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UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

California Department of Housing and Community Development Needed Stronger Controls to Prevent Improper Payments in Its ESG CARES Act Program

Audit Report Number: 2026-LA-1003

March 17, 2026

Highlights

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What We Audited and Why

In August 2024, we issued an audit report on the California Department of Housing and Community Development's (HCD) fraud risk management practices, finding that HCD was not adequately prepared to prevent, detect, and respond to fraud due to the lack of focus it placed on fraud risks and establishing a robust fraud risk management framework for the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act funding for the Emergency Solutions Grant (ESG) program to prevent, detect, and respond to fraud.¹ Building on that work, we audited HCD's ESG CARES Act program to determine whether improper payments existed.

What We Found

HCD made improper payments in its ESG CARES Act program because it did not consistently follow HUD's requirements. Specifically, HCD and its subrecipients did not, (1) determine whether 318 landlord incentives for holding fees², signing bonuses, and additional security deposits totaling \$1.02 million were eligible, reasonable, and necessary; (2) properly draw risk mitigation expenses, which resulted in an overpayment of \$6,549 to landlords and, therefore, called into question the remaining \$185,731 of risk mitigation expenses as unsupported; and (3) properly determine the reasonableness of payments to a contractor that provided kitchen services totaling \$96,561. We determined that these conditions occurred because HCD and its subrecipients believed their practices were in line with the flexibility HUD allowed for landlord incentives under the ESG CARES Act, and because these entities did not have policies and procedures for determining the types of landlord incentives that should be used and when to negotiate them. In addition, both HCD's Emergency Solutions Grants Financial Management and Monitoring Policies and Procedures were silent on subrecipients' monitoring responsibilities over sub-subrecipients and contractors. These results reduced the number of participants that could have been served by the program intended to reduce or mitigate homelessness and impacted on HCD's ability to maintain program and payment integrity of the ESG CARES Act program. Although the ESG CARES Act program has concluded, HCD could make some of the same types of improper payments in the annual ESG program and other HUD-funded program it operates, since these programs allow expenses for similar activities.

¹ HUD OIG audit report 2024-LA-1001 (California Housing and Community Development Should Improve Its Fraud Risk Management Practices for its ESG CARES Act Program), issued August 2, 2024. (See Background and Objectives)

² Unlike a signing bonus or security deposits, landlords received the holding fee subsidies only had to hold their units available for 2 months and not have to successfully rent the units to any participants.

What We Recommend

We made recommendations in this report to address the control deficiencies identified within the ESG CARES Act program, as well as ensure the risk of the deficiencies occurring within the annual ESG program is mitigated. Specifically, we recommend that the Director of HUD's San Francisco Office of Community Planning and Development instruct HCD to (1) repay HUD from non-federal funds for the ineligible landlord holding fees of \$964,952 drawn from ESG CARES Act funds, (2) determine whether the \$58,878 drawn for 18 signing bonuses from ESG CARES Act funds were reasonable under the program participant's particular circumstances, and not more than necessary to house the program participants, or repay HUD from non-federal funds, (3) repay HUD from non-federal funds for the risk mitigation overpayments of \$6,549 drawn from ESG CARES Act funds, (4) determine if the remaining risk mitigation expenses of \$185,731 drawn from ESG CARES Act funds were reasonable and necessary in accordance with program requirements, or repay HUD from non-federal funds, (5) support the cost reasonableness of \$96,561 drawn from ESG CARES Act funds for the kitchen services contractor, or repay HUD from non-federal funds, and (6) develop and implement additional written procedures and internal controls for the ESG program to ensure that it and its subrecipients do not charge holding fees, risk mitigation expenses, and that adequate ESG contracts are properly executed and maintained.

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Background and Objectives

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed on March 27, 2020, provided \$4 billion for the Emergency Solutions Grant (ESG) program to “prevent, prepare for, and respond to coronavirus among individuals and families who are homeless or receiving homeless assistance and to support additional homeless assistance and homeless prevention activities to mitigate the impacts created by coronavirus.” The Act provided funding in two rounds:

- Round 1: \$1 billion allocated under the ESG formula to grant recipients
- Round 2: \$2.96 billion under a formula targeted toward communities with a high incidence of sheltered and unsheltered homeless and those at the greatest risk for homelessness.

The requirements for the ESG program (24 CFR Part 576) applied to the use of the ESG CARES Act funds. ESG funds may be used for the five program components: (1) street outreach, (2) emergency shelter, (3) homelessness prevention, (4) rapid rehousing, and (5) Homeless Management Information System (HMIS). In addition, recipients are allowed to use ESG funds for administrative activities.

The ESG program provides funding to states, local governments, and territories to

- Engage with homeless individuals and families living on the street,
- Improve the number and quality of emergency shelters for homeless individuals and families,
- Help operate these shelters,
- Provide essential services to shelter residents,
- Rapidly rehouse homeless individuals and families, and
- Prevent families and individuals from becoming homeless.

HUD established alternative requirements and flexibilities, as authorized by the CARES Act, through Community Planning and Development (CPD) notices that were issued and posted on its website. For example, HUD included landlord incentives as an eligibility activity. These landlord incentives included (1) signing bonuses up to two months of rent, (2) security deposits of up to three months of rent, (3) paying the costs of repair damages incurred by the program participant, and (4) paying the costs of extra cleaning or maintenance of a program participant’s unit or appliances.

California Department of Housing and Community Development

HUD awarded the California Department of Housing and Community Development (HCD) over \$319.5 million in ESG CARES Act funds through three allocations, as shown in table 1. This amount represents a 2,505 percent increase from the annual formula ESG grant allocation HCD received from HUD for 2000. In fact, between 2020 and 2024, HCD received annual ESG funds totaling over \$62 million, as shown in table 2.

Table 1: ESG CARES Act funding allocated to HCD between 2020 and 2022 (as of August 11, 2025)

Allocation	Contract date	Allocation amount	Total disbursed	Balance	ESG CARES Act expenditure deadline
ESG CARES Act 1	July 23, 2020	\$43,990,603	\$43,990,603		September 30, 2023
ESG CARES Act 2	November 30, 2020	\$271,730,986	\$271,730,986		September 30, 2023
ESG CARES Act Reallocation	September 23, 2022	\$3,818,845 ³	\$3,745,974	\$72,872	June 30, 2024
Total ESG CARES Act		\$319,540,434	\$319,467,563	\$72,872	

Table 2: ESG Funding allocated to HCD between 2020 and 2024

Fiscal Year	Grant Amount
2020	\$12,757,275
2021	\$12,634,701
2022	\$12,513,276
2023	\$12,412,939
2024	\$12,442,477
Total ESG	\$62,760,668

HCD is a department within the California Business, Consumer Services, and Housing Agency (BCSH) of the State of California. HCD provides loans and grants to a range of entities, including public and private housing developers, nonprofit agencies, and various government partners. The Division of Financial Assistance (DFA), an operational division within HCD, is responsible for administering approximately 15 state and federal programs. In February 2021, due to the continued increase in funding HCD received, DFA split into two distinct divisions – State and Federal financial assistance divisions – to address housing and homelessness. As a result, the Division of Federal Financial Assistance (DFFA) assumed the responsibility for administering funding that HCD received from the U.S. Department of the Treasury and HUD, including the ESG CARES Act grant funds.

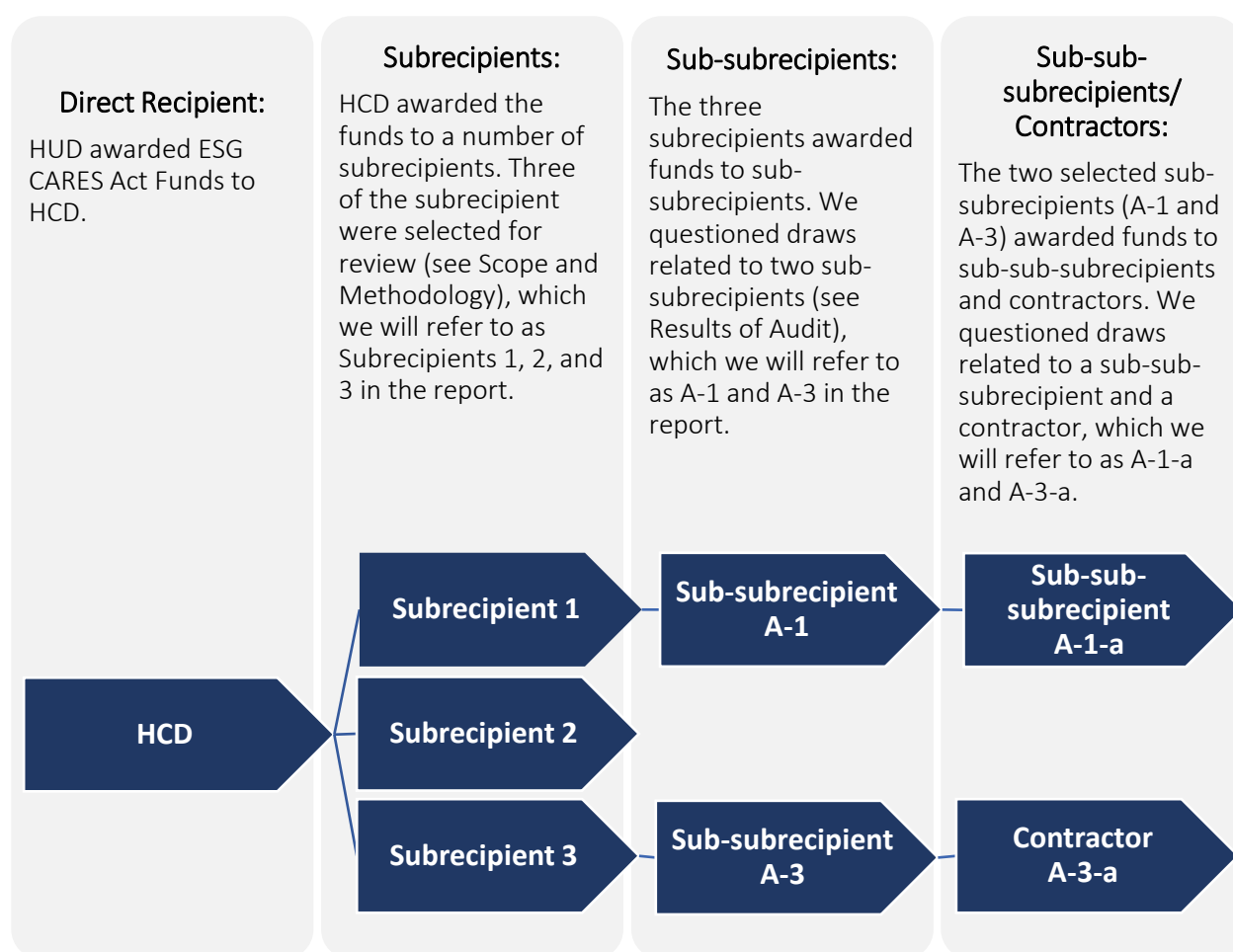
³ Allocation Amount (\$3,818,845) = Total Disbursed (\$3,745,974) + Balance (\$72,872). Difference of \$1 between Total Disbursed plus Balance Amount due to rounding.

HCD's Subrecipients Selected for Review⁴

We selected three⁵ HCD subrecipients for review because they drew \$94 million of the \$319.5 million in total ESG CARES Act funds HCD received from HUD. The subrecipients used \$43 million (or 46 percent) for a rapid rehousing program. The rapid rehousing program was designed to quickly move homeless people to permanent housing through relocation, and stabilization services and for short- and/or medium-term rental assistance. In addition, through CPD Notice 21-08, HUD allowed the ESG CARES Act program and the subrecipients to include landlord incentives as an eligible activity.

A monitoring of funding sequence, shown in table 3 below, traces the inflow and outflow of funds from HCD, the direct grantee, to the three subrecipients, and its lower tiered subrecipients or contractors of the ESG CARES Act program.

Table 3: ESG CARES Act Monitoring of Funding Sequence



⁴ See Scope and Methodology section for selection method.

⁵ Based on PR 91 report, as of May 7, 2025, HCD had 51 subrecipients. We selected three subrecipients for review using a risk-based approach.

Improper Payments

Appendix C to OMB Circular A-123, Requirements for Payment Integrity Improvement, defines an improper payment as a payment that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements. All improper payments fall into one of two categories: (1) improper payments resulting in a monetary loss or (2) improper payments that do not result in a monetary loss.

- Monetary loss improper payments can be either intentional or unintentional. Intentional monetary loss improper payments are referred to as financial fraud and overpayments that occur on purpose. Unintentional monetary loss improper payments are overpayments that are accidental in nature because at the time of the payment the program is unaware that the payment is an overpayment and the recipient has also not purposefully falsified information for gain.
- Non-monetary loss improper payments can be either underpayments or technically improper payments. Technically improper payments are instances where payments were made to the right recipient and for the right amount, but the payment process did not follow all applicable statutes and regulations.

Prior HUD OIG Audit Report: California Housing and Community Development Should Improve Its Fraud Risk Management Practices for Its ESG CARES Act Program

We issued audit report 2024-LA-1001, dated August 2, 2024, reviewing HCD's fraud risk management practices for its ESG CARES Act program and reporting that HCD was not adequately prepared to prevent, detect, and respond to fraud. Based on our audit findings, we recommended that HUD require HCD to:

- 1A Establish a fraud risk management framework consistent with GAO's Standards for Internal Control in Federal Government (Green Book), and in alignment with best practices from GAO's A Framework for Managing Fraud Risks in Federal Programs and the Chief Financial Officers Council's Antifraud Playbook.
- 1B Obtain training or technical assistance on the implementation of fraud risk management practices.

HCD addressed both recommendations and HUD closed them on April 9, 2025.

Based on our results reported in 2024-LA-1001, we initiated this follow-on audit with an audit objective to determine if improper payments existed in HCD's ESG CARES Act program.

Results of Audit

HCD Made Some Improper Payments in Its ESG CARES Act Program

HCD made some improper payments in the ESG CARES Act program. Specifically, HCD and its subrecipients did not (1) determine that 318 landlord incentives for holding fees, signing bonuses, and additional security deposits totaling \$1.02 million were eligible, reasonable, and necessary; (2) properly draw risk mitigation expenses, which resulted in an overpayment of \$6,549 to landlords and, therefore, calls into question the remaining \$185,731 of risk mitigation as unsupported; and (3) properly determine the reasonableness of 7 payments made to one contractor that provided kitchen services totaling \$96,561. These conditions occurred because we determined that HCD and its subrecipients believed their practices were in line with the flexibility HUD allowed for landlord incentives under the ESG CARES Act, and because these entities did not have policies and procedures for determining types of landlord incentives that should be used and when to negotiate them. In addition, both HCD's Financial and Monitoring Policies and Procedures were silent on subrecipients' monitoring responsibilities over sub-subrecipients and contracts. These results reduced the number of participants that could have been served by the program, intended to reduce or mitigate homelessness, and impacted HCD's ability to maintain program and payment integrity of the ESG CARES Act program. Although the ESG CARES Act program has concluded, HCD could make some of these types of improper payments in the annual ESG program and other HUD-funded program it operates, since these programs allow expenses for similar activities.

Subrecipients Improperly Paid \$1.02 Million in Landlord Incentives

HCD and its subrecipients made improper payments of \$1.02 million for landlord incentives, including holding fees, signing bonuses, and additional security deposits.

A Subrecipient Paid Ineligible Holding Fee Subsidies to Landlords as Incentives to Hold Units Available for 2 Months

HCD's subrecipient 1 provided ESG CARES Act funding to its own subrecipient (A-1) for rapid rehousing, who, in turn, passed the funding to a subrecipient nonprofit (A-1-a).



Sub-sub-subrecipient A-1-a used the ESG CARES Act funds to supplement a pre-COVID holding fee program using non-federal funds. Specifically, sub-sub-subrecipient A-1-a paid to landlords 300 holding-fee subsidies, limited to 2 months' rent, for the purpose of keeping some units available without having any prospective participants/tenants identified for or interested in those units. Unlike a signing bonus or a security deposit, landlords that received the holding fee subsidies only had to hold their units available for 2 months and not have to successfully rent the units to any participants. If the units were not rented after the 2 months, the landlords kept the holding fee subsidies without further obligation to rent the units at a future time.

The CARES Act authorized HUD to establish alternative requirements to the ESG regulations found in (24 CFR part 576), allowing recipients of ESG CARES Act funds to use the funds for paying certain incentives to landlords. These landlord incentives included signing bonuses, security deposits, costs of repairs not covered by the security deposits, and costs of extra cleaning or maintenance of the participant’s unit or appliances. The alternative requirements limited the landlord incentives to ensure they were used only when necessary to secure housing for an eligible household. This was meant to avoid the issuance of landlord incentives in cases where, for example, a landlord would have otherwise rented a unit to a program participant without the incentive, or the payment of an incentive would not have resulted in an eligible household obtaining a unit. Further, the alternative requirement established by the CARES Act did not identify “holding” fees arrangements as an eligible landlord incentive. HUD also required the grantees to support the landlord incentive costs by documenting that each cost was reasonable under the program participant’s particular circumstances, and not more than necessary, which Sub-sub-subrecipient A-1-a did not do. In addition, since the holding fee arrangement was established with the landlords before prospective program participant(s) had been identified, it did not show reasonableness under the program participant’s particular circumstances as required by HUD. We determined that HCD, Subrecipient 1, Sub-subrecipient A-1, and Sub-sub-subrecipient A-1-a all believed that they were in line with the flexibility allowed under ESG CARES Act for landlord incentives. However, they misinterpreted the landlord incentives requirements. HCD also had no policies and procedures properly defining the eligible types of landlord incentives on how it should be used or how to negotiate them. Consequently, we determined \$964,952 used to pay holding fee subsidies to landlords to be ineligible costs to the program.

A Subrecipient Paid Signing Bonuses and Additional Security Deposits to Landlords Without Supporting the Costs Were Reasonable

HCD’s Subrecipient 2 paid 18 landlord incentive signing bonuses or additional security deposits⁶ totaling \$58,878 on behalf of program participants but did not document the costs paid were reasonable, and necessary as required by HUD alternative requirements to the ESG regulations (24 CFR 576), as authorized under the CARES Act for landlord incentives, and were therefore improper payments.



Subrecipient 2 only documented the amount of the landlord incentives and not differentiating whether they were signing bonuses or security deposits.⁷ Further, the negotiation of the signing bonuses or security deposits with landlords were not documented. It stated that it had relevant case notes from its system reflecting the circumstances surrounding the incentives; however, for the three sample items reviewed totaling \$9,070, the notes and records provided only showed that the participants were on a

⁶ ESG CARES Act funded security deposits, equal to up to 3 months of rent, in addition to security deposit amounts allowed and funded by annual ESG funds.

⁷ Of the 3 landlord incentives reviewed, the invoices or supporting records did not specify the type of landlord incentives used. It was through our request for additional information, we were informed, via email, that one was for signing bonus and two were for additional security deposits for the 3 sample items we reviewed.

fixed monthly income and homeless. It also stated two⁸ of the 3 samples reviewed were used to pay for additional security deposits (3 months' rent). However, the amount funded by the ESG CARES Act program had not been incorporated into the participants' lease agreements, which only showed the amount of security deposit⁹ from its annual ESG. Subrecipient 2 indicated that there were no agreements with the landlord, documenting the additional security deposits received and held by the landlords. As a result, this meant that tenants did not have something in writing to show that they were entitled to an additional 3-month security deposit, separate from the security deposits under 24 CFR 576.105(a)(2), provided by the ESG CARES Act. Contrary to California State Law¹⁰, which subrecipient 2 said it defers to, subrecipient 2 said that "there was no expectation or requirement for the landlord to reimburse the [additional security deposits] funds."

Subrecipient 2 also did not follow HCD's Emergency Solutions Grant Program – Program Income Policy, which encourages subrecipients to require security deposits paid with grant funds to be disbursed by the landlord directly to the participant when they leave their subsidized unit or exits the project. California Civil Code Section 1950.5(h)(1) states that, no later than 21 calendar days after the tenant has vacated the premises, the landlord shall furnish the tenant, a copy of an itemized statement indicating the basis for, and the amount of, any security received and the disposition of the security, and shall return any remaining portion of the security deposit. The rental agreements signed by the tenants and landlords also had this stipulation like the California State Law. However, we determined that the landlords did not return to the tenants' ESG CARES Act funded security deposits. Subrecipient 2 did not track whether security deposits go back to tenants, leaving it to the owner/tenant, which resulted in the landlords not returning the security deposits as required by the California Civil Code section 1950.5. Further, there were no policies and procedures for determining when the signing bonuses should be used or how to negotiate them based on the program participant's particular circumstances. As a result, we determined \$58,878 used for landlord incentive signing bonuses or security deposits were unsupported costs to the program.

A Subrecipient Improperly Paid Risk Mitigation Expenses for Damage Claims, Delinquent Rent, and Vacancy Loss, in Excess of Three Months

HCD's second-tiered subrecipient (A-1) set aside risk mitigation funds up to \$10,000 per unit for damage claims, delinquent rent, and vacancy loss.



According to HCD's How-to Guide: Being Proactive About Potential Unit Damage, under section ESG and Unit Damage, ESG program funds can pay for security deposits, which can be used to pay for unit damages. In addition, neither ESG program funds, nor other funds recognized as ESG match, can pay for damage caused by participants. However, ESG recipients may leverage other funds to pay for damage

⁸ Due to personal identifiable information (PII), we provided the specific sample items including names of participants and addresses separately to HCD and HUD (see appendix C)

⁹ Not to exceed two times the monthly rent for unfurnished apartments or three times the monthly rent for furnished apartments.

¹⁰ California Civil Code Section 1950.5

caused by participants if permitted by the leverage funder. Grants from organizations, such as local charitable foundations are a common course of unrestricted funds that can be used as leverage. Although risk mitigation is not an eligible ESG expense, HUD’s CPD notice 21-08 allowed payments for damage claims as landlord incentives under ESG CARES Act, but not to exceed 3 months’ rent.

Despite HCD’s How-to Guide, Sub-subrecipient A-1 used ESG CARES Act funds for risk mitigation to cover excessive damage to the rental units caused by program participants. Overall, there were 56 payments towards risk mitigation totaling \$200,366, ranging from \$74 to \$14,105. Our review of risk mitigation for 2 clients, \$14,634, identified payments over the maximum allowed for owner incentives, resulting in ineligible overpayments of \$6,549 (45 percent). Due to Sub-subrecipient A-1’s risk mitigation policies not aligning with CPD’s requirements and the overpayments identified in our review, it calls into question the remaining risk mitigation expenses of \$185,731 (see appendix C) as unsupported. HCD lacked sufficient written procedures and internal controls to ensure its subrecipients followed program requirements and its own guidance concerning the use of landlord incentives for risk mitigation costs, resulting in improper payments of \$192,280.¹¹

A Subrecipient Did Not Properly Determine Cost Reasonableness for \$96,561 Paid to a Food Services Consulting Contractor

HCD’s subrecipient 3 did not ensure its own sub-subrecipient, A-3, properly determined and documented the reasonableness of costs paid to its kitchen services contractor totaling \$96,561¹².



The executed agreement between Sub-subrecipient A-3 and Contractor A-3-a was not adequate, resulting in the entire amount charged to ESG-CV being unsupported and therefore an improper payment. The agreement lacked essential information necessary to determine whether the services being procured were reasonable and allowable. For example, the agreement only stated that operational management for nutritional services would be provided for the period beginning on or around January 10, 2022, and ending July 31, 2022, with some billing information and minimal contract terms information concerning termination notice. The agreement did not clearly identify number of people being trained, the number of meals produced, days or hours of training, or the costs/rates. The biweekly invoices also had no details other than the total amount. Our review of procurement and bidding information found that sub-subrecipient A-3 had not obtained competitive bids, stating it considered the situation to be an emergency and that no other vendors were interested. It therefore could not provide cost information obtained from other sources at the time of the award. While Sub-subrecipient A-3 is a nonprofit that does provide meal services, we could not determine whether the cost paid to the contractor was reasonable due to the lack of information available regarding the number of individuals being trained, the number of meals produced, or through Subrecipient 3’s non-existent competitive procurement practice.

According to HUD’s CPD notice 21-08, the recipient may deviate from the applicable standards under ESG

¹¹ Improper payments of \$192,280 includes \$6,549 of ineligible overpayments and \$185,731 of unsupported costs

¹² The contractor was paid \$138,764 for their services, but only \$96,561 was charged to ESG CARES Act funds.

CARES Act; however, it must establish alternative procurement standards used to safeguard, and maintain documentation on the alternative written standards, and maintain documentation on the alternative procurement standards used to safeguard against fraud, waste, and abuse in the procurement of goods and services, which Sub-subrecipient A-3 had not done. Both HCD's Emergency Solutions Grants (ESG) Financial and Monitoring Policies and Procedures are silent on subrecipients' monitoring responsibilities over sub-subrecipients and contract term requirements. Without sufficient policies and procedures, in addition to adequate monitoring, HCD may become more vulnerable to making payments that should not have been made or were incorrect amounts.

Conclusion

HCD and its subrecipients paid over \$1.2 million in improper payments from its ESG CARES Act program funds for landlord incentives, and risk mitigation funds because we determined that they believed that they were in line with the program's flexibility but misinterpreted the requirements. Also, HCD did not have policies and procedures for determining when and the types of landlord incentives that should be used or how to negotiate them. Proper interpretation of the ESG CARES Act program requirements and the flexibilities allowed would ensure that these funds could have been used to further maximize the impact of the ESG CARES Act program had on the population intended to benefit from it -those who were homeless or at risk of homelessness. There were also improper payments of \$96,561 in cost reasonableness paid to a kitchen services contractor, because both HCD's Emergency Solutions Grants Financial Management and Monitoring Policies and Procedures are silent on subrecipients' monitoring responsibilities over second tiered subrecipients and contract term requirements. Without adequate monitoring, HCD will be more vulnerable to making payments that should not be made or are in incorrect amounts. While the ESG CARES Act program is over, some of the deficiencies identified related to holding fees, risk mitigation expenses, or unsupported contractor costs could be occurring in HCD's annual ongoing ESG program, resulting in additional improper payments.

Recommendations

We recommend that the Director of HUD's San Francisco Office of Community Planning and Development instruct HCD to:

- 1A. Repay ineligible landlord holding fees of \$964,952 drawn from ESG CARES Act funds to HUD from non-federal funds.
- 1B. Determine if the \$58,878 drawn for 18 signing bonuses or additional security deposits from ESG CARES Act funds were reasonable under the program participant's particular circumstances, and not more than necessary to house the program participants or repay HUD from non-federal funds.
- 1C. Repay risk mitigation overpayments of \$6,549 drawn from ESG CARES Act funds to HUD from non-federal funds.
- 1D. Determine if the remaining risk mitigation expenses of \$185,731 drawn from ESG CARES Act funds were reasonable and necessary in accordance with program requirements or repay HUD from non-federal funds.

- 1E. Support the cost reasonableness of \$96,561 drawn from ESG CARES Act funds for the kitchen services contractor or repay HUD from non-federal funds.
- 1F. Develop and implement additional written procedures and internal controls for the annual ESG program to ensure that it, and its subrecipients, do not charge holding fees and risk mitigation costs as expenses to the program, and that contracts are properly executed and maintained.

Management Response

HCD's Response

HCD generally agreed with our recommendations, except for recommendations 1A and 1B regarding the landlord incentives. HCD stated that during the COVID-19 pandemic, the environment for homelessness and housing faced unprecedented challenges that made housing people experiencing or at risk of homelessness increasingly difficult. HCD further specified that HUD waivers were meant to incentivize risk-averse landlords to rent to high-barrier individuals and families.

For subrecipient 1 and its lower-tiered subrecipients that administered the holding fee program (Recommendation 1A), HCD further explained that CPD-21-08 lists specific landlord incentives that are "included" in the definition; however, the notice does not specify that the list of included landlord incentives provided is exhaustive. This program was only available to landlords of high demand units, and 85 percent of those units were leased to participants in the Coordinated Entry System (CES).

Regarding subrecipient 2, which used landlord incentives for signing bonuses or additional security deposits (Recommendation 1B), HCD stated that the subrecipient's policies and procedures did include the approval and use of the ESG-CV landlord incentives, and that both signing bonuses and security deposits are allowed under the CPD Notice 21-08. HCD further explained that the lease-incentive security deposits allowed under the ESG-CV waiver were invoiced and tracked separately from the security deposits identified in tenant rental agreements. HCD confirmed that these lease-incentive security deposits were not returned to HCD or to Subrecipient 2 because they were not part of the rental agreement and, therefore, not subject to California Civil Code Section 1950.5(h)(1).

HUD CPD San Francisco Field Office Response

HUD's Office of Community Planning and Development (CPD) provided comments for recommendations 1A (ineligible landlord holding fees of \$964,952). HUD had no comments on the other findings and recommendations.

HUD stated that the alternative requirements established by the CARES Act (the notice) for the payment of landlord incentives includes a "non-exhaustive list of eligible landlord incentives, which does not explicitly include holding fees, nor does it explicitly exclude holding fees" Therefore, the cost that the subrecipient is classifying as a holding fee would be acceptable if it meets the other program requirements; 1) did not exceed three times the rent charged 2) reasonable and necessary to obtain housing for individuals and families; and 3) determined to be reasonable under the program participant's particular circumstances, and not more than is necessary to house the program participant. HUD further explained that in many communities, before, during, and after the COVID-19 pandemic, recipients and subrecipients were demonstrating that landlords were reluctant to rent to people experiencing homelessness and that additional incentives were, and continue, to be needed to convince landlords to

rent to people experiencing homelessness. HUD considered the presence of a pre-COVID holding fee program to demonstrate the community need for this type of assistance combined with program participant case files that demonstrate ESG eligibility, e.g., low-income and homeless status documentation, as reasonable certification of the need and the program participant's particular circumstances. HUD also asserted that the draft report stated that in certain cases the subrecipient paid less than two months of rent allowed by the notice which demonstrated that the incentive was limited to the need of that particular program participant.

HUD agreed that instances in which an individual was not placed in housing would be considered ineligible cost based on the intent of the waiver but offered an alternative consideration that could make the costs acceptable. HUD believes the subrecipients documentation would need to be viewed on a case-by-case basis, and suggested the recommendation be consistent with the others, to review supporting documentation to determine eligibility.

Both the HCD and HUD CPD management's comments are included in Appendix B.

OIG Evaluation of Management Response

OIG Evaluation of HCD's Response

While we recognize the extraordinary circumstances of the coronavirus pandemic, we disagree that no repayment is owed to HUD because HCD did not follow HUD's requirements for the landlord incentives.

Regarding subrecipient 1 and its lowered tiered subrecipients, the CPD Notice of 21-08, strictly defines the types of costs eligible for landlord incentives to only include signing bonuses equal up to 2 months of rent, security deposits equal up to 3 months of rent, the cost of repairing damages incurred by the program participant not covered by the security deposits, and the costs of extra cleaning and maintenance of a participant's unit or appliances. We determined that the system used by the sub-subrecipient A-1-a to track landlord incentives for holding fees and the placement of participants could not report out on ESG CARES Act funded activity. The manually generated spreadsheet and the data it used to pull the information had multiple errors. As a result, HCD's claim that 85 percent of those units were leased to participants was based on unreliable system data.

Regarding subrecipient2, we acknowledge that its ESG-CV Written Standards include basic information about landlord incentives. However, they lack detailed policies and procedures regarding when to use them, which types to use, and how to negotiate them based on the program's particular circumstances. While we acknowledge that both signing bonuses and landlord-incentive security deposits are allowed under the CPD Notice 21-08, the subrecipient did not keep proper records of these deposits. Upon our request for information, the subrecipient contacted the landlord and found that the landlord could not provide a valid reason for withholding the tenant's security deposits. It also said that it verbally informed the landlord of its violation of the state law, adding in the email that it is their policy to adhere to the California State Law. Finally, CPD Notice 21-08 states that requirements at 24 CFR Part 576 apply to the use of these (CARES Act) funds, unless otherwise provided by alternative requirements.

OIG Evaluation of HUD CPD San Francisco Field Office Response

We disagree with HUD that the CPD Notice 21-08 for the payment of landlord incentives was a “non-exhaustive list” of eligible landlord incentives and that holding fees met the other requirements. The notice establishes a closed set of four specific categories (i) signing bonuses; (ii) security deposits; (iii) repair damages incurred by the program participant not covered by the security deposits; and (iv) extra cleaning or maintenance. Because HUD chose to enumerate these specific costs, any cost not explicitly listed, such as a holding fee, falls outside the scope of the waiver’s authority. CPD Notice 21-08 references back to the requirements at 24 CFR Part 576 unless provided by the alternative requirements.

While we acknowledge the extenuating circumstances of COVID-19, holding fee subsidies were not identified as an eligible landlord incentive. Furthermore, holding fee arrangements were established with landlords before prospective program participants had been identified. Therefore, they did not demonstrate reasonableness under the program participant’s particular circumstances, as required by HUD.

We believe HUD has misinterpreted a statement in the draft report regarding the 300 holding fee subsidies. HUD indicated that instances of subrecipient paying less than two months of rent demonstrated that incentive were limited to individual participant need. However, our report was describing the (lower-tiered) subrecipient’s policy regarding their holding fee program structure, noting that payments were allowed for up to two months of rent and that 300 holding fee payments were paid out. We didn’t find any instances of holding fee subsidies that were less than two months’ rent as part of our sample review. We made a minor adjustment to the applicable sentence in the report for better clarity.

We can further discuss the recommendation (1a) and how to address the 300 ineligible holding fee subsidies paid to landlords with HUD as part of the audit resolution process.

Scope and Methodology


We conducted our audit offsite from August 2024 through July 2025. Our audit covered the period April 1, 2020, through June 30, 2024. Most interviews and discussions were conducted offsite, with a few conducted on-site in the greater Los Angeles area. Our audit focused on whether improper payments existed in HCD's ESG CARES Act program.

To accomplish our objective, we performed the following:

- Reviewed pertinent criteria, including applicable laws, regulations, policies, procedures, and other relevant documentation related to HUD's ESG and ESG CARES Act programs.
- Interviewed and/or obtained information from officials from HCD, HCD's subrecipients, the HUD San Francisco field office, and HUD CPD Headquarters.
- Reviewed the policies and procedures for HCD and its subrecipients, as well as other relevant documentation.
- Obtained and reviewed the general ledgers from HCD and its subrecipients for the ESG CARES Act program.
- Selected a sample of three subrecipients, based on risk factors, and reviewed transaction-level data.
- Reviewed the supporting documentation for sampled expenditures to determine if improper payments existed.
- Reviewed the general ledger for HCD's subrecipients to determine the number and amount of landlord incentives for holding fees, signing bonuses, and additional security deposits paid to landlords.
- Reviewed the general ledger for HCD's subrecipient to determine the number and amount of risk mitigation expenses paid to landlords.
- Reviewed HCD's subrecipient food service operation contract to determine the cost reasonableness paid to a kitchen services contractor.

Initially we selected a sample of three subrecipients, based on risk factors, to include in our review.¹³ From these three subrecipients, we obtained a universe of 30,273 ESG CARES Act expenses and selected a statistical sample of 90 records to determine if the payments were proper or improper. Based on our initial review of the 15 out of 90 expenses, we did not proceed with reviewing the remaining 75 expenses and instead focused our review on risk areas we identified. These areas included landlord incentives for holding fees, signing bonuses, additional security deposits, food services contract, and risk mitigation

¹³ Due to the significant number of sub-subrecipients awarded ESG CARES Act funds by some of our three selected subrecipients, we further refined our scope to focus on Subrecipient 1's largest sub-subrecipient of ESG-CV funds and Subrecipient 2's internal departments/divisions.



expenses. Therefore, in addition to the 15 statistical sample expenses initially reviewed, we selected 11 more sample expenses from our statistical sample, and an additional 2 expenses outside our statistical sample from general ledger data that were related to these risk areas.

We relied in part on data provided by HCD and its subrecipients. We determined that the data was sufficiently reliable for the purposes of our review because we corroborated the data with supporting documentation that was provided by HCD and its subrecipients.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objective.

Appendixes

Appendix A – Schedule of Questioned Costs

Table 4. Schedule of Questioned Costs

Recommendation Number	Ineligible 1/	Unsupported 2/
1A	\$964,952	
1B		\$58,878
1C	\$6,549	
1D		\$185,731
1E		\$96,561
Totals	\$971,501	\$341,170

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. In this instance, the ineligible costs associated with recommendations 1A and 1C represent the (1) 300 holding fee subsidies paid to landlords as incentives to hold units available for two months, and (2) overpaid payments, not to exceed 3 months' rent, paid over the maximum allowed for landlord incentives charged to risk mitigation expenses for unit damage claims, delinquent rent, and vacancy loss, on behalf of the program participants.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve legal interpretation or clarification of departmental policies and procedures. In this instance, the unsupported costs associated with recommendations 1B, 1D, and 1E represent the (1) the missing documentation that the 18 signing bonuses or additional security deposits totaling \$58,878, (2) the universe of \$200,366 less \$14,634 of the tested risk mitigation expenses, totaling \$185,731 in untested but questionable risk mitigation expenses, and (3) grant funds of \$96,561 drawn with no support for cost reasonableness.

Appendix B – Management Response

The Department of Housing and Community Development’s Response

The following comments were provided by HCD:

STATE OF CALIFORNIA - BUSINESS, CONSUMER SERVICES AND HOUSING AGENCY
DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF FEDERAL FINANCIAL ASSISTANCE
May Lee State Office Complex
851 Bannon Street
Sacramento, CA 95811
(916) 263-2771

www.hcd.ca.gov

GAVIN NEWSOM, Governor



HCD Response to OIG Draft Audit Report

February 13, 2026

MEMORANDUM FOR: Office of Audit/Office of Inspector General /US Department of Housing and Urban Development

FROM: Gustavo Velaquez, Director of the California Department of Housing and Community Development

A handwritten signature in blue ink, appearing to read "Gustavo Velaquez".

SUBJECT: Office of Inspector General Audit Report Number: 2026-LA-100X

Dear Tanya Schulze:

Thank you for the opportunity to review and provide comments on the audit titled, "California Department of Housing and Community Development Needed Stronger Controls to Prevent Improper Payments in Its ESG CARES Act PROGRAM." Thank you also for meeting with us to discuss the recommendations in the Draft Audit Report.

I would like to mention once again how much HCD appreciates its very productive working relationship with the HUD OIG team, throughout the course of this audit. HCD is immensely grateful for its federal resources, such as through this ESG CARES Act Program (ESG-CV), and extremely proud of its accomplishments in preventing homelessness and serving vulnerable Californians experiencing homelessness during the unprecedented Covid-19 pandemic.

I would also like to emphasize that, of the \$319.5 million in ESG-CV funds awarded to HCD, this Draft Report reflects recommendations relating to just 0.41% of total expenditures made under this grant.

As we have discussed, HCD disagrees with the conclusions drawn from the audit process and the recommendations OIG is making to the HUD San Francisco Office of Community Planning Development (CPD). However, HCD will take appropriate steps under the direction of the HUD CPD San Francisco Office to implement the recommendations provided by OIG, where feasible.

HCD is committed to adhering to the regulations for each program activity it awards and assisting grantees/subrecipients in administering funded programs within the regulatory framework. From October 2020 to October 2024, HCD administered \$319.5 million in ESG-CV funds, urgently and compliantly serving 47 communities, including seven tribal communities and 100,054 individuals across California during an unprecedented global pandemic, where housing vacancy rates were at historic lows and the risk of homelessness at historic highs. Below, HCD is pleased to provide a response for each of HUD-OIG's recommendations. (Note: 100% of funds were expended. The \$72,872 balance referenced in the HUD OIG report is a result of repayments for equipment sold after grant close-out in adherence with 2 CFR 200 rules around acquired property disposition.)

During the COVID-19 pandemic, the environment for homelessness and housing faced unprecedented challenges that made housing people experiencing or at risk of homelessness increasingly difficult. There was an urgency to move people off the streets and into non-congregate shelter or permanent living situations quickly, so they were not at risk of transmitting or being exposed to coronavirus. Non-congregate shelter and permanent housing were life-saving interventions to prevent hospitalization and reduce deaths.

During the pandemic, landlords became increasingly risk-averse, particularly as California's eviction moratorium temporarily limited their ability to remove tenants for nonpayment or lease violations. The very low rental vacancy rate made it even more difficult to secure units for high-barrier clients with unstable/inconsistent rent histories in this environment.

HUD released several CPD Notices beginning in 2020 that implemented waivers that lifted restrictions in the ESG federal regulations, 24 CFR 576. Landlord Incentives were presented in CPD-21-08. The Notice stated that "waiving the limitation of paying for landlord incentives would increase the number of housing units available for quickly rehousing people experiencing homelessness or at risk of homelessness, especially in tight rental markets, which is critical to preventing the spread of coronavirus and helping mitigate the economic impact of the crisis."

HCD strongly supports the rapid rehousing and emergency shelter programs that were developed and expeditiously implemented by Subrecipients 1, 2, and 3. These programs met the directive by HUD to mitigate the effects of the COVID-19 pandemic in the homeless population by quickly housing those on the streets. This often required expanding an already existing program to meet heightened need during the pandemic.

Responses to HUD recommendations

Recommendation 1A: Repay ineligible landlord holding fees of \$964,952 drawn from ESG CARES Act funds to HUD from non-federal funds.

HCD Response: Overall, HCD disagrees with OIG's restrictive interpretation of landlord incentives described in CPD-21-08. The HUD waivers were meant to incentivize risk-averse landlords to rent to high-barrier individuals and families. The open rental market requires prospective tenants to meet strict eligibility criteria, a minimum credit score (typically 600 or above), verifiable monthly income equal to 2–3 times the rent, and a clean rental history with no evictions or outstanding balances owed to previous landlords. People who are experiencing homelessness typically do not meet these standard screening criteria. Without additional assurances, landlords are unwilling to approve a rental application from someone in these circumstances, and the individual/family will remain on the streets.

Subrecipient 1, Sub-subrecipient A-1 (A-1) and Sub-sub-subrecipient A-1-a (A-1-a) administered the holding fee program in good faith with the understanding that the program design was compliant with ESG-CV, which waived the prohibition on landlord incentives usually present for ESG. The subrecipients classified holding fees as a type of landlord incentive. CPD-21-08 lists specific landlord incentives that are "included" in the definition; however, the notice does not specify that the list of included landlord incentives provided is exhaustive. The CPD Notice capped landlord incentives at no more than three months of rent. The subrecipient's holding fee program policies and procedures clearly stated a landlord could receive up to two months of rent per unit. We firmly believe they stayed within the overall guidance stated in the CPD Notice.

This holding fee program helped ensure all Coordinated Entry System of Care (CES) participants had a fair opportunity to secure stable housing and gave them a "right of first refusal" for a two-month period in which they could view and apply for units, and units could undergo quality inspections and then get leased up. Per Sub-subrecipient A-1 (A-1)'s 2021-22 Housing Location Scope of Required Services (SRS), the holding fee program was only available to landlords of high demand units that would best fit the needs of clients in CES, such as one-bedroom units, studios or efficiency units. In Subrecipient 1's county, vacancy rates were lower than the national average, ranging between 3-5 percent while the holding fee program was being administered during the years of the pandemic. Of the units for which landlords received a holding fee with ESG-CV funds, 85-percent of those units were leased to participants in CES. In the limited instances where it took longer than 60 days to get a CES participant qualified for a held unit, the landlord never received more than the two-month holding fee incentive.

The holding fee created a system-wide method for engaging with landlords that was much more effective than when individual case managers tried to advocate on behalf of a single client or tenant. This leveled the playing field, negotiating a standard holding fee and a standard rent that would bring the unit to the CES.

Recommendation 1B: Determine if the \$58,878 drawn for 18 signing bonuses or additional security deposits from ESG CARES Act funds were reasonable under the program participant's particular circumstances, and not more than necessary to house the program participants or repay HUD from non-federal funds.

HCD Response: HCD disagrees with the restrictive interpretation of the types of documentation required to support a landlord incentive. Landlord incentives served as a critical tool to mitigate the perceived financial risk and encourage landlord participation in the ESG-CV program. The landlord incentives served to mitigate the landlord's perceived risk in renting to a high-barrier tenant and were critical in successfully securing permanent housing for the clients in alignment with the goals of the ESG-CV program to rapidly rehouse individuals and families.

The vacancy rate in Subrecipient 2's county for the second quarter of 2021 was 1.9 percent. This low vacancy rate warranted the use of sign-on bonuses and security deposits in an environment where a tenant on the open market who was able to afford rent without any subsidy would be preferred over a tenant with no rental history, a history of homelessness, and extremely low income. In addition, there was an eviction moratorium in place in California which made it hard to motivate landlords to take tenants with unstable rental history.

Furthermore, HCD contends that homeless individuals share the same common eligibility barriers in the open rental market: minimum credit score, verifiable monthly income equal to 2–3 times the rent, and a clean rental history with no evictions or outstanding balances owed to previous landlords. People who are experiencing homelessness do not meet these strict standards of screening.

Subrecipient 2's policies and procedures document did include the approval and use of the ESG-CV landlord incentives. Both the signing bonuses and security deposits allowed under the CPD Notice 21-08, Landlord Incentives section, served as a negotiation tool with a purpose to mitigate potential risks perceived by the landlord and to facilitate access to stable housing for homeless tenants.

HCD confirmed with Subrecipient 2 that there was a landlord incentive approval process in place. Social workers were responsible for presenting each case to the manager, ensuring they were fully aware of the client's situation before authorizing the incentive. The regional manager of the administering department was required to review the circumstances and approve all assistance prior to issuance.

Landlord signing bonuses of up to two-month's rent and security deposits of up to three-month's rent were documented and allowed in Subrecipient 2's ESG-CV policies and procedures. Caseworkers were meeting with program participants, obtaining homeless status intake information, documenting the history and confirming all other financial and housing resources were exhausted. This information was completed for every person experiencing homelessness who came into the CES during the COVID-19 pandemic due to their vulnerability.

Lease-incentive security deposits allowed under the ESG-CV waiver were invoiced and tracked separately from the security deposits identified in tenant rental agreements. The security deposits identified in tenant rental agreements were allowed under ESG regulation (24 CFR 576.105(a)(2)) but could not exceed two months rent. Under California Civil Code Section 1950.5(h)(1), any unused portion of a security deposit identified in a rental agreement or lease must be returned to the tenant no later than 21 calendar days after the tenant has vacated the premises. The rental agreements signed by tenants and landlords under this program had this stipulation. Subrecipient 2 confirmed that lease-incentive security deposits were over and above the security deposit identified in the rental agreements and were not listed there. The lease-incentive security deposits were not returned to HCD or to Subrecipient 2, as they were not part of the rental agreement and therefore not subject to the aforementioned California civil code, which is intended to protect consumers from paying more than is reasonable for individual renters.

Recommendation 1C: Repay risk mitigation overpayments of \$6,549 drawn from ESG CARES Act funds to HUD from non-federal funds.

HCD Response: HCD will work with the HUD CPD San Francisco Office to address this issue.

Recommendation 1D: Determine if the remaining risk mitigation expenses of \$185,731 drawn from ESG CARES Act funds were reasonable and necessary in accordance with program requirements or repay HUD from non-federal funds.

HCD Response: HCD will work with the HUD CPD San Francisco Office to address this recommendation.

Recommendation 1E: Support the cost reasonableness of \$96,561 drawn from ESG CARES Act funds for the kitchen services contractor or repay HUD from non-federal funds

HCD Response: HCD agrees with the recommendation and will work with Subrecipient 3 and its sub-recipient A-3 to analyze the cost reasonableness of the funds used for kitchen services. Sub-subrecipient A-3 operates a homeless shelter and during this period, provided dinner for up to 44 individuals per day. Since the pandemic, they have expanded to 59 beds.

During the pandemic the Sub-subrecipient A-3 lost its kitchen staff and was unable to find new employees. In order to keep providing services, they needed to find a commercial kitchen operator who would be willing to provide meal service to clients and train interested program participants.

They contacted six or seven restaurants and catering companies by phone; however, only one entity responded to Sub-subrecipient A-3's calls. Contractor A-3-a, provided

high quality services and trained new staff cooks to take over at the end of the agreement, which included training several of the individuals living at Sub-subrecipient A-3's shelter. The contract between Subrecipient 3 and Sub-subrecipient A-3 outlined the scope of services which included purchase of food for meals, training shelter staff how to operate the commercial kitchen, and preparing meals for shelter clients. The contract was short term, beginning on January 10, 2022, and running through July 31, 2022. The length of the contract demonstrated the goal was to meet the urgent need to get shelter clients fed, train shelter staff to operate the shelter's commercial kitchen, and prepare shelter meals.

Although Sub-subrecipient A-3's shelter had a sole respondent, their intention was to get other vendors/suppliers to bid for this contract. The number of food service vendors/suppliers in the marketplace was very minimal during this period.

While Sub-subrecipient A-3 did not document their procurement process, they did attempt to get competition in an environment that was very difficult due to the pandemic and HCD will work with Subrecipient 3, and the San Francisco HUD office to determine and document cost-reasonableness of the program.

Recommendation 1F: Develop and implement additional written procedures and internal controls for the annual ESG program to ensure that it and its subrecipients do not charge holding fees and risk-mitigation costs as expenses to the program and that contracts are properly executed and maintained.

HCD Response: HCD agrees that written policies and procedures as well as monitoring are important for compliant program delivery; HCD is always open to adding additional policies and procedures as warranted.

HCD monitored all ESG-CV subrecipients except for one that was monitored directly by the San Francisco HUD Regional Office as part of routine grant monitoring.

HCD already has published policies and procedures on its ESG website, such as the ESG Program Manual for Subrecipients, that clearly identify the eligible activities under each ESG component. This program manual lists eligible expenses and does not include risk-mitigation fees or holding fees as allowable expenses under the ESG program, 24 CFR 576.

Internal control procedures are in place and are adhered to by ESG staff. Staff require supporting documentation for each request for funds (invoice) received from an ESG subrecipient. In addition, HCD's ESG program staff conduct annual monitoring of all ESG contracts.

HCD has recently published the **ESG Subrecipient Monitoring Plan and Procedures** document that provides subrecipients monitoring guidance over their ESG sub-subrecipients, including:

- Developing a monitoring plan for their sub-subrecipients;
- Establishing a monitoring schedule based on a risk assessment;
- Use of standardized checklists for on-site and desk reviews; and
- Ensuring compliance with ESG requirements and improving program performance.

HUD Management's Response

The following comments were provided by the HUD CPD San Francisco Field Office:



OFFICE OF COMMUNITY PLANNING
AND DEVELOPMENT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-7000

MEMORANDUM FOR: Tanya Schulze, Regional Inspector General for Audit, 9ZA

ANGELO TOM

Digitally signed by ANGELO TOM
Date: 2026.02.19 12:45:47 -08'00'

FROM: Angelo Tom, Acting Director, Community Planning and Development, San Francisco
Field Office, 9AD

SUBJECT: Response to Draft Audit Report – Prevent Improper Payments
California Department of Housing and Development
ESG CARES Act Program

Overall, the Office of Inspector General (OIG) completed an improper payment audit of the State of California Department of Housing and Community Development (HCD)'s administration of the Emergency Solutions Grants CARES Act Program (ESG CARE) and provided a draft report *California Department of Housing and Development Needed Stronger Controls to Prevent Improper Payments in Its ESG CARES Act Program* for HUD to comment.

The draft audit report identifies questioned costs in the amount of \$1,312,671.00 and makes six recommendations for HUD. OIG recommends that the HUD Field Office instruct HCD to:

- 1A. Repay ineligible landlord holding fees of \$964,952 drawn from ESG CARES Act funds to HUD from non-federal funds.
- 1B. Determine if the \$58,878 drawn for 18 signing bonuses or additional security deposits from ESG CARES Act funds were reasonable under the program participant's particular circumstances, and not more than necessary to house the program participants or repay HUD from non-federal funds.
- 1C. Repay risk mitigation overpayments of \$6,549 drawn from ESG CARES Act funds to HUD from non-federal funds.
- 1D. Determine if the remaining risk mitigation expenses of \$185,731 drawn from ESG CARES Act funds were reasonable and necessary in accordance with program requirements or repay HUD from non-federal funds.
- 1E. Support the cost reasonableness of \$96,561 drawn from ESG CARES Act funds for the kitchen services contractor or repay HUD from non-federal funds.
- 1F. Develop and implement additional written procedures and internal controls for the annual ESG program to ensure that it, and its subrecipients, do not charge holding fees and risk mitigation costs as expenses to the program, and that contracts are

www.hud.gov

espano@hud.gov

properly executed and maintained.

HUD appreciates OIG's review of California's ESG-CV program, particularly the insights into improvements for policies and procedures. In response to OIG's January 30th correspondence and invitation to provide feedback on the draft report, the San Francisco Field Office of Community Planning and Development (CPD) in consultation with the Office of Special Needs Assistance Programs (SNAPS) submits the following comments for inclusion in the final report.

**1. EMERGENCY SOLUTIONS GRANTS (ESG) – CORONAVIRUS (CV)
LANDLORD INCENTIVES:**

The draft report stated that HCD and its subrecipients made improper payments of \$1.02 million for landlord incentives, including holding fees, signing bonuses, and additional security deposits. Specifically, \$964,952 of the \$1.02 million was expended on holding fee subsidies to landlords.

First, the draft report reads the alternative requirement established by the CARES Act to not identify "holding" fees arrangements as eligible landlord incentive. However, HUD disagrees with the draft report's conclusion that "holding" fees are categorically ineligible landlord incentives.

- Section III.E.3.e of CPD Notice 21-08 (CPD-21-08), titled *Waivers and Alternative Requirements for the Emergency Solutions Grants (ESG) Program Under the CARES Act*, establishes the requirements for the payment of landlord incentives. The notice includes a non-exhaustive list of eligible landlord incentives, which does not explicitly include holding fees, nor does it explicitly exclude holding fees.
- CPD-21-08 does not define "holding fees."

Therefore, if the cost that the subrecipient is classifying as a holding fee meets the other requirements of Section III.E.3.e, HUD would have considered the holding fee an eligible landlord incentive. These other requirements are that the expense:

- Did not exceed an amount that is three times the rent charged for the unit for which the holding fee was paid;
- Was reasonable and necessary to obtain housing for individuals and families experiencing homelessness; and
- Was determined to be reasonable under the program participant's particular circumstances, and not more than is necessary to house the program participant.

Second, the report correctly identifies that HUD required recipients to support landlord incentive costs by documenting the cost was reasonable under the program participant's particular circumstances, and not more than necessary. However, HUD disagrees with the conclusion that since the holding fee arrangement was established before prospective program participant(s) had been identified, it did not show reasonableness under the program participant's circumstances.

In many communities – before, during, and after the COVID-19 pandemic – recipients and

subrecipients were demonstrating that landlords were reluctant to rent to people experiencing homelessness and that additional incentives were, and continue, to be needed to convince landlords to rent to people experiencing homelessness. The presence of a pre-COVID holding fee program would demonstrate the community need for this type of assistance. HUD would consider this, combined with program participant case files that demonstrate ESG eligibility, e.g., low-income and homeless status documentation, as reasonable certification of the need and the program participant's particular circumstances.

2. MANAGEMENT RECOMMENDATIONS

Related to holding fees, this draft report recommends that the San Francisco Office of Community Planning and Development (CPD) require HCD to repay landlord holding fees of \$964,952 drawn from ESG CARES Act funds to its line of credit from non-federal funds.

In response to OIG's January 30th correspondence and invitation to provide feedback on the draft report, HUD is providing the following comments:

1. Under recommendation 1A, HUD acknowledges OIG's concerns regarding the landlord incentives. However, HUD does not believe that it has the authority to require HCD to repay the entire amount of \$964,952 without reviewing the eligibility of costs for each program participant. OIG's recommendation that the entire amount must be repaid appears to be based on the criteria listed in items a-d below. HUD has provided its responses to each of these criteria to support its opinion that it does not have the authority to require HCD's repayment without a review of the costs associated with each program participant.
 - a. OIG found that the subrecipient paid the landlord incentives as a "holding fee" to hold the unit for two months while a prospective program participant was being identified and prepared to be placed in the unit. The report stated that "...the alternative requirement established by the CARES Act did not identify "holding" fees arrangements as an eligible landlord incentive."
 - i. HUD's perspective is that the notice provided multiple examples (but not exclusive ones) of landlord incentives that are not so narrowly defined to limit a grantee or subrecipient's innovative implementation of those incentives. While a grantee may refer to an incentive using different terminology than the notice, it could still meet the technical requirements of the notice and be considered an eligible cost. If, in this case, the grantee designed a process that provided a landlord incentive as a "signing bonus" which the landlord then used to hold a unit for a prospective tenant, then it could fit within the notice's intent for landlord incentives even if the grantee did not explicitly refer to the incentive as a "signing bonus".
 - b. OIG identified that the notice required grantees to support the landlord incentive costs by documenting that each cost was reasonable under the program participant's particular circumstances, and not more than necessary. The report states that OIG found that the subrecipient did not document that each cost was reasonable and necessary under the program participant's particular circumstances.
 - i. HUD agrees that the notice states that a grantee must determine and document that each of the costs is reasonable under the program

participant's particular circumstances; however, the notice does not prescribe a method by which a grantee must make this determination. HUD understands that in many cases a grantee or subrecipient was operating in the emergency situation of a highly competitive rental market and the rapid spread of Coronavirus among its unhoused population. HUD's perspective is that the notice does not prescribe a method to determine the necessity and reasonableness of costs to provide flexibility to grantees or subrecipients to act quickly to move program participants into housing. HUD believes that the recipient would need to review the subrecipient's documentation on a case-by-case basis to decide on the necessity and reasonableness of costs.

- ii. The draft report also stated that in certain cases the subrecipient paid less than the two months of rent allowed by the notice. HUD notes that the instances in which an incentive was paid that was less than the allowable maximum of two months of rent would demonstrate that the incentive was limited to the need of that particular program participant (i.e., the individual needed less than two months to be in a position to be housed). In those cases, it appears that the subrecipient was able to maximize the incentive (smaller payment to the landlord) while achieving the incentive's intended purpose (quickly securing affordable housing in a competitive market).
- c. OIG identified that since the holding fee arrangement was established with the landlords before the prospective program participant was identified, it did not show reasonableness under a particular program participant's circumstances.
 - i. The notice states that "Waiving the limitation on eligible costs under housing relocation and stabilization services to pay for the costs of landlord incentives will increase the number of housing units available for quickly re-housing people experiencing homelessness or at risk of homelessness, especially in tight rental markets, which is critical to preventing the spread of coronavirus and helping mitigate the economic impact of the crisis." Based on this statement, HUD's perspective is that the primary intention of the landlord incentives was to "increase the number of housing units available for quickly re-housing people..." and that a landlord incentive that resulted in the landlord holding available a unit of affordable housing in a "tight rental market" serves the purpose of the waiver so long as the housing outcome is achieved. The process of securing a rental unit can take a significant amount of time for an unhoused individual (e.g., gathering documentation, conducting inspections) and using a landlord incentive to hold a unit available until a program participant is ready could be considered a reasonable cost for that individual's circumstances. HUD agrees that in instances in which an individual was not placed in housing would be considered ineligible cost based on the intent of the waiver. At the same time, while considering the highly competitive local California housing markets, HUD would proffer that if the unit was found by recipient not to be occupied by

- an ESG eligible person and if owner agrees to include it in the portfolio of other assisted housing providers (i.e., public housing authorities, Continuum of Care (CoC) entities, etc.), targeting low and very low-income persons, for one year, that outlay would be forgiven, consistent with McKinney-Vento disposition instructions.
- d. Finally, OIG determined that "...HCD, Subrecipient 1, Sub-subrecipient A-1, and Sub-sub-subrecipient A-1-a all believed that they were in line with the flexibility allowed under ESG CARES Act for landlord incentives. However, they misinterpreted the landlord incentives requirements."
 - i. HUD notes that the activity in question is based on HCD and its subrecipient's interpretation of the notice's waiver of the limitation on eligible activities under 24 CFR Section 576.105 and its alternative requirements. Typically, HUD issues findings based on a grantee's non-compliance with regulatory or statutory requirements. In this case, repayment is being recommended based on an interpretation of an alternative requirement. HUD's perspective is that it must be judicious when issuing findings based on alternative requirements to ensure that it has the proper interpretation of the alternative requirement and the authority to issue those findings. This is another reason HUD's perspective is that recipient and subrecipient must review the eligibility of the activity on a case-by-case basis and consider actual housing outcome of the outlay rather than issuing a blanket repayment.

Based on the points above, HUD recommends that OIG update Recommendation 1A in a manner consistent with Recommendations 1B, 1D, 1E, which is to review supporting documentation to determine eligibility of the questioned costs and its corresponding repayment based on that review. HUD appreciates the opportunity to provide feedback on the draft report. If you have any questions, please contact Nicholas Nordahl, Senior Community Planning and Development Representative, at nicholas.d.nordahl@hud.gov or at 415-489-6762.

Cc:
Norm Suchar DNS
Rebecca Blanco 9AD

Appendix C – Schedule of Improper Payments by Subrecipient

Due to personal identifiable information, we directly provided to HCD Appendix C – Schedule of Improper Payments by subrecipient, broken out by landlord incentives (holding fees, signing bonuses, security deposits), risk mitigation funds, and the food services consulting contractor expenses.

Improper Payment Issue	Subrecipient 1		Subrecipient 2	Subrecipient 3
	Ineligible	Unsupported	Unsupported	Unsupported
Landlord incentive holding fees	\$964,952			
Risk mitigation funds	\$6,549	\$185,731		
Landlord incentive signing bonus or security deposits			\$58,878	
Food services consulting contractor				\$96,561
Totals	\$971,501	\$185,731	\$58,878	\$96,561