

§570.913 Other remedies for non-compliance.

(a) *Action to enforce compliance.* When the Secretary acts to enforce the civil rights provisions of Section 109, as described in §570.602 and 24 CFR part 6, the procedures described in 24 CFR parts 6 and 180 apply. If the Secretary finds, after reasonable notice and opportunity for hearing, that a recipient has failed to comply substantially with any other provisions of this part, the provisions of this section apply. The Secretary, until he/she is satisfied that there is no longer any such failure to comply, shall:

- (1) Terminate payments to the recipient;
- (2) Reduce payments to the recipient by an amount equal to the amount of such payments which were not expended in accordance with this part; or
- (3) Limit the availability of payments to programs or activities not affected by such failure to comply.

Provided, however, that the Secretary may on due notice suspend payments at any time after the issuance of a notice of opportunity for hearing pursuant to paragraph (c)(1) of this section, pending such hearing and a final decision, to the extent the Secretary determines such action necessary to preclude the further expenditure of funds for activities affected by such failure to comply.

(b) In lieu of, or in addition to, any action authorized by paragraph (a) of this section, the Secretary may, if he/she has reason to believe that a recipient has failed to comply substantially with any provision of this part;

(1) Refer the matter to the Attorney General of the United States with a recommendation that an appropriate civil action be instituted; and

(2) Upon such a referral, the Attorney General may bring a civil action in any United States district court having venue thereof for such relief as may be appropriate, including an action to recover the amount of the assistance furnished under this part which was not expended in accordance with it, or for mandatory or injunctive relief;

(c) *Proceedings.* When the Secretary proposes to take action pursuant to this section, the respondent is the unit of general local government or State

receiving assistance under this part. These procedures are to be followed prior to imposition of a sanction described in paragraph (a) of this section:

(1) *Notice of opportunity for hearing:* The Secretary shall notify the respondent in writing of the proposed action and of the opportunity for a hearing. The notice shall:

(i) Specify, in a manner which is adequate to allow the respondent to prepare its response, allegations with respect to a failure to comply substantially with a provision of this part;

(ii) State that the hearing procedures are governed by these rules;

(iii) State that a hearing may be requested within 10 days from receipt of the notice and the name, address and telephone number of the person to whom any request for hearing is to be addressed;

(iv) Specify the action which the Secretary proposes to take and that the authority for this action is section 111(a) of the Act;

(v) State that if the respondent fails to request a hearing within the time specified a decision by default will be rendered against the respondent; and

(vi) Be sent to the respondent by certified mail, return receipt requested.

(2) *Initiation of hearing.* The respondent shall be allowed at least 10 days from receipt of the notice within which to notify HUD of its request for a hearing. If no request is received within the time specified, the Secretary may proceed to make a finding on the issue of compliance with this part and to take the proposed action.

(3) *Administrative Law Judge.* Proceedings conducted under these rules shall be presided over by an Administrative Law Judge (ALJ), appointed as provided by section 11 of the Administrative Procedures Act (5 U.S.C. 3105). The case shall be referred to the ALJ by the Secretary at the time a hearing is requested. The ALJ shall promptly notify the parties of the time and place at which the hearing will be held. The ALJ shall conduct a fair and impartial hearing and take all action necessary to avoid delay in the disposition of proceedings and to maintain order. The ALJ shall have all powers necessary to those ends, including but not limited to the power to:

- (i) Administer oaths and affirmations;
- (ii) Issue subpoenas as authorized by law;
- (iii) Rule upon offers of proof and receive relevant evidence;
- (iv) Order or limit discovery prior to the hearing as the interests of justice may require;
- (v) Regulate the course of the hearing and the conduct of the parties and their counsel;
- (vi) Hold conferences for the settlement or simplification of the issues by consent of the parties;
- (vii) Consider and rule upon all procedural and other motions appropriate in adjudicative proceedings; and
- (viii) Make and file initial determinations.

(4) *Ex parte communications.* An ex parte communication is any communication with an ALJ, direct or indirect, oral or written, concerning the merits or procedures of any pending proceeding which is made by a party in the absence of any other party. Ex parte communications are prohibited except where the purpose and content of the communication have been disclosed in advance or simultaneously to all parties, or the communication is a request for information concerning the status of the case. Any ALJ who receives an ex parte communication which the ALJ knows or has reason to believe is unauthorized shall promptly place the communication, or its substance, in all files and shall furnish copies to all parties. Unauthorized ex parte communications shall not be taken into consideration in deciding any matter in issue.

(5) *The hearing.* All parties shall have the right to be represented at the hearing by counsel. The ALJ shall conduct the proceedings in an expeditious manner while allowing the parties to present all oral and written evidence which tends to support their respective positions, but the ALJ shall exclude irrelevant, immaterial or unduly repetitious evidence. The Department has the burden of proof in showing by a preponderance of the evidence that the respondent failed to comply substantially with a provision of this part. Each party shall be allowed to cross-examine adverse witnesses and to rebut

and comment upon evidence presented by the other party. Hearings shall be open to the public. So far as the orderly conduct of the hearing permits, interested persons other than the parties may appear and participate in the hearing.

(6) *Transcripts.* Hearing shall be recorded and transcribed only by a reporter under the supervision of the ALJ. The original transcript shall be a part of the record and shall constitute the sole official transcript. Respondents and the public, at their own expense, may obtain copies of the transcript.

(7) *The ALJ's decision.* At the conclusion of the hearing, the ALJ shall give the parties a reasonable opportunity to submit proposed findings and conclusions and supporting reasons therefor. Within 25 days after the conclusion of the hearing, the ALJ shall prepare a written decision which includes a statement of findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law or discretion presented on the record and the appropriate sanction or denial thereof. The decision shall be based on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. A copy of the decision shall be furnished to the parties immediately by certified mail, return receipt requested, and shall include a notice that any requests for review by the Secretary must be made in writing to the Secretary within 30 days of the receipt of the decision.

(8) *The record.* The transcript of testimony and exhibits, together with the decision of the ALJ and all papers and requests filed in the proceeding, constitutes the exclusive record for decision and, on payment of its reasonable cost, shall be made available to the parties. After reaching his/her initial decision, the ALJ shall certify to the complete record and forward the record to the Secretary.

(9) *Review by the Secretary.* The decision by the ALJ shall constitute the final decision of the Secretary unless, within 30 days after the receipt of the decision, either the respondent or the Assistant Secretary for Community

Planning and Development files an exception and request for review by the Secretary. The excepting party must transmit simultaneously to the Secretary and the other party the request for review and the basis of the party's exceptions to the findings of the ALJ. The other party shall be allowed 30 days from receipt of the exception to provide the Secretary and the excepting party with a written reply. The Secretary shall then review the record of the case, including the exceptions and the reply. On the basis of such review, the Secretary shall issue a written determination, including a statement of the reasons or basis therefor, affirming, modifying or revoking the decision of the ALJ. The Secretary's decision shall be made and transmitted to the parties within 80 days after the decision of the ALJ was furnished to the parties.

(10) *Judicial review.* The respondent may seek judicial review of the Secretary's decision pursuant to section 111(c) of the Act.

[53 FR 34466, Sept. 6, 1988, as amended at 64 FR 3802, Jan. 25, 1999]

APPENDIX A TO PART 570—GUIDELINES AND OBJECTIVES FOR EVALUATING PROJECT COSTS AND FINANCIAL REQUIREMENTS

I. Guidelines and Objectives for Evaluating Project Costs and Financial Requirements. HUD has developed the following guidelines that are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects which are financially viable and will make the most effective use of the CDBG funds. *The use of these underwriting guidelines as published by HUD is not mandatory.* However, grantees electing not to use these underwriting guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business. States electing not to use these underwriting guidelines would be expected to ensure that the state or units of general local government conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.

II. Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a micro-enterprise or other small business to take into account the differences in the capacity

and level of sophistication among businesses of differing sizes.

III. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. For example, a recipient administering a program providing only technical assistance to small businesses might choose to apply underwriting guidelines to the technical assistance program as a whole, rather than to each instance of assistance to a business. Given the nature and dollar value of such a program, a recipient might choose to limit its evaluation to factors such as the extent of need for this type of assistance by the target group of businesses and the extent to which this type of assistance is already available.

IV. The objectives of the underwriting guidelines are to ensure:

- (1) that project costs are reasonable;
- (2) that all sources of project financing are committed;
- (3) that to the extent practicable, CDBG funds are not substituted for non-Federal financial support;
- (4) that the project is financially feasible;
- (5) that to the extent practicable, the return on the owner's equity investment will not be unreasonably high; and
- (6) that to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

i. Project costs are reasonable. i. Reviewing costs for reasonableness is important. It will help the recipient avoid providing either too much or too little CDBG assistance for the proposed project. Therefore, it is suggested that the grantee obtain a breakdown of all project costs and that each cost element making up the project be reviewed for reasonableness. The amount of time and resources the recipient expends evaluating the reasonableness of a cost element should be commensurate with its cost. For example, it would be appropriate for an experienced reviewer looking at a cost element of less than \$10,000 to judge the reasonableness of that cost based upon his or her knowledge and common sense. For a cost element in excess of \$10,000, it would be more appropriate for the reviewer to compare the cost element with a third-party, fair-market price quotation for that cost element. Third-party price quotations may also be used by a reviewer to help determine the reasonableness of cost elements below \$10,000 when the reviewer evaluates projects infrequently or if the reviewer is less experienced in cost estimations. If a recipient does not use third-party price quotations to verify cost elements, then the recipient would need to conduct its own cost analysis using appropriate cost estimating manuals or services.

ii. The recipient should pay particular attention to any cost element of the project that will be carried out through a non-arms-

length transaction. A non-arms-length transaction occurs when the entity implementing the CDBG assisted activity procures goods or services from itself or from another party with whom there is a financial interest or family relationship. If abused, non-arms-length transactions misrepresent the true cost of the project.

2. *Commitment of all project sources of financing.* The recipient should review all projected sources of financing necessary to carry out the economic development project. This is to ensure that time and effort is not wasted on assessing a proposal that is not able to proceed. To the extent practicable, prior to the commitment of CDBG funds to the project, the recipient should verify that: sufficient sources of funds have been identified to finance the project; all participating parties providing those funds have affirmed their intention to make the funds available; and the participating parties have the financial capacity to provide the funds.

3. *Avoid substitution of CDBG funds for non-Federal financial support.* i. The recipient should review the economic development project to ensure that, to the extent practicable, CDBG funds will not be used to substantially reduce the amount of non-Federal financial support for the activity. This will help the recipient to make the most efficient use of its CDBG funds for economic development. To reach this determination, the recipient's reviewer would conduct a financial underwriting analysis of the project, including reviews of appropriate projections of revenues, expenses, debt service and returns on equity investments in the project. The extent of this review should be appropriate for the size and complexity of the project and should use industry standards for similar projects, taking into account the unique factors of the project such as risk and location.

ii. Because of the high cost of underwriting and processing loans, many private financial lenders do not finance commercial projects that are less than \$100,000. A recipient should familiarize itself with the lending practices of the financial institutions in its community. If the project's total cost is one that would normally fall within the range that financial institutions participate, then the recipient should normally determine the following:

A. *Private debt financing*—whether or not the participating private, for-profit business (or other entity having an equity interest) has applied for private debt financing from a commercial lending institution and whether that institution has completed all of its financial underwriting and loan approval actions resulting in either a firm commitment of its funds or a decision not to participate in the project; and

B. *Equity participation*—whether or not the degree of equity participation is reasonable given general industry standards for rates of

return on equity for similar projects with similar risks and given the financial capacity of the entrepreneur(s) to make additional financial investments.

iii. If the recipient is assisting a micro-enterprise owned by a low- or moderate-income person(s), in conducting its review under this paragraph, the recipient might only need to determine that non-Federal sources of financing are not available (at terms appropriate for such financing) in the community to serve the low- or moderate-income entrepreneur.

4. *Financial feasibility of the project.* i. The public benefit a grantee expects to derive from the CDBG assisted project (the subject of separate regulatory standards) will not materialize if the project is not financially feasible. To determine if there is a reasonable chance for the project's success, the recipient should evaluate the financial viability of the project. A project would be considered financially viable if all of the assumptions about the project's market share, sales levels, growth potential, projections of revenue, project expenses and debt service (including repayment of the CDBG assistance if appropriate) were determined to be realistic and met the project's break-even point (which is generally the point at which all revenues are equal to all expenses). Generally speaking, an economic development project that does not reach this break-even point over time is not financially feasible. The following should be noted in this regard:

A. some projects make provisions for a negative cash flow in the early years of the project while space is being leased up or sales volume built up, but the project's projections should take these factors into account and provide sources of financing for such negative cash flow; and

B. it is expected that a financially viable project will also project sufficient revenues to provide a reasonable return on equity investment. The recipient should carefully examine any project that is not economically able to provide a reasonable return on equity investment. Under such circumstances, a business may be overstating its real equity investment (actual costs of the project may be overstated as well), or it may be overstating some of the project's operating expenses in the expectation that the difference will be taken out as profits, or the business may be overly pessimistic in its market share and revenue projections and has downplayed its profits.

ii. In addition to the financial underwriting reviews carried out earlier, the recipient should evaluate the experience and capacity of the assisted business owners to manage an assisted business to achieve the projections. Based upon its analysis of these factors, the recipient should identify those elements, if any, that pose the greatest risks

contributing to the project's lack of financial feasibility.

5. *Return on equity investment.* To the extent practicable, the CDBG assisted activity should provide not more than a reasonable return on investment to the owner of the assisted activity. This will help ensure that the grantee is able to maximize the use of its CDBG funds for its economic development objectives. However, care should also be taken to avoid the situation where the owner is likely to receive too small a return on his/her investment, so that his/her motivation remains high to pursue the business with vigor. The amount, type and terms of the CDBG assistance should be adjusted to allow the owner a reasonable return on his/her investment given industry rates of return for that investment, local conditions and the risk of the project.

6. *Disbursement of CDBG funds on a pro rata basis.* To the extent practicable, CDBG funds used to finance economic development activities should be disbursed on a pro rata basis with other funding sources. Recipients should be guided by the principle of not placing CDBG funds at significantly greater risk than non-CDBG funds. This will help avoid the situation where it is learned that a problem has developed that will block the completion of the project, even though all or most of the CDBG funds going in to the project have already been expended. When this happens, a recipient may be put in a position of having to provide additional financing to complete the project or watch the potential loss of its funds if the project is not able to be completed. When the recipient determines that it is not practicable to disburse CDBG funds on a pro rata basis, the recipient should consider taking other steps to safeguard CDBG funds in the event of a default, such as insisting on securitizing assets of the project.

[60 FR 1953, Jan. 5, 1995]

PART 572—HOPE FOR HOME-OWNERSHIP OF SINGLE FAMILY HOMES PROGRAM (HOPE 3)

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AUTHORITY: 42 U.S.C. 3535(d) and 12891.

SOURCE: 58 FR 36526, July 7, 1993, unless otherwise noted.

Subpart A—General

§ 572.1 Overview of HOPE 3.

The purpose of the HOPE for Homeownership of Single Family Homes program (HOPE 3) is to provide homeownership opportunities for eligible families to purchase Federal, State, and local government-owned single family properties. HOPE 3 provides grants to eligible applicants to plan