

## COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM

# ENTITLEMENT PROGRAM

## FACT SHEET

### Introduction

The program provides annual grants on a formula basis to entitled cities and counties to develop viable urban communities by providing decent housing and a suitable living environment, and by expanding economic opportunities, principally for low- and moderate-income persons.

### In This Fact Sheet

- ✓ Grantee Eligibility
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### Nature of Program

HUD awards grants to entitlement communities to carry out a wide range of community development activities directed toward revitalizing neighborhoods, economic development, and providing improved community facilities and services.

Entitlement communities develop their own programs and funding priorities. However, grantees must give maximum feasible priority to activities which benefit low- and moderate-income persons. A grantee may also carry out activities which aid in the prevention or elimination of slums or blight, or to which it certifies are designed to meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community where other financial resources are not available to meet such needs. CDBG funds may not be used for activities which do not meet these broad national objectives.

CDBG funds may be used for activities which include, but are not limited to:

- ❖ Acquisition of real property;
- ❖ Relocation and demolition;
- ❖ Rehabilitation of residential and non-residential structures;
- ❖ Construction of public facilities and improvements, such as water and sewer facilities, streets, neighborhood centers, and the conversion of school buildings for eligible purposes;
- ❖ Public services, within certain limits;
  
- ❖ Activities relating to energy conservation and renewable energy resources; and

- ❖ Providing assistance to profit-motivated businesses to carry out economic development and job creation/retention activities.

Generally, the following types of activities are *ineligible*: acquisition, construction, or reconstruction of buildings for the general conduct of government; political activities; certain income payments and construction of new housing by units of general local government.

## **Grantee Eligibility**

Central cities of Metropolitan Statistical Areas (MSAs), other metropolitan cities with populations of at least 50,000, and qualified urban counties with populations of at least 200,000 (excluding the population of entitled cities) are entitled to receive annual grants. HUD determines the amount of each entitlement grant by a statutory dual formula which uses several objective measures of community needs, including the extent of poverty, population, housing overcrowding, age of housing, and population growth lag in relationship to other metropolitan areas.

## **Requirements**

To receive its annual CDBG entitlement grant, a grantee must develop and submit to HUD its Consolidated Plan, (which is a jurisdiction's comprehensive planning document and application for funding under the following Community Planning and Development formula grant programs: CDBG, HOME Investment Partnerships, Housing Opportunities for Persons with AIDS (HOPWA), and Emergency Shelter Grants (ESG)). In its Consolidated Plan, the jurisdiction must identify its goals for these programs, as well as for housing programs. The goals will serve as the criteria against which HUD will evaluate a jurisdiction's Plan and its performance under the Plan. Also, the Consolidated Plan must include several required certifications, including the certification that not less than 70% of the CDBG funds received, over a one, two, or three year period specified by the grantee, will be used for activities that benefit low- and moderate-income persons, and that the grantee will affirmatively further fair housing. HUD will approve a Consolidated Plan submission unless the Plan (or a portion of it) is inconsistent with the purposes of the National Affordable Housing Act or is substantially incomplete.

Following approval, the Department will make a full grant award unless the Secretary has made a determination that the grantee: (1) has failed to carry out its CDBG-assisted activities in a timely manner; (2) has failed to carry out those activities and its certifications in accordance with the requirements and the primary objectives of Title I of the Housing and Community Development Act of 1974, as amended, and with other applicable laws; or (3) lacks a continuing capacity to carry out its CDBG-assisted activities in a timely manner.

## **Citizen**

A grantee must develop and follow a detailed plan which provides for and encourages citizen participation and which emphasizes participation by

## **Participation**

persons of low- or moderate-income, particularly residents of predominantly low- and moderate-income neighborhoods, slum or blighted areas, and areas in which the grantee proposes to use CDBG funds. The plan must: provide citizens with reasonable and timely access to local meetings, information, and records related to the grantee's proposed and actual use of funds; provide for public hearings to obtain citizen views and to respond to proposals and questions at all stages of the community development program, including at least the development of needs, the review of proposed activities, and the review of program performance; provide for timely written answers to written complaints and grievances; and identify how the needs of non-English speaking residents will be met in the case of public hearings where a significant number of non-English speaking residents can be reasonably expected to participate.

## **Legal Authority**

Title I of the Housing and Community Development Act of 1974, Public Law 93-383, as amended; 42 U.S.C.-5301 *et seq.*

## **Information Sources**

If you are an interested citizen, contact your local municipal or county officials for more information. If your local government officials cannot answer your questions, or if you are a local official, contact the HUD field office\* that serves your area. Note that the local government administers the program and determines which local projects receive funding.

Information about HUD field offices may be found on the World Wide Web at <http://www.hud.gov/local.html>.

\* Hearing impaired users may call the Federal Information Relay Service at 1-800-877-8339.



# PUBLIC BENEFIT STANDARDS

## Introduction

The CDBG authorizing statute requires that activities qualifying under particular categories of eligibility must meet standards of public benefit established by HUD in regulations. Specifically, it requires that an activity carried out under the category of Special Economic Development (§570.203), or one which could be carried out under that category but is instead carried out under the category of Special Activities by CBDOs (§570.204), must meet the standards of public benefit set forth in §570.209(b). By regulation, HUD has also included under this requirement, under certain circumstances, a public improvement activity that qualifies under the L/M Income Jobs subcategory of the L/M Income Benefit national objective. (The situation in which such a Jobs activity must meet public benefit standards is described in Chapter 3 under the discussion of the L/M Income Jobs criteria.)

## Background

It should be noted from the outset that the public benefit requirement has, in effect, taken the place of the previously required “appropriate” determination for CDBG financial assistance to a for-profit business. While public benefit had long been required to be considered, the “appropriate” determination previously focused on financial underwriting of the assistance. Statutory changes were made that had the effect of removing this focus and replacing it with one of ensuring that the amount of public benefit to be derived from this type of activity (and some others as well) will be appropriate given the amount of CDBG assistance being provided to the activity. This statutory change required HUD to publish guidelines for performing a financial analysis of these economic development activities, but it also specifies that HUD may not find an activity ineligible for failure to meet them. HUD has published these underwriting guidelines as an appendix to the regulations in an attempt to make it clear that they are not required to be used.

Despite the fact that the HUD-published underwriting guidelines are not mandatory, a grantee is still expected to perform a due diligence assessment of any assistance it provides to a for-profit business as a means of ensuring that public funds are not wasted and that the expected economic benefit will flow from the project and help to meet a CDBG national objective.

As required by the statute, HUD has also established standards for public benefit and they are contained in the regulations at §570.209(b). Unlike the underwriting guidelines, the public benefit guidelines (or standards) are *required* to be used for the activities mentioned in the introductory paragraph to this Appendix.

It should be noted that the requirement for meeting the public benefit standards is a basic eligibility issue and should not be confused with the requirements concerning meeting a national objective. This caveat is provided in recognition of the fact that the same factors (jobs and area served) are involved in the criteria for both requirements. While the same factors come into play, they are used differently. For example, for public benefit purposes, compliance involves the *total number* of jobs created or retained without regard to how many (if any) benefit L/M income persons. In contrast, the use of jobs for meeting a national objective is determined by the *percentage* of the created or retained jobs that benefit L/M income persons, and only incidentally involves the total number of such jobs. The determination of compliance with the L/M Income Jobs national objective is based on the jobs that are *actually* created or retained and who actually benefits from those jobs. The focus for determining compliance for public benefit purposes lies in the number of jobs *expected to be* created or retained.

Similarly, for the area benefit factor, compliance with national objectives is based on the *percent* of L/M income residents served, while public benefit is determined based on the *number* of L/M income persons served.

It should also be noted that an activity that is subject to the public benefit standards does not have to use the same factor for meeting that standard as it does for meeting national objective requirements. For example, assistance to a grocery store serving a L/M income neighborhood that also retains some jobs may qualify as meeting the national objective based on the area served while the grantee may choose to qualify it under the public benefit standards based on the retained jobs.

The fact that an activity qualifies for national objective purposes under one of the Slum/Blight subcategories or even under the Urgent Need category does not affect its need to separately meet the public benefit standards.

## **The Standards**

In developing the public benefit standards, HUD attempted to make them unambiguous, reasonable, and fitting within the context of the rest of the program. Accordingly, while there are many aspects that could be considered to constitute a public benefit resulting from these activities, only two have been adopted for the standards: jobs and the provision of goods or services.

As formulated, the public benefit standards are to be applied to the activities funded under the relevant categories both on an *individual activity* basis and on all such *activities in the aggregate*. Thus, the standards fall into those two basic categories, each of which is described below:

#### *Individual Activity Standards*

The following individual activity standards apply to any activity subject to these standards:

- ❖ For an activity that creates or retains jobs, the use of CDBG funds cannot exceed *\$50,000 per full-time equivalent job*; or
- ❖ For an activity that provides goods or services to residents of an area, the amount of CDBG funds provided for the activity cannot exceed *\$1,000 per L/M person served*.

The effect of these dollar limits is that, if an activity could both create or retain jobs AND provide goods or services to persons, it must fail *both* dollar standards to be precluded on the basis of these individual activity standards (and thus ineligible to be carried out using CDBG funds).

HUD also determined that there are certain kinds of economic development activities that by their nature *fail* to provide sufficient public benefit. They are:

- ❖ An activity in which the grantee promotes the community as a whole (as opposed to promotion of specific areas and programs);
- ❖ Assistance to a professional sports team;
- ❖ Assistance to privately-owned recreational facilities that serve a predominantly higher-income clientele, where the recreational benefit to be derived by users or members clearly outweighs the employment or other benefits to L/M income persons;
- ❖ Acquisition of land for which the specific proposed use has not yet been identified; and
- ❖ Assistance to a for-profit business while that business or any other business owned by the same person(s) or entity(ies) is the subject of unresolved findings of noncompliance relating to previous CDBG assistance provided to the business.

Therefore, any activity subject to the public benefit standards that falls into any of the above descriptions *may not be assisted with CDBG funds* regardless of any other aspect of the activity.

### *Aggregate Standards*

Activities that are subject to the public benefit standards and pass the individual activity tests outlined above also must generally, in the aggregate, either:

- ❖ Create or retain at least *one full-time equivalent, permanent job per \$35,000* of CDBG funds used for all such activities; or
- ❖ Provide goods or services to residents of an area, such that the number of L/M income persons residing in the area served by the assisted businesses amounts to at least *one L/M income person per \$350* of CDBG funds used for all such activities.

As with the individual standards, if the activity can both create or retain jobs AND provide goods or services to residents of an area, the grantee may elect to apply either of the above aggregate standards to the activity. However, only *one* standard shall be used for each such activity. That is, if the grantee elects to use the area standard, any jobs created or retained by the activity are not to be counted for purposes of applying that aggregate standard.

### *Applying the Aggregate Standard*

In applying the aggregate standard, grantees are to aggregate the dollars and resultant jobs or L/M income persons served (as applicable) based on the following:

- ❖ Entitlement grantees shall apply the standards to all applicable activities for which CDBG funds are *first obligated* within each single CDBG program year, without regard to the source year of the funds used for the activity; and
- ❖ Grantees under the HUD-administered Small Cities or Insular Areas CDBG programs shall apply the aggregate standards to all funds obligated for applicable activities from a given grant. Obligations made using program income, if any, are to be aggregated with the most recent open grant. For any time period in which a community has no open grant under the HUD-administered Small Cities or Insular Areas programs, the aggregate standards shall be applied to all applicable activities for which program income is obligated during the period starting with the closeout of the most recent such grant and ending with the date the next such grant is received by the grantee.

### *Excludable Activities*

Certain activities that would otherwise be subject to the aggregate public benefit standards may be excluded from the aggregate calculations under the authority of §570.209(b)(2)(v). Such activities are those which have been determined by HUD to serve important national interests. The activities must still pass the individual activity tests. Activities that qualify for this optional exclusion from the aggregate calculations are those that:

- ❖ Provide jobs exclusively for unemployed persons or participants in one or more of the following programs:
  - ◆ JTPA,
  - ◆ JOBS, or
  - ◆ AFDC.
- ❖ Provide jobs predominantly for residents of Public and Indian Housing units;
- ❖ Provide jobs predominantly for homeless persons;
- ❖ Provide jobs predominantly for low-skilled, L/M income persons, where the business agrees to provide clear opportunities for promotion and economic advancement to such persons who are hired, such as through provision of training;
- ❖ Provide jobs predominantly for persons residing within a census tract (or BNA) that has at least 20% of its residents who are in poverty;
- ❖ Provide assistance to business(es) that operate(s) within a census tract (or BNA) that has at least 20% of its residents who are in poverty;
- ❖ Stabilize or revitalize a neighborhood that has at least 70% of its residents who are L/M income persons;
- ❖ Provide assistance to a CDFI that serves an area that is predominantly L/M income persons;
- ❖ Provide assistance to a CBDO serving a neighborhood that has at least 70% of its residents who are L/M income persons;
- ❖ Provide employment opportunities that are an integral component of a project designed to promote spatial deconcentration of L/M income and minority persons;

- ❖ With prior HUD approval, provide substantial benefit to L/M income persons through other innovative approaches;
- ❖ Provide services to the residents of an area pursuant to a Neighborhood Revitalization Strategy approved by HUD (see Appendix E); *or*
- ❖ Create or retain jobs through businesses assisted in an area pursuant to a Neighborhood Revitalization Strategy approved by HUD (see Appendix E).

Note that the above-listed activity types may be excluded *at the grantee's option*. This means, of course, that they do not have to be excluded. While a grantee might choose to exclude such activities in order to minimize the record-keeping requirements of complying with the aggregate public benefit standards, there is at least one good reason why the grantee would want to have one or more of them included. That reason is that the public benefit (jobs or goods/services per dollar) might be such that the grantee would want to include the activity in order to make the overall aggregate calculation more favorable. For example, if the grantee runs its economic development program in a way that stays very close to the aggregate standard (e.g., \$35,000 per job), it may want to include an activity that provides jobs at a much lower CDBG cost per job, even if that activity falls into one of the above-described categories and the grantee had the option of excluding it.

#### *General Ground Rules*

Both the individual and aggregate standards are to be applied based on the number of jobs to be created or retained or to the number of persons residing in the area served (as applicable), as determined at the time the funds are obligated to the activities. This is because there is always the possibility that an economic development activity might not proceed as planned, and for the purpose of this particular requirement, a grantee should generally only be held to the conditions that prevailed at the time it provided the assistance. Nevertheless, grantees are required to keep records that show how it performed against the public benefit standards based on actual jobs and L/M income persons served. Where the actual results attained by a grantee consistently fall substantially below what it expected, the grantee is expected to make adjustments in how it conducts its front end assessments for complying with the public benefit standards for future activities, and HUD may require that the grantee meet more stringent standards in the future, as appropriate.

Where the CDBG assistance for an activity is limited to job training and placement and/or other employment support services under §570.203 the jobs assisted with CDBG funds shall be considered to be created or retained jobs for the purposes of applying both the individual and aggregate standards.

## **Tips**

Although the aggregate standards may sound very difficult to keep track of, one way to minimize additional record-keeping burdens is for a grantee to operate its CDBG economic development program in a way which ensures that no assistance will be provided for an *individual* activity that exceeds the *aggregate* standard. For example, while the individual standard based on jobs created/retained is \$50,000 per job, if the grantee makes sure that no individual activity is funded that would exceed \$35,000 per job (which is the aggregate standard), the result becomes an amount of assistance that does not exceed \$35,000 per job in the aggregate. Since studies on the use of CDBG for economic development in the past have indicated that the average assistance per job created or retained is, on average, less than \$10,000 per job, it seems likely that few grantees would have difficulty operating their activities based on an individual activity limitation of \$35,000, which would ensure their compliance with the aggregate standard without any additional record-keeping.



# SPECIAL ASSESSMENTS UNDER THE CDBG PROGRAM

Many communities follow the practice of levying an assessment on property owners where the property is determined to benefit from a particular public facility or improvement. Examples of such facilities/improvements include the paving of streets, the installation of sidewalks, and the construction of water and sewer lines. Because of concerns about the implications for levying such assessments to recover capital costs incurred in providing a public facility or improvement with CDBG assistance, the statute contains certain restrictions. These restrictions and other related requirements are discussed in this Appendix.

## Definition

For purposes of the CDBG program, the term “*Special assessment*” means the recovery of the capital costs of a public improvement, such as streets, water or sewer lines, curbs and gutters, through:

- ✓ A fee or charge levied or filed as a lien against a parcel of real estate as a direct result of benefit derived from the installation of a public improvement, or
- ✓ A one-time charge made as a condition of access to the public improvement.

This term does **not** relate to:

- ✓ Taxes;
- ✓ Establishment of the value of real estate for the purpose of levying:
  - Real estate taxes,
  - Property taxes, or
  - Ad valorem taxes.
- ✓ Periodic charges based on the use of public improvements, such as water or sewer user charges, even if such charges include the recovery of all or some portion of the capital costs of the public improvement.

## **Special Assessment to Recover Capital Costs**

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Where CDBG funds are used to pay all or part of the cost of a public improvement, special assessments may only be used to recover capital costs as follows:

### *Restriction on levying a special assessment to recover CDBG funds*

Special assessments to recover the CDBG funds may be made *only* against properties **not** owned and occupied by L/M income persons. When assessments are levied against non-L/M income property owners, the proceeds are CDBG program income.

### *Special assessments to recover non-CDBG funds*

Special assessments to recover the non-CDBG funded cost of the public improvement may be made, provided that CDBG funds are used to *pay the special assessments on behalf of all properties owned and occupied by L/M income persons*; except that CDBG funds need not be used to pay the special assessments on behalf of properties owned and occupied by *moderate-income* persons if the grantee certifies that it does not have sufficient CDBG funds to pay the assessments on behalf of all of the L/M income owner-occupants. Funds recovered through such special assessments are not CDBG program income. *Reference: §104(b)(5) of the HCD Act*

### *Public improvements not initially assisted with CDBG funds*

The payment of special assessments with CDBG funds constitutes a form of financing the public facility/improvement, even though it was constructed without CDBG assistance at that time. Therefore, CDBG funds may be used to pay special assessments only if:

- ❖ Installation of the public improvement was carried out in compliance with requirements applicable to activities assisted with CDBG funds including environmental, citizen participation and Davis-Bacon requirements;
- ❖ Installation of the public improvement meets a criterion for national objectives (i.e., L/M Income Area Benefit, Slum or Blighted Area, or Urgent Needs); and
- ❖ Requirements described above for recovering non-CDBG funds are met (i.e., the assessment is paid on behalf of all L/M income property owner/occupants, or, where applicable, all low-income property owner/occupants).

**Note:** As discussed in Chapter 3 under L/M Income Area Benefit, restricting CDBG assistance to paying the special assessments levied against residential properties owned and occupied by L/M income persons is a permissible way of meeting L/M Income Area Benefit. *Reference: §570.208(a)(1)(iv)*

*Comparison of special assessments with impact fees*

Some communities make a practice of charging what is commonly called an “impact fee” for certain developments. For example, if a developer wants to construct housing in a new subdivision, the community would charge a fee per housing unit in recognition that the new development will place a burden on the existing infrastructure and will likely lead, together with other similar developments, to a need to reconstruct or build new facilities or improvements. These impact fees differ from “special assessments” in that they do not purport to be recovering the cost of a particular public improvement that benefits the assessed property, which is a defining feature of assessments. Nor do the impact fees usually represent a one-time charge for attaining access to a particular public improvement, another defining feature of special assessments in the CDBG program.

Impact fees generally are not eligible to be paid with CDBG funds, partly because they are providing funds for future, undefined public improvements and there is no way of telling whether the use of those CDBG funds would be for an improvement that would meet a national objective of the program. Contact your local field office if you have questions regarding specific impact fees in your community.

**Special  
Assessment  
Q's and A's**

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**1. Is the payment of special assessments a category of basic eligibility in the CDBG program?**

A. No. However, such payments are eligible because they are one way of financing a public improvement. Therefore, the public improvement itself must be eligible under §570.201(c) or §570.203(a). Special assessments are not included in the listing of eligible activities in §105(a) of the statute or in §570.201 through §570.206 of the regulations.

**2. Does the certification requirement pertaining to special assessments, as described in section 104(b)(5) of the statute, apply to special assessments levied against commercial or industrial properties?**

A. The certification applies to special assessments against properties owned and *occupied* by L/M income persons. HUD's position is that this refers only to residential properties.

**3. Does CDBG assistance in paying special assessments convert a non-assisted public improvement activity into one assisted with CDBG funds, thereby triggering all applicable Federal requirements, such as Davis-Bacon?**

A. Yes. When CDBG funds are used to recover some or all of the local funds used in financing a public improvement, they in effect are being used to pay at least part of the cost of the public improvement. This payment is frequently indirect, with the CDBG funds used to repay bonds which initially paid for the construction of the public improvement. However, use of indirect financing techniques cannot be used as a means of avoiding Federal requirements.

**4. Are there any exceptions to the requirement that CDBG funds must be used to pay assessments for L/M income persons?**

A. Yes. A grantee is not required to pay assessments for L/M income persons who own, but do not occupy, the assessed properties. Furthermore, a grantee is not required to pay assessments for *moderate* income owner/occupants if the grantee certifies to HUD that it lacks sufficient CDBG funds to pay assessments in behalf of all L/M income persons.

**5. Must outright grants be used to pay 100% of the special assessments levied on properties owned and occupied by L/M income persons or could the grantee choose to only lend the funds to some or all of such persons to meet this requirement?**

**A.** The payment must be in the form of a grant to the owner/occupants. This position is based on the fact that the statute does not speak in terms of partial payment or deferred payment but simply says that recovery of capital costs is impermissible unless CDBG funds are used “to pay” the assessments for the L/M income persons.

*Note:* This answer assumes the grantee has not made a special certification to HUD that it lacks sufficient CDBG funds to pay the assessments for moderate-income persons. If such a certification were made, the requirement for 100% grants would only be applicable to low- income persons; the grantee could lend funds to moderate-income owner/occupants.



## DETERMINING SERVICE AREAS

As discussed in Chapter 3 under the L/M Income Area Benefit subcategory of the L/M income national objective, once it has been determined that an activity provides a benefit to all the residents of an area, the activity may meet the L/M Income Benefit national objective only if the area served by the activity contains a sufficiently high percentage of L/M income residents. As also noted in that section, accurately determining the area served by the activity is critical for these purposes. This Appendix provides guidance on how to determine the area served by an activity.

Some activity types do not require any judgment in determining the area served for purposes of the CDBG program. This is because the area served by such an activity has already been determined for other purposes. Perhaps most notable among these activities are police precincts, fire stations, and schools. In each such case, specific boundaries have already been determined so that the persons involved know which facility serves persons or properties located at a particular address within the community. When boundaries such as these have been determined, no further work should be needed for purposes of identifying the area served by assisting the facility or providing the service.

Moreover, in many communities the planning department or the department or agency administering a particular facility or service, for their own purposes, establishes service areas for things such as libraries, parks, playgrounds, etc. Again, the decision to assist these services or facilities with CDBG funds should not require any additional work to identify the area to be served.

Generally speaking, it is reasonable to assume that certain kinds of facilities serve only very small areas. For example, sidewalks, gutters, trees, and street lights on a residential street would usually benefit only the residents of the immediately adjacent area. The same would be true for tot-lots and small playgrounds. Therefore, the area served by such activities is usually limited to a few census block groups surrounding the area in which they are located.

When the grantee does not already have an identification of the area served for a given facility or service, it will be necessary for the grantee to determine the service area before CDBG assistance may be provided if the activity is to qualify under the L/M Income Area Benefit criteria. As previously indicated, the grantee's determination of the area served will usually be accepted by HUD, unless there are indications that the grantee-defined area is clearly too small or too large. The factors to be considered in making the determination of the area served (both by the grantee and HUD) for these purposes are:

- ✓ The nature of the activity;

- ✓ The location of the activity;
- ✓ Accessibility issues, and
- ✓ The availability of comparable activities.

Each of these factors is discussed briefly below.

#### *Nature of Activity*

In determining the boundaries of the area served by a facility, its size and how it is equipped need to be considered. For example, a park that is expected to serve an entire neighborhood cannot be so small or have so little equipment (number of swings, slides, etc.) that it would only be able to serve a handful of persons at any one time. Conversely, a park which contains three ball fields, or a ballfield with grandstands that can accommodate hundreds of spectators, could not reasonably be said to be designed to serve a single neighborhood. The same comparison would apply to the case of assisting a small, two-lane street in a residential neighborhood versus that of assisting an arterial four-lane street that may pass through the neighborhood but is clearly used primarily by persons passing through from other areas.

#### *Location of Activity*

Where an activity is located will also affect its capacity to serve particular areas, especially when the location of a comparable activity is considered. A library, for example, cannot reasonably be claimed to benefit an area that does not include the area in which it is located. When a facility is located near the boundary of a particular neighborhood, its service area would be expected to include portions of the adjacent neighborhood as well as the one in which it is located. (Note that the grantee may carry out activities that are even outside its jurisdiction if it is done in accordance with §570.309.)

#### *Accessibility*

The accessibility of the activity also needs to be considered in defining the area served. For example, if a river or an interstate highway forms a geographic barrier that separates persons residing in an area in a way that precludes them from taking advantage of a facility that is otherwise nearby, that area should not be included in determining the area served. Other limits to accessibility may apply to particular activities. For example, the amount of fees to be charged, the time or duration that an activity would be available, access to transportation and parking, and the distance to be traveled can all constitute barriers to the ability of persons to benefit. Language barriers might also constitute an accessibility issue in a particular circumstance.

### *Comparable Activities*

The nature, location, and accessibility of comparable facilities and services must also be considered in defining a service area. In most cases, the service area for one activity should not overlap with that of a comparable activity (e.g., two community centers, two clinics, or two neighborhood housing counseling services).

### **"Fit" of Service Area**

Because the regulations require that census data be used to the maximum extent feasible for determining the income of persons residing in service areas, the boundaries of the service area determined by the grantee for the activity need to be compared with the boundaries of census divisions (tracts, block groups, etc.). The census divisions that best fall within the service area should be used for defining the service area for purposes of reporting on the activity and for calculating the percentage of L/M income persons residing in that area. While this means that the census divisions chosen for this purpose may exclude some limited number of persons that are in the actual service area or include some who are not, the practicality of using the census data will override unless the proportion of persons so excluded or included is too great. The alternative would be to survey excluded/included persons and to adjust the data obtained from the census computer runs accordingly. Surveys can be quite costly and their use should be limited whenever possible.

### **Commercial Service Areas**

A store will usually be considered to serve an area generally. Where the business itself has had a recent market survey to define the area it serves, it should be used for CDBG purposes. Where it does not have such a survey, an analysis of the location and accessibility of comparable stores should be undertaken to define the area served. When the CDBG assistance provided is not to a particular business but to the shopping center or commercial strip in which it is located (e.g., facade improvements), the area served would be that of the entire center or strip. Again, an analysis of comparable centers/strips should be undertaken in defining the service area. Note that it may not always be possible to determine the area served by a commercial business, such as in the case where the businesses depend on tourists. Moreover, some commercial facilities serve a very broad area (e.g., a regional shopping mall) and the area may be so large an area that it is unlikely to meet the 51% L/M income residents test.

## **Calculating the Upper Quartile**

As discussed in Chapter 3 concerning the L/M income Area Benefit subcategory under the L/M Income Benefit national objective, the criteria for meeting the national objective for activities that serve an area generally involve the percentage of L/M income residents in the area served by the activity. Certain communities are authorized to use their “upper quartile” percentage in lieu of 51% as generally required. Moreover, other provisions of the regulations make reference to a grantee’s upper quartile percentage for other purposes. The specific steps HUD uses in computing the upper quartile for a given community follow:

1. Determine the total number of block groups in the community’s jurisdiction. Subtract all block groups with zero persons to determine the net number of block groups.
2. Arrange the remaining block groups in descending order, based on the percent of L/M income residents in the block group. Compute the last block group in the upper quartile by multiplying the net number of block groups by 25%. The percentage of L/M income persons residing in this block group is the community’s “upper quartile” percentage.
3. If the percent of L/M income persons in the last block group of the upper quartile determined in step 2, above, is 51% or higher, the area benefit exception does not apply to this grantee.
4. If the percentage of L/M income persons in the last census block group in the top quartile is less than 51%, the jurisdiction qualifies to use the area benefit exception. The percentage of

L/M income persons in this block group becomes the threshold for L/M area benefit activities in place of the 51% to be used by grantees which do not qualify for this exception.

When the units of general local government participating with an urban county change, a new computation of the upper quartile will need to be made that applies to the new configuration. If the CD ROM provided by HUD does not reflect the new configuration, contact your local HUD field office to request a recomputation, since the configuration change in the urban county will likely change the relative ranking of specific block groups by quartile, and thus change the community’s upper quartile percentage. Where urban counties and metropolitan cities have signed joint agreements, the rank ordering must include the census block groups for both units of government.

Grantees which qualify for the exception criteria may use CDBG funds for area benefit activities in any service area, whether or not located in a block group in the highest quartile, if the percentage of L/M income persons in the entire area served is equal to or exceeds the upper quartile percentage.

If block group data are not available for the entire jurisdiction, other data acceptable to the Secretary will be used in the above calculations. The field office determines what data HUD will accept for this purpose.



# NEIGHBORHOOD REVITALIZATION STRATEGY AREAS

## Purpose

This Appendix outlines HUD's criteria for approving a jurisdiction's neighborhood revitalization strategy as described in the Consolidated Plan regulations at §91.215(e)(2). It describes the process for submission of the strategy, amending the strategy, and measuring, reviewing, and reporting on performance against the strategy.

## Background

In 1996, HUD established criteria for approving locally determined strategies for revitalizing an area that is among the community's most distressed. In order to provide some incentive for grantees to undertake such revitalization, the CDBG regulations provide certain benefits for the use of CDBG funds in such an area.

The requirements for developing such a strategy, the limitations on the areas that can qualify, and the benefits that accrue to the grantee upon HUD's approval of the strategy are key among the subjects covered in this Appendix.

## Citizen Involvement

HUD recognizes the fundamental necessity of partnering in problem-solving in order to achieve much greater success in our urban revitalization efforts. Many citizens, unhappy with their residential environments, have generally had three options available to them: pack up and move to a more satisfactory environment, change the unsatisfactory aspects of their communities, or stoically accept their living conditions. The continuing decline and widespread disinvestment in so many of our cities and counties and the spill-over effects in the surrounding communities point to a need for a different approach to rebuilding communities. No revitalization efforts in severely deteriorated areas can succeed in the long run without the support of all of the community actors. Successful neighborhood revitalization strategies are those that bring together the neighborhood's and the larger community's stakeholders to forge partnerships that:

- ❖ Obtain commitments to *neighborhood* building;
- ❖ Make neighborhoods attractive for investments, thereby creating a market for profits;

- ❖ Generate neighborhood participation to ensure that the benefits of economic activity are *reinvested* in the neighborhood for long-term community development;
- ❖ Support the use of neighborhood intermediary institutions (e.g., Community Development Corporations [CDCs], Community Development Financial Institutions [CDFIs], community housing development organizations [CHDOs under the HOME program], and religious institutions) to bridge gaps between local government agencies, the business community, community groups, and residents; and
- ❖ Foster the growth of resident-based initiatives to identify and address their housing, economic, and human services needs.

The participation of all of the stakeholders, particularly the neighborhood’s residents, in the development of a comprehensive neighborhood revitalization strategy enhances the chances of its successful implementation by bringing all of the affected parties into the process from the beginning, thus gaining participants’ trust and garnering needed financial support. This approach also recognizes that the complexity of the causes of neighborhood decline requires a multi-pronged coordinated approach. The value of this approach has been borne out in the strategic planning process that many communities participated in during the development of their Federal Empowerment Zone applications.

For these reasons, HUD will approve a revitalization strategy under the authority of 24 CFR 91.215(e)(2) only where it is clear that the strategy has been developed with the involvement and support of a wide segment of the area’s stakeholders.

## **Regulatory Framework and Incentives**

The submission of a neighborhood revitalization strategy is provided for as part of the regulations at 24 CFR Part 91 which cover a Consolidated Plan submission for CPD programs. It is important to note that separate approval is required for the revitalization strategy although it is to be included in the Consolidated Plan submission which has its own approval process.

The incentives for entitled metropolitan cities and urban counties to submit and secure approval for a revitalization strategy are described below, together with the location in the regulations where the incentive is found.

- ❖ **Job Creation/Retention as Low/Moderate Income Area Benefit:** Job creation/retention activities undertaken pursuant to the strategy may be qualified as meeting area benefit requirements, thus *eliminating* the need for a business to track the income of persons that take, or are considered for, such jobs (24 CFR 570.208(a)(1)(vii) and (d)(5)(i));
- ❖ **Aggregation of Housing Units:** Housing units assisted pursuant to the strategy may be considered to be part of a single structure for purposes

of applying the low- and moderate-income national objective criteria, thus providing greater flexibility to carry out housing programs that revitalize a neighborhood (24 CFR 570.208(a)(3) and (d)(5)(ii));

- ❖ **Aggregate Public Benefit Standard Exemption:** Economic development activities carried out under the strategy may, at the grantee's option, be exempt from the aggregate public benefit standards, thus increasing a grantee's flexibility for program design as well as reducing its record-keeping requirements (24 CFR 570.209 (b)(2)(v)(L) and (M)); and
- ❖ **Public Service Cap Exemption:** Public services carried out pursuant to the strategy by a Community-Based Development Organization (CBDO) will be exempt from the public service cap (24 CFR 570.204(b)(2)(ii)).

The strategy must be implemented in accordance with the civil rights-related program requirements stated in the Consolidated Plan rule at 24 CFR Part 91.

## **Contents of the Neighborhood Revitalization Strategy**

A grantee's strategy must be designed to provide for the *economic empowerment* of the low- and moderate-income residents of a particular area that is among the grantee's most distressed. It must also provide for other long-term improvements within a reasonable period of time. Therefore, the strategy must clearly describe how it meets the following criteria:

- ❖ **Boundaries:** The grantee must identify the neighborhood's boundaries for which the strategy applies. All areas within those boundaries must be contiguous.
- ❖ **Demographic Criteria:** The designated area must be *primarily residential* and contain a percentage of low- and moderate-income residents that is equal to the "*upper quartile percentage*" (as computed by HUD pursuant to 24 CFR 570.208(a)(1)(ii)) or 70%, *whichever is less* but, in any event, *not less than 51 percent*;

- ❖ **Consultation:** As mentioned above, the grantee must describe how the strategy was developed in consultation with the area’s stakeholders, including residents, owners/operators of businesses and financial institutions, non-profit organizations, and community groups that are in or serve the neighborhood;
- ❖ **Assessment:** The strategy must include an assessment of the economic conditions of the area and an examination of the opportunities for economic development improvement and the problems likely to be encountered;
- ❖ **Economic Empowerment:** There must be a realistic development strategy and implementation plan to promote the area’s economic progress focusing on activities to create meaningful jobs for the unemployed and low- and moderate-income residents of the area (including jobs created by HUD-assisted efforts) as well as activities to promote the substantial revitalization of the area; and
- ❖ **Performance Measurements:** The strategy must identify the results (e.g., physical improvements, social initiatives, and economic empowerment) expected to be achieved, expressing them in terms that are readily measurable. This must be in the form of “benchmarks.”

## Level of Detail

In order to avoid an unnecessary burden for the grantee in describing its strategy in the Consolidated Plan, the grantee may refer to specific portions of other documents that HUD has access to for this purpose. The grantee will only need to provide additional information to the extent that sufficient detail is not already contained in such existing documents in order that HUD may determine that each of the criteria in the “Contents” section of this Appendix has been met.

Since the grantee’s HUD CPD Field Office representative will review the neighborhood strategy submission, the grantee should consult with its HUD representative to discuss what existing documents and information the grantee will be relying on for its submission and what additional information HUD will need to make this approval.

While the grantee need not formally commit itself to the use of CDBG funds (or other resources it expects to receive from HUD) for future years, it will need to show in each year’s Action Plan the specific activities it plans to assist with any of the HUD formula program funds covered in the Consolidated Plan for that year, clearly identifying those that it will apply in pursuit of its strategy to revitalize the area.

## **HUD Partnership Approval Process**

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HUD expects to approve neighborhood revitalization strategies that are submitted by a CDBG grantee as part of its Consolidated Plan, or an amendment, if the proposed strategy describes how it will meet the criteria outlined in the “Contents” section above.

Any **Federally-designated Empowerment Zone (EZ) or Enterprise Community (EC)** located within an entitlement community will be *presumed* by the HUD CPD Field Office to meet the above criteria and will be approved by HUD, at the request of the grantee, without further review. Those entitlement grantees that submitted applications for designation as an EZ or EC but did not receive a designation should be able to meet these criteria, but may not yet have developed the necessary benchmarks.

Grantees and their HUD CPD field office representatives should work together in developing revitalization strategies that meet these guidelines. HUD’s review of strategies shall place particular importance on the grantee’s capacity, the likelihood that the planned actions will result in economic revitalization, and the extent to which the strategy reflects coordination with other public and private resources. HUD encourages innovative and creative strategies that promote the active and meaningful participation of the stakeholders throughout the development and implementation of the plan because HUD is interested in strategies that not only will successfully revitalize the neighborhood but will also economically empower its residents.

In the event HUD believes that a grantee’s submission is unlikely to achieve measurable progress in addressing the needs of the neighborhood, HUD will provide necessary technical assistance to the grantee to try to arrive at a consensus of what would constitute a “reasonable” strategy given the needs of the neighborhood and level of resources available. If after such technical assistance, HUD and the grantee remain apart in their assessment of what is a realistic strategy, HUD has the option of not approving the strategy.

The strategy may be submitted as part of the grantee’s Consolidated Plan or may be submitted as an amendment to it. When applicable, HUD’s approval of the jurisdiction’s Consolidated Plan will also state its approval of the revitalization strategy. *HUD will not hold up approval of the Consolidated Plan if the revitalization strategy cannot be concurrently approved without delaying the funding of the grant programs covered by the plan. In any event, HUD’s approval of a strategy for this purpose must be expressly stated.*

## **Performance Measurements: Baselines and Benchmarks**

HUD expects to approve strategies that will achieve substantial improvements in the delineated neighborhood/area and will create meaningful levels of economic opportunities for residents during the time frame of that grantee's approved Consolidated Plan, generally a five-year period. However, HUD does not require that the area be fully revitalized within that five-year period, but that the level of improvements will be substantial. Once HUD approves a revitalization strategy, the grantee may assume that this approval is in effect for the full time period of the strategy, provided that both the grantee and HUD agree that reasonable progress is being made in its implementation. In order for HUD to be able to gauge the effectiveness of the strategy, the strategy will need to provide baseline needs information for the area and set benchmark projections initially indicating the results that it hopes to achieve in addressing those needs over the period it expects will be needed to revitalize the area. Actual performance information will need to be submitted on an ongoing basis.

The benchmarks for this purpose should be readily measurable and specific enough to show expected outputs by the grantee and should clearly represent positive steps toward the desired ultimate outcome: economic revitalization of the designated area. Each year following HUD's approval of the strategy, HUD will expect the grantee to identify in its Action Plan for that year the benchmark outputs the grantee expects to achieve by the end of that year.

The benchmarks should include measures of outputs expected to be achieved through the use of the HUD program funds together with other resources it plans to use in a coordinated fashion as part of the strategy. An example of outputs would be the number of new businesses formed or the reduction, by a certain number or percentage, of persons on welfare. Since the benchmarks are to reflect the expected level of accomplishments at the end of each program year, they must be measurable at such times.

## **Performance Reporting**

The grantee will report progress against its benchmarks at the end of each program year. The Integrated Disbursement and Information System (IDIS) will be used to the maximum extent for the reporting of accomplishments, including performance against the grantee's own established benchmarks. For grantees with Federally-designated EZs or ECs that received HUD approval for a neighborhood revitalization strategy, reports that are required as part of the EZ/EC process shall suffice for purposes of reporting on approved revitalization strategies.

## **Performance Review**

HUD will review a grantee's progress at the end of each program year based upon information reported by the grantee and, when appropriate, information from on-site monitoring.

If based on its reviews, HUD determines that progress towards achieving the expected improvements in the area is lagging substantially behind the grantee's projections, HUD may suspend/withdraw its approval of the strategy. During any period of suspension/withdrawal, *the grantee would not be able to use the incentives provided under the CDBG regulations discussed earlier in this Appendix* for expenditures that are contingent upon an approved strategy. If the grantee submits and HUD approves an amended strategy for the area that satisfactorily addresses the lack of performance, the grantee would again be able to avail itself of the authorized benefits.

## **Amendments**

Because the neighborhood revitalization strategy is an element of the Consolidated Plan (albeit an optional one), it must be included with a jurisdiction's Consolidated Plan submission. When a jurisdiction makes a new Consolidated Plan submission in accordance with 24 CFR 91.15(b)(2), usually every five years, the grantee will have to either: submit the prior HUD-approved strategy with a statement that there has been no change in the strategy (in which case, HUD approval for the existing strategy is not needed a second time) or submit a new or amended neighborhood revitalization strategy (for which separate HUD approval would be required). The criteria for purposes of any amendment(s) to neighborhood revitalization strategies are the same criteria as for Consolidated Plan amendments described at §91.505.

It is presumed that these criteria would be applied whenever the conditions that existed at the time the strategy was developed have changed substantially (e.g., a decline in a dominant area industry, a natural disaster) or when a grantee determined that the strategy reflected in the HUD-approved plan was not working as well as it expected and it therefore wants to change its approach, or whenever HUD suspends/withdraws approval (or advises the grantee that it is so considering) as a result of performance lagging substantially behind the benchmarks.

Grantees should follow the guidance provided in the "Level of Detail" section of this Appendix. Amended strategies are to be reviewed by HUD using the same criteria as apply to initial strategy submittals.



# MAKING THE MOST OF YOUR CDBG RESOURCES

Almost any community that receives CDBG funds has a great number more community or economic development or affordable housing needs than it can possibly address with the CDBG funds it receives through its annual grant. It is therefore useful to consider ways in which these resources can be stretched to maximize the impact that can be attained in addressing those needs.

There are, of course, many things a grantee can do in the normal course of carrying out its CDBG program that can help in this regard. It can take steps to become aware of what other actors in the community are doing (most notably the nonprofit organizations in the area) that will affect the needs to be addressed. This will help not only in avoiding duplication of efforts but also to strive for symbiosis through the use of joint efforts to achieve common goals. Moreover, the grantee can take care to spend CDBG funds wisely through its procurement process and by holding its subrecipients to reasonable measures of progress. It can, under appropriate circumstances, stretch existing CDBG dollars through the use of Lump Sum Drawdowns and Escrows. (It should be noted that these latter two financing techniques are limited to rehabilitation and are discussed in more detail in Chapter Two of this Guide under the section entitled Rehabilitation.) It can carefully underwrite the assistance it provides to landlords and businesses to ensure that it is providing no more than the amount needed to achieve the expected results. And the grantee can set its own community development goals and objectives with measurable benchmarks so that it may evaluate whether reasonable progress is being made and whether any changes in direction are called for. Finally, it can make financial assistance available in the form of loans or loan guarantees instead of grants, whenever feasible.

All of the above approaches can and should be used to get the most impact from the CDBG program resources that the grantee receives. However, there are three other avenues that a grantee can consider taking advantage of in order to make more CDBG dollars available, or to make them available sooner. Considering one or more of these options can make it possible to fund special opportunities that may arise out of the normal planning cycle or when a high cost activity cannot be reached with funds currently available even though it might be very desirable to fund it.

This Appendix will cover the following three avenues that can be considered to expand available funds:

- ✓ CDBG Floats,
- ✓ Section 108 Loans, and

- ✓ Selling or Securitizing CDBG Loan Portfolios.

## **CDBG Floats**

Almost all CDBG grantees, especially those that receive entitlement grants, have some CDBG funds available to them in their CDBG Line of Credit that are not being used and will not be needed for some time to come. Such funds are referred to as the “float” since they seem to be just floating there, waiting to be used. Of course, all such funds should be budgeted for a particular use, but there are many reasons why some amount of funds, though already budgeted, will not be needed for months, and sometimes for over a year. The CDBG regulations provide that a grantee may make use of the funds in its float for the period during which they will not be otherwise needed for the activities for which they are budgeted, provided certain safeguards are taken. §570.301(b) provides the details for this purpose, but the following summary is provided.

### ***All the general rules apply***

Each activity carried out using the float must meet all of the same requirements that apply to CDBG-assisted activities generally, and it must be expected to produce program income in an amount at least equal to the amount of the float so used. A float-funded activity must be included in the action plan (often by amendment) for the current program year.

### ***Time period***

The action plan must identify the expected time period between obligation of assistance for a float-funded activity and receipt of program income in an amount at least equal to the full amount drawn from the float to fund the activity. *This time period may not exceed 2.5 years.*

### ***Safeguards***

A grantee that elects to fund an activity with its float must clearly declare, in the Consolidated Plan Annual Action Plan that includes the float-funded activity, the grantee’s *commitment* to undertake one of the following options in the event that the program income the activity is expected to produce is delayed or does not materialize:

- ❖ Amend or delete activities in an amount equal to any default or failure to produce sufficient income in a timely manner. If the grantee makes this choice, it must include a description of the process it will use to select the activities to be amended or deleted and how it will involve citizens in that process; and it must amend the applicable statement(s) or Action Plan(s) showing those amendments or deletions promptly upon determining that the float-funded activity will not generate sufficient or timely program income;
- ❖ Obtain an irrevocable line of credit from a commercial lender for the full amount of the float-funded activity and describe the lender and terms of such line of credit in the Action Plan that includes the float-

funded activity. To qualify for this purpose, such line of credit must be unconditionally available to the grantee in the amount of any shortfall within 30 days of the date that the float-funded activity fails to generate the projected amount of program income on schedule;

- ❖ Transfer general local government funds in the full amount of any default or shortfall to the CDBG line of credit within 30 days of the float-funded activity's failure to generate the projected amount of the program income on schedule; or
- ❖ Any other method approved in writing by HUD for securing timely return of the amount of the float funding. Such method must ensure that funds are available to meet any default or shortfall within 30 days of the float-funded activity's failure to generate the projected amount of the program income on schedule.

## **Section 108** **Loan Guarantees**

Section 108 provides HUD the authority to pledge the full faith and credit of the U.S. Government as a means of guaranteeing loans under the CDBG program. Under this provision, a grantee may request loan guarantee assistance under the following conditions:

- ❖ The proceeds from loans guaranteed under this provision may be used only for activities specifically eligible under Section 108, which include many of the same activities that other CDBG funds may assist. (Some notable exceptions are: CBDOs may only carry out a community economic development project; and the proceeds may not be used for activities under the Planning and Capacity Building (§570.205), Program Administration (§570.206), and Public Services (§570.201(e)) categories of basic eligibility. See 24 CFR 570 subpart M for further details.);
- ❖ The grantee must pledge its future grants under the CDBG program as security for the loans; and
- ❖ Additional security will also be required for repayment of the loans, with the specifics determined on a case-by-case basis.

## *Features*

- ❖ A grantee may borrow up to five times its annual grant under this authority. (This means that, at any one time, a grantee may have outstanding guaranteed loans that total as much as five times the grantee's most recent annual grant amount.)
- ❖ The loan repayment period can be for as long as 20 years.
- ❖ While Section 108 is taxable borrowing, the interest rate on the loans typically do not exceed the usual Treasury borrowing rates by more than 15 to 20 basis points. (Note: There are restrictions on mixing Section 108 loan guarantee assistance and tax exempt borrowing.)
- ❖ While most guaranteed loans are repaid using an income stream from the activity assisted by the loan proceeds, CDBG grant funds (and program income) can be used to make interest and principal payments on the loans.

Attachment A to Appendix G contains a Fact Sheet giving more details on the 108 Loan Program. Contact the local HUD field office for further information about such loans and for assistance in requesting Section 108 loan guarantee assistance.

## **Selling/ Securitizing Loan Portfolios**

Most grantees have, by now, a substantial number of outstanding loans made in the past using CDBG funds and for which a stream of program income can be expected. For a large number of grantees, the amount of program income received in a given year represents a very large percentage of the total CDBG funds they will have available to them. Some grantees have taken steps to accelerate the availability of this income by either selling all or part of their CDBG loan portfolios or by securitizing them.

In this way, additional funds can be accessed much earlier than they could otherwise be expected to be available. This can be very useful to a grantee in responding to opportunities to fund projects that would make an important contribution to its objectives, but which call for substantially more funds than that which can be made available using the existing grant and program income.

Selling a loan portfolio on the secondary market is not always possible. A grantee that is interested in doing so should contact the local HUD field office for guidance on how to proceed. But a grantee may be better able to securitize its portfolio. This is sometimes more appealing to an investor since they are purchasing a share of the entire portfolio, reducing the risk over that of purchasing one or more particular loans that might become delinquent or default. One way for a grantee to securitize its portfolio is through the Section 108 Loan Guarantee Program. The grantee can receive

a Section 108 loan for which the repayment is expected to come from the payback of the CDBG loans in the grantee's portfolio. See the discussion about 108 loans, above, for more details about this option. Also see Appendix G to this Guide that provides further information on this matter.

## **Conclusion**

Among these three alternatives for expanding available CDBG resources, the one that is most within the grantee's control is the use of the float. Depending on the amount of funds needed, assistance using the float can be arranged quite rapidly. Section 108 loans can provide a larger amount of funds, when needed, but it typically takes much longer to arrange to get a loan guarantee approved than to meet the requirements for float usage. Selling or securitizing CDBG loan portfolios would usually take a long time to arrange, but once set in motion, it can be managed in a way to provide as large an amount of funds as may be needed by the grantee through selective sales or securitizing.



**SELLING OR SECURITIZING  
COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)-  
FUNDED LOANS USING THE SECTION 108 PROGRAM  
AND OTHER SECONDARY MARKETS**

**Purpose**

This Appendix discusses securitizing CDBG-funded rehabilitation and economic development loans using the Section 108 program or selling the loans to secondary markets. It also describes solutions for common problems and issues communities encounter when implementing securitization and sales programs.

**Background**

Many communities have substantial sums invested in CDBG rehabilitation and economic development loan portfolios. A study funded by HUD a few years ago, *Secondary Markets for City-owned CDBG Loans* (available from the Communities Connections Information Center at (800) 998-9999), estimated that the “combined portfolio [of CDBG rehabilitation loans] surely exceeds \$2 billion” nationally. The volume of economic development loans is also substantial, because most economic development assistance to businesses is provided in the form of loans. While many communities retain and service the loans they originate, using the program income generated by loan payments to fund additional CDBG-eligible activities, other communities choose to speed up the return of the loan funds: they sell portions of their loan portfolios to a secondary market or securitize their portfolios using Section 108 loan guarantees.

The above-cited study of secondary market sales of CDBG rehabilitation loans describes and analyzes the mechanics of several types of loan sale efforts by several CDBG entitlement grantees during 1985–1992. The study inventoried the then-current use of CDBG revolving funds, summarized experience with the sale of CDBG rehabilitation loans, and illustrated the experiences of selected cities in their efforts to sell loan portfolios.

This Appendix focuses on why a community may choose to securitize or sell loans as part of its community development program and addresses specific regulatory requirements that must be met when a community uses this financing technique. Guidance on portfolio management and secondary markets, based on the HUD-funded study and other HUD experience, is also provided.

## Definitions

This section contains simple definitions of some of the technical terms used in this Appendix.

- ❖ *Discount rate*—Usually, “discount rate” means the market interest rate the investor would expect to receive over the same period of time in a different investment. The discount rate is applied in determining the present value to the investor of the future income stream of a loan or security. The discount rate usually varies from investor to investor based on varying investor perceptions of risk inherent in the loan, and investor motivation.

Since most CDBG loans are made at below-market (i.e., below discount) rates, this usually results in purchase offers that are substantially below the face value of the loans.

- ❖ *Income stream*—“Income stream” means the stream of loan payments (principal and interest) that the purchaser of the loan will receive over time as the loan is paid.
- ❖ *Loan*—“Loan” means to provide funds to a borrower in return for a promise to repay the principal, usually with interest. Investors are not often interested in forgivable and deferred loans because such instruments do not generate a predictable income stream.
- ❖ *Portfolio*—“Portfolio” means all the existing loans held by the grantee or subrecipient in a particular program or group of programs.
- ❖ *Present value*—“Present value” means the current value of the future income stream of an investment. The present value of an investment is calculated using a process called “discounting.” In discounting, the investor takes the income stream from the loan and divides it into two portions: investment and return. The discount rate selected by the investor represents the return percentage he or she wants to achieve, so this rate is applied to calculate the maximum value he or she would be willing to invest now to purchase the income stream, and to assure the acceptable return later. Communities selling loans have generally found that the amount an investor is willing to invest in a community development loan is lower than the face value of the loan.

The amount the investor is willing to pay **now** to secure the future income stream is called the present value of the loan.

If the interest rate that borrowers are paying on the loan or group of loans being sold is below the market rate, the present value of the loan to an investor will often be below the face value of the loan. Thus, if purchased by a private investor, the loan will likely sell “at a discount” to allow the investor to receive an acceptable return from the payments.

- ❖ *Recourse*—“Recourse” means the provisions of a sale or securitization agreement that govern the seller’s and buyer’s responsibilities if a loan

defaults. A sale made purely “without recourse” does not obligate the seller to take any action to protect the buyer’s financial investment in the event of default. Neither is the buyer obligated to take any action to protect the seller’s community development purposes. (However, under the CDBG program, grantees may not make sales without assuring that national objectives will be met.) Typical recourse options obligate the seller to repurchase a bad loan, to replace a bad loan with a good one, or to make payments on behalf of the borrower. The recourse agreement would obligate the buyer to pursue the selected alternate form(s) of recourse before, or instead of, pursuing foreclosure.

- ❖ *Seasoned loan*—A “seasoned loan” has a record of one or more on-time payments. Investors’ requirements on the length of seasoning necessary prior to consideration for purchase may vary substantially.
- ❖ *Secondary market*—“Secondary market” means any investor (institutional or individual) that purchases loans.
- ❖ *Securitization*—“Securitization” is the opposite of whole loan sales and happens when several investors each buy a share, or portion, of a pool of loans. The shares are called securities. The principal and interest payments made by borrowers on the loans are passed through to the owners of the securities. Pooling loans allows the risk that any one loan will default to be shared among several security holders and usually results in a higher resale value for the overall pool of loans. Pooling loans of various interest rates and terms can be complicated to manage. (See the section below discussing Section 108 securitization).
- ❖ *Whole loan sales*—“Whole loan sales” are the opposite of securitization. Instead of selling securities on a pool of loans, each loan is sold as a separate investment (although buyers often purchase more than one loan at a sale). Whole loan sales are often used when the volume of loans to be sold is relatively small, sales of loans infrequent, or money to be generated by the sales insufficient to justify the costs of managing a loan pool.

## Why Sell?

In virtually all communities, the funds available at any given time for community development are not sufficient to meet all current community development needs. Also, sufficient funds may not be available at a particular time to permit a community to address a particular need. Selling or securitizing CDBG loans can: 1) bring an income stream that would otherwise be scattered over future years into the present, creating a pool of funds for current investment, and 2) increase the volume of community development dollars available for investment by increasing the number of times the funds are re-spent each program year or planning cycle.

One caveat to consider is that when community development loans sell at substantial discounts, the initial investment of CDBG dollars may not be fully recaptured. The price paid for the loan, because it is discounted, may be less than the present value of what the grantee would have received in principal and interest, if the loan were not sold. In either case, the grantee gets its initial investment back: sooner, if the loan is sold to an investor; or later, if the loan is paid back directly to the grantee over the term of the loan. When the loan is substantially discounted for sale to an investor, a part of that repayment may be “leaked” out of the long-term community development economy. Sales can increase the volume of money available for community development over time only if the reuse of funds is quick enough to offset the discount or if the funds are leveraged in some manner.

Thus, in deciding whether to develop an ongoing loan sale effort, a community should consider whether a continuing volume of marketable loans will be generated quickly enough by the relevant loan program to support a program of repeated loan sales. Further, a loan sale vehicle involving the minimum possible discount might be considered as the best vehicle for reducing possible leakage (see discussion of Section 108 securitization later in this Appendix.)

## Valuing Loans

In determining whether to purchase CDBG loans, individual and portfolio loan value to the investor is not simply based on the dollar amounts and financial ratios involved. The value assigned in the discounting process is affected by the quality of the loan documentation, the payment record on the loan, how any defaults will be handled, the terms of the loan (for example, is it forgivable?), and on government policies that may affect the risk to the investor or cost of administering the loan portfolio. Usually, the private investor is trying to find a loan or security to purchase that offers maximum return for minimum risk. Some public and private purchasers have a second motive driving loan selection: they wish to invest in community development. These investors may therefore be able to accept a lower return if the loan program contributes to community development.

To most potential loan purchasers, quality loan documentation equals standardized loan documentation. This means the same underwriting tests, applications, and other documents are completed and present in EVERY loan file. A simple rule in dealing with secondary markets is to remember that the familiar, standard loan (whose return is more predictable) will nearly always sell better than a unique one that must be explained (sometimes called a “story loan”). Good files document each loan’s payment record for purchasers to use in determining the risk to their investments. Many purchasers prefer to purchase seasoned community development loans with quality loan documentation.

How will defaults be handled? What recourse is available for the purchaser, the grantee, and the family or business paying the loan in the event the loan defaults? These are critical questions in determining the marketability of the loan. They are also important policy issues whose solutions should support community development purposes. This topic is discussed in the section below entitled *In case of default...* and is examined in detail in the HUD-funded study. CDBG rules affecting the handling of defaults are generally related to the rules about handling program income. More information on program income is available in Subpart J of the CDBG regulations; other guidance on program income as well as defaults is available in the *Program Income Training Bulletin* (HUD/CPD-90-1, April 1990), available from HUD.

Government policies that may affect risk to the investor range from how the underwriting standards of the loan program are set to whether other community development support (in the form of assistance for affordable housing, infrastructure, businesses, and public service) is provided in the geographic areas served by the loan program. In general, the more risk perceived by the investor, the higher the return that investor will demand. So loans that are perceived to be more risky will generally sell for a greater discount off their face value. It appears from the HUD-funded study that large national or regional financial investors that have less of a stake in the local economy tend to look more at the financial risk factors associated with the loan, while local financial institutions are better positioned to evaluate the non-financial factors affecting investment risk. These local institutions may therefore accept a smaller discount on the loans and be more open to providing some additional benefits to the loan program.

## **Securitizing With Section 108 Loan Guarantees**

Section 108 provides all the tools needed to securitize new or existing loans. More information on the basics of the Section 108 program is included in the attachment to this Appendix entitled Section 108 Fact Sheet, and HUD field office staff are available to work with any community that would like to pursue using the Section 108 program.

To securitize *new* loans, Section 108 provides an interim financing facility for originating the loans. The Section 108 permanent financing program provides both the actual financing for the securities and a credit enhancement (the Federal guarantee backed by the pledge of CDBG grants). Payments on the loans are passed through to the Section 108 note holders.

Section 108 provides a securitization opportunity for *existing* CDBG loans as well. The securitization would be structured in a fashion similar to the securitization of new loans, except that the community would sell (and HUD would guarantee) securities backed by a pool composed of existing CDBG loans. By pledging future payments on existing CDBG loans to the repayment of Section 108 obligations, a community can “unlock” those loans from its balance sheet. The proceeds from the issuance of the Section 108 obligations can then be used by the community to make additional loans. And the process can be repeated as the new loans begin to generate income.

Using Section 108 would almost always generate higher net proceeds from the securitization than could be realized from an unsubsidized sale of whole loans or from conventional securitization. This is true because the use of Section 108 involves a lower discount rate (the interest rate of Section 108 obligations is only slightly higher than rates on comparable Treasury obligations). A lower discount rate generates a higher present value (or sales proceeds amount). Further, the issuance costs for Section 108 obligations would be significantly lower than the costs (e.g., accounting, legal, credit enhancement) associated with conventional securitization.

## **Other Secondary Markets**

After the above discussion of Section 108 securitization, it may be asked: “Why pursue any other form of secondary market?” The answers to this question vary depending on the community development objectives of the grantee. One answer is that when the secondary market is a local bank, or group of banks, significant other benefits may accrue by developing local partnership arrangements. Several of the examples in the HUD-funded study involve local governments leveraging additional funds by implementing programs with local banks. Also, some other investors, such as the Neighborhood Reinvestment Corporation (NRC) acquire loans at quite attractive terms, essentially providing a subsidy to the community development programs they support.

Another benefit to pursuing loan sales or securitization through a private secondary market is that the purchaser will generally conduct a thorough review of the portfolio focused on the seller’s underwriting and portfolio management practices. This review can provide valuable information, such as providing a realistic assessment based on private-market practices that supports allocating a dependable level of resources for managing these activities. Philosophically, some local governments may be most comfortable not involving another public resource or Federal approval for selling what is, in most cases, a local asset.

A HUD-funded technical assistance demonstration project resulted in one sale of a well-managed portfolio to a private investor. Securitization was essential in that case because the State was unwilling to allocate additional grants or guarantees to continue an ongoing loan program for small businesses. Analysis in two other jurisdictions found that similar transactions (through a private foundation, bank, or other institution) might be feasible. However, in all three cases the securitization approach involved significant costs of assembling data and negotiating the basic assumptions of each transaction.

## **Issues**

The issues discussed below arose during HUD staff discussions with communities developing and implementing loan sale programs.

### *Creaming*

“Creaming” means taking care of the richest of the poor, taking the fewest risks possible with community development dollars. Creaming may violate CDBG rules: activities that meet low- and moderate-income national objective criteria must be designed so that they “do not benefit moderate income persons to the exclusion of low-income persons.” [24 CFR 570.208(a)] Creaming is an issue when (re)designing a community development loan program to facilitate later sale of the loans because loans to moderate-income persons in stable neighborhoods are going to be more attractive investments on their face than loans to low-income persons living in or adjacent to slum or blighted areas. The design of a community development loan program must be primarily focused on solving a community development problem, and secondarily supportive of possible loan sale efforts.

### *In case of default...*

Grantees should pay close attention to the recourse terms in any loan sale. Although some may choose to sell their loans and be finished with them, this may not be the best course for assuring that community development objectives are met, and it may result in a deeper discount on the loans (without recourse, the buyer will have to take on all costs of any defaults). If loans are sold with recourse, the seller takes on any default risk, but generally will receive a higher price, because most buyers will pay more for a less risky investment.

Usually recourse terms require the seller to take responsibility for a defaulted loan, either through purchase, exchange, or by making good any payment shortfalls. Such repurchase using CDBG funds is eligible if the recourse terms are clearly specified in the original sale agreement. In the first two options, once the seller (usually the grantee or a subrecipient) has the loan, it can evaluate whether its community development objectives will be better met by negotiating a work-out agreement with the borrower, or by entering into foreclosure proceedings. Most purchasers, if not allowed this recourse, would move straight to foreclosure. By insisting on some alternate form of recourse, grantees will incur the additional administrative costs of handling any defaulted loans, but they can also ensure that their clients and goals are best served.

#### *Meeting a national objective*

Even after loans are sold, HUD holds the grantee responsible for ensuring that each loan meets all program requirements, including meeting a national objective. Note that most housing rehabilitation loans qualify under the low- and moderate-income housing national objective. This objective is met on occupancy of the rehabilitated unit by an income-qualified household upon completion of the rehabilitation. Thus, by the time of sale, most of these loans will have met a national objective. The Department expects that loans with national objectives unmet at the time of sale will primarily be for economic development. It is important that a community selling its economic development loan portfolio take precautions to ensure that the national objective has already been met for each loan (usually by creation of jobs) or that the responsibility for doing so is passed on to the purchaser of the loan.

#### *Program income*

Program income is income received by the recipient or subrecipient directly generated from the use of CDBG funds. Generally, program income must be treated as additional CDBG funds, subject to all applicable requirements governing the use of CDBG funds (24 CFR 570.504). If a grantee sells a loan, the proceeds of the sale are program income. In such a case, the income from the loan repayments, which are received by the investor, is no longer program income. Also, if the aggregate amount of income received by the grantee and its subrecipients during the program year totals no more than \$25,000, such income would not be program income (24 CFR 570.500(a)(4)(i)).

#### *Portfolio management*

The HUD-funded study identified deficiencies in portfolio management as one of the most common road blocks to the sale of CDBG loans. Such management deficiencies may also result in a grantee's failure to effectively meet its community development objectives or in unwitting regulatory

violations. In the context of this Appendix, sensible portfolio management can decrease loan defaults and delinquencies and thereby increase the sale value of CDBG loans. Although local government community development policies that dictate higher-risk loan types or clients may also entail a higher default rate, prudent management can maximize the value of even the riskiest loans.

HUD encourages grantees to take a “systems approach” to improving portfolio management. This means that, although portfolio management technically is concerned with activities taking place after loans are made, an effective portfolio manager examines every step of the process from marketing and application review to loan closing and disbursement, through the years of loan management until the final payoff. A systems approach to portfolio management will not only decrease delinquency and default rates, it will assure the best service for the borrowers and ensure CDBG regulatory compliance.

The systems approach to portfolio management allows each decision made in designing the loan program to be examined for its ultimate effect on default and delinquency rates and payoff. Clearly, designing a loan program with the sole goal of the highest possible return and lowest delinquency-default rates would not result in a program that served low- and moderate-income borrowers or loan needs such as gap financing for small start-up businesses. Using the systems approach to design a program to serve higher-risk borrowers will result in the lowest possible delinquency-default rates for that type of program. Already, some trade magazines for the home mortgage and banking industries have noted, with some surprise, that the default rates for many programs offering supposedly higher-risk lending to lower-income borrowers are not nearly as high as expected, often falling within acceptable mainstream rates. This record can be further improved by following the principles of effective loan portfolio management, which are:

- ❖ Institutional commitment to recovering funds,
- ❖ Active management of the portfolio,
- ❖ Comprehensive systems planning,
- ❖ Written policies and procedures,
- ❖ Complete documentation of loans, and
- ❖ Dedication to staff training in all aspects of the portfolio management process.

For in-depth information on the systematic approach to portfolio management, HUD has developed a guide called “Loan Portfolio Management” through a contract with Price Waterhouse. The guide includes a self-assessment for grantees to complete in determining how to improve their portfolio management system and program design. A paper or electronic copy of this guide, plus a list of any other available publications on related topics, may be obtained by contacting the Communities Connections Information Center (telephone 800-998-9999, or electronic mail at [Comcon@aspensys.org](mailto:Comcon@aspensys.org)). This guide was developed with a focus on economic development loans, but the principles are the same for almost any type of loan management by local governments.

**Attachment A**  
**Department of Housing and Urban Development**  
**Office of Community Planning and Development**

**Section 108 Loan Guarantees**

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Section 108 is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 provides communities with a source of financing for economic development, housing rehabilitation, public facilities, and large scale physical development projects. Regulations governing the Section 108 program may be found at 24 CFR 570, Subpart M, “Loan Guarantees.”

**Eligible  
Applicants and  
Activities**

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Eligible applicants include the following public entities:

- ✓ Metropolitan cities and urban counties (i.e., CDBG entitlement recipients);
- ✓ Nonentitlement communities that are assisted in the submission of applications by States that administer the CDBG program; and
- ✓ Nonentitlement communities eligible to receive CDBG funds under the HUD-Administered Small Cities CDBG program.

The public entity may be the borrower or it may designate a public agency to be the borrower.

Activities eligible for Section 108 financing include:

- ✓ Economic development activities eligible under CDBG;
- ✓ Acquisition of real property;
- ✓ Rehabilitation of publicly owned real property;
- ✓ Housing rehabilitation eligible under CDBG;
- ✓ Construction, reconstruction, or installation of public facilities (including street, sidewalk, and other site improvements);
- ✓ Related relocation, clearance, and site improvements;
- ✓ Payment of interest on the guaranteed loan and issuance costs of public offerings;
- ✓ Debt service reserves;
- ✓ Public works and site improvements in colonias; and
- ✓ In limited circumstances, housing construction as part of community economic development, Housing Development Grant, or Nehemiah Housing Opportunity Grant programs.

For purposes of determining eligibility, the CDBG rules and requirements apply. As with the CDBG program, all projects and activities must either principally benefit low- and moderate-income persons, or aid in the elimination or prevention of slums or blight, or meet urgent needs of the community.

## **How the Program Operates**

*Maximum commitment amount.* Commitments are limited as follows:

- ❖ *Entitlement public entities.* An entitlement public entity may apply for up to five times the public entity's latest (approved) CDBG entitlement amount, minus any outstanding Section 108 commitments and/or principal balances on Section 108 loans.
- ❖ *State-assisted public entities.* A nonentitlement public entity may apply for up to five times the latest (approved) CDBG amount received by its State, minus any outstanding Section 108 commitments and/or principal balances on Section 108 loans for which the State has pledged its CDBG funds as security.
- ❖ *Nonentitlement public entities eligible under the HUD administered Small Cities Program.* For a public entity in Hawaii, the maximum commitment amount is five times the public entity's latest grant under 24 CFR Part 570, Subpart F, minus any outstanding Section 108 commitments and/or principal balances on Section 108 loans. A nonentitlement public entity in New York may apply for up to five times the greater of:
  - ◆ the most recent grant made to the public entity under Subpart F,
  - ◆ the average of the most recent three grants made to the public entity under Subpart F, or
  - ◆ the average of grants made under Subpart F to units of general local governments in New York State in the previous fiscal year.

(The maximum amount calculated above for any New York State public entity is reduced by any outstanding Section 108 commitments and/or principal balances on Section 108 loans.)

*Security.* The principal security for the loan guarantee is a pledge by the applicant public entity or the State (in the case of a nonentitlement public entity) of its current and future CDBG funds. Additional security will also be required to assure repayment of the guaranteed obligations. The additional security requirements will be determined on a case-by-case basis, but could include assets financed by the guaranteed loan.

*Loan repayment.* The maximum repayment period for a Section 108 loan is twenty years. HUD has the ability to structure the principal amortization to match the needs of the project and borrower. Each annual principal amount will have a separate interest rate associated with it.

*Financing source.* Section 108 obligations are financed through underwritten public offerings. Financing between public offerings is provided through an interim lending facility established by HUD.

*Interest rates.* Interest rates charged on interim borrowing is priced at the three-month London Interbank Offered (LIBO) rate plus 20 basis points. Permanent financing is pegged to yields on Treasury obligations of similar maturity to the principal amount. A small additional basis point spread, depending on maturity, will be added to the Treasury yield to determine the actual rate.

*Default.* To date, there has been no default under Section 108 resulting in a payment by HUD. In the event of default requiring a payment, HUD would continue to make payments on the loan in accordance with its terms. The source of payments by HUD pursuant to its guarantee would almost always be pledged CDBG funds. However, HUD does have borrowing authority with the Treasury if the pledged funds are insufficient.

*Developing an application.* Public entities wishing to apply for Section 108 loan guarantee assistance are advised to contact HUD in advance for guidance in preparing an application. Public entities may contact either the Community Planning and Development staff at the appropriate HUD field office or the Section 108 office in Washington at (202) 708-1871.\* Application guidance can also be found in the Section 108 regulations at 24 CFR 570.704, "Application Requirements."

*\*Hearing impaired users may call the Federal Information Relay Service at 1-800-877-8339.*

## **Program Trends and Accomplishments**

The Section 108 program has undergone several major changes since its establishment in 1974. In 1987, HUD was directed by Congress to utilize a private sector financing mechanism to fund the loan guarantees as opposed to using Federal funds. In 1990, legislative changes increased public entities' borrowing authority to five times the CDBG allocation, extended the maximum repayment period to twenty years, and made units of general local government in nonentitlement areas eligible to apply for loan guarantee assistance. Since its implementing regulations were published in 1970 the following activity has occurred:

<b>Fiscal Year</b>	<b># of Commitments</b>	<b>\$ Amount (000)</b>
1978.....	1.....	476
1979.....	9.....	30,810
1980.....	23.....	156,933
1981.....	48.....	156,487
1982.....	52.....	179,377
1983.....	22.....	60,627
1984.....	29.....	86,952
1985.....	63.....	133,475
1986.....	25.....	113,290
1987.....	13.....	30,007
1988.....	43.....	143,578
1989.....	48.....	122,970
1990.....	44.....	119,260
1991.....	26.....	84,466
1992.....	46.....	163,780
1993.....	43.....	229,300
1994.....	88.....	350,520
1995.....	218.....	1,847,005
1996.....	89.....	433,775
1997.....	118.....	277,683