HUD-0050939

U.S. Department of Housing and Urban Development
Office of Policy Development and Research

ORIGINAL

An Impact Evaluation of the Urban Development Action Grant Program

An Impact Evaluation
of the
Urban Development Action Grant Program

January 1982

The research forming the basis for this report was conducted by the Division of Policy Studies in the Office of Policy Development and Research, U.S. Department of Housing and Urban Development (HUD).

FOREWORD

Soon after becoming Secretary of HUD, I directed Steve Savas, my Assistant Secretary for Policy Development and Research, to conduct a major evaluation of the Urban Development Action Grant (UDAG) program. A study was necessary because there was no systematic information on how well this program was doing its job, which would enable me to reach an informed decision whether the program was worth keeping.

The UDAG program is designed to stimulate the economies of distressed or declining cities. It does this by providing limited subsidies for a wide variety of economic development projects which otherwise would not be undertaken in these areas. To discover what the program is really achieving in terms of jobs, private investment, and local revenues, the HUD team conducting this study examined intensively a representative sample of 80 industrial, commercial, and neighborhood projects in 70 cities across the country. They inspected sites and held detailed personal interviews with key people involved in the proposal and review of the projects. They also consulted with a blue ribbon panel of real estate, financial and development experts on key elements of the program and its process.

The results of the study establish that the program is worthwhile, that it is an effective and proven asset in our efforts to help America's cities. There are some deficiencies in the program but the study gives specific recommendations for correcting them. I have already instructed the Office of Community Planning and Development to implement these recommendations so that the program will be even more successful in the future.

I commend Dr. Savas for completing this high quality evaluation. It has provided me with solidly-based answers to important questions.

Samuel R. Pierce, Jr.
Secretary of Housing and
Urban Development

TABLE OF CONTENTS

The first UDAG award was made just over three years ago and, although the program is relatively young, a sufficient number of projects has reached or is nearing completion to permit preliminary judgments regarding the program's value. To reach such judgments, an in-house study team intensively examined a representative sample of 80 industrial, commercial, and neighborhood UDAG projects in 70 cities (representing proportionately more of those completed or nearing completion). The study team obtained detailed information from the major public and private actors involved in the proposal and review of the 80 projects, carefully examined HUD's project files, and inspected the project sites. Members of the team also observed HUD's process for reviewing project applications and analyzed HUD's computer files having information on all UDAG awards. Finally, the study team consulted with a blue ribbon panel of real estate finance and development experts regarding the issues of substitution and the project review and selection process.

The Need for UDAG

Prior to assessing program impacts, it is essential to know the extent to which private investment in UDAG-supported projects really depends on the Federal subsidy. If it does not, then the grant is merely substituting for private or non-Federal public investment.

A detailed review of UDAG project documents by a panel of real estate finance and development experts, combined with information obtained first hand at project sites by the study team, leads to the conclusion that the majority of UDAG projects clearly required the Federal grant in order to proceed. In 64 percent of the cases, the private investment, jobs, taxes, and other benefits associated with these projects would not have appeared without UDAG support. This is true for a variety of reasons, including extraordinary site development costs and the need for improvements in public infrastructure to facilitate private investment.

Some projects, however, would have gone ahead either in part or in their entirety without the UDAG subsidy. In 13 percent of the projects, part of the project did not depend on the UDAG subsidy; therefore, partial substitution occurred. Full substitution of UDAG funds for private or non-Federal public funds occurred in another eight percent of the projects. In these cases, there is conclusive evidence that the same projects would have been undertaken without an Urban Development Action Grant. For 15 percent of the projects, the evidence on substitution is inconclusive.

UDAG funds awarded to projects with conclusive evidence of either partial or full substitution represent one of every six dollars expended. To assess the program's impacts, therefore, the benefits associated with these unnecessary dollars are subtracted ("discounted") from the aggregated benefits of the program as a whole.

The Benefits of UDAG

Most of the program impacts that were anticipated at the time

Summary and Recommendations

The Urban Development Action Grant (UDAG) program is assisting distressed cities and urban counties in promoting economic development. UDAG subsidies have stimulated additional private investment, jobs, and taxes that would not have occurred in these places in the absence of the program and, generally, this has been done effectively. However, the UDAG program has certain deficiencies that have prevented it from being even more successful. In some instances, for example, Federal funds have been awarded for projects that would have been completed without the UDAG subsidy. In other cases, original estimates of anticipated benefits were overstated. Given the program's underlying strengths, these deficiencies can be reduced or eliminated, and the program made more successful, through various administrative changes suggested in this report.

* * *

This evaluation of the Urban Development Action Grant program addresses four important issues:

Need for UDAG. Are UDAG funds used only where needed to stimulate economic development?

Benefits of UDAG. Are the benefits that are intended for economically distressed cities -- of new private investment, jobs, tax revenues, and housing -- being realized or likely to be realized?

Distribution of Funds. Are UDAG funds going to the cities with the greatest need for economic development?

Local Economic Development Capacity. What role does UDAG play in building cities' capacity to undertake economic development? How many cities have the capacity to put together UDAG-type development projects without UDAG staff assistance?

difficulty.

On a second employment dimension, the number of construction jobs associated with UDAG projects is very close to that originally predicted.

Housing. The amount of housing being delivered through the UDAG program is basically the same as that anticipated, with three-fourths of the units directly attributable to or dependent on the UDAG subsidy. UDAG costs per unit are projected to be one-third higher than expected; and fewer units than expected are likely to be priced within the reach of low- and moderate-income households.

Taxes. Total tax revenues that result from UDAG projects are projected to fall short of original estimates by as much as 40 percent or, after accounting for the effects of substitution, by about 50 percent. Unfortunately, exact estimation of the shortfall is precluded by the incomplete or poorly calculated original estimates of new revenues and by the inherent difficulty of projecting the net fiscal impacts of planned real estate and industrial developments.

Spin-offs. In nearly one-half of all projects, UDAG has been the catalyst for spin-off private investments such as other construction that is not part of the UDAG project.

Off-site impacts. About 45 percent of all UDAG projects have had off-site effects on existing businesses. Most of these are positive -- for instance, increases in sales volume in stores adjacent to UDAG-supported projects. In only a few cases is there evidence of adverse impacts.

Relocation. Compared to HUD's earlier Urban Renewal program, UDAG has produced relatively little dislocation of households or businesses; and, all of the dislocation that has taken place was anticipated when grants were awarded. Displacement of households has occurred or will occur in 19 percent of the 80 projects examined for this study, resulting in the relocation of just over 400 households. Most of those relocated have low- or moderate-incomes and pay, on average, about one-third more for housing after relocation than before. Most remain in the same city and receive substantial financial and other relocation assistance.

Some displacement of existing businesses has also taken place in one out of every four projects. All of the relocated businesses received or will receive financial compensation from the cities, and the majority have not been adversely affected by their displacement.

Differences Among Types of Projects

The UDAG program has funded three distinct types of projects: industrial, commercial, and housing developments. Industrial projects require smaller subsidies than the other types in order to stimulate private investment but, in the short run, they are not as likely to stimulate as many positive, secondary effects on other businesses within the community

Urban Development Action Grants were awarded are being achieved and, in addition, certain secondary off-site and spin-off benefits are being generated in a large number of cases. Private investment and housing impacts are closest to being on target; employment impacts are less so; and tax revenue impacts are farther from target. Except for tax revenues, the majority of positive benefits being achieved can be attributed directly to the award of an Action Grant.

Private Investment. Private investment benefits are being substantially realized. UDAG projects are, in fact, generating more private dollars than had been anticipated when grant awards were made, although a large amount of this is due to project costs being higher than expected. After discounting for UDAG dollars that were not needed, the amount of private investment falls a little short of the original level. It was anticipated that for each dollar of UDAG given to a project, 6.3 private dollars would be invested; actually, the number of discounted private dollars per UDAG dollar is 5.5.

One half of the projects examined for this study involve additional public funds besides UDAG; thus, the private investment is being stimulated by both UDAG and other public monies. In the program as a whole, for every public dollar (UDAG plus public grants) spent, there are 4.4 dollars of private investment.

Finally, the study team has concluded that certain program modifications can substantially reduce the number of awards to projects that do not need UDAG funds as an investment stimulus. If these changes are made, it is projected that 6.2 private dollars would be invested for each UDAG dollar spent -- an amount that is almost identical to the originally anticipated amount.

Jobs. The UDAG program is producing the majority of the new jobs that were promised when projects were initiated. Before discounting for dollars that were not needed, 77 percent of the anticipated employment is, in fact, generated. After discounting, this figure decreases to 62 percent of the original employment goal, at an average cost of 11,570 UDAG dollars per job. This cost is 62 percent higher than originally expected. Even so, although inter-program comparisons are difficult to make, the costs of each job created under UDAG roughly compare with the the costs of jobs created by other Federal programs such as EDA's Business Development Loan program, and are considerably less than the costs of creating public jobs through the Local Public Works programs. Furthermore, if program modifications were to eliminate instances in which UDAG funds are spent when not needed, the number of jobs attributable to the UDAG program would be 14 percent higher and the cost per job would be eight percent less than is currently the case.

Apart from those cases where funds were not needed, job shortfalls are most often due to poor calculations made at the time grants were awarded. In about nine percent of the projects, however, job creation has been reduced by 20 percent or more because the project is in economic

providing both funds and economic development expertise. As such, it is important to know the extent of city governments' capacity to promote local economic development both with and without the technical resources of the Federal government.

UDAG and Local Development Strategies. The large majority of UDAG projects appear to fit into cities' economic development plans, largely because of the wide latitude for local discretion that is built into the program. No instances were identified of direct conflict between a UDAG project and a city's economic development priorities. However, a minority of UDAG projects (perhaps one in four) are essentially ad hoc responses to opportunities that are not central to any plan.

Initiation of Proposed New Projects. More than half of the development ideas that eventually receive UDAG support are first conceived in the private sector, and a larger percentage are conceived prior to any thought of UDAG. Most successful project applications require changes after submission to make them more acceptable for funding. In this regard, the UDAG staff in Washington provides advice and guidance, and often takes a direct role in bargaining with private developers in order to increase a project's benefits to the city. Of the local officials who deal with UDAG, two-thirds of those in the 24 small cities included in this study, but only one-third of those in the 46 metropolitan cities, see this input as beneficial from their perspective.

Reuses of UDAG Funds by Local Governments. Three-fourths of the studied cities have received at least one UDAG award with a recapture provision which allows them to reuse some of the funds for future community and economic development activities. Four-fifths of these places have a mechanism, either planned or in place, to use this money, with most planning to capitalize city-controlled, revolving loan funds for commercial, industrial, or (in a few cases) housing and neighborhood developments. Thus, where the amount of money that can be recaptured is of sufficient magnitude, it has the potential to increase cities' future capacity to undertake additional development projects and to reduce their Federal dependence. Very few UDAG projects, however, have yet recaptured funds; therefore, the extent to which this potential will be realized is not presently known.

Local Government's Capacity to Stimulate Economic Development. A majority of cities included in this study currently possess at least a moderate amount of economic development capacity. About one in four of the metropolitan cities, and one in six of the small cities, have a strong capacity to put together UDAG-type projects without staff support from the UDAG office in Washington. These judgments assume that Federal funds are available. They consider the city's current administrative capacity, the trend in that capacity since 1977, the extent to which the city presently relies on UDAG staff for assistance in shaping projects, the number of UDAG awards received, and the opinions of local development officials on this subject.

In about 40 percent of the cities, the UDAG program has altered their long-run capacity to stmulate new economic development. UDAG has helped

as are commercial projects. The cost, in terms of UDAG funds, of creating new permanent jobs is somewhat similar for industrial and commercial projects. In contrast, housing developments do not appear to have many short-run economic development benefits, yet they may have secondary impacts that provide long-term benefits to distressed cities.

Projects with Problems

When projects do not achieve all of their anticipated impacts, this is most often due to over-estimations of benefits made at the time awards are given. In addition, the UDAG program cannot take credit for benefits that are associated with projects not needing UDAG support; this is another reason for some of the differences between anticipated and attained impacts.

A final reason for not achieving all of the original goals is that some projects, once initiated, experience unforeseen financial difficulties that reduce the level of program benefits. As of June 1981, about one in ten projects faced a serious financial or other problem that has or could seriously jeopardize the project's benefits. The sources of problems include: changes in national economic conditions; the risk inherent in some types of development; and, in one case, a violation of HUD's grant agreement. Neither the number of projects with serious problems nor the actual or potential loss of benefits stemming from these problems appears large in relation to the overall magnitude of the UDAG program.

A separate analysis of construction delays shows that 15 percent of the sampled projects will finish construction at least a year behind the original schedule; reasons for construction delays vary, including administrative problems and changes in financing or project scope.

Distribution of Funds

While the UDAG program bases a city's eligibility to participate on whether it meets the program's criteria of economic distress, the program relies on the capacity and initiative of cities to submit applications for awards. The resulting distribution of funds tends to favor the more economically distressed of eligible places, although this is less so for small as opposed to large cities. Among the large cities, over 60 percent of all UDAG awards and dollars go to the most distressed communities; this targeting, however, is due primarily to the larger number of UDAG applications submitted by the most distressed group of cities rather than from any competitive advantage in the application process. The less distressed large cities, in effect, select themselves out of the UDAG competition to a certain extent by applying less often. The distribution of UDAG awards and funds across states and regions closely corresponds to the distribution of the population eligible for the program.

Local Economic Development Capacity

UDAG projects are cooperative ventures between the private sector, local government and the Federal government, with the Federal government

award decisions are made; and early monitoring should be strengthened to detect emerging problems.

c. To improve the accuracy of the impact estimates used to rank projects for selection, steps should be taken to avoid the more common errors. Jobs should be estimated as full-time equivalents and be consistent with national or regional benchmarks for particular industries. Jobs merely transferred from existing facilities should not be counted. Cities should receive more guidance on how to estimate revenue impacts. And, alternative methods of estimating the leveraged private investment should be developed.

to enhance local capacity in the following ways: by stimulating the first use of some development tool; by creating new offices or staff positions; or by providing an initial opportunity to engage in UDAG-type negotiations. In the other 60 percent of the cases, UDAG appears to have had little or no impact on the city's capacity to stimulate economic development.

Recommendations

Based on these findings, it can be concluded that the Urban Development Action Grant program is substantially fulfilling its mandate. Although the results of UDAG projects do not quite meet the original expectations for those projects, the program as a whole is generally very successful and compares favorably with other programs. As a development tool, UDAG is providing primary and secondary benefits to distressed localities that constitute a net addition to their economies. This is being accomplished with few adverse side effects.

The program can be improved, however. Certain policy and program changes are in order to strengthen UDAG. In general, these can be accomplished through regulatory modifications under the existing statute.

The following recommendations are made:

1. The UDAG program should be continued.

2. To be true to its mandate, the program should sharpen its focus on economic development. This means placing primary emphasis on industrial and commercial projects or on mixed-use projects which include housing only as an integral part of a local economic-development strategy.

3. Program changes should be made to improve its performance.

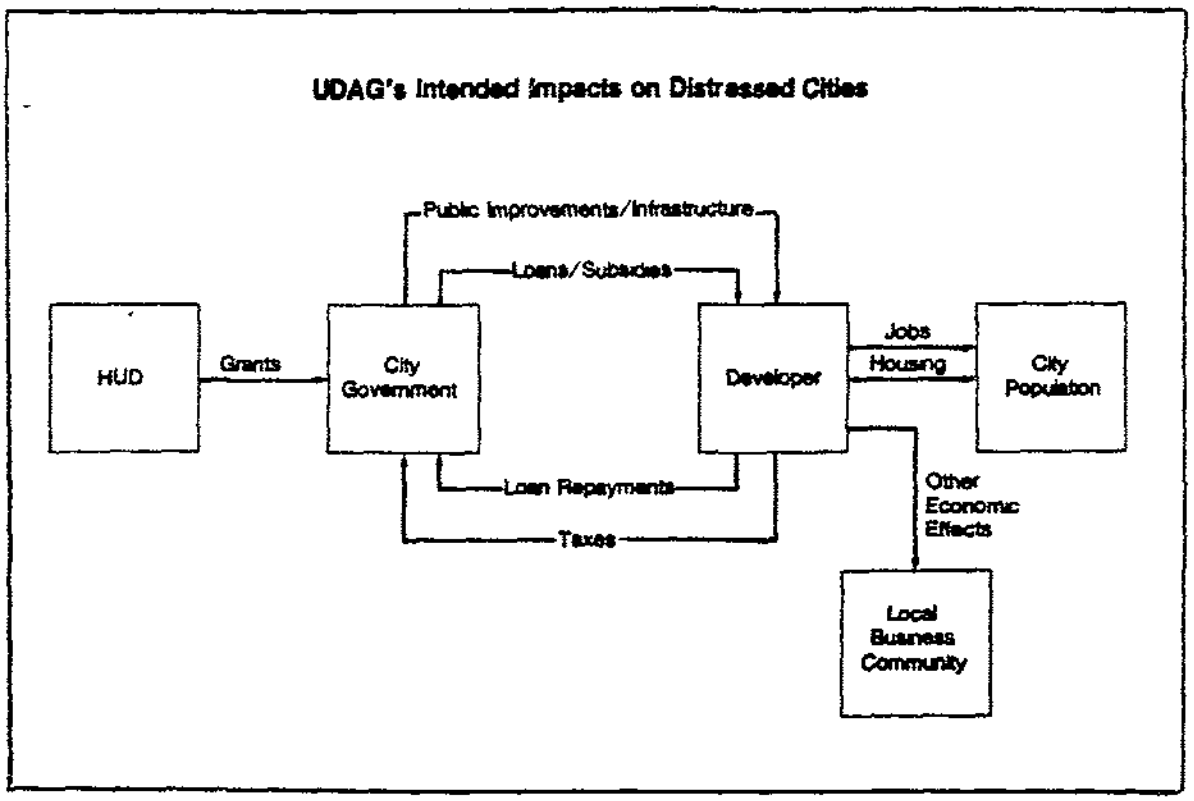
   a. To insure that Federal money does not substitute for private investment or non-Federal public funds, project selection procedures should be improved. Where feasible, expert opinion should be sought about local real estate and market conditions; applicants should be required to further document their claims that sufficient private funds are unavailable and that other public sources have been exhausted; and the process by which HUD Area Office personnel participate in project review should be strengthened.

   b. To assure that project benefits are fully realized, greater attention should be paid to financial feasibility when projects are selected. Discrepancies between Headquarters and Area Office evaluations should be reconciled before project

I. Introduction

more jobs and a larger local tax base. A city's eligibility is based upon the age of its housing stock, its per capita income, poverty and unemployment rates, and population and job lags/losses.

Under the UDAG program, grants made to local governments are used as incentives to stimulate private sector economic activity. Each one-time grant, in an amount mutually satisfactory to HUD and the local parties, is tied to a specific private investment. Several possible uses can be made of an Urban Development Action Grant. It can be used for: (a) below market rate loans to a developer; (b) land write-downs, demolition, relocation costs, on-site improvements, and similar subsidies to



reduce a developer's costs; (c) public infrastructure or other public improvements adjacent to a project site; or (d) a combination of these incentives.

An application for an Action Grant is generally prepared jointly by city officials and the developer(s), and is submitted to HUD by the city. All applications are reviewed by the UDAG staff in the Washington headquarters of HUD (utilizing comments and recommendations from the appropriate

CITY TYPES -- AS USED FOR UDAG PROGRAM PURPOSES

Small cities are cities under 50,000 population which are not central cities of a Standard Metropolitan Statistical area.

Metropolitan cities include cities of 50,000 population or larger, cities under 50,000 population which are central cities of an SMSA, and urban counties of 200,000 population or larger.

HUD Area Office). There are four metropolitan city funding rounds and four small city rounds each year during which new applications and those "held over" from previous rounds are reviewed. Because funds are limited, only some of the applications are approved and grants provided.

In an attempt to assure that only acceptable and viable projects are funded, the UDAG program places a heavy emphasis on the application review process. To further assure viability, no funds are transferred from HUD to the local government until a set of legally binding commitments is signed by the city, the developer(s), and the lenders(s), assuring that the private investment in the project will be made.

In its first three years of operation (i.e., through June 1981), the

UDAG program received 2,188 applications. A total of 1,201 awards have been

TERMINOLOGY: GRANT AGREEMENT

A grant agreement spells out the responsibilities of each of the parties involved in a UDAG project: HUD, the city, the developer(s) and the lender(s). This contractual relationship assures HUD that the private commitment to develop a project is firm. For instance, HUD agrees to provide funding for particular purposes, while the developer agrees to invest a specified amount in the project and to create a certain number of jobs. The grant agreement is signed by HUD and the city following HUD's decision to approve the project. The agreement is not enforceable, however, until supplemented by a set of legally binding commitments signed by the city, the developer(s) and the lender(s).

made, which includes 1,099 projects at various stages of completion (this includes some projects which are already fully constructed) and 102 projects terminated after award. The remaining 987 unfunded applications were either withdrawn by the city or rejected by the UDAG reviewers.

To date, slightly over $2 billion has been awarded. The average award has been $1.86 million. Projects are classified as industrial, commercial, and neighborhood. 1/ The number of projects funded to date has

1/ These are UDAG designations that have been used for administrative purposes in order to meet the statutory requirements of balance among the three types. This requirement was rescinded in the 1981 amendments to the program. Although many projects are multi-component, and thus are difficult to classify as, say, simply "commercial," these UDAG designations usually provide an accurate (though sometimes oversimplified) portrayal. The "industrial" and "commercial" categories are self-explanatory. The "neighborhood" category includes residential projects, but also includes some projects which are primarily or entirely industrial or commercial.

been split fairly evenly among these three types; however, commercial projects have received 50 percent of all UDAG funds. The average award for commercial projects has been about twice the value of industrial and neighborhood awards.

Why this Study?

Since the Urban Development Action Grant program is relatively new, information on real program impacts has tended to be anecdotal and inconclusive. Consequently, in March 1981, HUD Secretary Pierce requested a systematic evaluation. Although several studies of UDAG had been carried out previously, each had been handicapped by the lack of an in-depth data base for examining program impacts. This study fills that gap by looking thoroughly and objectively at a representative group of projects from which valid inferences can be drawn about the program and its effects.

Issues Addressed

This study examines the following important and controversial program issues:

- The Substitution Issue. In how many local economic development projects receiving subsidies under the UDAG program would the private investment have occurred in whole or in part without the UDAG-funded activities? And, in how many instances, and to what extent, do Federal funds merely substitute for private or other public investment?

- The Impacts Issue. Are the benefits intended for economically distressed cities -- of new private investment, jobs, revenues, and housing -- being realized or likely to be realized?

- The Distribution of Funds Issue. Are funds going to cities with the greatest need for economic development? and

UDAG PROGRAM HIGHLIGHTS

Population Coverage

- Thirty-five percent of the U.S. population lives in UDAG-eligible communities; of this group, 70 percent live in metropolitan cities, and 30 percent live in small cities.

Review and Awards

- There are four metropolitan city funding rounds and four small city funding rounds each year.
- The annual number of awards has increased from 236 in FY 1978 to 285 in FY 1979 and 416 in FY 1980.
- In a given funding round, one-half of the applications considered have been new and one-half have been "held over" from previous rounds.
- Fifty-five percent of all applications eventually have resulted in an award.

Projects

2,188 project applications were received through June, 1981.

1,099 projects received awards and were not terminated:
- 364 were commercial projects; total award: $1,013 million
- 354 were industrial projects; total award: $513 million
- 381 were neighborhood projects; total award: $512 million

102 projects were terminated after award.

987 projects were withdrawn or rejected.

Funds Awarded

o Total funds awarded through June 1981:	$2.04 billion
o Average project award:	$1.86 million
o Average commercial project award:	$2.78 million
Average industrial project award:	$1.45 million
Average neighborhood project award:	$1.34 million
o Average metropolitan city award:	$2.44 million
Average small city award:	$ .99 million
o Largest single award (to Hamtramck, Mich.):	$30 million
Smallest single award (to Dowagiac, Mich.):	$35 thousand

- The Local Economic Development Capacity Issue. What role does UDAG play in local economic development efforts and in building cities' capacity to undertake such activities? How many cities have the capacity to put together UDAG-type development projects without UDAG staff assistance?

KEY UDAG DATES

October 1977	UDAG program established; annual authorization set at $400 million.
June 1978	First UDAG projects received preliminary awards.
December 1979	Legislation amended; annual authorization increased to $675 million.
July 1981	Legislation amended; annual authorization decreased to $500 million.

Components of the Study

This study has five major components.

Issue Identification. To initiate the evaluation, a comprehensive literature review was conducted to identify the most important UDAG program issues. The issue list was modified and supplemented through extensive discussions with key policy makers in HUD and OMB.

Primary Data Collection and Analysis. A major component of the study was the on-site collection of a wide variety of information for a sample of 80 UDAG projects. These projects are intended to be representative of the program as a whole; to achieve this representation, a stratified random sample was chosen. Stratification occurs along three dimensions. First, metropolitan projects and small city projects are represented in

SOME PREVIOUS RELEVANT STUDIES OF UDAG

- U.S. General Accounting Office. Improvements Needed in Selecting and Processing Urban Development Action Grants (1979).
- Richard P. Nathan and Jerry A. Webman (eds.) Urban Development Action Grant Program: Papers and Conference Proceedings on Its First Two Years of Operation (1980).
- U.S. Congress. Congressional Budget Office. Urban Development Action Grants: Initial Program Experience, Issues and Options (1980).
- U.S. Department of Housing and Urban Development. Urban Development Action Grant Program: Third Annual Report (1981).
- Urban Land Institute. Findings of the Special Advisory Panel for the Urban Development Action Grant Program (1980).
- Abt Associates, Inc. The Urban Development Action Grant Program: A Comprehensive Evaluation Design (August 1981).
- U.S. Congress. House Appropriations Committee. A Report on the Urban Development Action Grant Program (1980).

NOTE: These documents and others are described more fully in an annotated bibliography which appears as an Appendix to this report.

the sample in roughly the same proportion that UDAG funds -- not projects -- are split between the two categories.1/ Second, since the program has evolved considerably since its first year of operation, especially in terms

1/ Through June 1981, 22 percent of UDAG funds have been awarded to small cities. Thirty percent of the sampled projects are in small cities.

of review of applications, projects funded in 1978 are intentionally under-represented.[1]/ Third, since the study emphasizes determining actual program impacts, projects at or near construction completion are intentionally over-represented in the sample.

MAJOR COMPONENTS OF THE STUDY

- Issue identification.
  - Literature review.
  - Discussions with principal staff of HUD and OMB.
- Primary data collection.
  - Discussion guides designed and pre-tested.
  - Sample of 80 projects selected.
  - Examination of UDAG project files.
  - In-depth collection of data on-site.
- Primary data analysis.
  - Analysis of data collected.
  - Analysis of the necessity of UDAG funds by an independent panel of nine nationally recognized real estate development and finance experts.
- Participant observation of UDAG application review process.
- Secondary data collection and analysis.
  - Use of UDAG computerized data base.
  - Analysis of the universe of UDAG applications.
  - Analysis of the universe of funded projects.

The intentional overrepresentation of metropolitan projects and more recently funded projects assures that the sample represents the program as

---

1/ Review of UDAG applications has evolved into a much tighter and stricter process since the program began. As a result, projects funded in 1978 are less representative (than later projects) of the current UDAG program.

it has evolved to date. The oversampling of projects at or near completion provides a large percentage of sampled projects where actual impact information -- rather than projected impact information -- could be obtained; also, more accurate projections can be made for nearly completed projects than for projects far from completion.1/

The 80 projects are located in 70 cities in 29 states. As shown on the accompanying map, the vast majority of the projects in the sample are located in the 16 states with the largest amount of UDAG funds received during the three-year period between June 1978 and June 1981; cities located in these states received 77 percent of the total funds awarded during that period.

A wide variety of activities was undertaken in the sampled projects. As indicated in the accompanying table, the 80 projects will result in a total of 292 components.

Study team members spent an average of two days at each project site. Prior to these visits, the UDAG files for each project were thoroughly reviewed. The file review enabled the team to identify major project actors, to determine cases of missing key information, to identify any apparent inconsistencies in the descriptions of various aspects of the project, and to obtain baseline data for the impact analyses.

While on site, the study team directly observed the project and its surrounding neighborhood. In addition, in-depth discussions were held with

---

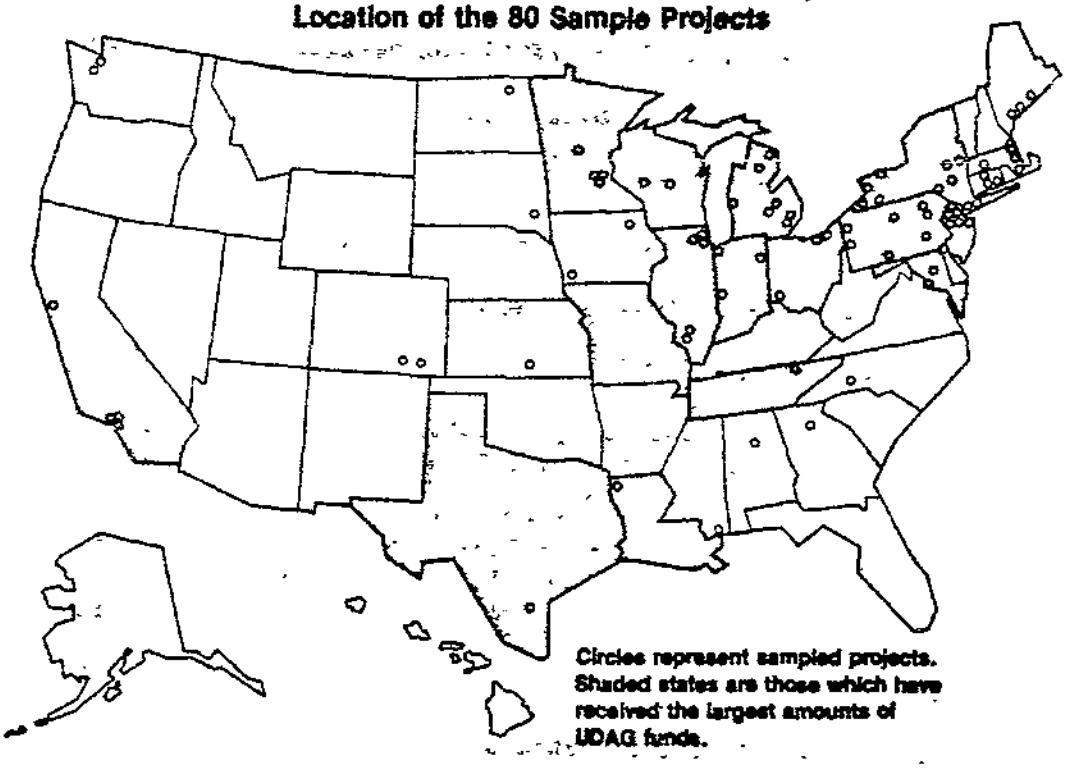
1/ The intentional overrepresentation of projects which are further along in construction does not result in a bias towards small projects. In fact, the median total investment in the 80 projects is slightly larger than the median investment in all UDAG projects funded through September 30, 1980.

COMPONENTS OF THE 80 UDAG PROJECTS EXAMINED FOR THIS STUDY

Type of Component	Number
Street construction, paving, curbing, gutters	31
Industrial buildings (new and rehabilitated)	28
Water, sewer and utilities	26
Retail buildings (new and rehabilitated)	23
Parking (including lots, ramps and garages)	23
Site preparation by public agency	22
Equipment (industrial)	21
Office buildings (new and rehabilitated)	21
Land acquisition by public agency	20
Relocation (business)	20
Beautification (including landscaping, parks, streetscaping, pedestrian malls and plazas)	16
Housing	15
Relocation (residential)	15
Shopping malls	8
Hotels and convention centers	6
Equipment (commercial)	5
Nursing homes	3
Other	12
Total Number of Components	315
(Total Number of Projects)	(80)

city development officials, developers, lenders, permanent employers, and other key participants.1/ These were structured by discussion guides, which had been pretested at three non-sample sites. Discussions with a wide range of project actors -- each with different roles, perspectives and interests -- were aimed at eliciting a complete and objective picture of each project. In many cases, consistent information was obtained from different persons but, in others, apparently contradictory facts were provided. In

Location of the 80 Sample Projects



Circles represent sampled projects. Shaded states are those which have received the largest amounts of UDAG funds.

1/ Across the 80 sites, discussions were held with a total of 600 individuals other than HUD Central Office and Area Office staff.

the latter, team members judiciously probed for further information and explanations in order to arrive at a reasonable conclusion. Following the site visits, this information was sytematically analyzed to address each of the basic issues of concern.

Expert Panel Analysis. In determining whether the UDAG was needed to stimulate private investment, considerable assistance was provided by an independent panel of nine nationally recognized real estate finance and development experts. These experts brought to bear a set of experience in, and knowledge of, urban real estate development that added significantly to the study team's capacity to address this issue. The panel utilized information available from the UDAG project files, as well as the information collected on site by the HUD staff; panel members worked independently, and also met in groups to discuss individual projects.

Participant Observation. To learn about the UDAG application review process, members of the study team observed two complete funding rounds -- one small city and one metropolitan city selection process. From this, the team gained an understanding of how UDAG reviewers analyze and approve (or reject) projects.

Secondary Data Collection and Analysis. Data for the entire universe of UDAG applications and awards are maintained in computerized form by HUD; secondary analyses of these data were conducted on (a) the universe of all UDAG applications received through June 1981, and (b) the universe of all projects funded through June 1981.

Organization of This Report

The study's findings on the extent to which UDAG funds were necessary are presented in Part II. If a project would have proceeded without UDAG, the jobs, taxes and other impacts generated cannot be said to have been stimulated by it. Part III, which presents the impact findings, takes into account whether those impacts can be attributed to UDAG. While Parts II and III address the extent to which UDAG's purposes are being accomplished, Part IV examines why some projects are not producing as many benefits as expected.

Although only cities which are officially designated as "distressed" are eligible to receive UDAG funds, there is a wide range of severity of distress among these cities. Part V examines the extent to which UDAG funds are targeted to the more distressed eligible cities.

Part VI examines the relationship between the UDAG program and local economic development, focusing on such issues as UDAG's impact on cities' economic development capacity, potential use by the cities of recaptured UDAG funds, and the process by which UDAG proposals are developed at the local level. Finally, options for program improvement are presented in Part VII.

II. Substitution -- Is UDAG Necessary?

Substitution - -
Is UDAG Necessary?

2

The primary goal of the Urban Development Action Grant program is to induce economic development in distressed cities and urban counties by stimulating private investment that would not otherwise have occurred. In the majority (64%) of cases, this goal has been realized: UDAG funds were definitely needed for the private investment, associated jobs and other benefits. In eight percent of the projects, the grants were unnecessary to stimulate any of the private investment while in another 13 percent, they were needed only for a portion of the private sector's undertaking. The evidence is inconclusive in the remaining 15 percent of the cases.

The amount of unnecessary UDAG funds awarded to projects amounts to one dollar for every six expended. Unnecessary expenditures occurred as often in recent years as in the first year of program funding.

An Urban Development Action Grant is intended to be used when it can can be demonstrated that it is a necessary catalyst for economic development in a distressed city. In spite of the fairly severe economic problems faced by such cities, some development projects will proceed without a UDAG

Preceding page blank

TERMINOLOGY: SUBSTITUTION

Substitution occurs in a project when Federal funds pay for some portion of an investment that the private sector or state or local governments would have paid for in the absence of UDAG funding.

"But for" is a shortened version of the statement, "but for" the UDAG, this project would not be built.* A project that meets the "but for" criterion would be contingent upon UDAG funding; without an Action Grant the project would not be built.

According to the Wydler Amendment, two conditions must be met: (a) UDAG funds should not substitute for or replace other non-Federal funds, and (b) the project would not be built "but for" the UDAG award. Any project that fails either of these tests, in whole or in part, is referred to in this study as having full (or partial) substitution.

*The "but for" criterion is found in the UDAG program regulations at Section 570.451 (i)(3) and 570.459(u).

subsidy as an inducement. For other projects, however, UDAG is a necessity because of the high risk and/or extraordinary development costs associated with these types of places; in these cases, development will not occur without UDAG. Often, the dividing line between these two types of projects is thin.

During the program's early months, UDAG reviewers did not emphasize the question of whether an Action Grant was necessary to induce the private investment in funded projects. By early 1979, however, this question was routinely addressed. In December 1979, the Wydler Amendment 1/ required

1/ P.L. 96-153, Section 104 (the Wydler Amendment) amended Section 119 of the Housing and Community Development Act of 1974.

such review. Thus, UDAG must determine on which side of the dividing line each proposed project falls.

Addressing the Substitution Issue

Substitution occurs if the UDAG is unnecessary (i.e., if it is merely substituting for private or non-Federal funds). The substitution issue has three aspects:

(1) Would a project have had the same scope without UDAG?

(2) Would a project have gone ahead at the same location (i.e., within the same city) without UDAG?

(3) Would a project have proceeded at the same time without UDAG?

If the answer to all three of these questions is yes, then full substitution has occurred (i.e., the same project would have proceeded at the same location and at the same time without UDAG). In contrast, if a project at the same location and time, but with a reduced scope, would have proceeded without UDAG, then partial substitution has occurred.

Scope. When examining scope, the question is whether a project of the same size (e.g., the same square footage or number of stories) and with the same basic components (e.g., a first floor retail mall with upper floors of office space) required the UDAG to go forward. For some projects, the answer to this question is neither yes nor no; rather, for them, part (but not all) of the project would have gone forward without UDAG. For example, with an Urban Development Action Grant, a multi-component project with a hotel, office building and parking garage would be built, but without the UDAG only one component, such as the office building would be constructed.

Location. For most projects, the location issue is addressed by determining whether the project would have proceeded in the same distressed city without UDAG. In a handful of cases, however, the UDAG project is designed to contribute to an explicit, location-specific city economic development goal, such as the revitalization of the Central Business District or the development of an industrial park. For these few projects, the appropriate location question is whether the project, without UDAG, would have proceeded in the same neighborhood or area of the distressed city.

Timing. When examining timing, the question is whether the project would have proceeded at the same time -- or with a delay of less than a a year -- without the UDAG. The one year time frame was selected for analytic purposes; it is not based on any legislative or regulatory specifications.

Study Approach

Two interdependent approaches are used to assess the substitution issue for the projects studied. The first involved visits to each project by members of the study team. Prior to these site visits, the team obtained extensive information from the UDAG project files and often discussed the projects with UDAG staff reviewers. At the project site, team members probed for information that would provide a broader perspective on the project beyond that obtainable from merely reading the files.

The site visits included inspections of the projects. In addition, discussions were held with a wide variety of project actors -- including developers, lenders, and city development officials, among others. Firsthand information was obtained on a variety of contextual factors, including

site history, market conditions, other economic development activities in the area, and the intentions and long-term economic interests of the major project actors. This approach enabled the HUD staff to form a full and accurate picture of the project -- especially with respect to the substitution issue.

A complementary approach to assessing substitution was made by convening a panel of nine nationally-recognized real estate finance and development experts. The panel used the data from the files and information gathered on site, in conjunction with their knowledge of and experience in real estate development, to arrive at an independent assessment of substitution. In this assessment, the expert panel examined such factors as rate-of-return on investment, market conditions, and development costs in order to facilitate analysis of the scope, location and timing questions. The evidence and conclusions of these two approaches were carefully considered and weighed in making a final judgment on the substitution question.1/

Findings

Full substitution occurred in eight percent of the 80 projects. In all cases of full substitution, conclusive evidence indicates that the

---

1/ There are other ways to approach the substitution issue, some of which appear to be conceptually simpler than the method used here. However, other approaches have not yet been tried and even their proponents admit that they suffer from both conceptual and practical difficulties that will take considerable time to pilot test and remedy. The approach used here is decidedly preferable to other, untried approaches given the purpose and time constraints associated with this evaluation.

THE INDEPENDENT PANEL OF REAL ESTATE INVESTMENT EXPERTS

Jean C. Felts, (New Orleans, LA) Vice-President, Waguespack, Dupree and Felts. Ms. Felts has had extensive experience in appraisal review of industrial and commercial real estate developments and carries the professional designations of CRE and MAI. She is also a member of the Urban Land Institute, the Real Estate Board of New Orleans and the Louisiana Realtors Association.

James A. Graaskamp, (Madison, WI) Professor and Chairman, Department of Real Estate and Urban Economics, the University of Wisconsin. Dr. Graaskamp is also the head of Landmark Research, Inc. He has written numerous books and articles on real estate investment. He has acted as a consultant to the Society of Real Estate Appraisers, the Mortgage Bankers of America and the Urban Land Institute. Dr. Graaskamp has received numerous academic and professional awards. His title includes the professional designations of: SREA, CRE and CUPU.*

William N. Kinnard, (Storrs, CT) Professor of Finance and Real Estate, University of Connecticut. Dr. Kinnard has received numerous academic and professional awards. He has written numerous books and articles on real estate and, in addition to being a certified Realtor, Dr. Kinnard carriers the designations of SREA, MAI, CRE, ASA, CMI.*

Robert T. Kist, (St. Louis, MO) Midwest Regional Vice-President, the Equitable Life Assurance Society of America. Mr. Kist is also a member of the Governing Council of the American Institute of Real Estate Appraisers and is also a member of the Board of Directors of Downtown St. Louis.

Richard D. Marshall, (Newark, NJ) LLB, Professor of Management, Graduate School of Management, Rutgers University. Mr. Marshall has been a Senior Investment Analyst and Senior Mortgage Loan Appraiser for the Prudential Life Insurance Company of America. He is the author of many articles on real estate investment. He is a member of the Board of Directors of the Trust for Public Land and the Rutgers University Minority Investment Company (among others). He is a certified Review Appraiser of the National Association of Review Appraisers and an associate member of the Society of Real Estate Appraisers.

Thomas F. Murray, (New York, NY) former Executive Vice-President and Chief Investment Officer, the Equitable Life Assurance Society; former member, Board of Directors, U.S. Chamber of Commerce; member of numerous corporate boards, among them: Franklin Savings Bank, Equitable Mortgage and Realty Investors, American Property Investors, Inc. (President), and Paine Webber Cash Fund. Mr. Murray is also a member of the following professional organizations: Urban Land Institute (President, 1975-1977), Real Estate Board of New York, New York Society of Real Estate Analysts, and SREA.*

Robert M. O'Donnell, (Denver, CO) President, HOH Associates. Since 1947, Mr. O'Donnell has led the planning for major shopping center developments, new communities and other residential developments. He is also a Trustee of the Urban Land Institute and has served on numerous panels dealing with national and international housing and development issues.

David Scribner, Jr., (Storrs, CT) Center for Real Estate and Urban Economic Studies. Mr. Scribner is a specialist in real estate investment analysis. He has many years of experience in analyzing cash flow projections, economic feasibility studies and marketing studies. He is a member of SREA and ASA.* He is the author and contributing author of a number of articles on real estate investment. Mr. Scribner has an MBA from the University of Connecticut with a specialization in Real Estate Finance.

Maury Seldin, (Washington, DC) Professor of Real Estate, College of Business and Administration, The American University; President and Board Member, Homer Hoyt Institute; Principal, Metro Metrics, Inc. Dr. Seldin has authored and co-authored several books and an extensive number of articles in real estate finance and development. He is a member of the board, American Real Estate and Urban Economics Association: Member, Board of Governors, George Washington Chapter of Lambda Alpha; Member, Washington Board of Realtors; Member American Society of Real Estate Counselors; Research Fellow, Urban Land Institute. Dr. Seldin served as coordinator of the panel but did not review any of the projects.

Arthur M. Weimer, (Bloomington, IN) President of Weimer Business Advisory Service; Chairman, Business and Real Estate Trends, Inc.; President, Foundation for Economic and Business Studies; former Dean of the Graduate School of Business, Indiana University; former Professor of Real Estate and Land Economics. Dr. Weimer is a member of several corporate boards. He is the co-author of a leading text on real estate and has written extensively in the field.

---

* Abbreviations for professional real estate organizations are:

ASA	The American Society of Appraisers
CMI	Certified Member of Institute, Institute of Property Taxation
CPCU	Certified Property Casualty Underwriter, College of Property Underwriters
CRE	Counselor of Real Estate, American Society of Real Estate Counselors
MAI	Member Appraisal Institute, The American Society of Real Estate Appraisers
SREA	Senior Real Estate Analyst, Society of Real Estate Appraisers

same project would have occurred in the same place and time without UDAG funding. In addition, partial substitution occurred in 13 percent of the projects. In these cases, some part of the project did not depend on UDAG

SUBSTITUTION			
Full	Partial	Inconclusive	None
8%	13%	15%	64%

funding. In 15 percent of the projects, there was some, but not sufficient, evidence to suggest that substitution might have occurred. Finally, in two out of three projects, the UDAG was clearly needed in order for the project to go ahead. 1/

The percentage of projects having substitution is approximately the same for projects funded in the early months of the program as those funded since that time. In addition, there appears to be no project type (commercial, industrial or neighborhood) which is more likely than any other to have substitution. Likewise, no difference appears to exist between small city and metropolitan city projects in terms of the frequency of substitution.

As stated above, UDAG projects are obligated to meet both requirements of the Wydler Amendment: UDAG funds should not substitute for private or non-Federal public funds; and the private investment should be

1/ In addition to projects involving substitution, three projects had grants or loans significantly in excess of the amount needed to obtain the same private investment. In these projects the UDAG was clearly needed, but the grant or loan was inefficient. A smaller grant/loan could have leveraged the same level of private investment.

contingent on the Action Grant. The amount of UDAG funds allocated to projects or project components which fail either of these requirements is equal to 17 percent of all UDAG dollars expended. 1/

Evidence of Full Substitution. Conclusive evidence that full substitution occurred was found in six projects (8%). Five of the six projects involved the substitution of Federal for private funds. In one project, Federal funds substituted for local funds. The following kinds of evidence led to these conclusions:

- o Existence of commitments to fund the same project (either publicly or privately) prior to applying for UDAG funding.
  - * Example: In a large industrial expansion, in which UDAG paid the major cost of a sewer line, there was irrefutable evidence of commitment between the firm and the city indicating that if the city did not receive a UDAG the firm would pay for its share of the sewer line. The UDAG was clearly unnecessary for leveraging the private investment.
- o No clear relationship between private investment and UDAG funded public improvements.
  - * Example: UDAG funded parking, street improvements and a pedestrian plaza in a downtown. In this case, however, the private investment bore no relationship to the public improvements. The major component of the private investment was a new office building located three blocks away from the nearest UDAG-funded improvement. The additional parking provided by UDAG is not related to the new office

---

1/ It should be noted that in the sample of projects examined for this study, one project alone accounts for nearly half of all of the substituted dollars. Although on some dimensions this project could be considered an outlier -- it has the largest private investment of any project in the sample and a leverage ratio of 30:1 -- the Action Grant, though large, is not the largest of sampled projects. Therefore, it is appropriate to retain this project in the sample despite its disproportionate impact on the number of substituted dollars. See Appendix A for further discussion of the calculations of substituted dollars.

building; the developer provided parking on lots adjacent to the new building.

- o Instances where, in the opinion of the expert panel, there was sufficient financial feasibility for the project to have occurred without UDAG and where evidence gathered from the field demonstrated a prior private commitment to the project.

  * Example: In a housing project where a UDAG was funded to help solve a drainage problem in the area, the panelists pointed out that under ordinary procedures of subdivision development, the future homeowners would have been assessed for the cost of correcting the drainage problem. Additional evidence made it clear that the same project would have been undertaken without UDAG because: (a) the developer had been building and selling homes in the same area for two years prior to funding; and (b) the demand for housing was strong due to the availability of below market financing provided by the state. The additional cost associated with a special assessment was unlikely to temper the demand for the housing.

Evidence of Partial Substitution. Conclusive evidence that partial substitution occurred was found in ten projects (13%). In these cases, some component of the project would have been developed in the absence of an Action Grant. Evidence of these findings falls into two categories:

- o Instances where the developer or lender indicated that a smaller or different project would have gone ahead in the absence of a UDAG.

  * Example: In one project, the developer stated that he would have built the smaller shopping mall that he had planned to build (and even started on) prior to considering UDAG funding.

  * Example: In a project where UDAG funded the paving of streets in an industrial park expansion, the president of one of the firms that moved in stated than his firm would have located in the park without the provision of paved streets.

- o Projects where the expert panel believed that a smaller or different development was economically feasible and where there was evidence from the field that the UDAG only induced a larger development than otherwise would have occurred.

  * Example: In one office/retail complex where UDAG funded the costs of clearing the site for development, the expert panel pointed out that the office component of the new building was economically feasible on its own. The lender for the the project stated that the bank (also the developer) had been planning to build an office building (without the retail complex) on the site and indeed, would have done so in the absence of UDAG funding.

Projects Considered Inconclusive. Fifteen percent of projects are categorized as inconclusive on the substitution issue because the evidence is mixed.

* Example: In a large industrial expansion, a firm required a below market loan and additional infrastructure in order to expand in a distressed city. The firm considered moving to a non-distressed city. This project appeared to be an example of substitution because the site proposed for expansion was owned by the major stockholder in the firm (who stood to make a large profit). Also, the claim that the firm needed below-market financing was not well documented and the city might have been able to set up a special arrangement with the firm on the assessments for the water and sewer lines. The project was categorized as inconclusive because: (a) the firm had considered another site and may have relocated; (b) there was some evidence that they were already heavily in debt and unlikely to be able to obtain market-rate financing; and, (c) it was uncertain whether the city would have been willing to provide a special arrangement on assessments.

Projects With No Evidence of Substitution. For the majority of projects (64%), there was no evidence of substitution. In these cases, the UDAG was clearly needed, though for a variety of reasons.

- o Extraordinary site development costs.

  * Example: In a downtown commercial development, the UDAG covered only the cost of making the site suitable for development. The site had not been previously developed due to the prohibitive cost of providing the concrete footings to correct for poor soil conditions. The site was the only undeveloped parcel in the city that had the necessary access for a commercial development. The project would not have been economically feasible without UDAG.

- o Genuine financing gap.

  * Example: In a downtown revitalization project, the developers were unable to obtain sufficient private financing despite a thorough search. A UDAG second loan provided by the city allowed the project to go forward.

- o Necessity of public improvements to allow private investment to occur.

  * Example: A farmers' cooperative in a small town was unable to expand its operation due to the lack of a large enough site that also had water and sewer lines. An Action Grant allowed the city to fund the infrastructure to a site it annexed, and a private investment was made that was not otherwise possible.

- o Extraordinarily high risk.

  * Example: Although a developer considered rehabilitating a 50-year old vacant industrial building in the CBD of a distressed city, the risk was too great for him to proceed. The project was speculative; no prospective tenants for the building were in sight, and it was the first new or rehabilitated office construction in this city in over ten years. A below-market rate UDAG loan induced the developer to take on the risk and proceed.

Possible Changes in the Definition of Substitution

The findings presented above are based on a definition of substitution that accounts for the manner in which the program operates as well as for legislative intent. However, the location and timing criteria used above could be altered to address different questions.

For example, the location criterion used above takes into account area-specific economic development goals of distressed cities. This criterion could be changed to incorporate whether the investment would have taken place anywhere in the city without UDAG. This change in the location criterion would result in an additional three projects being reclassified as instances of partial substitution. However, such an alteration in the definition is less consistent with the intent of the program since it is left to the discretion of distressed cities to determine how to focus aid in the form of UDAG subsidies and because up to July, 1981, the legislation allowed the use of UDAG funds for "reclamation of neighborhoods having excessive housing abandonment or deterioration."1/

It would also be possible to change the timing criterion to increase it from a one-year limit to a three-year limit; by expanding the time horizon, however, the reliability of the analysis is decreased due to an increase in the level of uncertainty regarding future investment decisions. By reanalyzing the sampled projects using this definition, it is likely that, with a three-year limit, the instances of full substitution would increase by one project and the instances of partial substitution would increase by three.

Alternatively, the timing criterion could have been dropped completely. Thus, any project which would have proceeded (either in whole

---

1/ The 1981 Amendments to Sec. 119 of the Housing and Community Development Act drop any reference to neighborhoods. See U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, Report to Accompany S.1197, May 15, 1981, p. 22.

or in part) at some unspecified time in the future would be counted as a project with full or partial substitution. This change would result in a small number of additional projects being reclassified as full or partial substitution. Such reclassification would necessarily be quite speculative in nature, however, as it requires judgments about what developers would do in the future and requires making assumptions about future interest rates, future demand for products and services, and future development trends of cities. It is, therefore, inappropriate to include such additional cases in the substitution findings.

Review of Applications for Substitution

Substitution occurs in projects for different reasons, not all of which are attributable to the current review process. In some instances, it is due to inadequate standards of review that applied at the time that the project was funded, but which subsequently have changed. The review process has evolved over time, with standards becoming increasingly stringent. Given the amount of substitution found in this study, however, it is apparent that the review process is still not completely adequate.

Since the passage of the Wydler Amendment, the program has required a written statement from developers specifying that they would not build the project "but for" UDAG. This is the principal test for substitution. When reviewers have serious doubt about the validity of the developer's "but for" statement, they use a variety of techniques to examine the assertion. For example, the UDAG staff may delay consideration of a project for a few months to see if the project will go ahead on its own. In addition, recently, reviewers have negotiated with developers to allow

EXPERT PANEL'S SUGGESTIONS FOR MINIMIZING SUBSTITUTION

The expert panelists all concluded that insufficient attention has been paid by UDAG reviewers to real estate/financial investment analysis in funding projects. In their opinion, a better undstanding of real estate development and a more thorough analysis of project feasibility on the part of the UDAG staff would help to avoid the occurrence of substitution. Panelists made the following observations and suggestions on improving the process of reviewing projects:

- The current policy of relying on a "but for" letter from a developer is an insufficient substitute for a thorough feasibility analysis. Some letters are vaguely written and, besides, may not be legally binding.

- The current policy of relying on a lender's willingness to loan funds for a project as a measure of project feasibility is not always adequate. This is especially true if a lender is not completely disinterested, as is the case when the lender is also the developer or will be a major tenant in the new development.

- In all cases, any market study or feasibility analysis used by the lender should be passed on to HUD for review.

- The feasibility analyses done by Economic Market Analysis Division (EMAD) reviewers in HUD's Area Offices have not been sufficiently taken into account in some funded projects. Frequently, the EMAD reviewer's conclusion that a project is infeasible appears to have gone unheeded.

- There has been insufficient consideration of possible alternative available sites and their current value.

- There was insufficient information about surrounding land uses in some project files. Panelists suggest that better maps and photographs be required as part of the application because they believe that real estate analysis cannot be done without site visits. Short of that, better information about the site and its surroundings is recommended.

- Better information is needed on the market value of land, commercial and office space, and parking space. Panelists suggest greater reliance on independent appraisals.

the city to share in the future profits of the development. This technique is based on the assumption that developers will only agree to such requirements if the UDAG is essential; otherwise, they are likely to withdraw their request for a subsidy.1/ In extreme cases, senior UDAG staff may stress to a developer that any misrepresentation of the need for an Action Grant is fraudulent. Finally, reviewers sometimes contact disinterested local developers and lenders to obtain their opinions about the requirement for UDAG funding.

The current review process does not emphasize the market demand for, or economic feasibility of, proposed projects. Commercial developments are the exception to this practice; for these, reviewers do closely examine projected cash flow statements and potential profitability. For the most part, however, the program relies on a private lender's willingness to lend on a project as the principal test of feasibility. This lack of emphasis on feasibility raises the issue of whether UDAG reviewers can fully determine when a proposed project has the potential to succeed without UDAG assistance.

1/ One piece of evidence which supports this assumption is the fact that although 16 percent of projects in the sample include "kickers" (profit sharing provisions), none of the projects found to have substitution have one.

III. Impacts

(2) Study team projections consist of estimates of what UDAG projects will ultimately produce in terms of private investment, jobs, revenues and housing units -- including available actual results for projects which are already fully or partially operational. They are derived from extensive discussions, first-hand observations, and a review of appropriate documents done during site visits to 80 project locations. These projections are based on the best available present knowledge of each project's current status and expected accomplishments.

(3) Study team discounted projections take into account the extent of substitution of UDAG funds for private or non-Federal public funds and, therefore, represent, the net benefits of UDAG with respect to the amount of leveraged private investment, jobs created, taxes generated, and housing provided. Because a project's impacts can only be attributed to the Urban Development Action Grant program if the investment would not have occurred without the Grant, impacts are discounted to disregard the effects of entire projects or certain project components which do not represent UDAG-stimulated investment.

IMPACT MEASURES

Originally anticipated impacts: These are the impacts that were originally anticipated to result from UDAG projects. They were made at the time of the signing of the projects' grant agreements.

Projected impacts: These are impact estimates that were obtained by the study team. They are estimated outcomes as of the time when projects are fully operational.

Projected (discounted) impacts: These are projected impacts, which are discounted in order that only those attributable to UDAG are included.

In Sections 3-6, originally anticipated impacts are compared, first, to the study team's projected impacts and, then, to the discounted projected impacts. These sections cover: (a) leveraging, (b) jobs, (c) fiscal effects, and (d) housing.

In addition to primary impacts, UDAG projects may also cause a variety of positive and negative secondary impacts. These are discussed in Sections 7-10 and include: (a) spin-off investment activity -- additional investment in construction or expansion of other business firms stimulated by UDAG projects; (b) off-site impacts on existing businesses -- effects on the level of business activity of firms located off the sites of UDAG developments; (c) business relocation -- the displacement of businesses associated with UDAG developments; and (d) household relocation -- families relocating as a result of UDAG projects.

A final section compares the impacts of industrial, commercial and housing projects.

Leveraging of Private Investment

3

An important measure of the UDAG Program's success in stimulating new investment in distressed places is the number of private dollars invested for each UDAG dollar. UDAG projects are, in fact, generating more private dollars than had been anticipated when grant awards were made, although a large amount of this is due to cost overruns in which no additional jobs or other benefits are attained. Disregarding any private investment that would have occurred without the UDAG subsidy, the program leverages an average of 5.5 private dollars for each UDAG dollar -- a small decrease from the 6.3 private dollars that were originally anticipated.

Since one-half of the UDAG projects involve additional public funds, the private investment is being stimulated by both UDAG and these other public monies. For every public dollar (UDAG plus other public grants) spent on a project, there are 4.4 private dollars invested.

UDAG funds are awarded to distressed cities in order to stimulate economic activity by attracting private investment. Proposed projects are judged, in part, by the amount of private investment that is "leveraged" by the Action Grant. Three questions regarding leveraging are addressed in this section. First how many private dollars are stimulated by each UDAG

Preceding page blank

dollar? Second, how many private dollars are leveraged by each public dollar (including UDAG, as well as other Federal, state and local funds) involved in UDAG projects? Third, for what reasons is the level of private investment in UDAG projects often different from that originally expected?

Calculation of the UDAG Leverage Ratio

In examining the impacts of the UDAG program, an important indicator of program efficiency is the amount of private investment stimulated by each UDAG dollar, referred to as the leverage ratio. The UDAG leverage ratio is (a) the dollar amount of private investment in the project divided by (b) the dollar amount of the Action Grant. To determine the number of private dollars leveraged by each UDAG dollar for the projects examined in this study,1/ an average UDAG leverage ratio is computed by, first, calculating the UDAG leverage ratio for each project and, then, taking the average of these individual ratios. 2/

Private Investment Leveraged by UDAG

To evaluate UDAG's leverage effects, the following three ratios are compared: (a) the average UDAG leverage ratio originally anticipated at the time that grant agreements were effected; (b) the average UDAG leverage ratio projected to exist at the time that projects are fully operational, and (c) the average UDAG leverage ratio projected after discounting for

---

1/ The leveraging analysis presented in this section is based on information from 79 projects. One of the 80 sampled projects is excluded from this analysis because it was terminated very shortly after the sample was drawn. No UDAG dollars were spent on this project and the UDAG amount for the project has been subtracted from the overall UDAG totals -- both anticipated and projected.

2/ This procedure reduces the effect of any outlier (i.e., an atypical project) on the calculation of the overall ratio.

substitution (i.e., subtracting out private dollars that would have been invested without UDAG). Projections (b) and (c) are based on information obtained on-site from the projects' developers, lenders and city development officials.

The originally anticipated average UDAG leverage ratio, which is based on private investment expected at the time of the grant agreement, is 6.30:1; that is, it is estimated that each UDAG dollar would stimulate, on average, $6.30 of private investment. Study team projections indicate that UDAG's leveraging ability will be even greater than expected: $7.10 of private investment will be stimulated by each UDAG dollar. This increased leveraging is due to a 19 percent increase in private investment while the UDAG investment is virtually unchanged.1/

After discounting for substitution, however, UDAG's projected leveraging ability drops to 87 percent of its originally anticipated level. Thus, after subtracting out private investment which was not generated by UDAG, study team findings indicate that each UDAG dollar stimulates $5.50 of private investment.

Private Investment Leveraged by Total Public Funds

In addition to the UDAG subsidy, 51 percent of the projects examined for this study have received other public funds. These other public monies may be Federal (e.g., Community Development Block Grant funds), state (e.g., a grant from a state economic development agency), and/or local (e.g., general revenues to be utilized for infrastructure).

1/ Two-thirds of this increase is due to a single project, in which private investment is projected to be $100 million greater than originally anticipated.

TERMINOLOGY: PRIVATE DOLLARS

Private Dollars (as used in computing leverage ratios*):

- Include the full amount of all unsubsidized private investment, e.g., equity and market rate loans.
- Include the present value** of all directly subsidized loans, such as UDAG loans and leases, as well as other low-interest loans made by public agencies (e.g., the Economic Development Administration or the Small Business Administration).
- Include the full value of industrial revenue bonds, Government National Mortgage Association (GNMA) financing and guaranteed loans with a guarantee of 90 percent or less.
- Exclude private investment for working capital, capital equipment which is moveable or has a depreciable life of less than 7 years, commitments for tenant improvements made after the preliminary UDAG award, acquisition costs for occupied buildings, developers' fees, and all investment occurring prior to the preliminary award.

---

* This definition of private dollars is the same as that currently used by the UDAG staff when they calculate UDAG leverage ratios.

** The present value of a loan is the total value, in current dollars, of the amount to be paid to the lender; i.e., future payments are "discounted" to reflect the fact that income to be received in the future is worth less than receipt of the same amount of income today. For the purpose of this analysis, a "discount rate" of 11% was used to calculate the present value of loans.

These other public funds may also be responsible for stimulating some of the private investment occurring in UDAG projects. As a result, in those projects with both UDAG and other public funds, it may be inaccurate to state that UDAG funds alone leveraged all of the private investment. Therefore a second way to examine leveraging -- in addition to looking at the UDAG leverage ratio --is to determine the amount of private investment stimulated by the total amount of public dollars that go into a project.

PRIVATE INVESTMENT LEVERAGED BY UDAG
(in millions of dollars)

		Projected*		Projected (discounted)	
	Originally Anticipated	Amount	Percent of Anticipated	Amount	Percent of Anticipated
Total Private Dollars	$816.0	$968.4	119.0%	$446.0	55.0%
Total UDAG Dollars	$117.1	$116.6	99.6%	***	***
Average UDAG Leverage Ratio**	6.3	7.1	113.0%	5.5	87.0%

* For the 21 projects which were fully operational in June 1981, the "projected" investment is the actual investment.

** Note that the ratios are not determined by dividing the total private dollars by total Action Grant dollars. Rather, the ratios are calculated by determining the leverage ratio for each of the 79 projects and then averaging these 79 ratios.

*** Projected UDAG dollars are not discounted. Therefore, this information is not applicable.

The total public leverage ratio is (a) the dollar amount of private investment in a project divided by (b) the dollar amount of public funds in a project. To determine the number of private dollars leveraged by each public dollar for the projects examined in this study, an average total public leverage ratio is computed. 1/

1/ The computation of the average total public leverage ratio is comparable in all respects to the computation of the average UDAG leverage ratio.

TERMINOLOGY: PUBLIC DOLLARS

Public Dollars (as used in computing leverage ratios):

- o Include all Action Grant dollars.
- o Include all other Federal, State, and local grants.
- o Exclude all non-UDAG subsidized government loans.

Based on investment figures contained in project grant agreements, each public dollar was originally anticipated to leverage $5.25 of private investment. Projections made by the study team of private investment that will occur when the projects are fully operational indicate that public funds will have a slightly greater leveraging ability than had been anticipated: $5.42 of private investment will be stimulated by each public dollar. After discounting for substitution, however, the average total public leverage ratio drops to 84 percent of what was anticipated -- to $4.41 in private investment for each public dollar. 1/

Reasons for Changes in Private Investment

As indicated earlier, the non-discounted projected leverage ratio for the UDAG projects examined is 19 percent greater than originally anticipated. There is considerable variation among projects, however, in the magni-

1/ It is possible that projects in which UDAG dollars substituted for private dollars may have needed the other public funds. The analysis of substitution done for this study only examined whether the UDAG subsidy was needed.

PRIVATE INVESTMENT LEVERAGED BY TOTAL PUBLIC DOLLARS
(in millions of dollars)

	Originally Anticipated	Projected		Projected (discounted)	
		Amount	Percent of Anticipated	Amount	Percent of Anticipated
Total Private Dollars	$816.0	$968.4	119%	$446.0	55%
Total Public Dollars	$173.3	$183.1	106%	*	*
Average Total Public Leveraging Ratio	5.3	5.4	103%	4.4	84%

*Projected total public dollars were not discounted. Therefore, this information is not applicable.

tude and direction of change, as well as in the factors responsible for such changes. In 56 percent of the projects examined for this study, there is or will be an increase in the amount of private investment; there will be decreases in only 9 percent.

There are three basic reasons for increases in private investment. First, in 40 percent of the projects with investment changes, cost overruns account for the entire increase. Such overruns occurred either because costs were underestimated or because of delays in project construction that increased the costs of materials and/or financing. For example, one UDAG project included a downtown parking garage and an adjacent office building. The costs of the office building escalated substantially over those originally anticipated, due to increases in materials and supplies.

REASONS FOR PRIVATE INVESTMENT LEVELS IN UDAG PROJECTS ABOVE THOSE ORIGINALLY ANTICIPATED

	Cost Overrun Only	Change in Scope/ Design Quality Only	Cost Overrun and Change in Scope/ Design Quality	Other	Total
Percentage of Projects With Increased Private Investment Level	40%	31%	24%	4%	100%

Second, in 31 percent of the projects with investment increases, scope or design quality changes have affected the cost of the project. For example, in a downtown revitalization project, the scope was increased since participation ultimately included several more small businesses than originally anticipated. This increased participation meant, in turn, increased private investment in the project.

Third, in 24 percent of the projects with investment increases, a combination of cost and scope changes are responsible for the increase. For example, in a housing construction project, costs increased because the developers decided to build more housing units than originally planned and costly delays were experienced in the start-up of construction.

Some increases in private investment can be explained by each of these. However, 86 percent of the net increase in private investment is attributable to cost overruns. Thus, very little of the increase in private investment in UDAG projects will produce additional benefits, such as more jobs.

NET INCREASE IN PRIVATE INVESTMENT DUE TO COST OVERRUNS

Total Projected Private Investment (in 79 projects)	$968 million*
Total Originally Anticipated Private Investment	-$816 million
Net Difference	$152 million*
Amount Attributable to Cost Overrun	$131 million*
Cost Overruns as a Percent of Net Difference	86%

*Includes a $100 million cost overrun on a single project.

Jobs Created and Retained

4

A major objective of the UDAG program is to increase the number of jobs in distressed cities. Detailed review of the projects examined for this study indicates that the program will produce a majority (77%) of the jobs that were anticipated at the time that awards were made. After discounting for the effects of substitution, an additional 15 percent of all anticipated jobs can not be attributed to the program; this means that UDAG can claim credit for 62 percent of its original job goal. Projects produce fewer jobs than expected because of errors, made at the time the grant is awarded, in calculating ultimate employment levels for projects and, less often, because of unexpected economic difficulties.

Using the most stringent method of calculating the cost per job created (not counting those that would have occurred anyway without the UDAG grant), each job will cost 11,570 UDAG dollars. While this is 62 percent higher than originally anticipated, it compares favorably with other Federal job-creating programs. A substantial portion of the jobs stimulated by the UDAG program to date is at low- and moderate-income wage levels. Most of these are clerical, sales, service work, and laborer positions.

One of the main purposes of the UDAG program is to assist distressed cities in creating new permanent employment and, to a lesser extent, in

Preceding page blank

retaining existing jobs.[1] In addition, UDAG requires that, to the extent possible, new job creation is to be targeted to low- and moderate-income persons.

Three main issues guide the analysis of employment in this section. The first is whether UDAG is actually achieving its employment-related objectives. Specifically, will the projects produce the number of new and retained jobs that are anticipated at the time the awards are made? These originally anticipated employment levels, and any modifications which are made to them, are contained in the UDAG project files or grant agreements. To assess the extent to which the program is reaching its

TERMINOLOGY: JOBS

A new permanent job is a full-time equivalent permanent position which did not exist previously within the distressed city or urban county and which was created by the UDAG project.

A retained job is a full-time equivalent permanent position which existed prior to the UDAG project within the distressed city or urban county. Without the UDAG project, this job would have been abolished or moved to a location outside the distressed city or urban county.

A low-and moderate-income job is a full-time equivalent position that pays the worker no more than 80 percent of the median income earned by all workers in the local market (based on the earnings of a family of four).

1/ This evaluation does not address whether UDAG is responsible for a net increase in the number of jobs nationally. While this may be a valid question, the legislative intent of the program is to create or retain existing jobs only in economically distressed cities. Some, although probably not all, of the jobs associated with UDAG would, most likely, have been created in non-distressed cities or counties where the perceived economic risk would be less and the private sector more prone to invest without any public inducement.

employment goals, employment data were gathered during site visits to 80 projects.

A second job-related issue is the cost, in Action Grant dollars, per job created. This is one indicator of how efficient UDAG is as an economic development tool.1/ Cost-per-job data are presented in three different ways to allow for comparison: the cost of each originally anticipated job; the cost of each projected job (based on new data obtained first hand at each project site); and the cost per projected job after subtracting out those which would have been created without the UDAG subsidy. Comparisons of these three figures will indicate how closely the program's projected job creating efficiency measures up to what was originally anticipated when the UDAG awards were made.

A third issue concerns the occupational classifications of jobs created to date and the extent to which such jobs offer low- and moderate-income wages, 2/ are filled by minorities, or filled by those eligible for the CETA program.3/

New Permanent Employment

As of June 1981, the sample of projects examined for this study

---

1/ As used here, efficiency is a measure of resources used to achieve a certain goal. Resources in this report are UDAG dollars and the goal is job creation.

2/ The analysis in this section refers to low- or moderate-income wage levels associated with the jobs created on UDAG projects and not to the income status of those filling the jobs.

3/ CETA is the Comprehensive Employment and Training Act administered by the U. S. Department of Labor. The analysis here includes not only those who may have participated in CETA (and who subsequently found employment on a UDAG project), but also those who would qualify for training under the program if they applied for it.

had generated almost 5,000 new permanent jobs, 76 percent of which had low or moderate wage levels. This total represents just under 31 percent of the new jobs originally anticipated for these projects and reflects the fact that almost 83 percent of these projects, even though far along in terms of construction, are not yet operational or fully hired up. 1/ Therefore, in addition to current employment as of June 1981, detailed projections of the employment levels that will be reached when these projects are fully operational were also obtained from developers and permanent employers. 2/ When these new employment projections are compared to employment that was originally anticipated in the grant agreements, it appears that UDAG projects will produce 77 percent of anticipated jobs. Put another way, collectively, these projects will miss their original job goal by 23 percent.

1/ A substantial lag exists between the extent of construction completion and when permanent hiring is completed. In most cases, new permanent jobs (not construction jobs) are filled once all of the construction is completed.

2/ For the projects which are fully operational, these projected figures equal the current figures, but in all other projects which are not completely operational, the current new employment figures are lower than the projected figures. In obtaining revised employment estimates for this study, intensive field study tracking occurred and interviews were held with relevant individuals. Two days, on average, were spent by HUD staff researchers at each of the 80 project sites. During this period, interviews were held with a variety of people to obtain accurate job data. In addition, whenever possible, access was also gained to employment records for further verification. In sum, these estimates are more reliable than the estimates contained in Quarterly Progress Reports submitted by cities because these estimates rely on multiple sources including interviews with city officials, developers, construction firms, and permanent employers. When necessary, multiple employment estimates were combined into one employment projection.

NEW PERMANENT JOBS GENERATED BY UDAG

	Originally Anticipated	Projected		Projected (Discounted)	
		Number	Percent of Anticipated	Number	Percent of Anticipated
Total Jobs	16,235	12,558	77%	10,077	62%
Low/ Moderate Income Jobs	9,258	7,519	81%	6,589	71%

Differences Between Originally Anticipated and Projected Jobs

Although, in the aggregate, UDAG will produce fewer jobs than had been anticipated, one-fifth of the sampled projects will employ more people than originally anticipated and 13 percent will exceed original estimates by at least 20 percent. The creation of more jobs than had been anticipated is due to a variety of reasons, including: increases in the size or scope of some projects which necessitate more employment; greater-than-expected increases in the volume of business which necessitate more employment; or under-calculation of anticipated employment levels at the time the projects were initiated. The following examples illustrate why some projects will experience more employment than had been originally anticipated.

* Example: Due to greater-than-expected private sector investment, a downtown rehabilitation and land reclamation project was able to provide more retail space than was specified in the grant agreement. This led to an increase in project scope and to a 64 percent increase in new, permanent full-time employment over that required by the grant agreement.

* Example: According to the grant agreement, a small-city industrial firm committed to create 50 new permanent jobs. At the time of this study, however, new employment had already exceeded expectations by 30 percent. According to the plant manager, an increase in business volume necessitated the addition of shift work (and more jobs) but no change in the scope of the UDAG project.

* Example: When the grant agreement was signed, the developers of an office building generated pessimistic employment estimates. This was due to the fact that no tenants had yet been identified. At the time of this study, however, the developers had attracted a major tenant and their revised new employment estimates exceeded the grant agreement by 700 percent.

While one-fifth of UDAG projects will do considerably better than expected in terms of job creation, about one-third will miss their employment objectives by at least 20 percent (which is roughly the average for all projects in the sample). This job shortfall most frequently results from miscalculations made at the time that grant agreements are signed. These miscalculations occur for a variety of reasons: because it is sometimes very difficult to make adequate job estimates in advance; because of overly optimistic expectations; because part-time positions were originally counted as full-time; or because retained jobs were counted as new permanent jobs. Just over one-third of those projects with at least 20 percent job short-falls have experienced some sort of financial problems, including a very few cases of project termination or bankruptcy. The following examples illustrate why some projects will not fulfill anticipated employment goals.

* Example: Employment in a large-city industrial firm is well below the anticipated level and may never equal it. The employer's current projection is that new employment will reach only 36 percent of that specified in the grant agreement. Factors contributing to this condition include: working capital shortage; excessive employee turnover; poorly operating equipment; and the cancellation of a major contract by a national firm.

* Example: Due to unfavorable economic conditions, an employer involved in a small-city commercial project cancelled plans for expansion of its headquarters facility. As a result, this project will generate only one-third of the new employment referenced in the grant agreement.

Discounting For Substitution. As discussed above, some UDAG-funded projects would have been completed in whole or in part without UDAG dollars, i.e., they were viable without Federal assistance. Therefore, some or all of the new permanent employment associated with these projects would also have been generated without UDAG funds. When this is taken into account, the program will generate 62 percent of the new permanent employment that was originally anticipated. 1/

Retained Employment

In addition to creating new jobs, another employment objective of the UDAG program is to assist distressed cities in retaining existing jobs that would otherwise leave. Only about 22 percent of all UDAG projects funded through the end of fiscal year 1980 are expected to retain jobs and, according to UDAG staff, less emphasis is given in their evaluations of UDAG applications to retained jobs than to new permanent employment. Although this lack of emphasis is due, in part, to the greater importance attached to creating new jobs, it is also due to the problems associated with

---

1/ The employment data are reduced on a project-by-project basis for those projects determined to have either full or partial substitution. For projects with full substitution, all of the jobs are subtracted from the revised estimates of employment generated by UDAG since they would have occurred regardless of the Action Grant. For those projects with partial substitution in which, for example, one component of the project would have gone ahead without the UDAG, only those jobs associated with that part of the project are excluded or subtracted.

knowing whether a job is really being retained -- that is, would the job have been lost to the city if the UDAG project were not funded. Discussions with many developers and permanent employers reveal that they did not use a uniform definition when they estimated the level of retained employment associated with their projects. As a result, some misclassifications occurred. For the purposes of this analysis, a retained job is one that existed within the distressed city prior to the UDAG project and that would have been lost to the city had the UDAG project not gone forward. In other words, there should be evidence that an employer would move to the suburbs of a distressed city, move to a nondistressed city, or go out of business if UDAG assistance were not provided.

RETAINED EMPLOYMENT GENERATED BY UDAG

	Originally Anticipated	Projected	Projected (Discounted)
Total Jobs	4,189	3,214	2,400
Percent of Originally Anticipated		77%	57%

The projected employment that will be retained when UDAG projects are fully operational is 23 percent less than anticipated in UDAG project files. Put another way, 77 percent of the original goals for job retention will be met. Most of the shortfall can be attributed to the original misclassification of these jobs -- i.e., some developers and permanent employers labelled certain jobs as retained when, in fact, they would not have been lost to their distressed cities in the absence of UDAG funding. Only two

falling short of retained employment goals will do so because of decreased project scope.1/

Discounting For Substitution. As is the case with new permanent employment, the net impact of UDAG on job retention can be determined only after the effects of substitution have been considered. When compared to UDAG's anticipated employment retention figures, after discounting for substitution, UDAG projects will reach 57 percent of their retained job goal -- a figure comparable to that found for new permanent jobs.

Job Shortfall By Project Type

In total, 61 percent of all originally anticipated new permanent and retained jobs are projected (after discounting for substitution) to be attained by the time the projects are fully operational. This pe varies widely by project type, however. At one extreme, the projected (discounted) jobs for industrial projects is 51 percent of that originally anticipated -- and, for commercial projects, the comparable number is 53 percent. At the other extreme, neighborhood projects (which produce relatively few jobs) attain 93 percent of the originally anticipated jobs.

Costs Per Job

The cost to the Federal government of creating new jobs through the UDAG program is an indicator of how efficient the program is as an economic

---

1/ The sample contains only 15 projects which are expected to retain jobs in their cities.

NEW AND RETAINED JOBS GENERATED BY UDAG
BY PROJECT TYPE

	Originally Anticipated	Projected Number	Projected Percent of Anticipated	Projected (Discounted) Number	Projected (Discounted) Percent of Anticipated
Jobs in Industrial Projects	6,589	4,602	70%	3,355	51%
Jobs in Commercial Projects	9,617	7,031	73%	5,108	53%
Jobs in Neighborhood Projects	4,308	4,139	96%	4,014	93%
Total: Jobs in All Projects	20,514	15,772	77%	12,477	61%

development tool. In turn, this efficiency can be compared to similar figures for other Federal programs that create jobs.

New Permanent Employment. Using the detailed projections of new permanent employment, it will cost 9,284 UDAG dollars for every new permanent job created. This is 29 percent higher than the 7,142 UDAG dollars per job that that were anticipated at the time that grant agreements were signed, and represents an average UDAG cost increase of almost $2,100 per job. 1/

The UDAG dollars-per-job figure increases even more when the extent of full and partial substitution is considered. Discounting for substitu-

1/ The sampled projects received a total of $116,588,000 in UDAG grants and are projected to create 12,558 new permanent jobs prior to accounting for substitution. This yields the $9,284:1 ratio reported above.

COST-PER-JOB CREATED AND/OR RETAINED BY UDAG

	Originally Anticipated	Projected		Projected (Discounted)	
		Cost	Percent of Anticipated	Cost	Percent of Anticipated
New Permanent Jobs	$7,142	$9,284	130%	$11,570	162%
New Permanent and Retained Jobs	$5,683	$7,392	130%	$ 9,344	164%

tion results in a UDAG cost of $11,570 per job. This is, on average, $4,400 higher than had been originally anticipated, and it represents an increase of 62 percent.1/

Twelve percent of the projects examined for this study are not expected to generate any new permanent jobs; they were approved because they provide for other types of benefits.2/ If these projects are excluded from the calculations, the projected ratio of UDAG dollars-to-jobs decreases to $10,624 (discounted). This compares to an originally anticipated cost of $6,552 per job and is still 62 percent higher than anticipated.

Comparison with Other Job-Cost Ratios. One way to assess UDAG's job

1/ The discounted new permanent employment estimate for the sample is 10,077 jobs and the total value of UDAG awards is $116,588,000.

2/ Nine of these are "housing only" projects and one is a mix of housing and commercial components. This last project, despite a commercial component, is not expected to create any new jobs.

creating efficiency is to compare its cost-per-job figure with those for other Federal programs that create or save jobs. These comparisons can give a rough idea about whether UDAG's costs are high or low and, thus, are useful evaluation tools. Such comparisons are difficult to make, however, and should be viewed with some degree of caution because of (a) substantial differences among programs in design and objectives, and (b) significant data and/or methodological problems.

Program variation is the biggest obstacle in making comparisons. Programs vary, for example, in terms of the types of subsidy given (that is, whether direct loans, loan guarantees, or outright grants); they also vary in the purposes for which the money can be spent. UDAG does not provide any guaranteed loans as does the Economic Development Administration's (EDA) Business Development program. The use of guaranteed loans reduces program costs per job in two ways: program outlays occur only when the guarantee is called (which is in a minority of cases) and the guarantee tends to reduce financing costs. Furthermore, EDA's loans are given mostly for working capital to businesses while UDAG grants/loans are usually for construction and are, therefore, more capital intensive. Unlike EDA, UDAG also pays for public costs, such as cities' administrative costs and needed public infrastructure.

Programs also vary in the extent to which Federal funds cover a portion or all of development costs or costs of creating jobs. At one end of the continuum is EDA's Local Public Works Program which involves no private contribution; it creates construction jobs through local public works projects at an average public cost of over $60,000 per job. 1/ EDA's

---

1/ U.S. Department of Commerce, Local Public Works Program: Final Report. (Washington, DC: U.S. Department of Commerce, December 1980), p. 29.

Business Development Loan program covers, on average, one-half of development costs while UDAG usually contributes less than one-fourth of project costs. Finally, Federal programs vary in terms of the areas eligible to receive program benefits. For instance, business loans made by the Farmer's Home Administration go to rural areas which are short of private credit while the UDAG program gives funds to urban areas designated as economically distressed.

Data or methodological problems also present difficulties in across-program comparisons. First and foremost, cost-per-job data are not available for all programs, and the data which do exist vary considerably in quality and reliability. Second, different programs have varying requirements (some have none) concerning substitution, and no other analysis of job costs discounts for substitution in the manner done in this study. 1/

Because of these programmatic and data-related issues, any comparison between UDAG and other Federal programs is somewhat tentative. However, the one program which is closest to UDAG in design and for which data exist on cost per job is EDA's Business Development program. To facilitate comparison, the cost figures are, in both cases, deflated to 1979 dollars and UDAG figures are not discounted for substitution. 2/ When these comparisons are made, the UDAG program's costs appear to compare

---

1/ See Abt Associates, Inc., Development of a Crosscut Evaluation System, Phase 1: Draft Final Report. (Cambridge, MA: Abt Associates, November 1980.)

2/ The dollar figures have been deflated by multiplying each by an approximation to the 1979 Fixed Non-Residential Investment deflator. See p. 16 of Abt, op. cit.

favorably with those of EDA, both for new permanent jobs and for all jobs -- whether new or saved. 1/ UDAG's cost for creating new permanent jobs is 12 percent less than EDA's, while its cost of creating or saving a job is 20 percent less.

JOB COST COMPARISONS: UDAG vs. EDA

	Cost Per New Permanent Job Only	Cost Per New Or Saved Permanent Job
EDA	$9739	$8538
UDAG	$8586	$6837
UDAG cost per job as a percentage of EDA cost per job	88%	80%

Total Employment Including New and Retained Jobs. Total new jobs and total retained jobs can be added together to assess the UDAG cost of all permanent jobs supported by UDAG projects. In this regard, the undiscounted cost per job is $7,392 while the discounted cost is 9,344 UDAG dollars per job. 2/ The discounted costs represent a 64 increase over the originally anticipated costs of $5,683 per job.3/

1/ In addition to the method employed here, an alternative measure of job creating efficiency is to compare the percentage of total job creation costs borne by a program. In this regard, UDAG is more efficient than most other Federal programs. See: Judith V. May, "Leveraging Performance of Federal Economic Development Programs." (Washington, DC: U.S. Department of Housing and Urban Development, May 1981.)

2/ The sample is projected to generate 15,772 new permanent and retained jobs before accounting for substitution, and 12,477 jobs after accounting for substitution. The UDAG awards remain constant at $116,588,000.

3/ The percentage difference between anticipated and projected ratios does not change if only the 70 projects which are expected to generate permanent jobs are included in the calculations.

Characteristics of Employees and Types of Jobs

Most of the permanent jobs created to date appear to be lower level blue collar and white collar positions. For example, 70 percent of the new jobs already created are sales, clerical, services, or unskilled laborer positions. These positions generally offer wages or salaries close to or below 80 percent of the area-wide, household median incomes for cities in the sample. There are variations, however, in the kinds of jobs created to date by type of project. On the one hand, over 40 percent of the new jobs in industrial projects are either craftsman or operative positions. Those persons hired for these jobs are likely to be skilled and to earn incomes at or above area-wide medians. On the other hand, almost 50 percent of the new jobs created so far in neighborhood and commercial projects are sales or clerical positions and are likely to be low-paying.

As indicated above, 62 percent of the originally anticipated new permanent jobs are projected (discounted) to be attained by the time the projects are fully operational. For new permanent low- and moderate-income jobs, however, the projects are somewhat closer to the original levels -- it is projected that 71 percent of the anticipated low- and moderate-income jobs (discounted) will be attained. Nearly two-thirds of all projected jobs will have low- and moderate-income wage levels.

The majority of employees hired to date have low- or moderate-incomes and just over one-fourth had been previously unemployed. About one in ten of the new permanent jobs created so far are filled by those who were part of, or qualified for training under, the CETA program. Many of these are included among those previously unemployed. Just over one-fourth of the new jobs created to date are filled by minorities.

DISTRIBUTION OF NEW PERMANENT JOBS AMONG CATEGORIES

	Industrial Projects	Commercial Projects	Neighborhood Projects	Total For All Projects
Professional and Managerial Jobs	14%	17%	20%	17%
Sales and Clerical Jobs	13%	43%	45%	36%
Craftsman and Operative Jobs	40%	1%	8%	13%
Service Worker and Laborer Jobs	33%	39%	27%	34%
Total	100%	100%	100%	100%*

* The percentages in this table are based on 4,993 new permanent jobs in existence in the 80 sampled projects at the time of the site visits (June 1981).

Construction Employment

In addition to assisting with job creation and retention of new permanent positions, the UDAG program also produces short-term construction employment.

Projecting the level of construction employment, however, is more complicated than estimating new permanent or retained employment. For the most part, construction jobs are not full-time positions and they are not expected to last for extended periods. Rather, construction firms continually hire craftsmen, as the job progresses, for relatively short-term

work. The problem, then, is to transform the number of construction workers employed on a particular UDAG site into comparable "full-time equivalent" (FTE) positions, i.e., the total number of full-time positions all construction work would represent. As examples, two construction workers, each employed on a UDAG site for four hours per day for a full year, would equal one FTE construction job; four workers, each employed four hours per day for 26 weeks, would also equal one FTE construction job.

As of the time that data were collected for this study (June 1981), the sampled projects had generated almost 9,400 FTE construction jobs, which represents three-quarters of the total construction employment originally anticipated. Given that, on average, 79 percent of the construction on these projects had been completed as of that date, construction employment so far appears to be on target.

Only 15 percent of the construction jobs created have paid low- or moderate-income wages. This low figure contrasts with the comparatively high (76%) figure for new permanent jobs. The difference is explained by by the higher pay scale in the construction trades relative to most of the new unskilled jobs being created in the UDAG projects. 1/

1/ The use of UDAG funds in a project requires that construction firms pay Davis-Bacon wages to employees (i.e., the "prevailing wage" in an area must be paid to construction workers). The data generated for this study, however, do not permit any conclusions as to whether project costs may be increased (and, if so, by how much) as a result of Davis-Bacon application.

Tax Revenues Generated

5

The total amount of local tax revenues generated by UDAG projects is projected to fall short of the amount that was originally anticipated by as much as 40 percent, before allowing for substitution, and by as much as 50 percent, after discounting. There are several possible explanations for this shortfall, including: the highly variable quality of procedures used to estimate anticipated tax revenues by the city and to review these estimates by HUD; changes that occur in projects subsequent to their original design that affect revenues; and the possible inclusion, in the original revenue estimates, of taxes that do not go directly to the city (such as state sales taxes). Additional analyses indicate that property tax yields directly attributable to UDAG projects may be less than comparable yields from other taxable properties. This suggests that cities may be applying an informal, as well as formal, form of tax abatement as an additional means of supporting these economic development activities.

The contribution of a UDAG project to a city's economic development is measured, primarily, by the amount of employment and private investment stumulated by the UDAG subsidy. There are, however, other ways to measure its contribution, such as the amount of tax revenues that each new project

Preceding page blank

generates. UDAG's mandate is to help to alleviate urban distress, and one way this is done is by enhancing the local tax base. Of course, UDAG can only be given credit for such tax base enhancement if the projects it supports would not have been developed without the program.

Taxes Generated by UDAG Projects

At the time that HUD makes a preliminary award of an Action Grant to a city, the city estimates the amount of taxes that the project will generate. 1/ These figures, then, consitute the originally anticipated tax impacts of the project. During the course of this evaluation, city officials provided the study team with information on taxes generated to date. In addition, they explained and updated, systematically and in detail, their original estimates of the revenues to be produced when their projects become fully operational.2/ The updated projections are compared with the

1/ Unlike employment and private investment impacts of each UDAG project, fiscal impacts are not specified in grant agreements.

2/ Revenue projections were made based on the information provided; the quality of these projections varied considerably, however, among projects. The quality depends upon such factors as whether the project was fully assessed and/or fully operational at the time of the site visit. The quality of the tax information available from each of the projects examined in the study was rated by the field study staff. For the analysis presented here, only information from the 40 projects where the staff rated the information as "very " or "somewhat" reliable is included. Although these 40 projects constitute 56% of the 71 projects with available information, they will produce only 36% of the projected (discounted) taxes from the 71 projects. The explanation is that revenue information for smaller projects has a greater probability of being classified as "very" or "somewhat" reliable. This, in turn, reflects the fact that smaller projects were more likely to have been completed and/or assessed at the time of the site visit.

earlier estimates to determine whether UDAG projects will, indeed, produce the originally anticipated amount of tax revenues.

For several reasons, which are discussed below, the UDAG program will not stimulate as much tax revenue as has been anticipated. Before taking substitution into consideration, UDAG projects will generate 61 percent of the taxes that had been anticipated at the time that grant awards were made; after subtracting out those projects or project components that would have occurred without UDAG, it will generate one-half of the amount that had been originally anticipated.1/

Revenues can be divided into property and non-property taxes. Looking at these categories separately does not alter the conclusion that the program falls short of its originally anticipated tax impacts. After discounting for substitution, 54 percent of anticipated property taxes and 46 percent of anticipated non-property taxes are projected to be generated.

Another way to assess tax impacts is to compute the total amount of local taxes that will be generated for each dollar of UDAG funds expended. Compared to an originally anticipated amount of 14 cents per dollar, it is projected (after discounting for substitution) that UDAG projects will generate 7 cents for each UDAG dollar -- 50 percent of the amount estimated at the time of preliminary award. 2/

1/ Although this finding is based on a subsample of 40 of the 80 projects examined for this study, virtually identical findings result if data for the full set of projects are used.

2/ See Footnote 1/ above.

TOTAL LOCAL TAXES GENERATED BY UDAG PROJECTS*

	Originally Anticipated	Projected Amount	Projected Percent of Anticipated	Projected (discounted) Amount	Projected (discounted) Percent of Anticipated
Total Taxes**	$5.4	$3.3	61%	$2.7	50%

* All dollars figures in this table are presented in millions.

** See footnote 2, page 2.

Explanation for the Revenue Shortfall

There are three possible explanations of why projected tax revenues will be about one-half of what was originally anticipated.

First, the methods and procedures used to estimate future tax revenues tend to be highly variable from place to place, and the quality of these procedures is uneven. This means that, in some cases, city officials are inaccurately estimating the amount of tax revenues to be generated for their cities. These inaccuracies are often not identified in the project review process for several reasons. Unlike employment and investment goals, revenue goals are not incorporated into grant agreements between the city and HUD; therefore, less attention is given by HUD reviewers to revenue estimates than to other anticipated impacts. Also, UDAG officials, and even city officials who prepare grant applications, are unlikely to have complete knowledge of all the potential tax consequences of the projects proposed for funding. In addition, HUD does not require applicant cities to provide a thorough account of how estimates are derived. It follows from all the above reasons that complete verification is impossible in many instances. Whatever procedures and methods are used to compute

PROPERTY AND NON-PROPERTY TAXES GENERATED BY UDAG PROJECTS *

	Originally Anticipated	Projected Amount	Projected Percent of Anticipated	Projected (discounted) Amount	Projected (discounted) Percent of Anticipated
Property Taxes **	$2.8	$1.8	64%	$1.5	54%
Non-Property Taxes**	$2.6	$1.4	54%	$1.2	46%

* All dollar figures in this table are presented in millions.

** See Footnote 2, page 2.

originally anticipated tax revenues, in the aggregate, the direction of bias is toward overestimation.

Second, changes may have occurred since the time when the original computations were made. For instance, prior to funding, some projects are substantially modified in scope, but it is not clear that revenue estimates are always modified in concert with such changes. As another example, significant increases or decreases in local property tax rates may have occurred since the original estimates were made.

Third, UDAG estimates may contain numbers reflecting fiscal benefits not actually accruing to the cities. Estimated property taxes may not all be for the exclusive use of funded cities; they may include tax revenues which are collected by the city, but transferred to other levels of government. In some cases, state sales or income taxes which will not be benefitting the city directly might be included in the original estimates, thus overstating the city's likely revenues.

TOTAL LOCAL TAXES PER UDAG DOLLAR

	Originally Anticipated	Projected Amount	Projected Percent of Anticipated	Projected (discounted) Amount	Projected (discounted) Percent of Anticipated
Total Taxes Per UDAG Dollar*	$.14	$.08	57%	$.07	50%

* See Footnote , page 2.

Projected Property Taxes Compared With Cities' Effective-Tax Rates

Another way to estimate property tax revenues is to apply the effective tax rate (ETR) of a city to the value of all private investment in its UDAG projects. This suggests the amount of property taxes that a development might be expected to pay if taxes were levied at the average rate prevailing in the city. While data are not available to compute these estimates for all projects, ETR calculations can be made for 36 projects for which U.S. Census of Government data are available. 1/ For each of these projects, effective property tax revenues are obtained by multiplying the total private investment by the city's ETR. These are then compared with the study team's projections of taxes to be generated by the same projects. The latter are only 50 percent of the estimates derived by the ETR method.

1/ An effective property tax rate (ETR) for a city is the average property tax rate for all types of real property. An ETR is a nominal tax rate, adjusted for tax exemption and assessment at less than full market value. The 1976 ETRs, which are the most recent available, were used in this analysis.

There are several potential explanations for the difference between the two estimates. First, not all types of private investment in UDAG developments may be counted as taxable property by city governments. However, most of the UDAG investment would be expected to be counted, since it goes largely for physical structure and nonmoveable fixtures and equipment, both of which are usually taxable by cities. Second, effective tax rates are inclusive of some taxes which may not have been included when making projections. However, the opposite may also true: projections may include taxes which were not included by the Census Bureau in deriving effective rates.

Third, 1976 effective rates may imperfectly reflect 1981 rates (although they are probably fairly accurate for 1978 and 1979 (the years when the UDAG estimates were made for most of the sampled projects). Finally, a large number of projects funded by UDAG receive formal tax abatement (16 of the 36 projects were accorded at least partial property tax abatement).

Despite these caveats, it appears that property tax yields directly attributable to UDAG projects may be less than the yields from other taxable properties. The implication is that "informal" abatement may be occurring as well as formal tax abatement. The large difference between "expected" and projected revenues for UDAG projects is further confirmation of distressed cities' desires to retain or attract economic activity; formal or informal abatement is a major means by which cities can encourage private sector investment to improve their fiscal health or, at least, stem decline.

PROJECTED PROPERTY TAXES GENERATED BY UDAG PROJECTS, COMPARED WITH EXPECTED PROPERTY TAXES*

	Expected, Using ETR Method ***	Projected	
		Amount	Percent of Expected
Property Taxes, 36 Selected Projects **	$7.0	$3.5	50%

* All dollar figures in the table are presented in millions.

** The set of 36 projects includes all projects where information on the city's effective property tax rate (ETR) is available from the U.S. Census of Governments.

*** The "expected" property taxes to be generated by each project is computed by multiplying the private investment in the project by the city's effective property tax rate (ETR).

Housing Provided

6

Nineteen percent of the UDAG projects examined for this study contain housing elements of one sort or another. These projects vary considerably from new construction to housing rehabilitation to conversion of non-residential buildings for residential purposes. Ninety percent of the more than 5,000 housing units originally anticipated in these projects at the time of the grant agreements will be realized. Since, however, four of the projects would have been undertaken fully or in part without UDAG assistance, the number of units that can be attributed to UDAG is 74 percent of the number originally anticipated. The UDAG cost per housing unit will be 33 percent higher than expected.

Until recently, the Action Grant legislation included specific language about "reclamation of neighborhoods." 1/ To date, about one-third of UDAG-funded projects are classified as neighborhood because of the legislative requirement for a balance of project types. 2/ These

---

1/ The original UDAG legislation (P.L. 95-128, Section 110) included this language. The 1981 amendments (contained in "Omnibus Budget Reconciliation Act of 1981") deleted this. See Conference Report (to accompany H.R. 3982) of July 29, 1981.

2/ Legislative amendments in 1981 abolished the requirement of a reasonable balance among project types.

projects are either industrial, commercial, or housing (or some combination of these) and are designated as "neighborhood" if the benefits of the project are aimed at a neighborhood or its residents. This section briefly examines those projects which are exclusively or partially housing in nature.1/ Most, but not all, of the housing projects examined in this study are designated as "neighborhood" projects. These housing projects make up 19 percent of the sampled projects.

Types of Housing Projects

There is considerable variety in the types of housing projects funded by UDAG. Of the 15 housing projects included in this study, four involve new construction (one of which is for Section 8 rental units), five provide for the rehabilitation of existing homes and multifamily buildings, five are conversions of non-residential buildings (a schoolhouse, an office building, a department store and two hotels) to residential use, and one offers assistance to home purchasers in the form of lowered interest rates.

The number of housing units provided or assisted also varies from project to project. The smallest provides four new sales units, while the largest involves the rehabilitation of 1,500 houses (3,000 units).

UDAG funds in these projects are most commonly used for site improvements or infrastructure, but are also used for a wide variety of other purposes. These include land acquisition, land writedown, household relo-

1/ Since the number of housing projects in the sample is small, generalizations about the universe of all UDAG housing projects, in general, will not be highly statistically reliable.

cation, second mortgage loans, rental subsidies, rehabilitation subsidies, and a mortgage interest pool for subsidizing home purchase interest rates.

Housing Generated

The 15 housing projects were originally anticipated to produce and/or assist 5,316 units. Based on data gathered from developers, city officials and others at the time of this study, it is projected that 90 percent of these units will actually be generated. A reduction in units in one large project accounts for most of this change. 1/

In four of the housing projects (those with full or partial substitution), UDAG funds were not necessary to stimulate the development, purchase or rehabilitation of 840 units. Seventy percent of these units are attributable to one project. If these units are subtracted from the projected figures, UDAG is responsible for 3,922 units, which is 74 percent of the units originally anticipated.

Costs per housing unit vary widely from project to project and, because of the very different kinds of housing activities, an average unit cost figure for these projects is not very useful. However, comparisons of anticipated and projected costs are meaningful -- and costs have risen. Before discounting, the projected UDAG cost per unit is only nine percent higher than anticipated. Subtracting those projected units which did not need the UDAG subsidy, the UDAG cost per unit is 33 percent higher than originally expected.

1/ The number of units was revised downward in this project to less than one-half of the original target because of higher-than-estimated rehabilitation costs and insufficient demand.

HOUSING GENERATED BY UDAG*

	Originally Anticipated	Projected Number	Projected Percent of Anticipated	Projected (discounted) Number	Projected (discounted) Percent of Anticipated
No. of Housing Units	5,316	4,762	90%	3,922	74%
UDAG Dollars Per Unit**	$2,198	$2,403	109%	$2,913	133%
Total Public Dollars Per Unit	$2,561	$2,972	116%	***	***
Total Project Cost Per Unit	$15,919	18,586	117%	***	***

* Data were collected on 15 housing projects. Since this number is small, generalizations from these data about all UDAG housing projects cannot be considered highly reliable.

** For projects with both housing and non-housing components, the costs presented here include only the costs associated with the housing components.

*** Not applicable.

Population Served

Most of the housing projects are located in deteriorating or transitional neighborhoods. Only about half of the projects, however, are targeted to low-income or moderate-income households. In eight of the 15 housing projects, there is no specified income targeting and units are generally priced for middle-income or upper-middle-income households.

Spin-off Investment Activities

7

UDAG projects may indirectly stimulate other private investment activity in distressed cities. Actual or expected spin-off investment was found in 48 percent of the projects studied. An additional seven percent of the projects created the infrastructure or positive investment climate for potential future investment. Small city projects are more likely to generate spin-off investment activity than those located in metropolitan cities; and commercial and neighborhood projects are more likely than industrial projects to involve spin-offs.

In addition to the private investment directly associated with UDAG projects, these projects may indirectly stimulate other private investment activity (new construction or expansion) in distressed cities. A UDAG project was determined to involve such spin-off investment when: (a) the investment activity was not located on the UDAG site; (b) such activity followed the announcement of the UDAG-funded project; and (c) evidence obtained led to the conclusion that this investment was very much influenced by the UDAG award. Spin-off activities were classified as actual,

Preceding page blank

expected or potential. Actual spin-offs involved construction or expansion already underway at the time of the site visits; expected spin-offs were those where specific plans existed for the additional investment. Spin-offs were classified as potential when the UDAG project involved the installation of infrastructure that could be used by another investor, or the creation of a strong positive investment climate which could induce more investment sometime in the near future.

Actual or expected spin-off investment activity was found in 48 percent of the projects examined for this study. An additional 7 percent created the potential for further investment.

UDAG PROJECTS WITH SPIN-OFF INVESTMENT ACTIVITIES

	Actual Spin-offs	Expected Spin-offs	Potential Spin-offs	No Spin-offs	Total
All UDAG projects (n=80)	39%	9%	7%	45%	100%
Metropolitan city projects (n=56)	34%	7%	4%	55%	100%
Small city projects (n=24)	50%	12%	17%	21%	100%
Industrial projects (n=22)	23%	0%	23%	54%	100%
Commercial projects (n=28)	50%	7%	0%	43%	100%
Neighborhood projects (n=30)	40%	17%	3%	40%	100%

In 39 percent of the projects, actual spin-offs were found.

* Example: In a medium-sized Northern city, a UDAG was used by the city to build a pedestrian connector system between a previously vacant building and a department store. This once-vacant building had been acquired by the city and leased to a private developer who, in turn, converted the building into commercial-residential use. In an effort to take advantage of the increased pedestrian traffic resulting from the connector system, department stores on both sides of the converted building, collectively, spent approximately $800,000 in renovations.

Nine percent of the projects had expected spin-offs.

* Example: In a small Midwestern city, a UDAG was used by the city to provide water and sewer extensions to a retail and service center that had been developed by a farmers' cooperative. Immediately adjacent to the site of this retail and service center, plans are presently underway by a related farmers' cooperative to go ahead with the construction of a food distribution warehouse expected to involve about $750,000 in private investments.

Seven percent of the projects created the potential for additional investment.

* Example: In a Southern city, a UDAG was used by the city to construct a water line serving a newly constructed plant that manufactures wooden parts used in furniture. Although no other investment activity in the immediate area of the plant could be attributed to the UDAG-funded water line at the time that this city was visited, this infrastructure is expected to attract and service future industries that may construct their plants somewhere along this water line.

Small city projects are more likely to generate spin-off investment activity than those located in metropolitan cities. Sixty-two percent of the small city projects involved actual or expected spin-offs, compared to 41 percent of the metropolitan city projects. An additional 17 percent of the small city projects created the potential for further investment, compared to four percent of the metropolitan projects.

Among all of the UDAG projects examined for this study, commercial

and neighborhood projects were more likely than industrial projects to have actual or planned spin-off investment activity. The commercial and and neighborhood categories have 57 and 59 percent, respectively, of their projects involving these spin-offs, compared to 22 percent of the industrial projects. However, industrial projects are much more likely to create the potential for future investment (23% of the projects), than either commercial (0%) or neighborhood (3%) projects.

Off-Site Effects on Existing Businesses

8

UDAG-funded projects have had a secondary impact on off-site existing businesses in 45 percent of the projects examined for this study. In the majority of these cases, the impacts were positive. They most often involved commercial projects where the commercial/retail sector adjacent to them benefited through an increase in sales volume. In a few cases, business activity was negatively affected by UDAG projects; all of these cases involved businesses directly competing with those being supported through the UDAG.

UDAG projects may have an impact on the business activity (e.g., sales employment) of existing local firms located off the site. Off-site firms may be affected because of their proximity to the UDAG development or because they compete directly with the UDAG-funded project. Data on the nature and extent of such impacts were obtained from developers, lenders, city officials, and other interested parties. It is not possible at this time, however, to determine the longer-term impacts of UDAG projects on the business activity of a city as a whole. For example, it is not known whether, and to what extent, UDAG projects will result in a shift of business activity from one part of a city to another.

Off-site business activity has been affected in 45 percent of the projects examined for this study. Although both positive and negative impacts have occurred, positive impacts (i.e., increases in business activity) are found in 35 percent of the projects studied, while purely negative impacts are found in only five percent of the projects. An additional five percent of projects provide mixed results (i.e., both positive and negative impacts).

In small cities, UDAG projects are associated with off-site business activity in a little over half of the projects compared to 40 percent of those in metropolitan cities. This difference between city types may, however, only reflect the relative difficulty of identifying and attributing these impacts in a larger city. In both metropolitan and small cities, about three-fourths of the impacts are positive.

UDAG PROJECTS WITH IMPACTS ON EXISTING BUSINESSES

	Positive Impacts	Negative Impacts	Mixed Impacts	No Impacts	Total
All UDAG projects (n=80)	35%	5%	5%	55%	100%
Metropolitan city projects (n=56)	32%	4%	5%	59%	100%
Small city projects (n=24)	42%	8%	4%	46%	100%

By far the largest proportion of off-site impacts is associated with commercial projects. Three-fourths of the commercial projects caused off-site changes in business activity compared to 38 percent of the neighborhood and 17 percent of the industrial projects.

A typical project with positive impacts is a commercial development where the commercial/retail sector adjacent to it benefited through an increase in sales volume.

* Example: A three-story UDAG shopping mall was built in the declining retail district of a large Northeastern city. The stores immediately adjacent to the mall reported increased sales after the mall's opening, and the nearby stores expect to benefit from the increase in pedestrian traffic in the area.

* Example: Several UDAG projects involve the construction of multi-story office buildings, many of which include parking facilities. Such a project in a city in the South is expected to boost the sales of the surrounding commercial/retail sector, not only because of the net influx of office workers, but also because the additional parking facilities make the area a more attractive and accessible shopping district for the city's residents.

Projects with negative impacts are those involving businesses in competition with UDAG-supported firms.

* Example: A multi-story office building was constructed in a commercial business district where vacancy rates for other, off-site office buildings were high. The landlords of the off-site buildings will be hurt if their tenants choose to rent space in the UDAG-developed building.

* Example: A neighborhood UDAG project to construct a small shopping center is likely to cause a decrease in sales for another older retail center close by.

Business Relocation

9

An important program impact is the extent to which businesses operating on what become UDAG sites will be displaced by UDAG developments. Business displacement is found in one-quarter of the sampled projects. All of the displaced businesses received or will receive monetary compensation from the city. In the short run, three-fourths of them seem not to have been adversely affected by the displacement, while 25 percent of them have experienced negative effects.

UDAG-funded developments may cause displacement of existing, on-site businesses since these projects often involve the demolition or renovation of business structures. A displaced business is one that must relocate to continue in operation. Data on displacement were obtained from city relocation specialists who are responsible for monitoring and administering relocation compensation in all UDAG projects. Twenty-five percent of the projects involved business displacement.

Collectively, these projects displaced 81 separate businesses. Most of them displaced three or fewer businesses with the largest amount occurring in one commercial development which affected 14 firms. All of those

Preceding page blank

displaced are small businesses, ranging from one-person enterprises to firms employing up to 30 workers. Examples of types of business enterprises affected are rooming houses, pawn shops, restaurants, a furniture store, beauty salons, a costume maker, a plumber, and a tool and die manufacturer.

Metropolitan city projects account for a larger proportion of displacement than small city projects: thirty percent of the former resulted in relocation, compared to 13 percent of the latter. Among project types commercial projects are more likely to cause displacement than others: 36 percent of commercial projects involved displacement compared to 26 percent of industrial and 14 percent of neighborhood projects.

UDAG PROJECTS WITH BUSINESS RELOCATION

	Percent of Projects with Business Displacement	Percent of Projects with No Business Displacement	Total
All UDAG projects (n=80)	25%	75%	100%
Metropolitan city projects (n=56)	30%	70%	100%
Small city projects (n=24)	13%	87%	100%

All but one of the displaced businesses have received, or will receive, monetary compensation. Compensation was received for leasehold interests and moving expenses, and assistance was often provided in finding new locations. Most often, the compensation was funded through

HUD's Community Development Block Grant (CDBG) program; in some projects, however, a portion of the UDAG funds was earmarked for this purpose. In the one project that did not provide compensation, the business displaced was a State-owned and operated liquor store.

Some of the displaced businesses were, or will be, adversely affected by their displacement. A firm was considered to be adversely affected if it: (a) subsequently went out of business; (b) relocated, but found the new site less desirable, or experienced a reduction in sales after relocation; or (c) was involved in litigation with the city because the amount of relocation compensation was in dispute. About one-fourth of the 81 displaced firms had been adversely affected at the time of this study. Two-thirds of these firms, including the State liquor store, had already gone out of business.

It is too early to determine the longer-term effect on all the displaced firms. Many of the affected businesses have not yet relocated and, for others, not enough time has passed to judge the impact of the relocation on sales. As of this time, however, far fewer displaced businesses have been adversely affected by UDAG than will relocate and successfully continue operations on other sites.

Household Relocation

10

Household relocation is not involved in most UDAG projects. Only 19 percent of the projects examined for this study have caused any household relocation and, in all cases, the extent of relocation was anticipated at the time of project approval. Relocation assistance, usually financial help provided under the Uniform Relocation Act, was provided in each of these projects to almost all families who were displaced. Most of these households have low or moderate incomes and pay, on average, about one-third more for housing after their moves.

One possible reason why so little relocation has resulted from UDAG projects is that 24 percent of them are located on urban renewal sites which had been cleared at an earlier date.

Household relocation is a policy issue in the UDAG program because an earlier HUD program, Urban Renewal, caused extensive amounts of relocation. This often created significant local opposition to Urban Renewal and, in some cases, the opposition blocked or postponed successful completion of projects.1/

1/ Martin Anderson, The Federal Bulldozer (Cambridge,MA: The MIT Press, 1964).

Preceding page blank

The extent of relocation that will be caused by proposed UDAG projects is a selection factor used during the UDAG application review process. Projects that will cause minimal amounts of involuntary displacement are more competitive or attractive than those that will cause extensive relocation.[1]/ This section examines the extent to which funded projects involve relocation of households and the extent to which assistance is provided.

HOUSEHOLD RELOCATION

Percentage of projects causing household relocation:	19%
Number of households relocated, as originally anticipated:	430
Number of households relocated, as projected:	448
Number of households relocated, as % of number anticipated:	104%
Average annual household income of relocated households:	$6,600
Average financial assistance provided to relocated households:	$6,000

The majority of UDAG projects do not cause any relocation of households. Of the 19 percent that do, relocation was, in all cases, anticipated at the time of the UDAG application. Similarly, the total number of households actually needing to relocate is only four percent greater than

1/ The current HUD policy is to extend coverage of the Uniform Act to all aspects of a UDAG project, including activities which do not receive direct federal assistance. See U.S. Department of Housing and Urban Development, UDAG Program Regulation: Supplementary Information, Section 570.457.

originally anticipated in the project applications. Most of these households (85%) remain in the same city.

The vast majority of households that have been relocated have low or moderate incomes with the average being $6,600. Although they receive financial and personal assistance in moving, these households pay an average of about one-third more for housing after relocating. 1/

In most of the projects with relocation, financial assistance was provided under the Uniform Act. 2/ Renter households received varying amounts up to $4,000 in rental assistance, including security deposits, and up to $500 in moving expenses. Homeowners were paid up to $15,000 plus moving expenses. While project relocation costs tend to vary widely, they average $6,000 per household and account for an average of 2.4 percent of total project costs.

Other forms of assistance, including referrals, transportation, and telephone calls were provided for most projects. In several UDAG projects, some households were relocated into housing units which were eligible for HUD's Section 8 rental assistance payments or into public housing.

Household relocation is associated with all types of UDAG projects,

---

1/ The difference in rent-to-income ratios before and after relocation would provide a measure of increased burden, but such data are not available.

2/ Title I of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (84 Stat. 1894) established uniform policies for the fair and equitable treatment of persons, including businesses and associations, displaced as a result of Federal and federally-assisted programs. The responsible Federal agency pays for moving expenses, search expenses of businesses, losses of tangible personal property as a result of moving (or discontinuing a business), including payments for up to four years or stated maximums to assist in meeting higher rents or ownership costs.

but those which contain housing components account for over one-half of all relocation.1/ Household relocation is also more likely to occur in metropolitan than in small city developments and it often occurs simultaneously with displacement of businesses.

One factor that may contribute to relatively little relocation in the UDAG program is the frequency with which UDAG projects are located on sites that were originally cleared under the Urban Renewal program. Twenty-four percent of the UDAG projects reviewed for this study are either fully or partially located on urban renewal sites. Thus, some household relocation may have occurred earlier under Urban Renewal than later under UDAG. As these available sites decline in number in the future, the extent of household relocation among prospective UDAG applications may increase.

1/ A single project, which is a neighborhood housing project, is responsible for 37 percent of the households relocated in the sampled projects.

Comparison of Impacts by Project Type

11

Industrial projects require smaller subsidies than other UDAG projects in order to stimulate private investment, but, in the short run, it does not appear that they are as likely to stimulate other positive effects on businesses within the city as are commercial projects. The cost, in terms of UDAG funds, of creating new permanent jobs is somewhat similar for industrial and commercial projects. Housing developments do not appear to have many short-run economic development benefits. These projects may, however, have secondary impacts that could provide long-run benefits to distressed cities.

The preceding sections on impacts have examined the extent to which benefits anticipated at the time of the grant agreements have been or will be realized. This section compares industrial and commercial projects on several measures of economic development benefits, and separately discusses projects that produce or subsidize housing.

Until recently, the UDAG program has designated projects as "industrial", "commercial", or "neighborhood."1/ Projects are designated here by

1/ This requirement has been deleted by the 1981 amendments to the Housing and Community Development Act.

their primary characteristic except in the case of neighborhood projects. These can be either industrial, commercial or housing developments, and are designated as "neighborhood" if they involve housing or are located in a predominantly residential area or if they primarily benefit a neighborhood or its residents.

For purposes of this analysis, neighborhood projects are reclassified as either industrial, commercial or housing. 1/ The small number of housing projects, however, precludes comparison between these and commercial or industrial projects.

The following are used as indicators of economic benefits:

- o Projected (Discounted) UDAG Leverage Ratio. This ratio provides a measure of the total amount of private investment stimulated by UDAG at the project site.
- o Total Public Funds as a Percentage of Total Development Cost. This percentage gives an indication of the depth of public subsidy involved in a project.
- o Projected (Discounted) UDAG Cost Per New Permanent Job.
- o Recaptured Funds as a Percentage of UDAG Funds. To provide a measure of the value of the future income to distressed cities generated by the payback of loans, payment of leases, and "kickers," the present value of those payments is estimated. This figure is then divided by the UDAG funds expended.
- o Percentage of Projects with Relocated Households. This indicates the frequency of relocation associated with development projects.

1/ The reclassification of projects in the sample resulted in 33 commercial projects, 31 industrial projects, 10 housing projects and 5 projects that were a mixture of housing and commercial or industrial. Projects in this last category were excluded from this analysis.

- o Percentage of Projects with Positive Effects on Other Businesses in the City. This measures the short run effects of various project types on businesses within the city. Positive effects include increased sales volume for other businesses, as well as the stimulation of new business investment. This is only a measure of the frequency of indirect economic effects, since it is too early in the life of most projects to measure the magnitude of the effects in terms of increased sales, private investment, jobs and taxes.

- o Percentage of Projects with Tax Abatements. This measure provides a relative indicator of how frequently cities forego future income in order to encourage development projects.

Industrial Projects. Industrial projects have a much higher average leverage ratio than do commercial projects (6.30 as compared to 3.90). In terms of the total amount of subsidy required to stimulate private investment, industrial projects require substantially less. On the other hand, industrial projects are less likely, in the short run, to have positive effects on other city businesses. The percentage of commercial projects that cause positive effects on city businesses is twice that of industrial projects (79% vs. 39%). Using other measures of economic development impact, industrial projects compare less favorably with commercial projects. Industrial projects are three times more likely to cause household relocation than are commercial projects, and industrial projects generate a smaller amount of recaptured dollars as a percentage of UDAG funds invested.

Commercial Projects. The deeper subsidy found in commercial projects may be a function of the higher development costs associated with them. Such costs tend to be higher due to higher costs for well-located sites, requirements for the provision of parking, and higher quality buildings. Because the deeper subsidy often comes in the form of a loan, commercial projects generate a higher amount of recaptured funds.

They are also more likely, however, to have tax abatements which may partially offset the greater value of recaptured funds. 1/ The cost of creating new permanent jobs is somewhat similar for industrial and commercial projects ($9,619 and $10,827, respectively).

Although commercial projects require a deeper subsidy than industrial projects, they are more likely to have short-run positive effects on other businesses. Unlike industrial projects, the market effects of commercial developments appear to be more likely to remain within the city, at least in the short run. Although commercial projects appear to have positive effects on other businesses more frequently, it is too early in the life of most of them to determine the actual magnitude of these effects in terms new jobs, private investment, and taxes. A tentative finding, therefore, is that some tradeoff exists between the deeper subsidy required for commercial development and other short-run positive impacts that these projects generate.

Housing Projects. The inclusion of housing projects in the UDAG program has been criticized by some because housing directly provides fewer economic development benefits than commercial or industrial projects. Although the recent Congressional amendments to the UDAG legislation remove the emphasis on funding neighborhood projects, housing projects may be funded if, "such projects can be fully justified as contributing

---

1/ Data are not yet available to enable a comparison of (a) the magnitude of the recaptured funds in commercial projects with (b) the magnitude of the tax abatements in these projects.

COMPARISON OF ECONOMIC DEVELOPMENT IMPACTS OF
INDUSTRIAL AND COMMERCIAL PROJECTS

	Industrial (n=31)	Commercial (n=33)
Projected (Discounted) UDAG Leverage Ratio	6.30	3.90
Total Public Funds as a Percent of Total Development Cost	10%	25%
Projected (Discounted) UDAG Cost Per New Permanent Full Time Job	$9,619	$10,827
Recaptured Funds as a Percentage of UDAG funds.	11%	23%
Projects With Relocated Households	29%	9%
Projects With Tax Abatements	26%	46%
Projects With Positive Effects on Other Businesses within The City	39%	79%

to the revitalization of the community or the retention or creation of jobs." 1/

Although housing projects provide fewer direct economic development benefits than commercial or industrial projects, they may have substantial secondary impacts. For instance, a number of cities have used housing development as a part of an integrated strategy for overall city economic development. Some have proposed housing developments to increase the number of middle-income residents, which, in turn, may increase the aggregate demand for goods and services. This greater demand may, in turn, increase sales volume for businesses within the city since people are more likely to shop closer to home than to places of employment. 2/ Most housing projects also generate additional property tax revenues. Housing projects that do not serve to increase the supply of housing within the community are unlikely to have anything other than short-run economic development benefits. However, they may provide a one-time stimulus to the local economy in the form of increased construction employment.

1/ U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, Report to Accompany S.1197, May 15, 1981, p. 22.

2/ Karl E. Case, "The Role of Housing in Urban Development Strategies." Cambridge, MA: Urban Systems Research and Engineering, Inc., November 1980. (Report prepared for U.S. Department of Housing and Urban Development.)

IV. Explanations -- Why Some Projects Are Not Meeting Their Goals

Explanations -- Why Some Projects Are Not Meeting Their Goals

12

Some of the projects examined for this study will fail to produce expected benefits either because the Action Grant was not needed for all or part of the investment to have occurred or because prediction errors made at the time of the grant agreement caused benefits to be overestimated. Other projects are experiencing serious unforeseen difficulties that may constitute a real loss of benefits. At this time, about one in ten UDAG projects has a serious problem that either has or could substantially reduce its benefits. The sources of problems include changes in the national economy, the risk inherent in some types of development and, in one case, a violation of HUD's Grant Agreement. To date, the resulting actual or potential loss of benefits does not appear large in relation to the overall magnitude of the UDAG program.

A separate analysis of construction delays shows that 15 percent of the 80 projects will finish construction at least a year behind the original schedule. Of these, one has a serious problem and four have less serious or potential problems; in the others, the construction delays are not associated with any as-yet-identified problems that could lead to a substantial shortfall of benefits.

A UDAG project may not generate the expected level of benefits for one or more of the following reasons:

Preceding page blank

- o Substitution. Based on the analysis described in Section 2 and subsequently used in the reestimation of projected impacts, the benefits produced by some or all project components cannot be attributed to UDAG since these investments would have occurred anyway;

- o Miscalculation. As noted in the preceding discussion of impacts, prediction errors made at the time of grant agreement account for much of the downward revision in estimates of projected benefits -- especially for new permanent jobs and fiscal impacts; and

- o Unforeseen Problems. Another explanation for the shortfall in projected impacts is where projects are encountering difficulties not anticipated at the time grant agreements were made. These difficulties are, in most cases, financial -- often resulting from changes in the national economy.

This section first looks at the numbers of projects not producing all of their expected benefits, and then isolates the smaller number of projects where the loss of benefits indicates that unforeseen difficulties have arisen in carrying out the projects as planned.

The following questions are addressed:

- o How many projects are falling well short of the benefits predicted when their grant agreements were signed?

- o What proportion of projects have problems that either substantially reduce or threaten to substantially reduce their benefits? How many of these could be considered "serious" problems?

- o What are the kinds of problems encountered and their most frequent causes?

Numbers of Projects Producing Fewer than Expected Benefits

After discounting for substitution, a minority of projects will miss at least one of their planned impacts by 20 percent or more. The number of new permanent jobs will be substantially (20 percent or more) less than planned in 39 percent of the projects where new permanent jobs

were originally expected. The originally predicted private investment will be substantially less in 13 percent of the projects. The expected fiscal gains will be substantially short in 38 percent of the projects. Of the 15 housing projects in the sample, 7 percent will produce substantially fewer units than anticipated when the grant agreements were signed.

THE PROPORTION OF UDAG PROJECTS WHERE BENEFITS WILL FALL 20 PERCENT OR MORE SHORT OF ORIGINAL EXPECTATION, BY TYPE OF BENEFIT

	New Permanent Jobs (n=70)**	Leveraged Private Investment (n=80)	Fiscal Gain (n=80)	Housing (n=15)***
Projected	36%	4%	31%	7%
Projected (discounted)*	39%	13%	38%	33%

* If full substitution were found (see Section 2), no benefits of the project are counted. If partial substitution were found, the benefits associated with the components of the project which did not depend on the UDAG are subtracted from total benefits projected.

** Ten of the 80 projects were expected to produce no new permanent jobs.

*** Fifteen of the 80 projects have a housing component.

Projects With Problems. Predicted benefit shortfalls do not necessarily indicate projects where financial or other problems have reduced or threatened to reduce benefits. As noted elsewhere, errors made at the

PROBLEMS IDENTIFIED IN UDAG PROJECTS

Serious Problems	No. projects
o Terminated due to lack of private commitments	1*
o Actual bankruptcy or closure	3
o In serious financial difficulty	2
o Project changed so as to greatly reduce benefits	1
Less Serious or Potential Problems	
o Cancellation of one or more project components	4
o Temporary financial difficulty or shrinkage	4
o Poor physical design	2
o Major delay in completion	1

* At present, about 8.5 percent (102 of 1,201) of all UDAG awards have been cancelled or terminated

time of grant agreement in calculating expected benefits are the largest single cause of downward revisions in the projected benefits either before or after discounting for substitution.

It is important, however, to know the numbers of projects in which there is a real or threatened loss of benefits due not simply to calculation errors but, rather, to problems in executing the project as planned. If the number of such projects is large, this could indicate substantial waste of Federal investment and raise questions about the type of projects selected for UDAG support. Therefore, an effort has been made to document and classify all actual or potential problems, leading to a possible failure to deliver intended benefits, encountered among the 80 sampled projects. The

kinds of actual or potential problems are grouped according to their relative severity, and the numbers of projects in each category are indicated below.

About one in ten of the projects examined for this study has a serious problem that either has or threatens to substantially reduce its potential benefits. A somewhat larger number have less serious or potential problems that will probably reduce their benefits somewhat or could become serious problems. However, while some projects are now experiencing financial problems, they may ultimately be profitable and of benefit to the cities where they are located.

Some examples of more serious problems are as follows:

* Terminated Due To Lack Of Private Commitments: A UDAG was awarded in 1979 to finance a long-term loan for development of a large truck service plaza and motel. Subsequently, none of of the private investments materialized; a $6 million state industrial development bond issue could not be marketed and an apparent $7 million in equity and mortgage loan commitments from brokers fell through. The project was terminated in June, 1981, with no loss of public funds. A combination of risk factors such as relatively unknown developers, a problematic site, and a slumping bond market doomed a project that, if successful, would have produced 400 to 600 low and moderate income jobs in a highly distressed city.

* Bankruptcy: A joint venture, involving an industrial firm, failed to produce a product acceptable to its principal customer, the Department of Defense; as a result, the company lost the large DOD contract it had secured prior to receiving a UDAG and was forced into bankruptcy. The firm's collapse may have been due to lack of experienced management combined with DOD's rejection of its product for failing to meet quality control standards. In June 1981, a reorganized corporation was seeking a similar but smaller DOD contract and was prepared to reestablish production using the previously purchased equipment and materials.

* In Serious Financial Difficulty: In 1979, a newly organized manufacturing company received a UDAG loan to start production

in one of the most distressed urban areas. This project promised to produce as many as 300 low-income and minority jobs. Despite sufficient and growing demand for its product, its problems are so severe and it is so under-capitalized that future profitability is far from assured. Problems include difficulty in getting assembly line equipment to work properly, excessive employee turnover, an unexplained fire, muggings, cancellation of a major purchase commitment, and a shortage of working capital. As of June 1981, the company's production volume and employment were far lower than projected. The owners are seeking either to sell the company or raise additional working capital.

* Project Change Reduces Benefits: A 1980 small city UDAG was given for construction of eight moderate-income rental apartments. Instead, the developer built four larger condominium units for the same total investment. These are for sale at an average price of $50,000.

Less serious or potential problems that could reduce the benefits of some UDAG projects are illustrated by the following examples:

* Cancelled Expansion: Under the terms of a 1979 small city UDAG Grant Agreement, a bank committed itself to build new offices and to create 40 new permanent jobs. This construction represented about 45 percent of the total projected private investment in the project. Later, due to unfavorable economic conditions, the bank altered its plans. Rather than construct a new building, it has remodeled an existing building to provide additional space for its staff and will use the remainder of the construction site for customer parking. It has asked the city and HUD to relieve it of any further financial commitment.

* Financial Difficulties: A downtown commercial and housing development that received one of the first Action Grants in 1978 is not complete and the constructed portion is in some financial difficulty. A skywalk component of the project may may never be built due to the lack of private financing. The principal developer has succeeded in renting 100 percent of the the project's residential units but only 50 percent of its retail space; as a result, he is behind in his mortgage payments and the lenders are contemplating foreclosure.

* Design Problem: A basic design flaw has substantially reduced the attractiveness of retail space in a publicly-owned parking garage funded in part by a 1979 UDAG. There is no plumbing in the building. Recently, the city has identified from local sources the money needed to install plumbing fixtures.

* Major Delay: This neighborhood project, originally submitted in the spring of 1979, is not yet underway. Because the UDAG staff believed a project of the scope originally proposed was beyond the city's capacity and also disapproved of the proposed use of the UDAG funds, they asked for two major changes in the city's application and ultimately funded only a much smaller "first phase" of the development. Further delays have resulted from difficulty in securing legally binding commitments and from a major reorganization of the city's community development function. It is still uncertain when the project will proceed.

Reasons For Failure To Produce Full Benefits

Aside from projects where benefits were overestimated initially due to unrealistic calculations, the actual or potential failure of a UDAG project to generate expected benefits can be traced, in most cases, to one of three broad factors: (1) changes in the national economy; (2) an unusual degree of risk inherent in a particular project; or (3) violations of the spirit or letter of the Grant Agreement.

Economic Conditions. Changes in the national economy are a major, but not predictable, source of problems in some UDAG projects. High interest rates have caused cancellation or postponement of some UDAG project components just as they have affected other, unsubsidized real estate development plans. Recessions in the auto industry or other business sectors have reduced, at least temporarily, the job creation potential of some UDAG investments. In many cases, the loss of project benefits due to national economic conditions may be temporary.

Risky Projects. Although there is some risk of financial failure associated with any investment, this risk may be above average for real estate development in distressed cities. Those responsible for awarding UDAGs, like other investors, must assess the probability of failure and determine whether it is acceptable. In reaching this decision, they must

also weigh whether very high potential benefits are associated with some of the riskiest proposed projects.

Based on analysis of the projects examined for this study, several sources of financial failure are potentially identifiable in advance and, therefore, can be considered explicitly when UDAG award decisions are made. Among the identifiable sources are: inexperienced management; new products or new production technologies; and problems associated with a project site. However, these may or may not be the major factors in determining whether projects succeed or fail.

Grant Agreement Violations. In at least one case, either the spirit or the letter of the UDAG Grant Agreement apparently has been violated, leading to a reduction in benefits. In such instances, a tightening of Agreement language and/or earlier, closer monitoring of projects might avoid a loss of benefits.

The failure of a number of UDAG projects to produce the intended benefits is reason for concern. Just how serious that concern should be depends partly on how the loss of benefits compares in magnitude to the overall benefits achieved by the program and on what steps can be taken to remedy or avoid such problems. To date, the numbers of projects with serious problems do not appear large given the risks sometimes associated with development in distressed cities. Nor does the loss of benefits appear large in relation to the overall magnitude of the program's benefits for these cities.

Projects Behind Schedule

Because the projects examined in this study are at various stages of

realization, a final accounting of the numbers that will fail to produce their expected benefits is not possible. A further indication of emerging problems in some projects is provided by looking at construction progress. At present, 15 percent of the projects have fallen one year or more behind their original construction schedules although some of these are fully built. Another 16 percent are between 3 and 12 months behind original construction schedules. Five projects, however, were completed at least one year ahead of schedule. Delayed construction does not necessarily mean that a project has failed or will fail to produce all of the planned benefits; but, at the very least, it suggests a reason for cost overruns and a delay in generating the expected gains in jobs, housing, and other benefits.

The major reasons for construction delays of three months or more include administrative problems, changes in financing, changes in design or scope, and various uncontrollable factors such as weather or health. Administrative problems include: problems in assembling sites; arranging for relocation; and negotiations among the parties over project terms. The other types of problems encountered are so varied that it is difficult to generalize about the sources of delay.

Of the projects which are one year or more behind schedule, one was also found to have a serious problem as described earlier in this section and four were determined to have less serious or potential problems. In the remaining seven projects, construction delays are not associated with any as-yet-identified problems that could lead to a substantial shortfall of benefits.

V. Distribution -- Who Gets UDAG Awards?

Preceding page blank

Distribution -- Who Gets UDAG Awards?

13

In general, the most distressed UDAG-eligible cities are more likely than others to receive UDAG awards and dollars. However, this is not as true for small as for metropolitan cities. The greater targeting of awards to the most distressed metropolitan cities appears to result from a larger share of applications being submitted by this group of cities rather than from a higher success rate for their applications. In the case of small cities, however, the most distressed group has a better success rate than less distressed cities of getting its applications funded.

Those states and regions which have received a large share of UDAG funds also contain large proportions of the total eligible population living in distressed metropolitan cities.

The UDAG program bases city eligibility on whether a city meets criteria of economic distress. Yet the program relies on the capacity and initiative of the eligible cities and private investors to put together competitive projects and apply for the grant. An important issue,

Preceding page blank

therefore, concerns the distribution of UDAG funds which results from this combination of Federal targeting and local initiative. The primary selection criterion for awards, as set forth in the program regulations, is the "comparative degree of physical and economic distress among applicants;" therefore, one way of addressing this issue is to see whether the most economically distressed of the eligible cities benefit most from the UDAG mechanism for economic development.

To address this issue, this section examines the distribution of program benefits to cities, calculated in terms of number of UDAG awards, total UDAG award dollars, and UDAG dollars per capita.1/ The distribution of awards is evaluated separately for metropolitan and for small cities, since UDAG separates cities into these two groups when making funding decisions. Eligible metropolitan cities compete only with other eligible metropolitan cities and eligible small cities compete only with other eligible small cities.2/

Before cities can be ranked in terms of their comparative degree of physical and economic distress, their basic eligibility must be established. A city's eligibility for UDAG assistance is measured by an index

---

1/ The data used for the analysis in this section are maintained by the Office of the Assistant Secretary for Community Planning and Development, Office of Management, Data Systems and Statistics Division. Data on UDAG awards and award dollars do not include any information from cities classified as non-distressed but with "pockets of poverty." Also excluded are those grants which have been terminated by UDAG.

2/ Metropolitan cities include cities of 50,000 population or larger, cities under 50,000 population which are central cities of an SMSA, and urban counties of 200,000 population or larger. Small cities are cities under 50,000 population which are not central cities of an SMSA. Twenty-five percent of the total annual UDAG allotment is set aside for small cities.

composed of six indicators: the percentage of the city's housing stock built before 1940; the percentage increase in per capita income from 1969 to 1977; the 1970 percent of population at or below the poverty level; the rate of population growth between 1960 and 1978; the rate of growth of retail and manufacturing employment between 1972 and 1977; and the most recent average annual unemployment rate. 1/ The eligibility threshold on each indicator is the median value for all metropolitan and small cities. Cities receive a qualifying point for each indicator on which they exceed the distress threshold. 2/

If determined to be eligible for UDAG assistance, cities are given "impaction" scores which are the weighted sum of the standardized scores of percent poverty, percent pre-1940 housing, and percent population lag. Weights are .3, .5, and .2, respectively, as set by the Congress. Based on these scores, cities are ranked according to relative impaction. The city with the impaction rank of "1" is the most distressed metropolitan city. For small cities, the impaction ranks are converted to percentiles

---

1/ The last of these indicators is used for metropolitan cities only.

2/ To be eligible for UDAG, metropolitan cities must meet three of the six thresholds if their percentage of persons in poverty is at least one-half of the threshold or must meet four of the five standards other than poverty if the percent in poverty is less than one-half the threshold. If the percentage of poverty is greater than one and one-half the median for all metropolitan cities and the absolute per capita income is below the median, the community must meet only one other distress factor. For small cities, eligibility is determined in a similar but slightly different manner.

and cities in the first percentile are the most distressed cities, while cities in the 100th percentile are the least distressed.1/

For purposes of this analysis, the ranked lists of metropolitan and small eligible cities are divided into five groups or "quintiles" of distress. For instance, East St. Louis, the most distressed of the metropolitan cities, is at the top of the first quintile (Q1) of metropolitan cities. Huntsville, Alabama, the least distressed of the UDAG-eligible metropolitan cities, is at the bottom of the fifth quintile (Q5). The variation in distress between East St. Louis and Huntsville is very great, although both are classified as distressed metropolitan cities and, therefore, are eligible to receive Action Grants.

City Distress and Receipt of Awards

A larger share of UDAG awards goes to the most distressed group of eligible metropolitan cities than to the least distressed group.2/ From the beginning of the UDAG program through June 1981, 37 percent of all UDAG awards went to the most distressed quintile of eligible metro-

---

1/ In addition to the "impaction" rankings of eligible cities, UDAG also uses another index -- referred to as the "distress" index -- to rank cities in terms of economic need. This latter index relies on different indicators than those used in the impaction index. They are: percent increase in per capita income, rate of population growth between 1960 and 1978, and the rate of retail and manufacturing employment between 1972 and 1977. Cities rank somewhat differently depending on which of these two indexes is used. For the purpose of this analysis, the impaction index is used as the sole measure of economic distress.

2/ If award dollars, rather than number of awards, are analyzed, the distribution is similar; the more distressed groups of cities receive more dollars than the less distressed.

politan cities, while only eight percent went to the least distressed quintile.

Although the most distressed metropolitan cities receive more benefits, on average, than those that are less distressed, a small group of the most distressed metropolitan cities has not received any awards.1/ Twelve cities, or 17 percent of all of the cities that are in the most distressed quintile, have never received an award as of June 30, 1981 2/ These cities tend to be relatively smaller metropolitan places; with the exception of Mayaguez, Puerto Rico, none has a population much above 50,000.3/ Although none of these cities has received awards, seven have made applications and another five have applications in progress. Discussions with local officials in these cities revealed that the most frequent reason for their lack of success was an inability to obtain firm commitments of private investment from developers.4/

Although there are a few very distressed metropolitan cities with no

---

1/ Two-thirds of all the eligible metropolitan cities have received awards as of June 1981.

2/ If distress is viewed in terms of eligibility points, 15 percent of all metropolitan cities earning six eligibility points, the highest number possible, have never received UDAG awards.

3/ The cities are: Augusta, GA; Harrisburg, PA; Atlantic City, NJ; Asbury Park, NJ; Anniston, AL; Harlingen, TX; Edinburg, TX; Mayaguez, PR; Easton, PA; Passaic, NJ; Pine Bluff, AK; and Steubenville, OH.

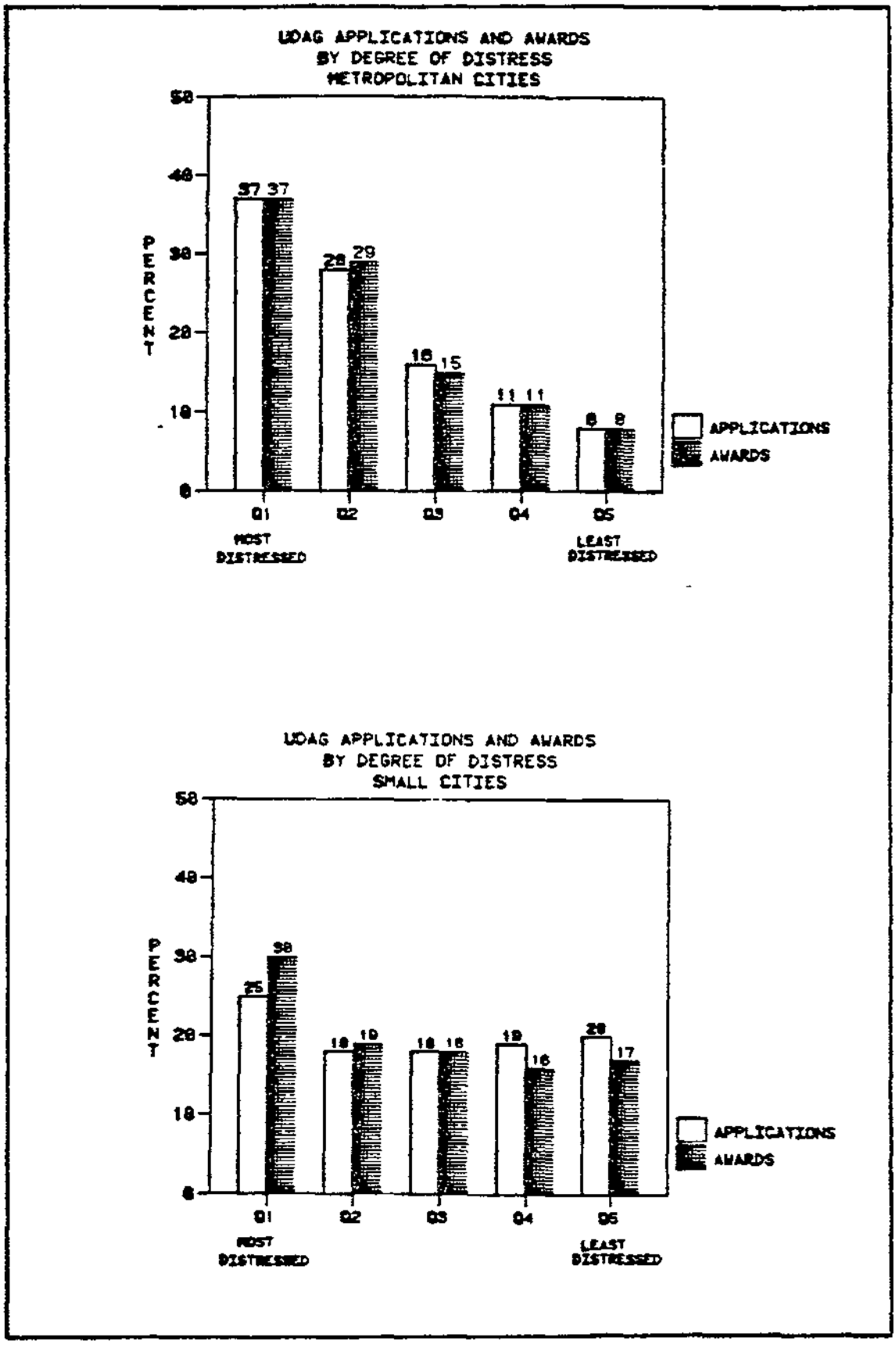
4/ One city which had applied but had failed to receive any UDAG award, indicated that its primary economic development activities have involved seeking economic development projects that involve no Federal contribution.

DISTRIBUTION OF UDAG AWARDS AMONG CITIES
BY DEGREE OF DISTRESS

Group of Eligible Cities	Metropolitan Cities		Small Cities	
	Number of Awards	Percent of Awards	Number of Awards	Percent of Awards
Q_1 (Most Distressed)	236	37%	136	30%
Q_2	188	29%	86	19%
Q_3	97	15%	79	18%
Q_4	70	11%	71	16%
Q_5 (Least Distressed)	49	8%	75	17%
Total	640	100%	447	100%

awards, the pattern overall indicates a stronger tie to economic distress for metropolitan cities than for small cities. About one half of the small city awards go to the two most distressed quintiles compared to two-thirds of the awards to metropolitan cities. In fact, only the most distressed one-fifth (Q_1) of small cities received a disproportionate share of Action Grants. The remaining quintiles of small cities have received about equal proportions, despite their varying levels of distress.

The greater targeting of UDAG awards to metropolitan cities than to small cities may be explained either by the pattern of UDAG applications, by the UDAG selection process, or by both factors in combination. As


UDAG APPLICATIONS AND AWARDS
BY DEGREE OF DISTRESS
METROPOLITAN CITIES
PERCENT
50
40
30
20
10
0
37 37
28 29
16 15
11 11
8 8
APPLICATIONS
AWARDS
01
02
03
04
05
MOST DISTRESSED
LEAST DISTRESSED
UDAG APPLICATIONS AND AWARDS
BY DEGREE OF DISTRESS
SMALL CITIES
PERCENT
50
40
30
20
10
0
25 30
18 19
18 18
19 16
20 17
APPLICATIONS
AWARDS
01
02
03
04
05
MOST DISTRESSED
LEAST DISTRESSED

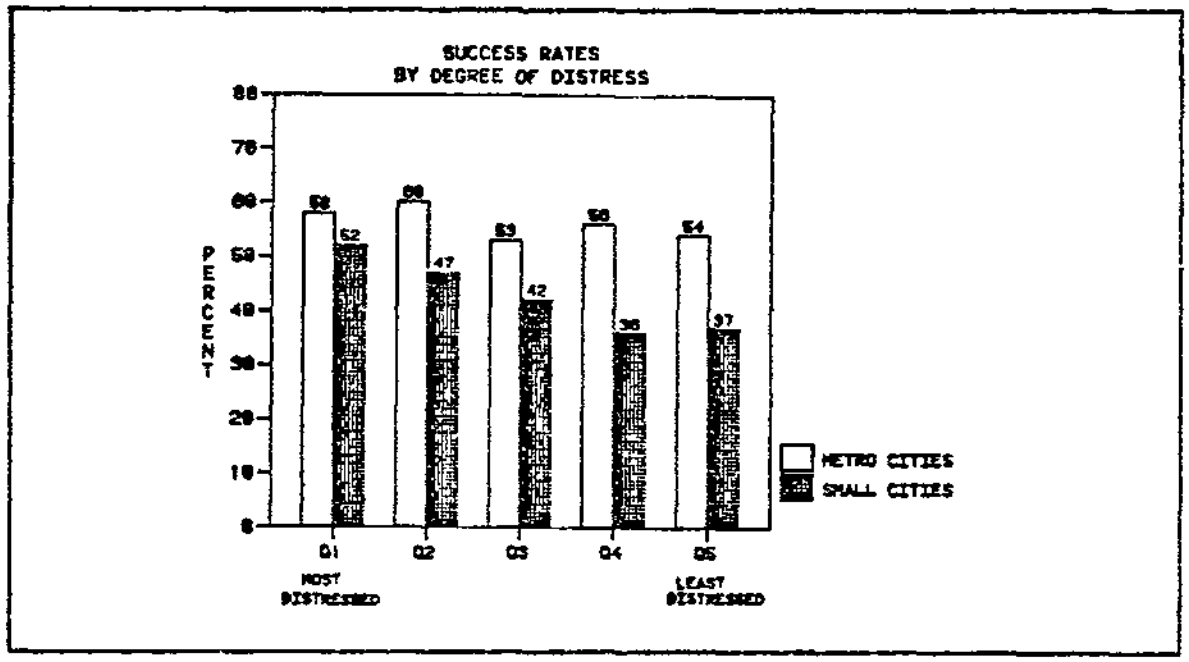
shown on the previous page, metropolitan city applications are more likely to come from the more distressed cities. Thirty-seven percent of them come from the most distressed quintile while only eight percent are from the least distressed quintile -- a 29 percentage point difference. By contrast, applications are almost as likely to come from the less distressed quintiles of small cities as from the more distressed quintiles.

There is a difference, therefore, between small and metropolitan cities in terms of where applications are originating; the less distressed metropolitan cities, are in effect, selecting themselves out of the award competitions to some extent. This is not the case for less distressed small cities.

A second kind of targeting may occur when the UDAG staff decides which applications should receive awards. Evidence for this exists when more distressed cities have greater success than less distressed cities in the UDAG competition -- that is, when the likelihood of getting an award is higher for every application they submit.

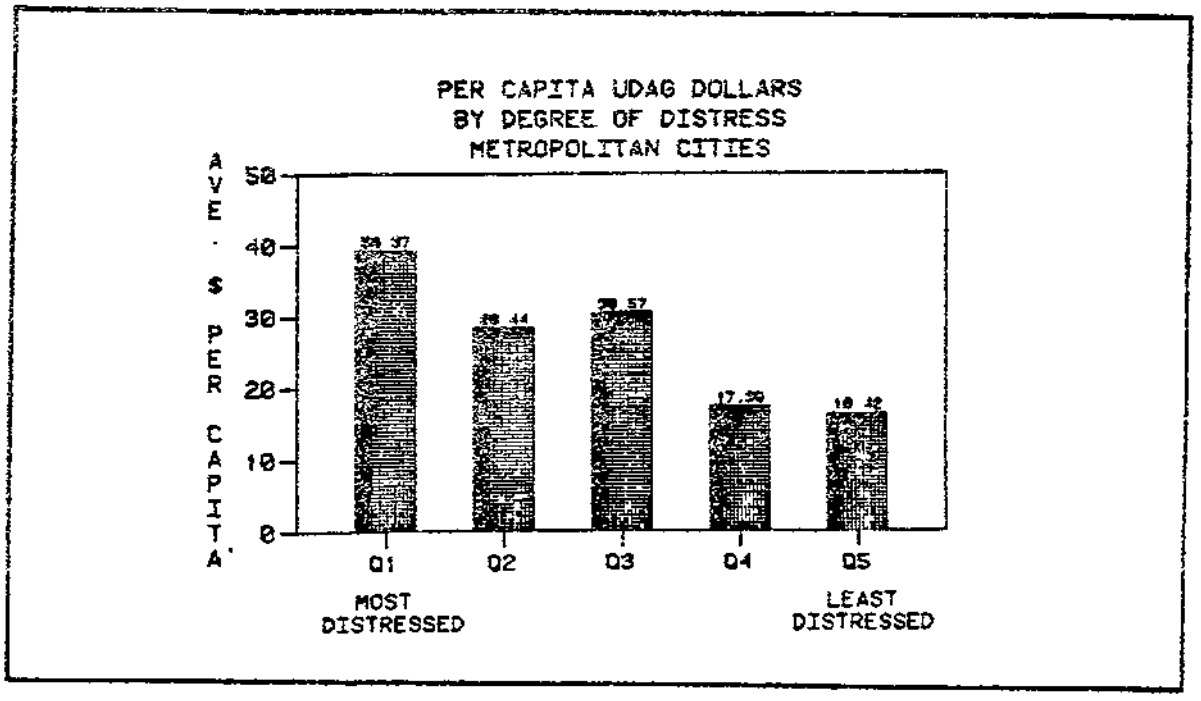
Among metropolitan cities, the less distressed are just as successful in getting their applications funded as are the more distressed. Fifty-eight percent of all applications coming from the most distressed cities culminate in awards, while 54 percent of all applications coming from the least distressed cities are successful. In small cities there is a noticeable difference in the success rates of the most and least dis-

tressed groups. Fifty-two percent of all applications coming from the most distressed small cities, compared to only 37 percent of applications coming from the least distressed cities, culminate in awards.



In conclusion, the most distressed small cities are not more active than their least distressed counterparts when it comes to submitting applications, but they are more successful in receiving awards. This contrasts with the metropolitan pattern where more distressed cities apply more often but have no greater success rate than less distressed cities.

Because awards and award dollars go to particular economic development projects and not to distressed populations, they are more direct measures of program benefits than are per capita award dollars. Nevertheless, the latter does provide one indication of the breadth of UDAG's subsidy to a city. Using this indicator, the findings are similar to those for UDAG awards or total award dollars: per capita dollars to metropoli-



tan cities increase with greater levels of economic distress.1/ The per capita figure is two and one-half times greater for the most distressed quintile of cities than for the least distressed quintile.

While UDAG awards are made only to distressed cities, it is possible that most of the program benefits may go to the less distressed eligible cities. To address this issue, the top ten metropolitan cities, both in terms of total award dollars and dollars per capita, are shown below. Only one city appears on both lists -- St. Paul.2/ Even so, most of the cities in either group are in the top two distress quintiles -- eight of

---

1/ An analysis of this relationship was not possible for the 10,000 small cities because of the lack of computerized data on population.

2/ The ten metropolitan cities with the highest total dollar amounts are, with one exception, all above 300,000 in population. The cities with the highest per capita awards are, with one exception, all below 100,000. While this might suggest that all smaller metropolitan cities receive higher per capita UDAG dollar amounts than larger metropolitan cities, this is not true. When all eligible metropolitan cities are examined, there is not a strong relationship between the city's population size and the per capita UDAG dollars received.

the ten cities with the highest per capita dollars and seven of those with the highest total award dollars. Furthermore, 31 percent of the eligible

THE TOP TEN METROPOLITAN CITIES:
TOTAL UDAG AWARD DOLLARS AND PER CAPITA AWARD DOLLARS

City	Quintile of Distress	Total UDAG Dollars (Millions)	City	Quintile of Distress	UDAG Dollars Per Capita
Detroit, MI	Q1	$76.9	Duluth, MN	Q2	$322
New York, NY	Q2	$76.3	Wilmington, DE	Q1	$315
Chicago, IL	Q2	$55.5	Charleston, WV	Q1	$210
Baltimore, MD	Q1	$45.2	New Brunswick, NJ	Q3	$180
Boston, MA	Q1	$45.2	Bay City, MI	Q2	$178
St. Paul, MN	Q3	$43.2	Texarkana, TX	Q1	$166
Los Angeles, CA	Q3	$42.3	St. Paul, MN	Q3	$164
San Antonio, TX	Q4	$41.5	Portland, ME	Q1	$163
Minneapolis, MN	Q2	$31.8	Superior, WI	Q2	$157
St. Louis, MO	Q1	$30.7	Johnstown, PA	Q1	$134

metropolitan population is in those ten cities with the highest award dollars and 30 percent of all metropolitan award dollars have gone to these cities. Therefore, the big winners among the metropolitan cities are among the most distressed and contain a large proportion of the UDAG-eligible population.

Most of the top ten small cities, in terms of total award dollars, also have very high per capita figures. 1/ Five of them are in the top 25

1/ The ten small cities with the largest UDAG dollar amount (in millions) are: Hamtramck, MI -- $30.0; Commerce, CA -- $12.7; Muskogee, OK -- $11.7; Peabody, MA -- $10.0; Chelsea, MA -- $8.0; Dayton, KY -- $8.0; Quincy, IL -- $6.9; Woodlawn, IL -- $6.4; Montezuma, GA -- $5.8; Monrovia, CA -- $4.1.

percent of the small city distress rankings but the other five have lower levels of economic distress. Hamtramck, Michigan, in the Detroit SMSA, has the largest UDAG award of any city -- $30 million dollars, which converts into $1,346 per capita. Commerce, California, in the Los Angeles SMSA, has the second largest award -- $12,693,000, or $1,269 per capita. 1/ Unlike Hamtramck, which is one of the most distressed small cities, Commerce is among the least distressed. Both Hamtramck and Commerce, as well as several of the other small cities with large awards, are located within metropolitan areas with other distressed cities.2/

State and Regional Breakdown in UDAG Funds

The top ten states, in terms of program benefits, have each received in excess of 77 million UDAG dollars, with most of this money going to metropolitan cities. In fact, 66 percent of all the metropolitan city award dollars through June 1981 has gone to these states. The distribution of metropolitan award dollars is very similar to the distribution of eligible metropolitan population: two-thirds of the nation's population living in eligible metropolitan cities (and over three-fourths of the population living in the most distressed cities) are in these ten states.

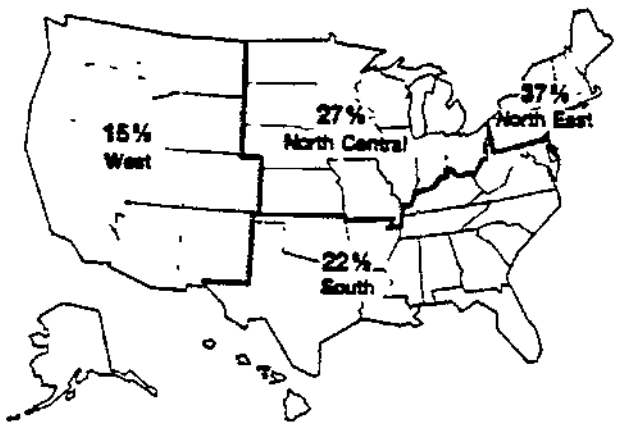
The regional breakdown in metropolitan UDAG dollars, which is shown on the map below, also reflects where most of the UDAG eligible population

---

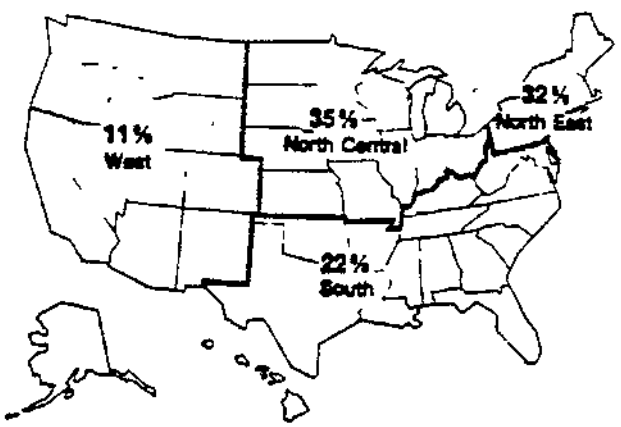
1/ Woodlawn, IL with a population of 321 and an award of $6,433,000 has the highest per capita award -- $20,040.

2/ Despite the fact that some small cities have received a large amount of UDAG dollars, the average metropolitan city award is two and one-half times larger than the average small city award: $2.46 million compared to $.99 million.

Regional Distribution of UDAG-Eligible Metropolitan Population and UDAG Metropolitan Dollars



Distribution of Population in UDAG-Eligible Metropolitan Cities



Distribution of UDAG Funds Among Metropolitan Cities

THE TOP TEN STATES: TOTAL UDAG AWARD DOLLARS AND METROPOLITAN AWARD DOLLARS

State	Total UDAG Award Dollars*	State	Metropolitan UDAG Award Dollars*
New York	$202.6	New York	$161.0
Michigan	174.6	Michigan	131.4
Massachusetts	155.7	Massachusetts	124.8
California	146.3	California	114.7
Pennsylvania	130.2	Ohio	111.1
Ohio	116.9	Pennsylvania	100.0
Illinois	110.0	Illinois	83.8
Texas	88.0	Minnesota	76.4
Minnesota	86.2	Texas	76.3
New Jersey	77.0	New Jersey	59.7

* All dollar figures in this table are in millions.

is found.1/ Sixty-four percent of the eligible population in metropolitan cities (and over 77 percent of those living in cities ranked in the top two distress quintiles) are in the Northeast and North Central regions; these regions received 67% of the metropolitan award dollars. The West, by contrast, has 15 percent of the eligible population in metropolitan cities (and only 4 percent of the population in the most distressed cities); it has received 11 percent of the awarded funds. The South has 22 percent of the eligible population and a comparable share of the UDAG dollars awarded.

1/ The regional breakdown in total UDAG dollars is very similar to the metropolitan distribution. The Northeast region has 32 percent, the North Central, 33 percent, the South, 24 percent, and the West, 11 percent.

VI. UDAG and Local Economic Development

Preceding page blank

Introduction to UDAG and Local Economic Development

The UDAG program provides two basic economic development tools to local governments: (1) the funds with which to subsidize economic development projects; and (2) the staff expertise to assist local officials in putting together the components, terms, and financing of such projects. The extent to which cities have these tools independently of Federal programs such as UDAG is, of course, an important question relating to the need for and impacts of the UDAG program. This section begins to address this issue of local government capacity to promote economic development by providing some preliminary answers to the following questions: 1/

1. How often are proposed UDAG projects consistent with cities' economic development plans or strategies?

2. Are proposals conceived independently of UDAG, as a means of fulfilling a local development need, or are they primarily ideas for obtaining available Federal aid, regardless of their relationship to local needs?

3. What is the potential contribution of UDAG to cities' capacity to stimulate private economic development through experience with new tools and techniques, new administrative arrangements, better business-government cooperation, and through future recapture and reuse of UDAG funds?

4. How many cities would have the capacity to undertake UDAG-type negotiations and "deal-making" without assistance from the UDAG staff in Washington?

These questions are addressed in Sections 14-17.

1/ It is beyond the scope of this evaluation to assess local governments' financial capacity to undertake economic development projects.

UDAG and Local Economic Development Strategies

14

The large majority of UDAG projects fit into a preexisting city economic development strategy or formal plan, reflecting the fact that UDAG provides city officials wide latitude to use the program in varied ways. The remainder are neither related to nor in conflict with local development plans or priorities. In cities with no preestablished strategy, but also occasionally in cities with consciously developed strategies and priorities, a minority of projects (about one in four) are essentially ad hoc responses to opportunities that are not central to any plan: such opportunities are pursued because they do not conflict with other priorities and are seen to offer a net economic gain to the city. About one-fourth of the observed UDAG projects are located on Urban Renewal sites.

Cities pursue a diversity of development objectives and the UDAG program is designed to provide them with sufficient latitude to adapt the Federal funds to varied local situations. Unlike many other Federal programs, UDAG allows wide discretion: (1) to support virtually any type of new private development, provided its benefits can be demonstrated in terms of the program's objectives; and (2) to structure the Federal subsidy in whatever way -- loans, grants, infrastructure, land writedowns,

Preceding page blank

etc. -- they determine to be most appropriate. Such latitude helps to explain why no instances were identified, in any of the 70 cities studied, of a direct conflict between a UDAG project and a city's development plan or strategy.

At least three-fourths of the UDAG projects in metropolitan cities are consistent with a preexisting city economic development plan. The remaining one-fourth of metropolitan city UDAGs are neither related to nor in conflict with these cities' development plans or priorities. In small cities, about two-thirds of the observed UDAG projects conform to an existing development strategy -- although most of the small cities do not possess formally drafted development plans or priorities -- and a minority apparently has no such plans. In cities with no preestablished strategy, but also occasionally in those with consciously developed plans, a minority (about one in four) of UDAG projects are essentially ad hoc responses to opportunities that are not central to any strategy. Such opportunities are pursued because they do not conflict with other priorities and are seen to offer a net economic gain to the city.

The following examples illustrate the range of situations where UDAG has been used to implement carefully formulated local plans for:

* Industrial Development: An Eastern port city has been trying to revive its harbor area since the 1960s. It has spent Urban Renewal money to acquire and clear waterfront land, CDBG funds to modernize piers for the fishing industry and for related public improvements, and an EDA grant for a harbor project. Its 1979 UDAG award was used by the city to construct a seawall and prepare the site for a $6 million frozen fish packaging plant.

* Downtown Redevelopment: A city whose downtown was devastated by flooding in 1972 subsequently determined that the rebuilt area must be service-oriented, with a hotel as a principal component. The city at the time had no Class A hotels.

Redevelopment efforts produced a new public square and covered pedestrian malls. The city's 1978 UDAG award was used to finance construction of a Class A hotel on the new public square.

* Neighborhood Commercial Retention: A large Western city has pursued a multi-part economic development strategy, one component of which is an effort to retain small neighborhood businesses and customers which might otherwise gravitate to new suburban shopping malls. Also, because city land area is 99 percent developed, it has limited opportunities to attract major new employers. Instead, it has concentrated on attracting smaller businesses. To implement both components of its development strategy, the city has established under its control an SBA Small Business Investment Corporation. Also, most of the city's UDAGs have been used to assist small neighborhood businesses. For instance, a 1978 project employed a UDAG to stimulate construction of a small neighborhood shopping center.

* Neighborhood Revitalization: A large city is experiencing significant household displacement due to revitalization of some older neighborhoods. In one of these areas, its development strategy combines adaptive re-use of an arsoned zone with efforts to control displacement. Its 1980 UDAG project in the neighborhood is a unique and innovative effort to subsidize rents in 40 rehabilitated apartments in order to maintain a mix of income levels in the neighborhood.

In cases where projects do not reflect a formal local plan, they generally can be interpreted as being consistent with the cities' broad aim of encouraging desirable private investment. For example:

* Commercial Development: One Northeastern city's 1979 UDAG application took shape after a national supermarket chain announced plans to close its two city stores. However, only when approached by a private developer who proposed to construct a shopping center, including space for the chain store, did the city take action to retain one of the two outlets. This city, which has received ten Action Grants, appears to have no carefully conceived economic development plan but rather pursues development projects, including UDAGs, as opportunities arise.

* Nursing Home Construction: A small city suffers the special disadvantage of being located in two counties, neither of which has incorporated it into its economic development plans. Moreover, the city has few attractions for industry and few development opportunities. A private proposal to build a

nursing home here had, in 1980, to the city's first UDAG; the Mayor says of the award: "For the first time in 20 or 30 years years, the UDAG has given us some destiny of our own instead of of being a part of somebody else's."

* Industrial Development: A very small Midwestern city had little economic development planning capacity prior to 1978. In that year, local bankers started to formulate an industrial development program and asked the regional planning council for advice on Federal aid available to the city. Coincidentally, a developer approached the city for help in building a food products processing plant. The resulting UDAG not only created new private investment but also enabled the city to establish its first economic development program and to hire a half-time development director.

UDAG and Urban Renewal

The relationship of UDAG to HUD's earlier Urban Renewal program 1/ is a particular aspect of the general relationship between UDAG and cities' economic development strategies. Cities have used Action Grants to stimulate development on former Urban Renewal sites that, in some cases, had been vacant for years. Of the UDAG projects examined for this study, about one-fourth involve Urban Renewal land; eight of the 19 projects funded in 1978 (UDAG's first year) were on Urban Renewal sites. Here, the cities had previously employed Urban Renewal to acquire, clear, and prepare sites they considered desirable for redevelopment. However, the land had then

---

1/ From 1949 to 1974, the Urban Renewal program was the Federal government's major financial tool for stimulating comprehensive private and public redevelopment of physically blighted areas in cities. The program's character shifted from emphasis in its early years on slum clearance to a greater emphasis on rehabilitation and, after 1967, on improving housing and economic opportunities for lower-income persons. Representative analyses are those of Martin Anderson (The Federal Bulldozer, Cambridge, MA: The MIT Press, 1964) and Heywood T. Sanders ("Urban Renewal and the Revitalized City: A Reconsideration of Recent History", in Donald Rosenthal, Urban Revitalization, Beverly Hills: Sage Publications, 1980).

remained idle or underutilized until UDAG's later subsidy finally allowed city-sponsored projects to proceed. The combination of the two subsidies -- Urban Renewal and UDAG -- thus produced private investment on what, for some time, had been regarded by these cities as key redevelopment sites. Because they complete programs begun under Urban Renewal, these UDAG projects can be classified as part of cities' economic development strategies.

Origination of UDAG Project Proposals

15

Most development ideas receiving UDAG support are conceived prior to any thought of UDAG; but about one out of four projects is viewed from the outset as requiring or being appropriate for an Action Grant subsidy. More than half of the developments were first conceived by their private developers or by another major private participant. Typically, the first person to identify a project idea as a candidate for UDAG funding is a city official. These patterns suggest that most UDAG projects are not merely ideas for obtaining public subsidies but rather development plans conceived independently of UDAG. Most projects require UDAG staff-suggested changes before they are considered acceptable for funding.

Over half of the development ideas that ultimately become UDAG projects originate with the private sector. However, city officials themselves are the original source of a significant proportion of the development proposals. In metropolitan cities, about one in five UDAG projects is first conceived by city officials; in small cities, about twice this proportion arise inside City Hall.

Wherever development ideas arise, most (at least two-thirds) precede any thought of UDAG. This was as true in 1978 as it was in 1979 or 1980.

Preceding page blank

On the other hand, about one project in four was apparently viewed from first conception as appropriate for, or requiring, UDAG subsidy. Four times out of five, the first person to identify a development idea as a potential UDAG project was a city official. This pattern suggests that most projects funded through UDAG are not merely ideas for obtaining public subsidies but rather development ideas conceived independently and judged first locally and later by HUD to require subsidy.

Three-fourths of the successful UDAG applications are prepared principally by city staff. However, some cities (both small and metropolitan) rely on consultants or even developers and others to draft their applications. Small cities are more likely than metropolitan cities to use consultants in this process. At least one-third of the small cities make some use of consultants, and about one out of five relies on a consultant to draft its application.

Once an application is submitted to HUD, the UDAG staff in Washington often asks the city for major revisions in order to produce a final project proposal meeting UDAG's funding requirements. About one-half of the successful applications submitted by metropolitan cities and about two-thirds of those submitted by small cities require changes prior to funding. Typically, these changes are negotiated between UDAG staff, city officials, and private parties to the proposed project within the 60 days between submission and HUD's decision on funding.

In two out of every three instances, officials of small cities think that these changes improved the projects from their perspective. However, only one in three metropolitan city officials thinks that the changes made the projects better from their viewpoint, with two-thirds of them uncertain

or negatively disposed toward the changes. Officials of metropolitan cities may be less favorably disposed toward the intervention of the UDAG staff than small city officials because of their greater capacity to negotiate such projects themselves and/or their stronger negotiating positions.

Cities' Plans to Use Recaptured UDAG Funds

16

UDAG projects that include loans, lease arrangements, and provisions for city profit participation will generate, for some cities, significant new income to finance future community development activities. Of the 70 cities included in the study, about three-fourths have received at least one UDAG that allows them to recapture and reuse their Action Grant funds. Of these, four out of five have a mechanism to reuse these funds either planned or in place. In most cases, this mechanism involves the use of recaptured funds to capitalize city-controlled revolving loan funds for commercial, industrial, or (in a few cases) housing and neighborhood development.

One feature of the UDAG program that may assume greater importance in future years is its potential for local recapture and recycling of Action Grant funds to subsidize additional community development activities. Recaptured UDAG funds include loan repayments, lease payments and, where applicable, city participation in profits generated by UDAG-subsidized investments. The last of these forms of recapture occurs when the project grant agreement includes a "kicker" provision. One of the intended purposes of a kicker is to allow private investors in UDAG projects a reasonable rate of return, while protecting against excessive or "windfall" profits

Preceding page blank

that could result from the public subsidy to these projects.

TERMINOLOGY: KICKER AND RECAPTURE

Kicker: A provision in some UDAG grant agreements giving terms under which the city will share in any net income or net cash flow from operation or sale of UDAG-subsidized private development. For instance a kicker might take the form of a specified percentage of the project's net cash flow to be paid to the city above and beyond any loan repayment.

Recapture: Recovery by a city of its Action Grant investments, generally with interest, taking the form of loan repayments, lease payments, or kickers.

Fourteen percent of all the projects examined for this study include kickers. Few kicker provisions were included in earlier projects. They have become more common in more recently funded projects. These kicker provisions tend to be uniquely written to fit the circumstances of a particular project. Some examples of the varied provisions encountered are:

* Example: A city will receive 30 percent of the net income from a parking garage constructed with UDAG subsidy.

* Example: A city will receive 12 percent of any annual net cash flow (all income less real estate taxes, debt service, and operating expenses) from a newly developed hotel and commercial space.

* Example: A shopping center developer will pay the city 50 percent of annual net cash flow from all sources.

Because most of these projects are not very far along and their future profitability cannot be predicted accurately, it is uncertain whether the cities' profit participation will be, in very many cases, a significant

source of recaptured funds. All indications are that the largest proportion of recaptured funds will result from loan paybacks or lease payments rather than direct profit participation.

About 30 percent of UDAG funds awarded through FY 1980 were loaned by the cities to private developers. Through the end of FY 1980, about 40 percent of all UDAG projects provided for recapture of funds through loan paybacks or lease payments. The proportion of all projects including loan or lease arrangements has increased from 30 percent, in FY 1978, to 35 percent, in FY 1979, and 62 percent, in FY 1980. Over one-half of the projects examined for this study used UDAG funds for development loans; and three-fourths of the 70 cities included in the study had received at least one UDAG involving future recapture of Action Grant funds.

For some cities, the magnitude of recapture is such that this will soon become a significant source of new income. For instance, one city of 340,000 people has five UDAG projects that, over a period of 20 years or so, will produce recaptured income with a combined present value of nearly $1 million. Cities may use such recycled funds for any activity eligible under Title I of the Housing and Community Development Act of 1974, as amended.1/ Thus, recapture adds to cities' financial capacity to undertake other economic and community development projects of their choice, and to reduce their future dependence on Federal development assistance.

1/ Eligible activities are those which address the needs of low- and moderate-income persons, elimination of slums and blight, and cities' urgent needs and may take the form of public works and facilities construction; property acquisition and demolition; relocation assistance; rehabilitation of structures; and provision of public services.

Planned Uses of Recycled Funds

By far, the most common planned uses of recycled UDAG funds are to capitalize revolving loan funds for commercial, industrial, or (in a few cases) housing and neighborhood development. Below are descriptions of the main categories of planned use for recaptured funds.

Commercial or Industrial Loan Pools. More than 40 percent of the cities with mechanisms planned or in place to receive paybacks or kickers have set up or definitely plan to establish revolving loan funds to support what several call "mini-UDAG" programs to aid small industrial or commercial projects. Typically, these funds combine UDAG paybacks with money from other sources; and, often, they are administered by a separate nonprofit development corporation.

* Example: One small city will eventually receive paybacks totalling $1 million plus interest from its UDAG projects. The money will be turned over to a nonprofit development corporation controlled by local government and private interests where it will be combined with other funds from SBA and the state job development authority and used for economic development activities. The project selection criteria will be modeled after UDAG's.

* Example: A large city will place its UDAG paybacks in a similar revolving fund established with money from CDBG and EDA. The fund is managed by a nonprofit, city-controlled capital corporation which works to couple private lending with public programs to finance smaller industrial and commercial development. Projects are selected using job creation and leverage criteria very similar to UDAG's; the loan can be for no more than one-fourth of all funds or one-half of all borrowed funds. Loan limits are $300,000 or up to $600,000 in areas targeted for development.

* Example: Another city, which has lost many thousands of manufacturing jobs in recent years, has chosen to emphasize loans for industrial development in its recycling of UDAG funds. Individual loans may not exceed $500,000 and the maximum cost per job created has been set at $5000.

Housing and Neighborhood Improvement Loan Funds. A few cities have definite plans to reuse UDAG repayments only or primarily for loans to rehabilitate housing or support neighborhood revitalization.

* Example: UDAG loan repayments received by one West Coast city will be placed in a revolving loan fund established as part of the city's CDBG program. Loans are made from this fund for housing rehabilitation.

* Example: In a Midwestern city, both loan payments and tax increment receipts from two UDAG projects will be used to help pay off housing bonds issued by the city to acquire housing for Section 8 substantial rehabilitation.

Other Revolving Loan Funds. Other cities plan to use recaptured UDAG funds for loans supporting unspecified economic or community development activities.

* Example: One Eastern city will establish an economic development fund from proceeds of a UDAG project lease and kicker. The money will be used to benefit low-income and minority persons, according to city officials. However, the first use of recaptured funds will be to service debt on general obligation bonds.

Finally, about one-fifth of the cities expecting or receiving loan paybacks or other income from UDAG projects plan to use their recaptured UDAG funds not to make loans but in various other ways: for grants, infrastructure improvements, costs related to the UDAG projects themselves, or other unspecified economic or community development activities.

Local Capacity to Initiate Economic Development

17

Since the UDAG program began in 1978, most of the cities included in this study have experienced an increase in local administrative capacity to promote economic development. Experience with the UDAG program itself has improved that capacity in somewhat over 40 percent of the cities; for the other sixty percent, however, UDAG is not perceived as having had this impact.

Economic development specialists in four out of five cities visited believe that the principal role of the UDAG staff is to provide advice and guidance to local governments on how applications can be made more "competitive" and projects "better." Forty percent of the metropolitan cities look to the UDAG staff in Washington to play the "heavy" in negotiating the terms and conditions of projects with the private sector. Thirty percent of metropolitan cities, but only 17 percent of small cities, appear to have a "strong" capacity to make feasible economic development deals with minimal or no UDAG staff assistance. The majority of the remaining cities have some "deal-making" capacity but do need some assistance.

This section evaluates the current administrative capacity to promote economic development of the cities whose projects are examined in this study, the changes in that capacity since early 1978, and the estimated

Preceding page blank

impact which UDAG has had on those changes. Also examined are the cities' perceptions of the role played by the UDAG staff in Washington in developing projects for funding, and a judgment is made as to the relative abilities of various cities to undertake feasible economic development projects with no "deal-making" or other assistance from the UDAG staff.

The Current Economic Development Capacity of City Governments

There are a number of "tools" which city governments can use, where available, to stimulate and support economic development activities. These include: Federal and state government economic development grant programs (based on eligibility); state and local government special purpose bonds (industrial revenue and tax increment bonds); loan pools and revolving funds (such as from UDAG project paybacks); financial incentives such as land writedowns, tax abatements, payments in lieu of taxes, etc.; and the provision of technical assistance to businesses in applying for direct loans or loan guarantees available from a number of Federal and state government programs which support economic development investment.

However, the administrative capacity of local governments to use those tools effectively is a function of:

1) organizational arrangements which institutionalize the responsibility for economic development activities;

2) a professional staff skilled in acquiring (i.e., grantsmanship) and using the tools appropriate to the needs of the community and of specific situations;

3) a constructive, cooperative relationship between local government officials and the private sector.

Based on the information obtained from city development officials, lenders and private developers, a determination was made of whether the current administrative capacity to support economic development in each city visited for this study is "strong", "moderate", or "weak". A city is classified as having a "strong" economic development capacity if the following conditions are met: (a) the organizational responsibility for carrying out economic development activities is clearly defined; (b) it has a staff skilled in the use of economic development tools (as evidenced by the effective use of them in the past); and (c) a high level of cooperation exists between the city government and the private sector. To the degree that these standards are not met, a city's economic development capacity is assessed as either "moderate" or "weak".

As would be expected, there is a significant difference in economic development capabilities between metropolitan cities and small cities. While nearly one-half of the metropolitan cities are considered to have a "strong" administrative capacity, this is the case in less than five percent of the small cities. At the other end of the scale, just under 40 percent of the small cities are judged to have a "weak" capacity as compared to about 17 percent of the metropolitan cities. The basic explanation for this pattern is that the larger the city, the greater the resources available to establish and maintain the capacity for undertaking economic development activities. About 40 percent of metropolitan cities and almost 60 percent of small cities have "moderate" capacities.

The Trend in Administrative Capacity Since January 1978

Between 1978 and 1981, just over 70 percent of the metropolitan

cities and approximately one-half of the small cities included in this study strengthened their ability to foster economic development. For example, somewhat over one-half of the cities either created new offices or added new staff positions concerned with economic development or with helping to solve business problems; a larger number have undertaken efforts to attract new business or industry to the community. According to city officials, there is increasing cooperation in the working relations between city government and business in over 90 percent of both metropolitan and small cities. 1/ This latter trend was generally confirmed by representatives of lending institutions contacted in a number of cities. Over the last three years, about one-half of the cities have used, for the first time, at least one of a variety of economic development tools.

UDAG's Impact on Trends in Administrative Capacity

The impact of the UDAG program on the cities' administrative capacity to promote economic development was estimated for each of the cities included in the study. The following are illustrative of the ways in which UDAG has strengthened capacity:

- The creation of new offices or staff dealing with economic development can be attributed to UDAG in

1/ A 1980 HUD survey of 564 business executives of firms' headquartered or solely located in metropolitan cities found that 59 percent perceive cooperation between business leaders and their city governments over the past five years to be "very" or "somewnat close." However, 33 percent describe these relationships as "not very close" or "not close at all", and the remainder are unsure. Most urban business leaders would prefer that local government, rather than other levels of government or the private sector, take the lead in organizing local economic development.

about one-fifth of the metropolitan cities and over one-fourth of the small cities.

- The first use of at least one "economic development tool" (such as a local or state bond issue) was associated with a UDAG project in about one out of six metropolitan cities and in over 40 percent of the small cities.

- In about one-sixth of the cities, the first time the city took a lead role in negotiating a land development deal was in connection with a UDAG project.

Based on this type of information, it is estimated that the UDAG program has had an impact that ranges from "some" to "major" on slightly more than 40 percent of both metropolitan and small cities. In the majority of cities, however, the program seems to have had little or no impact on administrative capacity.

Cities' Perceptions of the Most Important Roles Played by the UDAG Program Staff in Developing New Projects 1/

Providing advice and guidance to city officials at all stages of the process is seen by 80 percent of both metropolitan and small cities as the most important role played by the UDAG Central Office staff in developing projects for funding. This help ranges from what is needed to make either a planned or submitted application more "competitive" (reflecting the changing but often unpublished priorities of project selection established by the program staff) to how a project can be made "better" following preliminary application approval.

1/ These findings are based on the opinions of city officials (in each city visited in the study) who were most familiar with the development of UDAG projects.

Going a step further, one-third of metropolitan cities and one-sixth of small cities see the most important role of the UDAG staff in Washington to be its direct involvement with both city officials and private sector participants in "deal-making" negotiations. Some cities lack the sophisticated financial knowledge or skill to negotiate or put together complex or mixed-use projects and look to the acknowledged ability of the UDAG staff for assistance in such situations. In other cases, there is simply no "deal-making" ability at the city level.

An especially interesting finding of this study is that almost 40 percent of metropolitan city officials believe that the most important role played by UDAG staff is that of being the "heavy" in driving hard bargains with private sector investors and developers to maximize a project's financial benefits to the city. This relates to situations where there is to be a payback of funds to the city either in the form of a loan and/or the taking of an equity position. Some officials say that negotiating the terms and conditions of these loans and "kickers" is a role which they themselves do not want to play for fear of alienating a developer or of killing a deal.

That "deal-making" and "playing the heavy" on the part of the UDAG staff seem to be of less importance to small cities than to metropolitan cities may well be accounted for by the fact that 75 percent of the small cities studied had received only one Action Grant award and thus have had no continuing contact with the program. In contrast, metropolitan cities visited averaged (median) 4 awards per city, with just 15 percent having received only one award.

The Capacity of Local Governments to Design and Carry Through Feasible Economic Development Projects Without any "Deal-Making" or Other Assistance from UDAG

This evaluation of a city's ability to make its own deals with no assistance from the UDAG staff takes into account the current quality of the city's economic development capacity, the trend in that capacity over the last 3-1/2 years, the nature of the city's present reliance on the UDAG staff in project development, the number of UDAG projects awarded, and the opinions of local officials on this subject.

In making this particular judgment, it is assumed that there will be continued availability to cities of Federal funds, using an eligibility/distribution formula earmarked for economic development, and that cities can make their own "deals" not subject to HUD approval but within a limited set of guidelines. For a city to be able to make UDAG-like deals which involve up-front, legally binding commitments from the private sector, it must have funds to use for infrastructure, writedowns, relocation, loans, interest subsidies, rebates, direct grants, or whatever is needed to leverage private investment.

About 30 percent of the metropolitan cities and 17 percent of the small cities studied are judged to have a "strong" capacity for making their own deals without UDAG staff support. Another 55 percent of metropolitan cities and 42 percent of small cities are judged to have a "moderate" capacity in this regard. These findings suggest that the majority of cities have some level of "deal-making" capacity, although only a minority appear able to negotiate, on their own, UDAG-like deals with the private sector.

VII. Options for Program Improvement

Preceding page blank

Options for Program Improvement

18

There are several options for improving the UDAG program. First, to insure that UDAG subsidies are awarded only when absolutely necessary, program officials could: seek additional outside expert opinion about local real estate and market conditions; strengthen the process by which HUD Area Office economists participate in project review; and/or require documentation from private lenders that sufficient private funds are not available.

Second, to increase the probability that projects will be financially viable, program officials could: explicitly consider financial feasibility when selecting projects; and/or strengthen early monitoring of projects to detect emerging problems.

Third, to improve the accuracy of the impact estimates used to rank projects for selection, program officials could: refine the employment estimating procedures to correct the more common calculation errors; provide cities with more guidance on how to estimate revenue impacts; develop alternative methods to supplement the presently-used leverage ratio as a criterion for selection; and/or, possibly, use one or more combined benefits indices for project selection purposes.

Fourth, to alter the distribution of funds among cities, it is possible to either increase the amount of targeting to cities with the greatest need or, alternatively, to encourage as much

Preceding page blank

participation as possible among eligible cities. There are several ways to accomplish the former goal: give greater weight to economic distress in project selection; reduce the eligibility list; and/or concentrate technical assistance on highly distressed cities which have received few or no awards. To accomplish the alternative goal, it is possible to: place a limit on the amount of awards or funds going to any one city; and/or offer technical assistance to any city with few or no awards.

Finally, an additional way to strengthen the program would be to encourage cities to recycle recaptured UDAG funds into subsequent UDAG or UDAG-type projects, thereby diminishing, by some amount, dependence on Federal funding and, as well, increasing the city's own investment in new projects.

This section has two purposes: (1) to assess the programmatic implications of the study; and (2) to review options for improving the program's performance relative to the purposes established by Congress. The following discussion is not intended to address those proposals for change that would alter either the purposes or major features of UDAG: for instance, proposals to fold Action Grants into CDBG or to substitute for UDAG a new economic development block grant to states. Nor will this discussion contribute directly to broad philosophical debate over the proper Federal role in local economic development. Instead, the alternatives considered assume a continuation of UDAG within its present legislative mandate.

Implications of Evaluation Findings for Program Improvement

In summary, this evaluation has addressed the following issues which are central to the UDAG program:

(1) The need-for-subsidies issue.

(2) The realization-of-benefits issue.

(3) The benefit-projection issue.

(4) The distribution issue.

These are briefly reviewed below.

Need for Subsidies. Are UDAG funds going only to projects where they are needed to produce the private investment? With regard to this question, it has been shown that at least two-thirds of UDAG projects could not have occurred without the Action Grant. In these instances, distressed cities benefited from increased private investment, new jobs or jobs saved, and added revenues that, at best, would have been delayed and, at worst, never would have materialized. This positive finding must be weighed against the discovery of partial or full substitution of UDAG funds for private or other public funds in one out of five projects examined.[1/] The implication is that improved review of project proposals might avoid some instances of substitution, thereby redirecting funds to projects where subsidies are needed. Options for reducing substitution are considered in Subsection A below.

Realization of Benefits. Will the projects selected for UDAG support produce substantial and lasting economic benefits for distressed cities?

1/ For 15 percent of the projects, the evidence regarding substitution is inconclusive.

Concerning this question, it has been shown that most projects will produce the bulk of the intended benefits, but that initial forecasts of some categories of benefit tend to be high -- most often because of improper calculations or forecasting difficulties. However, about one in ten of the projects examined has a serious problem that either has or is likely to substantially reduce its benefits. This finding implies a need for more careful consideration of the financial viability of proposed projects. After award, improved monitoring could help identify and respond to emerging problems and avoid further investment of UDAG funds in non-viable projects. Options for improving the chances that projects selected will be viable are presented in Subsection B.

Benefit Projections. Are projects being selected on the basis of reasonably accurate projections of benefits? It has been shown that initial forecasts of some categories of benefit tend to be high -- often because of miscalculations or lack of guidelines about how benefits should be measured. Inaccurate benefit estimates can lead to less than optimal use of the available dollars and becomes a greater problem as the competition for funds increases. Options for improving the accuracy of benefit forecasts are offered in Subsection C.

Distribution. Are UDAG funds distributed among cities in a way that is consistent with the purposes of the program? UDAG is intended for cities that are, in the words of the legislation, "severely distressed." However, the Congress has not specified the distribution of funds within the group of eligible cities. HUD may, therefore, choose to increase the concentration of funds toward the most severely distressed metropolitan and small cities and/or to increase participation by cities that, regard-

less of the degree of economic distress, have received few awards in the past. It has been shown that the more distressed of the eligible cities receive a greater share of awards and dollars than less distressed cities and that there is less concentration toward severe distress among small cities than among metropolitan cities. The latter difference probably results, in part, from the relatively poorer quality of applications for the 25 percent of UDAG funds reserved for small cities. Greater targeting increases the proportion of total benefits received by the cities most in need but tends to reduce participation by other eligible cities that are less distressed. Options for altering the distribution of funds among cities are discussed in Subsection D.

Options for Program Improvement

The following four subsections present groups of options addressed to each of the questions raised above. An additional option that deals with several areas of program improvement is presented in the final subsection. These options are not meant to be mutually exclusive or exhaustive.

A. Insuring that Subsidies are Needed.

Option 1:	Seeking Expert Opinion.
Option 2:	Strengthen the Area Economist's Review.
Option 3:	Obtain Letters of Rejection from Lenders.

At present, the UDAG staff in Washington attempts to guard against substitution by requiring written assurances from private developers and

cities that each project is contingent on the Action Grant, by conducting its own analysis of the projects' financing (sometimes including inquiries to local lenders), and sometimes by offering stiffer terms (such as "kicker" requirements) to test the intentions of developers. In doubtful cases, an otherwise fundable project may be held over to the next funding round to see whether the developer will proceed with other financing. UDAG's small staff relative to the number of applications processed in each funding round, combined with the very brief (effectively 30 day) time period in which staff can review, refine, and evaluate project proposals, are major constraints on the ability to screen out projects where substitution is likely to occur. Current procedures have not always prevented awards that were not needed or where at least one component of a project would have proceeded without subsidy. Therefore, various options for improving the review for substitution should be considered.

The options discussed below all involve the review of project proposals and include changes (1 and 2) that would improve information and analysis and one (3) that would involve a procedural test for possible substitution.

Option 1: Seeking Expert Opinion. UDAG staff could make greater use of outside expert opinion in its review of project proposals for potential substitution. This could be done routinely for all applications or only for those projects that are difficult to analyze. Two kinds of expertise are relevant. One is intimate knowledge of a local real estate market. The second is broad national experience with the appraisal of a particular type of development, e.g., industrial.

In some cases, useful information can be provided by a quick phone call to verify the reasonableness of specific figures in the applications. In other instances, detailed study of a project's development cost estimates and projected cash flow may be required to generate a useful assessment. Given the extremely tight schedule for reviews, it will be almost essential to identify appropriate expertise in advance and to have professional consultants not personally involved in any UDAG applications on call.

Option 2: Strengthening the Area Economist's Review. Applications are currently reviewed for market feasibility in the office of the HUD Area Economist; the results of these analyses are then transmitted as part of the complete Area Office review and are available to UDAG staff when they begin to intensively analyze proposed projects. It appears that UDAG staff have not relied heavily on the Area Economist's review, and project revisions sometimes render some parts of the review irrelevant to the final form of the proposal. The Area Economist's review might be refocused to include the gathering and analyzing of information useful in evaluating substitution. A substitution analysis by the Area Economist could consider surrounding land uses and values, determine the availability of comparable sites (both within the city and in the suburbs), and examine the validity of market studies done for the developer. This type of analysis would not only aid UDAG staff in evaluating substitution but also help in assessing risk of failure (see Subsection B) and in negotiating terms of the awards.

Option 3: Obtaining Letters of Rejection from Lenders. In some Federal business loan programs, the method of documenting need for subsidy is to require letters from private lenders rejecting the Federal applicant's

request for a private market rate loan. Following a somewnat similar approach, HUD could require that, when the UDAG will be used as a development loan, the private developer first seek to borrow from one or more private lenders. Letters would be obtained from these lenders stating that a loan at the required loan-to-value ratio and at the required interest rate is not available and indicating the terms under which a loan would be available. These letters would be submitted with the UDAG application. Two problems with this option are the time and paperwork burden created and the possible unwillingness of some lenders to make public the information on terms they will or will not offer.

B. Improving Consideration of Financial Viability.

Option 1: Explicitly Considering Financial Feasibility in Project Selection.
Option 2: Strengthening Early Monitoring.

One rationale for the UDAG program is the greater probability of financial failure with new investment in economically distressed cities. It follows, therefore, that HUD will not use the same standards for determining acceptable risk that a private lender would use. Nevertheless, certain proposed UDAG projects carry a higher probability than others of financial failure for reasons unrelated to their location in distressed cities. The present study shows that financial difficulties have caused a loss of benefits in enough cases to make this a focus of concern. The probability of financial failure is based on such identifiable factors as inexperienced management, new production technology, and the extent to which profitability is contingent on events or other investments not under

control of the developers. Also, projects whose future profitability is very sensitive to changes in the national economy may carry a greater-than-average risk of financial failure. Such risks are often signalled by the unwillingness of a private lender to make a loan as an indication that, with the UDAG subsidy, a project promises to be a viable investment.

However, in some cases, lenders are also the developers, the development company is a lender subsidiary, or the lender will be a major tenant in the project. Also, where a lender is making a relatively small construction or first mortgage loan or where a large percentage of the loan is government-guaranteed, the lender's commitment should not be the sole determinant of feasibility because its exposure in the project is too small. In short, there are several instances where HUD cannot interpret a lender's willingness to loan as indication of a project's market feasibility. To reduce its reliance on this method of assessing feasibility, HUD should seek alternatives.

Option 1: Explicitly Considering Financial Feasibility in Project Selection. Improving the assessment of feasibility may be accomplished by some of the same methods used to insure that the UDAG subsidy is needed. These would involve improving the information available to reviewers on project financing and expected profitability and strengthening the analysis of that information. As noted above, the Area Economists currently assess the market feasibility of each proposed project. Various means of strengthening these analyses and insuring uniform quality should be examined, including additional training, the development of a handbook or guidelines, and improved communication between the Area Economist and UDAG reviewers as proposals are being revised and considered. Also as noted

above, it may be possible for HUD to increase its use of outside expertise in assessing both substitution and feasibility.

It may be possible to estimate the probability of financial failure from characteristics of the proposed projects based on standard investment underwriting criteria. A professional, systematic approach to analysis of risk is likely to be cost-effective, more than paying for itself by reducing the UDAG dollars wasted on non-viable projects. In addition, it would be useful to compare the characteristics of the 100 or so projects that have been terminated, and of other projects that have not produced a substantial portion of benefits expected at time of grant agreements, with those of successfully completed projects. Another useful step would be to determine whether a larger proportion of deeply subsidized projects than of other projects fail to produce all or part of their expected benefits. At present, the UDAG staff does not formally estimate the combined subsidy from all public sources including other Federal grants, public loans and loan guarantees, local or state sponsorship of industrial revenue bonds, tax abatements, and land writedowns. The combined total of all public subsidies, as a proportion of the project investment, gives a better indication than the size of the UDAG alone of the degree to which the private sector considers the project to be viable as well as the potential return from a UDAG-supported project. Thus, the depth of subsidy may prove to be a useful indicator of viability and of the probability of failure.

Option 2: Strengthening Early Monitoring. The Area Office has primary responsibility for monitoring UDAG projects in progress. Because the UDAG program is relatively new and the number of active projects is growing, the monitoring function is still evolving. It is already difficult for

Area Office personnel to devote sufficient time to this function and the burden is increasing. Given the potential importance of monitoring for early identification of projects in financial trouble (as well as other problems, such as violation of the grant agreement), further study is desirable to determine the most beneficial approach to project monitoring. One useful step would be to quickly provide Area Offices with information on changes in projects that occur before and after award, so that they do not lose touch with project status and have an opportunity to comment. Another would be to give Area Offices training and written guidelines on how to monitor effectively. If early monitoring is to be beneficial, it must be followed by effective action to resolve emerging problems.

C. Refining Projections of Benefit.

Option 1:	Refining Employment Estimates.
Option 2:	Providing Cities with More Guidance on How to Estimate the Revenue Impacts of Proposed Projects.
Option 3:	Developing Alternate Methods of Estimating Leverage.
Option 4:	Developing and Using One or More Benefits Indices in Project Selection.

Accurate projections of impact are essential to selecting those proposed projects likely to provide greatest benefit to distressed cities. Any errors that cause relatively weaker project proposals to be selected over stronger ones not only produce inequities among cities but may also reduce the credibility of the selection procedure. As the number of

applications rises in relation to available funds, the need increases to determine not only whether proposed projects meet threshold criteria of projected benefit but also to rank them accurately relative to one another. The options discussed in this subsection deal either with improving the numbers used to predict impacts or with improving the use of those numbers in ranking projects for selection.

Option 1: Refining Employment Estimates. Many instances have been found where, at the time grant agreements were signed, calculation errors have resulted in misestimation of the numbers of new permanent jobs likely to be created or jobs likely to be retained by a proposed project. When errors of calculation were made, they usually resulted in predictions of greater benefits than projected. One source of error was the failure to convert part-time or seasonal jobs to their full-time equivalents. In other cases, jobs were counted as "retained" when they would not have been lost to the city without the UDAG. Improved estimation of jobs impact can be achieved by providing cities and private parties with better guidelines for developing employment projections and by placing greater emphasis on the checking and refining of job numbers by UDAG staff during the application review period. National or regional benchmark figures are available or can be developed for particular industries indicating the average number of jobs created per dollar of new investment. However, more study is necessary to determine whether such benchmarks are useful in checking the realism of employment projections for UDAG projects. Future enforcement of grant agreement provisions specifying the numbers of jobs to be created or retained by a UDAG project would further increase

both the incentive and the need for precise jobs projections.

Option 2: Providing Cities With More Guidance on How to Estimate the Revenue Impacts of Proposed Projects. Currently, the amount of error in projecting the fiscal impacts of proposed projects is so large that these estimates are not very useful in selecting projects for award. Property tax impacts have been estimated with reasonable accuracy, but other revenues have not. In fact, relatively little attention has been given by HUD to the methods cities use in projecting fiscal impact. As a result, there is room for improving the accuracy of these projections. Cities should be given a uniform straightforward method to follow, and the application form should indicate prominently that only city, not state or Federal, revenues are relevant to project selection. In developing a uniform method for revenue projection, consideration should also be given to estimating separately the revenue which would otherwise have been lost in projects where a UDAG award induces business retention. While this is not additional revenue to the city, it would be lost to the city without the UDAG, and this is another type of fiscal benefit. Finally, the variation in revenue impacts over time due to temporary tax abatements or other factors must be recognized in developing a projection method.

Option 3: Developing Alternate Methods of Estimating Leverage. The estimated ratio of private investment to the requested amount of UDAG dollars is a major criterion for project selection. However, the "leverage" ratio is a flawed indicator of the UDAG's impact on private investment for two reasons. First, where other public capital subsidies are involved, it is usually unclear what proportion of the private investment can be attributed to any single component of the total subsidy. In these

cases, the leverage ratio inflates the role of UDAG in generating benefits. Second, where the UDAG is sought partly so that a private firm can employ industrial revenue bonds totalling up to $20 million, the leverage is exerted by the combination of benefits jointly and not by the UDAG alone. Because HUD's practice has been to restrict UDAG amounts in such projects to between five and eight percent of total project cost, the normally computed private-dollar-to-UDAG ratio is quite high, but also misleading. The conceptual weaknesses of the presently-used leverage ratio as an indicator of UDAG-generated benefits illustrate the need to find alternate ways of calculating leveraged investment and to use more than one measure in ranking proposed projects for selection.

Option 4: Developing and Using One or More Benefits Indices in Project Selection. Given the quantitative nature of most of the measures of predicted project benefits, it is possible to develop an index combining the individual measures. The weight given to each type of benefit (jobs, fiscal impact, etc.) in calculating index scores would reflect its relative importance in ranking projects for selection; alternate weights could be used for some project types (e.g., those with housing components). The diversity of project proposals and the importance of non-quantifiable factors in the selection process work against rigid use of such a formula approach. However, the advantage of this type of index would be greater consistency -- both real and perceived -- in the use of selection criteria related to projected benefits.

D. Altering the Distribution of Funds Among Cities.

Option 1:	Giving Greater Weight to Distress in Project Selection.
Option 2:	Reducing the Eligibility List.
Option 3:	Concentrating Technical Assistance on Highly Distressed Cities With Few or No Awards.
Option 4:	Placing a Limit on Awards or Funds Given to Any One City.
Option 5:	Offering Technical Assistance to Any City With Few or No Awards.

Within terms set by the Congress, UDAG can be either a targeted program for the most highly distressed cities or a program that ignores variations of distress among eligible cities. If the program is to be targeted, awards or funds should go disproportionately to cities with the greatest relative distress. On the other hand, if the goal is to encourage as much participation as possible among all eligible cities, targeting of program awards is not as important. Therefore, depending on which goal is preferred, different options are suggested.

It has been shown that the cumulative distribution of UDAG funds to date favors the cities that are more distressed. More distressed metropolitan cities receive a larger proportion of Action Grants, on the average, than less distressed cities, but the difference is related to the fact that the former submit more applications than the latter. Applications from the most distressed cities do not have a better than average chance of being funded by UDAG. Even so, there is still a wide range in the number of awards and dollars received among cities of similar

levels of economic distress, with some cities having received no grants.

Among small cities, the most distressed group also receives a greater share of awards than others, and applications from this group have a somewhat greater chance than others of being funded. However, the overall distribution of awards among small cities is not as highly skewed toward the most distressed places as it is for metropolitan cities.

If even more targeting is the goal, Options 1 2, and 3 are suggested.

Option 1: Giving Greater Weight to Economic Distress in Project Selection. The UDAG staff could give greater weight to distress or impaction rankings, relative to other selection criteria, in choosing which projects to fund. For instance, if all the selection factors were quantified, then the distress factor could be assigned a greater weight than any of the other selection factors. At present, the probability that an application will be funded is no greater for the more distressed metropolitan cities than for other cities. 1/ Another way to insure that the most distressed cities receive a larger share of funds would be to set aside a predetermined fraction of the total appropriation for these cities, and allow them to compete for awards as a separate group.

Option 2: Reducing the Eligibility List. By reducing the eligibility list, those cities which have the lowest levels of economic distress would become ineligible, except through "pockets of poverty" applications. One way of doing this is to increase the number of distress thresholds which must be met by an eligible city from the currently required three to

---

1/ Among small cities, the most distressed one-fifth of those eligible for the program has a higher rate of application success than the less distressed eligible cities.

four (or five).

Option 3: Concentrating Technical Assistance on Cities with Few or No Awards But High Levels of Distress. A third way to increase targeting of funds toward the most distressed places would be to provide concentrated advice and technical assistance to that minority of highly distressed small and metropolitan cities that have received few or no awards. This option would require a reallocation of staff time or other departmental resources.

If, on the other hand, a preferred goal is to increase the extent of participation in the UDAG program by all eligible cities, regardless of distress level, the preceding options should not be pursued and the following should be considered.

Option 4: Placing a Limit on Awards or Funds Given to Any One City. A limit on the number of UDAG awards or total dollars going to one city is a somewhat arbitrary but administratively inexpensive mechanism for preventing some cities from receiving excessive numbers of awards or UDAG dollars. This limit could take the form of a ceiling or cap on the amount of UDAG dollars per capita going to any one city. So that the cap affects the future distribution of program awards without severely penalizing past success, this limit could take the form of an annual ceiling. Any such limit is arbitrary and, of itself, does not contribute directly to increased participation by cities that, in the past, have submitted few applications or have received few, if any, awards. This option, therefore, should be considered along with the next.

Option 5: Offering Technical Assistance to Any City With Few or No Awards. A program of technical assistance that is open to any eligi-

ble city, especially those with few or no awards, would help to reduce the present variation in program benefits across all eligible cities.

E. Encouragement of Recycling Recaptured Funds.

This last subsection addresses several of the areas of potential improvement discussed previously.

Option: Encouraging Cities to Recycle Recaptured UDAG Funds in Subsequent UDAG Projects. One distinctive feature of the Action Grant program has been its emphasis on local recapture of funds loaned to private developers and the recycling of these funds for other community development activities. Among cities expecting recapture, the most frequent plan is to supplement or capitalize a revolving business loan fund. HUD should consider encouraging cities that are recapturing funds from past UDAGs to commit them to future UDAG or UDAG-type projects. Such a change would be consistent, in spirit, with the currently proposed regulation change making commitment of funds by the applicant city (although not necessarily recaptured UDAG funds) a factor to be considered in selecting projects. As one possibility, HUD could advise and assist cities not already doing so to use recaptured funds to capitalize revolving business loan funds. Alternatively, HUD could count a city's contribution of recaptured UDAG funds to a newly proposed UDAG project as one positive factor in its selection process. Or, HUD might actually require cities receiving large flows of recaptured funds to use these in support of any future UDAG projects. Cities with many UDAGs and high rates of recapture could be required to make a greater contribution of recycled funds per project than other cities. The latter two forms of recycling would accomplish several things. First, the amount of HUD's contribution to each of the

projects would be reduced, thereby enabling the Department to support additional projects at the same funding level, while making the high recapture cities more nearly self-sufficient. Second, recycling would encourage cities to use recaptured funds for projects that meet the specific objectives of the UDAG program. Third, it would encourage cities to take a more active role in monitoring and managing future UDAGs to insure that any emerging problems are identified and dealt with promptly. The higher the share of the local subsidy, the more cities could be expected to assume greater responsibility for negotiating, selecting, and administering UDAG-type projects to stimulate new private investment.

For a set of projects, the calculation of the proportion of the total dollars that were unnecessary (i.e., U) can be obtained by the following formula:

$$U = \frac{S_1 + S_2 + L_2 + L_3}{T}$$

(where T = total UDAG funds in project grant agreements).

L_1 is excluded from the formula because, in these cases, all of the UDAG was necessary, even though some of the private investment was not stimulated by the UDAG. For example, in a project that involved a housing co-operative and a condominium conversion, the UDAG was fully expended on the condominium and was necessary. The co-op, however, was contingent upon neither the condominium nor the UDAG.

For the 80 projects examined in the field study, U is calculated as follows:

S_1 = \$10.29 million*

S_2 = \$ 4.05 million

L_2 = \$ 2.57 million

L_3 = \$ 2.74 million

T = \$116.59 million

$$U = \frac{S_1 + S_2 + L_2 + L_3}{T} = \frac{\$19.6 \text{ million}}{\$116.6 \text{ million}} = .17$$

* One project accounts for \$8.825 million of S_1 or 45 percent of total unnecessary funds in sampled projects.

APPENDIX B: BIBLIOGRAPHY

Abt Associates, Inc., and Dalton-Dalton-Newport, Inc. The Urban Development Action Grant Program: A Preliminary Assessment of Impacts and Issues. Cambridge, MA: Abt Associates, March 1980. (Report prepared for U.S. Department of Housing and Urban Development.)

This paper is Part I of a series of reports commissioned by HUD's Offices of Community Planning and Development and Policy Development and Research. A preliminary discussion of program goals, impacts, measurement techniques and problems, and key program issues (e.g., substitution) is offered in the context that actual program impacts are impossible to assess because of the newness of the UDAG program. Reported are the results of analyzing projected primary impacts for 235 projects for which contracts had been signed as of the end of fiscal year 1979. Projections were made using data supplied in original grant applications, adjusted for changes made between time of application and time of award. Since the data represent planned activity, the analysis can be considered representative only of potential program impacts. No policy recommendations are offered.

_____. The Urban Development Action Grant Program: A Preliminary Evaluation Design. Cambridge, MA: Abt Associates, July 1980. (Report prepared for U.S. Department of Housing and Urban Development.)

Second in a HUD-commissioned series on the design and implementation of an evaluation of the UDAG program, this report provides a somewhat theoretical discussion of evaluation methodology. Focus is on the issues of substitution, economic and social displacement, indirect and multiplier effects of subsidized development, and the potential fiscal impacts of projects. The report provides the methodological framework on which a study of the UDAG program might be based.

_____. The Urban Development Action Grant Program: A Comprehensive Evaluation Design. Cambridge, MA: Abt Associates, March 1981. (Report prepared for U.S. Department of Housing and Urban Development.)

Building upon an earlier paper (see previous entry), this report provides a detailed description of how to implement an evaluation of the UDAG program -- either the entire program, individual projects, or groups of projects. Five categories, and the means by which to measure impacts within each category, are discussed: investment, employment and income, housing and residential location, local fiscal effects, and local government capacity to perform economic development. The evaluation design emphasizes survey-based methodology.

_____. Questionnaires for UDAG Evaluation. Cambridge, MA: Abt Associates, July 1981. (Report prepared for U.S. Department of Housing and Urban Development.)

This is a compilation of proposed data collection instruments designed to provide information necessary for answering questions regarding the impacts of individual UDAG projects or groups of projects. The categories of impacts mirror those identified in the third report of this series (see previous entry), and assume a survey-based evaluation methodology.

Abt Associates, Inc. The Urban Development Action Grant Program: A Preliminary Assessment of Impacts and Issues. Cambridge, MA: Abt Associates, 1980. (Report prepared for U.S. Department of Housing and Urban Development.)

This study addresses a broad range of the possible impacts of UDAG (e.g., investment effects, employment, housing, fiscal impacts, historic preservation, displacement, minority participation, and land use impacts) as well as the substitution issue and multiplier effects. Data files on 235 UDAG projects were analyzed. Data were compiled from grant applications, grant agreements and quarterly progress reports. The study concludes, that because of considerable time lags between grant application and actual achievement, it is too early to make a fair assessment of UDAG's actual impacts. Estimated impacts based on grant application data are presented.

Birch, David L. "The Job Generation Process." Program on Neighborhood and Regional Change, M.I.T., Cambridge, MA 1979.

This paper analyzes changes in employment by size and age of firm and by region. It employs data covering four-fifths of private sector employment in four different time periods (from 1969 to 1976). This paper concludes that small and independent firms created more than half of all new jobs and that larger corporations are more likely than small firms to redistribute their operations, through expansions in growing areas and through contractions in declining areas. Thus, it is differential branching, not physical migration, that causes many of the regional differences in job growth, especially in manufacturing. Since small and independent firms are also inherently riskier, it is difficult to develop an effective strategy of net new job creation utilizing their growth potential.

Blair, John. "Increasing UDAG's Economic Development Impact." Washington, DC: U. S. Department of Housing and Urban Development, undated.

This paper compares UDAG grants to UDAG loans and concludes that the stimulus for economic development generated by UDAG could be maximized if cities borrowed against the present value of future loan repayments. Alternatively, the UDAG office could structure a modified tandem plan for buying and selling such loans.

Byrne, Robert M.; Porter, Douglas R.; and Baker, Elizabeth D. "Urban Development Action Grants: An Investment Solution." Urban Land, Vol. 39 (June 1980),

This article reviews the UDAG program's goals and achievements. It describes the Urban Land Institute's role in the promotion and assessment of UDAG through publications, conferences, and the use of a panel of experts to review and comment on program issues.

Case, Karl E. "The Role of Housing in Urban Development Strategies." Cambridge, MA: Urban Systems Research and Engineering, Inc., November 1980. (Report prepared for U.S. Department of Housing and Urban Development.)

The role of housing as a component of economic development strategy is examined. Among the issues discussed are the rationale for including housing in economic development activities, housing impacts of existing federal programs (UDAG, EDA, FmHA), and relative employment impacts of public assistance to residential, commercial and industrial development. This study finds that different types of projects generate almost equal numbers of construction jobs per dollar. If housing is in short supply, the secondary employment effects of commercial or industrial projects are reduced. The longer term economic impacts of housing projects are very much dependent on local employment and housing market conditions. If the resident population and/or local income are increased as a result of housing investment, the local economy -- and employment -- improves since people are more likely to shop closer to home.

Clink, Elnora, Cathleen Finn, and George Reigeluth. Program Design and Program Results in Federal Economic Development Programs: A Discussion of Issues. Cambridge, MA: Dalton-Dalton-Newport, Inc., January 1981. (Report prepared for U.S. Department of Housing and Urban Development.)

This study attempts to determine the extent to which the stated designs of economic development programs conform to actual experience. After briefly describing the characteristics of UDAG, EDA, and FmHA programs, the report then traces the programs through the predevelopment stage, project conception, and initiation. It then examines the effects that selected aspects of program design have on the achievement of program objectives.

Crawford, Everett, and Jusenuis, Carol. "Economic Development Policies to Reduce Structural Unemployment." In The National Commission for Employment Policy, Sixth Annual Report. Washington, DC: National Commission on Employment Policy, December 1980.

This report focuses on how Federal programs to improve the employment prospects of unemployed persons (who are economically and educationally disadvantaged) could be more efficiently coordinated with Federal economic development programs designed to assist distressed regions. It reviews current public and private economic development programs, and the issues involved in (as well as the barriers to) effectively coordinating economic development,

employment and training programs.

Finally, several recent demonstrations, designed to overcome the barriers, are reviewed.

Farnham, Paul. "The Targeting of Federal Aid: Continued Ambivalence." Public Policy 29 (Winter 1981): 75-95.

This paper examines the process by which HUD categorical grants for urban and community development were transformed into community development block grant programs. In addition the paper focuses on the debate that has occurred over the implementation and renewal of this legislation. It then examines briefly the benefits and costs of targeting, i.e., administrative and compliance costs at all levels of government and the loss of flexibility at the local level.

Gist, John R. "Urban Development Action Grants: Design and Implementation:" Urban Revitalization, pp. 237-252. Edited by Donald Rosenthal. Beverly Hills, CA: Sage Publications, 1980.

This paper addresses the design and operation of the UDAG program. The issues addressed include: the regional distribution of UDAGs; the program's ability to target funds to the most distressed areas; the ability to attract private investment; and the types of projects that UDAG has funded. The author concludes that UDAG is similar to the Urban Renewal Program in the kinds of activities undertaken. With respect to the targeting of funds to distressed cities, the author concludes that the intent of Congress -- to use the level of distress as the primary selection criterion for UDAG awards -- is basically met during implementation. The author also concludes that the UDAG program's claims about successful leveraging of private funds are questionable. Finally, the author reports difficulty in assessing the legislative requirement regarding a "reasonable balance" of funds among industrial, commercial and housing project types.

Gottschalk, Peter T. "Regional Allocation of Federal Funds." Policy Analysis, 7 (Spring 1981): 183-197.

This study provides an empirical analysis of the regional allocation of federal funds. Federal spending was found to vary with the state s unemployment rate, average real income, and level of urbanization. Holding these factors constant, the Snowbelt states still received a smaller net flow of federal funds than comparable Sunbelt states. Within the Snowbelt region (including Northern New England, Southern New England, the Mid-Atlantic, and Great Lakes States), there were differences in amounts of federal funding. The Great Lakes states received

the smallest net flow of funds, while the Northern New England states received a relatively large flow. Northern New England, however, is considerably poorer than the other three subregions, as measured by the incidence of poverty or mean incomes.

Greer, Nora Richter. "St. Paul and the Uses of UDAG." AIA Journal, 70 (March 1981): 82-84.

This article examines the use of UDAG funds in St. Paul for projects ranging from neighborhood rehabilitation to hotel renovation to development of an industrial park. The projects have boosted property and sales taxes, retail sales, and have had a spin-off effect of creating additional new employment. The article also recounts the origin of the UDAG program during the Carter Administration, its environmental impacts, and the Reagan Administration's proposals for UDAG.

Jacobs, Susan S. "Assessing UDAG as an Urban Economic Development Policy." Paper presented at the meetings of the Eastern Economics Association, April 1981.

This paper reviews the UDAG program and outlines a framework for assessing effectiveness. In addition to those specific impacts which can be measured in time, the author suggests that the program's value should be determined by its ability to achieve Federal goals in establishing urban economic development policy.

Jacobs, Susan S. and Roistacher, Elizabeth A. "The Urban Impacts of HUD's Urban Development Action Grant Program." In The Urban Impacts of Federal Policies, pp. 335-365. Edited by Norman Glickman. Baltimore, MD: Johns Hopkins University Press.

The authors discuss the issues behind targeting of assistance and the urban impacts of UDAG, including different types of potential substitution. They then examine available data for the early months of the program (through October 1978) for the various impacts that can be expected, suggest some alternative strategies, and point out areas where the results from practical research would be useful to policymakers.

Jacobs, Susan. " A Preliminary Assessment of UDAG Program." Washington, DC: U.S. Department of Housing and Urban Development, March 1981.

This preliminary assessment of UDAG as a Federal tool for urban economic development discusses UDAG program characteristics and program experience in the context of the program's stated objective of helping to alleviate economic deterioration in declining areas. It suggests a framework for assessing the

effectiveness of UDAG and other development programs. The report concludes that early evidence indicates that UDAG is achieving its narrowly-defined objectives but that these objectives need to be reevaluated from a broad public policy perspective in view of their potential implications for aggregate productivity and growth.

Katzman, Martin T. "The Case Against Bailing Out Distressed Cities." Policy Studies Journal, forthcoming.

According to the author, regional and area development strategies are less effective than policies that target benefits directly to the poor. It does not follow that because poor people live in distressed areas that the local institutions of those areas (public and private) should benefit from a redistribution of funds. An area development strategy tends to reward nonproductive businesses and governments. Moreover, such a strategy often requires a complexity of competing objectives and selection criteria, and thus makes implementation subject to favoritism for special interests. Finally, the capital subsidy is not an effective instrument, because firms in distressed cities are not necessarily hurt by problems of access to private capital. Moreover, a negative income tax would be a more effective way to provide benefits to the poor than area-wide economic development and job creation strategies.

Kurtz, Daniel P. The Lodging Business in New England: Operations Investment and Labor in a Highly Seasonal Industry. Cambridge, MA: Harvard-MIT Joint Center for Urban Studies, May 1980. (Draft.)

In a broader review of the lodging business in New England, the role of UDAG is touched upon briefly. The author cites a General Accounting Office staff interview with three large institutional lenders concerning their investment criteria and judgements. One interviewee said that he, if given the choice, would avoid any involvement with government in joint-financing a project. Another stated that UDAG was being used to push "crazy deals" with financing at 100% cost. The third lender saw UDAG as "the gravy;" a project was evaluated on its merits and UDAG was irrelevant to the investment decision.

May, Judith V. "Leveraging Performance of Federal Economic Development Programs." Washington, DC: U.S. Department of Housing and Urban Development, May 1981.

This paper examines the leveraging performance of four different federal economic development programs: Title I Public Works and Development Facilities under the Economic Development Administration, HUD's Urban Development Action Grants, EDA's Business Development Program, and the Farmers Home Administration Business and Industrial Loan Program. The author describes the

four different programs in terms of objectives, strategies and definitions of private and public investment. She describes the difficulty in comparing the leveraging performance of the four programs. She then presents and compares the findings of separate analyses of each of the four programs that were conducted by other evaluators and analysts. The findings are grouped into two measures of leveraging performance: private investment leveraged by each of the federal economic development programs and total (public and private) investment per job created or saved.

Myers, Phyllis. "Examining UDAG's Record." Urban Land 39 (October 1980): 25-28.

This article was based on a study conducted by the Conservation Foundation to determine the effect of UDAG projects on urban environmental conservation. The author states that UDAG probably funds more rehabilitation projects than any other government programs; however, the UDAG program gives only limited attention to assessments of environmental impact. In only half the projects studied, the City governments called for environmental impact statements. The conclusion of the study is that UDAG should expand and improve consideration of environmental issues in the review of project applications.

Myers, Phyllis. UDAG and the Urban Environment. Washington, DC: The Conservation Foundation, March 1981.

This study was conducted by the Conservation Foundation to assess the effect of UDAG projects on the urban environment. Specifically, this paper examines the importance of Environmental Impact Statements and Section "106" review (impacts on buildings listed on or eligible for the National Register) in UDAG planning and review. In 1979, local controversies arose in several communities over issues of environmental quality and historic preservation, causing delay in project implementation. A major research question of this study is the extent to which these issues are identified and resolved early in the UDAG planning process, and whether the local controversies were exceptions or indicative of a more general problem. The study reports that procedures in place during this study for local environmental assessment and 106 review did not generate the information concisely or early enough to be used by UDAG staff in reviewing projects for preliminary approval. The study concludes by observing that recent trends in UDAG legislation and regulations, as well as new procedures for State Historic Preservation Officers and the Advisory Council on Historic Preservation, emphasize early identification of key issues and a streamlined review process.

Myers, Phyllis, ed. Urban Conservation and Federally Assisted Economic Development in Cities: Putting It Together.

Washington, DC: The Conservation Foundation, July 1980.

This report includes papers presented during a conference sponsored by urban conservation groups to discuss the impact of UDAG on preservation and rehabilitation activities. The papers have shown that UDAG's impact is generally positive. However, 40% of commercial projects involved major clearance, lacked consideration of potential re-use and appeared to threaten the city's economic and architectural make-up. Controversial projects were characterized by a lack of survey information about historic buildings in the community. The preservation-oriented projects compared favorably to the more conventional demolition-oriented projects in terms of private investment leveraged and jobs created. The report recommends more attention to conservation concerns in project planning and more federal influence to encourage preservation planning by cities.

Nathan, Richard P. and Webman, Jerry A., eds. Urban Development Action Grant Program: Papers and Conference Proceedings On Its First Two Years of Operation. Princeton, NJ: Princeton Urban and Regional Research Center, 1980.

Distinguished government, business, and research representatives met for two days in November 1979, to discuss the nature and effects of the UDAG program. In a format of talks, workshops, and papers, the conference focused on the operation of the UDAG program, and the ways in which the program can best be assessed and improved as an effective economic development tool. This volume presents edited proceedings of the conference, an analytical paper on the UDAG program and a statistical profile of the program's activities.

Pierce, Neal and Hagstrom, Jerry. "Preservationists Oppose Developers Over Use Of HUD Action Grants." National Journal (June 7, 1980): 933-935.

The article describes a growing controversy between preservationists and downtown developers over the re-use or destruction of historic buildings. In addition, the article discusses the role of UDAG in the controversy. Cities referenced include Pittsfield, Charleston, Louisville, and Detroit.

Raffel, N. "Industrial Policy and Regional Policy." (draft) Washington, DC: U.S. Economic Development Administration, November 1980.

This paper discusses the interaction between industrial and regional policies as tools to aid the revitalization of the U.S. economy. In particular, the paper indicates that reliance upon one policy direction may not produce the positive adjustments in

the economy necessary to respond to competitive pressures stemming from different sectors of the U.S. economy and from foreign sources. The paper uses data from EDA, FmHA, and UDAG.

Rich, Michael J. "Hitting the Target: The Distributional Impacts of the Urban Development Action Grant Program." Evanston, IL: Northwestern University Center for Urban Affairs and Policy Research, 1980.

This paper is a quantitative analysis of the extent to which UDAG has been targeted to the most distressed cities according to its legislative mandate. In addition, the paper examines the kinds of projects supported by the UDAG program. The model incorporates the six categories used by HUD in determining degree of distress and tests each for relative importance in UDAG's allocation of funds. The paper concludes, however, that population is relatively more important than any of the distress criteria in predicting the allocation of UDAG dollars. Moreover, when population is normalized, (i.e., when distribution of UDAG dollars is reported on a per capita basis), smaller and medium sized cities fare better than larger cities.

Rutgers University Center for Urban Policy Research. The Fiscal Impact of Economic Development Programs: Case Studies of the Local Cost-Revenue Implications of HUD, EDA, and FmHA Projects. New Brunswick, NJ: Rutgers University, November 1980. Washington, D.C.: (Report prepared for U.S. Department of Housing and Urban Development.)

This paper is a quantitative analysis of the primary and secondary fiscal benefits that flow to local jurisdications which have received Federal economic development assistance. Eleven cities in New Jersey that have received UDAG, EDA, and FmHA assistance are used as case studies for the development of complex measures of costs and benefits. The paper concludes that overall, both primary and secondary fiscal benefits exceed the costs of generating these benefits. This is especially true in declining communities which are relatively poor.

Satterthwaite, Ann. "Is It the New Urban Renewal?" Preservation News 19 (December 1979): 1.

This article reports on the October 1979 meeting of the National Trust for Historic Preservation at which four case studies of UDAG-funded projects threatening historic buildings or neighborhoods were presented by local preservation and neighborhood groups. The article contends that conventional review processes were ignored while the four case study projects were streamrolled through. Overall, the article concludes that UDAG threatens historic preservation efforts.

Stanfield, Rochelle L. "Economic Development Aid: Shell-Game or the Key to Urban Rejuvenation." National Journal (March 21, 1981): 494-497.

Through the use of interviews with a number of government officials, this article presents the pros and cons of the UDAG program. All of the interviewees have been involved with the program at either the Federal or local level. Both the arguments for creating the program (i.e., the Carter Administration's position) and the arguments for ending the program (i.e., OMB's recent position) are presented.

Stevenson, Eric. "A Developer's Guide to Urban Development Action Grants." Real Estate Review, 10 (Winter 1981): 80-86.

This is a brief summary of the major features of the UDAG program. The article includes discussions of the criteria for selection of UDAG projects, the application process, the selection procedure for a grant, and the types of projects and methods of financing UDAG projects. The role of Industrial Revenue Bonds is also emphasized.

Todd, William R. Review of Urban Development Action Grant Program. Washington, DC: U.S. Department of Housing and Urban Development, Office of Inspector General, 1980.

This report attempts to determine the adequacy of the policies, procedures, and systems in effect for processing and approving applications and for executing grant agreements in the UDAG program from October 1977 through June 30, 1979. The review found that delays in execution of grant agreements and drawdown of approved UDAG funds indicate a need to implement procedures to strengthen the project selection system. The review also recommends improvement in file control and documentation.

U.S. Congress. Congressional Budget Office, "Urban Development Action Grants: Initial Program Experience, Issues and Options." August 1980. (Draft)

This report details UDAG activities during FY 78-79 in order to provide preliminary information to the Congress (in its reauthorization review) regarding long-term issues, as well as the balance to be sought among different types of projects and appropriate funding levels. Issues addressed are eligibility requirements, types of projects aided, projects' impacts, and the mixture of public and private funds.

U.S. Congress. House Appropriations Committee, Surveys and Investigation Staff. A Report to the Committee on Appropriations, U.S. House of Representatives, on the Urban Development Action Grant Program. April 1980.

This report is based on a review of the UDAG program that was requested by the House Appropriations Committee in June 1979. It addresses the general issues of program regulations, program practices, expenditure rates, and program impacts. The methodology includes field staff visits to an unspecified number of projects in ten states. Over one hundred interviews were conducted with HUD, state, and local officials and with bankers, contractors, representatives of community organizations, and private individuals. Staff found that UDAG stimulates economic development in some cases and in others assists "already acting market forces," and recommended balance in project types and more encouragement of neighborhood revitalization projects. Overall, the report concludes that UDAG works well in industrial and commercial areas but not as well as in conservation of viable residential neighborhoods.

U.S. Congress. House Committee on Government Operations. Statement of Dennis J. Dugan, Chief Economist of U.S. General Accounting Office, Before the Subcommittee on International Relations and Human Resources. May 1979.

This testimony reviews the impact of UDAG for selected projects. It includes information on the number of jobs created, the extent of leveraging, and program beneficiaries. Seventeen grants were reviewed; grant sites were visited, and interviews held with city and HUD officials and some developers. The testimony includes fact sheets for each grant awarded. It also includes grant profiles and economic impacts as calculated by HUD, by grantees, and by GAO.

U.S. Department of Housing and Urban Development. The Action Grant Information Book. Washington, DC: USDHUD, September 1980.

This pamphlet provides a brief description of the eligibility requirements for UDAG funding and the process involved for gaining a grant.

U.S. Department of Housing and Urban Development, Action Grants: Revitalizing and Conserving Cities. Washington, DC: USDHUD, 1980.

This publication describes examples of UDAG's projects developed to revitalize central business districts, older neighborhoods and industrial areas.

U.S. Department of Housing and Urban Development, HUD Answer Book No. 1: Urban Development Action Grant Program For Small Cities. Washington, DC: USDHUD, Atlanta Regional Office, 1980.

This booklet uses a question and answer format to describe criteria for small city participation in the UDAG program. HUD offices are listed and UDAG awards for some small cities are described.

U.S. Department of Housing and Urban Development. Urban Development Action Grant Program. Washington, DC: USDHUD, 1977.

This pamphlet provides a brief description of the UDAG program. It includes information on the criteria for metropolitan city eligibility and selection and a description of the application and award process.

U.S. Department of Housing and Urban Development, Urban Development Action Grant Program: First Annual Report. Washington, DC: Government Printing Office, 1979.

This report provides an overview of UDAG program background, a review of progress made in the program's first fiscal year, a description of the project selection process, and a description of the results of an analysis of project application data (236 projects awarded through FY 1978) and the responses from a January 1979 survey of city officials that had received UDAG awards.

U.S. Department of Housing and Urban Development, Urban Development Action Grant Program: Second Annual Report. Washington, DC: Government Printing Office, 1980.

This report examines all UDAG projects awarded grants for the two years FY 1978 and 1979. Information is provided on project locations and characteristics, potential impacts, and progress toward achieving those impacts as of the end of fiscal year 1979. Some data on projects (including financial characteristics and potential impacts) are derived from a sample of 235 projects with signed grant agreements.

U.S. Department of Housing and Urban Development, Urban Development Action Grant Program: Third Annual Report. Washington, DC: US DHUD, 1981.

This report examines all UDAG projects awarded grants as of FY 1980 to assess project characteristics and planned impacts. Analysis is presented on a sample of 546 projects with executed grant agreements.

U.S. General Accounting Office. Criteria for Participation in Urban Development Action Grant Program Should Be Refined. Washington, DC: USGAO 1980.

A review was made of the six major criteria used by HUD to measure urban distress and cities' eligibility for UDAG participation. The study found that data on which criteria are based are old and/or unreliable, that (for some criteria) time frames and assumptions are questionable, and that HUD's method of determining a city's eligibility does not consider severity of distress for most of the criteria.

U.S. General Accounting Office. Improvements Needed in Selecting and Processing Urban Development Action Grants. Washington, DC: USGAO, 1979.

This early study evaluated UDAG grant approval, rejection, and noldover decisions with reference to program's objectives and criteria for grant approval. Eighteen selected program grants from the 1978 funding rounds were reviewed. The study found deficiency in documentation and a lack of relationship of some grants to program objectives and suggested the necessity for improvement.

"A UDAG Example: The Radisson Wilmington Hotel." Urban Land 39 (June 1980): 5-8.

This article describes a successful UDAG project -- the Radisson-Wilmington Hotel. It reviews the background, project design, primary actors in the development process, and development issues.

Urban Land Institute. Findings of the Special Advisory Panel for the Urban Development Action Grant Program. Washington, DC: Urban Land Institute, 1980.

A panel of experts in development, financing, and public policy met for two days in December 1979 and reviewed 15 representative UDAG projects. The issues examined were the relationship of UDAG to other local efforts at economic revitalization, the necessity of UDAG funding for project development, the role of UDAG in attracting private sector funds, and the types of public objectives met by UDAG. The Panel concluded that UDAG is accomplishing its objectives and is worthwhile for both the public and private sector. The major danger to the program is "bureaucratization," which would endanger its principal advantage: "fast delivery in a high risk enterprise." The Panel also urged a delicate balance between UDAG deal making and city initiative and suggested that present policy of providing loans instead of grants raised concerns. It suggested some possible improvements.

Urban Land Institute. UDAG Partnerships: Nine Case Studies. Washington, DC: Urban Land Institute, 1980.

Nine Case studies, representing a range of UDAG-eligible activities, are presented. Some cases describe how real estate development deals between the public and private sectors can be structured.

Weiman, Jerry A. "UDAG: Targeting Urban Economic Development." Political Science Quarterly 96 (Summer 1981): 189-207.

This article analyzes whether UDAG is successful in attracting new private investment into declining urban areas. A study of impaction shows that more distressed cities did receive disproportionately more UDAG Grants than the less distressed cities. However, the pattern is reversed for the private investment that UDAG leverages. Less distressed cities received more private investment than more distressed cities. The author concludes that UDAG must be considered as one of a number of available types of aid to distressed cities. By encouraging shifts in investment among areas, UDAG can speed the transition of distressed areas to new -- if reduced -- economic functions. If UDAG indeed shifts investment to distressed areas where it would not otherwise occur, then UDAG can play an important rate in this adjustment process.

Weicher, John C. Government Urban Policy and the Lender. Washington, DC: The Urban Institute, 1979.

In the context of an overview of HUD's programs designed to carry out Federal urban policy, the author briefly discusses some characteristics of the UDAG program and compares and contrasts the program to the old urban renewal program.

This report was prepared by:

Division of Policy Studies
Office of Policy Development and Research
U.S. Department of Housing and Urban Development

E. S. Savas, Assistant Secretary
for Policy Development and Research

Feather O'Connor, (Acting) Deputy Assistant Secretary
for Policy Development

Martin D. Abravanel, Director, Division of Policy Studies

Kathleen A. Peroff, Deputy Director

Paul Gatons, Director, Division of Urban Studies, Office of Community Planning and Development

Members of the Study Team:

Michael Brown
Charles E. Connerly
Deborah Devine
Jill S. Ehrenreich
Stephen R. Godwin
Christine M. Howells
Anna Lloyd
Joseph P. McCormick, II
F. Stevens Redburn
Lester Rubin
Howard A. Savage
David W. Sears
Cecile Small
Ron Wienk
William Zook

Special Assistance was provided by: Deborah Arnold, Pat Daly, Dick Fath, Rita V. Gantt, Charlie Hughes, Barbara J. Murphy, John Nagoski, and Sammie Sneed.