



TO: John McDonough, City Manager
FROM: Jim Tolbert, Assistant City Manager
DATE: August 4, 2016
ITEM: Section 108 Loan Process

Attached is information regarding the HUD Section 108 loan program and process. The Mayor has discussed using the 108 program to fast track the sidewalk/ streetscape project currently under design. The rules of the program are pretty simple. A community can borrow up to five times its approved CDBG grant amount. For Sandy Springs that would be approximately \$2,500,000 based on our current annual allotment of about \$500,000.

Basic rules are as follows:

- Repayment can be stretched to 20 years if desired.
- The CDBG allocation can be used to repay the loan or other funds can be used for repayment with CDBG funds continuing to be used for other eligible activities.
- CDBG funds are pledged as security for the loan. In addition they may ask for some other security interest.
- Sidewalk/streetscape work is an eligible activity for these funds.
- Projects funded must meet basic CDBG criteria and the sidewalk work does that.

While the sidewalk project is an eligible activity there are other uses of CDBG or Section 108 funds. These include:

- Housing Rehabilitation
- Property acquisition for an eligible activity
- Construction of other public facilities
- Limited economic development
- Related relocation, clearance or site improvements

If City Council is interested we can move this pretty quickly. We would need a resolution authorizing application and after submittal of a simple allocation we should have a decision in less than a month on a loan commitment. It would then take another 30 to 60 days to complete the underwriting and we could then have access to the funds. Our two decision points are whether to apply and how we want to structure repayment.

Please let me know how to proceed.

Thanks.

*City
Manager*



Section 108 Loan Guarantee Program

(Program Regulations: 24 CFR, Part 570, Subpart M—"Loan Guarantees")

The loan guarantee component of the **Community Development Block Grant (CDBG) Program**, *Section 108* provides States and local governments access to low cost, private financing for economic development, housing rehabilitation, public facilities/improvements, and large-scale real property development projects. Such public investment is often needed to encourage private economic activity in distressed areas. State and local government promissory notes are **guaranteed by the Secretary of HUD with the full faith and credit of the United States** for the timely payment of principal and interest, to provide easy, low cost private financing with variable and fixed interest rates for local community and economic development projects.

Eligible applicants ("Borrowers") are States and *public entities*, i.e., units of general local government who are CDBG entitlement communities, including urban counties, as well as nonentitlement communities assisted by their States.

Eligible activities for economic development, housing rehabilitation, public facilities, and public infrastructure projects are outlined at 24 Code Federal Regulations, 570.703. Section 108 eligible activities must meet applicable CDBG National Objective requirements.

National Objectives are activities that 1) provide benefits to Low and Moderate Income persons through job creation/retention, housing rehabilitation, services in distressed neighborhoods, or 2) Aid in the prevention or elimination of slums or blight, or 3) meet a particular urgent community development need.

Section 108 Loan Guarantee Fee: In FY 2016, State and local government applicants approved by HUD for a Section 108 commitment will be charged a non-recurring fee of 2.58% of the principal amount(s) advanced under the loan guarantee commitment. This fee may be deducted from the loan disbursement(s), or paid with CDBG funds, or paid with other funds. This fee is not added to the interest rate of interim variable rate loans or permanent fixed rate loans.

(Continued on back of page)

Loan Details

- **Maximum Loan:** Up to five times the State or local government's latest approved CDBG grant amount, minus any outstanding Section 108 commitments and/or principal balances of current Section 108 loans.
- **Loan Term and Repayment:** The loan term may be up to 20 years. HUD can structure the principal repayment schedule to match the financing needs of projects and developing entities. Debt service payments (principal and/or interest) are due quarterly for variable interest rate interim loans (February 1, May 1, August 1, and November 1), or semi-annually for fixed interest rate permanent loans (February 1 and August 1).
- **Loan Repayment Security:** A pledge by the State or local government of its current and future CDBG funds plus *additional security for loan repayment* determined on a case-by-case basis. Additional loan security generally includes assets financed by the guaranteed loan (real property, machinery and equipment), but other types of security may be accepted, including personal/corporate guarantees, parking revenue, and tax increment financing (TIF).
- **Financing Source and Interest Rates**
 - **Permanent Financing:** Fixed interest rate financing (comparable to U.S. Treasury obligations of similar maturity with a small interest rate spread) is generally available once a year through HUD's *public offering*, which is the sale to capital market investors of Guaranteed Participation Certificates. The Certificates provides investors access to annual cash flows from a trust consisting of federally guaranteed, promissory notes issued by States and units of general local government. These promissory notes may be *defeased* in whole or in part during the first 10 years, or prepaid in whole or in part after 10 years.
 - **Interim Financing:** Variable interest rate financing between public offerings is available by selling State and local government promissory notes to investors through an interim credit facility (money market fund). Interest rates are based on 3-month LIBOR (London Inter-Bank Offered Rate) plus 20 basis points (0.2%). These notes may be prepaid at any time without penalty, in whole or in part. Variable rate interim financing is converted to fixed rate permanent financing in the next public offering.

FOR MORE INFORMATION:

Please visit <https://www.hudexchange.info/programs/section-108/>

Section 108 Loan Guarantee Program Overview

Section 108 of the Housing and Community Development Act of 1974 provides for a loan guarantee component of the Community Development Block Grant (CDBG) Program. The Section 108 Loan Guarantee Program (Section 108) provides communities with a source of financing for economic development, housing rehabilitation, public facilities, and other physical development projects, including improvements to increase their resilience against natural disasters. The funds can be used by a designated public entity to undertake eligible projects, or, alternatively, can be loaned to a third party developer to undertake the projects. This flexibility makes it one of the most potent and important public investment tools that HUD offers to local governments.

Regulations governing the Section 108 program may be found at 24 CFR 570, Subpart M, Loan Guarantees.

Purpose of the Section 108 Program

The program allows local governments to transform a small portion of their CDBG funds into federally guaranteed loans large enough to pursue physical and economic revitalization projects capable of renewing entire neighborhoods. Such public investment is often needed to inspire private economic activity, providing the initial resources or simply the confidence that private firms and individuals may need to invest in distressed areas. While local governments borrowing funds guaranteed by HUD through the Section 108 program must pledge their current and future CDBG allocations as security for the loan, the goal is for the proposed project to have sufficient cash flow to repay the loan without any need for current or future CDBG dollars used for the repayment.

The 2010-2015 HUD Strategic Plan goals target the Section 108 program to implement two very important goals:

Goal 2B: Meet the Need for Quality Affordable Rental Homes -Expand the Supply of Affordable Rental Homes Where they are most needed; and

Goal 4A: Build Inclusive and Sustainable Communities Free from Discrimination: Catalyze economic development and job creation, while enhancing and preserving community assets.

How the Section 108 Program Works

The borrowers for Section 108 loan guarantees are local or state governments. If approved, private lenders are incentivized by this security to lend funds to the borrower.

Depending on the type of project, the borrower has two basic options for using the loan funds:

- Loan the funds to a third party developer are known as third party loans. This borrower is referred to as the **obligor**.
- Directly expend the funds on the project.

The borrower will be required to secure the loan by pledging current or future CDBG allocations to either repay the loan or secure it. In addition, the borrower may be required to pledge additional security to the loan. Additional security may include property liens or other collateral.

Section 108 Eligibility Requirements

Eligible Applicants (24 CFR 570.702)

Eligible applicants include the following public entities:

- States
- 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
- Nonentitlement communities eligible to receive CDBG funds under the HUD-Administered Small Cities CDBG program (Hawaii). The public entity may be the borrower or it may designate a public agency as the borrower

Eligible Section 108 Projects (24 CFR 570.703)

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

Activities eligible under CDBG include:

- 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
- Finance fees
- Public works and site improvements in colonias
- In limited circumstances, housing construction as part of community economic development

Financing Infrastructure with Section 108 Loans

Section 108 loans may be used to finance the construction, reconstruction, or installation of public facilities including street, sidewalk, and other site improvements that are part of the overall project. The funds can also be used for related relocation, clearance or site improvements.

Disaster Recovery or Resilience

Section 108 loans are generally used for long term community needs but may be used for long term recovery or to prevent further damage only if such use does not duplicate funding available from FEMA, the Small Business Administration, and USACE (U.S. Army Corps of Engineers). Section 108 loans can be used to match FEMA grants to rebuild for recovery or future resilience.

Administration of Section 108 Loans

The borrower's cost of administering a Section 108 loan can be allocated to the CDBG administration cap of 20%, or the costs can be included as an activity delivery cost in carrying out the project. For example, if a borrower's employees underwrite economic development loans that are to be made with CDBG funds, the portion of their salaries spent on this function can be treated as costs of carrying out the activity. This is important because these costs are not subject to the limitation on the use of CDBG funds to pay planning and administrative costs.

Projects NOT eligible for 108 Loans (24 CFR 570.207(a))

Projects funded with Section 108 loans must meet basic CDBG criteria, including meeting a national objective and public benefits standards. Projects are also subject to compliance with all other local, state or federal regulations including cross cutting regulations. While a specific type of activity may not be prohibited by HUD, the borrower may have local priorities and projects that are deemed ineligible. There are some activities eligible under CDBG that are not eligible for Section 108, such

as public services. Projects that are not CDBG eligible and are thus not eligible for Section 108 loans include the following:

- Projects where the public benefits standards have been triggered (which is common for many large-scale projects) and where a sufficient level of public benefit is not achieved are ineligible.
- Buildings used for the conduct of government are also ineligible even if they are to be funded as a commercial enterprise. For example, even though office buildings may be eligible in general as an economic development activity, an office building that will house a City Hall is not acceptable.
- Projects that do not meet a national objective are not eligible. It is important to remember that while development of a high tech manufacturing facility may be an eligible special economic development activity, it cannot be funded unless it also meets a national objective.
- All other projects deemed ineligible under 24 CFR 570.207(a) cannot be undertaken as a large-scale development project.

Micro Enterprises (24 CFR 570.201(o))

The formation and operation of small business developments, including incubators and micro enterprises are not eligible for funding with Section 108 loans, however, a small business, incubator or microenterprise may apply for guaranteed loan funds for eligible projects. As with all Section 108 projects, the public benefits requirements would apply.

Source of Section 108 Loans

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

Public Offerings

When HUD schedules a Section 108 public offering, state and local government borrowers may request to participate and receive long-term, fixed rate financing for approved community and economic development projects. Section 108 borrowers with interim loans will be able to convert variable rate financing to permanent fixed rate financing. In addition, borrowers that participated in prior public offerings may refinance their loans. Generally borrowers that have not received the full amount of approved loan guarantee commitments may be eligible to participate in a public offering. Visit the Section 108 webpage for more information.

Section 108 Loan Requirements and Underwriting (24 CFR 570.704-705)

Maximum commitment amounts

Section 108 loan 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.** Generally, the maximum commitment amount is up to five times the latest approved CDBG amount received by the 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.

Section 108 Loan 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 may be required to assure repayment of the guaranteed obligations. The additional security requirements are determined on a case by case basis but could include assets financed by the guaranteed loan. The applicant should utilize established credit underwriting guidelines in the approval of projects to be financed with 108 loan guarantees.

Section 108 Loan Guarantee Program Underwriting Requirements

Section 108 loans are evaluated on several levels. Once it is determined that the project meets CDBG requirements, including a national objective and complies with other applicable federal regulations, there are two further levels of underwriting. The first must demonstrate a sufficient public benefit in return for the CDBG investment. The second is third party credit underwriting to determine if the project and Obligor is an acceptable credit risk and the collateral meets HUD's security requirements.

Public Benefits Standards

Economic development projects must demonstrate a sufficient benefit in return for the CDBG investment. There are established guidelines to demonstrate sufficient benefit and are necessary to demonstrate the financial viability of a project.

The underwriting process for public funds evaluates the suitability of using public funds in a specific way for a specific project. The process ensures that public funds are not substituting for other financing sources and that the project is not being overly subsidized. HUD has provided guidance in 24 CFR Appendix A to Part 570. The objectives of the underwriting guidelines are to ensure:

- Project costs are reasonable;
- All financing is committed – public funds will not be wasted on a project not implemented;
- The 108 funds are essential to the project – not substituting for private financing;
- The project is financially feasible – the anticipated public benefits will materialize;
- Return on equity is reasonable – the minimum amount of public funds is being invested; and
- CDBG funds are disbursed on a pro rata basis – not before other financing sources.

See 24 CFR Appendix A to Part 570 - Guidelines and Objectives for Evaluating Project Costs and Financial Requirements

Third Party Loan Underwriting Guidelines

HUD is providing third party underwriting guidelines to assist Section 108 applicants in deciding if a proposed third party loan and Obligor is an acceptable credit risk and if the proposed collateral meets HUD's security requirements. The credit underwriting process is critical in evaluating the risk of making third party loans. If the third party loan goes into default, the community will be required to repay the loan and may have to use their CDBG funds to do so. The Underwriting Guidelines address two types of loans:

- Economic Development Loans Secured by Real Estate
- Business Credit Loans Secured by Machinery, Equipment, Receivables or Inventory

The third party loan underwriting process seeks to answer the following questions for both types of loans:

- Is there a market demand for the goods or services to be provided by the project?
- Is the project ready to proceed- for example, is the land, zoning, and financing in place?
- Is there sufficient committed financing for the project to be completed?
- Does the borrower have the capacity to operate and manage the project?
- Will the project generate sufficient revenue to repay the loan?
- Is there sufficient collateral to back up the loan?

HUD anticipates making the Section 108 Loan Guarantee Program Credit Underwriting Guidelines available in February, 2016. The guidelines will provide instruction on how to answer these questions. To receive notification, please join the mailing list.

Section 108 Loan Term

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.

Section 108 Loan 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.

Loan Guarantee Fee

The loan guarantee fee covers the long term cost to the Federal Government of a Section 108 loan guarantee. The amount of the fee will be determined annually in the appropriations process. The fee charged to Section 108 borrowers will be a percentage of the Section 108 loan amount. The fee may be paid with CDBG funds or may be included in the pledge of future CDBG awards. The fee is paid upon disbursement of the loan proceeds. The fee is considered a financial cost that is part of the overall project cost. Fees that are paid with CDBG funds must be identified in the Consolidated Plan as part of project costs.

Apply for the Section 108 Program

Pre-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 local HUD Field Office or the Section 108 office in Washington at (202) 402-4654.*

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

See application guidance Section 108 regulations at 24 CFR 570.704: Application Requirements.

Overview of Application Process

The following is a summary of the process required for submitting an application for 108 funds. For detailed requirements see 24 CFR 570.704, "Application Requirements":

Pre-submission and Citizen Participation Requirements

- Indicate proposed activities in sufficient detail
- Define the national objective that will be met
- Indicate which activities are expected to generate program income

- Explain citizen participation opportunities
- Publish the proposed application community wide and solicit comments.

Final Application Submission Requirements:

- Describe compliance with CDBG National Objectives and Eligible Activities
- Describe pledge of CDBG funds as security
- Describe how loan guarantee fee will be paid or financed
- Provide schedule for repayment
- Include certifications (standard HUD documentation)
- Include the final application in the Consolidated Plan

Process After Application Submittal

Local HUD Office. After consulting with the local HUD office and the preparation of the final application, the local office will conduct a "due diligence and compliance review," where a Community Planning and Development representative will check to ensure compliance with the above process, as well as verify national objectives, eligible activities, and certifications. Once this review is complete, the office will forward the application to the Section 108 staff in HUD headquarters along with a recommendation of approval or disapproval.

HUD Headquarters. Upon arrival in HUD's main office, the application will be assigned to a staff underwriter who will examine the application in detail. It is at this stage that the requested loan terms and additional security offered will be examined. It is customary for the staff reviewer to be in contact with the local HUD office representative as well as the applicant in order to resolve questions or issues that may arise during the review.

Upon completion of the review, a Project Review Panel (consisting of headquarters staff and the local HUD office representative) will examine the application, suggest ways to resolve issues, request additional information, or recommend the application be approved. Once an application has received an approval recommendation, it is forwarded to the Secretary of HUD for final approval and release.

Timeframe. The length of time the application approval process takes depends on the individual application. For questions on a specific application, contact your local HUD office or the staff underwriter in HUD headquarters who is reviewing the application.

Disbursement, Reporting, and Repayment of Section 108 Loans

Disbursement and Reporting

The tracking and disbursement of Section 108 Loan Guarantee funds are administered through HUD CPD's Integrated Disbursement Information System (IDIS.). Approved loans are added to a borrower's IDIS online. The borrower can view details of the loans, such as approval date, cancellation date, committed and drawn amounts. The borrower adds IDIS projects to group all 108 related activities in the program year loan approval was received. The Section 108 activities entered into IDIS track expenditures and program outcomes similar to other CDBG activities.

View additional IDIS guidance:

- IDIS for CDBG Training and Tutorials
- IDIS Online for Entitlement Communities Manual and Slides
- IDIS for CDBG Entitlement Manual Chapter 8 108 Loans
- IDIS Online for States Manual and Appendices
- IDIS for States CDBG Manual Chapter 8 108 Loans