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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

This letter report presents the results of a review conducted by the Bureau of State Audits (bureau) concerning the Department of Community Services and Development's (Community Services) progress in spending funds provided by the American Recovery and Reinvestment Act of 2009 (Recovery Act) for the Weatherization Assistance for Low-Income Persons (Weatherization) program before the Recovery Act grant expires. On February 17, 2009, the federal government enacted the Recovery Act, in part, to promote economic recovery and stabilize state and local government budgets. The U.S. Department of Energy (Energy) awarded \$185.8 million of Recovery Act funds to Community Services for its Weatherization program. In February 2010 the bureau issued an audit report titled *Department of Community Services and Development: Delays by Federal and State Agencies Have Stalled the Weatherization Program and Improvements Are Needed to Properly Administer Recovery Act Funds*. Our report concluded that Community Services was moderately prepared to administer the Recovery Act Weatherization program award, noting that delays in weatherizing homes could jeopardize Community Services' ability to reach by September 30, 2010, a key performance milestone established by Energy as necessary to access \$93 million of the Recovery Act Weatherization program funds. By December 22, 2009, Community Services had awarded grants to 36 service providers totaling \$54.8 million; however, only eight of the 36 service providers were ready to begin weatherizing homes.

Additionally, Community Services had not identified and received approval from Energy for the measures to weatherize homes using the Recovery Act funds, but expected the average cost to weatherize a home to increase significantly—reducing the number of homes receiving weatherization services. To ensure it received the remaining 50 percent of its award, we recommended that Community Services seek an extension from Energy for fulfilling the progress milestones. In addition, we recommended that it promptly develop and implement the necessary standards for performing weatherization activities under the program, and make any necessary adjustments in its state plan for implementing the Weatherization program. This letter report concludes that Community Services faces challenges in its efforts to determine how to allocate the remaining funds to maximize production and weatherize enough homes to ensure that the grant funds are spent so that they do not revert by the March 31, 2012 deadline, while also ensuring that it meets its production goals under the annual weatherization grants that expire June 30, 2012. Specifically, we are concerned that if Community Services is not able to ensure that service providers increase both the number of homes they weatherize and the measures they install in each home, the State may not expend \$37.4 million of the federal grant award.

Community Services Is Not on Track to Spend Remaining Recovery Act Funds Before the Grant Expiration Date

Community Services is currently administering multiple Energy weatherization grants, including the \$185.8 million Recovery Act grant, two annual weatherization grants totaling \$19 million awarded during 2009 and 2010, and \$400,000 carried over from grants awarded during 2007 and 2008. The Recovery Act grant expires on March 31, 2012, while the annual grants awarded during 2009 and 2010 expire on June 30, 2012. In addition to the grants it is currently administering, Community Services expects to receive a \$4.8 million weatherization grant during 2011; however, Energy notified the State that it cannot award the funds until the federal budget is passed. Community Services awards 85 percent of the grant funds it receives to service providers who perform the weatherization services, and retains 15 percent for administrative costs and for providing training and technical assistance to ensure weatherization staff is properly trained to successfully deliver Weatherization program services. According to its staff counsel, as of May 9, 2011, Community Services had not yet awarded \$16.6 million of the Recovery Act funds because of low performance by some providers, but it intends to distribute those funds to high-performing service providers. Table 1 provides a summary of the weatherization funds that Community Services is currently administering.

Table 1
Status of Weatherization Program Funding Allocated to Service Providers as of April 30, 2011 (in Millions)

| | WEATHERIZATION FUNDS | AWARDED | SPENT | UNSPENT FUNDS | EXPIRATION DATE |
|--------------------|----------------------|----------------|---------------|---------------|-----------------|
| Recovery Act grant | \$157.9 | \$141.3 | \$68.1 | \$89.9 | March 31, 2012 |
| 2009 annual grant* | 12.4 | 12.2 | 6.9 | 5.5 | June 30, 2012 |
| 2010 annual grant | 4.2 | 4.1 | 0 | 4.2 | June 30, 2012 |
| Totals | \$174.5 | \$157.6 | \$75.0 | \$99.6 | |

Sources: U.S. Department of Energy's grant award notices and Department of Community Services and Development's State Plan and accounting records.

* Includes \$402,205 carryover of unspent funds from prior grant awards.

In its State Plan for administering the Recovery Act funds, Community Services estimated it will weatherize 43,150 homes at an average cost of \$3,660 per home. As shown in Table 2 on the following page, on April 30, 2011, Community Services had spent on average just \$2,539 per home to weatherize 26,807 homes using Recovery Act funds. Although, based on its monthly production reports from service providers, Community Services is on pace to meet its unit production goals, it has not yet determined how much it will need to increase production in order to spend the remaining Recovery Act funds or how it will meet the increased production requirements. At its current production rate and lower than expected expenditures, Community Services has underspent its planned outlay for the Recovery Act funds by approximately \$30 million as of April 30, 2011.

Although Energy made the funds for the 2009 annual weatherization grant available on July 1, 2009, Community Services did not award contracts to service providers until June 30, 2010. Community Services reported that service providers began weatherizing homes under the 2009 annual grant in July 2010. The 2009 and 2010 annual grants were originally scheduled to expire on June 30, 2011; however, Energy recently approved a one-year extension to June 30, 2012, thus providing additional time for Community Services to weatherize more homes under the annual weatherization grant. By April 30, 2011, service providers reported spending only \$6.9 million of the \$16.6 million provided

by the 2009 and 2010 annual grants, and reported they had weatherized 4,321 homes. Similar to the Recovery Act program, average costs have been significantly less than expected, which will require Community Services to also increase the number of homes it weatherizes under the annual weatherization grants. While Community Services estimated it would spend \$2,500 to weatherize a home under the annual weatherization grants, service providers have spent an average of just \$1,588 per home.

Table 2
Homes Weatherized as of April 30, 2011

| | WEATHERIZED UNITS COMPLETED | TOTAL EXPENDITURES | ACTUAL AVERAGE COST | PLANNED AVERAGE COST | PLANNED EXPENDITURES BASED ON ACTUAL PRODUCTION | EXPENDITURES OVER/ (UNDER) PLAN |
|--------------------|-----------------------------|---------------------|---------------------|----------------------|---|---------------------------------|
| Recovery Act grant | 26,807 | \$68,067,136 | \$2,539 | \$3,660 | \$98,113,620 | (\$30,046,484) |
| Annual grants | 4,321 | 6,863,154 | 1,588 | 2,500 | 10,802,500 | (3,939,346) |
| Totals | 31,128 | \$74,930,290 | | | \$108,916,120 | (\$33,985,830) |

Source: Department of Community Services and Development's production plan, production reports, and accounting records.

Community Services expects the average cost to increase within the next few months after its new weatherization protocol is implemented; however, as we explain below, it is currently unable to estimate how much costs will increase or how many homes it must weatherize to spend the remaining grant funds.

Some Service Providers Are Not Meeting Production Expectations

Community Services reported that it contracted with new service providers in June 2010 to serve three geographic regions; however, two of those service providers had not yet begun performing weatherization as of April 30, 2011, and by May 31, 2011, the other had weatherized very few homes. According to Community Services, the service providers are governmental entities that have experienced delays due to the need to build the program infrastructure to support the new programs:

- The City of Oakland (Oakland) forecast it would weatherize 269 homes by April 30, 2011. Although it reported expenditures of \$228,268—12 percent of its \$1.9 million award—it had not completed any units as of April 30, 2011. According to Community Services, Oakland commenced weatherization activities in April and expected to begin reporting completed units in May 2011.
- The City and County of San Francisco (San Francisco) forecast it would weatherize 204 units by April 30, 2011. Although it reported expenditures of \$87,249—7 percent of its \$1.3 million award—it had not completed any units as of April 30, 2011. Community Services reported that San Francisco had identified a sufficient inventory of eligible projects and intends to begin weatherization work on 722 units by mid-May.
- The Los Angeles Department of Water and Power (LADWP) forecast it would weatherize 806 homes by May 31, 2011. Although it reported expenditures of \$2 million—43 percent of its \$4.6 million award—it had weatherized only 78 units by that date, or just 9.7 percent of its planned production. Nonetheless, according to Community Services, in June 2011 it increased LADWP's Recovery Act Weatherization program award to \$8.5 million. Although LADWP had met less

than 10 percent of its planned production as of May 31, 2011, under the amended agreement, LADWP is to weatherize a total of 2,544 homes by the end of the Recovery Act grant on March 31, 2012. According to Community Services, it plans to ensure LADWP meets its goals under the amended agreement through monitoring that includes on-site visits every three months and reviewing weekly reports from LADWP regarding its weatherizing activities.

Service Providers Have Installed Fewer Weatherization Measures Because of Delayed Implementation of the New Protocol

Community Services based its estimated average cost of \$3,660 per home on its expectation that service providers would be installing additional weatherization measures under a new protocol it planned to submit to Energy. The weatherization protocol identifies cost-effective measures that have been approved by Energy, and allows service providers to determine which measures to install by either performing an energy audit using Energy-approved computer software, or to install measures based on a predetermined priority list that identifies cost-effective measures in a similar dwelling-type based on climate zone. In its response to our 2010 audit report, Community Services stated that although it had not yet developed the new protocol, the program would not be affected because service providers would use the existing allowable measures until the new protocol became available. However, there is a significant difference between the old and new protocols in that the new protocol requires service providers to install all priority measures that meet the energy savings criteria; whereas, the old protocol listed some priority measures, such as wall insulation, as optional, and allowed the service provider to decide which measures to install. In November 2010 Energy cited concerns about missed opportunities for saving energy after seeing only minimal measures being installed by service providers. The program's objectives include increasing the energy efficiency of dwellings owned or occupied by low-income persons and reducing their total expenditures on energy, thus, by installing only minimal measures, service providers do not maximize the potential benefits of the program. During a follow-up visit in April 2011, Energy inspected four recently weatherized homes and found that in three of the four homes service providers had installed only minimal measures, such as compact fluorescent lighting, water heater tank wrap and pipe insulation and low-flow showerheads and faucet aerators. In fact, only one of the four homes had attic insulation and air sealing, such as weatherstripping, installed. All four homes were assessed and weatherized prior to implementation of the new protocol when some priority measures were optional.

Energy approved the new weatherization protocol in October 2010, and Community Services instructed service providers to start using the new protocol effective February 1, 2011; however, Community Services did not complete its training of weatherization workers on its new protocol until April 2011. Community Services reported that its training efforts were hampered, in part, by the limited basic computer skills of the weatherization workforce. To overcome the computer literacy deficiencies of the weatherization workers, service providers created two-person assessor teams by adding a staff support person to assist the assessors with the computer input. The team approach necessitated changes to the training curriculum to gear instruction to support staff and increased the number of training sessions needed to accommodate the increased number of people requiring training. In addition to the difficulties already noted, Community Services reported that the service providers' need for increased understanding of how energy audits and the priority list work, and the need to develop standards and procedures related to the new protocol, caused the training timeline to be extended beyond the protocol implementation date. During its April 2011 monitoring visit, Energy noted that weatherization crews were still struggling to implement the new protocol and recommended that Community Services provide additional targeted training.

Community Services Has Yet to Develop and Implement a Plan to Weatherize Enough Homes to Spend the Remaining Funds

At its current monthly production rate and its current average cost to weatherize a home, about \$37.4 million in Recovery Act funds will remain unspent at March 31, 2012, when Community Services' grant expires. Community Services could ensure the remaining funds are spent by increasing either the number of homes its service providers weatherize, the average cost spent to weatherize each home, or a combination of the two; however, it is currently unable to tell us how it will achieve full use of the Recovery Act weatherization grant funding. Community Services noted that its current ability to perform any meaningful review of production forecasts on any level is compromised due primarily to the fact that implementation of the new weatherization protocol just got underway and the average cost to weatherize a home under the new protocol has not yet been established. Community Services expects to be able to provide more reliable estimates in August 2011, based on production performed under the new protocol; however, that leaves little time to identify service providers who cannot satisfactorily meet their production and expenditure goals and to reallocate the funds awarded to them to other service providers with sufficient capacity to weatherize additional homes. In the meantime, Community Services issued a survey to the service providers on May 26, 2011, which will identify which service providers have fully implemented the new protocol, service providers' expectations for achieving production and expenditure goals, and any difficulties that may be preventing full implementation of the new protocol. According to Community Services, it will use the information collected in the survey, in addition to an internal analysis of service providers' historical performance and expenditures, to develop the strategic plan to maximize the full Recovery Act grant, which will likely include reallocating some funds. Although it has the ability to take back awards from underperforming service providers and to reallocate the awards to service providers with additional capacity, Community Services' inability to determine the average cost per unit will hinder its ability to make timely decisions and implement funding modifications. Table 3 shows that at an average cost of \$2,539, Community Services will need to weatherize significantly more homes than its current production levels support. In fact, at its current production rate it faces a potential shortfall of 14,750 homes. Based on its current average cost to weatherize a home, if it fails to weatherize the additional 14,750 homes Community Services will leave \$37.4 million unspent.

Table 3
Increased Production Required to Expend Remaining Funds at Current Costs

| | AVERAGE MONTHLY PRODUCTION | CAPACITY THROUGH GRANT EXPIRATION | FUNDS REMAINING | AVERAGE ACTUAL COST | UNITS NEEDED TO EXPEND FUNDS AT AVERAGE ACTUAL COST | POTENTIAL PRODUCTION SHORTFALL |
|--------------------|----------------------------|-----------------------------------|-----------------|---------------------|---|--------------------------------|
| Recovery Act grant | 1,877* | 20,647 | \$89,872,266 | \$2,539 | 35,397 | 14,750 |
| Annual grants | 535† | 7,490 | 9,695,931 | 1,588 | 6,106 | NA |

Source: Department of Community Services and Development's production reports and accounting records.

NA = Not applicable.

* Calculated based on service providers' reported production over a 13-month period from April 2010 through April 2011. To provide a more realistic estimate of production capacity, we excluded January through March 2010 production from the average production calculation because few service providers had begun production. The grant has 11 months remaining.

† Calculated based on production activity from September 2010 through April 2011. To provide a more realistic estimate of production capacity, we excluded activity prior to September 2010 because few service providers had begun production. The grant has 14 months remaining.

Community Services believes that average costs will increase because service providers will install more energy-saving measures under the new protocol. According to Community Services, the strengthened policy requiring that service providers follow the new protocol and monitoring to ensure strict adherence to the protocol will result in significant increases to unit costs and level of services provided. As noted earlier, the old protocol permitted service providers to deviate or avoid the installation of measures at their own election. Under the new protocol, service providers are required to install measures identified as a priority, such as ceiling, wall, and floor insulation, and programmable thermostats, unless installation is not feasible. Community Services intends to enforce compliance with the new protocol through its inspection process, which requires any feasible priority measure not installed be documented as a performance issue on the inspection report. Service providers are required to install those measures during the inspection if possible, and if not, to install any such measures within 20 working days. As shown in Table 4, average costs will need to increase significantly to spend the remaining funds based on the current production capacity.

Table 4
Increased Average Cost Required to Expend Remaining Funds at Current Production Levels

| | FUNDS REMAINING | CAPACITY THROUGH GRANT EXPIRATION | AVERAGE COST REQUIRED TO EXPEND FUNDS | ACTUAL AVERAGE COST | INCREASE IN AVERAGE COST PER UNIT REQUIRED |
|--------------------|-----------------|-----------------------------------|---------------------------------------|---------------------|--|
| Recovery Act grant | \$89,872,266 | 20,647 | \$4,353 | \$2,539 | \$1,814 |
| Annual grants | 9,695,931 | 7,490 | 1,295 | 1,588 | NA |

Source: Department of Community Services and Development's production reports and accounting records.

NA = Not applicable.

Community Services anticipates that some service providers may face difficulties complying with the requirements to install all priority measures, but noted that service providers will need to subcontract for any work related to installation of feasible priority measures they are unable to install due to staffing or equipment limitations. However, subcontracting for certain weatherization measures will further delay and complicate the service providers' efforts to meet production and expenditure goals before the grant terms expire.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code. We limited our review to those areas specified in the letter report.

Respectfully submitted,



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State Auditor

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For questions regarding the content of this letter, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.