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THE WHITE HOUSE

WASHINGTON

January 3, 1977

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR:

JAMES T. LYNN

FROM:

JIM CONNOR *JEC*

SUBJECT:

Community Development Block Grants

The President reviewed your recent undated memorandum on the above subject and approved the following option:

- Option 1 - Propose a change in formula (HUD)
  - (a) Increase funding by \$100 million

Please follow up with appropriate action.

cc: Dick Cheney  
Carla A. Hills

MEMORANDUM FOR THE PRESIDENT

Subject: Community Development Block Grants

Background

The Community Development Block Grant Program currently distributes funds via the following allocation devices:

1. A formula to determine the shares of entitlement cities and counties.
2. "Hold-harmless" funding which provides communities that were recipients of funding under prior categorical grants with at least the same level of funding they received under those earlier programs.
3. Grants to metropolitan communities with populations below 50,000 on a discretionary grant basis, out of the "metro discretionary balances".
4. Twenty percent of program funds are set aside for discretionary grants to rural communities, on a State-by-State basis. (The 1978 budget will endorse legislation to give the States responsibility for distributing these funds, per your decision.)

Between 1978 and 1980, "hold-harmless" funding is scheduled to phase-out, with two effects:

1. The 187 "hold-harmless" cities will lose a substantial amount of their funding as compared to 1977. Funds would be shifted from the Northeast and Midwest to the South and West, and from major cities to small suburban discretionary grantees. More than half of the fiscally troubled cities identified by various studies would be hard hit by the "hold-harmless" phase-out; a few such cities, such as New York, Cleveland, and Los Angeles will continue to get the same amount as in 1977.

Congress, in its 1974 legislation, mandated that HUD study the current formula allocation and report to Congress no later than March 1977. That study has been completed and it concludes that the current formula does not take adequate cognizance of the physical dimension (housing deterioration, etc.) of community development needs and does not adequately address the needs of fiscally troubled, older cities. Several other studies have come to the same conclusions, including a massive study by the Brookings Institution and the work of the Urban Institute. The U.S. Conference of Mayors and your own Committee on Urban Development and Neighborhood Revitalization have endorsed changes that would provide more money for these cities.

#### Statement of Issue

What should be the Administration's position on changes to the current CDBG formula?

#### Alternative Formula

HUD and OMB agree that:

1. "Hold-harmless" is an inherently arbitrary funding mechanism because it depends entirely on prior grantsmanship. However, it is unlikely that the continuation of "hold-harmless" could be avoided without a new formula mechanism, to prevent some major central cities from suffering funding losses of up to 60 percent as "hold-harmless" phases out.
2. The current formula is generally perceived as an inadequate distribution mechanism, because the critics believe it fails to address adequately the needs of older and declining major cities.
3. To address these concerns with a new single formula which reallocates funds from one group of entitlement cities to another, without a massive increase in funding, would lead to serious political problems by creating a new group of hold-harmless losers.

4. If "hold-harmless" phases out and the SMSA discretionary balances increase as expected under the current formula, those balances will become unworkable, threatening to turn the Community Development Block Grant Program back into a massive categorical. These balances would be administered in the form of small one time categorical grants to individual jurisdictions with populations under 50,000. The administrative and staff cost of running such a program would be very substantial.

#### HUD Proposal

HUD has now proposed a two formula mechanism, as in general revenue sharing, wherein a recipient could choose the higher of its allocation under the current formula or HUD's proposed second formula.

The two formulas are described below:

#### Current Formula

Poverty - 50%  
Population - 25%  
Overcrowded housing - 25%

#### Proposed Second Formula

Poverty - 30%  
Loss of population (1960-1973) - 20%  
Age of housing stock - 50%

#### Options

- #1. The budget would endorse HUD's proposed two formula approach and, if a legislative package is transmitted to the Congress, this would be part of it.
- #2. The budget would acknowledge the criticism of the current formula and discuss alternatives to the present formula, including the one favored by HUD, but would not endorse that proposal (or any other). Secretary Hills would be free to describe the HUD proposal as a promising alternative for Congressional consideration which she would support.
- #3. The budget would not raise the issue of a formula change thereby implicitly supporting the current formula.

Analysis

Arguments for HUD's two formula approach:

- o HUD's proposed second formula results from the recognition by your Committee on Urban Development and Neighborhood Revitalization, the Urban Institute, the Brookings Institution, and the U.S. Conference of Mayors that the current formula does not adequately assess the relative needs of older urban centers. After conducting the two-year study mandated by Congress and considering the effects of innumerable possible formulas, HUD has concluded that its proposed second formula uses the factors (for which data are available) which best correlate with the community development needs of older cities.
- o The new formula factor of "age of housing stock" measures community development need arising from an aging physical infrastructure and housing stock with the attendant high maintenance costs and rehabilitation needs or from a lack of new residential construction, resulting in upwardly mobile families abandoning the city for the newer housing elsewhere in the metropolitan area.
- o The second formula shifts substantially more funds into some of the most fiscally troubled cities such as San Francisco, Detroit, Newark, Boston, and Baltimore, and generally protects this class of cities from the sharp reductions in funding which more than half of them would experience under the current formula as hold-harmless phases out. It thus makes the phase-out of hold-harmless possible within scarce resources.

- o HUD believes that the two formula approach recognizes that the same factors cannot be used to measure the very different community development needs of growing and declining urban centers.
- o The two formula approach results in no entitlement community receiving a smaller allocation than under the current formula, hence creates no new losers.
- o The only "losers" are smaller communities in metro areas, which compete for SMSA discretionary grants, nonetheless, the balances for which they compete will increase under HUD's proposal by 34% in 1978, 61% in 1979 and 116% in 1980, over 1977 while the overall program level and the shares of entitlement communities remain constant. These communities were well aware that the formula would be reviewed and probably revised in 1977, and, in HUD's soundings, would be satisfied with the substantial rate of growth in the SMSA balances resulting from HUD's proposal. This more reasonable level of discretionary funding also would preserve the block grant character of the program.

Arguments against the alternative formula:

- o There should be only one needs-based formula, not two. To the extent that the current formula fails to measure "need", allowing cities to receive entitlements based on it is inequitable and wasteful. However, political and budgetary considerations make a change to a new single formula impossible at this time.

- o OMB believes the current formula's failure to emphasize physical needs recognizes that all urban problems stem from the lack of income of urban dwellers, and not from the physical characteristics of the city.
- o Although the factors in HUD's alternative formula may correlate highly with most conventionally accepted indices of urban needs, there is no logical reason why they should better reflect relative need than does poverty (50% of the current formula).
- o Buying off hold-harmless cities at the expense of small suburban, rural or satellite communities in SMSA's, which are discretionary grantees, could be controversial, because:
  - Some of these communities may believe that they will be competing for a massively increased share (more than 700% of their 1977 level in 1980) of community development funds once hold-harmless is phased out, and OMB believes they would not be satisfied with the increases projected under HUD's proposal.
  - Smaller communities, which compete for discretionary balances, as a group, receive less than their perceived "fair" share under either formula, undercutting the objective basis for allocating funds between entitlement cities and those smaller communities.
- o The administrative problems posed by a large discretionary balance could be dealt with in ways that do not require a second formula.
- o The two formula approach could lead to demands for extending this precedent beyond GRS and CDBG to other block grant programs.
- o Administration-sponsored changes in the formula are likely to serve as a new starting point for further changes in the Congressional process.



HUD Recommendation

Alternative #1. Secretary Hills believes that a failure to acknowledge the nearly unanimous criticism of the current CDBG formula as inadequately addressing the needs of hard-pressed cities would make the Administration appear insensitive and insincere, in view of the HUD studies of the formula and your Cabinet Committee's recommendations.

OMB Recommendation

Alternative #3. The Administration should not endorse changes in the formula, for the reasons given above.

In the event you chose Alternative #1, OMB agrees with HUD that the addition of \$100 million to the funding level approved for the block grant program (\$3.4 billion) would be desirable.

President's Decision

Option 1. Propose a change in formula (HUD).

(a) increase funding by \$100 million

(b) do not increase funding by \$100 million \_\_\_\_\_

Option 2. Acknowledge the validity of criticisms of the current formula but do not endorse formula change in budget. \_\_\_\_\_

Option 3. Do not alter position (OMB). \_\_\_\_\_

*Handwritten signature/initials*

James T. Lynn  
Director

Carla A. Hills  
Secretary of Housing  
and Urban Development