MAKING THE MOST OF YOUR CDBG RESOURCES

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

Under appropriate circumstances, existing CDBG dollars can be stretched 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 2, Categories of Eligible Activities, under the section entitled Rehabilitation.) Careful underwriting of the assistance provided to landlords and businesses can ensure that funding is limited to the amount needed to achieve the expected results. States and state grant recipients should set community development goals and objectives with measurable benchmarks so that they may evaluate whether reasonable progress is being made and whether any changes in direction are called for. Finally, financial assistance can be provided in the form of loans or loan guarantees instead of grants, whenever feasible.

There are three other avenues that states and state grant recipients 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.

Float-Funded Activities

Most activities carried out by state grant recipients do not require immediate expenditure of the full amount of funds awarded for the activity. There might be a lag of several months between grant award and the first expenditure/draw of funds from the state's line of credit. Activities involving construction (especially public facilities and housing rehabilitation) may occur in stages over a period of one or two years, with funds being drawn down at intervals as work is completed. Multiply this effect by 20, 50 or 80 grants awarded by a state; the result is that a state can have millions of dollars which are under contract, but which will remain for months, underutilized, in the state's line of credit. Such funds are sometimes referred to as the "float" since they seem to be just floating there, waiting to be used. The CDBG program provides states with a way to make use of this "float" during the period that they will not otherwise by needed for the activities for which they were awarded.

Float-funded activities are referred to in the Entitlement CDBG program as "float loans"; however, in the context of the State CDBG program, the term "float loan" is a misnomer. States cannot make loans, either to a local government or directly to businesses, with CDBG funds. States can only make grants to units of general local government. While there is a loan involved, the state itself is usually not directly a party to it. The loan is between the state grant recipient and the entity to which it provides CDBG funds. In nearly all cases, the loan is to a business for an economic development activity. "Float loans" are not an activity in an of themselves; they are a technique for financing CDBG-eligible activities.

Even though a state's CDBG funds are already under contract to grant recipients, the state can award the same funds to another grant recipient, **providing that the state is repaid before the initial grant recipients need the funds** to meet their obligations for their CDBG-funded activities. A float-funded activity is, in essence, simply a speeded-up version of the process by which states normally reuse program income that is returned to the state. The rationale is to make maximum use of funds in a state's line of credit, while taking advantage of financing opportunities & projects that might arise on short notice (and quite possibly after the state has already awarded its funds for the year.) Thus, the state's program design must require program income generated from certain types of grants or activities to be returned to the state, rather than to be retained and reused by the unit of local government.

The following conditions must be met in order for a state to take advantage of float funding:

- ❖ The method of distribution contained in a state's annual Action Plan must spell out the situations in which the state will allow float-funded activities, how much, what terms & conditions must be met, etc.

- ❖ The state's program design must require that program income from float-funded activities be returned to the state (either repaid from the business through the local government to the state, or directly from the business to the state).

- ❖ Section 104(j) of the HCDA requires that, in certain situations, a state cannot require locally-earned program income to be returned to the state, if the locality uses it to continue the same activity that generated the program income. To get around this, the state must define very narrowly what "continuing the same activity" means. (Some states define this to mean provision of another loan to the same business for the exact same project.)

- ❖ Each activity carried out using the float must meet all of the same requirements that apply to CDBG-assisted activities generally.

- ❖ Any float-funded activity must be expected to produce program income to the state in an amount at least equal to the amount of the float so used.

- ❖ The state must actually receive the program income in time to honor requests for funds from the original grant recipient(s). States are strongly encouraged to obtain additional security to ensure that it will receive the repayments on time. (This could take the form of an irrevocable line of credit from a lender, an unconditional commitment from the state grant recipient to repay the state out of local resources, or some other mechanism.)

Here's an illustration of how float funding might work in a State CDBG program:

1. State Z awards all of its FY2000 funds on 7/1/00.
2. One of its grants is to City A for $500,000, for infrastructure activities that will not commence until 4/1/01.

3. In the meantime, a "hot deal" arises in Town Q: a business expansion project has permanent financing, but needs $500,000 of construction financing for six months.
4. State Z makes a grant of $500,000 to Town Q on 9/1/00. The state specifies in its contract that Town Q will loan the money to the business for construction financing; state specifies that Town Q (or the business) must repay $500,000 plus interest to the state by 3/1/01.
5. On 3/1/01 Town Q receives $525,000 (principal + interest payments) from the business & returns this program income to the state.
6. On 4/1/01, City A signs a construction contract for its $500,000 infrastructure project; the state now has the funds on hand to honor funds requests from City A.
7. The $525,000 of program income to the state is eventually used to make more grant awards to other local governments.

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 non-entitlement unit of general local government 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: Section 105(a)(15) nonprofit development organizations may only carry out a community economic development project; and the proceeds may not be used for activities under the Planning and Capacity Building, Program Administration, and Public Services categories of basic eligibility. See 24 CFR 570 subpart M for further details.);

❖ The state 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 non-entitlement unit of general local government may borrow up to $7,000,000. However, the maximum amount of guaranteed outstanding guaranteed loans for all non-entitlement borrowers in a state cannot exceed five times the amount of the state's most recent annual CDBG allocation. (If a state's most recent CDBG allocation was $20,000,000, there could not be more than $100,000,000 worth of outstanding Section 108 debt obligations among all the non-entitlement communities in that state.)

- ❖ 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.

- ❖ It is up to each state, in developing its method of distributing CDBG funds, to decide whether it will allow units of general local government to participate in the Section 108 program.

Attachment A to Appendix H, Selling or Securitizing CDBG-funded Loans Using the Section 108 Program, 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

Some state grant recipients may have a substantial number of outstanding loans made using CDBG funds and for which a stream of program income can be expected. The value of all the outstanding loans may be large, but the stream of repayments may be small enough that program income must be held over an extended time until sufficient funds have accumulated to make a new loan. A similar situation can exist with states that require that program income from loan repayments must be returned to the state. It may take an extended time period for the state to accumulate enough program income to be able to award another grant to a community.

Some states and local governments 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 state grant recipient 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 state that is interested in doing so should contact the local HUD field office for guidance on how to proceed. But a state or state grant recipient 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 to securitize its portfolio is through the Section 108 Loan Guarantee program. A state grant recipient can receive a Section 108 loan for which the repayment is expected to come from the payback of the CDBG loans in their portfolio. See the discussion about 108 loans, above, for more details about this option. Also see Appendix H 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 state's control is the use of "float loans." 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 through selective sales or securitizing.