NORTH CAROLINA GENERAL ASSEMBLY

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John W. Turcotte
Director

MEMORANDUM

Date: June 10, 2019

To: Joint Legislative Program Evaluation Oversight Committee

From: Program Evaluation Division

Subject: Follow-Up on Disaster Recovery Funds Administered by DPS

SUMMARY

In May 2019, as directed by Session Law 2018-5, Section 5.6(n), the Program Evaluation Division issued a report entitled "*Administrative Missteps and Lack of Expertise Led to Delays and $3.7 Million in Unnecessary State Spending for Hurricane Matthew Recovery*." At its May 20, 2019 meeting, the Joint Legislative Program Evaluation Oversight Committee directed staff to conduct further research into Hurricane Matthew disaster recovery funds administered by the Department of Public Safety (DPS). Together, the 2016 and 2017 Disaster Recovery Acts placed responsibility for administering five funding streams with DPS. PED's report showed that the only source of funds administered by DPS that was not reliant on another governmental entity and did not have available timeliness data was "$9,000,000…to develop, implement, and fund disaster assistance programs to meet the emergency sheltering and short-term housing needs of individuals affected by Hurricane Matthew, the western wildfires, and Tropical Storms Julia and Hermine." DPS selected local governments and not-for-profits to receive this emergency sheltering and short-term housing funding. PED's review led to the identification of several issues:

- **The Department of Public Safety (DPS) ignored grant-making best practices when it selected the North Carolina Community Development Initiative as a recipient and did not follow state law when it distributed grant funds to the Initiative.** DPS did not use formal mechanisms to solicit proposals or select recipients to administer emergency sheltering and short-term housing funds. Further, DPS did not follow state law when it made up-front lump-sum payments of $5.35 million to the Initiative.
- **DPS established an agreement with the Initiative to spend state funds for purposes that do not align with the legislative directive of the disaster recovery legislation.** DPS's agreement with the Initiative permits the Initiative to use state funds to "provide flexible, low-cost financing for expanding affordable housing opportunities, as well as access to critical community facilities..." As permitted by the agreement, the Initiative has funded loans and grants for several projects intended to provide long-term housing for low-to-moderate income individuals, such as funding for new construction projects, rather than adhering to the legislatively-mandated purpose of using the funding stream solely to fulfill emergency sheltering and short-term housing needs. In addition, the agreement between DPS and the Initiative did not specify that projects would be undertaken strictly for hurricane survivors.
- **More than six months following the expiration of the agreement, DPS still has not recaptured an estimated $1.3 million in unencumbered funds and potentially disallowed expenses.**
- **Funds designated for emergency sheltering and short-term housing for hurricane survivors appear to financially benefit the Initiative, real estate developers, and private landlords.**
- **$732,450 in state-supported loan principal may not be returned to the State because such a stipulation was not made in the agreement; additionally, it is unclear if associated accrued interest has been used in accordance with state law.**
- **It appears the Initiative is engaging in additional transactions after its grant with DPS has ended, which is in conflict with this agreement and potentially the emergency sheltering and short-term housing purposes outlined in the legislative directive.**

BACKGROUND

Taken together, the 2016 and 2017 Disaster Recovery Acts placed responsibility for administering five funding streams with DPS.[1,] Exhibit 1 provides details on these funds. Because these streams were funded in some part by state appropriations, the speed of distribution of these recovery funds is of particular legislative interest. As the exhibit shows, the average number of days to distribute funds to recipients was either

- reflected in other programs, such as is the case with matching funds;
- not applicable because it is either a reserve or internal use of funds;
- not available because it relied upon the coordination of other governmental entities (FEMA); or
- not available because of limited data.

Exhibit 1: Department of Public Safety Administered Five Primary Programs that Were Funded to Some Degree by State Appropriations

Funding Source (Purpose)	Total Amount Spent (as of Mar. 2019)	Total Award	Percentage Spent	Average Days to Distribution
State Emergency Response and Disaster Relief Fund (state match for federal disaster programs)	$53,379,811	$ 88,528,370	60%	N/A – shown in other programs
Emergency Management (housing purposes identified in S.L. 2017-119)	8,805,187	20,000,000	44%	$8,452,942 obligated with 13 County agreements that have terms ending December 31, 2021.
Emergency Management (resilient redevelopment planning)	10,706,672	11,500,000	93%	N/A – no approval required
State Emergency Response and Disaster Relief Fund (ensure sufficient funds are available to provide relief/assistance for future emergencies)	801,429	10,000,000	8%	N/A – reserve account overseen and managed by OSBM.
Emergency Management (Emergency sheltering and short-term housing)	8,651,855	9,000,000	96%	Data unavailable
Total	**N/A**	**$ 139,028,370**	**N/A**	**N/A**

Notes: State funds only include those from the Disaster Recovery Acts of 2016 and 2017. Amount and percent spent data is as of March 2019.

Source: Program Evaluation Division based on data from DPS and OSBM.

The Program Evaluation Division's report showed that the only source of funds administered by DPS that was not reliant on another governmental entity and did not have available timeliness data was the $9 million allocated for emergency sheltering and short-term housing. The legislation directing use of these funds stated:

> "$9,000,000 shall be allocated to the Division of Emergency Management to develop, implement and fund disaster assistance programs to meet the emergency sheltering and short-term housing needs of individuals affected by Hurricane Matthew, the western wildfires, and Tropical Storms Julia and Hermine."[2]

DPS selected five local governments and not-for-profits to receive this emergency sheltering and short-term housing funding. Exhibit 2 provides information on the arrangements between DPS and the entities.

[1] N.C. Sess. Laws 2016-124, 2017-119.
[2] N.C. Sess. Law 2016-124, Section 4.1(2).

Exhibit 2: Summary of Entities Receiving Funds from DPS for Emergency Sheltering and Short-Term Housing

Recipient of Emergency Sheltering and Short-Term Housing	Purpose Identified in Agreement with DPS
Disaster Rental Assistance Program (DRAP - Bladen, Cumberland, Edgecombe, and Robeson County Departments of Social Services)	Provide housing assistance for a short period of time, utility deposits, pay-off of past-due utilities, and moving costs
NC Community Development Initiative	Provide flexible, low-cost financing for rehabilitating and/or constructing affordable rental housing and for establishing a loan loss or capital fund of less than $500,000 to provide flexible, low-cost financing (for public entities, non-profit corporations, privately held entities, or individual borrowers) for affordable housing and critical community facilities
NC Housing Coalition	Provide housing counseling intermediary services (one-on-one consumer counseling and group education workshops) in Edgecombe, Robeson, and Cumberland Counties
NC Housing Finance Agency	Provide disaster intervention services call center, search for available housing and landlords, and maintain listings for those seeking housing
Various Individual Citizens (n = 12 households) – Transitional Sheltering Assistance	Pay hotel bills for those needing rental assistance or whose homes were being repaired prior to transitioning to stable housing solutions

Source: Program Evaluation Division based on reviews of agreements between DPS and listed entities.

In May 2019, as directed by Session Law 2018-5, Section 5.6(n), the Program Evaluation Division issued a report entitled "*Administrative Missteps and Lack of Expertise Led to Delays and $3.7 Million in Unnecessary State Spending for Hurricane Matthew Recovery*." At its May 20, 2019 meeting, the Joint Legislative Program Evaluation Oversight Committee directed staff to conduct further research into Hurricane Matthew disaster recovery funds administered by the Department of Public Safety (DPS). The Program Evaluation Division's review identified one recipient, the North Carolina Community Development Initiative (the Initiative), whose disbursement raises concerns about DPS's administration and oversight of state funds awarded for disaster recovery efforts. This concern merited a follow-up review into DPS's administration and the Initiative's implementation of these funds. This review led to the identification of several issues, which subsequent sections of this memorandum discuss, including:

- alignment of the use of funds with legislative directive,
- initial selection and distribution of funds to the Initiative,
- enforcement of provisions with the contractual agreement, and
- maximizing assistance to hurricane survivors.

ISSUES IDENTIFIED

Issue 1. The Department of Public Safety (DPS) ignored grant-making best practices when it selected the North Carolina Community Development Initiative as a recipient and did not follow state law when it distributed grant funds to the Initiative.

Selecting recipients for hurricane recovery should be done in accordance with best practices, and disbursing funds should be done in accordance with state law. The process of choosing recipients should be formal, meaning it should be competitively bid, systematic, and based on the proven track record of implementation demonstrated by applicants. These best practices help ensure the most qualified recipient is selected to implement state resources. Once a recipient has been selected, the distribution of funds should also mirror best practices and state law, in this case by avoiding up-front payments. None of the abovementioned criteria were met in DPS's selection and distribution of Hurricane Matthew disaster recovery funds to the Initiative for meeting emergency sheltering and short-term housing needs.

DPS did not use formal mechanisms to solicit proposals or select recipients to administer emergency sheltering and short-term housing funds. A standard best practice in awarding funds is to undertake formal processes in selecting vendors, such as through the use of a Request for Proposals (RFPs) or other similar methods whereby potential grant recipients are required to specify key aspects of the intended use of funds, the intended projects to be completed, and the amounts required for such projects. These processes also include a mechanism by which individuals and entities seeking funds will be scored and selected and additionally contain mechanisms to ensure recipients are not receiving duplicative benefits from various funding sources.

During interviews, DPS staff stated that no RFPs, other applications, or scoring mechanisms were used for entities seeking emergency sheltering and short-term housing funds; instead, DPS relied on informal communications and proposals from various entities seeking these state funds. Thus, DPS did not apply any systematic criteria to ensure it selected the most qualified entities to perform work in this area of disaster recovery. Failure to apply this criteria increases the risk of selecting grantees without demonstrated success or concrete plans for how to spend state funds. In addition, there is greater risk of awarding duplicate funding for projects because of the lack of controls in place.

DPS did not follow state law in making up-front, lump-sum payments of $5.35 million to the Initiative. Standard best practices dictate distributing funds on a pay-as-you-go (invoice-based) or installment basis. This practice gives the funding entity (in this case, DPS) a mechanism to ensure activities outlined in agreements with funding recipients (in this case, the Initiative) are being completed. In many cases, entities receive funds upon completing work at a pre-defined time interval, such as every two weeks, by using invoices to show how funds were spent. In accordance with standard best practices, state law requires any award exceeding $100,000 to or for the use of a nonprofit entity to be made in quarterly or monthly payments.[3] As Exhibit 3 shows, DPS appears to have not followed best practices or state law. Of the $5.35 million disbursed up-front to the Initiative, $600,000 was allowed to be spent for administrative purposes.

Exhibit 3: DPS Did Not Follow Best Practices or State Law in Providing Up-Front Payments to the Initiative

Recipient of Emergency Sheltering and Short-Term Housing	Payment Method	Payment Method Consistent with Best Practices and State Law?
Disaster Rental Assistance Program (DRAP) - Bladen, Cumberland, Edgecombe, and Robeson County Departments of Social Services	Installment-based payment; required information must be verified before subsequent installments; specific criteria for qualifying and processing applicants and for administration	Yes
NC Community Development Initiative	100% up-front payment within 10 days of MOA execution; DPS can de-obligate any portion of administrative or loan loss funds or any or all of the MOA amount; initial award of $3.35 million paid up-front ($350,000 for administration and $3 million for other activities); additional award of $2 million paid up-front ($250,000 for administration and $1.75 million for activities)	No
NC Housing Coalition	Installment-based payment; payment across two installments (one up-front payment of $217,250 and $145,000 six months later)	Yes
NC Housing Finance Agency	Invoices every two weeks for prior services in that pay period	Yes
Various Individual Citizens (n = 12 households) – Transitional Sheltering Assistance	Direct bill to state; requirement for household member to be involved with FEMA caseworkers	Yes

Note: MOA stands for memorandum of agreement.

Source: Program Evaluation Division based on reviews of agreements between DPS and listed entities, and OSBM.

[3] N.C. Gen. Stat. § 143C-6-21.

Issue 2. DPS established an agreement with the Initiative to spend state funds for purposes that do not align with the legislative directive of the disaster recovery legislation.

The Disaster Recovery Act of 2016 appropriated $9 million to

> "be allocated to the Division of Emergency Management to develop, implement and fund disaster assistance programs to *meet the emergency sheltering and short-term housing needs* of individuals affected by Hurricane Matthew, the western wildfires, and Tropical Storms Julia and Hermine."[4] [*Emphasis added*]

A 2017 Memorandum of Agreement (MOA) between DPS and the Initiative permits the Initiative to use state funds to "provide flexible, low-cost financing for expanding affordable housing opportunities, as well as access to critical community facilities in support of NC Emergency Management recovery activities." Although providing access to critical community facilities (i.e., hotels, shelters, etc.) may align with the legislative directive of the disaster recovery funds, allowing the Initiative to provide flexible low-cost financing to expand affordable housing does not. As a result, PED staff subsequently examined the specific purposes for which the Initiative awarded or committed these state funds to sub-recipients; these purposes are displayed in Exhibit 4. In total, the Initiative received $5.35 million, or 59% of all funds made available by the State for emergency sheltering and short-term housing. Appendix A shows the flow of funds from the General Assembly to each of the various entities receiving state funds from the Initiative.

Exhibit 4: Some Grants and Loans Awarded or Encumbered by the Initiative Do Not Align with the Legislative Directive

Entity	Purpose Specified in Agreement	Grant	Loan	Aligns with Legislative Directive?
First Baptist Homes Development Corporation	Repair expenses for Section 8 apartment housing facility	$430,050		Likely
East Point Homes, LLC	Pre-development and development of the 72-unit Lafayette Park Apartments, an affordable rental housing development in Fayetteville	$150,000	$300,000	Unlikely
MC Morgan and Associates	Development of Griffin Park Apartments, a 72-unit multi-family affordable housing development in Lumberton	$150,000	$150,000	Unlikely
Private Landlord 1	Repair and renovation of eight units of affordable rental housing in Fayetteville	$47,500	$47,500	Likely
St. John Community Development Corp.	Fund renovation costs for a proposed multi-family, mixed-use project in Wilson		$ 212,450	Unlikely
Private Landlord 2	Repair and rehabilitation of apartments/house in Lumberton	$22,500	$22,500	Likely
Rocky Mount Land Bank	Fund the acquisition of vacant, abandoned or distressed housing in communities impacted by Hurricane Matthew and holding them for redevelopment as high quality affordable housing	Minimum of $1,800,000		Unlikely

Notes: Amounts shown include potentially disallowed spending (discussed in more detail in later sections). Administrative funds for the Initiative totaling $600,000 are not shown. Administrative expenses are included in the figure shown for the Rocky Mount Land Bank. Not included in this table is $500,000 the Initiative reported to DPS in December 2018 as being in process for the redevelopment of Elijah's Landing in Morehead City. This exhibit does not include actual or planned transactions with Mt. Sinai Homes.

Source: Program Evaluation Division based on information from OSBM and the Initiative.

A closer examination of the projects undertaken with funds distributed by the Initiative shows that the legislative directive that these funds be used for "emergency sheltering and short-term housing needs" is frequently not being met. The Program Evaluation Division's review of grant agreements in place between the Initiative and its

[4] N.C. Sess. Law 2016-124, Section 4.1(2)

recipients shows purposes that cannot reasonably be claimed to be addressing an emergency or temporary housing need. For example, other recipients of funds from this funding stream besides the Initiative paid for hotel stays for hurricane survivors.

As permitted by its MOA with DPS, the Initiative has funded loans and grants for several projects that focus on establishing long-term housing for low-to-moderate income individuals rather than adhering to the legislative purpose of this funding stream to fulfill emergency sheltering and short-term housing needs.

- **Funding new construction projects.** As shown in Exhibit 4, some of the Initiative's funds are being loaned or granted to construction companies that have not even begun construction on projects, such as the funds awarded to East Point Homes and St. John Community Development Corporation. It is unclear how these projects could be meeting an "emergency" or short-term housing need. According to the Initiative's most recent report, 328 (70%) of the 470 units cited as impact attributable to the Initiative appear to be new construction.
- **Buying land for future development.** The Initiative has also disbursed a minimum of $1.8 million for a "land bank" in Rocky Mount for the future development of housing units for low-to-moderate income individuals.[5] Specifically, these funds were disbursed to the Rocky Mount Housing and Revitalization Initiative, LLC, an affiliate of the nonprofit Initiative which, as an LLC, could be considered a for-profit entity. Again, it is unclear how these projects funding future developments meet an "emergency" or short-term need.
- **Funding for mixed-use development.** Additionally, the Initiative has made loans of more than $212,450 for a multi-family, mixed-use project in Wilson; as with the examples above, this mixed-use development does not appear to be providing emergency shelter or temporary housing.

In addition, the agreement between DPS and the Initiative did not specify that projects would be undertaken strictly for the benefit of hurricane survivors. The MOA between DPS and the Initiative does not specify that units renovated or constructed using state funds should be set aside or reserved for individuals affected by Hurricane Matthew. Typically, one would expect such housing to be made available for individuals while their dwellings are being repaired soon after a disaster. Without such requirements in place, individuals not affected by Hurricane Matthew have the same opportunity to occupy dwellings funded with state dollars as actual victims of the natural disaster.

In fact, the agreement does not require the Initiative to report on the number of housing units occupied by those affected by Hurricane Matthew nor does it reference any requirements that individuals occupying the units demonstrate they were affected by the storm. Unlike many other disaster recovery programs, it does not appear that there was an application process in place to match state-funded resources with the needs of hurricane survivors. Thus, reports showing the number of housing units made available using these state funds would include units made available to any individual and not necessarily just those individuals who were victims of the hurricane. Whereas DPS reports that the Initiative has assisted 433 existing homes that received storm damage, a review of the Initiative's most recent report to DPS shows only 90 units have actually been rehabilitated, with the others being newly constructed units.

DPS contends these funds have been used in areas with shortages of affordable housing for low-to-moderate income individuals. However, it is unclear how preference was given, if any, to projects to address shortages caused by Hurricane Matthew. For example, and although no funds appear to have been distributed to date, the Initiative stated in its report to DPS that it is in the process of funding a new construction project in Morehead City, which according to HUD data, has a lower need for affordable housing than several other hurricane-affected counties. Funding such a project raises the question of why these funds were not instead used in counties with greater need for affordable housing, if the purpose was to increase the supply of affordable housing in areas with the greatest need.

DPS's agreement granted/awarded funds to the Initiative to create a greater supply of low-to-moderate-income housing, which does not fit within the legislative directive of these funds to provide emergency sheltering and short-term housing. Much of the funding provided to the Initiative is being disbursed to entities for longer-term housing projects. If the General Assembly had intended for these types of expenditures to be a focus of its appropriations, one would expect that the appropriations would not have appeared in the Disaster Recovery Act

[5] This figure includes administrative expenses.

of 2016 but instead in the traditional Appropriations Act. Indeed, many of the Initiative's projects are similar to those that can be supported by federal Community Development Block Grant funds as opposed to state funds.

Issue 3. More than six months after DPS's agreement with the Initiative has ended, DPS has not recaptured $1.3 million in unencumbered funds and potentially disallowed expenses from the Initiative, and thus has not followed provisions set forth in the MOA with the Initiative.

DPS's agreement with the Initiative provides a mechanism to ensure unencumbered funds could be de-obligated or recaptured by DPS. In addition, DPS distributed funds to the Initiative that the Initiative subsequently spent on services provided outside of the performance period, potentially making them disallowable expenses.

- **Unencumbered fund balances not recaptured.** Agreements often contain requirements that unspent portions of awards be returned to the grantee. At the end of the grant period (December 31, 2018), the Initiative had a total unencumbered balance of $877,218, or 16% of its total award, according to data provided by OSBM. As the agreement between DPS and the Initiative states, any uncommitted portion is to be returned to the State.
- **Disallowed spending amounts not recaptured.** Agreements should also contain provisions requiring funds spent on disallowed purposes be returned to or recaptured by the granting entity. For example, service agreements entered into by the grantee (such as subscriptions for subsequent years) that are outside the performance period of the agreement could be considered as disallowable expenses. The Initiative entered into an arrangement with an entity on the last day of the MOA period (December 31, 2018) for which services could not possibly have been completed within the agreement period. Based on data from OSBM, the Program Evaluation Division estimates the agreement between DPS and the Initiative resulted in a total of $389,419 in potentially disallowable expenses.

It does not appear that DPS has recaptured any of these funds to date, although the department reports that its Internal Audit Office is conducting a review of these and other issues. As a result of this effort, DPS staff stated they expect to receive a full accounting of all Initiative activities related to these funds.

Issue 4. Funds intended for emergency sheltering and short-term housing for hurricane survivors appear to financially benefit the Initiative, real estate developers, and private property owners providing rental housing.

DPS distributed $5.35 million, including $600,000 for administrative expenses, to the Initiative for projects that do not meet the statutory directive of providing emergency sheltering and short-term housing. The Initiative is an investor in projects, such as the Rocky Mount Housing and Revitalization Initiative, which are likely to generate revenues for the nonprofit entity that it or its affiliates will retain. Thus, by DPS providing funds to the Initiative without mechanisms in place to recapture any of the earnings realized from these state funds by the nonprofit, its affiliates, or other private entities, the State has essentially subsidized private development without being able to receive any revenue in return. DPS staff report that pursuant to the department's ongoing internal audit and a written request to the Initiative, they anticipate receiving a full accounting of all Initiative activities related to these funds.

Issue 5. State-supported loan principal may not be returned to the State and it is unclear if interest accrued has been used in accordance with state law.

DPS's MOA allowed the Initiative to use the funds it was awarded to provide loans to entities for rehabilitating, reconstructing, or constructing housing units for low-income individuals. Providing such loans raises two issues:

- **The principal for loans may not be returned to the State or retained by the Initiative.** The Initiative has made loans totaling $732,450 to various entities for low-income housing purposes.[6] The agreement between DPS and the Initiative specifies that funds used for loans shall remain with the Initiative. Therefore, it appears that the principal, upon repayment, may remain with the Initiative. Because DPS

[6] This figure includes loan commitments of $567,450.

allowed the Initiative to use state funds in the form of loans, one might expect the loan principal to be returned to the State upon repayment from borrowers; however, this stipulation is not made in the agreement between the Initiative and DPS. Since such funds appear unlikely to be returned to the State, and since the performance period for the agreement has expired, it is unclear if the Initiative will continue to use the funds to make additional loans for purposes specified in its agreement or use them for other purposes as they desire.

- **Lack of clarity regarding interest earned from state funds provided to the Initiative.** State law allows interest earned from grants to remain with the receiving entity and requires these funds be used for the same purposes for which the award was made.[7] As discussed earlier, the Initiative provides both loans and grants to entities seeking to rehabilitate, renovate, or construct low-income housing units.

  Although the agreement between DPS and the Initiative specifies the Initiative must abide by the portion of the State Budget Act relating to the use of interest, there does not appear to be an accountability mechanism in place to ensure such revenue is re-invested for the purposes specified in the agreement.

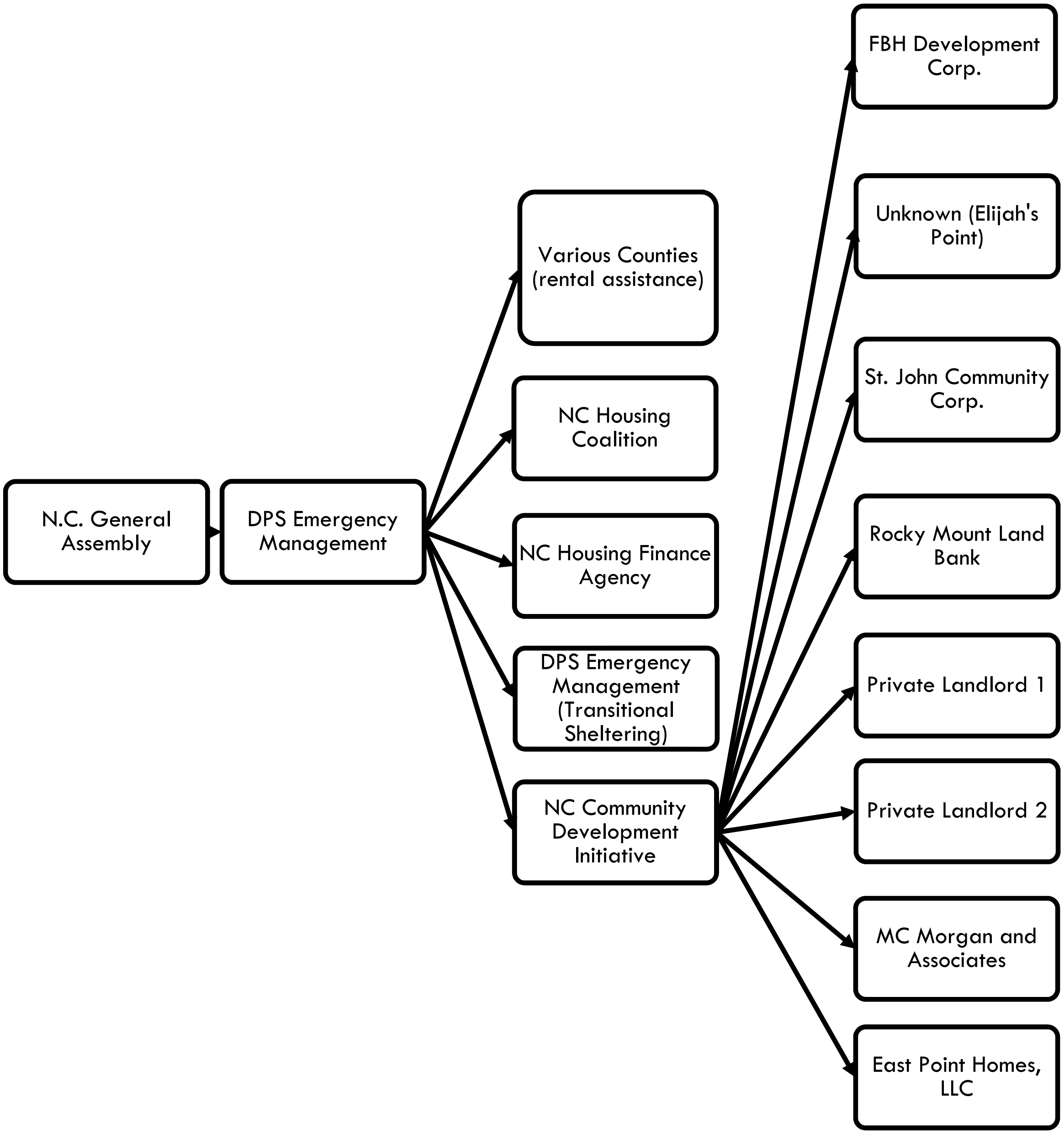
Thus, it is unclear if $732,450 in state funds used by the Initiative for loans will remain with the Initiative or be returned to the State when repaid by borrowers, and if interest the Initiative earns is being used as required by state law. Neither issue is addressed in detail within the agreement. DPS staff report that pursuant to the department's ongoing internal audit and a written request to the Initiative, they anticipate receiving a full accounting of all Initiative activities related to these funds.

In addition, it appears the Initiative is engaging in additional transactions after its grant with DPS has ended, which is in conflict with this agreement and potentially the emergency sheltering and short-term housing purposes outlined in the legislative directive.

For more information on this report, please contact the lead evaluator, Brent Lucas, at brent.lucas@ncleg.net. Sean Hamel and OSBM made key contributions to this report. John W. Turcotte is the director of the Program Evaluation Division.

[7] N.C. Gen. Stat. § 143C-6-23(j).

Appendix A: Flow Chart of Funds Distributed and Planned to Be Distributed by the Initiative



Notes: Only entities receiving funds from the Initiative are shown; other entities receiving funds from DPS are not shown. The Elijah's Point project was reported as in process, and it does not appear any funds have been distributed. This exhibit does not include actual or planned transactions with Mt. Sinai Homes.

Source: Program Evaluation Division based on a review of agreements between DPS, the Initiative, and fund recipients.

Roy Cooper, Governor
Erik A. Hooks, Secretary

Michael A. Sprayberry, Director

June 10, 2019

Mr. John Turcotte
Director, Program Evaluation Division
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Dear Mr. Turcotte:

I want to express my appreciation for the work of you and your team on the Memorandum regarding Follow-Up on Disaster Recovery Funds administered by the Department of Public Safety (DPS), Division of Emergency Management (NCEM). Disaster recovery is long, hard and complicated work, and your report gives DPS and NCEM the opportunity to correct misinformation and discuss lessons learned. Technical corrections regarding errors in your report are attached. This response is based upon the PED draft report provided to NCEM on June 7, 2019.

SUMMARY

Any true evaluation of Disaster Recovery Act 2016 and 2017 funds must include the successful deployment of these funds in a time immediately following an extraordinary disaster. Emergency Management leadership directed funding to organizations which could deploy housing assistance to affected communities, which it regularly reported to the legislature.

Emergency Management is now asked to explain why it is both slow to deploy funds and too fast to deploy funds. The May 2019 PED report focused largely on the slow release of CDBG-DR funding while ignoring the extraordinary federal requirements and arduous process for securing and releasing those funds. PED's June 10 follow-up memorandum criticizes the Emergency Management Division of DPS for acting swiftly to push state funds out into hard hit communities. PED does not acknowledge state funds deployed have provided a wide range of housing services for families in need of assistance. For example, these funds provided housing counseling services, short-term rental assistance, short-term motel stay assistance, a call center for housing, housing listings, housing workshops, housing/landlord search services, housing rehabilitations and construction. It is important to look at the state's expenditure of funds in totality and recognize many citizens and local projects have been assisted with these state funds.

Of the $359.7 million in state appropriated disaster relief funding for Hurricane Matthew, $160 million (45.5%) has been spent to date. An additional $106 million (29.5%) is obligated and $93 million (26%) is the remaining balance to close out those recovery programs. With regard to the issues outlined in your Memorandum, we note the following for your consideration.

As you are aware, DPS and the Office of State Budget and Management (OSBM) have taken numerous steps to begin auditing and reclaiming state funds from the Community Development Initiative, Inc. ("the Initiative), as appropriate and required by law.

The Initiative has been formally notified they must return $1,627,218.08 in unexpended and unencumbered funds. The Department has also initiated an internal audit of the Initiative, that will provide additional program and financial information to conclude the grant close out process.

As confirmed by the OSBM financial and accounting assessment, the PED memorandum may contain some financial and procedural inaccuracies that we have not been able to verify and confirm. With more time and completion of our internal audit these discrepancies can be addressed and resolved.

We are committed to addressing this matter head on and to improving our processes. Background information and more comprehensive responses to issues outlined in your memorandum are provided below.

BACKGROUND

Consideration regarding the state of emergency and policy imperatives for engaging the Initiative in storm recovery efforts is appropriate.

- More than 80,000 families requested individual or family assistance from FEMA following Hurricane Matthew.

- The 2016 General Assembly found that "Approximately 88,000 homes were damaged with a total loss of more than $967 million. Of these, ***<u>4,424 homes were completely destroyed</u>***. This damage represents an extraordinary economic loss as 68% of the damages, or $659 million, is not expected to be covered by insurance or FEMA assistance."[1]

- Session Law 2016-124, the Disaster Recovery Act of 2016, (hereafter, DRA-16) was signed on December 15, 2016, over two months after Hurricane Matthew devastated North Carolina communities. By the time these funds were received, most of the emergency sheltering needs had been met by a FEMA program.

[1] Source: Section 2.1.(b) of Session Law 2016-124, the "Disaster Recovery Act of 2016".

- NCEM is overseeing a FEMA acquisition program to acquire and demolish over 475 homes in Matthew impacted counties, that will further decrease the available housing supply and decrease the tax base in these hard-hit counties.[2]

- The North Carolina Housing Finance Agency has reported a significant affordable housing deficit and shortage of 192,000 housing units in disaster declared counties.[3]

Given the extreme need and shortage of affordable housing in storm-stricken areas, NCEM entered into a Memorandum of Agreement with the Initiative in March 2017 to support the short-term housing, redevelopment and expansion of affordable housing in eastern North Carolina. The funds were intended to help address the affordable housing crisis in the region that was made worse by Hurricane Matthew.

Since February 2017, funding for the Initiative has resulted in the following positive outcomes for Hurricane Matthew impacted communities and families:

- 433 existing homes which received storm damage restored in the hardest hit counties including Robeson, Edgecombe, Cumberland and Wayne Counties.[4]

- 144 new affordable homes in construction to address a critical affordable housing deficit in Robeson and Cumberland Counties. Cost of $750,000 has been supported by this grant.[5]

- Additional significant investments to improve and increase housing stock in hard-hit storm areas.

The original Initiative agreement was approved in March 2017, four short months after Hurricane Matthew made landfall. The DRA 2016 special provision authorized the use of funds "to develop, implement and fund disaster assistance programs to meet the emergency sheltering ***and*** short-term housing needs of individuals affected by Hurricane Matthew"[6]. As noted above, a significant level of Initiative resources and effort helped restore over 433 homes damaged by the storm. Please note that federal CDBG-DR funds for housing recovery were not approved and available to NCEM until August 2017, or 11 months after Matthew landfall. These DRA funds were essential to helping families recover in this critical short-term time period after the storm.

[2] Source: NCEM update of FEMA HMGP Matthew grants, May 13, 2019 NCORR report.
[3] Source: NC Housing Finance Agency report to OSBM, dated March 18, 2019.
[4] Source: OSBM Monthly report on the Implementation Status of S.L. 2016-124 and 2017-119 "The Disaster Recovery Acts of 2016 and 2017", dated March 2018.
[5] Source: December 3, 2018 report to NCEM, titled "Resilient Communities Summary of Activity – NC Emergency Management Report", prepared by the North Carolina Community Development Initiative.
[6] Source: Subsection 4.1.(2) of S.L 2016-124.

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ISSUES IDENTIFIED

Issue 1. DPS did not follow state law and grant-making best practices.

The report states that DPS did not use formal mechanisms to solicit proposals or select recipients to administer emergency sheltering and short-term housing funds. This statement is correct. NCEM was working very hard to deploy all recovery programs as quickly as possible to assist residents of the disaster-stricken counties. Going through a formal Request for Proposal to select a non-profit to assist in housing operations is not required by state law and creates significant delays in providing needed disaster assistance. A few short months after the award, First Baptist Homes in Lumberton was already moving disaster survivors back into their homes. With regard to front loading payments exceeding $100,000 to non-profits, NCEM addressed this issue through the deployment of staff training and the agency is now in compliance.

Issue 2. DPS established an agreement with the Initiative to spend state funds for purposes that do not align with the legislative directive of the disaster recovery legislation.

As noted in the PED report, the legislative purpose for this funding was emergency sheltering and short-term housing. In order to provide context, it is important to note that by the time NCEM received the funding in early 2017, emergency sheltering operations for Hurricane Matthew, which struck on October 8, 2016, had mostly concluded. NCEM initially utilized the funds from this appropriation to place families in motels and to fund the Disaster Rental Assistance Program, which provided short-term housing needs. At this point, many low-to-moderate income families were in desperate need of housing assistance and neither FEMA nor HUD funding was available to help. This lack of affordable housing was and remains an emergency. According to the North Carolina Housing Finance Agency, after Hurricane Matthew there was a shortage of 192,000 affordable housing units in the disaster declared counties.

NCEM determined the Initiative, established in 1993, was a solid vehicle to assist NCEM in providing families with an affordable housing solution. NCEM in partnership with the Initiative worked successfully to provide 433 units in Robeson, Cumberland, Edgecombe and Wayne counties.

It should be noted the PED Memorandum is incorrect on page six where it states, "For example, the Initiative has funded a new construction project in Morehead City, which according to HUD data is in one of the State's counties with the lowest rate of affordable housing shortage." The OSBM financial and accounting assessment determined there was no grant executed and no funds disbursed for this project by the Initiative. Thus, statements indicating this project was funded with these state funds are erroneous.

Overall, NCEM met the spirit of the legislation by providing a wide range of housing services for families in need of assistance in our hardest hit counties to include housing counseling services, short-term rental assistance, short-term motel stay assistance, a call center for housing, housing listings, housing workshops, housing/landlord search services, housing rehabilitation and construction. This funding was executed quickly to assist families in disaster counties during what was, at that time, North Carolina's most severe disaster. Additionally, NCEM reported its activities with this funding, to include the Initiative, for 22 consecutive months to the General Assembly with no issues raised.

Issue 3. DPS did not recapture $1.3 million in unencumbered funds and potentially disallowed expenses from the Initiative.

As noted previously, DPS is in the process of recapturing unencumbered funds and potentially disallowed expenses from the Initiative. It is inaccurate for PED to suggest to the legislature that DPS is not taking appropriate steps to recapture unspent and disallowed funds. By letter dated February 13, 2019, the Director of NC Emergency Management notified the Initiative regarding the grant close out process. Specifically, the Initiative was notified that a financial assessment and compliance review would be completed. The letter further informed the Initiative of its obligation not to encumber or disburse any remaining funds and not to donate any property purchased with funds received pursuant to the grant. From February through late April, OSBM staff completed a financial and accounting assessment to assist in the grant close-out process. In May and June DPS began reviewing this OSBM information and initiated additional audit and notification procedures to the Initiative. Specifically, the initiative has been formally notified they must return a minimum of $1,627,218.08 in unexpended and unencumbered funds. DPS also requested the return of $1,702,873.71 in potentially disallowed expenses if the Initiative cannot provide sufficient information and documentation to show the expenses are allowable. Additional funds and resources may also have to be returned to the State, as a result of the completion of the ongoing internal audit.

Issue 4. Funds intended for emergency sheltering and short-term housing for hurricane survivors appear to financially benefit the Initiative, real estate developers, and private property owners providing rental housing.

Pursuant to our ongoing internal audit and a written request to the Initiative, we anticipate receiving a full accounting of all the Initiative activities related to these funds. As noted earlier, the Initiative has already been formally notified they must return unexpended and disallowed state funds. Additional funds and resources may also have to be returned to the State, as a result of the completion of the ongoing internal audit.

Issue 5. It is unclear if state-supported loan principal will be returned to the State and if interest accrued has been used in accordance with state law.

Pursuant to our ongoing internal audit and a written request to the Initiative, we anticipate receiving a full accounting of all the Initiative activities related to these funds. Additional funds and resources may also have to be returned to the State, as a result of the completion of the ongoing internal audit.

Thank you for the opportunity to review this memorandum, and we look forward to working productively together to rebuild North Carolina stronger and smarter. As the State continues to recover from recent storms and plans for future storms, DPS looks forward to the continuous opportunity to coordinate with the General Assembly to make the best use of available funds and provide the best outcomes for hurricane victims.

Sincerely,

Michael A. Sprayberry

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