

Section 108 Loan Guarantee Program

The Section 108 Loan Guarantee Program is a source of financing allotted for the economic development, housing rehabilitation, public facilities rehab, construction or installation for the benefit of low- to moderate-income persons, or to aid in the prevention of slums.

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. This makes it one of the most potent and important public investment tools that HUD offers to local governments. It allows them to transform a small portion of their CDBG funds into federally guaranteed loans large enough to pursue physical and economic revitalization projects that can renew 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. **Section 108 loans are not risk-free, however; local governments borrowing funds guaranteed by Section 108 must pledge their current and future CDBG allocations to cover the loan amount as security for the loan.**

Lexington-Fayette Urban County Government's annual award of federal funds under the Community Development Block Grant Program is \$1,993,717. The allocation was \$2,724,000 in 2002. It is reasonable to believe that this downward trend in funding will continue in the future.

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 program.

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, aid in the elimination or prevention of slums and blight, or meet urgent needs of the community.

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 of Section 108 loans.

Loan Details

Security: The principal security for the loan guarantee is a pledge by the applicant public entity of its current and future CDBG funds. Additional security will also be required to assure repayment of guaranteed obligations. The additional security requirements will be determined on a case-by-case basis, but could include assets financed by the guaranteed 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 on interim borrowing are priced at the 3 month London Interbank Offered (LIBO) rate plus 20 basis points (0.2%). Permanent financing is pegged to yields on U.S. 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.

Economic Development Activities

A recipient may use CDBG funds for special economic development activities which may be carried out as part of an economic development project. Guidelines for selecting activities to assist under

this paragraph are provided at 24 CFR 570.209. **The recipient must ensure that the appropriate level of public benefit will be derived pursuant to those guidelines before obligation of funds.** Special activities authorized under this section do not include assistance for the construction of new housing. Special economic development activities include:

(a) The acquisition, construction, reconstruction, rehabilitation or installation of commercial or industrial buildings, structures, and other real property equipment and improvements, including railroad spurs or similar extensions. Such activities may be carried out by the recipient or public or private nonprofit subrecipients.

(b) The provision of assistance to a private for-profit business, including, but not limited to, grants, loans, loan guarantees, interest supplements, technical assistance, and other forms of support, for any activity where the assistance is appropriate to carry out an economic development project, excluding those described as ineligible in 24 CFR 570.207(a). In selecting businesses to assist under this authority, the recipient shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods.

Public Benefit Standards

■ Recipients making loans for special economic development projects (24 CFR 570.203) must comply with the public benefit standards (24 CFR 570.209). These standards have two levels:

Aggregate benefit – minimum of one job per \$35,000 of CDBG or one LMI resident served per \$350 of CDBG; and

Individual benefit – maximum of \$50,000 of CDBG per job created or one LMI resident served per \$1,000 of CDBG

Financial Guidelines mattielou

24 CFR 570.209 outlines six objectives for economic development underwriting:

- That project costs are reasonable;
- That all sources of project financing are committed;
- To the extent practicable, CDBG funds are not substituted for non-Federal financial support;
- That the project is financially feasible;

- To the extent practicable, the return of the owner's equity investment will not be unreasonably high; and
- To the extent practicable, CDBG funds are disbursed on a pro-rata basis with other finances provided to the project.

The underwriting guidelines give public underwriters a good framework for lending public funds. The guidelines allow communities great flexibility and ensure that public investments are utilized judiciously and add value.