among need factors and voluntary participation by eligible communities creates this unpredictability. Since factors are correlated, the potential weight of absolute and percentage measures of each need will differ from the nominal point system weights. And, the actual weights of the need measures will vary from competition to competition depending on the correlation among factors of those communities who actually participate in each competition.

In an entitlement formula allocation, the actual weight of factors in alternative formulas can be determined using needs data for all entitled communities. But, with a competitive grant process, only with program experience regarding who applies can a probability distribution of actual factor weights be estimated, for a particular set of nominal weights.

Note also that errors (unanticipated effects) of a refinement of the formal allocation system for a competitive grant process are more costly for those who suffer the effects of the errors, than the errors in an entitlement process: losers get nothing.

HUD's response to bias in selection of winners, though not predictable in its results, did deal with the questions of need and equity, but not with respect to the nature of a competition.

Responding to the latter issue, HUD expanded the list of criteria that rating systems had to consider: 1) the degree of benefit to low- and moderate-income persons of a proposed program; and 2) the consistency of that program with local and area community development plans. However, the response may not have intentionally dealt with the need for competitive

selection criteria; the two factors can be argued on their own merits as consistent with national program objectives.

Even so, these factors, unlike the initial four, can be influenced by applicant communities, and are drawn from the multiple objectives of the legislation. However, by expanding the list of factors, the weight of community wide need measures, whether absolute or percentage, could be reduced significantly.

The addition of these factors was a major change because the new criteria were essentially judgmental. Area Offices were given no regulatory guidance for determining "benefit" or "consistency". Furthermore, the introduction of the benefit measure, while consistent with the "primary benefit to low- and moderate-income persons" objective of the CDBG legislation, moved the selection system away from a formula allocation based on proxy measures of community wide need, and toward a system that estimated the effects of particular programs on defined target areas within a community. This further specification of factors defined new areas in which Area Office subjective judgment was to be exercised, while constraining to those areas Area Office discretion in the selection process.

So, we see that HUD responded to additional concerns by expanding the list of rating factors. In so doing, HUD reduced the weight of community-wide need measures, introduced grounds for competition, and initiated a strategy of constraining Area Office strategy by clearly specifying the areas in which discretion could be exercised.

## HUD's Responses: Redistribution of Discretion

HUD responded in another way to the first year's experience with the discretionary grant allocation process: shifting the responsibility for design of the project rating systems to its seven Regional Offices.

This response may have occurred for any of several reasons. First, the central office may have felt that the Regional Offices were more competent than Area Offices to design acceptable rating systems. Second, the central office may have felt it could more easily predict and control the direction of Regional Office activities. Third, this centralization may have been seen as a way to relieve the Area Office workload by moving an essentially policy oriented task to a higher level. Fourth, by having fewer entities designing rating systems, the move could be viewed as way to reduce excess variations in the selection systems in various parts of the country. Alternatively, as a fifth reason, Regional Offices might be less susceptible to local political influences or to excessive identification with local priorities in conflict with national program objectives. And a sixth, contrary justification could be that Regional Offices would be more politically reliable to the Executive Office in an election year.

Most notable about these possible justifications is that they stem, not from the requirements of a formula allocation process or the competitive nature of the program, or decentralizing logic of the block grant approach, but instead from a process of internal agency adjustments for the purposes of control and predictability of branch office operations.



From the point of view of the Area Offices, the move may have been seen as an inappropriate diminution of responsibility (a signal of central office displeasure), or alternatively, if Area Offices had been criticized by their area communities for the rating approach, as a relief of unwanted authority--moving the responsibility, as well as the criticism to another organizational level. These speculations must remain untested as there was no available evidence on the reasons for or reactions to the shift of rating system design responsibility.

In any case, from the point of view of those communities who had been critical of the outcomes of the first year's competitions (the various types of losers), the shift to the Regional Office would have served to confirm, through an organizational signal, the changes in the criteria for the ranking systems (to confirm that the criteria changes were not feints, but seriously intended).

#### HUD's Responses: Tightened Procedures

HUD also required several changes in the procedures to be used in designing and administering the second year's project selection systems: Regional Offices were to design the systems prior to the submission of applications, and communities were to be informed of the weights and factors used; preapplications were to be required of all applicants and no late full applications were to be accepted.

These procedural responses can be linked back to the earlier analysis of what constitutes a "fair" competition. The first procedural change deals with the issue of fairness directly: how can a competition be fair if participants don't find out the basis for the competition? The second

change related to fairness, and also to Area Office capacity. In 1975, late full preapplications were accepted from communities who had not submitted preapplications, due to delays in program startup. The acceptance of late applications required a second round of scoring, after the scoring of preapplicants, disappointing some who thought they had won, and burdening Area Office staff with duplicate work.

These procedural changes do not relate directly to the program objectives, arising less from the multiplicity of objectives, imperfect measurement, legislative ambiguity, or the nature of community need, than from administrative requirements brought on by program users' desire for a fair and open selection process. These tightened procedures would be a problem to no one as long as the rating criteria and the weighting scheme actually worked as intended.

To summarize the changes in the first and second program years, three tendencies are discernable in HUD's modifications:

- o A shift away from a need-based formula;
- o Accretion of subsidiary program and organizational goals via addition of new point factors;
- o Increasingly narrow definition of how rating factors are to be implemented.

All three tendencies reflect a changing interpretation of program goals by the central office and an attempt to increase central control of the discretionary program allocation process.

PROGRAM YEAR THREE (1977)

In the third program year, HUD responded to problems of Area Office discretionary power, community capacity, sensitivity of the selection system and bias in the selection of grant winners. The modifications of the discretionary allocation process took the following forms: 1) continuing to dilute the impact of community-wide need measures; 2) introducing thresholds to control for community capacity and quality of proposed activities; 3) adding new point system factors to reflect more related CDBG goals; 4) refining the earlier selection criteria and 5) for the first time, specifying the range of weights to be applied to the rating systems.

## HUD's Responses: Refinement of the Formal Allocation Process

As additional program and operational goals became apparent, HUD needed to move away from a system that seemed to award dollars based on need toward an allocation system that rewarded conformance with these subsidiary or substitute goals. The means apparently available for this purpose included compliance regulations--"an acceptable program will provide X% benefit to low- and moderate-income persons" and point system incentives--"an applicant may score additional points and increase the chance of winning a grant by...".

Of the two means, the second would seem preferable to HUD, since the communities would willingly comply with the national (and organizational objectives), preserving local choice by making compliance "voluntary".

However, the first means is more sure, since compliance regulations can take the form of thresholds to enter a competition. In a point system approach using need factors, an applicant with marginal capacity or performance might yet win due to the weight of those need factors. And, the "errors" of the compliance approach bear less on the agency than those of the point system approach. For example, a poorly performing yet demonstrably needy grantee can get training, or consulting help, or leniency in monitoring, but a misdirected project (one with ineligible activities or with primary benefit to the non-poor) is less likely to be "saved", and the agency will face the blame for approving the project in the first place.

There is another aspect to the move away from the need-based, objective system. The starting place was not the professional judgment of agency personnel, but instead quantitative measure of community need. This standard of measurement would subsequently be used to judge the merits of a selection process involving Area Office discretion--quantified explicit criteria would be expected by program users.

The most natural way to assure an "objective" approach would be through an increasingly narrow set of criteria to which subjective staff judgments would be exclusively applied. The dictates of fairness would suggest a uniform system of criteria and procedures across the country. Thus, the form of verifiable need-based allocation formulas would be preserved in an increasingly subjective selection process.

Whether HUD's field offices actually developed and used point systems in this manner in the first three program years could only be resolved

(for the central office) by requiring documentation at each step in Area Offices' administration of the competitive selection processes. Still, the discretionary program had built into it a tendency toward elaboration of the formal allocation process, much in the same way that compliance regulations were elaborated and qualified in the CDBG entitlement program.

In refining the selection systems and expanding the list of selection criteria, HUD saw the need to give "firm guidance to field offices on how to establish ranking systems and "to downplay...the pure numbers game of discretionary grants." Some Area Offices had "strictly interpreted" HUD instructions and the statutory requirements that the funds be distributed on the basis of verifiable need.

So, the regulatory instructions and shifting of system design responsibility to Regional Offices in the second program year had not resolved the issues of: 1) bias in the system toward smaller communities; and 2) insufficient screening of ineligible, incapable, or low "quality" projects. Some types of communities continued to gather in all the money in some areas because their numerical need was greatest.

The diagnosis of the source of these problems as the insufficient or inappropriate exercise of field office discretionary power, while a common theme in the relations between central and branch offices of a bureaucracy, seems remarkable, even disingenuous, in the context of the use of a formal, formula-based allocation approach.

Formal allocation schemes depend on a literal interpretation to work as predicted; in fact, the explicit, mechanical nature of their de-

cisions can be seen as their main strength--Congress shifted to HUD the burden of justifying any allocation decision not based upon the entitlement formula. However, if discretionary adjustments around the formal selection system are expected, then regulations defining the selection system must provide two types of information: 1) the features of the formal method of selection and 2) instructions on how literally to apply that formal method.

Thus, there is a subtle tension introduced that can have profound operational effects. If the response of the central office to errors in the outcomes is that "branch offices used poor judgment" rather than "we gave instructions that had effects other than we anticipated--that is, the wrong instructions," then the most forceful programmatic reason for using a formula scheme, its apparent predictability, is negated. Additionally, the most appropriate Area Office response to central office displeasure with the exercise of discretionary power, namely, literal interpretation of central office policy, becomes confused as well. Even more confusing is the substitution of a numbers game based on subjective criteria for a numbers game based on need measures.

To further deal with the "bias" towards certain types of communities, HUD introduced a range of permissible weights to be used in the point systems, with verifiable need representing no more than 25 percent of the possible nominal weight in the systems. The needs factors continued to be split, half absolute measures, half percentage measures. The housing need factor was given a new proxy measure, the sum of overcrowded units and units lacking plumbing.

The strategy of changing selection criteria and their weights had its limits though. HUD for the first time introduced strict thresholds requirements: 1) quantitative measures of past performance (expenditure and obligation of funds); 2) local effort to further HUD approved housing assistance plans; and 3) apparent eligibility of proposed activities. These entry requirements were applied before communities' preapplications were rated.

The second of these threshold represents an additional goal brought into the administration of the discretionary grant program. This goal can be linked back to the early Congressional intent of the discretionary program to promote area-wide planning, particularly for central cities, with particular reference to the failure of metropolitan suburbs to comply with central city housing assistance plans required by the entitlement program, and calling for spatial deconcentration of low-income housing.

In addition to housing threshold, HUD specified a new factor "housing effort", which had greater weight than verifiable need, 25-35 percent of total nominal weight. Thus HUD injected a new objective into the program, closely related to HUD's subsidized housing programs.

This addition of objectives reveals another tendency in the implementation of selection systems for multiple objective programs. Expansion of the point system is used in an attempt to improve performance of grantee communities in related agency programs under the umbrella program legislation. Expanding the list of selection criteria moves the system away from verifiable need factors, but also provides new means to subjectively

discriminate among applicants according to some defensible criteria. (And also allows redefinition of program objectives through a technical adjustment).

The addition of new goals relating to a particular eligible activity immediately provides new incentives for applicant communities, and a new source of problems: "bias" in the selection of activities. The change in the system did have some effect: in the second program year, communities with high percentages of poverty who proposed projects with high benefit to poor people had a competitive edge; in the third program year, communities who proposed housing rehabilitation projects with exclusive benefits to the poor were favored.

The addition of new goals into the selection system created another problem as well. With less (nominal) weight given to community-wide need measures, and more to factors which communities could affect by skillful packaging of activities, the problem of unfairness resulting from grantsmanship was increased. Communities with comparatively less need (whether relative or absolute) were now in a much stronger position to win discretionary funds.

HUD made other refinements of the formal allocation process. The third year program regulations instituted a threshold for apparent eligibility of project activities, required Area Offices to rate proposed activities according to three categories of benefit to low and moderate-income persons, and clarified that different activities in a preapplication be rated separately, unless designed to meet a single objective.



These more specific rules of classification and rating procedures can be interpreted in three ways: as the result of the discovery by the central office of what field offices were actually doing, and the iterative correction of practices that led to "bad" outcomes; as a means of creating more uniformity among the Area Office competitions; and third, as one more aspect of the deemphasis of need and the overriding concern of the central office with problems of implementation, rather than community-wide need.

The first change, the threshold to assure eligibility of approved projects is striking when compared with the first year system. Rather than relying on Area Offices to design workable ranking systems, HUD in the third year felt the need to make sure Area Offices understood that approved projects at least seemed to be consistent with the most definite criteria in the legislation, the list of eligible development activities. This response no doubt arose from egregious error in the first two program years' selection processes (in the entitlement program, as well as the discretionary program).

The requirement that proposed activities be rated separately could have had two functions: first, to require a more careful review of pre-applications, rather than an overall assessment of project quality--subjective judgment was to be applied finely, rather than grossly; second, and more critically, to preserve the local choice objective of the program by countering some of its incidental incentive effects.

If Area Office raters evaluated projects as a whole, they would be assessing the relative merits of widely varying activities (for example,

housing rehabilitation versus a water line project). However, that type of assessment works against the decentralization objective of a block grant program: the relative worth of different activities is a matter of local choice. So, the overall ranking of different types of projects would need to be a resultant of the mechanics of the point system selection process, an "objective" result of a primarily discretionary ranking system.

However, this means of preserving local choice while subjectively assessing project worth increases the unpredictability of the selection process, for Area Office raters as well as for the central office. The effective weights of the selection factors by which individual activities were judged could vary widely from competition to competition, depending on which communities chose to apply the type of activities they proposed, and the nominal weights of a particular Area Office point system.

The unpredictability of the selection process could be greater for another reason as well. For those field offices that had in previous years developed selection system strictly based on HUD instructions and the statutory requirements that allocation of funds be based on verifiable need, the increasing complexity and subjectivity of the evolving point systems allowed for juggling of the process to obtain results closer to Area Office values for the "best" outcomes.

On the other hand, by restricting Regional Offices in their design of the selection systems, and further constraining Area Office authority to interpret the regulations, the HUD central office took on greater responsibility for the outcomes of the selection process, whether good or

bad. In the process, it made itself more vulnerable to an "enforce a bad law" approach by Area Offices. For field offices that believed a more need-based system was more appropriate, or that wanted discretion to be redistributed back to the field office level, strict interpretation of the regulations might seem a good tactic.

Yet, HUD would need the Area Offices to identify and correct at the local level any deficiencies in the formal allocation system, to ignore a "bad law". For legitimate exceptions to threshold requirements, circumstances unanticipated by the program designers, and conditions beyond applicants' control are almost always present. For example, in the previous program year, HUD had instructed Area Offices not to be too rigid in their assessments of applicant performance because of legitimate reasons for program delays.

Thus, centralization of point system design arising from apparent field office error can initiate internal organizational tensions that get played out in the creation of and reactions to the rules for the formal allocation process around the issues of community need and program merit.

#### HUD's Responses: Reacting to Legislative Review

The third program year was also the time for legislative reassessment of the entire CDBG program, and an opportunity for the new Democratic administration to recast the discretionary CDBG program.

HUD was under intense criticism from interest groups and academic analysts for its failure to monitor the targeting of benefits to poor people in the entitlement program.

Also in that year, large and small cities were beginning to become aware of the impact of the formula reduction of "hold-harmless" entitlement grants, and the formula shifting of dollars to the Southwest and Western States. One reaction was lobbying by "hold-harmless" communities to maintain the status quo. As these cities faced reduced funding, they would increase the pressure and competition for discretionary aid dollars.

In analyzing the first three program years, HUD noted the effect of the phaseout of "hold-harmless" status, and two other characteristics of the discretionary program: 1) communities under 5,000 population had been underrepresented in receipt of grants in terms of their proportion of eligible communities; and 2) the program posed an inherent conflict between the number of eligible communities and the agency's ability to select and administer a large number of grants.

These two issues were in conflict as well; the number of grants had grown slightly each year. The revisions to the formal allocation process in the first three program years had not resolved this dilemma, but HUD, in its plans for the fourth program year, suggested changes in the program that would make it more responsive to the needs of small hold-harmless communities.

PROGRAM YEAR FOUR (1978)

In the fourth program year, HUD took the next step in the centralization of the discretionary program selection process.

The program was renamed the Small Cities Program, and a division of the central office in Washington created to oversee it.

There were five significant revisions of the program arising from the 1977 legislative review: 1) reformulating the program objectives to give primary benefit to low- and moderate-income persons; 2) providing two different grant types, single purpose annual grants and comprehensive purpose multi-year grants; 3) developing a unitary national selection system to be used by Area Office staff for both objective and subjective assessments of applications; 4) imposing additional performance and capacity thresholds for eligibility to enter grant competitions; and 5) using a new need formula, similar to the entitlement program's dual allocation formula, to distribute aid to State pools for the Small Cities grant competitions. These revisions will be treated in turn in this section.

While the 1978 program underwent substantial changes for the most part these changes continued the trends of earlier administrative responses. These trends included reduction of the weight of community-wide objective need indices in the selection process, expansion of program objectives through an increase in the number of factors in the rating system, and increased definition and standardization of Area Offices procedures for selecting grant winners.

## HUD's Responses: Redefining Program Objectives

In the 1978 Small Cities Program regulations, HUD specified five program objectives (see p. 50 ), with primary emphasis on the objective of benefit to persons of low- and moderate-income, and practical implementation of this objective by means of new weights and selection criteria in the national competitive selection system.

A first interpretation of this change is the political mandate of the 1977 legislative revisions to the Housing and Community Development Act of 1974. In the discretionary program, as in the entitlement program, benefit to the poor had been one among a number of procedural and substantive program objectives.

By 1977, the failure of communities to target funds to low- and moderate-income persons was increasingly seen by Congress as an administrative failure of HUD. Congress then, made its intent clear by declaring the primacy of the benefit goal.

HUD responded initially by proposing a minimum 75 percent benefit threshold. However, communities opposed this as inappropriately restricting local flexibility in meeting critical needs and as not taking into account the character of those cities where the poverty population is not concentrated.

HUD responded by deleting the threshold, and instead, altered the ranking scheme to give preponderant nominal weight to projects with high benefit to poor people, as measured by the percentage of project dollars estimated by the applicant as benefiting those persons.

Thus, the increased emphasis of the benefit objective can be seen as a response to legislative intent, while the form of the emphasis was influenced by acceptability to program users.

A second interpretation is possible as well. A program such as the CDBG program has many diverse, competing, and possibly conflicting goals. The original legislation did not specify which of these goals were of primary importance, and to that extent the legislation was vague.

Apart from the particular mechanism used to administer the funds, the tendency in such a program may well be to use administrative experience to test out which objectives should be primary. If the program had no national objectives other than the transfer of revenues, then a competitive system would hardly be necessary.

However, any administrative process, such as the one HUD used in the first three years of the program, provides valuable information to the administering agency regarding which objectives will be most acceptable to its various constituencies. Or, to put it another way, which mix of administrative procedures will invoke critical values for the agency.

A program as broad in its scope as the CDBG program will undergo a process of adjustment by the gradual learning of what types of "errors" in administration are tolerable to system participants. "Errors" here refers to administrative actions (intentional or otherwise) whose apparent results conflict with some values of program participants. Thus, an emphasis on benefit to poor persons that takes the form of minimum benefit entry requirements is unacceptable because program users believe it will restrict local choice and close the door to certain types of communities.

The same emphasis, when implemented through the subjective selection criteria, is acceptable, although the ultimate effects of the second alternative are much less predictable.

However, the particular tension in the block grant approach between national objectives and local priorities would have been played out no matter HUD's starting place.

If HUD had emphasized benefit to low- and moderate-income persons at the start of the discretionary program, by means of thresholds, point system incentives, and close monitoring, an adjustment (enacted through the political process) toward those objectives which agreed with other local priorities would probably have occurred. The strength of those priorities is indicated by the reaction to the proposed benefit threshold.

In administrative terms, the articulation of a primary objective for the program in the 1977 review was probably more important than the particular objective emphasized. However, this is only true as a general statement, because the particular objective chosen would have great impact on the administrative direction taken--an emphasis on community-wide need might have indicated a return to emphasis of need factors in the selection system, with new errors resulting from a reduction in bases for competition, and the necessity to deal with community capacity problems by means other than skimming the applicant pool;--an emphasis on a particular program area, such as economic development, would probably lead to new subjective selection factors, with concomitant reduction in the weight of other factors, and "biases" away from other activities such as housing;



--an emphasis on local flexibility might lead to refinement of criteria and searches for ways to rid the selection process of "biases" toward certain activities or communities, which in prior years might have been initiated as incentives to applicants.

Additionally, legislative changes of primary objectives would require HUD to deal with the rigidities in the formal allocation process introduced by prior efforts to adjust the system to the latest politically salient program goals. This would occur in an environment of uncertainty about the effects of each change in the formal selection system; for example, the Isserman evaluation of the 1978 competitions found that proposed programs with high benefit to low- and moderate-income persons were not funded (see Appendix D).

#### HUD's Responses: Create New Programs

The second major change for the fourth program year was the creation of two different grant types: single purpose annual grants and comprehensive purpose multi-year grants.

City groups had raised the issue of lack of assured funding for comprehensive, long-range development plans under the original discretionary grants program, during the Congressional hearings on the 1977 CDBG legislative revision.

In particular, small cities with "hold-harmless" status wanted the continuation of that status as their "hold-harmless" entitlement grants were phased out, in accordance with the provisions of the 1974 Act.

The Carter Administration proposed a new comprehensive, multi-year

grant type for the Small Cities CDBG program. Larger small cities would presumably have a greater chance of winning these grants, given their greater planning and administrative capacity (compared to smaller cities), and the likelihood that they would have a greater range of identifiable needs to address through a comprehensive program, than would those smaller communities that the discretionary program initially served. Moss's evaluation found that community size and prior experience increased a community's chances of applying for and winning a grant in the Small Cities competitions.

In the final program regulations for Fiscal Year 1978, HUD directed Area Offices to reserve sixty five to seventy five percent of funds in both the metropolitan and non-metropolitan pools in each State for comprehensive grant competitions, subject to modification based on the relative demand for the two grant types in each State.

Two circumstances made this change politically salient: 1) increased pressure and competition for discretionary funds by small "hold-harmless" cities as they lost temporary entitlement status; and 2) a reduction in the potential pool of available discretionary funds, because a portion of these funds were being used to finance the shift to the dual formula system in the entitlement program.

The initial HUD regulations to enact this revision proposed combining the new program provisions with performance thresholds. Communities with no prior CDBG experience would be eligible to compete for annual single-purpose grants; having that type of experience, communities could compete for annual comprehensive grants; and those communities with

successful experience with those grants could compete for multi-year comprehensive funds.

The use of these thresholds would seem a logical direct way for HUD to deal with the problem of inadequate community capacity (that refinements of the point system could not deal with), although the thresholds would screen out some communities who, lacking experience, would still be able to successfully operate a larger program, if they were given the opportunity to compete.

However, smaller communities strongly opposed this proposal as an arbitrary restriction on their access to a program (i.e., grant type) that might be most appropriate for their needs. Analyses of the proposal at the time predicted that it would produce a split between smaller and larger non-entitlement cities over the issue of access to comprehensive grant funds. The three-step performance threshold was deleted in the final rules, as was a minimum population requirement for comprehensive grant applicants.

From the point of view of eligible communities, the main positive features of the comprehensive grant program were greater predictability and continuity of funding, and greater flexibility in designing larger, more complex programs.

The timing and predictability requirements are in part conditions by the list of eligible activities included in the objectives of the HCD Acts of 1974 and 1977. An allocation system may be criticized if it "biases" the selection process toward certain activities or types of communities because of the weights built into its rating schemes. It also

may be criticized as "biasing" the selection process if some eligible activities are not feasible because they require a longer project period than allowed, or a long-term commitment of funds for completion. For example, a housing rehabilitation program in a smaller city can be designed and implemented in eighteen months, while significant redevelopment of a target area may require several years.

This issue can be traced back to the previous chapter's analysis of the requirements for a formula allocation system to work well. Formulas and point systems never address the question of distress (i.e., need as measured by formula factors) versus the capacity to act to alleviate stress. The latter issue is different from the community capacity problem identified in Chapter One. The list of eligible activities may require project planning and implementation levels that outstrip both community capacity and the delivery cycle of the allocation system. Attempting to alleviate this by increasing the allowable period for commitment of funds creates another tension: longer term commitment of funds for some communities reduces the pool of open funds available for future competitions for other communities.

Apart from the overt political aspects of the creation of the new grant type, it can also be interpreted as a necessary response to an incipient change in the pool of eligible communities. The phasing-out "hold-harmless" communities as a group differed from non-hold-harmless small communities in types of need, planning capacity, and experience with federal programs. Both on these grounds, and because it suited their purpose of maintaining funding levels, "hold-harmless" communities could argue for creation of the comprehensive, multi-year grant program.

Hold-harmless provisions, and other transition devices that separate a class of eligible communities from the effects of a developing competitive allocation system may have the primary function of postponing political battles until the provisions run out. The administering agency should anticipate pressures for major adjustments to the allocation system as that class enters the applicant pool.

#### HUD's Responses: Reformulation of the Formal Allocation Process

HUD developed a national rating and ranking system for the Small Cities Program for Fiscal Year 1978.

In prior years, HUD had given increasingly detailed instructions to its field offices on how to design rating and ranking point systems for the discretionary grant competitions. HUD was responding to a perceived bias in the selection process toward certain types of communities, without enough sensitivity in the selection systems to quality of the proposed projects, to community capacity to complete activities, and to the greater absolute need of some larger communities with high quality preapplications.

To deal with these problems, in the new national Project Selection System for Comprehensive and Single Purpose grant competitions, HUD created new thresholds, gave greater weight to absolute need measures, and expanded the list of point system factors to include measures of program quality.

The addition of new factors continued the trend toward decreased weight for measures of community-wide need. The factor for benefit to low- and moderate-income persons, as quantitatively measured, had as much

nominal weight as the poverty and housing need factors. Performance in the areas of housing and equal employment opportunity (as assessed by Area Office raters) had three fourths the nominal weight of the need factors. "Hold-harmless" status had one eighth the need factors' weight.

A new factor, program impact, was a subjective measure of program quality. This factor was given twice the nominal weight of the need factors, and represented 40 percent nominal weight out of total possible points of 1025 in the Comprehensive grant selection system. The new factor required a subjective comparison, along specified design criteria, of applicants in a competition who addressed similar problem areas.

The comparison of similar projects was an attempt to avoid "biases" in the system toward particular activities such as housing rehabilitation. Such "biases" might occur in Area Office raters directly compared dissimilar activities with incommensurable impacts. Thus, it extended the strategy of the previous year's instructions to Regional Offices on how to design rating systems.

The new national selection system injected an additional element of discretion into the selection process, although the level of detail in the regulations concerning how discretionary Area Office judgment was to be exercised was much greater than in the past. At the same time, the system provided more bases for competition among applicants, by adding more factors which communities could influence through design of their proposed activities.

The overall sensitivity of the system to the community-wide need

criteria was reduced, and sub-area measures of actual benefit to needy persons (through the benefit measure) and assessments of program merit were given preponderant weight. But, the complication of the rating process also reduced its predictability.

William Moss analyzed the 1978 Small Cities competitions and noted four unanticipated results:

- o Community size and previous experience are important determinants of program participation, project selection, and the chances of being funded.
- o The percent of communities applying for Single-Purpose grants is larger than that applying for Comprehensive grants, in marked contrast to estimates of the allocation of funds.
- o The nominal or official weights used in the PSS scoring system are different from the actual or effective weights. The four need factors are significantly less important in practice, and the factors for program benefit and the benefits to low- and moderate-income individuals are more important.
- o The award of points for previous experience in the amount of 25 points for "hold-harmless" status in Comprehensive competitions has very little effect on the ranking of applicants, and therefore little direct effect on the likelihood of being funded.

Therefore, two non-formula characteristics of applicant communities had more effect than the need measures, and the two program quality fac-

tors had more effects than anticipated. The efforts to weight the need factors toward larger communities had little effect, as the effects of jurisdiction size were more indirect. Additionally, the effort to bias the system toward "hold-harmless" applicants was unsuccessful--a 25 point rating factor had more symbolic than actual impact on the rankings of applicants.

Andrew Isserman evaluated the 1978 competitions and found that:

- o Proposed programs with high benefit to low- and moderate-income persons went unfunded.
- o Community flexibility in program design and funding opportunities for non-housing programs were discouraged by the point system.
- o The point system by itself did not curtail Area Office discretionary power, as measured by the differences in rankings using only the need measures as compared to the actual rankings with the full point system.

Unpredictability in the new allocation system can also arise from the actual implementation of the point systems by the Area Offices. Given the high nominal and effective weights of the two subjective selection factors for program quality, the system will be sensitive to Area Offices' use of the system.

The evidence confirms that Area Office practice was less than ideal. A U.S. General Accounting Office review of rating procedures in

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\*This finding is consistent with Moss' conclusions about the actual weights of the need factors on the results of the 1978 competitions.



Fiscal Year 1977 found that "deficiencies in HUD's review and approval of applications (had) resulted in funds being given to some communities which did not have the most promising projects."<sup>1</sup> In addition, "HUD reviewers drew conclusions about estimated project benefits which were not consistent with information contained in the application," the report said, "and in other cases, they did not resolve conflicting statements about estimated project benefits."

Later program experience indicated additional problems in Area Office implementation of the detailed rules of the national allocation system. Some Area Offices overcommitted Small Cities multi-year comprehensive grant funds, creating fund scarcities for future competitions. HUD also found Area Offices approving grants in excess of the ceilings that they had established for single purpose and comprehensive grants. Many offices were also not recording the basis for the award of points in rating preapplications, as required by program regulations "to ensure that the decisions are based on regulations and policy requirements and applied consistently to all preapplicants."<sup>2</sup>

With no good sense of what a good allocation of funds in the competitive system should be, evaluation of the system, other than procedurally, is problematic. The above evidence of Area Office practice indicates that procedural uniformity in use of the selection systems is not guaranteed.

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<sup>1</sup> Housing and Development Reporter. Vol. 6. No. 16. September 18, 1978. p. 437.

<sup>2</sup> Housing and Development Reporter. October 27, 1980. pp. 442-443.

However, evaluations such as the Isserman study based on some community-wide indices of need, no matter which measure of need is chosen, do not judge the allocation system on its own terms, given the intent to select grant winners based on program quality as well as need.

Therefore, two types of unpredictability are introduced when the allocation system is elaborated. The first, uncertainty arising from the degree of field office compliance with operational rules, would be present in any allocation system,<sup>3</sup> but would tend to increase as the system became more complicated. The second, uncertainty of results due to the effects of correlations among selection factors and the voluntary nature of entry into the system, would also increase as point systems were expanded; however, this type of unpredictability is peculiar to formula-based competitive allocation systems.

Given this situation, the appropriate agency strategy for improving the performance of the system might seem to be the following:

- o design a point system which includes all salient objectives and add factors for new objectives as they arise
- o ensure procedural uniformity via increasingly detailed definition of selection criteria
- o deal with problems iteratively as they become perceived by a sufficient number of program users

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<sup>3</sup> However, this uncertainty would be least in a pure need-based formula allocation approach.

o as errors creep in (for example, a low benefit project in a high need community with a skillfully written proposal working the "merit" factors), establish thresholds for each selection factor in response to error from that factor's contribution to the ranking.

However, such a system will become increasingly rigid and more difficult to adjust in response to shifts in program priorities by Congress or the Executive Office. Inevitable complaints about the allocation system will elicit responses increasing the rigidity of the system in ways that, in the longer term, may be viewed as suboptimal.

It will be useful to consider the role of thresholds in the new national selection system.

The 1978 program revisions also created more definite performance and capacity thresholds. The political reactions to some of the proposed thresholds were noted earlier.

In the competitive block grant program, HUD has more influence on grantee performance than in the entitlement program: future chances of winning a grant can be conditioned on current performance, either through new rating factors or through performance thresholds. HUD faces a greater burden in denying an "entitlement."

However, if many program users perform poorly, a rigid adherence to performance thresholds will not be possible. Just as no criterion for a good allocation of funds is unanimously accepted by program users, no standard of efficiency is universally recognized as best. If communities

perform poorly, then the agency will be blamed for not administering the program in a way that increases local capacity. Thresholds that bar many eligible communities can be criticized as inconsistent with that program goal.

Additionally, community inefficiency or inability in program administration affects the equity of the allocation system for ultimate program beneficiaries: why should residents of an inefficient, even incompetent unit of local government be denied access to Small Cities aid, if their needs are as great as those of better performing grantees?

To deal with the problem of insufficient community capacity to compete and to administer Small Cities grants, HUD permitted joint applications, applications by one community in behalf of another, and the contracting out administration of local programs.

HUD contracted for technical assistance for communities to better compete and perform in the Small Cities Program, in order to increase and redistribute capacity among communities. HUD preferred this alternative to allowing increased administrative expenses for communities to hire their own experts. This suggests another HUD objective in this approach: to increase control over the quality of applications and administration by having influence over the type of technical assistance that communities received. Providing other resources can be more effective than thresholds in increasing the predictability of the allocation system.

#### Formula Allocation to States

In the 1978 Program Year, Congress altered how Small Cities funds were distributed into State pools for the Comprehensive and Single Pur-

pose grant competition. Congress applied the dual formula system of the entitlement program to Small Cities funds, with the substitution of a population factor for growth lag.

As a result of the debate over this change, HUD made a study of small city needs and alternative allocation formulas for the Small Cities program.

This formula change altered the relative availability of discretionary funds among states, and as a result, the intensity of competition for funds. Andrew Isserman's evaluation noted that the opportunity for funding varies tremendously across Area Offices, since the number of applicants per aid dollar varies.

The issue of differences in intensity of competition has not been raised with respect to the Project Selection System. This may be due to the difficulties in connecting the issues of competition and area allocation. In any case, the lack of agreement on needs and measurement apply to the formula allocation to states as well as the Project Selection System. Since many measures of community distress, capacity and program quality are inapplicable to State areas, the debate over the best allocation formula has been around the issues of need and the "right" proxy measures.

To summarize the changes in Program Year 1978, the trends in previous years were continued: redefinition of objectives and selection of a primary objective; continued centralization of the selection system design responsibility; expansion and refinement of the selection formula and

reduced weight for need factors; increasing emphasis on performance to counter the selection system's insensitivity to this issue. And, a new program for comprehensive grants was created.

Evidence indicated that the selection system had unanticipated results: subjective selection factors had more impact than intended, and need factors had less; two community characteristics not included in the selection system, community size and prior experience, were major determinants of success in the competitions; "incentive" and "preference" factors, such as the "hold-harmless" factors had very little effect on the competitions. Area Office implementation increased the unpredictability of the system.

INTERPRETATION OF THE DEVELOPMENT  
OF THE PROJECT SELECTION SYSTEM

STAGE I                      1975                      A NEED-BASED SELECTION SYSTEM

Competitive selection required more of need-based allocation formulas than do block grants, for equity and precision.

HUD Area Offices faced different incentives in designing selection systems than did the central office.

STAGE II                      1976-  
1978                      CENTRALIZATION OF SYSTEM DESIGN AND  
LEGITIMIZATION OF DISCRETION

A competition based solely on need was not a competition at all; HUD moved away from need-based selection.

HUD centrally designed the selection systems to avoid unexpected results in the competitions.

HUD legitimized Area Office discretionary power by increasing narrow definition of the selection systems.

HUD created a new program when formula refinement could not resolve rigidities in the allocation process.

Tensions among program goals resulted in shifts in priorities by HUD.

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|-----------|---------------|--|
| STAGE III | 1979-<br>1980 | REFINEMENT   |
|           |               | The new selection process was stable; HUD concentrates on enforcement and monitoring.          |
|           |               | In response to new program emphases, HUD attempted to reduce "bias" and "error" in the system. |

PROGRAM YEAR FIVE (1979)

The Small Cities Program allocation process remained essentially unchanged in the fifth year of program operations.

Participants in the system--HUD central and Area Office staff and program grantees had no major complaints about the Project Selection System in Fiscal Year 1979. This may reflect the complexity of the new system, and the time necessary to gain information about its outcomes. A type of stability may be possible following a period of elaboration and centralization of the selection process, indicating that the major issues, "bias" in the selection of winners and activities, Area Office capacity, and "hold-harmless" communities, were resolved. It can also indicate that more fundamental issues, such as disagreement over needs, measurement, organizational stability, and confusion over multiple objectives were abated as a "merit"-based competition replaced a "need"-based one.



PROGRAM YEAR SIX (1980)

For Fiscal Year 1980 HUD retained all the essential features of the Small Cities allocation process. Three technical changes were made in the Project Selection System.

First, HUD attempted to reduce the "bias" toward certain activities in the Single Purpose Grant System. For the program impact factor in the original system, all preapplications addressing the same "problem area" were compared to determine their program impact points. This procedure was extended to the benefit to low- and moderate-income persons factor. Thus, some activities which, due to their nature, always benefit a lower percentage of poor persons than other activities (for example, economic development versus housing rehabilitation), would still be able to achieve maximum points.

This feature of the scoring process ensures greater flexibility for local communities in proposing activities, since they will not be penalized for choosing lower benefit activities. However, the change also works against the fourth year program objective of awarding funds to projects that most benefited low- and moderate-income persons. If the number of problem areas were to be increased and this procedure applied, the selection system would drift further from this primary objective, unless thresholds for benefit were put in place as well.

The second technical change increased the ways in which communities could earn points for performance in equal opportunity. The effective weight of this factor is very slight.

Communities must participate in other HUD programs (such as the New Horizons Fair Housing program or Areawide Housing Opportunity Plans) to earn extra points. The addition of new ways to earn points may seem an easy, cheap way to increase participation in other programs, while not changing the importance of other factors in the Selection System. However, this factor contributes so little to the distribution of winners that its main purpose in the selection process is symbolic.

The third change allows Area Offices to award current year's funding to a community that failed to win funds the previous year due to processing or mathematical errors. This housekeeping change preserves the fairness of the competitions.

INTERPRETATION OF THE DEVELOPMENT  
OF THE PROJECT SELECTION SYSTEM  
(Continued)

STAGE IV

1981

REFINEMENT AND DECENTRALIZATION

Changes in formula measurement preserve the competitive equilibrium at expense of system sensitivity to changes in need.

Decentralization to States will increase drift of program away from original program goals, and reduce equity across States.

PROGRAM YEAR SEVEN (1981)

The most recent changes in the allocation system for the Small Cities Program are consistent with prior revisions.

I will consider three types of changes: refinement of the allocation system, redistribution of discretion, and transfer of program responsibility to the States.

HUD's Responses: Reformulate the Formal Allocation Process

HUD made only minor changes to the Small Cities Project Selection System for Fiscal Year 1981, altering the factors used to award points:

- o Deleting the housing needs factors
- o Giving equal weight to the two poverty needs factors
- o Adding program design criteria for economic development and energy conservation in the Comprehensive Grant program
- o Increasing the weight of the program impact factor in the Single Purpose Grant program
- o Combining the two criteria about State growth resource coordination plans into a single state rating factor
- o Changing the criteria for awarding bonus points for participation in an Areawide Housing Opportunity plan
- o Adding an energy conservation selection factor.

Thus, these changes continue the trend of reducing the weight of need factors in the system, increasing the ways in which subjective program quality factors could be earned, and adding new selection factors to reflect new or newly emphasized program goals. The relatively minor changes in the national selection system since 1978 indicate a much greater

stability in the allocation system than in the first three program years, a stability associated with a "recategorization" of the program, with less emphasis on community need, and more on performance, grantsmanship, and the traditional determinants of success in a competitive system, community size and planning expertise.

The stability of the system arises in part from the reduced impact of proxy measures of need in the allocation formula. The housing need factor was eliminated, according to HUD officials, because it was difficult for applicants to get adequate information on housing, and because "the measures of housing need...are declining in some areas, but not others," giving an unfair advantage to communities with improving housing stock.

In other words, housing need is changing, while poverty need is remaining relatively stable. Elimination of the housing need factor (which would be updated by 1981 census information) then contributes to maintenance of a status quo based upon discretionary competitions emphasizing performance more than relative need among cities.

The measurement problem with housing need (statistical reliability for small places, obsolescence, incomparability of more accurate local or state data) might suggest finding new measures sensitive to rapid changes in need. For a need-based formula such as in the entitlement program, such a response would be a rational refinement to the system. However, in a system that uses a linear weighted allocation formula, not to ration based on need, but to constrain and legitimize discretionary selection of winners by branch offices, rapid change in the measures of need are con-

sidered disruptive to the system by most program participants.

HUD also gave equal weight to the poverty need measures, returning the system to the weights of Program Years Two and Three. This change responded to complaints that the 1978 systems were biased toward larger communities. HUD thus has moved back and forth on the issue of size bias in the system; however, the actual effect of these changes has been minor, as HUD noted in its Third Annual Report, and as suggested by the results of William Moss's evaluation of the 1978 competitions.

A surer means to ensure "fairness" across city size would have been to create separate city classes, based upon population. However, this proposal would have opened a new political debate on the proper formula to use to divide up the state pools among the new classes, much along the lines of the criticisms of the set-aside of funds for non-metropolitan communities. (Using the entitlement formula as the basis for allocating funds, the non-metropolitan towns would receive a much larger share of all funds.)

Several changes in the allocation process were not directly expressed in the regulations: interpretation of regulations by field offices and new grant award thresholds.

#### Interpretation of Regulations

HUD communicated additional policy changes to Area Office staff in its operational field manual. Area Office raters were advised to be more

broadminded, and flexible and open to innovation, in evaluating energy and economic development proposals. These instructions are consistent with the earlier observation that changes in factors would have to be accompanied by information about how or how literally field staff should interpret the changes in the discretionary selection factors.

#### Grant Award Thresholds

HUD also imposed thresholds based upon rating scores, as well as the older thresholds to entry into competition. Area Offices were instructed to award funds only to those preapplications with greater than 50 percent benefit to the poor, except on an exceptional basis. (In 1978, HUD deleted a 75 percent benefit threshold due to community opposition.) Additionally, Area Offices are to rank each applicant in one of four categories, depending upon demonstrated need, benefit to low- and moderate-income persons, likely community impact, and support from A-95 clearinghouses. Those preapplications falling into the lowest category would not be invited to submit a full application regardless of their total points.

Again, these new thresholds indicate the insensitivity of the selection system to certain errors, and consequent unexpected results. Some low need, low benefit, low impact projects had been funded in previous years.

Thresholds are an easy, logical response to the insensitivity of linear weighted formulas. By the eighth program year, HUD had developed a set of thresholds that were acceptable to eligible communities and that addressed the most striking errors in the selection system, errors due in part to the lack of performance factors and the large number of different factors in the point system.

## HUD's Responses: Redistribute Discretion

HUD changed the State role in the Small Cities allocation process in two ways for Fiscal Year 1981: 1) a new State factor to be rated by States; and 2) a demonstration project for States to design and administer the selection system for their state competitions.

Since the passage of the 1974 Housing and Community Development Act, state participation had been an issue in the discretionary CDBG program. The Ford administration had proposed that States administer the program. In Program Year One, the design criteria for the Area Office selection systems had allowed extra priority to projects where States and local governments cooperated. In the national selection system introduced in 1978, bonus points could be earned by communities participating in State development plans. That same year HUD reserved a section of the program regulations for State participation guidelines.

## The State Rating Factor

For Fiscal Year 1981, HUD added a State rating factor of 25 points to be scored by State officials for Comprehensive and Single Purpose grant competitions. The majority of commentors to the change opposed increased state participation, even though the nominal weight of the factor (less than 3 percent of the total possible score) would contribute very little to the final ranking.

## State Selection of Grant Winners

In Fiscal Year 1981, Kentucky and Wisconsin participated in a demonstration project to see whether state design and administration of the



the Small Cities grantee selection process will increase links between local Small Cities projects and State and Regional development plans.

Kentucky's selection system is substantially the same as HUD's national system.

Wisconsin's criteria are substantially different, although their changes follow the general direction of the evolution of HUD's system.

The major new features of the Wisconsin system include:

- o Reducing the nominal weight of the benefit to low- and moderate-income persons factor by 75 percent, and omitting the HUD threshold for that factor
- o Providing bonus points for economic development projects
- o Introducing "distress" criteria to select the "most troubled" cities
- o Evaluating communities with less than 5,000 population separately from communities with over 5,000 population
- o Use of locally available, rather than national, data.

In terms of earlier analysis of the national selection system, Wisconsin's system represents a further drift from the original block grant goals of allocating aid for projects primarily benefiting the poor on the basis of verifiable community need.

The reduction in weight of the benefit factor and elimination of the HUD threshold for that factor decreases the importance of that criteria in distinguishing applicants. Substitution of city "distress" criteria for aggregate measures of individual need represents a further divergence from the program's conception (more akin to the UDAG program than the block grant program). However, separate evaluation of applicants

according to city size directly addresses the issue of fairness of competition. And, use of local data reduces one aspect of the measurement problem, its accuracy and timeliness, at the expense of another, its comparability across the States.

Embodied in the State selection systems are all the significant strategies used by HUD to make its Project Selection System work better:

- o addition of new scoring factors to reflect new program objectives
- o revision of the need factors in the linear weighted formula
- o use of factors and thresholds to deal with performance and capacity problems of eligible communities
- o changes in measurement of need and program impact
- o division of eligible communities into separate classes.

Two sources of problems are relevant for the Wisconsin and Kentucky selection systems.

First, the outcomes may be inconsistent with the stated goals of the systems. HUD had continuing problems of this sort during the seven year evolution of the Small Cities allocation system. For example, Wisconsin's system may have "bias" toward economic development projects to the exclusion of other types of eligible activities. Or, the lack of thresholds on some factors can result in "low quality" projects receiving funds.

Second, the outcomes may be inconsistent with HUD and other evaluators' expectation of how the Small Cities program should work. Without benefit thresholds (formal or informal), funds may be awarded to projects

with little benefit to the poor. And emphasizing city "distress" rather than "need" may result in high need communities going unfunded.

Either of the sources of the problem can serve as grounds for future criticism of the program based on 1) the unpredictability and imprecision of linear weighted formulas and 2) disagreement about the relative priority of the multiple objectives of the program.

On a more general level, the development of separate State rating systems (or State programs) which differ substantially from one another will increase the variation in outcomes along a number of evaluation criteria. The move toward uniformity in the national selection system was one response to a desire for equity of treatment of eligible communities.

The State administration of the selection process moves in the other direction--equity is traded for greater sensitivity to the needs and objectives of the eligible communities in a subarea of the program's coverage. This trade-off between efficiency in meeting local needs and equity of treatment for all eligible communities is just one of a number of polarities in the Small Cities allocation system.

Identifying these polarities can not only help the agency better identify symptomatic and more fundamental problems in the program, but can also help the agency anticipate future directions the allocation system (and its participants) will take in response to the agency's "solutions" to those problems. This analysis of the evolution of the Small Cities program provides a useful catalogue of the "problems" and "errors" of a competitive grant process that makes use of need-based linear weighted allocation formulas. It also identifies the trade-offs and dilemmas in

implementation, the tensions in the system. In the following section, I describe the important tensions I see in the Small Cities allocation process.

TENSIONS IN THE ALLOCATION PROCESSNational and Local Objectives

An inevitable tension between national objectives and local objectives will occur in a block grant program. The national objectives are often an assortment of goals that are purposely ambiguous because various interests could not agree on priorities among the goals; a block grant program is passed because certain interest agree with a part of it. Letting localities determine the priorities for community projects detracts from the intended national program. However, both the objectives of the program and the points of view of participants in the allocation process are varied and complex. Easy definition of national and local priorities and compromises among those priorities are impossible in advance.

This tension has been played out in three ways in the Small Cities CDBG program. First, both HUD officials and communities have tried to interpret Congressional intent in a way consistent with their own priorities. HUD wished to respond to clear legislative mandates and to new Congressional interpretations of the national objectives (such as emphasis on benefits to the poor). Communities wished to broaden the ways in which the grant dollars may be used to enable pressing current problems to be met regardless of their nature.

Second, the debate over how dollars are allocated by an objective formula has mediated the tension between national and local objectives. No "best" formula will be consistent with all the different objectives: the formula chosen relates more to the prevailing view of what Congress will support (or what they won't reject). The standard against which the

Small Cities Program's allocation process has been measured is first, the past distribution of dollars and second, simple measures of need.

Third, the competitive nature of the Small Cities allocation process has been a focus of this tension. The use of explicit, weighted rating criteria to select grant winners necessarily embodies a particular interpretation of the multiple objectives. Three sources of potential disagreement arise: 1) how money should be distributed to the competitive pool; 2) what activities are eligible; and 3) what activities are competitive due to the effective weighting of the selection criteria.

No natural balancing point has been found for this tension in the Small Cities program because local and national objectives have changed over time and HUD's responses to those changes have created new disagreements over priorities for the program.

#### Agency and Grantee Discretion

A second tension occurs between agency discretion and grantee discretion. Arguments about discretion are often arguments about who should have the authority to interpret the enabling legislation's spirit and mandates.

The block grant concept moves discretion to grantees: they know best for choices confined to a specific set of national purposes. However, the distribution of discretion serves other purposes than the program goals.

The amount of discretion grantees are allowed will help shape the local debate over community development. Discretion (or its absence) can

be used by local elected officials to sanction an unpopular program direction (the regulations require it), to excuse poor program performance ("we didn't have the authority to act"), or permit substitution of federal for local resources ("the law means we know our needs best").

For HUD, how discretionary power is distributed among central and field offices and program grantees serves diverse purpose. Shifting responsibility for design of the selection systems to the national office: 1) increased the uniformity of program outcomes; 2) reduced egregious error, such as improper political influence in project selection; and 3) increased the reliability of the system in its implementation and its responsiveness to central decisions.

Such a transfer also shifts the relation between HUD and eligible communities, since Area Offices have the primary contact with grantees. Decisions on interpretation of guidelines take longer since Area Offices must check with the central office.

In addition, shifting discretion toward the center decreases the ability of the Area Offices to deal with defects or errors in the formal allocation system. Informal Area Office action is required by the rapidity with which formal guidelines become outdated and by the often inappropriate or too narrow policies based on insufficient information about the problems of implementation.

For example, one evaluator concluded that high benefit and high need projects went unfunded in the 1978 competitions. Area Office discretionary power could have avoided this "error" of the formal system, by applying thresholds or judgmental factors outside the selection system.

When HUD centrally designed the strict rating system, it reduced the ability of Area Offices to shortcircuit "bad" features of the allocation process. Those who implement procedures often can recognize smaller errors sooner than those who designed the system. "Bias" in the selection of activities, such as housing or redevelopment, would be easily noticed (and corrected) by staff raters.

A continuing theme of early adjustments in the rating system was the too strict interpretation by field offices of the legislative mandate and HUD guidelines. Once a national rating system was in place, HUD had to formally alter the system to correct errors, rather than instructing Area Offices to use their discretion. Likewise, communities had to wait for policy decisions from Washington to correct problems. By redistributing formal discretion among the participants in the allocation system, HUD gained one type of predictability at the expense of another.

The tension arises because "who know best for what purposes" is also related to who will use their discretionary power to further program goals, rather than to pursue non-program goals or other interests. Who has the right incentives to use what they know properly brings up a real dilemma: HUD's efforts to correct "bad" use of Area Office discretion by drawing in responsibility for design of the selection systems reduced the incentives of Area Offices to use their discretion well; the Area Offices decreased ability to respond quickly to policy questions reduced communities' incentives to pursue innovative uses of the program. Thus, redistributing discretionary power requires not only trade-off among goals, but also creates new, unintended incentives among program participants.



### Program and Organizational Goals

The tension between program and organizational goals manifests itself in ways other than the distribution of discretion. HUD, in its Fifth Annual Report, drew attention to the inherent conflict between the high number of eligible communities and the agency's ability to administer a large number of small grants.

Here, the tension is explicit: the program objective of providing aid to needy communities and the organizational objective of balancing the field offices' workload and capacity in a way that satisfies internal (central and field staff) and external (Congress and program users) standards of quality and efficiency.

HUD responded by reducing the workload (taking over design responsibility, and emphasizing community capacity and program quality over community need). By emphasizing quality over need, HUD has decreased the chances that grantees will perform poorly, has enhanced the agency's performance record, and as a result reduced the relative workload of its staff. At the same time, less capable but more needy communities have less chance to win funds.

### Stability and Sensitivity of the System

The desire for stability and continuity of funding conflicts with the desire to refine the allocation system so that it detects finer changes in community need and performance. Communities want a constant flow of aid, with relatively stable guidelines; program participants also want to distribute aid on the basis of objective need--money should go to the neediest first, and reduced need should result in reduced aid.

HUD increased the stability of the system by creating multi-year grants, by eliminating the housing need measure which was sensitive to rapid changes in housing need, and by imposing a uniform, stable national selection system. HUD attempted to increase the sensitivity of the system by adding selection factors, by requiring extra data from applicants, and by analyzing the differences in need among small cities. The two types of HUD responses work in opposite directions: increasing sensitivity makes the outcomes of the system more volatile; efforts to make outcomes more stable increases the degree of mismatch between aid and need.

#### Multiple Objectives and Meeting Acute Need Well

Another tension arises between the desire to pursue many program objectives and the desire to target aid to a single, acute problem. Efforts to widen the scope of the selection system, to allow maximum flexibility among the activities chosen reduce the sensitivity of the system to rapid increases in a single need for few communities.

For example, increasing the number of selection factors reduces the contribution of a single factor to the ranking of applicants. Increasing the weight of one factor or need measure targets aid more closely to a single type of need (or communities with a particular need).

HUD has responded to the desire to pursue multiple objectives by increasing the number of selection factors, reducing the weight of need measures, and, most importantly, by only allowing the comparison of like projects in determining benefit and program impact scores.

To retain the ability to respond rapidly to acute need, HUD has relied on a separate "imminent threat to health or safety" grant type,

with maximum discretion (and no point system) for Area Offices to award grants for this purpose. Thus, the pursuit of multiple objectives in the larger Small Cities Program was increased at the expense of the Project Selection System's sensitivity to acute community need.

#### Community Need and Administrative Efficiency

The tension between meeting community need well and having an efficient, well run program has also been present in the Small Cities allocation process. Having a system that awards funds based upon the communities' distress or objective indicators of absolute or relative need conflicts with a system that awards funds based on good performance, rapid completion of projects goals, and minimal administrative problems. Communities with high need may not have the capacity to run programs well, communities with administrative expertise may have little need.

HUD has responded to the issues of need versus performance throughout the evolution of the allocation system. Thresholds were introduced for capacity and performance; major weight was given to "program quality"--benefit to the poor (at the target area level) and program impact. Need thresholds were introduced to make sure the lowest need communities were not funded. Additionally, other resources such as technical assistance were made available to increase community capacity, apart from the level of community need.

CHAPTER V

SUMMARY AND CONCLUSIONS

SUMMARY

In this thesis I have examined the evolution of the Project Selection System of the Small Cities Program, and have developed a framework for analyzing that system.

I noted several trends in its evolution:

1. A shift away from allocation formulas based on community-wide need toward selection formulas based on subjective measures of program impact and quality.
2. Accretion of new program and organizational goals by means of additional formula factors, with consequent "formula drift" away from the block grant concept.
3. Shifting of formula design responsibility to the center, and constraint of Area Office discretion, to reduce errors and to legitimize discretionary selection of grantees.
4. A continuing process of HUD adjustment of the formal allocation process, in response to the limitations of linear weighted allocation formulas.
5. Responses to those adjustments based on polarities or tensions in goals, that is, program participants attempting simultaneously to pursue conflicting goals.

CONCLUSIONS

The Small Cities formal allocation process has evolved predictably.

Over the seven year history of the Small Cities CDBG Program, its allocation process has developed progressively in a series of related, understandable changes. This development has been constant, and relatively insensitive to political shifts in the Department of Housing and Urban Development.

While the outcomes of a competitive selection system are unpredictable when using linear weighted allocation formulas (due to divergence in the nature of need, measurement, and participant response), my analysis suggests that the evolution of a competitive grant process can be predicted. Program participants can anticipate generic problems and the likely effects of different agency responses to those problems.

HUD has responded effectively to unexpected results of the program's allocation process.

The responses by HUD have generally diminished the unexpected results (the generic problems) of the Small Cities Program allocation process. Progressively greater stability in the design and administration of the selection system and greater attention to logistical and enforcement issues in the later stages are evidence of successful HUD response. Fewer communities are dissatisfied with the selection system, and,

as a result of HUD's responses to their problems, more communities accept direct and effective features of the allocation system (such as capacity and performance thresholds) which they opposed in its early stages of development.

Although the outcomes of the Small Cities allocation process are progressively more predictable and acceptable, this evolution does not imply convergence toward an "optimal" allocation system.

While HUD's responses to unexpected results of the Project Selection System have increased its stability and predictability, evolution along a different path could be stable and predictable as well. Due to the limitations of selection of grant winners by formula, HUD's adjustments to the system have given the appearance of a better working system for eligible communities, while the actual effects on outcomes are discovered years later through lengthy and expensive evaluation research.

Additionally, since its responses have not helped HUD, the Congress, or eligible communities to identify and resolve the tensions among the goals of the Small Cities Program, the allocation system continues to produce unanticipated and unplanned trade-offs among those goals.

Finally, because the greater predictability of the allocation system has depended on HUD's ability to respond to the expectations of Congress and the communities, the adjustments in the system, in order to be politically effective, have been directed more toward changing expectations and providing an appearance of responsiveness, rather than toward more fundamental questions about program priorities and the underlying

sources of conflicts among expectations. As a result, the stability of the system is likely to be illusory and temporary.

The Small Cities competitive selection approach is incompatible with the block grant concept.

While community need and capacity, administrative efficiency and equity, agency monitoring and enforcement, and the limitations of linear weighted formulas will be concerns in all block grant programs, the use of a competition to select grantees creates a unique conflict in the allocation process. This fundamental conflict arises between choice based on need and choice based on merit. Competitive selection formulas that combine need and merit criteria are incompatible with basic assumptions of the block grant approach:

- \* that community-wide need provides a sound basis for distributing aid, separate from the issue of how well the aid can be used
- \* that local capacity is a resource to be developed rather than a criteria for distributing aid
- \* that relative need among communities should be the criterion for allocating aid.

For that reason, the debate over fairness and equity of outcomes in the Small Cities Program is not similar to the debate over those issues in the CDBG and other block grant programs. A competition based solely on need is not a competition, while a competition based on merit is not a block grant allocation. Needy cities are often not meritorious, and cities with meritorious programs are often not needy.

As a consequence, the Small Cities competitive selection process, incorporating need measures, has a special source of conflict and tension,



which surfaces as dissatisfaction with the selection formula, rather than as dissatisfaction with HUD monitoring and enforcement of communities' administration of local programs. This result is not surprising since the competitive process is basically a yes/no decision, taking an applicant's grant request as the starting point. The formal allocation system includes no objective process for determining the "right" grant amount for an eligible community.

Further research should be directed to the role of competition in need-based allocation systems.

Even though the need for a competition has dominated the evolution of the Small Cities allocation process, my analysis has been unable to determine the real role of competition in that process. While the use of linear weighted allocation formulas to determine pro rata grants for entitled communities is fairly well understood, the use of such formulas to make all or nothing decisions about grant awards is less well known.

The incompatibility of merit selection and entitlement selection based on community need increases the difficulty of interpreting the competitive process. A formal analysis of the major features of the Small Cities Program allocation process--

Allocation of resources based on need  
 Taking into account community capacity  
 Through a competitive selection process  
 Administered by a decentralized bureaucracy--

would contribute greatly to better understanding the role of need-based allocation formulas in competitive grant processes.

APPENDICES

Appendix A  
 Characteristics of Allocation Formulas  
 THE CDBG ENTITLEMENT GRANT ALLOCATION FORMULA

80% funds for SMSA's  
 20% funds for non-SMSA's

Hold-harmless provision is phased  
 out in 5 years

The larger of two formulas is chosen to determine a grantee's share of appropriation:

$$\begin{aligned}
 \text{NEED A} &= .25 \frac{\text{Area population}}{\text{Total population of all areas}} \\
 &+ .50 \frac{\text{Area poverty count}}{\text{Total poverty count for all areas}} \\
 &+ .25 \frac{\text{Area overcrowded dwelling units}}{\text{Total overcrowded dwelling units for all areas}} \\
 \\ 
 \text{NEED B} &= .20 \frac{\text{Area growth lag}}{\text{Total growth lag for all areas}} \\
 &+ .30 \frac{\text{Area poverty count}}{\text{Total poverty count for all areas}} \\
 &+ .50 \frac{\text{Area age of housing}}{\text{Total age of housing for all areas}}
 \end{aligned}$$

Population: the most current estimates from the Bureau of the Census

Poverty: from the 1970 Census of Population

Overcrowded dwelling units: from the 1970 Census of Population (number of dwelling with more than 1.01 persons per room)

Age of housing: the number of existing year-round housing units constructed in 1939 or earlier from the 1970 Census of Population.

To the initial entitlement, any appropriate hold-harmless credits are added; if needed, a pro rata reduction is carried out to conform with the total funds appropriated.

Extent of growth lag: the number of persons who would have been residents in a metropolitan city or county, in excess of current population if the population growth between 1960 and the date of the most recent population count had been equal to the population growth rate of all metropolitan cities or urban counties.

Source: Maria Elena Gonzalez. "Characteristics of Formulas and Data Used in the Allocation of Federal Funds." The American Statistician. Vol. 34, No. 4. November 1980. pp. 203-204.

The general characteristics of the block grant entitlement "dual" formula includes the following:

1. The formula is additive and uses several factors differentially weighted.
2. The primary purpose of the formula is to determine appropriate grant amounts for an eligible area, as a share of the total appropriation.
3. Readily available, uniformly comparable official statistics are used as proxies for community need as defined in legislation for the aid program.
4. Hold-harmless provisions or minimum amounts of entitlement based on previous program levels are established.
5. The initial estimates of entitlement are reduced so that the total dollars distributed will equal the amount of funds appropriated by Congress to be distributed by the program to state and local areas.
6. Two formulas are defined and entitlement areas are allowed to choose the one with the higher value.<sup>1</sup>
7. Only a portion of the available funds are distributed by formula, with the balance being distributed at the discretion of the sponsoring federal agency.<sup>2</sup>

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<sup>1</sup>Gonzalez. Ibid.

<sup>2</sup>John L. Goodman. "Federal Funding Formulas, Population Redistribution During the 1970's and the 1980 Census." Washington, D.C.: The Urban Institute. April 1980. p. 15.

8. The formula reserves funds for an eligible community, contingent upon the community meeting certain requirements, having approved programs and applying for the funds.
9. The size of the annual appropriation affects the formula distribution.

Other features of allocation formulas not in the CDBG program are nevertheless typical of many formula grants-in-aid:

10. A two-tiered procedure is used, with allocation by formula to the state level, and then allocation within the state using local data or administrative discretion.
11. Many programs have minimum and maximum allocations for eligible areas.
12. Eligibility criteria are often used to establish cutoffs to determine which areas may receive funds.
13. Matching grants may be required of participating areas, usually some percentage of the entitlement amount.
14. Many of the allocation systems dampen the fluctuations in annual funding to shifts in the values of need factors by lagging the adjustments in funds (basing current year funding, in part, on previous year funding).

While the allocation to States in the Small Cities Program is essentially the same as the CDBG entitlement process, the Project Selection System differs in several key respects from past formula allocation systems:

1. The primary purpose is to rank grant applicants to determine winners in a competitive process.

2. Subjective merit criteria receive greater weight than objective need measures.
3. The burden of proof is on the applicant to justify granting funds, rather than on the agency to deny funding.

Legislative Issues in the Small Cities CDBG Program

Prior to the establishment of the CDBG program by Title I of the 1974 Housing and Community Development Act, federal urban development assistance had consisted of individual categorical programs with specific purposes. The participation of small communities in the prior categorical aid programs is summarized in Tables 2.10-2.12.

In those categorical programs, federal staff selected grant recipients from competitive applicants, and closely monitored utilization of funds. In the CDBG program, non-entitlement cities (both metropolitan and rural) continued to face a competitive allocation. However, the 1974 Act preserved the ability to undertake activities included in the categorical programs.

Funds for Non-Metropolitan Communities

While the original Block Nixon Grant proposal assured no funding for non-metropolitan areas, The House version of the 1974 Act earmarked 20 percent of the funds for these areas, and the Senate version called for a 25 percent share. The final version followed the House proposal, and included the House's formula allocation of funds among the states. The Senate version had linked funding to prior levels under the categorical programs being replaced. For transition purposes, small governments were given temporary funding entitlement based on prior grant experience (the hold-harmless provision).<sup>1</sup>

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<sup>1</sup>Rural America, Inc. Limited Access: A Report on the Community Development Block Grant Program in Non-metropolitan Areas. Washington: Rural America, Inc.: December 1977.

Table 2.10

Participation by Small Communities in HUD  
Categorical Grant Programs  
(as of December 31, 1971)

| <u>Program</u>                           | <u>Total Program Dollars</u> | <u>Dollars Awarded to Communities Less Than 50,000 Population</u> | <u>Percent Of Program Dollars</u> |
|--|------------------------------|---|-----------------------------------|
| Water and Sewer Facilities Grant Program | \$ 986,741,000               | \$ 666,332,000  | 68%                               |
| Urban Renewal                            | 11,363,847,000               | 2,941,975,000   | 26                                |
| Neighborhood Facilities                  | 229,207,000                  | 90,789,000  | 40                                |
| Model Cities                             | 1,937,857,000                | 177,600,000   | 9                                 |
| Open Space Land Grant Program            | 576,006,000                  | 183,051,000   | 32                                |
| TOTAL                                    | \$15,093,658,000             | \$4,059,747,000   | 27%                               |

Source: HUD. Third Annual Report. p. 278.



Table 2.11

Percentage Distribution of the Dollars Awarded  
to Small Communities by Grant Type and Population  
Categories

| <u>Population</u> | <u>Categorical Grants</u> | <u>Discretionary<br/>Balances Grants<sup>a</sup></u> |
|-------------------|---------------------------|--|
| 5,000             | 12%                       | 40%  |
| 5,000 - 9,999     | 14%                       | 19%  |
| 10,000 -49,000    | 74%                       | 41%  |

Source: HUD. Third Annual Report. p. 279.

Table 2.12

Water and Sewer Expenditures Under Categorical  
Programs vs. Under the CDBG Nonmetropolitan General  
Purpose Fund

|   | Water and Sewer<br>Categorical<br>Program 1968-72 | Nonmetropolitan<br>General Purpose<br>Fund FY 1975        |
|---|---|---|
| Average HUD Water and<br>Sewer Grant Amoung<br>Average Project Size | \$ 439,332<br>\$1,424,508                         | \$ 23,491<br>Not available,<br>no local share<br>required |
| Recipients Under<br>50,000 Population                               | 76%   | 100% of munici-<br>palities; most<br>counties             |
| Total Dollars Approved<br>for Recipients Outside<br>SMSAs           | \$291,866,000                                     | \$85,208,803  |

Source: HUD. First Annual Report. p. 64.

Future Funding for Hold-Harmless Cities

The future funding for small cities with "hold-harmless" status was that principal concern of those cities' officials in the 1977 Congressional review of the HCD Act. This issue was mainly a small city versus large city problem, particularly since a large share of discretionary funds were redirected to pay the additional costs of 1977 legislative changes in the entitlement program's allocation process.<sup>2</sup>

In its proposal to Congress the Carter administration dealt only with the hold-harmless issue, proposing that the discretionary funds be used "primarily for comprehensive community development grants" rather than single purpose activities. Presumably this would be an advantage to many of the small hold-harmless communities since their programs tended to be set up on a long-term, multi-purpose basis. The only other significant change proposed by the Administration concerned the discretionary balances metropolitan areas. The Administration recommended that the metropolitan discretionary balances be aggregated at the state area level rather than by individual metropolitan areas within the states, since, in a number of cases, the SMSA balance for a metropolitan area was considered too small to have a significant impact.

In the House hearings, several organizations representing small city interests appealed for retention of the hold-harmless grants.

The Ad Hoc Committee for Adequate and Assured Community Development Funding testified that "There is no predictability in the discretionary

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<sup>2</sup>This part is based on pp. 8-15 of HUD. Report on the Allocation of Community Development Funds to Small Cities. Washington: U.S. Government Printing Office.

funding system for programs with long-term implication" and requested an entitlement program for small cities with critical needs. The Northeast-Midwest Economic Advancement Coalition, a group which represented almost half of all small hold-harmless cities, also criticized the discretionary grant program: "Forcing cities to compete each year for a "one shot" grant cannot result in the orderly, planned and effective community development effort which our distressed small cities clearly need." The coalition presented the subcommittee its proposal for a Small Cities Entitlement Program. A third group representing small cities, Rural America, Inc. praised the CDBG program for the expansion in participation afforded non-metropolitan cities, but criticized the low level of funding for non-metropolitan areas. The National League of Cities also testified in behalf of small cities. According to League officials, the discretionary grant system had not been an improvement over the old categorical system: "One year programming, no flexibility and 'point systems' which vary from region to region make the discretionary program into a continuation of the old categorical grants."<sup>3</sup>

#### Small City Needs and the Dual Allocation Formula

The Project Selection System is the second in the stages of the formula allocation system for the Small Cities Program.

Metropolitan and nonmetropolitan discretionary funds are apportioned into state pools using a need-based formula. The 1974 formula, identical to that used for entitlement city allocations, was based on population size, poverty and overcrowding.

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<sup>3</sup>  
Ibid.

In the 1977 amendments to the Housing and Community Development Act, Congress approved a two tier formula to distribute CDBG funds. It was designed to provide more funding to older central cities which were considered by many to have been slighted under the initial 1974 formula.<sup>4</sup> The application of the dual formula to the division of small city funds touched off a Congressional debate along both small city versus large city and Frostbelt versus Sunbelt lines.

The formula added in 1977 was based on population growth lag, age of housing and poverty in the entitlement cities. Each city could choose the higher of the allocations from the 1974 and 1977 formulas.

HUD, and Secretary Patricia Harris, had proposed this two-tier or "dual formula". According to one analyst of alternative allocation formulas,

"The 1974 Act's formula would have made a large proportion of funds--nearly a billion dollars--available for discretionary grants; potential problems in administering such a large sum in fact contributed to HUD's willingness to develop an alternative formula."<sup>5</sup>

The applicability of the dual formulas to the needs of small cities was questioned in the Senate. In a regional split over the issue, the dual formula system was adopted for the Small Cities discretionary funds (substituting a population factor for growth lag, due to inadequacy of

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<sup>4</sup> HUD. Fourth Annual Report. p. 2.

<sup>5</sup> Robert Schafer. Alternative Formulas for Allocating Community Development Block Grants. Cambridge: Department of City and Regional Planning, Harvard University, October, 1977. p. 9.

data for small places). This dual formula had the effect of shifting funds from the West and South to the Northeast and Midwest; thus, it shifted discretionary funds among the state pools.<sup>6</sup>

An opponent to the adaption of the dual formula for small cities, Senator Sasser, succeeded in amending the Act to require a study of the differences between large and small cities, and the implications of those differences for alternative allocation formulas.<sup>7</sup>

One study prior to that required by the Sasser amendment found significant differences in need between metropolitan and non-metropolitan small cities.

"By every test--population change, poverty, income, unemployment, housing deficiencies--small non-metropolitan cities are in much greater need than small metropolitan cities."<sup>8</sup>

Need on most counts was also found to be greater in small non-metropolitan cities than in large cities. A regional effect was noted as well: "faster growth but more poverty and deficient housing in the southern and western than in the northeast and north central regions."<sup>9</sup> Additionally, looking only at rural areas, the study indicated that poverty is a better

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<sup>6</sup> HUD. Report on the Allocation of Community Development Funds to Small Cities. Washington: U.S. Government Printing Office, 1978. p. 8.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid. p. 63.

<sup>9</sup> Ibid. p. 63-64.

measure than community age to allocate non-metropolitan Small Cities funds to areas of greatest need.

The Congressionally mandated Small Cities Study revealed small cities perceptions and priorities about their developmental needs.<sup>10</sup> Regarding community problems related to development, lack of jobs, lack of adequate housing for low- and moderate-income persons and conditions of streets were most frequently mentioned by small cities. Top priorities for improvements in facilities, however, were sewer and drainage facilities, water facilities and streets. Size of city was more important than metropolitan or non-metropolitan status in determining development priorities. Cities under 2,500 population were twice as likely to cite water facilities as cities from 25,000 to 50,000. Those larger cities mentioned housing for low- and moderate-income families and central business district improvements twice as often as smaller cities.<sup>11</sup>

The HUD study of small city needs also looked at a number of alternative allocation formulas to divide non-metropolitan discretionary funds among states.<sup>12</sup> The report recommended no particular alternative formula, but instead recommended further research incorporating 1980 census data on population, employment and poverty trends, prior to altering the current dual formula.<sup>13</sup>

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<sup>10</sup> HUD. Developmental Needs of Small Cities. Washington: U.S. Government Printing Office, 197 .

<sup>11</sup> Ibid. pp. 3-4.

<sup>12</sup> Metropolitan small cities were not analyzed due to lack of data.

<sup>13</sup> Ibid. p. 177.

This concludes the discussion of additional legislative issues affecting the Small Cities program allocation. process. The next section is a compilation of available data on the outcomes of that process.



Outcomes of the Allocation Process

In each of its annual reports for the first five years, HUD has tabulated the outcomes of the discretionary grants selection process--dollars available, categories of grant winners, types of activities funded. This section presents that material.

## Comparisons of CDBG and Categorical Grant Program

Table 2.13

Comparison of CDBG and HUD Categorical Programs:  
Average Grant and Percent of  
Universe Funded, by Population  
Category\*

| Population      | Incorporated Recipients | Categorical Programs               |            | Average Grant | CDBG Program**                   |             | Average Grant |
|-----------------|-------------------------|------------------------------------|------------|---------------|----------------------------------|-------------|---------------|
|                 |                         | Average Number of Cities Each Year | %          |               | Total Funded in First Year Grant | %           |               |
|                 |                         | No.                                | %          |               | No.                              | %           |               |
| 500,000         | 26                      | 26                                 | 100.0      | \$23,459,150  | 26                               | 100.0       | \$23,765,615  |
| 250,000-499,999 | 30                      | 30                                 | 100.0      | 9,840,700     | 30                               | 100.0       | 9,981,500     |
| 100,000-249,999 | 97                      | 95                                 | 98.0       | 3,580,611     | 95                               | 98.0        | 3,721,505     |
| 50,000-99,999   | 232                     | 204                                | 87.9       | 1,190,951     | 223                              | 96.1        | 1,149,427     |
| 25,000-49,999   | 455                     | 253                                | 55.6       | 953,573       | 269                              | 59.1        | 921,640       |
| 10,000-24,999   | 1,127                   | 344                                | 30.5       | 599,590       | 375                              | 33.2        | 554,272       |
| 0-9,999         | 16,699                  | 450                                | 2.7        | 332,096       | 938                              | 5.6         | 207,379       |
| <b>Total</b>    | <b>18,666</b>           | <b>1,403</b>                       | <b>7.5</b> |               | <b>1,956</b>                     | <b>10.5</b> |               |

\* Data excludes all places not considered incorporated by the Bureau of the Census, e.g., townships, counties, Indian reservations, and States, as well as Puerto Rico, Guam, and the Virgin Islands.

\*\* SMSA discretionary balance recipients' data is not included since review is in process.

Source: Department of Housing and Urban Development, Office of Community Planning and Development.

First Annual Report. p. 142.

Table 2.13 compares the first year of CDBG program aid with the prior HUD categorical programs. The most notable change was in the smallest size category, with the number of grantees doubling, while the average grant amount decreased by a third.

In program participation by non-metropolitan communities in the first program year, HUD statistics indicated that a high percentage of non-metropolitan discretionary grant winners, 75%-93% by city size, had not had previous experience with HUD categorical grants.

Table 2.14

**CDBG Nonmetropolitan Discretionary Recipients: Comparison of HUD Categorical Grant Program Participation, by Population Groupings Under 50,000**

| Population    | Total Incorporated CDBG Nonmetropolitan Discretionary Recipients | CDBG Nonmetropolitan Discretionary Recipients That Did Not Receive Categorical Grants FY 1968-1972 | % of Total |
|---------------|--|--|------------|
| 25,000-50,000 | 39   | 31   | 79.5       |
| 10,000-24,999 | 110  | 82   | 74.5       |
| 0-9,999       | 679  | 6  | 92.2       |
| TOTAL         | 828  | 739  | 89.2       |

Source: Department of Housing and Urban Development, Office of Community Planning and Development.

First Annual Report. p. 142.

In Table 2.11 in the previous section, HUD data showed that, in terms of dollars awarded, the very smallest cities showed a large percentage increase in dollars won in the CDBG program in the first three program years, when compared to categorical grant programs. The largest category of cities under 50,000 reduced their share by about one third. (Many cities in this category were recipients of "hold-harmless" entitlement grants.) Seventy-four percent of the SMSA and non-metropolitan discretionary grants for Fiscal Years 1975 and 1976 went to recipients who had no experience with HUD categorical grant programs.<sup>1</sup>

<sup>1</sup> HUD. Third Annual Report. p. 279.

## Average Grant Size of Grants in the Small Cities Program

In the first five years of program experience, Small Cities grants, on average, increased in size, more than triple from 1975 to 1979.

As shown in Table 2.15, non-metropolitan grants were consistently larger than metropolitan discretionary grants for the first three years.<sup>2</sup>

Table 2.15  
Average Size of Grants by Program Category and  
Fiscal Year  
(Dollars in Thousands)

| Program Category     | FY 1975 | FY 1976 | FY 1977 | FY 1978 | FY 1979 |
|----------------------|---------|---------|---------|---------|---------|
| Entitlement          | \$1,587 | \$1,793 | \$2,025 | \$2,135 | \$2,093 |
| Small Cities         | 141     | 175     | 233     | 400     | 438     |
| Secretary's Fund     | 610     | 568     | 999     | 241*    | 282*    |
| Financial Settlement | 793     | 649     | 2,326   | 2,841   | 1,765   |

SOURCE: U.S. Department of Housing and Urban Development, Office of Finance and Accounting; and, Community Planning and Development, Office of Management, Data Systems and Statistics Division.

## Average Discretionary Balance Grant

| Fiscal Year | <u>SMSA Balances</u> | <u>Nonmetropolitan Balances</u> |
|-------------|----------------------|---------------------------------|
| 1975        | \$ 87,500            | \$168,800                       |
| 1976        | 129,500              | 199,900                         |
| 1977        | 168,000              | 244,900                         |

Source: U.S. Department of Housing and Urban Development, Community Planning and Development, Office of Management, "Management Information System."

Third Annual Report. p. 282.

<sup>2</sup> Data were only available for 1975-1977.

## Number of Grants

The number of Small Cities grants awarded has remained relatively constant, as shown in Table 2.16. The largest reduction from year-to-year was in Fiscal Year 1978, when the national Project Selection System was introduced.

Table 2.16  
Number of Approved Grants by Program Category and  
Fiscal Year As of December 31, 1979

| Program Category     | FY 1975 | FY 1976 | FY 1977 | FY 1978 | FY 1979 |
|----------------------|---------|---------|---------|---------|---------|
| Entitlement          | 1,321   | 1,312   | 1,313   | 1,301   | 1,290   |
| Small Cities         | 1,831   | 1,965   | 1,878   | 1,563   | 1,809   |
| Secretary's Fund     | 44      | 93      | 51      | 272     | 170     |
| Financial Settlement | 63      | 77      | 43      | 35      | 36      |
| Total                | 3,259   | 3,447   | 3,285   | 3,171   | 3,305   |

SOURCE: U.S. Department of Housing and Urban Development, Office of Finance and Accounting; and, Community Planning and Development, Office of Management, Data Systems and Statistics Division.

Fifth Annual Report. p. I-17.

## Availability of Funds

Annual Small Cities funds, as shown in Table 2.17, increased from \$259.0 million in Fiscal Year 1975 to \$840.2 million in 1979, or an increase of about 210 percent, while total CDBG funds grew by 54 percent. Metropolitan funds increased at a greater rate, by 300 percent, than did non-metropolitan funds during the same period, at 180 percent.

As a share of total annual funds, the Small Cities program grew

from 1975 to 1979. Small Cities funds accounted for 10.6 percent of the total CDBG allocation in 1975; in 1979 that share was 21.4 percent. During that period, metro funds increased from 2.4 percent to 6.4 percent of total CDBG dollars. Non-metropolitan funds almost doubled their share of the total, going from 8.2 percent to 15.0 percent.

For the entire period, Small Cities funds accounted for 15.6 percent of the total CDBG appropriation, with 4.4 percent going to the Metro fund, and 11.2 percent to the Non-Metropolitan fund.

#### Rate of Expenditure by Small Cities Grantees

One HUD measure of performance by CDBG grantees is the "drawdown" rate, that is, the rate at which grantees "draw down" or request disbursements from their annual grant amount for local program expenditures.

Table 2.18 indicates the percentage of CDBG funds drawn down at the end of 1979, for each program category and fiscal year.

Table 2.17  
 Distribution of CDBG Funds\* by Program Category and Fiscal Year  
 (Dollars in Thousands)

| Program Category     | FY 1975       | FY 1976     | FY 1977     | FY 1978     | FY 1979        | Total        |
|----------------------|---------------|-------------|-------------|-------------|----------------|--------------|
| Entitlement          | \$2,096,405   | \$2,352,888 | \$2,659,020 | \$2,777,593 | \$2,744,268    | \$12,630,174 |
| Metro                | 1,835,763     | 2,087,534   | 2,405,405   | 2,619,318   | 2,667,401      | 11,615,421   |
| Non-Metro            | 260,642       | 265,354     | 253,615     | 158,275     | 76,867         | 1,014,755    |
| Small Cities         | 259,058       | 345,274     | 438,005     | 627,907     | 804,182        | 2,474,426    |
| Metro                | 59,738        | 91,596      | 113,823     | 189,912     | 241,561        | 696,630      |
| Non-Metro            | 199,320       | 253,678     | 324,182     | 437,995     | 562,621        | 1,777,796    |
| Secretary's Fund     | 26,903        | 52,978      | 50,960      | 94,499      | 101,994**      | 327,334      |
| Financial Settlement | 49,987        | 49,980      | 100,000     | 100,000     | 100,000        | 399,967      |
| Total                | 2,432,353     | 2,801,120   | 3,247,988   | 3,600,000   | 3,750,260      | 15,831,721   |
| Lapsed               | 646           | 880         | 12          | 0           | 0              | 1,538        |
|                      | \$2,432,999** | \$2,802,000 | \$3,248,000 | \$3,600,000 | \$3,750,260*** | \$15,833,439 |

SOURCE: U.S. Department of Housing and Urban Development, Office of Finance and Accounting.

\* Does not reflect initial distribution contained in HUD budget submissions. Amounts initially allocated for entitlement grants that are not applied for or disapproved are subsequently allocated to the Small Cities Program as well as statutory pro rata reductions.

\*\* Includes appropriations of \$127 million for Model Cities and \$197 for Urban Revneal which were transferred to the CDBG program, but excludes \$117 million of transition funds that were uncommitted.

\*\*\* Includes \$260,000 transferred from other Federal agencies.

Table 2.18  
 Drawdown Rates by Grant Category and Fiscal Year  
 As of December 31, 1979

| Program Category     | FY 1975 | FY 1976 | FY 1977 | FY 1978 | FY 1979 | Total |
|----------------------|---------|---------|---------|---------|---------|-------|
| Entitlement          | 99.6    | 99.1    | 93.5    | 49.9    | 5.0     | 67.0  |
| Metro                | 99.6    | 99.2    | 94.0    | 49.7    | 4.7     | 65.6  |
| Nonmetro             | 99.6    | 98.6    | 88.4    | 53.6    | 12.6    | 82.8  |
| Small Cities         | 97.9    | 95.7    | 86.2    | 54.4    | 5.4     | 54.6  |
| Metro                | 95.7    | 95.1    | 81.7    | 48.2    | 4.7     | 49.4  |
| Nonmetro             | 98.6    | 96.0    | 87.7    | 57.0    | 5.7     | 56.7  |
| Secretary's Fund     | 90.5    | 77.8    | 59.3    | 45.7    | 13.9    | 52.3  |
| Financial Settlement | 97.0    | 83.4    | 69.9    | 56.9    | 20.7    | 64.7  |
| Total                | 99.3    | 98.2    | 91.2    | 50.8    | 5.5     | 64.7  |

SOURCE: U.S. Department of Housing and Urban Development, Office of Finance and Accounting.

## Activities Funded

In the first program year, HUD reported the following pattern of grantee activities:

SMSA sample recipients placed greatest emphasis upon housing activities, followed closely by water system activities. Like the nonmetropolitan cities with less than 1,000 population, however, the smallest SMSA discretionary cities concentrated their CDBG dollars on water activities (62 percent). Compared to nonmetropolitan cities over 1,000 population, SMSA cities over 1,000 placed very limited emphasis upon sewer system activities. Both SMSA and nonmetropolitan cities over 1,000 population emphasized housing. The greatest emphasis upon housing among SMSA cities occurred in the 10,000-24,999 population stratum where 34 percent of the funds were budgeted for this purpose. SMSA cities greater than 25,000 population invested heavily in public facilities (28 percent), followed closely by water system activities (25 percent) and housing (21 percent).<sup>3</sup>

Table 2.19

PERCENTAGE OF SAMPLE SMSA AND NONMETROPOLITAN CITIES' DISCRETIONARY BALANCES BUDGETED FOR FOUR ACTIVITY AREAS

|          |                   | POPULATION STRATA |                 |             |                 |               |                 |          |                 |
|----------|-------------------|-------------------|-----------------|-------------|-----------------|---------------|-----------------|----------|-----------------|
|          |                   | < 1,000           |                 | 1,000-9,999 |                 | 10,000-24,999 |                 | 25,000 + |                 |
|          |                   | SMSA              | Nonmetropolitan | SMSA        | Nonmetropolitan | SMSA          | Nonmetropolitan | SMSA     | Nonmetropolitan |
| Activity | Water             | 62%               | 57%             | 23%         | 26%             | 3%            | 14%             | 25%      | 12%             |
|          | Sewer             | 11                | 6               | 5           | 19              | 7             | 32              | 4        | 10              |
|          | Housing           | 8                 | 2               | 26          | 19              | 34            | 17              | 21       | 24              |
|          | Public Facilities | 11                | 9               | 19          | 6               | 6             | 7               | 28       | 12              |

SOURCE: U.S. Department of Housing & Urban Development, Community Planning and Development, Office of Evaluation. Based upon analysis of applications from 199 sample communities receiving SMSA balances and 275 sample communities receiving nonmetropolitan balances for Fiscal Year 1975.



By 1977, activities funded had shifted markedly from public work, facilities and site improvements to rehabilitation loans and grants.<sup>4</sup>

Table 2.20

## Activity Shifts by Budget Line Item

| Fiscal Year | SMSA<br>BALANCES<br>(PERCENT) |                       | NONMETROPOLITAN<br>BALANCES<br>(PERCENT) |                       |
|-------------|-------------------------------|-----------------------|--|-----------------------|
|             | Budget Line<br>Item 2         | Budget Line<br>Item 5 | Budget Line<br>Item 2                    | Budget Line<br>Item 5 |
| 1975        | 54%                           | 13%                   | 68%                                      | 7%                    |
| 1976        | 58                            | 15                    | 64                                       | 11                    |
| 1977        | 41                            | 28                    | 50                                       | 21                    |

Source: U.S. Department of Housing and Urban Development, Community Planning and Development, Office of Management, "Management Information System."

Third Annual Report p. 285.

In the 1978 Small Cities grant competitions, applicants who proposed redeveloping and housing rehabilitation projects had well above average success rates in every competition. Redevelopment projects always had the highest success rates with housing rehabilitation close behind. Water and sewer projects, under the Project Selection System, had well below average success rates in every competition.<sup>5</sup> Figure 2.2 in-

<sup>4</sup> HUD. Third Annual Report. p. 285.

<sup>5</sup> William G. Moss and Cameron Huff. An Evaluation of the Small Cities Program: Who Applies, Who Wins. Cambridge: Urban Systems Research and Engineering, Inc., (forthcoming). p. 165.

Figure 7-12  
PERCENT OF APPLICANTS THAT ARE SUCCESSFUL, BY  
PROJECT TYPE AND COMPETITION

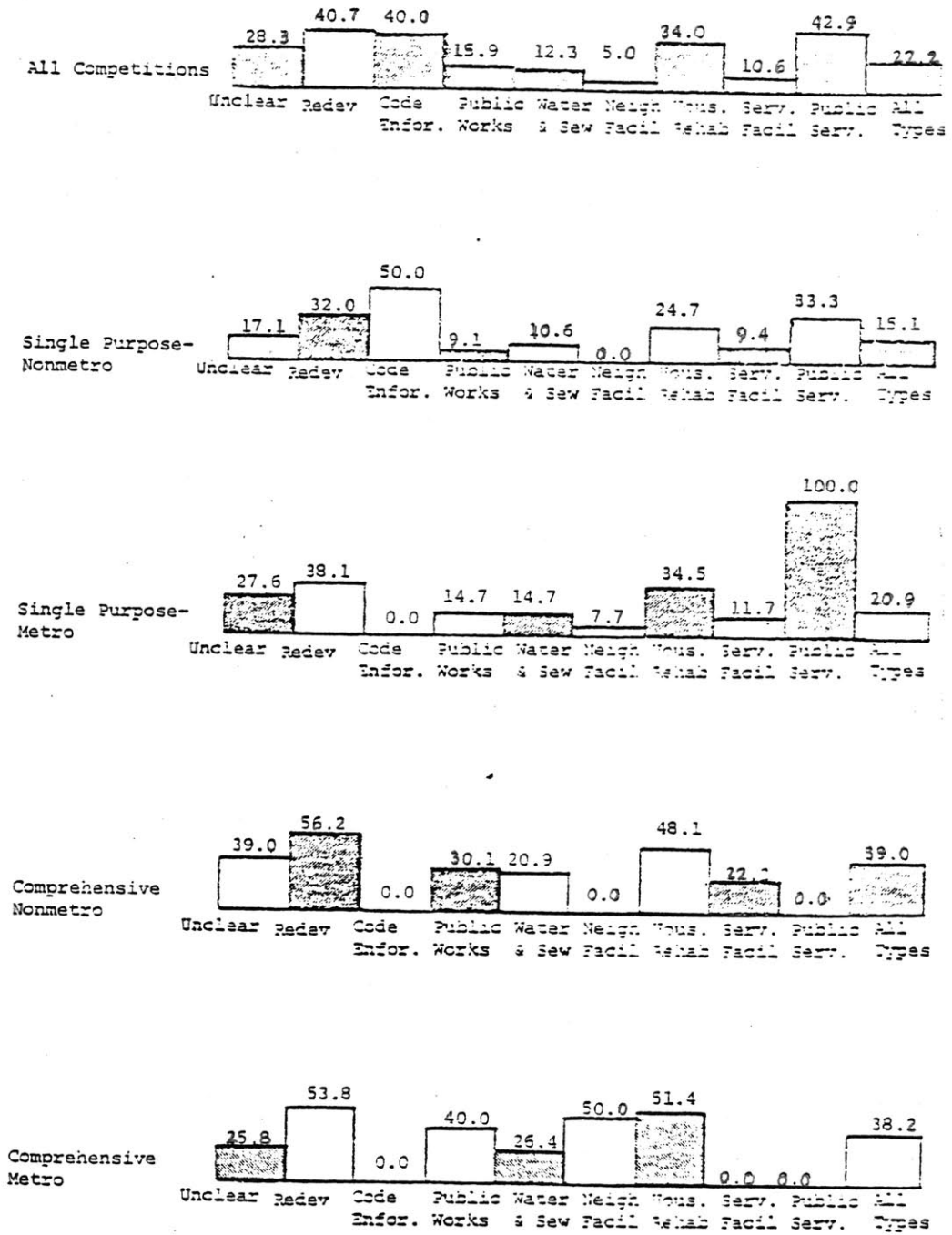


TABLE 20.18

PERCENTAGE OF SAMPLE SMSA AND NONMETROPOLITAN  
DISCRETIONARY BALANCES BUDGETED FOR FIVE ACTIVITY GROUPINGS,  
FY 1975 and FY 1976

|                                 | Water/Sewer Combined |       | Rehab. Loans & Grants |      | Public Facilities |      | Development/Redevelopment |      | Other |      |
|---------------------------------|----------------------|-------|-----------------------|------|-------------------|------|---------------------------|------|-------|------|
|                                 | 1975                 | 1976  | 1975                  | 1976 | 1975              | 1976 | 1975                      | 1976 | 1975  | 1976 |
| <u>SMSA Cities</u>              |                      |       |                       |      |                   |      |                           |      |       |      |
| <1000                           | 66.6                 | 43.3  | 0                     | 0    | 10.5              | 16.9 | 7.5                       | 1.2  | 15.4  | 38.6 |
| 1000-9999                       | 28.9                 | 36.5  | 16.0                  | 9.5  | 20.9              | 10.1 | 9.1                       | 14.6 | 25.10 | 29.3 |
| 10,000-24,999                   | 11.1                 | 20.4  | 7.6                   | 16.2 | 5.6               | 5.6  | 31.7                      | 17.7 | 44.0  | 40.1 |
| ≥ 25,000                        | 28.2                 | 21.1  | 0                     | 30.5 | 28.4              | 6.0  | 23.6                      | 26.0 | 19.6  | 16.4 |
| <u>Nonmetropolitan Cities</u>   |                      |       |                       |      |                   |      |                           |      |       |      |
| <1000                           | 73.6                 | 50.2  | 1.0                   | 6.2  | 8.3               | 6.0  | .5                        | 5.6  | 16.6  | 32.0 |
| 1000-999                        | 49.4                 | 41.2  | 6.2                   | 10.7 | 5.7               | 2.0  | 11.5                      | 12.2 | 27.2  | 33.9 |
| 10,000-24999                    | 44.5                 | 8.0   | 4.8                   | 4.8  | 6.4               | 4.0  | 26.4                      | 39.3 | 17.9  | 43.9 |
| ≥ 25,000                        | 20.6                 | 7.7   | 14.3                  | 31.5 | 10.3              | 2.9  | 19.9                      | 29.9 | 34.9  | 28.0 |
| <u>SMSA Counties</u>            | 28.3                 | 14.0  | 7.5                   | 14.3 | 16.6              | 20.4 | 9.7                       | 7.8  | 37.9  | 43.5 |
| <u>Nonmetropolitan Counties</u> |                      |       |                       |      |                   |      |                           |      |       |      |
| 1000-9999                       | 14.2                 | 42.6  | 19.4                  | 10.2 | 39.7              | 14.9 | 7.1                       | 1.9  | 19.6  | 30.4 |
| 10,000-24999                    | 54.1                 | 48.10 | 9.0                   | 3.3  | 5.6               | 11.8 | 8.4                       | 2.3  | 22.9  | 34.5 |
| ≥ 25,000                        | 33.7                 | 31.8  | 5.4                   | 17.4 | 14.5              | 10.6 | 11.0                      | 6.2  | 35.4  | 34.  |

Source: U. S. Department of Housing and Urban Development  
Community Planning and Development, Office of Evaluation.

dicates the percent of preapplicants that were successful by project type and competition.

#### Per Capita Distribution of Small Cities Aid

Additional information is available on per capita distribution of the total Small Cities allocations for Fiscal Years 1977, 1978 and 1980 (estimated) as shown in Table 2.22. Levels of per capita aid for non-metropolitan discretionary grants were consistently higher than for the metropolitan discretionary funds. However, for both categories of discretionary aid, per capita funds available were about half that available to metropolitan cities as a whole. Non-central cities with population over 50,000 had a per capita level comparable to non-metropolitan communities eligible for discretionary grants.

Table 2.22  
Per Capita Distribution of CDBG Allocation by Type of Recipient

| Type of Recipient                                  | Fiscal Year and Formula   |   |   |
|--|---|---|---|
|  | 1977 Actual<br>Allocation<br>(1974 Formula<br>and Hold<br>Harmless) | 1978 Actual<br>Allocation<br>(Dual Formula<br>and Hold<br>Harmless)** | 1980<br>Projected<br>Allocation<br>(Dual<br>Formula)*** |
| <u>SMSA</u>  | \$16.11   | \$17.87   | \$19.10   |
| <u>Metropolitan Cities (559)</u>                   | 23.82   | 26.56   | 68.36   |
| <u>Central Cities (381)</u>                        | 25.79   | 28.59   | 30.48   |
| Non-Central Cities over<br>50,000 Population (178) | 14.39   | 16.64   | 18.22   |
| <u>Remainder of SMSA</u>                           | 7.94  | 8.54  | 9.12  |
| Urban Counties (Entitled)****                      | 9.94  | 11.27   | 13.37   |
| SMSA Balance (Discretionary)                       | 6.39  | 6.64  | 5.81  |
| <u>Non-SMSA (Discretionary)</u>                    | 9.70  | 10.17   | 11.74   |
| <u>U.S. Total</u>                                  | 14.34   | 15.75   | 17.57   |

\* The \$3.148 billion appropriation in fiscal year 1977 was distributed on the basis of the 1974 single formula and hold harmless averages.

\*\* The \$3.5 billion appropriation in fiscal year 1978 was distributed on the basis of the dual formula and hold harmless averages. Hold harmless credit in fiscal year 1978 was equal to two-thirds of the excess of the hold harmless amount over the basic dual formula amount.

\*\*\* These are full formula (i.e., no hold harmless) amounts based on a projected 1980 appropriation of \$3.8 billion.

\*\*\*\* Data not available for breakdown of hold harmless between urban counties and the SMSA balance.

Source: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, Office of Economic Affairs, Economic Development and Public Finance Division.

Evaluations of the Project Selection System

Preliminary evaluations have criticized the performance of the Project Selection System on a variety of grounds.

One study found significant differences in need between metropolitan and non-metropolitan small cities. Looking at rural areas, the study indicated that poverty is a better measure than community age to allocate non-metropolitan small cities funds to areas of greatest needs, while implying that other measures might better target need to metropolitan small cities.<sup>1</sup> While the report was particularly concerned with alternative formulas for division of small cities funds among states, its findings seem relevant to the community-wide measures of housing need and poverty used in the PSS: a single set of needs measures may be insufficient to consistently target aid to neediest cities, given the diverse development needs of small cities.

HUD study of the System's implementation in Washington State recommended numerous changes in the allocation system and in the PSS. Changes to the PSS were to include: lowering the level of grant ceilings (the PSS regulations gave Area Offices discretion in setting the maximum amount a community could compete for); creating separate competitions in each state based on population categories, with proportional allocation of state pools to each category, in order to reduce the unfairness of very small communities (say, under 1,000) having to compete with cities forty or fifty

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<sup>1</sup> HUD. Report on the Allocation of Community Development Funds to Small Cities. Washington, D.C.: U.S. Government Printing Office, 1978. pp 63-64.

times their size; increasing the ratio of single purpose to multi-purpose grants awarded (the PSS regulations stipulated that 65 to 75 percent of the Non-Metro Balance Funds in a State were to be awarded in the comprehensive grant competitions); and eliminating the absolute poverty and housing needs criteria from the rating system, since they unfairly biased the PSS toward larger cities.<sup>2</sup>

Still another study found numerous deficiencies in the point system: funds do not go to the neediest communities; proposed programs with high benefit to low- and moderate-income persons are not funded; the opportunity for funding varies tremendously across Area Offices, since the number of potential applicants per aid dollar, and thus the intensity of competitions, differs greatly across Area Offices; the point system by itself does not curtail Area Office discretionary power, as measured by the differences in rankings using only the needs measures as compared to the actual rankings with the full point system; community flexibility in program design and funding opportunities for non-housing programs are discouraged by the point system; and funding outcomes in terms of types of program vary considerably across Area Offices despite the point system.<sup>3</sup>

The final study to be reviewed examined in detail the outcomes of the 1978 Small Cities Program Grant Competitions. William G. Moss, as part of a national evaluation of the Small Cities Program, analyzed HUD's scoring system and who are the winners and losers in the Small Cities CDBG

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<sup>2</sup> HUD. Small Cities '79: A Study of the Small Cities Block Grant Preapplication Cycle in Washington State During Fiscal Year 1979. (Draft).

<sup>3</sup> Andrew M. Isserman. Allocation of Community Development Funds Among Small Cities: A Partial Evaluation. (Draft). p. 1.

Program.<sup>4</sup> His summary and conclusions are presented below:

In this study we have analyzed the decisions of eligible jurisdictions with respect to their participation in the Small Cities CDBG program and the decisions of HUD personnel with respect to which applicants for CDBG grants are and are not funded. We have also analyzed the operations of the Project Selection System to compare the theoretical or intended operation of the point system with its actual operation. Two findings recur in almost every aspect of the study: size and previous experience are important determinants of program participation, project selection, and the chances of being funded.

#### Who Applies

Of all eligible jurisdictions, 89 percent are municipalities and 11 percent are counties. There are significant regional variations; counties are relatively more numerous in the South and West and relatively less numerous in the North and North Central regions.

Twenty-five percent of eligibles apply. The highest rates of applications are in the South followed by the West, and the lowest are in the North and North Central regions.

Over 75 percent of applicants are nonmetropolitan jurisdictions and between 80 and 90 percent are municipalities. In the descriptive analysis application rates (the proportion applying) are positively related to jurisdiction size measured by 1976 population, 1970 poverty population, and the number of inadequate housing units. Also previous experience with block grant application and other HUD funding programs are very important in explaining the decision to apply. The latter experience is represented by hold-harmless status. The effect of experience on the probability of applying is also exceedingly important in the multivariate analysis. Hold harmless status increases the probability of applying from between 40 and 50 percentage points. However, the effect of size is less clear, although it may be represented by the effects of the poverty population size.

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4.

William G. Moss and Cameron Huff. An Evaluation of the Small Cities Program: Who Applies, Who Wins. Cambridge: Urban System Research and Engineering, Inc., (forthcoming).



### Who Applies for What

The percent of eligible jurisdictions applying for Single-Purpose grants is larger than that applying for Comprehensive grants in metropolitan and non-metropolitan competitions. This is in marked contrast to estimates of the allocation of grant funds. We estimate that there are approximately 2.3 dollars allocated to Comprehensive competitions for every dollar allocated to Single-Purpose competitions. However, the ratio of Comprehensive to Single-Purpose applicants varies from 0.3 to 0.45.

The effects of size and experience are also evident here. Applicants to Single-Purpose competitions are smaller and those to Comprehensive competitions are larger than average for all CDBG grant applicants. This outcome and the effects of previous experience are also confirmed in the multivariate analysis of the probability of applying for a Comprehensive grant. The effects of hold harmless are especially large; hold harmless status increases the probability of applying for a comprehensive grant by about 50 to 60 percentage points after holding constant the effects of other influences.

Finally, the types of projects proposed varies with the type of competition and characteristics of applicants. Smaller applicants with less previous experience tend to apply for water and sewer projects and service facilities, and these occur relatively more often in Single-Purpose competitions. In contrast, larger jurisdictions tend to apply more often for redevelopment and housing rehabilitation projects, and these occur more often in Comprehensive competitions. The success rate also tends to be somewhat higher in the latter project types.

### Who Wins

Applicants to Comprehensive competitions have a higher probability of being funded than those to Single-Purpose competitions, and the difference is about the same as the allocation of funds. Again, previous experience is an important influence increasing the probability of being funded. On average, winners are larger than losers. But the effect of jurisdiction size on this probability is not as evident when other characteristics of applicants and competitions are taken into account in the multivariate analysis.

Success rates in the North Central and South are higher than the North and West in nonmetropolitan Single-Purpose competitions when other influences are held constant. Success rates are also greater than average in the North Central in the metropolitan Comprehensive competitions, other things held constant.

#### PSS Scoring

Finally, we find that the nominal or official weights used in the PSS scoring system are different from the actual or effective weights. The four needs factors are significantly less important in practice, and the factors for program impact and the benefits to low- and moderate-income individuals are more important in practice.

This is interesting because the four needs factors are nominally biased in favor of absolute jurisdiction size; the absolute poverty population and numbers of inadequate housing units are given much greater nominal weight in the scoring system than the percent poverty population and percent inadequate housing. Our findings suggest that the effects of jurisdiction size on success in the Small Cities CDBG Program is more indirect. It effects the willingness to apply and the type of participation.

Previous experience is awarded points in Comprehensive competitions in the amount of 25 points for hold harmless status. Our analysis of the point system implies that this has very little effect on the rankings of applicants and therefore little direct effect on the likelihood of being funded. However, our other findings suggest that the effect of experience is strong."<sup>5</sup>

This presentation of the evaluations of the Small Cities Project Selection System of 1978 concludes this chapter on outcomes of the Small Cities Program allocation process.

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<sup>5</sup> Ibid. pp. 184-187.

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