

Economic Development Toolkit

| | |
|---|-----------|
| 1. Economic Development Strategies | 1 |
| Overview..... | 1 |
| Steps in the Strategy Process..... | 3 |
| Step 1: Assess Existing Conditions | 3 |
| Step 2: Assess Local Resources and Barriers..... | 6 |
| Step 3: Select Outcome or Goal | 8 |
| Step 4: Selection of Market Sector to Target | 8 |
| Step 5: Determine the General Approach for Directing Your Assistance | 8 |
| Step 6: Identify the Appropriate Intervention Activity..... | 9 |
| Step 7: Write a Mission Statement for the Program | 10 |
| Step 8: Prepare an Economic Development Strategy..... | 10 |
| Step 9: Develop an Action Plan to Implement the Strategy | 11 |
| Step 10: Monitor, Evaluate, and Update the Strategy | 12 |
| Coordinating with the Consolidated Plan | 13 |
| Required ConPlan Contents | 13 |
| Citizen Participation | 13 |
| Submission to and Review by HUD | 14 |
| Amendments..... | 14 |
| | |
| 2. CDBG Foundation | 15 |
| Program History and Primary Objective..... | 15 |
| Regulations..... | 17 |
| Key CDBG Changes Related to Economic Development | 17 |
| Eligible Activities..... | 18 |
| Eligible CDBG Activities —General..... | 19 |
| Eligible CDBG Activities—Economic Development | 22 |
| Ineligible Activities | 23 |
| National Objectives..... | 24 |
| Benefit to Low- and Moderate-Income Persons | 25 |
| Elimination of Slums and Blight | 37 |
| Urban Renewal (SBR) | 39 |
| Urgent Need (URG) | 39 |
| Documenting National Objectives | 40 |
| Choosing the Right National Objective | 40 |
| CDBG Activity Requirements: Limitations, Benefit Standards, & Cost Caps | 41 |
| Participation of Faith-Based Organizations..... | 41 |
| Job Pirating..... | 42 |
| Limitations on Eminent Domain | 43 |
| Low- and Moderate-Income Benefit Expenditures | 44 |
| Administrative & Planning Costs Cap | 47 |
| Public Services Cap..... | 48 |
| Uniform Administrative Requirements..... | 48 |
| Program Income | 48 |
| Pre-Award Costs..... | 49 |
| Timeliness..... | 50 |

| | |
|--|-----------|
| Other Federal Requirements | 51 |
| Attachments: CDBG Eligible Activities & Documentation for National Objectives..... | 53 |
| 3. Revitalization Strategy Areas | 57 |
| Background and Benefits..... | 57 |
| Neighborhood Revitalization Strategy Areas | 58 |
| Preparing a Neighborhood Revitalization Strategy | 58 |
| HUD Review, Approval, and Monitoring of the NRSA..... | 61 |
| Amending the Strategy | 62 |
| Community Revitalization Strategy Areas..... | 63 |
| Preparing a Community Revitalization Strategy..... | 63 |
| HUD Review, Approval, & Monitoring of the CRS..... | 63 |
| Local Target Areas (Other than CRSAs)..... | 64 |
| 4. Small Business Development..... | 65 |
| Overview..... | 65 |
| Small Business Development | 66 |
| Eligible CDBG Activities for Small Business Development | 66 |
| Special Economic Development Activities | 67 |
| Training and Technical Assistance | 67 |
| Small Business Financing..... | 69 |
| Microenterprise Development..... | 69 |
| Definition of Microenterprise | 70 |
| Eligible Activities for Microenterprises..... | 70 |
| Documenting National Objective for Microenterprise Activities..... | 71 |
| Program Design for Microenterprise & Small Business | 71 |
| Implementing Microenterprise Programs | 75 |
| Business Incubators | 76 |
| Eligible CDBG Activities for Incubators..... | 77 |
| Evaluation Criteria for Business Incubators | 78 |
| Preparing a Feasibility Study for a Small Business Incubator | 78 |
| The Incubator Development Process..... | 79 |
| Documenting National Objective for Incubator Activities..... | 79 |
| 5. Job Training & Other Public Services..... | 82 |
| Overview..... | 82 |
| Eligible CDBG Job Training & Public Service Activities | 82 |
| Eligible Public Service Activities | 82 |
| Ineligible Public Service Activities | 84 |
| Public Services Cap..... | 84 |
| Public Services Cap Exceptions | 85 |
| Documenting National Objective..... | 86 |
| Design of Job Training & Service Delivery..... | 87 |
| Types of Job Training Programs..... | 88 |
| Critical Elements of Successful Job Training Programs..... | 88 |
| 6. Large-Scale Commercial Development | 93 |

| | |
|---|------------|
| Overview of Large-Scale Development | 93 |
| Eligible CDBG Activities for Large-Scale Development | 94 |
| Special Economic Development | 95 |
| Community Based Development Organizations | 96 |
| Commercial Rehabilitation | 97 |
| Large-Scale Projects under Section 108..... | 97 |
| Ineligible CDBG and Section 108 Activities | 98 |
| Documenting the National Objective..... | 99 |
| Design of Large-Scale Development Activities | 99 |
| 7. Infrastructure | 103 |
| Overview..... | 103 |
| Eligible CDBG Infrastructure Activities..... | 103 |
| Ineligible CDBG Activities | 105 |
| Documenting the National Objective..... | 106 |
| Design Considerations: Infrastructure Activities..... | 107 |
| Infrastructure Case Study—Sioux City, Iowa | 108 |
| 8. Financing Economic Development Projects | 109 |
| Overview..... | 109 |
| Financing Tools | 110 |
| Equity (with or without ownership) | 110 |
| Debt | 113 |
| Credit Enhancement | 115 |
| Revolving Loan Funds..... | 116 |
| Other Sources of Economic Development Financing | 118 |
| 9. Underwriting | 124 |
| What is Underwriting?..... | 124 |
| Public vs. Private Underwriting | 124 |
| Overview of Economic Development Underwriting..... | 125 |
| HUD Guidelines for Evaluating and Selecting Economic Development Projects | 125 |
| Public Benefit Standards..... | 126 |
| Financial Guidelines | 126 |
| OMB Cost Principles..... | 129 |
| Additional Guidance for Section 108..... | 130 |
| Underwriting Business Loans | 131 |
| Business Loan Criteria..... | 131 |
| Evaluating Startups/Small Loans | 133 |
| Underwriting Real Estate Transactions..... | 134 |
| Real Estate Loan Underwriting Criteria..... | 135 |
| 10. Section 108, EDI & BEDI..... | 139 |
| Section 108 Overview..... | 139 |
| History..... | 141 |
| Eligible Activities and Requirements | 141 |
| Players and Their Roles..... | 142 |

| | |
|---|------------|
| Terms of Section 108 Financing | 143 |
| Level #1 Terms of Financing..... | 143 |
| Level #2 Terms of Financing..... | 144 |
| Implementation | 145 |
| The Section 108 Process..... | 145 |
| Underwriting and Risk Management..... | 149 |
| Loan Servicing..... | 151 |
| Brownfields..... | 152 |
| Brownfields Economic Development Initiative (BEDI)..... | 152 |
| 11. Program Development & Administration..... | 155 |
| Overview..... | 155 |
| Entities Involved in Economic Development Activities | 155 |
| Economic Development Program Set-Up Tasks..... | 159 |
| Administrative Plans and Procedures | 159 |
| Projected Operation Budget..... | 159 |
| Loan Servicing and Administration | 161 |
| Roll-Out Strategy and Schedule | 161 |
| Marketing the Program | 162 |
| Recordkeeping | 163 |
| General Administrative Records | 163 |
| Financial Records | 164 |
| Project/Activity Records..... | 164 |
| Records on Subrecipients..... | 165 |
| Record Retention Period..... | 166 |
| Access to Records..... | 166 |
| Program Evaluation | 166 |
| Program “Success” & the Government Performance and Results Act (GPRA) | 166 |
| Steps in Measuring and Reporting Program Performance..... | 167 |
| Reporting on HUD CPD Objectives & Outcomes..... | 169 |
| Recipient Monitoring of Subrecipients and Beneficiaries | 174 |
| HUD Review of Recipient Performance..... | 177 |
| Appendices..... | 183 |
| 24 CFR Part 570 CDBG Program Economic Development Guidelines (570.200 – 570.210) | |
| 24 CFR Part 570, Appendix A (Guidelines and Objectives for Evaluating Project Costs and Financial Requirements) | |
| 24 CFR Part 570.700 - 570.710 (Section 108 Loan Guarantees) | |
| CPD Notice CPD-89-33 (Policy Guidance on Using CDBG Funds for Small Business Incubators) | |
| 24 CFR 570 (Prohibition on the Use of CDBG Assistance for Job-Pirating Activities) | |
| Matrix for Eligible National Objectives | |
| CDBG Economic Development Flow Chart | |
| CDBG Economic Development Resources on the HUD Web Site | |
| | |

1. Economic Development Strategies

This chapter addresses the following questions:

- What is an economic development strategy and why should your community develop one?
- What are the key steps in developing an effective strategy?
- How, when, and why should a needs assessment be conducted?
- How does an economic development strategy relate to the Consolidated Plan?

This chapter consists of two sections. The first section is a step-by-step guide for the preparation of an economic development strategy and the second section discusses the Consolidated Plan. This chapter is written for Community Development Block Grant (CDBG) grantees, although the information contained herein might be useful to other groups and organizations participating in the economic development planning process.

Overview

- The term **economic development** encompasses the process, policies, and activities by which a community improves the long-term economic and social well-being of its people. The objective of economic development is a sustainable increase in living standards, including per capita income, education, health, and environmental protection.
- A local **economic development strategy** offers government, the private and not-for-profit sectors, and local communities the opportunity to work together to improve the local economy. An economic development strategy provides a framework for making programmatic and development choices. A typical public economic development strategy focuses on enhancing competitiveness, increasing sustainable growth, and ensuring that growth is inclusive.

Approaches can include:

- Ensuring that the local investment climate is functional for local businesses;
- Supporting small and medium-sized enterprises;
- Encouraging the formation of new enterprises;
- Attracting external investment (nationally and internationally);
- Investing in physical (hard) infrastructure;
- Investing in soft infrastructure (educational and workforce development, institutional support systems, and regulatory issues);
- Supporting the growth of particular clusters of businesses;

- Targeting particular parts of the city for regeneration or growth (area-based initiatives);
 - Supporting informal and newly emerging businesses; and
 - Targeting and assisting certain disadvantaged groups.
- The practice of local economic development can be undertaken at different geographic scales, including neighborhood, municipal, regional, and Statewide.
 - The CDBG program includes many eligible economic development activities and encourages the development of comprehensive economic development strategies that tie CDBG-funded activities to those that result in greater economic impact.
 - CDBG strategies may be stand-alone or part of larger grantee strategies in economic development.
 - Many communities have strategies or plans that have been developed by an economic development agency or authority. The CDBG/Section 108 economic development strategy should either be coordinated with, or part of, these other plans.
 - In addition, it is also critical that the economic development strategy be tied closely to the housing and community development plans of the community, including the Consolidated Plan, which will be discussed later in this chapter.
 - Grantees approach economic development activities in many ways.
 - Some communities take an opportunistic approach—evaluating each economic development project on a case-by-case basis as it is proposed.
 - Other communities take a more proactive approach—seeking out and choosing only those projects clearly falling within the scope of a concrete series of objectives and plans.
 - Many communities are somewhere in between these two—on the lookout for interesting opportunities but working from a basic program design framework.

Regardless of which approach a community uses, it is important to understand economic development needs and evaluate potential projects in relationship to these needs.

- Basing a program on a larger strategy can prevent:
 - Poorly focused programs that do not serve any particular objective;
 - Establishing an economic development program for which there is no market; and
 - Wasting resources by duplicating existing programs provided by others.
- No two economic development strategies are exactly alike. Each strategy must be tailored, in both format and content, to the needs and interests of the community.

- The following section of this chapter highlights some key steps that a grantee can use to develop an effective economic development strategy.

Steps in the Strategy Process

- There are numerous methodologies describing how a community might formulate its economic development strategy.
- Based on research, communities tend to undertake the following general steps in creating ED strategies: ¹
 1. Assess existing conditions
 2. Assess local resources
 3. Select desired outcome(s) or goal(s)
 4. Select market sector to target
 5. Select general approach
 6. Identify appropriate techniques
 7. Develop a mission statement
 8. Prepare a written strategy
 9. Develop an implementation Action Plan
 10. Assess, evaluate, and modify
- These steps need not be taken in this exact sequence, but it is important to complete the first three prior to making decisions about specific aspects of program design.
- The following sections of this chapter describe these steps in more detail.
- Note: Developing an economic development plan is eligible as a CDBG planning cost. Implementation of economic development activities, however, should be defined according to their eligible activity area.

Step 1: Assess Existing Conditions

- It is important that communities begin (or renew) their economic development efforts based upon a sound analysis of their local economy.

¹ Two sources provided much of the information for this chapter:

◦ *Small Business Lending for Economic Development, Volume 1: Strategic Responses for Urban Communities.* Daniel Immergluck and Malcolm Bush, Woodstock Institute, Chicago, IL, 1995, pp. 13-20.

◦ *Understanding Your Local Economy: Using Analysis to Guide Local Strategic Planning.* Mary L. McLean and Kenneth Voytek, Planners Press, American Planning Association, 1992, pp. 2-3.

- Without such analysis, projects may not be fully targeted at the greatest needs or concerns in the community.
- There are generally two types of analysis: quantitative and qualitative.
 - A quantitative analysis is numbers-based and answers questions such as: What is the unemployment rate? What level of economic growth is expected over the next 10 years? What is average income?
 - A qualitative analysis is based on issues and concerns and should answer questions such as: What types of businesses do we want to attract? What are the greatest priorities for residents in this part of town? What are the greatest needs of our local business community? What skills does the local labor market offer?
- When conducting a **quantitative** analysis of the local economy, the following types of information are typically collected and reviewed:²
 - Size of the resident labor force (levels of employment, by industry if possible);
 - Levels of unemployment;
 - Education levels;
 - Earnings;
 - Income (total, per capita, per household);
 - Population (total and by age group);
 - Commuting flows and levels; and
 - Business establishments (types, locations, sizes).
- The end result of the quantitative analysis should be a composite picture of the local economy and the expected trends in that economy.
- The **qualitative** analysis should focus on describing the contextual information about your community and might answer such questions as:
 - How do local business leaders want to see their establishments grow? Increase in levels of employment? Grow to a region-wide presence? Maintain or enhance market share?
 - What types of businesses do citizens want to attract? Manufacturing jobs? Service jobs? Tourism-related industries? Locally owned small businesses? Large national employers? Are these desires realistic?
 - What do local citizens perceive as the greatest problems in their economy? Unemployment? Jobs for youth? Loss of jobs to the suburbs? Closing of local factories? Deteriorated physical condition of inner-city business establishments? Lack of job training programs?

² Ibid., p. 16.

- Qualitative analyses can be done in a variety of approaches. Some communities use an asset mapping approach, while others might adopt more of a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis that attempts to identify both strengths and weaknesses.
- Qualitative information may be collected during community events such as neighborhood association meetings, Chamber of Commerce events, city council meetings, and any other format where community members are asked to express their opinion.
- After collecting this basic data, perform an environmental scan to identify the factors affecting the particular area or population the grantee wishes to serve.
 - An environmental scan is a focused approach to gathering information about the community's economic environment and services. An environmental scan might include an examination of:
 - Conditions affecting startups and small businesses;
 - Conditions affecting small-to-medium-sized existing industrial businesses;
 - The availability of business financing;
 - The education and skills levels of the local workforce;
 - A particular area as a business location;
 - The availability of technical assistance to businesses; and
 - The status of commercial development or revitalization in the target neighborhood.

Sample Scan Section

Business Startups

Asset: Many residents are interested in starting, or have already established, a small business.

| | |
|---|-----------|
| <i>Known new starts over the past 3 years</i> | <i>27</i> |
| <i>Estimated additional starts</i> | <i>15</i> |
| <i>Estimated success rate (%)</i> | <i>40</i> |

Challenges: Little significant job creation
High failure rate
Limited financing

Existing Programs:

Conventional commercial loans are available to borrowers with good credit history and adequate collateral at the First Bank of Newton.

Circle lending program lends up to \$1,500 through West Side CDC.

Step 2: Assess Local Resources and Barriers

- After determining community needs, it is important to determine how they can be addressed.
- To do this, recipients must evaluate what type and level of resources are available within the community.
- There are generally three types of resources to be considered:³
 - Monetary: What types of funds are available to accomplish the mission? What are the objectives and limitations on those funds?
 - Human: Who is available to help accomplish these goals? What skills do they need/have?
 - Physical Resources: What types of infrastructure are available to aid with economic development? Are there any natural resources that our locale can offer?
- Some of these resources will be public and might include:
 - CDBG;
 - Section 108 loan guarantee financing;
 - Small Business Administration (SBA) programs such as Small Business Investment Companies and, the microloan fund, small business loans, and one-stop capital shops in Empowerment Zones (EZs) and Renewal Communities (RCs);
 - Various housing programs such as HOME, public housing, etc.;
 - Workforce Investment Act (WIA), Section 3, and other job training programs/requirements from Department of Labor (DOL);
 - Department of Transportation (DOT) infrastructure programs; and
 - State programs.
- However, it is important (both for purposes of strategy development as well as the consultation requirements of the Consolidated Plan) to take stock of private resources such as:
 - Nonprofit organizations;
 - Local, regional, or national foundations;
 - Local business leaders or the Chamber of Commerce;
 - Universities or community colleges;
 - Community organizations (such as neighborhood associations);
 - Civic groups (such as Lions Clubs or local charities);
 - Resident management corporations in public and assisted housing;

³ Ibid., p. 136.

- Business improvement districts; and
- Religious groups.
- In addition to determining the resources available within their community, recipients should also assess the obstacles that may impede their ability to achieve the stated mission.
- These obstacles may vary across communities but typically include such issues as:
 - ***Not-in-my-backyard (NIMBY):*** NIMBY sentiments may prevent recipients from developing services and facilities that are needed by the community. For example, job training for homeless persons may be a great need in the community. However, some neighborhood residents may oppose the location of such a facility within their area.
 - ***Limited resources:*** Virtually all communities face this dilemma—too many potential projects, not enough resources. Thus, communities may simply be unable to address economic development needs that are particularly costly or that benefit relatively few citizens.
 - ***Limited land area:*** Some communities are “built out” and thus are limited in the types of growth that can occur. For example, developing a large new industrial park in Manhattan is likely to be very difficult without significant urban renewal or condemnation efforts.
 - ***Limited development infrastructure:*** For many types of economic development, it is critical to have an existing infrastructure that can support the planned activity. For example, development of a new commercial district may be hampered by a lack of roads or sewers.
 - ***Labor market limitations:*** If the recipient’s local labor force is either unskilled or of a modest size, development options may be limited. If, for example, a community has very low levels of unemployment, new businesses may have a difficult time hiring workers at an affordable wage.
 - ***Housing shortages:*** In some communities there is a significant lack of housing. This limited supply of housing units may constrain local growth and discourage corporations from moving to the area.
 - ***Cost:*** High construction or land costs in some communities may significantly hamper the types of development activities that can be undertaken. Given limited resources, it may simply not be cost-effective for the community to build facilities. The community may instead seek to focus on funding activities such as job training programs, technical assistance to businesses, or small business startup loans.
 - ***Regulations and zoning:*** In some communities restrictive zoning and other regulations significantly limit the types of development that may occur in particular neighborhoods. For example, if the recipient wishes to target new businesses development assistance toward a particular low-income neighborhood, it may be unable to do so if that neighborhood is zoned purely residential. Note that some types of zoning and regulation may not necessarily be an impediment to development and may, in fact, encourage growth.

Step 3: Select Outcome or Goal

- There are many possible goals or outcomes of economic development programs. Some of the common ones include:
 - Wealth creation for LMI residents;
 - Part-time or entry jobs for neighborhood residents, including youth;
 - Full employment opportunities at livable wages for adults;
 - A revitalized commercial area;
 - Retention of key employers;
 - Improved access to goods and services in the neighborhood; and
 - A diversified local economy.
- It may be possible to select more than one outcome, but it is unlikely that a single program can affect all of them because some are incompatible. If a program focuses on assisting business startups, it is unlikely to have much of an impact on overall employment or provide full-time, high-paying jobs to adults.
- In choosing the outcome or goal of your program, it is important to consider the impact of other economic development programs in the neighborhood. For example, if you succeed in providing good jobs but the neighborhood continues to lack access to goods and services, the result may be the people you benefit will move out.

Step 4: Selection of Market Sector to Target

- The key step is to decide which segment(s) of the local business economy has or will have the most direct effect on these goals.
 - Does the grantee want to target small retail businesses so the availability of goods and services and provide small-scale employment can improve?
 - Does the grantee want to promote entrepreneurship and opportunities for wealth creation by assisting startup businesses?
 - Does the grantee want to promote job creation by assisting existing industrial businesses to expand or by attracting new businesses?

Step 5: Determine the General Approach for Directing Your Assistance

- If you cannot assist all businesses in your targeted market, you will need to establish general parameters for your program. Common targeting approaches are by:
 - Location: Assist businesses in the target market who also are located in a particular neighborhood.

- Minority business: Assist businesses in the target market with minority or female owners.
- Business sectors: Assist businesses in a particular sector because certain industries may offer economic development agglomeration opportunities.
- These approaches need not be exclusive.

Step 6: Identify the Appropriate Intervention Activity

- Once the recipient has identified the types of businesses with the greatest potential for achieving the selected outcome, then it can identify which need or opportunities its program will try to meet. This decision requires an understanding of the challenges faced by these businesses as well as a clear understanding of what the recipient can do with the resources available to meet those needs.
- Examples of needs that might be addressed include:
 - Lack of capital for businesses in the target market;
 - The lack of information as to potential markets, or new products;
 - Scarcity of suitable sites for commercial or industrial development;
 - Scarcity of suitably trained labor; and
 - Safety and security.
- The recipient can then choose the economic development activity that best fits the need or opportunity it wishes to address.
- Examples of activities a recipient may undertake using the CDBG and Section 108 programs, include:
 - Land acquisition, property improvements, rehabilitation, leasing, etc.
 - Housing development such as rehabilitation of owner-occupied units or multifamily units and new construction of rental housing development, etc.
 - Financing tools (including loans, loan guarantees, and grants) to assist businesses by providing purchase assistance for needed equipment/fixtures, working capital, etc.
 - Technical assistance activities such as general program assistance, business planning, startup consulting, accounting/fiscal controls, marketing, etc.
 - Infrastructure development such as roads, sewers, sidewalks, etc.
- For example, applying this thought process to the sample environmental scan could result in a decision by the CDBG program to develop a loan program for new businesses with startup costs in excess of \$1,500.
- The chart below describes some options for an economic development strategy. It compares financing/program options with possible activities.

| Funding Strategy Options | | | | | | |
|--|------|-------------|------------------------------|-------------|----------------|--------------|
| | CDBG | Section 108 | Other Federal CDFI, SBA, AG. | Other State | Private Lender | Other Agency |
| Technical Assistance and Services | | | | | | |
| Job Training | | | | | | |
| Microbusiness | | | | | | |
| Incubators | | | | | | |
| Expand Existing Small Businesses | | | | | | |
| Infrastructure | | | | | | |
| Large-Scale Projects (real estate, major businesses) | | | | | | |

Step 7: Write a Mission Statement for the Program

- After selecting the goals, the targeted business segment, and the general approach and technique, the recipient should be able to articulate the mission of its economic development program. An example might be the following:
 - “Newtown’s economic development mission is to attract, create, and retain business establishments by providing financial assistance to support business expansion, thereby increasing employment opportunities for the community’s residents.”
- The mission statement for the community development agency that operates as one of a group of agencies carrying out economic development might be more focused.
 - The recipient should coordinate its economic development initiatives with any plans created by other entities and should develop a mission statement that is specific to its role in the local government.
 - For example, such a recipient might develop a mission statement like: “Newtown will use its CDBG and Section 108 funds to support business development likely to increase levels of employment for LMI residents of the West Side Neighborhood.
- The mission statement should be developed in concert with community residents.

Step 8: Prepare an Economic Development Strategy

- Based upon a clear understanding of its goals, assets, needs, obstacles, and resources, the recipient can then develop its specific economic development strategy.
 - This strategy should be clearly linked to the mission statement.

- As noted above, it is important for the recipient to consult with any other agency within the community that is charged with economic development activities. It is possible that the recipient's strategy for the use of its CDBG and Section 108 funds will be a portion of a larger strategy for the community as a whole.
- The economic development strategy should be sufficiently detailed so as to guide investment decisions.
- In general, the strategy should include the following components:
 - **Overview of economic data:** Set out the facts about the community, including the current status of the economy and projected needs, and concerns of the citizens. Topics to cover include employment, income, types and locations of area businesses, expected trends, and areas of anticipated need.
 - **Description of the mission statement and program objectives:** Describe the community's goals for its economic development programs and highlight the resources available to address those goals.
 - **Description of the types (and possible areas) of development:** Highlight the types of projects that the recipient will seek to fund and describe selection criteria. Where known, note the particular neighborhoods or areas where development will be focused.

Step 9: Develop an Action Plan to Implement the Strategy

- The strategy may be ready for immediate implementation or additional work may be needed such as precise market studies for a loan program, specific program design work, the development of procedures, application forms, marketing materials, etc.
 - The Action Plan identifies these tasks, assigns them, and establishes a schedule for their completion.
 - Once all the up-front design work is complete, the program can be implemented.
- The first step in selecting projects is to develop the program application and/or notice of funding availability (NOFA).
- It is important that recipients carefully develop the application and selection criteria to ensure that projects meet the CDBG requirements **and** are within the scope of their strategy.
 - If, for example, the recipient will focus its efforts on a particular neighborhood, it is important to carefully explain the boundaries of this area. It may be helpful to include a map in the application package.
 - In addition, the application/NOFA must clearly describe the types of activities to be funded. Consider using a Web-based application.
 - The application/NOFA should also describe any limitations on funding and highlight the selection criteria.

- In order to attract applications that are likely to meet the application selection criteria and strategic elements, the recipient should market its program to local developers, nonprofits, community organizations, and others who are involved in local economic development or housing initiatives.
 - It may be helpful to prepare written materials summarizing the contents of your economic development strategy (e.g., an executive summary) or provide interested applicants with a copy of the strategy itself. Put information on the Web. Post frequently asked questions (FAQs).
 - In addition, recipients may wish to conduct an “open house” or other types of community meetings to share information about the strategy and the CDBG application process.
- Some grantees have a window of opportunity within which all applications must be submitted, while others permit a continuous *over-the-counter* application process.
- Once the applications are received, they should be reviewed against established selection criteria and the community’s strategy.
- The strategy should guide the decisions of recipient staff with regard to type of project selected, project location, funding levels, and communities served.
- The recipient should also evaluate the project for economic feasibility and potential benefit to the targeted community.

Step 10: Monitor, Evaluate, and Update the Strategy

- To be successful, the economic development strategy must be consistently reviewed and evaluated.
- This is particularly true when one facet of the economy has changed due to elapsed time or to a particular event such as a plant closing.
- The program should be evaluated against the outcomes that were established such as:
 - The flow of capital into the community has increased;
 - Capital leakage has decreased and the multiplier effect has been stimulated;
 - The economy has become more diversified;
 - Quality jobs (particularly for LMI residents) have been created or retained;
 - Productive assets have expanded in amount, capacity, and local control; and
 - Labor force has increased in skill and productive capacity.
 - Self-sufficiency among residents (particularly LMI residents) has increased;
 - LMI residents have better access to essential goods and services; and
 - Barriers to employment for LMI residents have been eliminated.

Coordinating with the Consolidated Plan

- As noted earlier in this chapter, it is important that the economic development plan not exist in a vacuum, but that it be coordinated with other housing and community development plans.
- The primary tool for describing the community development and housing activities that will be undertaken by the recipient is the Consolidated Plan (ConPlan).
 - The ConPlan is a plan from three to five years in length that describes community needs, resources, priorities, and proposed activities to be undertaken and serves as the application for certain HUD programs, including CDBG, Home Investment Partnerships (HOME), Emergency Shelter Grant, and Housing Opportunities for Persons with AIDS (HOPWA).
 - Annually, recipients must submit an update, the ConPlan (referred to as an Action Plan) to HUD. This annual update describes the specific planned uses of the covered HUD programs, including CDBG, as well as certain other program requirements. The Action Plan serves as the community's annual application for funds.

Required ConPlan Contents

- To meet the minimum requirements set forth by HUD, a ConPlan must include five main components:
 - Description of the lead agency or entity responsible for overseeing the development of the ConPlan and a description of the process undertaken to develop the plan;
 - Housing and homeless needs assessment;
 - Housing market analysis;
 - Strategic plan (of 3 to 5 years in length); and
 - One-year Action Plan.

Citizen Participation

- The ConPlan regulations stipulate that recipients meet certain minimal citizen participation requirements. In fact, each recipient is required to prepare a citizen participation plan which details the community's procedures for involving the public in its program planning and implementation. Each grantee is also required to consult with certain entities in the preparation of their ConPlan. (For local governments, the citizen participation requirements can be found in 24 CFR 91.105, and the consultation requirements at 91.100. For States, citizen participation requirements are at 91.115 and the consultation requirements at 92.110.)
- In developing the ConPlan and making choices about the types of programs to be undertaken, recipients need to consider the range of possible CDBG activities and how these activities compare to the needs of the community.

Submission to and Review by HUD

- A recipient's ConPlan must be submitted to its respective field office for review and approval at least 45 days before the start of the recipient's program year. HUD will not accept a submission earlier than November 15 or later than August 16 of the Federal fiscal year for which the grant funds are appropriated.
- HUD will review the ConPlan upon receipt. The recipient should consider the plan approved after 45 days unless HUD notifies the recipient before that date that it is disapproved.
 - Within 15 days of a disapproval notice, HUD must provide the recipient with written reasons for disapproval and corrective actions.
 - The recipient then has 45 days to resubmit its corrected Consolidated Plan.
- HUD will disapprove a plan related to CDBG programs if:
 - Any portion of the plan is inconsistent with the Housing and Community Development Act, as amended; or
 - It is "substantially incomplete," meaning:
 - The plan was developed without the required citizen participation or the required consultation;
 - The plan does not include all the elements listed in 24 CFR 91.200 through 91.225; or
 - The plan contains an inaccurate certification.

Amendments

- There are times when recipients must amend their ConPlan after it has been approved:
 - To make a change in its allocation priorities or a change in its method of distributing funds;
 - To carry out a new activity using funds covered under the consolidated plan; or
 - To change the purpose, scope, location or beneficiary of an activity.
- The recipient's citizen participation plan must specify what changes constitute a "substantial amendment" to its Consolidated Plan.
- While all amendments must be made public, it is substantial amendments that are subject to a citizen participation process, in accordance with the citizen participation plan. Such plan must provide a period of not less than 30 days to receive public comments on substantial amendments before they are implemented.
- Grantees must submit a copy of each substantial amendment to HUD as it occurs or at the end of the jurisdiction's program year.

2. CDBG Foundation

This chapter answers the following questions:

- What are the basic goals of the CDBG statute and regulations?
- What types of activities are eligible?
- What are the national objective criteria?
- How are public benefit standards calculated?
- What are some of the basic CDBG administrative requirements?

Program History and Primary Objective

- The Community Development Block Grant (CDBG) program is authorized under Title I of the Housing and Community Development Act (HCDA) of 1974, as amended. Prior to this, there were numerous Federal programs which addressed community development issues. CDBG consolidated numerous categorical programs under which communities competed nationally for funds, including:
 - Open space;
 - Urban renewal;
 - Neighborhood development program grants;
 - Historic preservation grants;
 - Model Cities supplemental grants;
 - Public facilities loans;
 - Neighborhood facilities grants; and
 - Water and sewer grants.
- The primary objective of Title I of the HCDA of 1974, as amended, is the development of viable urban communities.
- These viable communities are achieved by providing the following three national outcomes, principally for persons of low and moderate income:
 - Decent housing;
 - A suitable living environment; and
 - Expanded economic opportunities.

- The initial recipients of the CDBG program were local governments, which are known as entitlements. Entitlements may be metropolitan cities or urban counties, and each receives annual CDBG funding via an established formula run by HUD.
 - The Entitlement program is the largest component of the CDBG program, receiving 70 percent of CDBG appropriations.
- From 1975 to 1981, States did not participate in CDBG and HUD conducted an annual competition to fund State's small cities. Amendments to HCDA in 1981 allowed States to administer CDBG program for small cities starting in 1982. In 1982, many States began to administer the Small Cities CDBG program.
 - Under the State CDBG program, States are responsible for:
 - Developing the ConPlan;
 - Designing the CDBG program within statutory and regulatory parameters;
 - Setting priorities and deciding what activities to fund;
 - Distributing funding to Units of General Local Government (UGLG) according to the method of distribution;
 - Establishing financial management, recordkeeping, reporting, monitoring, audit, and close-out systems for their programs; and
 - Ensuring compliance by UGLGs.
 - Under the State CDBG program, nonentitlement localities are known as UGLGs and they are responsible for:
 - Prioritizing the types of activities they apply for;
 - Handling local citizen participation;
 - Carrying out the funded activities; and
 - Complying with Federal and State requirements.
- HUD is responsible for monitoring States to ensure compliance with CDBG program requirements.
- The primary objective of HCDA is the development of viable urban communities. These viable communities are achieved by providing the following – known as the “Primary Objectives,” principally for persons of low and moderate income:
 - Decent housing;
 - A suitable living environment; and
 - Expanded economic opportunities.
- To achieve these national objectives, the CDBG statute and regulations set forth eligible activities and the national objectives that each activity must meet.

- The following sections of this chapter provide a basic overview of the CDBG regulations, including eligible activities and national objectives. The subsequent chapters of this manual provide a more in-depth exploration of how these regulations can be used to develop and implement economic development programs.

Regulations

- The regulations implementing the CDBG program are found at 24 CFR Part 570. A current copy of these regulations may be found in the appendix.
- The CDBG regulations have been dramatically revised over the past several years. These changes occurred due to:
 - Input to HUD from grantees desiring additional flexibility and regulatory clarity to undertake new types of programs, particularly programs related to economic development;
 - Statutory changes that necessitated changes in the CDBG regulations (not only in the HCDA but also in other statutes—such as the National Affordable Housing Act and the Multifamily Housing Property Disposition Reform Act — where CDBG was referenced); and
 - Concerns raised by HUD’s Office of Inspector General regarding certain administrative or operational issues.
- Below is a brief summary of the key regulatory changes and dates.
 - **December 23, 2005 (interim rule, effective February 21, 2006)** —This rule implemented a statutory amendment regarding limitations on the use of CDBG funds for activities involving job relocation. Provisions are codified at 24 CFR 570.210.
 - **May 24, 2006 (final rule, effective June 23, 2006)** —This rule clarifies the eligibility of brownfields redevelopment activities and makes changes to national objectives provisions that relate to brownfields.
- The regulatory flexibilities specifically related to economic development are briefly highlighted below and are described in detail throughout this manual. In addition, the regulatory changes are summarized in memorandums from HUD located in the appendix.

Key CDBG Changes Related to Economic Development

- A number of important statutory, regulatory, and policy changes over the past decade or two have made economic development more feasible under CDBG.
- Key changes include:
 - The law now contains a new category of eligibility to provide assistance for the “establishment, stabilization, and expansion of microenterprises;”

- The law also now contains the presumption of low- and moderate-income status for employees or prospective employees based on the census tract where they live or work, under certain circumstances;
- Additional flexibilities have been added for job training outside of 15 percent cap on public services;
- There are new flexibilities regarding when recipients can aggregate jobs in order to document national objective compliance;
- HUD established guidelines for “financial and cost” objectives — now known as “underwriting” guidelines — *but may not enforce their use*;
- HUD established mandatory guidelines (standards) for “public benefit” to ensure that the amount of public benefit will be commensurate with the amount of CDBG funds used for certain economic development projects;
- There are new standards for how and when infrastructure projects must meet the public benefit standards;
- There is a new limited clientele national objective provision for persons owning or developing a microenterprise;
- In addition, there is a new limited clientele national objective provision making it permissible, under certain circumstances, to fund job training when less than 51 percent of the beneficiaries will be LMI;
- Recipients may now submit a Neighborhood Revitalization Strategy in order to target resources to a particular part of their communities. This provides new flexibility not funds;
- Additional CDBG flexibilities are offered to entities qualifying as Community-Based Development Organizations (CBDOs) and Community Development Financial Institutions (CDFIs) ; and
- HUD added a requirement for minimizing displacement of businesses or jobs from neighborhoods when assisting a for-profit entity.

Eligible Activities

- As outlined in HUD’s Guide to Eligible Activities and National Objectives (provided in the appendix), grantees should take several key steps prior to funding any economic development activity. These steps include:
 1. Determine if the proposed activity is included in the list of eligible activities;
 2. Determine if the proposed activity falls within a category of explicitly ineligible activities;
 3. Determine if the proposed activity can meet one of the national objectives; and
 4. Ensure that carrying out the activity will help to meet the grantee’s certification that 70 percent of its CDBG expenditures will be for activities that benefit LMI persons.

- The remainder of this chapter summarizes the eligible and ineligible activities, and describes in detail the national objectives and the LMI benefit certification. A summary chart appears at the end of this chapter.

Eligible CDBG Activities —General

- This section describes the range of activities eligible under the CDBG Program (§ 570.201, 570.202, 570.205, 570.206).
- CDBG offers recipients a high level of flexibility in choosing program activities. Recipients are free to select those activities that best meet the needs of their communities, in accordance with the national objectives and requirements of the CDBG program.
- Determining the category of eligible activities under which an activity falls is important. The regulations and statutes place different requirements and stipulations on different categories. For example, the regulations and statute cap the amount of CDBG funds that can be used for public service and program administration activities. Additionally, the category of eligibility may dictate the costs that are eligible, the national objective under which the activity falls, and the rules that are triggered.
- This section describes the range of activities eligible under the CDBG Program that are not specifically economic development activities but might be part of a comprehensive economic development strategy.

Activities Related to Housing

- There are many activities related to housing that are eligible under the CDBG program and may be tied to economic development strategies discussed in this guide, including:
 - Housing services in connection with Home Investment Partnerships (HOME) program activities [105(a)(20)];
 - Construction of housing by eligible organizations [105(a)(15)] or as last resort housing under 24 CFR Part 42;
 - Homeownership assistance (such as downpayment assistance and interest subsidies) [105(a)(8)] and [105(a)(24)];
 - Rehabilitation to buildings that are residential, low-income rental, or homeowner housing [105(a)(4) and (a)(5)]. This also includes conversion of nonresidential structures for residential use. The following types of rehabilitation activities may be undertaken:
 - Acquisition for rehabilitation and rehabilitation for residential purposes;
 - Labor, materials, etc., for rehabilitation of properties;
 - Loans for refinancing existing secured indebtedness;
 - Energy improvements;
 - Water efficiency improvements;
 - Connection to water and sewer lines;

- Homeowner warranty, hazard, and flood insurance premiums;
- Testing for and abatement of lead-based paint;
- Costs of acquiring tools to be lent for rehabilitation;
- Rehabilitation services;
- Removal of material and architectural barriers that restrict accessibility; and
- Lead-based-paint testing and abatement as a stand-alone program or included as rehabilitation as noted above [105(a)(25)];
- Activities that support new housing construction such as acquisition [105(a)(1)], clearance [105(a)(4)], and street improvements [105(a)(2)].

Other Real Property Activities

- In addition to the housing-related activities outlined above, many other real property activities are eligible to be funded by CDBG such as:
 - Acquisition [105(a)(1)];
 - Disposition [105(a)(7)];
 - Clearance and demolition [105(a)(4)];
 - Rehabilitation of publicly or privately owned commercial or industrial buildings [105(a)(4)];
 - Code enforcement [105(a)(3)];
 - Historic preservation [105(a)(4)];
 - Renovation of closed buildings [105(a)(2)];
 - Interim assistance to arrest severe deterioration or alleviate emergency conditions [(§ 570.201(f)]—Note: this activity is not explicitly listed in the statute, but States may refer to the entitlement regulations for guidance; and
 - Privately owned utilities—Note: this activity is not explicitly listed in the statute but States may refer to the entitlement regulations for guidance.

Public Facilities

- CDBG funds may be used for the acquisition, construction, reconstruction, rehabilitation, or installation of public improvements or public facilities [105(a)(2)] .
- “Public improvements” include, but are not limited to, streets, sidewalks, water and sewer lines, and parks.
- “Public facilities” include, but are not limited to, neighborhood/community facilities and facilities for persons with special needs (e.g., homeless shelters, group homes, and halfway houses).

Activities Related to Public Services

- Public facilities used in conjunction with public services are also generally eligible under the CDBG Program [105(a)(8)]. These public service activities may include, but are not limited to:

- Healthcare and substance abuse services;
- Childcare;
- Educational services;
- Crime prevention; and
- Fair Housing counseling.

Assistance to Nonprofit Development Organizations

- Grantees may also provide grants or loans to nonprofit development organizations to carry out the following types of projects [105(a)(15)]:
 - Neighborhood revitalization;
 - Community economic development; and
 - Energy conservation.

Other Types of Activities

- Certain other types of activities are also eligible under CDBG, including:
 - Payment of non-Federal share of grants in connection with CDBG-eligible activities [105(a)(9)];
 - Relocation assistance [105(a)(11)];
 - Loss of rental income (related to relocation) [105(a)(6)];
 - Technical assistance to public or nonprofit entities to increase the capacity of such entities to carry out eligible neighborhood revitalization or economic development activities [105(a)(19)]; and
 - Assistance to institutions of higher education with the capacity to carry out other eligible activities [105(a)(21)].

Planning and Administration

- CDBG funds may be used for planning activities [105(a)(12)] and [105(a)(16)]. Such activities might include:
 - Comprehensive plans;
 - Community development plans (including the ConPlan);
 - Functional plans (for housing, land use and urban environmental design, economic development, open space and recreation, energy use and conservation, floodplain and wetlands management, transportation, utilities, historic preservation, etc.);
 - Other plans and studies (e.g., small area and neighborhood plans, capital improvements program plans, individual project plans, general environmental, urban environmental design, historic preservation studies, etc.); and
 - Policy planning, management, and capacity-building activities.

- Finally, within certain caps and constraints, States may use CDBG funds for program administration activities [105(a)(13)]. Such activities may include:
 - General management, oversight, and coordination;
 - Public information;
 - Fair Housing activities;
 - Indirect costs; and
 - Submission of applications for Federal programs.

Eligible CDBG Activities–Economic Development

- Economic development may be undertaken in several ways under the CDBG program regulations:
 - Special economic development activities [105(a)(17)] and [105(a)(14)];
 - Microenterprise assistance [105(a)(22)];
 - Commercial Rehabilitation [105(a)(4)];
 - Public facilities [105(a)(2)];
 - Public services [105(a)(8)]; and
 - Activities by nonprofit development organizations [105(a)(15)].
- The following sections briefly describe these eligible activities. Additional information is provided in the various activity chapters that follow.

Special Economic Development Activities

- CDBG funds may be used to undertake special economic development activities. These activities include:
 - Real estate and real property activities;
 - Assisting a for-profit business; and
 - Providing economic development services in connection with other eligible CDBG special economic development activities.

Microenterprise Activities

- CDBG program funding can be also used to provide assistance to microenterprises, which are defined as a commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise.
- Eligible activities include the provision of:
 - Financial support;
 - Technical assistance;

- General support; and
- Training and technical assistance or other support services to increase the capacity of grantees to carry out microenterprise activities.

Commercial Rehabilitation

- Grantees may also undertake certain types of commercial rehabilitation activities.
 - Assistance may be provided to for-profit or nonprofit entities.
 - However, some restrictions do exist on how these activities may be accomplished.

Public Facilities for Economic Development

- In addition to the general types of infrastructure noted earlier, jurisdictions may also use CDBG funds to develop public facilities that are specifically related to creating employment and economic opportunities.
- This may include infrastructure that benefits businesses such as improved water or sewer service in a business area.

Economic Development Public Services

- In addition to the wide range of services listed above, grantees may also undertake services specifically related to employment and business creation, such as:
 - Job training;
 - Employment and job placement services; or
 - Training for potential entrepreneurs.

Assistance to Nonprofit Development Organizations for Economic Development

- As noted above, one of the key activities that can be undertaken by nonprofit development organizations under [105(a)(15)] of the statute is community economic development.
- These are projects that are designed to improve the overall economy of a jurisdiction or a neighborhood within the jurisdiction and may include a wide range of activities.

Ineligible Activities

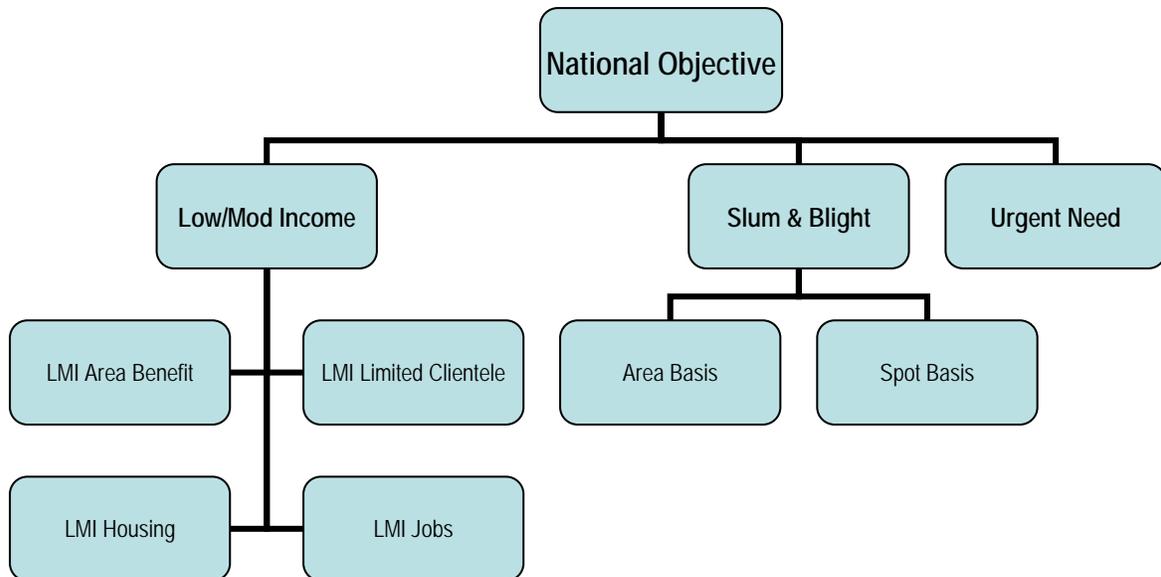
- The general rule is that any activity not authorized under the CDBG regulations is ineligible to be assisted with CDBG funds.
- The State CDBG program relies on the statute to describe eligible programs and its regulations do not directly address ineligible programs. States may use the entitlement program regulations as guidance.
- The entitlement regulations stipulate that the following activities may not be assisted with CDBG funds:

- Buildings for the general conduct of government are ineligible. However, the removal of architectural barriers from government buildings is eligible under the category of public facilities and improvements.
- General government expenses are ineligible.
- Financing for political activities or to engage in other partisan political activities are ineligible. However, a facility assisted with CDBG funds may be used on an incidental basis to hold political meetings, candidate forums, or voter registration campaigns, if the building is available to all community organizations on an equal basis.
- Per the entitlement regulations, the following activities may not be assisted with CDBG funds unless authorized as a special economic development activity or when carried out by a Community-Based Development Organization (CBDO) (under the State program, these organizations are known as nonprofit development organizations under [105(a)(15)]):
 - Purchase of equipment is generally ineligible; however:
 - Compensation for the use of construction equipment through leasing, depreciation, or use allowances is eligible.
 - Fire protection that is considered an integral part of public facilities is eligible. This includes fire engines and specialized tools such as "jaws of life" and life-saving equipment as well as protective clothing worn by fire fighters.
 - Purchase of personal property, including equipment, fixtures, motor vehicles, furnishings, or other personal property is generally ineligible.
 - Operating and maintenance expenses (of public facilities, improvements, and services) are ineligible.
 - Specific exceptions to this general rule are operating and maintenance expenses associated with public service activities, interim assistance, and office space for program staff employed in carrying out the CDBG program.
 - New housing construction except under certain conditions or when carried out by a 105(a)(15) nonprofit development organization.
 - Income payments made to an individual or family for items such as food, clothing, housing, or utilities are ineligible. One-time grants, emergency type grants, or loans for such purposes may be eligible under the category of public services.

National Objectives

- CDBG recipients are responsible for assuring that each eligible activity meets one of three national objectives (§ 570.208):
 - Benefit to LMI persons;
 - Aid in the prevention or elimination of slums or blight; or
 - Meet a need having a particular urgency (referred to as urgent need).

- The following sections outline each of these national objectives.
- An activity that does not meet a national objective is not compliant with CDBG requirements and may be subject to remedial actions.
- The following exhibit depicts the different categories associated with each of the national objectives.



- This chapter will also explore the strategic decisions grantees can make when qualifying an eligible activity under a national objective. It is possible for an activity to qualify under more than one national objective, although only one national objective may be selected for an activity. Additionally, activities can qualify under more than one category.
- HUD has developed a matrix of the national objectives, eligible activities, and IDIS matrix codes. These are attached to Chapter 11. Grantees may wish to refer to this matrix when selecting national objectives.
- Note that the text below provides suggestions for the types of records to document national objectives. Under the State CDBG program, HUD determines recordkeeping requirements in consultation with States, so the recordkeeping lists are a suggested good practice.

Benefit to Low- and Moderate-Income Persons

- The LMI national objective is often referred to as the “primary” national objective because the statute requires that grantees expend 70 percent of their CDBG funds to meet the LMI national objective.

- Additional information on how to meet the 70-percent test and certification to HUD is located later in this chapter.
- In addition to meeting the 70-percent test, grantees must ensure that the activities proposed, when taken as a whole, will not benefit moderate-income persons to the exclusion of low-income persons. This does not mean that each activity has to include both low- and moderate-income beneficiaries.
- This section covers the four categories that can be used to meet the LMI national objective:
 - Area benefit activities,
 - Limited clientele activities,
 - Housing activities, or
 - Job creation or retention activities.

Area Benefit

- The area benefit category is the most commonly used national objective for activities that benefit a residential neighborhood. An area benefit activity is one that benefits all residents in a particular service area, where at least 51 percent of the residents are LMI persons.
- Examples of area benefit activities located in a predominantly LMI neighborhood include:
 - Acquisition of land to be used as a neighborhood park;
 - Construction of a supermarket or assistance to a retail business that predominantly serves a LMI area;
 - Improvements to public infrastructure like the installation of gutters and sidewalks; and
 - Development of a community center.
- The activities listed above benefit all LMI residents in a service area and thus are the type of activities that may qualify under the LMI area benefit category for the purposes of meeting a national objective.
- Grantees are responsible for determining the service area of an activity. HUD will generally accept a grantee's determination as long as it is reasonable.
 - The factors that may be considered in making a determination regarding the service area include:
 - ***The nature of the activity:*** In general the size and the equipment associated with the activity should be taken into consideration. A small park with a limited number of slides and benches would not be expected to serve the entire neighborhood. In the same way, a larger park that can accommodate a considerable number of people would not be expected to service just the immediately adjacent properties. The same applies to improvements or assistance to an alleyway versus a small two-lane street versus an

arterial four-lane street within the same neighborhood. The service area for each of these infrastructure projects will be different in size and population.

- ***The location of the activity:*** In general, the immediate area surrounding a facility is expected to be included in the service area. Additionally, when a facility is located near the boundary of a particular neighborhood, its service area could likely include portions of the adjacent neighborhood as well as the one in which it is located.
 - ***Accessibility issues:*** Geographic barriers can separate and preclude persons residing in a nearby area from taking advantage of a facility. Other limits to accessibility can include access fees, language barriers, time or duration that an activity is available, access to transportation and parking, etc.
 - ***The availability of comparable activities:*** Comparable activities within the service area should be taken into account so that the service area does not overlap with the service area of another comparable activity.
 - ***Boundaries for facilities and public services:*** The service area for some public facilities and services are determined based on specified and established boundaries or districts. Examples of such services and facilities are police precincts, fire stations, and schools.
- If the service area has not already been identified for an activity, the State has to determine the service area before CDBG assistance can be provided under the LMI Area Benefit category.
- An area is considered to meet the test of being LMI if it principally benefits (51 percent) of LMI persons residing in the service area as determined by:
 - The most recently available decennial census information, together with the Section 8 income limits that would have applied at the time the income information was collected by the Census Bureau; or
 - A current survey of the residents of the service area.
 - With respect to using census information to document that the service area qualifies, grantees can obtain the following data:
 - A listing of all census tracts and block groups in the community's jurisdiction;
 - The number of persons that resided in each such tract/block group at the time of the last census; and
 - The percentage of such persons who were LMI (based on the CDBG definition) at that time.

The above data is available directly from HUD online at:
<http://www.hud.gov/offices/cpd/systems/census/lowmod/sc/index.cfm>.

- If the proposed activity's service area is generally the same as a census tract or block group, then the census data may be used to justify the income characteristics of the area served.

Additionally, grantees can compute the percentage of LMI persons in multiple census tracts and block groups because the data includes both the total number of persons as well as the number of LMI persons within a tract and block group.

- Income surveys are often used to determine LMI area in one of two instances:
 - If HUD data does not indicate the service area contains at least 51 percent LMI persons, and if a State has a compelling reason to believe the data is incorrect, then the State may conduct household surveys based on a change in either population or income of the area since the census.
 - Also, when the service area is not generally the same as a census tract or block group, then the State should conduct household surveys to determine the LMI percentage for the service area.
- The survey instrument must be methodologically sound for the purpose of establishing the percentage of LMI persons in a service area.
 - A survey must meet standards of statistical reliability that are comparable to that of the decennial census data for areas of similar size.
 - Additional guidance is available in CPD Notice 05-06.
- Finally, the service area of the activity must be primarily residential and the activity must meet the identified needs of LMI persons.
 - An activity with a service area that is not primarily residential may not qualify under the LMI area benefit category even if the activity provides benefits to all residents in the service area and 51 percent of the residents are LMI persons.
 - This requirement does not apply to the location of the activity itself but rather the service area of the activity. As such it does not mean that activities located in commercial districts cannot be qualified under the LMI area benefit category on the virtue of their geography. The primary residential test is applied to the service area of the activity.
 - For example, activities that support the infrastructure of a commercial district composed of institutions and firms that serve a national and international clientele will not qualify under LMI area benefit.
 - In contrast, if the commercial district is composed of stores and businesses that serve local customers such that the service area boundaries of the commercial district is around a primarily residential area with the requisite percentage of LMI residents, the activity qualifies under the LMI area benefit category.
- Activities under Public Facilities and Improvements and some Public Service activities (e.g., police or fire services) tend to provide benefits to all residents in the service area. Additionally, public schools can be qualified under LMI area benefit because of the affect a school may have on the value of the residential property in the area. Public schools are considered to benefit all the residents of the service area and may qualify under this category.

- There are activities and facilities that are located in a service area but are designed to meet special needs. These activities cannot be qualified under this category. For example, a senior center would qualify under the LMI limited clientele category and not the LMI area benefit category.
- With respect to exceptions and special situations, the statute allows two kinds of area benefit activities to meet the national objective of benefit to LMI persons even when the general requirements of the area benefit category cannot be met. The two kinds of area benefit activities are described below:
 - 911 Systems: With prior HUD approval, a State may develop, establish, and operate for up to 2 years after the establishment of a uniform emergency telephone number system serving an area having less than the percentage of LMI persons otherwise required.
 - Special Assessments: The use of CDBG funds to pay special assessments levied against residential properties that are owned and occupied by LMI persons will qualify under the LMI area benefit category provided that this is the only use of CDBG funds in the financing of a public improvement. The activity will qualify even if the public improvement provides a benefit to all the residents of an area.
- Finally, there are two special situations that can meet the national objective of benefiting LMI persons under either the area benefit category or the job creation or retention category, at the option of the State grantee:
 - Activities undertaken pursuant to an approved Neighborhood Revitalization Strategy Area (NRSA) for the purpose of creating or retaining jobs [referred to as Community Revitalization Strategy Area (CRSA) for States]; and
 - Activities carried out for the purpose of creating or retaining jobs by a community development financial institution (CDFI) whose charter limits its investment area to a primarily residential area consisting of at least 51 percent LMI persons.
- The following records will demonstrate compliance under this national objective category:
 - Boundaries of service area;
 - Information on the primarily residential character of the service area;
 - Percentage of LMI persons that reside in the service area; and
 - The data used for determining percentage of LMI persons.

Low Mod Limited Clientele (LMC)

- The limited clientele category is a second way to qualify specific activities under the LMI benefit national objective. Under this category, 51 percent of the beneficiaries of an activity have to be LMI persons.
- In contrast to the area benefit category, it is not the LMI concentration of the service area of the activity that determines whether the activity will qualify or not, but rather the actual number of LMI persons that benefit from the activity.

- Activities in this category provide benefits to a specific group of persons rather than everyone in an area. It may benefit particular persons without regard to their residence, or it may be an activity that provides a benefit to only particular persons within a specific area.
- An example of an economic development activity that qualified under the limited clientele category would be a job training program for low- and moderate-income persons.
- With respect to determining the beneficiaries of activities as LMI and qualifying under the limited clientele category, activities must meet one of the following tests:
 - Benefit a clientele that is generally presumed to be principally LMI. This presumption covers abused children, battered spouses, elderly persons, severely disabled adults (see the box below), homeless persons, illiterate adults, persons living with AIDS, and migrant farm workers; or
 - Require income documentation on family size and income in order to show that at least 51 percent of the clientele are LMI persons; or
 - Have income eligibility requirements limiting the activity to LMI persons only; or
 - Be of such a nature and in such a location that it can be concluded that clients are primarily LMI. An example is a daycare center that is designed to serve residents of a public housing complex.
- In addition, the following activities can qualify under the limited clientele national objective:
 - Microenterprise activities carried out in accordance with the HUD regulations when the person owning or developing the microenterprise is LMI; or
 - Activities that provide training and other employment support services when the percentage of persons assisted is less than 51 percent LMI may qualify if: the proportion of total cost borne by CDBG is no greater than the proportion of LMI persons assisted; and when the service assists businesses, CDBG is only used in the project to pay for the job training and/or supportive services.
- There are two sets of activities that are precluded from qualifying under this category based on statutory limitations:
 - Acquisition, construction, or rehabilitation of property for housing, including homeownership assistance must qualify under the housing national objective which will be discussed below in further detail; and
 - Creation or retention of jobs generally qualifies under the jobs or the area benefit category of the LMI benefit national objective.
- One of the following five types of records should be kept regarding limited clientele activities:
 - Documentation showing that the activity is designed for exclusive use by a segment of the population presumed by HUD to be LMI persons;

- Documentation describing how the nature and the location of the activity establishes that it will be used predominantly by LMI persons;
- Data showing the family size and annual income of each person receiving the benefit;
- Data showing that barriers to mobility or accessibility have been removed and how the barrier removal was restricted to the extent feasible to one of the particular cases authorized under this category; or
- Documentation showing that the activity qualifies under the special conditions regarding job services where less than 51 percent of the persons benefiting are LMI persons.

Low Mod Housing Activities (LMH)

- The LMI housing national objective qualifies activities that are undertaken for the purpose of providing or improving permanent residential structures which, upon completion, will be initially occupied by LMI households.
- Examples of eligible activities include, but are not limited to:
 - Acquisition of an apartment house to provide dwelling units to LMI households at affordable rents, where at least 51 percent of the units will be occupied by LMI households;
 - Site improvements on publicly owned land to serve a new apartment structure to be rented to LMI households at affordable rents; and
 - Housing rehabilitation of single-family units owned and occupied by LMI households.
- In order to meet the housing LMI national objective, structures with one unit must be occupied by a LMI household. If the structure contains two units, at least one unit must be LMI occupied. Structures with three or more units must have at least 51percent occupied by LMI households.
 - Rental buildings under common ownership and management that are located on the same or contiguous properties may be considered as a single structure.
 - For rental housing, occupancy by LMI households must be at affordable rents, consistent with standards adopted, and publicized by the State grantee.
- Under the following limited circumstances, structures with less than 51 percent LMI occupants may be assisted:
 - Assistance is for an eligible activity that reduces the development cost of new construction of nonelderly, multifamily rental housing; **and**
 - At least 20 percent of the units will be occupied by LMI households at an affordable rent; **and**
 - The proportion of cost borne by CDBG funds is no greater than the proportion to be occupied by LMI households.
- When housing activities are conducted by a CBDO or as part of an approved NRSA or CRSA, multiple units (e.g., scattered-site housing) may be aggregated and treated as a single structure for the purposes of meeting the LMI housing national objective.

- NOTE: This flexibility does not apply to activities under the Direct Homeownership Assistance eligibility category at 24 CFR 570.201(n); and
- Please refer to the chapter on Revitalization Areas for more information.
- Code enforcement, interim assistance, microenterprise assistance, public services, and special economic development activities do not qualify under the LMI housing national objective.
- The following records should be maintained:
 - A written agreement with each landlord or developer receiving CDBG assistance, specifying the total number of dwelling units in each multiunit structure and the number of those units which will be occupied by LMI households after assistance;
 - Total cost of the activity, including both CDBG and non-CDBG funds; and
 - The household size and income eligibility for each of the LMI households occupying an assisted unit.
 - For rental housing:
 - The rent charged (or to be charged) after assistance for each dwelling unit in each assisted structure; and
 - Documentation of compliance with the locally established standards for housing that is “affordable to LMI households.”
 - When assisting structures with less than 51 percent LMI occupants, documentation of qualification under the special conditions:
 - Number of units to be occupied by LMI households at an affordable rent;
 - Total development cost of new construction; and
 - Amount of CDBG funds expended for activity.
 - When aggregating scattered sites, documentation of the basis for aggregating scattered sites and considering them as a single structure.
 - When assisting with the delivery costs of HOME-assisted projects and assistance, evidence that housing projects and/or tenant-based rental assistance achieves HOME income targeting requirements.
- While compliance with the housing national objective is based on the initial occupancy of the housing following completion of the CDBG-assisted activity, jurisdictions are urged to establish their own requirements for replacing such households with other LMI households whenever the assisted unit becomes vacant within a period of time following completion that is commensurate with the amount of CDBG financial assistance that was provided to the developer.
- Another consideration when documenting compliance is that occupancy of the unit may not be for some time after the completion of the activity. For example, there may be a time lag between the acquisition or land clearing activity subsidized by CDBG funds and the

development of the housing units. It is not sufficient to document the intention to comply. The jurisdiction is responsible for documenting that the housing units are constructed and that the required units are initially occupied by LMI households.

Low Mod Job Creation or Retention Activities (LMJ)

- The job creation and retention LMI benefit national objective addresses activities designed to create or retain permanent jobs, at least 51 percent of which (computed on a full-time-equivalent basis) will be made available to or held by LMI persons.
 - If the business will create permanent part-time jobs, the part-time jobs must be added together in order to calculate the needed 51 percent of full-time-equivalent (FTE) jobs.
 - For example, if the business creates two quarter-time jobs and one half-time job, together these constitute one FTE.
 - The calculation of FTE is based on the number of hours worked per week, divided by 40.
- Some examples of activities that qualify when at least 51 percent of jobs created/retained will be for LMI persons include:
 - Clearance activities on a site slated for a new business;
 - Rehabilitation activity that will correct code violations and enable a business to survive and retain jobs;
 - Financial assistance to a manufacturer for the expansion of its facilities that is expected to create permanent jobs; and
 - Assistance to expand a small house cleaning service with four employees that agrees to hire three additional LMI employees.
- The following requirements must be met for **jobs to be considered created or retained**.
 - If jurisdictions fund activities that **create jobs**, there must be documentation indicating that at least 51 percent of the jobs will be held by, or made available to, LMI persons; and
 - For funded activities that **retain jobs**, there must be sufficient information documenting that the jobs would have been lost without the CDBG assistance and that one or both of the following applies to at least 51 percent of the jobs:
 - The job is held by a LMI person; or
 - The job can reasonably be expected to turn over within the following two years and steps will be taken to ensure that the job will be filled by, or made available to, a LMI person.
- The following requirements apply for jobs to be considered available to or held by LMI persons.
 - Created or retained jobs are only **considered to be available to LMI persons** when:

- Special skills that can only be acquired with substantial training or work experience or education beyond high school are not a prerequisite to fill such jobs, or the business agrees to hire unqualified persons and provide training; and
 - The State and the assisted business take actions to ensure that LMI persons receive first consideration for filling such jobs.
- Created or retained jobs are only considered to be held by LMI persons when the job is actually held by a LMI person.
- For the purpose of determining if the preceding requirements are met, a person may be presumed to be LMI if:
 - He/she resides in a census tract/block numbering area that has a 20-percent poverty rate (30-percent poverty rate if the area includes the central business district); and the area evidences pervasive poverty and general distress; or
 - He/she lives in an area that is part of a federally designated EZ, EC, or NRSA (see p. 58); or
 - He/she resides in a census tract/block numbering area where at least 70 percent of the residents are LMI.
- Jobs created or retained by assisted businesses may also be presumed to be LMI if the job and business are located in an area that:
 - Has a 20-percent poverty rate (30-percent poverty rate if the area includes the central business district) and the area evidences pervasive poverty and general distress; or
 - Is part of a federally designated EZ or EC; and
 - The jobs will be located in the qualifying area.
- To determine if an area evidences pervasive poverty and general distress, the following standards are applicable:
 - All block groups in the census tract have poverty rates of at least 20 percent;
 - The specific activity being undertaken is located in a block group that has a poverty rate of at least 20 percent; and
 - Upon the written request of the State grantee, HUD determines that the census tract exhibits other objectively determinable signs of general distress such as high incidence of crime, narcotics use, homelessness, abandoned housing, and deteriorated infrastructure or substantial population decline.
- As a general rule, each assisted business shall be considered to be a separate activity for purposes of determining whether the activity qualifies under the job creation and retention category for meeting a national objective.
- However, in certain cases, such as where CDBG funds are used to acquire, develop, or improve a real property (e.g., a business incubator or an industrial park), the requirement may

be met by measuring jobs in the aggregate for all the businesses that locate on the property, provided such businesses are not otherwise assisted by CDBG funds.

- Additionally, where CDBG funds are used to pay for the staff and overhead costs of an entity making loans to businesses from non-CDBG funds, this requirement may be met by aggregating the jobs created by all of the businesses receiving loans during any program year.
- As mentioned under the area benefit category, certain job creation or retention activities carried out by a CDFI or under a community revitalization strategy can meet the national objective of benefiting LMI persons under either category. In these instances, the State will decide which category it will use to qualify the activity and record the decision in program files so that HUD will know which category is being applied.
- Recordkeeping requirements in this category relate to both the status of the business, the jobs created or retained, and the LMI persons benefiting from the activity. The following is an outline of the documents that should be maintained by grantees:
 - Written agreement with the business in which the following is specified:
 - A commitment from the assisted business to hire or retain LMI persons;
 - The type of job and whether the job will be full or part time; and
 - The actions that the business will take to ensure that at least 51 percent of the hires or retainees will be LMI persons.
 - Compliance with the written agreement must be documented as follows:
 - The jobs that were actually created and/or retained;
 - Whether each such job was held by or made available to a LMI person; and
 - The full-time equivalency status of the jobs.
 - **For created jobs that will be held by LMI persons**, the records must demonstrate:
 - Listing by job title of the jobs created;
 - Listing by job title of the jobs filled;
 - The name and income status of the person who filled each position; and
 - The full-time equivalency status of the jobs.
 - **For created jobs that will be made available to LMI persons** but are not taken by LMI persons:
 - The title and description of the jobs made available;
 - The full-time equivalency status of the job;
 - The prerequisites for the job; special skills or education required for the job, if any; and the business commitment to provide needed training for such jobs; and

- How first consideration was given to LMI persons for the job can be recorded as the name(s) of person(s) interviewed for the job and the date of the interview(s), and the income status of the person(s) interviewed.
- **For retained jobs that would otherwise be lost:**
 - Specific evidence that the jobs would be lost without the CDBG assistance; and
 - If the retained job is held by a LMI person:
 - ~ A listing by job title of permanent jobs retained;
 - ~ The jobs that are known to be held by LMI persons at the time of assistance;
 - ~ The full-time equivalency status of each job; and
 - ~ Family size and annual income of each LMI person.
- **For retained jobs that are projected to turn over to LMI persons:**
 - A listing of the retained jobs that are projected to become available within two years of assistance;
 - The basis of the determination that the job is likely to turnover within two years of assistance;
 - The actual turnover date;
 - The name and income status of the person who filled the vacancy;
 - If the person who took the job was not a LMI person, records to demonstrate that the job was made available to LMI persons:
 - ~ The name(s) of person(s) interviewed for the job and the date of the interview(s);
 - ~ The income status of the person(s) interviewed; and
 - Information on the family size and annual income of each LMI person hired.
- There are five suggested options for documenting the LMI status of an applicant or employee:
 - Referrals from an agency that has agreed to refer individuals who are determined to be LMI based on HUD's category. These agencies must maintain records, which must be available to the State or Federal inspection, showing the basis upon which they determined that the person was LMI;
 - A written self-certification by the employee or applicant of his/her family size and total income that is signed and dated and subject to Federal review. Certification can either include actual size and income of family or can contain a statement that the annual family income is below the Section 8 low-income limit for the applicable family size;
 - Qualification of employee or application for assistance under another program with income qualification that are as restrictive as those used by the CDBG program. Examples include referrals from public housing, welfare agency, or the Workforce Investment Act (WIA) program;
 - Evidence that the individual is homeless; and

- Evidence that the individual may be presumed to be LMI by way of residence address and poverty rates of applicable census tract or documentation of area designation as EZ or RC.
- When documenting income, the income status of an individual is made at the time the CDBG job is filled. This may have an effect on the retention of high-paying, unskilled jobs counting as eligible except for turnover purposes. This is because a person who occupies a high-paying but low-skilled job may not qualify as a LMI person. Whereas a LMI person may fill the job at a lower pay rate if it were created or if it became available through turnover.

Elimination of Slums and Blight

- This section highlights the national objectives related to the elimination of slums and blight.
- Activities under this national objective are carried out to address one or more of the conditions which have contributed to the deterioration of an area designated as a slum or blighted area.
- The focus of activities under this national objective is a change in the physical environment of a deteriorating area. This contrasts with the LMI benefit national objective where the goal is to ensure that funded activities benefit LMI persons.
- This difference in focus has an impact on the information that is required to assess the qualifications of an activity. Under the LMI benefit national objective, determining the number of LMI persons that actually or could potentially benefit from an activity is central to qualifying the activity. Under the elimination of slum and blight national objective, determining the extent of and physical conditions that contribute to blight is central to qualifying an activity.
- There are two categories that can be used to qualify activities under this national objective:
 - Prevent or eliminate slums and blight on an area basis; or
 - Prevent or eliminate slum and blight on a spot basis.

Slum Blight Area Basis (SBA)

- This category covers activities that aid in the prevention or elimination of slums or blight in a designated area. Examples of economic development activities that qualify when they are located within the slum or blighted area include:
 - Infrastructure improvements in a deteriorated area; and
 - Economic development assistance in the form of a low-interest loan to a business as an inducement to locate a branch store in a redeveloping blighted area.
- To qualify under this category, the area in which the activity occurs must be designated as slum or blighted. The following tests apply:
 - The designated area in which the activity occurs must meet the definition of a slum, blighted, deteriorated or deteriorating area under State or local law;
 - Additionally, the area must meet either one of the two conditions specified below:

- Public improvements throughout the area are in a general state of deterioration; or
 - At least 25 percent of the properties throughout the area exhibit one or more of the following:
 - ~ Physical deterioration of buildings/improvements;
 - ~ Abandonment of properties;
 - ~ Chronic high occupancy turnover rates or chronic high vacancy rates in commercial or industrial buildings;
 - ~ Significant declines in property values or abnormally low property values relative to other areas in the community; and
 - ~ Known or suspected environmental contamination.
 - Documentation must be maintained by the State on the boundaries of the area and the conditions that qualified the area at the time of its designation. The designation of an area as slum or blighted must be re-determined every 10 years for continued qualifications.
- As stated above, qualified activities must address the identified conditions that contributed to the slum and blight.
 - NOTE: When undertaking residential rehab in a slum/blight area, the building must be considered substandard under local definition, and all deficiencies making the building substandard must be eliminated before less critical work is undertaken.
 - Records to be maintained for area slums and blight may include:
 - Area designation (e.g., boundaries) and date of designation; and
 - Documentation and description of blighted conditions (e.g., photographs, structural surveys, or development plans).
 - For residential rehabilitation:
 - Building qualification as substandard;
 - Pre-rehabilitation inspection report and work plan describing deficiencies;
 - Scope of work performed with documentation that substandard elements were addressed first; and
 - Evidence that the activities undertaken address the conditions that contributed to the deterioration.

Slum Blight Spot Basis (SBS)

- These are activities that eliminate specific conditions of blight or physical decay on a spot basis and are not located in a slum or blighted area.

- Activities under this category are limited to acquisition, clearance, relocation, historic preservation, remediation of environmentally contaminated properties, and building rehabilitation activities.
- Furthermore, rehabilitation is limited to the extent necessary to eliminate a specific condition detrimental to public health and safety.
- Program files should include the following:
 - Description of condition addressed by activity;
 - Documentation of activity eligibility under this category; and
 - Records required for residential rehabilitation as listed above under Area Basis.

Urban Renewal (SBR)

- The use of the urban renewal national objective category is rare. It is designed only for activities are undertaken within an urban renewal area and in support of completing the urban renewal plan.

Urgent Need (URG)

- Use of the urgent need national objective category is rare. It is designed only for activities that alleviate emergency conditions. Examples include:
 - Acquisition of property located in a flood plain that was severely damaged by a recent flood;
 - Public facility improvements like the reconstruction of a publicly-owned hospital that was severely damaged by a tornado; and
 - Special economic development assistance to a grocery store that was damaged by an earthquake.
- Urgent need qualified activities must meet the following criteria:
 - The existing conditions must pose a serious and immediate threat to the health or welfare of the community;
 - The existing conditions are of recent origin or recently became urgent (generally, within the past 18 months); and
 - The grantee certifies that it is unable to finance the activity on its own, and other sources of funding are not available.
- Files should include:
 - Documentation of urgency of need and timing; and
 - Certification that other financing resources were unavailable and CDBG had to be used.

Documenting National Objectives

- Grantees must maintain records (see 24 CFR 570.506) that funded activities meet one of the national objectives. The records depend on the national objective category. Each of the suggested record types is included in the national objective sections above.
- Chapter 11 (Program Development & Administration) has more details regarding records that should be maintained to document compliance with CDBG, including records on meeting national objectives.
- The timing of documentation for activities is an important consideration. Compliance with national objectives can be documented upfront for a number of the categories. For example, compliance documentation for the following national objectives can be established upfront:
 - Under the national objective of benefit to LMI persons, the LMI area benefit;
 - Under the national objective of elimination of slums or blight, both categories (area basis, spot basis); and
 - The urgent need national objective.
- Some national objectives have to be documented over time.
 - For example, the LMI Housing requirement that 51 percent of the occupants must be LMI households will require collecting documentation demonstrating compliance until completion of lease-up.
 - In the same way, future hires of created jobs cannot be identified and documentation of compliance cannot be obtained upfront. Rather, hires by the assisted business have to be monitored over a period of time.

Choosing the Right National Objective

- Grantees may have options regarding which national objective is used for a particular activity. This section provides tips on selecting the right national objective.
- Activities may qualify for more than one national objective category. If an activity meets the LMI benefit national objective, then the best decision for most grantees will be to use the LMI benefit national objective because of the 70 percent requirement associated with that national objective.
- For the activities that meet more than one national objective, grantees may find it useful to document compliance with all the applicable national objectives, especially if there is some uncertainty regarding the ability of an activity to meet the chosen national objective upon completion.
- For example, grantees may have concern that an activity qualifying on the basis of creating jobs may not meet the test that at least 51 percent of the jobs created will benefit LMI persons. If the activity could also qualify under the slum/blight area category, it may be best served by documenting compliance with both national objectives. This way, if the activity does not meet

the LMI job creation criteria the State can switch the activity to the slum/blight area national objective rather than have the activity in noncompliance with CDBG rules. Note that switching the activity from LMI benefit to slum/blight area may affect the grantee's certification that 70 percent of expenditures are associated with the LMI benefit national objective, so grantees should proceed with caution.

CDBG Activity Requirements: Limitations, Benefit Standards, & Cost Caps

Participation of Faith-Based Organizations

- Effective October 30, 2003, HUD issued a new Final Rule to remove barriers to the participation of faith-based organizations in eight of HUD's Community Planning and Development programs, including the CDBG program, while adhering to the First Amendment requiring separation of church and State.
- The amended CDBG entitlement regulations establish the following policies (§570.200(j)):
 - Faith-based organizations are eligible for CDBG funding on an equal footing with any other organization. There is no Federal requirement for an organization to incorporate or operate as a nonprofit to obtain tax-exempt status under Section 501(c)(3) in order to receive CDBG funds.
 - Organizations may not use direct CDBG funds to support inherently religious activities such as worship or religious instruction. If an organization does conduct such activities, the activities must be offered separately from activities funded by the CDBG program, in time or location.
 - Faith-based organizations retain their independence from Federal, State, and local governments, including their exemption from the Federal prohibition on employment discrimination on the basis of religion for employees not involved in CDBG-funded activities (§570.607).
 - Faith-based organizations, like all organizations implementing HUD-funded programs, must serve all eligible beneficiaries without regard to religion. The CDBG statute and regulations prohibit any person from being denied the benefits of, or being subjected to discrimination, on the basis of religion under any activity funded in whole or in part with CDBG funds.
 - Faith-based organizations, like all organizations, may receive CDBG funds to acquire, construct, or rehabilitate buildings and other real property as long as the funds only pay the costs attributable to CDBG activities.
 - The Final Rule applies to State or local funds if a State or local government chooses to commingle its own funds with CDBG funds.
- For more information regarding the participation of faith-based organizations in the CDBG Program, see the following resources:

- HUD Center for Faith-Based and Community Initiatives: <http://www.hud.gov/offices/fbci/>;
- Guidance to Faith-Based and Community Organizations on Partnering with the Federal Government: <http://www.whitehouse.gov/government/fbci/guidance/>; and
- CPD Notice 04-10: Notice of Guidelines for Ensuring Equal Treatment of Faith-based Organizations: <http://www.hud.gov/offices/cpd/lawsregs/notices/2004/04-10.pdf>.

Job Pirating

- Job pirating is prohibited under Section 588 of the Quality Housing and Work Responsibility Act of 1998. Job pirating refers to the use of Federal funds to lure or attract a business and its jobs from one labor market to another.
- CDBG funds may not be used to assist for-profit businesses, including expansions, as well as infrastructure improvement projects or business incubator projects designed to facilitate business relocation, if:
 - The funding will be used to assist directly in the relocation of a plant, facility, or operation; and
 - The relocation is likely to result in a significant loss of jobs in the labor market area from which the relocation occurs.
- The following are definitions to assist in determining if a business location falls under these provisions:
 - Labor Market Area (LMA): An LMA is an economically integrated geographic area where individuals can live and work within a reasonable distance or can readily change employment without changing their place of residence.
 - Operation: A business operation includes, but is not limited to, any equipment, production capacity, or product line of the business.
 - Significant Loss of Jobs: A loss of jobs is significant if:
 - The number of jobs to be lost in the LMA in which the affected business is currently located is equal to or greater than one-tenth of one percent of the total number of persons in the labor force of that LMA; or, in all cases
 - A loss of 500 or more jobs.
 - A job is considered to be lost due to the provision of CDBG assistance if the job is relocated within 3 years of the provision of assistance to the business.
 - Notwithstanding the above definition, a loss of 25 jobs or fewer does not constitute a significant loss of jobs.
- Before directly assisting a business with CDBG funds, the grantee shall include appropriate language in the written agreement with the assisted business to ensure that no pirating has occurred. In addition to other required program clauses, the written agreement shall include the following:

- A statement from the assisted business as to whether the assisted activity will result in the relocation of any industrial or commercial plant, facility, or operation from one LMA to another, and, if so, the number of jobs that will be relocated from each LMA.
- If the assistance will not result in a relocation covered by this section, a written certification from the assisted business that neither it, nor any of its subsidiaries, have plans to relocate jobs at the time the agreement is signed that would result in a significant job loss as defined in this rule; and
- The agreement shall provide for reimbursement of any assistance provided to, or expanded on behalf of, the business in the event that assistance results in a relocation prohibited under this section.

Limitations on Eminent Domain

- The statute appropriating FY2006 funds for CDBG (Pub. L. 109–115) included an administrative provision that prohibits the use of FY2006 funds to support any Federal, State, or local project that seeks to use the power of eminent domain, unless that power is sought for certain public uses. This provision has been extended in subsequent appropriations.
- HUD considered this a “self-implementing” provision that did not require regulatory amendment, but issued a Federal Register Notice on July 17, 2006 to provide guidance to CDBG administrators.
- Section 726 of the statute indicated that “public use” shall not be construed to include economic development that primarily benefits private entities. Therefore, the restriction exists on the use of CDBG funds for or in connection with applications of eminent domain powers.
- The statute made the following uses specifically eligible as public uses:
 - Mass transit, railroad, airport, seaport, or highway projects;
 - Utility projects which benefit or serve the general public (including energy-related, communication-related, water-related, and waste water-related infrastructure);
 - Structures for use by the general public or which have other common-carrier or public-utility functions that serve the general public and are subject to regulation and oversight by the government; and
 - Projects that involve the removal of an immediate threat to public health and safety or the removal of brownfields.
- HUD indicated that the development of LMI housing generally is not considered economic development within the meaning of Section 726. Therefore, CDBG funds, as well as HUD’s housing assistance programs, can be used to support projects in which the sole use of eminent domain is to acquire land exclusively for the development of housing for low- to moderate-income families.
- Mixed-use housing developments may raise Section 726 concerns, especially where the amount of retail or commercial space is more than incidental in relation to the amount of

housing. All mixed-used housing developments require careful evaluation, and jurisdictions should consult with HUD.

- HUD encourages CDBG grantees to consult with HUD on any project that might involve eminent domain, which could occur under any of the following eligible activities:
 - Acquisition of real property;
 - Provision of CDBG assistance to for-profit entities to carry out an economic development project;
 - Provision of assistance to public or private nonprofit entities for activities including acquisition of real property; and acquisition, construction, or installation of commercial or industrial real property improvements;
 - Relocation payments and assistance; and
 - Assistance to community-based development organizations carrying out activities including community economic development projects.
- CDBG grantees should also check State law, which may also limit eminent domain.
- Where a project involves eminent domain and is determined to be subject to this funding prohibition, grantees may not use CDBG funds to pay for staff time expended on the project. This will require grantees to carefully allocate time in accordance with **OMB Circular A-87**.

Low- and Moderate-Income Benefit Expenditures

- As noted above, the primary objective of the CDBG program is the development of viable urban communities principally for LMI persons.
- To meet this objective, the CDBG regulations require that recipients expend not less than 70 percent of CDBG funds for activities which benefit LMI persons.
 - Activities meeting this requirement are those which qualify under one of the four LMI benefit national objective categories:
 - Area basis;
 - Limited clientele;
 - Housing activities; and
 - Job creation or retention.
 - Planning and administrative costs are excluded from the LMI benefit calculation.
 - The calculation is based on aggregate CDBG expenditures over a period specified by the recipient (up to 3 years) in its certification to HUD. The certification must be included in a recipient's annual ConPlan Action Plan submission.

- Due to the 70-percent LMI benefit standard, recipients must limit expenditures under the slum/blight and urgent needs national objectives in order to meet the LMI expenditure requirement.

Public Benefit Standards

- There is a vast array of possible public benefits resulting from CDBG-funded economic development activities that could be selected, but most would be difficult to measure objectively (§570.209). Examples include making an area more attractive or increasing private investment in an area.
- The provision of the 1992 Act that requires HUD to establish these guidelines has the effect of introducing a new requirement to the CDBG program. It means that the program would now have explicit, quantifiable standards for what constitutes reasonable public benefit for special economic development activities (24 CFR 570.203).
- With the public benefit standards:
 - HUD attempted to keep recipient documentation requirements to a minimum.
 - HUD selected jobs as a measure because that is what recipients are primarily trying to stimulate. In addition, other Federal agencies that fund economic development also use this test.
- Unlike the voluntary CDBG underwriting guidelines, the use of the standards for public benefit is mandatory.
- Public benefit standards apply to all activities that are eligible under special economic development activities at §570.203 and special activities by CBDOs at §507.204, but would otherwise be eligible under §570.203.
 - The public benefit test also applies to infrastructure projects carried out for ED purposes where less than 1 job is created per \$10,000 of CDBG.
- The public benefit standards have two levels:
 - Standards for individual activities: An activity is considered by HUD to provide insufficient public benefit and cannot be assisted with CDBG funds if:
 - The amount of CDBG is greater than \$50,000 per full-time-equivalent, permanent job (created or retained), or the CDBG cost of goods and services provided by the activity exceeds \$1,000 per LMI person.
 - The activity consists of or includes:
 - ~ General promotion of the community (as a whole);
 - ~ Assistance to professional sports teams;

- ~ Assistance to privately owned recreational facilities that serve a predominantly higher income clientele where the benefit to users clearly outweighs the benefit of jobs created or retained;
- ~ Acquisition of land for which a specific use has not been identified (i.e., land banking); or
- The for-profit business that is, or its owner is, the subject of unresolved findings of noncompliance related to previous CDBG assistance.
- Aggregate standards: Activities, in the aggregate, must either:
 - Create or retain at least one full-time-equivalent, permanent job per \$35,000 of CDBG funds used;
 - Provide goods and services to an area where the number of LMI persons served by the assisted business amounts to at least one LMI person per \$350 of CDBG funds used; or
 - Certain activities can be excluded from the aggregate standards (refer to 570.209(b)(2)(v) for a list).

Applying the Public Benefit Standards

- As discussed previously, when CDBG funds are used for special economic development projects and when used for public facilities and improvements undertaken for economic development purposes, recipients must ensure that a minimum level of public benefit is obtained. The HUD aggregate and individual activity standards must be used to make this determination.
- Applying the individual activity standards:
 - If an activity both creates/retains jobs and provides goods/services to residents of an area, the activity is ineligible ONLY IF it fails BOTH standards;
 - The standards are applied to the number of jobs or area residents at the time funds are obligated; and
 - If the activity is limited to job training/placement or employment services, the jobs assisted with CDBG are considered jobs created/retained for the purpose of applying the individual activity standards.
- Applying the aggregate standards:
 - Entitlement communities must apply the aggregate standards to all activities for which funds were first obligated during any given program year;
 - Recipients may elect to apply the standards to the creation/retention of jobs OR to the provision of goods and services, but cannot count an activity under both standards; and
 - If the activity is limited to job training/placement or other employment services, the jobs assisted with CDBG are considered as jobs created or retained when applying the aggregate standards.

- The following activities may be excluded from the aggregate standards:
 - Jobs provided exclusively for unemployed persons or participants of WIA, JOBS, or TANF programs;
 - Jobs provided predominantly for residents of public or Indian housing units;
 - Jobs provided predominantly for homeless persons;
 - Jobs provided predominantly for low-skilled, LMI persons and the business agrees to provide clear opportunities for promotion and economic advancement (e.g., provision of training);
 - Jobs provided predominantly for persons residing in a census tract with at least 20 percent of the residents in poverty;
 - Assistance provided to businesses that operate in a census tract with at least 20 percent of the residents in poverty;
 - Activities that stabilize or revitalize a neighborhood that has at least 70 percent LMI residents;
 - Assistance provided to a CDFI that serves a predominantly LMI area;
 - Assistance provided to a CBDO that serves a neighborhood that has at least 70 percent LMI residents;
 - Activities that provide services or create/retain jobs in an approved Neighborhood Revitalization Strategy Area; or
 - With prior HUD approval, activities that represent some other innovative approach with substantial benefits to LMI residents.

Administrative & Planning Costs Cap

- No more than 20 percent of each year's CDBG grant plus *estimated* program income may be obligated for planning and administrative costs. To comply with this requirement, recipients must limit obligations to 20 percent of the annual grant plus program income.
 - Planning and administrative costs subject to the cap do not include staff and overhead costs directly related to carrying out eligible activities since these costs are eligible as part of those activities.
- In the State CDBG program, total State and local government (UGLG) expenditures charged under planning, administration, and technical assistance (TA) may be no greater than 20 percent of the sum of the grant for the funding year, reallocated funds, and the program income received by State and UGLGs.
 - Within that overall administrative and planning cost cap, the State's administrative, planning, and TA costs cannot exceed: \$100,000 + 50 percent of its administrative, planning, and TA costs up to 3 percent of the grant plus program income plus reallocated costs.

Public Services Cap

- The CDBG regulations limit the amount of funding that can be used for public service activities. The limit is based on obligations for public services and cannot exceed:
 - **15 percent** of that program year's entitlement grant; **PLUS**
 - **15 percent** of the preceding year's program income.
- Refer to Chapter 5 (Job Training & Other Public Services) for detailed information on which public service activities must be included in the calculation and how to do the calculation.

Uniform Administrative Requirements

- The CDBG regulations require that grantees and subrecipients that are governmental entities or public agencies adhere to certain administrative requirements. These requirements include:
 - **OMB Circular A-87 "Cost Principles for State, Local and Indian Tribal Governments"**—This circular establishes principles and standards for determining allowable costs under Federal grants. (This can also be located at 2 CFR Part 225.)
 - **Specific provisions of 24 CFR Part 85 (see 570.502(a))**—These regulations set forth uniform requirements for financial management systems, reports and records, and grant close-outs for recipients of Federal grant funding.
 - **OMB Circular A-133 "Audits of Institutions of States, Local Governments and Nonprofit Institutions"**—States, local government, and nonprofit organizations are required to comply with OMB Circular A-133 (revised June 24, 1997).
- In addition, nonprofit subrecipients are required to comply with the following uniform administrative requirements:
 - **OMB Circular A-122 "Cost Principles for Nonprofit Organizations" or, for institutions of higher education, OMB Circular A-21 "Cost Principles for Educational Institutions"**—This circular establishes principles for determining allowable costs under grants, contracts, and other agreements with nonprofit organizations. (This can also be located at 2 CFR Part 230.)
 - **Specific provisions of 24 CFR Part 84 [see 570.502(b)]**—These regulations set forth uniform requirements for nonprofit organizations, including financial management systems, property standards, procurement standards, reporting, and recordkeeping. NOTE: 24 CFR Part 84 implements OMB Circular A-110.

Program Income

- Program income defined: Program income is the gross income received by the grantee and its subrecipients directly generated from the use of CDBG funds.
 - Program income includes:
 - Proceeds from the sale or lease of property purchased or improved with CDBG;

- Proceeds from the sale or lease of equipment purchased with CDBG funds;
 - Gross income from the use or rental of real or personal property acquired, constructed, or improved by the grantee (or its subrecipients) less costs incidental to the generation of income;
 - Payments of principal and interest on loans made using CDBG funds;
 - Proceeds from the sale of loans or obligations secured by loans made with CDBG funds;
 - Interest earned on funds in a Revolving Loan Fund (RLF) pending its disposition;
 - Interest earned on program income, except RLFs;
 - Funds collected through special assessments on properties not owned and occupied by LMI households in order to recover the CDBG portion of a public improvement; and
 - Grantee or subgrantee income from an ownership interest in a for-profit entity that was assisted with CDBG.
- Program income does not include:
 - Total income in a single program year, including that earned by the grantee and its subrecipients, that does not exceed \$25,000;
 - Income generated by certain Section 108 activities [refer to 570.500(a)(4)(ii)];
 - Amounts generated and kept by a nonprofit development organization.
 - Proceeds from subrecipient fundraising activities;
 - Funds collected through special assessments to recover non-CDBG outlays of capital improvements; and
 - Proceeds from the disposition of real property acquired or improved with CDBG funds if the disposition occurs 5 years after grant close-out.

Pre-Award Costs

- Under certain conditions, CDBG grantees and their subrecipients may incur costs prior to the effective date of their CDBG grant agreement with HUD.
 - The effective date of the grant agreement is the program year start date, or the date that the ConPlan is signed by HUD, whichever is later.
- CDBG regulations offer more flexibility to grantees in incurring pre-award costs. Grantees can incur any eligible cost provided it meets certain conditions:
 - The activity for which the costs are being incurred is included in a ConPlan Action Plan or an amended ConPlan Action Plan prior to the costs being incurred;
 - Citizens are advised of the extent to which these pre-award costs will affect future grants;
 - The costs and activities funded are in compliance with the CDBG regulations and the environmental review requirements;

- The activity for which payment is being made complies with the statutory and regulatory provisions in effect at the time the costs are paid for with CDBG funds;
 - CDBG payment will be made during a time no longer than the next two program years following the effective date of the grant agreement or amendment in which the activity is first included; and
 - The total amount of pre-award costs to be paid during any program year is no more than 25 percent of grant amount for that year or \$300,000, whichever is greater.
- Upon the written request of the grantee, the HUD field office may authorize payment of pre-award costs for activities that do not meet the above requirement for a two-year payback or where the total amount exceeds 25 percent of the grant amount. An exception to any of the other criteria requires a waiver that has to be approved by the Assistant Secretary for Community Planning and Development of the U. S. Department of Housing and Urban Development (HUD).
 - The factors HUD will consider in granting exceptions include:
 - Whether granting the authority would result in a significant contribution to the goals and purposes of the CDBG program;
 - Whether failure to grant the authority would result in undue hardship to the grantee or beneficiaries of the activity;
 - Whether granting the authority would not result in a violation of a statutory provision or any other regulatory provisions;
 - Whether circumstances are clearly beyond the grantee's control; and
 - Any other relevant considerations.
 - The HUD review begins at the field office level, but, if necessary, is referred to the Assistant Secretary's office.
 - An example of the flexibility that this provision offers to grantees: a grantee constructs a large public improvement using a mix of current year CDBG funding, proceeds from a local bond issuance, and a portion of its CDBG funding from the subsequent program year to pay off local indebtedness without requesting any pre-award cost waiver from HUD (provided the construction meets the applicable requirements).

Timeliness

- Timeliness refers to how quickly the grantee is expected to commit and expend CDBG funds. Since Federal program budgets are tight all across the government, and since there is a huge need for community development programs, it is vital that CDBG grantees make every effort to quickly use their funds.
- HUD may determine that an entitlement grantee is not carrying out its activities in a timely manner (see 570.902) if:

- The amount of CDBG program income the recipient has on hand 60 days prior to the end of its current program year, together with the amount of funds in its CDBG line of credit, exceeds 1.5 times the entitlement grant amount for its current program year; and
 - The grantee fails to demonstrate to HUD's satisfaction that the lack of timeliness has resulted from factors beyond the grantee's reasonable control.
- For State CDBG programs, timeliness is defined as:
 - A grantee's annual grant has been obligated and announced to UGLGs within 15 months of the grantee signing its grant agreement with HUD.
 - In addition, HUD encourages States to adopt a goal of obligating and announcing 95 percent of funds to UGLGs within 12 months of signing the grant agreement with HUD.

Other Federal Requirements

- In addition to the programmatic CDBG requirements noted in this chapter, CDBG projects may also be subject to other Federal requirements.
- These other Federal requirements include:
 - **Fair Housing and Equal Opportunity:** Discrimination on the basis of race, color, national origin, religion, or sex is prohibited.
 - **Handicapped accessibility:** Generally, federally assisted buildings and facilities must be accessible.
 - **Employment and contracting:** Recipients may not discriminate in employment and must make efforts to provide training and employment opportunities to low-income residents.
 - **Environmental review:** Recipients must undertake environmental reviews in accordance with 24 CFR Part 58.
 - **Flood insurance:** CDBG funds may not be provided in a Federal Emergency Management Agency (FEMA)-designated special flood area unless specific precautions are undertaken.
 - **Lead-based paint:** CDBG rehabilitation and construction activities must comply with 24 CFR Part 35 and Section 401(b) of the Lead-Based Paint Poisoning Prevention Act.
 - **Labor standards:** Construction activities may be required to comply with the Davis Bacon Act and the Contract Work Hours and Safety Standards Act.
 - **Debarred, suspended, and ineligible contractors and subrecipients:** CDBG funds cannot be provided to debarred, suspended, or ineligible contractors, subcontractors, or subrecipients.
 - **Conflict-of-interest:** CDBG recipients and subrecipients must comply with procurement requirements found at 24 CFR 85.36 (State and local governments) and 85.42 (nonprofits) and with any other applicable conflict-of-interest provisions.

- **Acquisition and relocation:** Acquisition, rehabilitation, and/or demolition activities may be covered by the Uniform Relocation Act and/or Section 104(d) of the Housing and Community Development Act.
- The above-noted descriptions are very brief and do not give all of the information that recipients need to know about other Federal requirements.
 - Additional information may be found in subpart K of the CDBG regulations.
 - Recipients should also contact their HUD field office for more information and/or available guidance on each of these other Federal requirements.

Attachments: CDBG Eligible Activities & Documentation for National Objectives

| CDBG Eligible Activities |
|---|
| <p>570.201 Basic Eligible Activities</p> <ul style="list-style-type: none">(a) Acquisition of Real Property(b) Disposition(c) Public Facilities and Improvements(d) Clearance(e) Public Services(f) Interim Assistance(g) Payment of Non Federal Share(h) Urban Renewal Completion(i) Relocation Costs(j) Loss of Rental Income(k) Housing Services(l) Privately Owned Utilities(m) Construction of Housing(n) Homeownership Assistance(o) Microenterprise Development(p) Technical Assistance(q) Institutions of Higher Education |
| <p>570.202 Rehabilitation and Preservation</p> <ul style="list-style-type: none">(a) Types of Eligible Buildings and Improvements<ul style="list-style-type: none">(1) Privately Owned Residential (include. Single family residential containing a business)(2) Low Income Public Housing(3) Public or Privately Owned Commercial Property (only exterior and code violation correction)(4) Non Profit Owned Non Residential Property (not eligible under basic activities)(5) Manufactured Housing (when constitutes part of permanent housing stock)(b) Types of Assistance (see regulations) |
| <p>570.203 Special Economic Development</p> <ul style="list-style-type: none">(a) Acquisition, Construction, Rehab of Commercial or Industrial Property (grantee or subrecipient)(b) Assistance to a For-Profit Business (grants, loans, TA, etc.)(c) Economic Development Services (in connection with above, e.g., underwriting applications, placement for employment opportunities) |

570.204 Special Activities by CBDOs

- (a) Eligible Activities
 - (1) Neighborhood Revitalization (impact decline of a geographic area)
 - (2) Community Economic Development (increase economic opportunity for LMI persons)
 - (3) Energy Conservation
- (b) Ineligible Activities
 - (1) Ineligible activities under 570.207
 - (2) Public services that do not meet requirements under 570.201(e) and would result in exceeding the spending limitation except services designed to increase economic opportunities and any services provided as part of Neighborhood Revitalization Strategy
 - (3) Activities that would otherwise be eligible under 570.203 but do not meet Public Benefit Requirements (570.209)
 - (4) Activities that would otherwise be eligible under 570.205 or 206 that would result in exceeding the spending limitation
- (c) Eligible Community Based Development Organizations (see regulations)

570.205 Planning and Capacity Building

- (a) Studies, analysis, data gathering, preparation of plans
- (b) Capacity Building

570.206 Administration

- (a) – (i) Staff and related costs associated with CDBG program admin. (not project related)

Documentation Required for each National Objective

| National Objective | Records to be Maintained |
|-----------------------------|--|
| Low/Mod – Area Benefit | <ul style="list-style-type: none"> • Boundaries of the area • Income data pertaining to residents (Census/Survey) • If less than 51% LMI, exception criteria |
| Low/Mod – Limited Clientele | <ul style="list-style-type: none"> • Documentation that facility/service designed for or used exclusively by one of the eligible “special needs” groups; or • Documentation of nature and location of the facility/service such that it can be presumed to service LMI; or • Data on household size and income of each person receiving the benefit |
| Low/Mod – Housing | <ul style="list-style-type: none"> • Copy of written agreement with landlord/developer with total # of units and total # to be occupied by LMI • Total cost of project (CDBG and non-CDBG) • Income and household size data for occupants/purchasers • Rent charged if applicable |
| Low/Mod – Job Creation | <ul style="list-style-type: none"> • If qualifying under “jobs available to LMI” <ul style="list-style-type: none"> - Copy of written agreement with required provisions - Listing of permanent job titles available to LMI and evidence of first consideration given to LMI • If qualifying under “jobs held by/taken by LMI” <ul style="list-style-type: none"> - Copy of written agreement with required provisions - Listing of permanent job titles filled that were initially taken by LMI - For each LMI person hired, household size and annual income prior to hiring or referral for qualifying program/agency - If “LMI Presumption” applies, (person living in 70% LMI CT or person or business in 20% poverty area, EC/EZ) - only need address of resident or business and qualifying demographic data for the area or CT |
| Low/Mod – Job Retention | <ul style="list-style-type: none"> • Evidence that without CDBG, jobs will be lost • Listing by job title of permanent jobs retained • For each job retained and held by LMI person, household size and income • Identification of jobs expected to turnover to LMI within 2 years • Turnover date, household size and income data for persons hired or records equivalent to jobs “available to” LMI |
| Slum/Blight- Area | <ul style="list-style-type: none"> • Boundaries of the area • Description of the conditions which qualified the area as blighted • For residential rehab – local definition for substandard • Pre-rehab inspection report and noted deficiencies • Details of CDBG funded rehab |

| | |
|---|---|
| Slum/Blight- Spot | <ul style="list-style-type: none"> • Description of the specific condition of blight or decay • Description of specific conditions detrimental to public health and safety (for rehab) • Details of CDBG- funded rehab if applicable |
| Slum/Blight- Urban Renewal | <ul style="list-style-type: none"> • Copy of urban renewal plan • Maps and supporting documentation |
| Meeting Urgent Community Development Need | <ul style="list-style-type: none"> • Nature and degree of seriousness of condition • Certification that CDBG activity is designed to address the need • Timing of the development of the serious condition • Evidence that other financial resources were not available |

3. Revitalization Strategy Areas

This chapter addresses the following questions:

- What is a Neighborhood Revitalization Strategy?
- What are the benefits of an approved Strategy?
- What are the required contents of a Strategy?
- How will HUD review and approve a Strategy?
- How can and how should communities measure progress in achieving Strategy goals?

Background and Benefits

- The HUD regulations published on January 5, 1995, authorize entitlement recipients to develop comprehensive approaches to address economic development needs in a designated neighborhood within their community. This approach is referred to as a Neighborhood Revitalization Strategy. In the State CDBG program, it is referred to as a Community Revitalization Strategy. (The term “revitalization strategy” will be used to refer generically to both.)
- Revitalization strategies are submitted as a part of a jurisdiction’s ConPlan (or as an amendment to the Consolidated Plan).
- Communities with approved revitalization strategies are offered enhanced flexibility in undertaking economic development activities with their CDBG funds.
- This flexibility is designed to promote innovative programs in revitalizing economically disadvantaged areas of the community.
- Areas of enhanced regulatory flexibility include:
 - Any job creation or retention effort undertaken pursuant to the approved Strategy and focusing on the selected neighborhood is deemed to meet the LMI area benefit national objective requirements.
 - Therefore, businesses that receive such assistance are not required to track the specific income of applicants they hire or interview. (The businesses do need to continue to account for the overall number of persons who get jobs.); and
 - This is a significant reduction of administrative burden to the business (and the recipient) that is intended to provide an incentive to businesses to participate in the community’s job creation/retention programs.
 - Recipients are permitted to track scattered-site housing units developed in accordance with the strategy as a single structure.

- Fifty-one percent of total number of units must be low/moderate income;
- This permits recipients greater leeway in applying the LMI housing national objective criteria;
- In turn, recipients get greater flexibility in using housing to assist in the revitalization of the neighborhood; and
- NOTE: This flexibility does not apply to activities undertaken under the Direct Homeownership eligibility category.
- Economic development activities carried out in the approved neighborhood under the Strategy are exempt from the aggregate public benefit standards.
 - This increased flexibility is at the recipient’s option—recipients may still elect to track and follow these criteria;
 - This affords much greater flexibility in selecting and implementing development activities and reduces the amount and scope of information that recipients must collect and document regarding its programs. This, in turn, frees up additional funds for development activities; and
 - Note, however, that projects are still subject to the individual/project public benefit standards.
- All public services offered within the subject neighborhood strategy area and carried out as part of qualified projects by a qualified CBDO are exempt from the public services cap.
 - This permits recipients to offer a more intensive level of services with the approved community, as needed to stimulate revitalization.
 - This flexibility includes job training and other employment-related services and, as such, it can provide an important foundation for economic opportunity for neighborhood residents.

Neighborhood Revitalization Strategy Areas

Preparing a Neighborhood Revitalization Strategy

- The written Strategy must be complete and include each of the key items discussed below.

Neighborhood and Demographic Criteria

- The submission must fully describe the geographic area to be covered by the Strategy. The areas covered must be contiguous—no checkerboard areas across the community.
 - The selected area must be primarily residential; and
 - The area must contain a high percentage of LMI households.
- The percentage of LMI residents within the neighborhood must be equal to:

- 70 percent of the total population in the selected area (if the recipient's upper quartile is greater than 70 percent LMI); or
 - The upper quartile percentage (if the recipient's upper quartile is greater than 51 percent, but less than 70 percent LMI in the total population); or
 - 51 percent of the total population (if the recipient's upper quartile percentage is less than 51 percent).
- Neighborhoods within federally designated EZs and Renewal Communities (RCs) are presumed to meet this test.

Community Consultation

- The written submission must outline the process used by the community to develop the Strategy. The Strategy must be developed in consultation with members of the community, including:
 - Residents of the area;
 - Owners/operators of businesses in the area;
 - Local financial institutions;
 - Nonprofit organizations; and
 - Community groups.
- When describing the consultation process, it is important to highlight the methods used by the community to provide outreach to the types of groups noted above. In addition, it is important for the community to describe how the needs and concerns of the consulted parties—particularly residents of the selected neighborhood—were incorporated into the Strategy.

Assessment

- In this section of the Strategy, the recipient must assess the area selected.
- First, the Strategy must assess the economic conditions of the proposed neighborhood. This analysis might include a discussion of such topics as:
 - Levels of unemployment;
 - Numbers of businesses located within the area, including numbers of service facilities such as grocery stores, drug stores, gas stations, etc., and the number of people employed by such businesses;
 - Access to capital (or lack thereof) in order to form businesses in the area;
 - Housing needs of residents in the area including rents, home prices, and housing quality; and
 - Current availability of economic development resources or other community services within the area.

- Next, the Strategy must describe the opportunities for economic development improvement within the neighborhood. This analysis might include a discussion of such topics as:
 - Unmet demand for specific types of facilities or services (such as the need to create/foster a lending institution within the neighborhood);
 - Community organizations that are ready and available to assist with economic development efforts;
 - Skills or services that are currently unused or underutilized within the community; and
 - Fledgling projects started within the neighborhood but unable to take root due to lack of funding.

- Finally, the Strategy must describe the problems that the community is likely to face as it implements programs in this neighborhood. This discussion might cover such common problems as:
 - Hesitation from private sources (such as area banks) to invest in the area;
 - Community opposition to certain types of development activities (NIMBY sentiments);
 - Inexperience of local community groups or organizations; and
 - Crime and/or security concerns at project sites.

Economic Empowerment

- The Strategy must discuss the activities that will be undertaken to create meaningful jobs for unemployed LMI residents of the area. This discussion should be realistic and indicate exactly how the recipient plans to accomplish this objective.

- The Strategy must also highlight how the plan will promote revitalization of the neighborhood. In other words, what the Strategy is really going to do to help turn the neighborhood around and promote economic opportunity for residents.

Performance Measures

- Finally, the Neighborhood Revitalization Strategy must set goals and anticipated results for the implementation of the plan. These results must be described in clearly measurable terms. These performance standards are referred to as benchmarks. Recipients are expected to report on their progress toward these benchmarks.

- Benchmarks may cover such areas as physical improvements, social initiatives, and economic empowerment.
 - Examples of some benchmarks might include:
 - Twenty new businesses created;
 - Five percent increase in employment;
 - Two new job training centers opened;
 - Five percent reduction in families on welfare;

- Community lending institution attracted to the neighborhood;
- Community business association formed; and
- Ten training seminars offered to area residents about small business startup.

Funding the Strategy Area

- Recipients do not need to commit specific future funds for use in the Neighborhood Revitalization Strategy Area at the time that the Strategy is submitted.
 - For example, the recipient is not required to commit a portion of its fiscal year (FY) 2011 CDBG funds to the revitalization initiatives in the Strategy submitted in 2010.
- After approval of the Strategy, the recipient's subsequent Action Plans must describe the HUD formula program resources that will be directed toward the Strategy area.
 - Also, each year after the initial Strategy submission, the recipient must identify in its Action Plan for that year the benchmarks it expects to achieve during the year for the Strategy area.

HUD Review, Approval, and Monitoring of the NRSA

- As noted above, the completed Strategy is submitted with the ConPlan to HUD for review and approval.
 - The ConPlan already includes detailed information about the community and its residents. If this ConPlan information is also used to describe the Neighborhood Revitalization Strategy, it need not be duplicated. The recipient may simply reference other parts of the ConPlan or other documents that HUD already has in its possession.
 - If the recipient has already submitted its ConPlan for a given year, the Neighborhood Revitalization Strategy may be undertaken as an amendment to the plan.
- Once approved, the Strategy remains in effect for the term designated by the recipient in the Strategy. If the recipient wishes to extend the Strategy beyond the original timeframe, it must explain this in its subsequent ConPlan submission.
- As applicable, HUD will approve the Neighborhood Revitalization Strategy at the same time it approves the Consolidated Plan. NOTE: HUD will not withhold its approval of the ConPlan if all else is acceptable and the Strategy piece is not in order.
- CAREFUL! HUD must expressly state its approval of the Strategy. It cannot be assumed that approval of the ConPlan is also an approval of the Strategy.
- Strategies for HUD-designated EZs and RCs located within an entitlement community will be approved by HUD without further review. However, the EZ/RC recipient must submit a Neighborhood Revitalization Strategy request to HUD in order to get this approval.
- HUD's review of neighborhood revitalization strategies will emphasize:

- The recipient's capacity to undertake this effort;
- The likelihood that the plan will achieve its revitalization goals; and
- The extent to which the Strategy effectively coordinates public and private resources.
- HUD will only approve strategies that seek to achieve measurable results.
 - Meaningful economic opportunities must be created;
 - Opportunities must be created within the timeframe of the ConPlan (generally a 5-year period); and
 - The Strategy is not required to fully revitalize the selected neighborhood during the ConPlan period but must be able to demonstrate significant, measurable results.
- Recipients must report, and HUD will monitor, the progress against the established benchmarks each year.
 - The new Integrated Disbursement and Information System (IDIS) and the Consolidated Annual Performance and Evaluation Report (CAPER) will provide a mechanism for tracking and reporting this data.
 - Reports submitted periodically by EZ/RC communities will cover this requirement.
 - If performance is lacking, HUD may suspend or withdraw the Strategy approval.
 - CDBG program flexibilities would then be withdrawn until and unless the recipient can submit an acceptable revised Strategy.
- Recipients should consult with their CPD field office representative often when developing the Strategy. The CPD staff can provide insight about the types of information to be submitted. In addition, HUD can provide technical assistance on how to analyze appropriate data.

Amending the Strategy

- Recipients may amend their strategies. These amendments would follow the ConPlan amendment process found in §91.505.
- An amendment may occur when:
 - Conditions that existed at the time of the original submission have changed substantially, OR
 - When the recipient has determined that the originally approved Strategy has not been effective and a different approach is needed.
- A Strategy may also be amended if HUD suspends or withdraws its approval because benchmarks have not been achieved.
- Note: Recipients will be submitting a new five-year ConPlan soon. At the time of the new plan, recipients with Neighborhood Revitalization Strategies can either:

- Submit the prior strategy with a statement that there is no change in the strategy; OR
- Submit an amended Strategy.

Community Revitalization Strategy Areas

Preparing a Community Revitalization Strategy

- Similar to NRSAs, States may designate Community Revitalization Strategy Areas.
- In its Consolidated Plan, the State must describe its implementation approach and process for reviewing local Community Revitalization Strategy (CRS) plans prepared by Units of General Local Government (UGLG.)

Boundaries

- The UGLG CRS submission must identify the boundaries of the CRS area. While the UGLG does not need to focus on a particular “neighborhood,” it does need to focus on an area with enough mass and population density that it will be effective.
- The UGLG CRS submission must fully describe the geographic area to be covered by the CRS.
 - The selected area must be primarily residential; and
 - The area must contain a high percentage of LMI households.
- The percentage of LMI residents within the neighborhood must be equal to:
 - 70 percent of the total population in the selected area;
- Neighborhoods within federally designated EZs and RCs are assumed to meet this test; or
 - All of the census tracts/block groups in the area have at least a 20 percent poverty rate and at least 90 percent have a 25 percent poverty rate.
- HUD does not require that UGLGs commit specific future funds for use in the CRSA at the time that the CRS is submitted to the State but a State may wish to require this.

HUD Review, Approval, & Monitoring of the CRS

- The State's CRS process request is submitted with the ConPlan to HUD for review and approval or is submitted as an amendment to an existing plan.
- If the State has already submitted its ConPlan for a given year, the CRS request may be undertaken as an amendment to the plan.
- HUD will approve the State's CRS process at the same time it approves the Consolidated Plan. NOTE: HUD will not withhold its approval of the ConPlan if all else is acceptable and the CRS piece is not in order.

- CAREFUL: HUD must expressly state in writing its approval of the CRS process. It cannot be assumed that approval of the ConPlan is also an approval of the CRS.
- Once approved, the CRS process remains in effect for the term designated by the State in the Consolidated Plan. If the State wishes to extend the CRS beyond the original timeframe, it must advise HUD in its subsequent Con Plan submission.

Local Target Areas (Other than CRSAs)

- Many CDBG States or UGLG decide to take a locally targeted approach to the investment of their CDBG funds to focus on neighborhood revitalization and set up specific target areas in their community.
- States may offer special incentives or additional funding may be provided by the State in target communities.
- These target areas do not have specific criteria like CRSAs. These areas do not need to be specifically approved by their HUD Field Office; however, these areas are typically included as part of the State's ConPlan and Annual Action Plan.
- The Integrated Disbursement and Information System (IDIS) provides a way for local target areas to be setup and identified within the system (e.g., Riverfront Homeownership Area). There are two ways to set up a local target area in IDIS:
 - Utilities Menu: With appropriate access to this section of the IDIS Main Menu, the user can set up a local target area through the State Table Maintenance Menu;
 - CDBG-06 Screen: This screen first identifies if the activity will be located in a local target area. Under the field, indicate if this activity will be located in a Strategy, CDFI or Local Target Area, indicate an "L" for a local target area. If the area is already identified in IDIS, this screen allows the user to input the information about the local target area. However, if the area is not identified in IDIS, this screen will prompt a help screen, CDBG-H12, for the user to provide information on the local target area such as name and the type of revitalization effort (e.g., comprehensive, commercial, housing, other).
 - IDIS also provides a mechanism for tracking and reporting data within a local target area. (NOTE: IDIS report PR84 provides a list of performance measurement data collected within local target areas.)

4. Small Business Development

This chapter addresses the following questions:

- Why is small business development an important component of a community's overall economic development strategy?
- What can recipients do to foster small business development in their communities?
- What are microenterprises and what types of programs are eligible under CDBG?
- How can incubators foster small businesses and microenterprises?

Overview

- Community development practitioners have grown increasingly attuned to the importance of small businesses within the national, regional, and local economies. Small businesses often provide critical sources of:
 - New or improved job opportunities;
 - New or expanded goods and services;
 - Increased personal income; and
 - New tax revenue to a local economy.
- In addition, self-employment and small business ownership can offer an important path to economic self-sufficiency for low- and moderate-income and other disadvantaged entrepreneurs.
 - According to the Small Business Administration's (SBA) Office of Advocacy, small businesses make two crucial economic contributions: (1) they help foster experimentation and technological change, thereby increasing productivity; and (2) they help women, minorities, and immigrants to "enter the economic and social mainstream."⁴
- SBA/Census Bureau data indicate that firms of less than 500 employees account for most of net new employment, with about half of the gain concentrated in firms of fewer than five employees.⁵
 - Among the fastest-growing small business-dominated industries are restaurants, outpatient care, offices of physicians, special trade construction contractors, computer and

⁴ *The Facts About Small Business*, 1997, Office of Economic Research within the Office of Advocacy, Small Business Administration, September 1997.

⁵ *Ibid.*

data processing services, credit reporting and collection firms, medical and dental laboratories, providers of daycare, and counseling and rehabilitation services.⁶

- For entrepreneurs, small business ownership entails a very high degree of risk. Small businesses often fail due to a lack of good business planning and research, inadequate capitalization, or management inexperience.
- Startup or very small businesses (“microenterprises”), many of which are one and the same, face particularly daunting challenges. Market research and business planning are especially critical in enhancing their survival prospects.
- For public agencies, small business development is also risky. It is often a very labor-intensive activity, with the resulting need for a high level of administrative capacity. If financing small businesses, government entities face the potential loss of public funds.
- However, with clear development goals and well-designed programs, CDBG recipients can successfully mitigate these risks and spur the expansion of existing businesses, as well as the creation of new businesses.
- The remainder of this chapter describes how grantees can establish small and microbusiness programs. In addition it highlights how incubators can be created.

Small Business Development

- A “small business” is usually defined by the number of employees or overall sales level.
 - The CDBG regulations make reference to Section 3(a) of the Small Business Act of 1958, which establishes specific employment or sales standards for each industry.
 - For most business categories, businesses with 500 or fewer employees are considered small, although in some industry categories business can have up to 1,500 employees and still be considered a small business.
 - For purposes of the CDBG program, small businesses have more than 5 employees, as a business with fewer than 5 employees, including the owner, is designated as a “microenterprise.”
- Small businesses are not all created equal; they run the continuum from struggling startups to successful, on-going enterprises with millions of dollars in sales. It is critical to define and analyze the specific development needs of the segment(s) that will be served.

Eligible CDBG Activities for Small Business Development

- A CDBG recipient (or its subrecipient) can support small business development with a wide array of direct and indirect tools, including:
 - Infrastructure development;
 - Public services;

⁶ Ibid.

- Planning;
 - Technical assistance (TA) and training;
 - Financing programs and mechanisms that provide access to much-needed capital; and
 - Incubators or shared physical facilities that can enhance small business survival rates.
- The last three services, which are more direct forms of assistance, are described in this chapter, with a focus on how they may be funded through the CDBG program.
 - Training/TA, financing, and incubator development are all eligible activities under 570.203 Special Economic Development.

Special Economic Development Activities

- CDBG funds may be used to undertake small business assistance as special economic development activities (§570.203). These activities include:
 - Acquiring; constructing; reconstructing; rehabilitating or installing 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.
 - Assisting a private, for-profit business (e.g., loans, grants, interest subsidies, and technical assistance).
 - Providing economic development services in connection with other eligible CDBG special economic development activities. This includes, but is not limited to, outreach efforts to market available forms of assistance; screening of applicants; reviewing and underwriting applications for assistance; preparation of necessary agreements; management of assisted activities; and the screening, referral, and placement of applicants for employment opportunities generated by CDBG-eligible economic development activities. This may include the costs of providing job training for persons filling those positions.
- A CDBG recipient may provide eligible economic development assistance directly, or it may offer the assistance through public and private organizations, agencies, and other subrecipients.
- CDBG assistance to a for-profit business under 570.203 Special Economic Development triggers the requirements for the optional underwriting guidelines and mandatory Public Benefit standards.

Training and Technical Assistance

- Training and technical assistance are among the most frequently cited needs by small business owners, bankers, and ED practitioners. This assistance can range from general help with business planning to specialized assistance in creating an Internet site for online sales.
- Whatever its nature, good training and TA can enable entrepreneurs to recognize and address the inherent operating and financial risks of owning and managing a business.

- The scope and intensity of the assistance will depend heavily upon the owner's level of business experience and specific situation. For example, startup businesses may require assistance with business planning and accounting systems, while existing firms might need help with quality improvement or facility design. Training and TA programs must be tailored to specific needs and should utilize professionals with solid industry experience and an ability to assess the critical problems within any business.
- Training and TA efforts aimed at helping startup businesses often focus on development of a coherent business plan. While each plan is unique, the following items are typical components:
 - Vision of company and its capacity;
 - Description of product or service;
 - Market for the product or service, including competitors;
 - Marketing strategy, including image, packaging, pricing, and distribution methods;
 - Management experience and commitment;
 - Necessary staffing and skills; and
 - Financial history and projections.
- In contrast to startup businesses, existing small businesses often have problems managing cash flow, since they must use available funds for equipment, inventory, and debt service.
- Furthermore, training/TA usually works hand-in-hand with financial assistance because:
 - There is a strong incentive for a small business owner to use technical assistance productively if access to financing is made contingent upon receiving up-front and/or continuing training and TA;
 - Timely TA can help prevent a business loan from going into default.
- Among the most common sources of training/TA are local nonprofit agencies and community development corporations, private-sector professionals willing to discount/donate their services, and the service programs of the U.S. Small Business Administration (www.sba.gov). Many recipients work closely with such entities to ensure the delivery of quality training and technical assistance.
- Under the CDBG program, training/TA to small (not micro) businesses is usually qualified under:
 - 570.203 Special Economic Development activities. , by combining it with a financial assistance package. In this case, it is possible to aggregate all the jobs created/retained by all of the businesses that receive loans/TA during each program year;
 - 570.201(e) Public Services, where the LMI limited clientele national objective may be used if at least 51 percent of the training participants are LMI. Note, however, that these costs would count within the public service cap; and

- 570.204, assistance provided by a community-based development organization as a part of one of the three types of eligible CBDO activities.

Small Business Financing

- As a lender, a CDBG grantee effectively becomes a financial partner with the assisted business; if the project fails, there may be a loss of public funds and credibility. Lending therefore necessitates a strong and continuous flow of information between borrower and lender.
- Recipients can mitigate these risks through prudent screening, underwriting, structuring, and monitoring of business loans. In addition, the new flexibility of the CDBG regulations concerning economic development means that more recipients are funding small business loans.
- Providing CDBG financing to a for-profit business qualifies under Special Economic Development. This assistance, however, triggers the use of optional underwriting guidelines and mandatory Public Benefit tests.
- Financial assistance to small businesses (non-microenterprises) can meet the LMI National Objective under the following two criteria:
 - As an Area Benefit activity if the business provides a service that is available to all residents of a primarily residential service area; or
 - As an LMI Job Creation/Retention activity.
- Financial assistance to businesses rarely qualifies under the Slum and Blight or Urgent Need National Objectives.

Microenterprise Development

- CDBG recipients have flexibility in serving a special subset of the small business community (§570.201(o)).
- Microenterprises are the smallest, least visible portion of the business world, but are one of the major job generators in our economy. However, they range in type and capacity. They include a range of service providers and retail businesses. Some examples are the home-based daycare provider, the roving automobile mechanic, or the hairdresser who serves the neighborhood. Some microenterprise businesses are operated part-time, by owners who use the extra income to supplement wage and salary employment.
- With careful planning, microenterprise development can be an effective self-sufficiency and empowerment strategy for a variety of special populations, including:
 - Displaced workers;
 - Women and minority entrepreneurs; and
 - Former public assistance recipients.

Definition of Microenterprise

- The CDBG regulations provide the following definitions:
 - A “microenterprise” is a commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise.
 - “Persons developing microenterprises” means persons who have expressed interests in and who are, or after an initial screening process are expected to be, actively working toward developing businesses, each of which is expected to be a microenterprise at the time it is formed. §570.201(0)(3)

Eligible Activities for Microenterprises

- Eligible microenterprise activities under the CDBG program include providing:
 - Credit, including, but not limited to, grants, loans, loan guarantees, Individual Development Accounts (IDAs), and other forms of financial support for the establishment, stabilization, and expansion of microenterprises;
 - Technical assistance, advice, and business services to owners of microenterprises and persons developing microenterprises;
 - General support to owners of microenterprises and persons developing microenterprises. General support may include such activities as peer support programs, counseling, childcare, or transportation; and
 - Training, technical assistance, or other support services to increase the capacity of recipients or subrecipients to carryout microenterprise activities.
- The CDBG program does not cap the amount of assistance that may be provided to a microenterprise.
 - However, many recipients limit the level of microenterprise financial assistance in order to target small startups, minimize the recipient’s financial exposure, and help the assisted business to maintain a reasonable debt level.
- Given their size and level of development, loans to microenterprises are usually quite small, ranging from \$500 to \$20,000. The small size of the loans, combined with the cost of large amounts of technical assistance, means that such programs usually require ongoing public subsidy.
 - Some recipients provide microenterprise assistance as a grant, while others choose to focus on loans.
 - Depending upon the program type selected by the recipient, underwriting criteria must be established. See the chapter on underwriting for more information.
- Microenterprise activities are not subject to the Public Benefit tests if they are maintained as a separate program, apart from assistance to “larger” small businesses.

- The CDBG regulations specifically state that a small business lending program open to both microenterprises and non-microenterprises cannot exempt a microenterprise applicant from the Public Benefit tests. For this reason, a microenterprise loan fund should be kept separate from any small business loan fund.
- Many recipients require that the microenterprise borrower obtain technical assistance on issues such as budgeting, marketing, or business planning in conjunction with the microloan in order to help alleviate risk and assure success.
 - Training and technical assistance are critical for microenterprises, many of which are startup concerns requiring intensive business planning, basic accounting, and market research assistance.
 - This makes microenterprise development a very labor intensive and expensive strategy.

Documenting National Objective for Microenterprise Activities

- There is substantial flexibility in how CDBG-funded microenterprise activities can meet a National Objective. The most typical approaches are:
 - Microenterprise assistance can qualify under the limited clientele criteria for LMI benefit, if the business owner is LMI. This eliminates the need to track job creation or retention. In certifying LMI status, the recipient need look only at the owner's income, not that of any employees. Furthermore, there is a 3-year presumption of LMI status to allow for continued assistance. (Note, however, that in order to qualify as an eligible microenterprise activity, the business must still meet the definition of "microenterprise" each time new financing is provided.)
 - If the owner is not LMI, the recipient can still provide microenterprise assistance by meeting the LMI job creation/retention criteria.

Program Design for Microenterprise & Small Business

- There are several key steps in setting up a microenterprise or small business development program. These include:
 - Defining the goals of the program;
 - Identifying and researching the target market;
 - Determining technical and/or credit needs;
 - Finding partners, such as a small business development center;
 - Establishing a lending program;
 - Developing support services and technical assistance;
 - Designing training programs and methods;
 - Constructing a sources and uses of funds statement;

- Securing funds and services;
 - Implementing the program; and
 - Monitoring and evaluating program results.
- The remainder of this section will describe these steps. See Chapter 7 also for a discussion on establishing a revolving loan fund as a means for assisting economic development strategies.
 - Define program goals.
 - What do you want to achieve by setting up a micro or small business program? How will you integrate your small business development efforts with larger community concerns? Are you trying to create jobs, service businesses, or generate more income in a specific area?

Remember: There is no one program that can possibly address the needs of the area as a whole. Select the type of program model or models that will achieve your goals and long-term strategy.

- Identify and research the target market.
 - What is the geographic area you want to serve?
 - What kinds of industries/businesses are needed to improve the community?
 - What model do you want to adopt (location, population, industry, or maybe a combination of these models)?
 - Location: When availability and access to jobs is a barrier for LMI people, targeted lending to businesses located in and around LMI areas may be an effective mechanism for new job creation.
 - Population: Targeted lending to increase job opportunity and wealth among minority or other disadvantaged residents of the community.
 - Industry: A sectoral approach can be used when a particular industry (retail, commercial, or industrial) would spur economic growth in the community and create job opportunities.
 - Many times objectives will require integrating two or more of these target markets. The grantee must carefully incorporate all these models into one program to address similar objectives.
- Determine technical and credit needs in the target market.
 - This may be done through a variety of methods, such as interviews with conventional lenders, focus groups with microbusiness hopefuls, and community leaders.
 - This research will set the stage for the type of program a grantee will provide to its target market.
 - Some questions to ask when assessing the credit needs and gaps in the community.
 - What sources of commercial debt and equity are available in the community?

- Are banks and other lenders serving all or any markets in the area?
- What are the most common reasons why certain segments have difficulty accessing credit?
- What types of credit services are most needed by the target market?
- What type of lending mechanisms (capital access or incentive programs) would best serve the target market?
- What organizations can train and support businesses in underserved market segments?
- Establish a lending program.
 - Decide on the appropriate lending mechanism (direct loans, co-lending, third-party guarantees, etc.) by measuring anticipated loan demand against potential sources of loan capital.
 - Identify the underwriting criteria.
 - What types of borrower will be eligible?
 - What uses of funds will be eligible?
 - How will ability to repay be analyzed (cash flow ratios)?
 - What kind of collateral will be required?
 - How will credit history be assessed?
 - Be sensitive to the circumstances of your clients. Since small businesses may not be able to meet traditional lending criteria, the public lender may want to consider some other factors on a case-by-case basis:
 - Does the business plan outline the financial and planning objectives and activities of the potential owner, and give an indication of the fiscal soundness of the business?
 - What is the commitment of the owner to his/her business venture and repayment of the loan (borrower personally signs for the loan)?
 - What are the skills of the entrepreneur? Is he/she flexible enough to make quick adjustments in order to address ever changing circumstances?
 - Develop/adopt administrative procedures for administering the loans (or select an administering entity).
 - Identify the loan processing fees, interest rates, and required level of equity to be injected with each loan.
- Design training and technical assistance components (classes, workshops, lectures, and/or group meetings) to help entrepreneurs establish the basic skills needed to start and run a business.

- Some topics that may be considered are: self-esteem building; skill development; and training in accounting, budgeting, financial management, marketing, sales, planning, technology, etc.
- Teach applicants how to write a business plan and present a loan application.
- Small business development centers (SBDCs), community colleges, and others may already offer supporting services such as business planning, so do not duplicate available services.
- Construct a sources/uses statement.
 - It is critical to know whether the business program will have access to sufficient lending and operating funds when it “hits the street.” What funding sources will be approached to support each program component?
- Secure funds and services.
 - Establish relationships with all partners to ensure as smooth a transition to implementation as possible.
- Implementation.
 - Market the program and accept applications for assistance.
- Monitoring/ evaluation.
 - It is important to continuously evaluate the program, as implemented, to determine if it is meeting its target constituencies’ needs. Seek regular input from customers, partners, and the public, and make adjustments as necessary.

Microloan Program: Harris County, Texas

- *Harris County and its Corporation for Economic Development have been working together to provide microloans by leveraging Section 108 Loan Guarantee funds in order to create jobs and other opportunities for business growth throughout the county.*
- *The Microloan Program in Harris County was begun 7 years ago using CDBG funds. Since then, the program has grown to over a \$2 million loan program incorporating both public and private investments.*
- *One important aspect that the county contributes to the success of the program is the technical assistance component. The program is three-tier combining classroom training, credit, and future growth opportunities giving the program the logo of "From Classes to Capital."*
- *To be a recipient of one of the county's microloans, the potential customer must first attend and complete a technical assistance and training program. The program focuses on financial management and planning, writing a business plan, how to market your business and developing computer skills. After they have successfully completed the training, the recipient is guaranteed credit.*
- *Through the use of Section 108 Loan funds in addition to CDBG funds, the county has created almost 900 jobs, of which more than half have been filled by LMI persons. The county has also been successful in bringing additional dollars into the services area and creating new partnerships. It has also set aside \$10,000 to fund a Youth Entrepreneurs Program to encourage area youth to participate in job creation and income generation.*

Implementing Microenterprise Programs

- A large number of microenterprise funding programs are managed for recipients by subrecipients.
 - These subrecipients can be for-profit companies (such as lenders) or nonprofit organizations. This exception for for-profits as subrecipients is unique in the CDBG program.
 - A recipient must determine up front the roles that it will play versus the role the subrecipient will play in managing this program.
- Regardless of who manages the program, the recipient must be aware of limits on how the microbusiness loans may be made under CDBG.
 - Current Treasury Department regulations prohibit any lump sum drawdown of Federal funds (except for rehabilitation of properties as allowed by HUD statute).
 - Thus, the actual funds may not be disbursed until the microenterprise lender has borrowers ready to receive and spend the funds.
 - Local governments, however, can create a "line of credit" for the subrecipient intermediary by assigning a specified amount of CDBG funds for the intermediary to draw against when it is ready to make a loan.

- There are many ways to reduce the risk and cost of a microenterprise program, including:
 - Early and effective screening of participants to ascertain commitment and feasibility of the business or concept;
 - Emphasis on careful business planning to identify risks and develop contingency strategies;
 - Group-training formats, with donated services from local business professionals, in order to reduce training and technical assistance delivery costs per entrepreneur;
 - Equity investments or favorable payment plans to allow businesses to stabilize;
 - “Stepped” lending, in which the amount of available financing gradually increases as the entrepreneur establishes a business and credit track record;
 - Peer groups, (i.e., self-selecting groups of 5 to 10 entrepreneurs) who meet regularly to discuss business plans, review loan applications, and monitor loan delinquencies;
 - Partnerships with local banks to provide low-cost loan capital and/or to collect loan payments at no or minimal cost; and
 - Partnering with existing community-based agencies to enable participants to access affordable childcare, transportation, and education services.

- Because two out of three startups fail, you must expect losses. However, don't become so conservative that few applicants will qualify.

Business Incubators

- Incubators are shared facilities that offer small businesses the opportunity to collectively share space and general expenses, including:
 - Office space;
 - Research or manufacturing space;
 - Basic business support such as telephone and clerical services; and
 - Common office equipment, including copy and fax machines.

- Incubators offer access to business and technical assistance provided through in-house expertise and/or a network of community resources, including:
 - Mentoring and networking opportunities;
 - Group marketing and promotion; and
 - Group purchasing discounts.

- These types of assistance are often critical to new or small businesses. Thus, the development of incubators can be a common element of the grantees' small business and/or microbusiness programs.

- Cluster-based incubators, focusing on a particular industry, are a popular strategy, providing value-added services including:
 - Alliances among cluster companies;
 - Physical identity (for emerging clusters);
 - Enhanced ability to learn from each other; and
 - Connections to large established companies.
- Examples of potential cluster-based incubators are:
 - Software/multimedia;
 - Food processing;
 - Aquaculture/fisheries;
 - Health care technologies;
 - Environmental businesses;
 - Wood products; and
 - Advanced technology centers.
- The National Business Incubator Association (NBIA) is a source of information and technical assistance. Potential incubator developers and CDBG grantees should refer to its website at www.nbia.org.

Eligible CDBG Activities for Incubators

- Recipients may use CDBG funds to:
 - Fund the development/construction of the incubator; and/or
 - Provide assistance to the businesses locating within the incubator.
- If the recipient funds the development of the incubator, this is typically paid for under Special Economic Development (570.203).
 - The regulations at Section 203 are broad, permitting the recipient to undertake a wide range of construction, rehabilitation, or property improvement activities.
 - Remember! The public benefit tests requirements apply to these activities.
- If the recipient assists the businesses located within the incubator, it may be undertaken as a microenterprise assistance activity [570.201(o)] if so qualified.
 - This assistance is not subject to the Public Benefit tests.
 - Note: entities receiving this assistance must meet HUD's definition of a microenterprise.

- See the previous section of this chapter for more information on providing financial assistance to microenterprises.
- Recipients may provide assistance to private businesses that do not qualify under the microenterprise definition under Special Economic Development.
- Again, these special economic development activities are subject to the public benefit tests.

Evaluation Criteria for Business Incubators

- Proposals for the seed funding of business incubators typically must meet the following basic thresholds:
 - Evidence of demand for incubator services;
 - Qualified management;
 - Broad-based support from community-based organizations and businesses;
 - Cluster concentration;
 - Ability to leverage resources;
 - A plan for self-sufficiency;
 - Solid growth potential;
 - An "economic base" sector that serves markets outside the region;
 - A feasibility study and business plan; and
 - Evidence of adequate support, since incubators often provide more services than the rents support.

Preparing a Feasibility Study for a Small Business Incubator

- At a minimum, a feasibility study for a small business incubator must address the following:
 - Evaluation of demand and the ability to market and recruit business tenants;
 - Cost of real estate;
 - Available subsidies;
 - Zoning requirements;
 - Parking;
 - Accessibility;
 - Space available for future expansion;
 - Utilities;
 - Level of community support; and
 - Operating revenues and expenditures (rough projections).

The Incubator Development Process

- Assuming that the basic threshold criteria are met and the feasibility study yields a “go,” the process of developing the incubator can commence.
- This process will necessitate that the following steps be taken:
 - Locate a site for construction of new building or rehabilitation of existing building.
 - Assemble a development team that includes:
 - Project sponsor;
 - Architect;
 - Attorney;
 - Engineer;
 - Contractor;
 - Financial consultant; and
 - Marketing consultant.
 - Prepare financials, including pro formas, for the development phase and subsequent operational phase.
 - Prepare marketing plan.
 - Prepare management plan and ensure the availability of qualified staff.
 - Identify project financing sources for both construction and permanent debt.
 - Engage in design phase and environmental review.
 - Address general developmental issues (e.g., zoning, utilities, curb cuts, etc.).
 - Finalize construction contract with general contractor.
 - Commence marketing phase and obtain preconstruction lease commitments, whenever feasible.

Documenting National Objective for Incubator Activities

- CDBG-funded development of incubators is usually documented under the LMI job creation/retention national objective, or the LMI limited clientele national objective if it is a qualifying microenterprise.
- This test usually requires that each business guarantee that 51 percent of employees are LMI persons.
 - In the CDBG program, an exception exists whereby jobs can be aggregated with job creation/retention activity when CDBG funds are used to acquire, develop, or improve real property (e.g., business incubator or an industrial park).

- The national objective requirement may be met by measuring jobs in the *aggregate* for all the businesses that locate on the property, provided such businesses are not otherwise assisted by CDBG funds.
- It is possible that the development of an incubator would fall under the Area Slum and Blight National Objective, although the recipient would need to demonstrate how the incubator helped address conditions that contributed to the decline of the area.
- Assistance to businesses located in the incubator would fall under either the LMI Job Creation/Retention National Objective or the LMI Limited Clientele National Objective depending upon the characteristics of the business.

Incubator Case Study: Project THRIVE – West Philadelphia Enterprise Community (WPEC), Philadelphia, Pennsylvania

Project THRIVE is a program of resources and services designed to help increase business opportunities in the West Philadelphia Area. The project consists of an actual facility housing numerous offices open to startup businesses. The goal is help startup businesses by giving them the resources needed to be successful with the eventual belief that they will expand into traditional office space creating more development and employment in the area. Project THRIVE follows some guidelines to ensure the success of the program, as well as the businesses it supports. These guidelines are listed below.

There is a 10-week business preparation training course to give participants an overview of the challenges they may face while beginning their business. It also teaches them the fundamentals of business and business plan development.

Incubator Case Study: Project THRIVE – West Philadelphia Enterprise Community (WPEC), Philadelphia, Pennsylvania (Continued)

- *Each client, in conjunction with WPEC, must draw up a contract outlining their commitments and obligations to each other (WPEC and the new client) during the business incubation period, as well as write a plan setting bench marks for themselves in creating a self-sufficient business for the future.*
- *There is an orientation day to acquaint the clients with the facility, resources, opportunities, and policies that will assist the business while it is part of the incubator.*
- *WPEC provides technical assistance to its clients while they are staying in the incubator. Each client has an Account Manager, who helps him/her with strategic decisions and financial planning. There are also peer group sessions so that the clients can learn from one another's experience. All businesses in the incubator also have access to a Service Provider Network, which helps put clients into contact with providers of business services (i.e., legal assistance, budgeting).*
- *Each client is given a scholarship to attend classes at the nearby Wharton Small Business Management Certificate program (part of the Small Business Administration).*
- *WPEC has also partnered with many leaders in the technology world to bring their clients the best in technological operations.*
- *WPEC has also invested in forming relationships with other large area businesses with the belief that networking is an integral part of business success.*
- *There are meetings held periodically to assess the progression and achievements of each client so that they do not get lost in the day-to-day shuffle.*
- *There are celebrations for businesses within the incubator who have started to prosper and expand, as well as graduation ceremonies for those businesses that have become successful enough to move out of the incubator and into their own office space.*

WPEC also realizes that setting guidelines and providing resources and assistance are not the only aspects needed to establish successful businesses, so they have set up their own in-house Micro-Invest fund. The Micro-Invest Fund provides businesses in the incubator with much needed seed capital, a flexible repayment structure and targeted business assistance to enhance their opportunities for effective business development. With this comprehensive plan, Project THRIVE and WPEC have produced an effective environment allowing businesses to thrive and succeed throughout the area.

5. Job Training & Other Public Services

This chapter addresses the following questions:

- What are the eligible public service activities related to economic development?
- What, if any, exceptions are there to the 15 percent cap on public services?
- How can a community use public service programs in conjunction with economic development programs?

Overview

- Job training and other public services can play an important role in a community's economic development program.
- This is particularly true in the era of welfare reform, when communities are looking to help former recipients make the transition to work.
- Job training and other related public services can increase the impacts of other economic development efforts, such as financial assistance to a business or large-scale commercial development.
 - For example, many municipalities adopt "first-source" hiring policies, under which an assisted business agrees to hire workers from a designated pool of pre-screened applicants.
- The following sections of this chapter further highlight how job training and other public services may be undertaken with CDBG funding, including key program design steps.

Eligible CDBG Job Training & Public Service Activities

- Under CDBG, job training may be undertaken in a number of ways:
 - As a public service;
 - As part of a special economic development project or as part of microenterprise technical assistance; or
 - By a community-based development organization.

Eligible Public Service Activities

- Under Section 570.201(e), there are a wide variety of public service efforts that may be undertaken with CDBG funds. Many of these can directly complement economic development activities. Typical examples include:

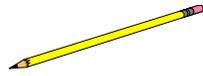
- Childcare;
- Transportation services; or
- Crime prevention services.
- However, the most common type of public service that is used in conjunction with economic development is job training.
- CDBG funds may be used to pay for labor, supplies, and materials, as well as to operate and/or maintain the portion of a facility in which the public service is located.
- This includes the purchase or lease of a facility, equipment, and other property needed for the public service.
- Income payments that are provided as a loan are permissible within the public services cap. In addition, CBDOs may provide income payments as an eligible activity if they are a part of a community development, neighborhood revitalization, or energy-efficiency program.
 - Income payments are payments to an individual or family that are used to provide basic levels of food; shelter (including payment for rent, mortgage, and/or utilities); or clothing.
 - Income payments do not include emergency grant payments for food, shelter, or clothing needs provided that:
 - The payments do not extend beyond 3 months; and
 - The payments are made directly to the provider of such services on behalf of an individual or family.
 - Some communities have designed income support programs that provide financial assistance or stipends to participants in job training or placement programs. In order to do this under CDBG, the assistance would need to (1) qualify as an emergency as described above, (2) be provided as a loan, or (3) be offered by a qualified CBDO as part of an eligible activity.
 - Otherwise, income payments are ineligible as noted below.
- To utilize CDBG funds for a public service, the service must be either:
 - A new service; OR
 - A quantifiable increase in the existing level of service that has been provided by the recipient (or another entity on its behalf) with local government funds (or funds from the State to the local government) in the 12 months preceding the submission of the recipient's ConPlan Annual Action Plan to HUD.
- An exception to this requirement may be made if HUD determines that any decrease in the level of a service was the result of events not within the control of the local government.

Ineligible Public Service Activities

- The provision of “income payments” is not an eligible public service activity if these payments are provided as a grant.
- Political activities are ineligible.
- In accordance with First Amendment Church and State Principles, as a general rule, CDBG assistance may not be used for religious activities or provided to primarily religious entities for any activities, including secular activities.
 - CDBG funds may be used for eligible public services to be provided through a primarily religious entity, provided the religious entity:
 - Will not discriminate against any applicant for the program on the basis of religion and will not limit admission or give preference in admission to the program to persons on the basis of religion;
 - Will not discriminate against any person applying for such public services on the basis of religion and will not limit such services or give preference to persons on the basis of religion; and
 - Will provide no religious instruction or counseling, conduct no religious worship or services, engage in no religious proselytizing, and exert no other religious influence in the provision of such public services or programs. (See Participation by Faith-Based Organizations in Chapter 2 for further discussion.)
 - An example of CDBG assistance to a religious organization under the above-stated circumstances is a childcare program. If the religious organization runs a childcare program that is open to any resident of a particular designated area, CDBG assistance can be used to help fund this activity. This is an eligible activity.
 - When eligible public services are carried out on property owned by a primarily religious entity, CDBG funds may be used for minor repairs to such property if:
 - The repairs are directly related to carrying out the public services; and
 - The cost constitutes in dollar terms only an incidental portion of the CDBG expenditure for the public services.
 - An example of CDBG assistance to a religious organization under the above stated circumstances is a childcare program. If the religious organization runs a childcare program that is open to any resident of a particular designated area, CDBG assistance can be used to help fund this activity. This is an eligible activity.

Public Services Cap

- The total amount of CDBG funds obligated by the recipient for public services must not exceed 15 percent of the recipient’s annual CDBG allocation plus program income received during the prior program year.



Public Services Cap Calculation Example

| | |
|---|-------------|
| entitlement grant amount | \$1,000,000 |
| <i>plus</i> program income | + 100,000 |
| <i>equals</i> amount subject to cap | \$1,100,000 |
| <i>multiplied</i> by 15 percent | x 0.15 |
| <i>equals</i> maximum that can be obligated for public services | \$ 165,000 |

- Public services carried out by the subrecipients are subject to the recipient's 15-percent public service cap.
- Because the public services category covers numerous important activities but is limited by the 15 percent cap, recipients should check to see if a proposed service meets another CDBG eligible activity category.
 - For example, removing graffiti from public buildings is a public service. However assisting private properties with graffiti removal may be better categorized as eligible property rehabilitation activities. See below for more information on these types of exceptions.

Public Services Cap Exceptions

- The CDBG regulations offer increased flexibility in using CDBG for certain public services, particularly services designed to increase employment opportunities that are not subject to the 15 percent cap.
- The eligibility options include:
 - Provision of assistance to microenterprises as a separate eligible activity. This includes technical assistance, business support services, and other similar services to owners of microenterprises or persons developing microenterprises. (Note: This exception does not cover the direct provision of these types of services to the owner's employees by the recipient or subrecipient.);
 - Certain job training and job placement services are considered to be an activity delivery cost if provided in connection with special economic development projects. See below for more details;
 - Job training, job placement, and other employment support services that are carried out by qualified nonprofit development organizations and that are specifically designed to increase economic opportunities including peer support programs, childcare, counseling, transportation, and other similar services; and
 - Any type of services carried out by qualified CBDO under a HUD-approved revitalization strategy. This includes other economic development-related services such as childcare; transportation; or basic skill-building, educational, or literacy services.
- Economic development services carried out in connection with special economic development activities do not count against the 15 percent cap. These services include:

- Outreach efforts to market available assistance;
- Screening of applicants;
- Reviewing and underwriting applications for assistance;
- Preparation of all necessary agreements;
- Management of assisted activities; and
- Screening/referral/placement of applicants for jobs generated by CDBG-eligible economic development activities, including training for those filling positions.

Documenting National Objective

- Public services most often qualify under the LMI Limited Clientele National Objective.
- In order to qualify under the Limited Clientele criteria, recipients must ensure that entities administering CDBG-funded public services use one of the following methods to select and serve beneficiaries:
 - Document beneficiary family size and income (through intake/application forms and certifications) and ensure that at least 51 percent of those served are LMI;
 - Limit the service (through procedures, application forms, etc.) to only those persons/households meeting the LMI income requirement;
 - Serve only a group of persons primarily presumed to be LMI (e.g., abused children, battered spouses, severely disabled adults, homeless persons, persons living with AIDS, illiterate adults, elderly persons, or migrant farm workers); and
 - Require that the service be of such a nature and in a location that it may be concluded that the activity's clientele are low/mod. (Meeting these criteria may be difficult for most public services. If this is used, recipients should ensure that it has sufficient documentation on the nature of the service and the conditions in the area in which it is located to justify how this presumption was made.)
- When funding public services, recipients must determine upfront which of the four options will be used to document compliance with the national objective requirements.
- Examples of ways to achieve this include:
 - Requiring a job training program (as set forth in a written agreement) to document each participant's income and household size (documents 51 percent LMI compliance);
 - Offering childcare assistance to residents of public housing who are attempting to start up a small business. (Nature and location of the activity indicate LMI persons.); and
 - Offering transportation services to homeless persons who are attending a job training program (presumed LMI clientele).
- The placement of the employment-related service in terms of its location in the community is directly related to meeting one of the national objectives.

- If the service will be offered to all residents of a LMI income area, then it may meet the LMI Area Benefit National Objective criteria.
- If the service is not offered to all residents of a LMI area, then it must serve at least 51 percent LMI income persons, or persons presumed to be LMI income, in order to qualify under the LMI Limited Clientele National Objective criteria.

Design of Job Training & Service Delivery

- Some of the entities that can carry out a CDBG-funded public service include:
 - The recipient;
 - Other governmental nonprofits (e.g., human service or health departments, housing authorities); or
 - Public or private nonprofit organizations.
- Public service delivery (including job training, childcare, and transportation) is often carried out by subrecipients in the CDBG program.
- Recipients should consider the following types of organizations with experience and track records in the provision of job training and/or childcare, transportation, or other employment-related services in the community:
 - Social service agencies;
 - Community colleges;
 - Local Private Industry Council (PIC) and/or a Workforce Development Board; and
 - Housing authorities.
- CDBG funds may be used to purchase, lease, operate or maintain the portion of a facility in which a public service is located. However, certain requirements must be taken into account:
 - If CDBG funds are used to acquire real property for the purpose of a CDBG-funded public service:
 - The property can only be acquired for a specific purpose;
 - It must continue to be used for that purpose so long as it is needed for that purpose;
 - The use must be controlled and taken care of;
 - Accurate records must be kept concerning the property; and
 - If it is sold, the CDBG share of the property's value must be repaid to the recipient.
 - The cost must be allocable to the CDBG activity. For example, if two programs are utilizing the same facility and only one is CDBG-funded, the cost of the facility must be allocated between the two programs. The specific amount will depend upon the proportionate share of the facility used by each program;

- CDBG cannot be used for any portion of buildings used for the general conduct of government;
- If the property is owned by a primarily religious entity, discrimination or preferences based on religion are not allowed, and the entity may not offer any counseling, worship services, or exert any other types of influence; and
- CDBG funds can be used for repairs to a facility owned by a primarily religious entity where assisted public services are being carried out provided the repairs are limited to the portion of the facility where the public service is located and where the cost is only an incidental portion of the CDBG funding for the public service.

Types of Job Training Programs

- A job training program's success depends upon whether or not it meets the needs of the people it serves. Many models have proven successful when used in the correct context.
- For example, if a significant number of people in a particular area are high school graduates but do not have the skills needed to obtain jobs in their community, a classroom-based job training program may not be effective. On the other hand, on-the-job training will allow participants to obtain necessary skills, as well as form professional relationships with employers, thereby improving their long-term job prospects.
- Some examples of different job training programs are:
 - **Job search assistance** – staff assist clients in conducting a focused job search, including interviewing skills, resume development, and employer referrals. This approach can make finding a job easier and faster for the clientele. It generally does not, however, lead to better employment;
 - **Short-term classroom training** – program participants attend a 3- to 6-month classroom style training focused on development of specific technical job skills or general education. Afterward, they may be offered job search assistance;
 - **Long-term classroom training** – continuing education (community college, university) to enhance the employability of a low/moderate-income individual; and
 - **Subsidized employment** – public subsidies are given to a private-sector employer to hire and provide on-the-job training to disadvantaged individuals.
- Job training program evaluations have shown that a combination of work and learning is often more effective than any single strategy.

Critical Elements of Successful Job Training Programs

- When creating a job training program, the steps below will optimize prospects for success:
 - Conduct a needs assessment;
 - Identify economic sectors with the greatest employment opportunities;

- Form partnerships between employers, residents, service agencies, and community institutions;
 - Address barriers to employment;
 - Develop “soft skills” training;
 - Create a flexible program;
 - Define performance measures;
 - Consider other sources of funding; and
 - Research other innovative steps that increase the rate of success.
- These steps are described below.
 - Conduct a needs assessment in your community.
 - Determine the needs of local residents who are unemployed, underemployed, or welfare-to-work candidates. Assess their level of education and job skills (educational level, previous work experience, interests, and ambitions);
 - Many job-training programs have a tendency to work only with the most job-ready candidates; special efforts should be made to include the most disadvantaged;
 - Identify which industries provide the greatest employment opportunity in the region by:
 - Reviewing the classified ads and tracking sectors most often listed;
 - Reviewing different trade journals or contacting industry-specific trade associations. Associations may be central sources of information on industry hiring needs. Business journals often print the top employment sectors in the city;
 - Researching recent economic data at the local library and on the Internet; and
 - Conducting a telephone survey of employers in different sectors to identify hiring needs.
 - Form partnerships with local employers.
 - Work with local employers to identify their needs. If possible, link the training program to employers’ own search and recruitment efforts;
 - Promote employer “ownership” by encouraging their input into the design and content of the program;
 - Work toward the ultimate goal of job placement, in which employers agree to place graduates of the training program within their organization. A guaranteed job also gives the trainees a greater incentive to remain in the program.

- Identify and address barriers to employment.
 - Some common barriers to employment are childcare, transportation, and healthcare.
 - Analyze why other programs in the area have failed (e.g., because most participants in the program were single mothers with no means of childcare).
 - Partner with agencies to provide services that address these needs (childcare, transportation, etc.).
 - Have counseling readily available before, during, and after job training and placement.
- Develop “soft skills” training. One important element of creating an effective job training program is job readiness.
 - In addition to providing job skills training, there should be counseling and/or classes teaching self-esteem building, how to take constructive criticism, getting to work on time, dressing professionally, interviewing, and resume writing. This will improve the participants’ chances of obtaining a job. Often times an employer is willing to provide job skills training and simply seeks people who are job ready and have a good work ethic and attitude.
- Create a flexible program.
 - Programs that are able to adjust to changing client populations and needs usually have greater success.
- Define performance measures.
 - Job retention is the ultimate measure of job training success. Assess why employees are or are not retaining the jobs in which they are placed; and
 - To continue to obtain funding for the grantee’s program it is necessary to show how successful the program is as a whole (job readiness, training and retention).
- Consider other sources of funding. It is likely that CDBG funds will not completely support the job training program, and the program will have to use other grants and loans from a variety of sources. Some other funding sources to consider are:
 - Local Private Industry Council (PIC) or Workforce Development Board. These agencies receive 85 percent of the Welfare to Work grants from the Department of Labor. Inquire as to what their plans are for the area and how they are planning to spend the money;
 - Other foundation grants; and
 - Other Workforce Investment Act (WIA) grants from the U.S. Department of Labor or the State.
- Other elements to consider to increase the success of the job training program are:

- If working with former public assistance recipients, research your State's Welfare Reform requirements;
- Consider a living wage assessment. Research the cost of rent, taxes, food, utilities, etc. to identify what wage is required to live in your area;
 - One source is the Out of Reach report done annually by the National Low-Income Housing Coalition (www.nlihc.org).
- If you have the discretion, do not partner with any employer who cannot pay the minimum salary structure. Look for clear advancement opportunities within each job track; and
- Do an organizational assessment of potential partners. Make sure employees are mentored, there is a good retention rate, and the work culture is supportive.

*Coordinated Employment and
Training Case Study – Charleston, West Virginia*

The initiative was started by the local HUD office in cooperation with area businesses, nonprofit organizations, and residents.

The goal of the initiative was to provide employment and training for low-income persons under the city's Section 3 provisions of its CDBG-assisted contracts.

The success of the program is attributable to the dedication of those on the Charleston Section 3 Task Force that was established to address the needs of the community, as well as the culmination of a variety of area resources.

During its inception, the task force did an analysis of the area's needs and obstacles. It also researched other barriers to job training and placement specific to the area (looked at why other training programs have failed in the past).

As a result of its efforts, there have been job training fairs which have resulted in 341 Section 3 adults receiving job training this year, as well as 59 Section 3 residents obtaining full-time employment.

Because of its outstanding success, this system is expected to be used as West Virginia's Welfare Reform requirements for persons on welfare are implemented.

Jefferson Riverport Case Study – Jefferson County, Kentucky

After identifying the needs of the community, Jefferson County and Jefferson Riverport International (JRI) partnered to form a job development strategy that incorporated all aspects (social, physical, economic) of job training and placement.

The County used Section 108 funds in combination with investments of private funds in order to subsidize the construction of the industrial park.

The program focuses on supportive services, as well as job opportunities for low- to moderate-income residents of Jefferson County.

Today, the industrial park has about seventy businesses that employ 4,500 residents of Jefferson County. In addition to job opportunities, there is also onsite training, child care, and affordable housing for employees of JRI, as well as a Job Link office to assist low-income persons seeking a job.

6. Large-Scale Commercial Development

This chapter addresses the following questions:

- What is meant by “large-scale commercial/industrial development”?
- How can such activities be undertaken with CDBG funds?
- What types of projects have been undertaken by recipients?
- What are some of the key design steps recommended for these types of projects?

Overview of Large-Scale Development

- Large-scale commercial or industrial development is a broad-ranging category of activities covering a wide variety of economic development tasks, including development of:
 - Retail facilities such as shopping centers or stores;
 - Commercial facilities such as hotels, shipping distribution centers, or office buildings;
 - Industrial/manufacturing complexes such as factories or industrial parks; and
 - Public commercial spaces such as convention centers or parking garages.
- Infrastructure development (such as a new road to a commercial facility) often accompanies these types of large economic development activities. Infrastructure activities, as related to large-scale development projects, are nonhousing activities that support improvements to the public capital stock.
 - Activities related to infrastructure have historically constituted a significant portion of city general fund expenditures. Much spending related to public works has been for two groupings: transportation facilities (street rehabilitation, sidewalk improvements, parking facilities, etc.); and water, sewer, and drainage improvements; and
 - CDBG infrastructure activities are often linked with large-scale development projects, and are discussed further in Chapter 7.
- Taken together, these large-scale development tasks share several common characteristics:
 - They are typically projects where a large level of financial investment is planned. Note, however, that the CDBG portion of these financial investments may range from intensive to minor;
 - The projects are usually planned to have a large impact for the community, whether in terms of job creation, service to the neighborhood, or renewal of a given area;

- Although certainly not always true, these projects generally involve some sort of real estate development, whether it is the construction of a new facility or the expansion of an existing building; and
- Finally, the projects often involve several types of financing and sources of funds. For example, large-scale projects often have a combination of private lender financing, various types of public financing, and business owner cash injections. In addition, these funds are often used for a wide variety of purposes including real estate development (noted above), improvement/creation of business process systems or purchase of fixtures and equipment, staff training, inventory creation, and/or site acquisition/improvements.
- CDBG may play a wide variety of roles in the large-scale development process, including such activities as:
 - Providing financing to the business to build/expand their facility;
 - Providing a ground or facility lease;
 - Building ancillary facilities, such as parking lots for public use;
 - Financing the business' purchase of equipment or process systems;
 - Funding business services such as job training or assistance with a marketing or business plan;
 - Developing/financing onsite infrastructure; or
 - Developing public infrastructure that assists the business (such as adjacent streets, sidewalks, streetlights, etc.)
- In addition, HUD's Section 108 loan guarantee financing is frequently used to undertake large-scale development projects.

Eligible CDBG Activities for Large-Scale Development

- Under the CDBG regulations, large-scale economic development tasks may be undertaken under several eligible activity categories, including:
 - Special economic development (570.203);
 - Community-Based Development Organizations (570.204);
 - Commercial rehabilitation (570.202); and
 - Infrastructure (public facilities and improvements) [570.201(c)].
- To a lesser extent, the following types of CDBG eligible activities may comprise portions of an overall large-scale development project:
 - Acquisition [570.201(a)];
 - Clearance [570.201(d)];
 - Public Services [570.201(e)]; and

- Privately owned utilities [570.201(l)].
- The following sections of this chapter highlight how each of the key eligible activities may contribute to a large-scale economic development project.
- Note, however:
 - Many projects which qualify as eligible activities under CDBG may not meet a national objective. Be sure to screen early and meet both the national objective and the activity eligibility criteria; and
 - Some large-scale projects are likely to involve eminent domain. Jurisdictions should review the limitations on eminent domain in Chapter 2, and consult with HUD before obligating CDBG funds to such activities.

Special Economic Development

- This category of eligible activities is very broad in its ability to assist in large-scale project development and is a very common way of undertaking such activities.
- This eligibility category has three key components:
 - Activities undertaken by the recipient or public/private nonprofit subrecipients;
 - Activities undertaken by a for-profit business; and
 - Economic development services.
- Recipient/Subrecipient/UGLG Activities: Under this eligibility category, recipients, subrecipients or (in the case of the State CDBG program) UGLGs may:
 - Acquire, construct, reconstruct, rehabilitate, or install commercial or industrial buildings, structures, and real property equipment and improvements, including railroad spurs.
 - Possible activities under this category might include things like:
 - Recipient-owned commercial facilities such as a farmer’s market or a convention center;
 - Subrecipient-owned commercial properties, such as an office building or retail plaza; or
 - Purchase or installation of recipient- or subrecipient-owned commercial equipment such as the walk-in freezer or the air cooling system in a recipient-owned farmers’ market.
 - Note that under this portion of the special economic development eligibility category, other types of commercial assistance such as working capital, inventory, etc. are ineligible when the activity is undertaken and directly managed by the recipient or subrecipient.
- **For-Profit Business Activities:** This category is extraordinarily flexible and permits recipients to provide the for-profit business with a loan, grant, loan guarantee, interest supplement, technical assistance, and other forms of support for any type of activity for which assistance is appropriate to carry out an economic development activity.

- Activities explicitly prohibited under 570.207(a) or not listed as eligible under the statute may not be undertaken.
- The assistance to the business must minimize displacement of existing businesses and jobs in the neighborhood.
- Given the flexibility within this category, there are a huge variety of large-scale activities that may be funded by recipients, including assistance to a business to:
 - Build or renovate their commercial establishment;
 - Buy or install equipment;
 - Increase the amount of working capital (receivable financing, purchase inventory, commercial supplies, etc.); or
 - Clean up or clear the site of their business.
- **Economic Development Services:** Note: Recipients may pay for economic development services in conjunction with eligible activities outside of the public services or administrative caps.
 - Such activities might include:
 - Outreach efforts to market available forms of assistance;
 - Screening of applicants;
 - Reviewing and underwriting applications for assistance;
 - Screening, referral, and placement of applicants for employment activities generated by CDBG-eligible economic development activities, *including the costs of necessary job training for persons filling those positions.*
 - These employment activities are eligible forms of CDBG assistance—even if the primary economic development activity is not funded with CDBG—as long as job training assistance is:
 - For a CDBG-eligible economic development project; and
 - Linked to a specific job position (i.e., this eligibility category is not an opportunity to set up a generic job training program but rather is for training related to specific jobs).
- Remember! All activities under the special economic development category are subject to the mandatory public benefit standards (see Chapter 2 for more information) and must meet a national objective. This includes all of the economic development services activities where the only CDBG funding may be for a service (such as job-related employee training).

Community Based Development Organizations

- Community Based Development Organizations (CBDOs) may be involved in large-scale economic development in one of two ways under section 570.204 of the regulations:

- Neighborhood revitalization activities such as renovating a commercial strip within a declining neighborhood. These activities must be of a size and scope to impact the decline of the neighborhood; and
- Community economic development activities such as development of a neighborhood grocery store or of a manufacturing facility that will primarily employ LMI residents of an area. These activities must be designed to increase economic opportunity for LMI persons (such as permanent jobs or housing for LMI employees) or expand/retain businesses within the area.
- Remember! When the CBDO activity would otherwise have been undertaken as a 570.203 special economic development activity, the public benefit standards apply.

Commercial Rehabilitation

- Recipients may also undertake certain types of commercial rehabilitation as a rehabilitation activity, rather than a special economic development activity.
 - Rehabilitation for a for-profit business is limited to the exterior of the building and the correction of code violations; and
 - Additional CDBG assistance must be considered under the special economic development activities category discussed above.

Large-Scale Projects under Section 108

- Section 108 provides the ability for the grantee to borrow funds for larger scale activities that can't be funded entirely out of current CDBG funds with the grantee guaranteeing repayment with future CDBG allocations. Section 108 is described fully in Chapter 10.
- Under the Section 108, a wide variety of large-scale projects are permissible. These projects are:
 - Economic development activities eligible under CDBG;
 - Acquisition of real property; and
 - Construction, reconstruction, or installation of public facilities (including streets, sidewalks, and other site improvements).
- Some specific sample Section 108 large-scale projects are described below.
 - Neighborhood Shopping Center –
 - A particular property area where a variety of local businesses will be housed in one large structure or in different buildings; and
 - Creates jobs and offers services to area residents and businesses.
 - Grocery Store –

- A franchise or local business where property needs to be acquired and a facility built; and
- Creates job opportunities and benefits to the area it covers by offering essential services.
- Mixed use-retail and housing rehabilitation –
 - Renovation of a facility to be used partly as housing for LMI households, and partly to house businesses that will benefit the area and create jobs.
- Industrial expansion –
 - An industrial entity in the servicing area that would like to expand its facilities or its process systems, thus, creating jobs; and
 - CDBG money can be used to acquire the property the industrial company would need in order to expand or construct another facility related to its expansion.
- Infrastructure –
 - CDBG funds can be used to repair or construct infrastructure, such as streets, water pipes, and sidewalks, which has a direct impact on the economic development of an area; and
 - For example, before a company can expand and create more jobs for residents in a designated service area, there may be infrastructure improvements that need to be made. CDBG funds can be used to make those improvements.
- Section 108 projects are also subject to the limitations on eminent domain. Note that some large-scale development projects will occur in areas that qualify as brownfields and Section 108 financing can be used to remediate contaminants. Such projects may not be subject to the same eminent domain limitations. See the discussion of brownfields in Chapter 10.
- Caution: If the project does not repay the borrowed funds, the grantee must make it up out of CDBG allocations.

Ineligible CDBG and Section 108 Activities

- 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.
- Also ineligible are projects that do not meet a national objective. 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. See the section below for more information on this.

- All other projects deemed ineligible under 570.207(a) cannot be undertaken as a large-scale development project.

Documenting the National Objective

- Recipients may qualify a large-scale development activity under the LMI job creation and/or retention National Objective. Under this objective, the large-scale project must lead to the creation or retention of full-time-equivalent (FTE) permanent jobs, at least 51 percent of which will be available to or held by LMI persons.
- Within large-scale development, some projects may also, in some instances, qualify based on the benefits accrued to the neighborhood in which the activity takes place.
 - Activities in LMI neighborhoods may qualify under the criterion for the LMI area benefit National Objective if they provide a service to that neighborhood; or
 - Activities benefiting severely deteriorated areas may qualify under the Slums/Blight Area National Objective if the area meets the CDBG requirements.
- Commercial rehabilitation activities may qualify under the Slum/ Blight Spot National Objective if that rehab is limited to public health and safety violations. Special economic development activities do not qualify under the Spot Slum/Blight category.
- Note: In mixed-use projects, each component of the project (e.g., housing and retail) must meet a national objective.

Design of Large-Scale Development Activities

- When deciding on how to issue large-scale business development loans, consider the following steps to optimize your success. These steps are:
 - Determine if you want to target neighborhoods to have a concentrated impact;
 - Ensure potential projects meet HUD requirements and associated criteria;
 - Choose projects that are job generators;
 - Screen early;
 - Assess and control lending risks;
 - Make an early decision as to the best way to conduct the project; and
 - Monitor results to improve your program management and ensure success.
- These steps are described below.

Determining whether you want to target particular neighborhoods

- Large-scale development projects may be more effective when carried out in a specific area.

- For example, a community might wish to revitalize a particular block. Simply building a new sewer system alone will probably not meet this objective. But, building a new sewer system and providing assistance to the businesses located on that block might be effective.

Ensure potential projects meet HUD criteria

- The project must be eligible under CDBG and/or Section 108.
- The project must meet one of the following national objectives:
 - Elimination of slum blight;
 - Job creation; or
 - Area revitalization/benefit

Choose projects that are job generators

- To generate jobs, the business must succeed. Review the project prospects such as a prudent lender would.
 - How likely is it that the business will succeed and hire LMI residents?
 - Is the target environment feasible for the business success?
 - What type of profit will the business turn? Is there sufficient cash flow to hire new employees?
 - Can the business overcome any hurdles it faces?
- Take full consideration of the social impact of the business as well.

Screen early

- Make sure they are aware of all HUD requirements and other criteria particular to the city's program.
 - Some cities might require that the 51 percent of the LMI individuals required to be hired under HUD criteria be local residents of the city that is funding the project; and
 - As a public entity, you will want assurances that the project will be successful. If the project fails, you run the risk of violating the public benefit standard.
- Take into account public support.
 - Social services institutions and rehabilitation clinics are examples of businesses the city may want to consider funding because they are beneficial to the area even though they may not be extremely profitable. These types of organizations are usually rejected by banks for financing.
- Consider whether or not the project addresses a part of the city's strategic plan.

Assess and control lending risks

- What is the risk of exposure to the city if the loan is not repaid?

- Again, review the project as a prudent lender with some empathy to social impact.

Make early decisions as to the best way to conduct the project

- Decide what tasks will be performed and by whom.
- Develop a project timeline.
- Remember: The best way to conduct one project may not be the best for another project.
 - Defining the role a project will undertake early on minimizes confusion later.

**Worcester Loan Guarantee Program Case Study —
Worcester, Massachusetts**

The city of Worcester had the goal of providing financial and technical assistance to its developers, nonprofit organizations, microenterprises and private businesses to start up, locate or expand business in Worcester. The city focused on entities that 1) would create new, full-time jobs; 2) could not receive loans from conventional sources; and 3) had sufficient security and collateral.

The city used \$500,000 of Section 108 funds as a credit enhancement to help Kennedy Diecasting, Inc. to obtain financing to expand its facility. As a result, the company received \$1.2 million in conventional financing that resulted in 135 saved jobs. In addition, 90 jobs were created exceeding original projections of 15-20 new jobs. This particular company is no longer dependant on the Section 108 Guarantee (Kennedy has refinanced their loan with conventional sources).

The city's strategy concentrates on the use of Section 108 funds to gap finance loans as a credit enhancement to secure conventional financing. Potential borrowers must participate in a strict application process that requires final approval from city council. With the use of the Section 108 funds as a credit enhancement, the city gains the added benefit of avoiding any cost (unless the borrower defaults) while attracting private investment and creating new jobs. Worcester has avoided any cost thus far because there have been no instances of default.

The city recommends protecting an investment almost as much as a bank would by paying close attention to the collateral. Since the investment is somewhat risky, the city looks at the potential total finished value of a building as collateral. The city also looks to the personal guarantees of borrowers or of corporations to cover the loan.

**Urban Brownfield Redevelopment, Site Mitigation, and
Comprehensive Revitalization Case Study – Bangor, Maine**

The city of Bangor wished to 1) revitalize the long-vacant urban "Brownfield" left from an abandoned coal-gas utility; 2) remove other abandoned, derelict, and under-utilized structures; 3) develop essential neighborhood services; and 4) create new jobs.

The city redeveloped a property that once housed the Bangor Gas Works. The city acquired and removed the unused facility and the remaining industrial soil contamination using the city's CDBG grant. The city then redeveloped the area into one that provides neighborhood services by providing partial tax increment financing. What was once an eyesore is now a thriving community with a supermarket, bank, and drugstore. A portion of the land was used to expand a neighborhood park in order to build a playground for nearby children. Another parcel of land was donated to Habitat for Humanity for construction of a single-family house for a low-income family. With the addition of business, the area has 200 new service jobs, primarily for low- to moderate-income residents.

The city stresses the importance of developing a long-range plan with a clear final goal. The city also emphasizes the importance of developing cooperative relationships with regulatory agencies and private-sector firms.

University Village Service Center Case Study – Charlotte, North Carolina

The city of Charlotte had the goal of revitalizing nine corridors leading into the city. The city devised a plan to build a shopping center (University Village Service Center) in the area. The shopping center needed to include a franchised food store and a drug store in order to be viable.

The city chose a number of strategies in order to ensure that key businesses, such as Food Lion and Revco, would relocate to the area. The city provided a 20-year loan with CDBG funds to fill the gap between the costs and what Food Lion could finance with a conventional lender. The second strategy was to make job creation the responsibility of the tenants of the shopping center, taking undue pressure off the borrower. The third strategy was an emphasis on partnership, by working together with other community development entities and banks to negotiate mutually beneficial financing strategies.

The program has been highly successful. Food Lion is the first store in the inner city and is greatly exceeding company sales projections. In addition, 93 of the 95 projected new jobs have been created in the area. Seventy-one of these jobs have been filled by low/moderate income residents. This program has also acted as a catalyst, bringing further investment to the area.

Reindeer Processing Facility Case Study – Alaska

The State of Alaska wished to support the growth and expansion of the reindeer industry in order to stimulate local economic growth and create jobs. The State needed to create a processing plant in order to ensure this expansion of the reindeer industry to existing profitable markets.

The State of Alaska awarded a CDBG grant of \$200,000 to the Northwestern community of Tellers and the Reindeer Herders Association, Inc. to construct a Reindeer Processing Facility in Teller, Alaska. Teller was chosen as the site for the new facility because of its accessibility to Nome, Alaska's deep-water port. This new facility serves 11 native Bering Straits communities. The facility produces quality reindeer meat that can compete with Scandinavian and Canadian reindeer and New Zealand deer markets. The number of seasonal jobs created, while low by national standards, is significant in rural Alaska.

7. Infrastructure

This chapter addresses the following questions:

- How can infrastructure projects contribute to economic development?
- What is eligible and ineligible under CDBG?
- What national objectives can be met by infrastructure activities?
- What are some of the key steps necessary to undertake infrastructure projects?

Overview

- Infrastructure development (such as a new road to a commercial facility) often accompanies large economic development activities.
- Much spending related to public works for economic development has been for two groupings:
 - Transportation facilities (street rehabilitation, sidewalk improvements, parking facilities, etc.); and
 - Water, sewer, and drainage improvements.
- CDBG infrastructure may include:
 - Developing/financing onsite infrastructure; or
 - Developing public infrastructure that assists one or many businesses (such as adjacent streets, sidewalks, streetlights, etc.)
- Infrastructure activities are discussed in further detail below.

Eligible CDBG Infrastructure Activities

Public Facilities

- The acquisition, construction, reconstruction, rehabilitation, or installation of public facilities and improvements are eligible activities under CDBG and can be carried out by a grantee, subgrantee,, or other nonprofit. Public facilities may only be owned by these types of entities.
- There are two categories that constitute infrastructure – public works and community facilities.
 - Under the public works category, the following are CDBG eligible activities:
 - Street improvements;
 - Sidewalk improvements;

- Sewer improvements;
- Water improvements,
- Flood and drainage improvements;
- Parking facilities; and
- Solid waste facilities.
- Under community facilities, the eligible activities are:
 - Senior facilities;
 - Handicapped facilities;
 - Homeless facilities;
 - Youth facilities;
 - Neighborhood facilities;
 - Parks and recreational facilities; and
 - Childcare facilities.
- Infrastructure financing also often plays an important part in the development of large-scale projects. For example, a grantee might finance:
 - Roads, streets, sewers, sidewalks, street lights, etc., that approach a specific site being developed by a private business;
 - In addition, grantees sometimes finance infrastructure improvements in a developing area as a commercial or industrial park.
- If the assisted facility is owned by a nonprofit, the CDBG regulations stipulate that the facility must be open to the public during normal working hours.

Special Assessments

- Special assessments are used to recover the capital costs of a public improvement through a fee levied or a lien filed against a parcel of real estate, either as:
 - A direct result of the benefit derived from the installation of a public improvement; or
 - A one-time charge made as a condition of access to an improvement.
- The State CDBG regulations do not discuss special assessments but States may refer to the entitlement regulations for guidance.
- Special assessment activities under CDBG can be used to:
 - Recover capital costs of a public improvement; and/or
 - Pay for special assessments for public improvements not initially assisted with CDBG funds.

- In order to **recover CDBG funds used to pay for all or part of the cost of a public improvement**, special assessments may be imposed:
 - To recover CDBG funds only against properties owned and occupied by non-LMI persons (and such assessments are program income); or
 - To recover non-CDBG sources of financing, provided that CDBG funds are used to pay the special assessment on behalf of all properties owned and occupied by LMI persons. (CDBG funds do not have to be used to pay special assessments on behalf of properties owned/occupied by moderate-income residents if the grantee does not have sufficient CDBG funds to pay the assessments on behalf of all the LMI owner/occupants).
- CDBG funds may be used to **pay for special assessments** for public improvements not initially assisted with CDBG funds, provided:
 - The installation of the public improvements was undertaken in compliance with all applicable requirements (e.g., environmental, citizen participation, and Davis-Bacon); and
 - The CDBG funds are used to pay the special assessment on behalf of all LMI owner occupants (or for low-income owner/occupants only if there are not sufficient funds to pay for all LMI owner/occupants).
- Special assessments are not taxes and the establishment of the value of real estate for the purpose of any type of taxes is ineligible.
- Periodic charges based on the use of a public improvement, such as water or sewer user charges, even if the charges include the recovery of all or some portion of the capital costs of the public improvement, are ineligible.

Privately Owned Utilities

- Privately owned utilities are those owned by a private company rather than a public agency. The rehabilitation or construction of these utilities may be undertaken with CDBG funds under certain conditions. The following is a summary of the topics in this section, applicable statutory and regulatory cites, and other reference materials available from HUD.
 - CDBG funds may be used by a grantee, subgrantees, and other for-profit and public entities to acquire, construct, reconstruct, rehabilitate, and install the distribution lines and related facilities for privately owned utilities;
 - A privately owned utility refers to service that is publicly regulated and is provided through the use of physical distribution lines to private properties; and
 - Utilities include, but are not limited to, electricity, telephone, water, sewer, natural gas, and cable television.

Ineligible CDBG Activities

- Projects where the public benefits standards have been triggered (which is common for many large-scale public facilities 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 city hall is not acceptable.
- Also ineligible are projects that do not meet a national objective. 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. See the section below for more information on this.
- All other projects deemed ineligible, or not listed as eligible under the regulations or HCDA statute, cannot be undertaken as a large-scale development project.
- The following types of infrastructure projects are ineligible:
 - The maintenance and repair of public facilities and improvements is generally ineligible (e.g., filling potholes, repairing cracks in sidewalks, mowing grass at public recreational areas, or replacing street light bulbs);
 - Operating costs associated with public facilities or improvements are ineligible unless part of a CDBG-assisted public service activity or eligible as an interim assistance activity;
 - A public facility otherwise eligible for assistance under the CDBG program may be assisted with CDBG funds even if it is part of a multiple-use building containing ineligible uses, if:
 - The public portion of the facility that is otherwise eligible and proposed for assistance will occupy a designated and discrete area within the larger facility; and
 - The grantee can determine the costs attributable to the facility proposed for assistance as separate and distinct from the overall costs of the multiple-use building and/or facility. Allowable costs are limited to those attributable to the eligible portion of the building or facility.

Documenting the National Objective

- Grantees may qualify a large-scale development activity under the LMI job creation and/or retention criterion National Objective. Under this objective, the large-scale project must lead to the creation or retention of permanent jobs, at least 51 percent of which will be available to or held by LMI persons.
- For infrastructure projects, the 51 percent LMI job requirement may be met by aggregating the jobs created or retained by affected businesses under the following criteria:
 - If the CDBG cost per job created or retained is less than \$10,000 per full-time-equivalent (FTE) employee, the grantee must ensure that 51 percent of the jobs created or retained **by the businesses for which the project is principally undertaken** are made available to or held by LMI persons; and
 - If the CDBG cost per job created or retained is \$10,000 or more per FTE, the grantee must ensure that 51 percent of the jobs created or retained **by all businesses in the service**

area are available to or held by LMI persons. For this purpose the jobs may be *aggregated*. This includes all businesses which, as a result of the project, locate or expand in the service area between the date the activity is identified in the Action Plan and one year after completion of the project. In addition, the activity must comply with the Public Benefit standards.

- Within large-scale development, some projects may also, in some instances, qualify based on the services provided and benefits that accrued to the neighborhood in which the activity takes place.
- Activities in LMI neighborhoods may qualify under the LMI area benefit National Objective if they provide a service to that neighborhood; or
 - Activities benefiting severely deteriorated areas may qualify under the Slums/Blight Area National Objective if the area meets the Slum/Blight area requirements; and
 - Commercial rehabilitation activities may qualify under the Slums/Blight Spot National Objective if that rehab is limited to public health and safety violations. Special economic development activities do not qualify under the Slum/Blight Spot category.
- Remember that the public benefit standards are triggered by infrastructure projects that use either the LMI job creation/retention national objective OR the Slums/Blight Area national objective, where more than \$10,000 per FTE job is spent.

Design Considerations: Infrastructure Activities

- When deciding on how to use infrastructure to support economic development, consider the following steps to optimize success. These steps are:
 - Determine if the objective is for target neighborhoods to have a concentrated impact;
 - Ensure potential projects meet with HUD criteria;
 - Choose projects that are job generators;
 - Screen early;
 - Assess and control lending risks; and
 - Make an early decision as to the best way to conduct and oversee the project.
- See Chapter 6 for more information about this process.

Infrastructure Case Study—Sioux City, Iowa

- *In Sioux City, Iowa, annual allocations of CDBG money were used to provide infrastructure improvements to Riverside, a declining low-income neighborhood. Using the “If You Build It, They Will Come” slogan, the Riverside Commercial Corridor Plan attracted private investment to the neighborhood, without saddling current residents with assessments.*
 - *On one street, paving the road and providing water and sewer connections helped attract new housing investments, including a 12-unit condominium complex and six townhouses.*
 - *On another street, providing utilities was linked to the development of 140 manufactured homes.*
 - *A community Nature Center was also constructed with partial funding from CDBG funds.*
- *In conjunction with these infrastructure improvements, a housing rehabilitation program was funded to help existing residents improve their properties.*
- *These CDBG-funded activities were also complemented by the City's offer of 10-year tax abatement on physical improvements made to properties located in Riverside.*
- *These investments of public resources have effectively paved the way for private-sector interest—private dollars have matched CDBG investment at a ratio of four-to-one.*
- *HUD recognized the Riverside project as a “Blue Ribbon Best Practice in Community Development.” Among the factors contributing to the project's success were the following:*
 - *The investment of CDBG dollars for infrastructure helped attract the interest of private investors and developers, but equally important was the provision of the tax abatements which helped existing residents and businesses avoid adverse tax consequences from the community's rebirth.*
 - *The city actively engaged neighborhood businesses and residents in planning the revitalization effort, ensuring community support.*
 - *The city also worked through the local Chamber of Commerce to ensure that the local business and lending leaders were willing to commit their resources in concert with the public funds.*

8. Financing Economic Development Projects

This chapter addresses the following questions:

- What are some of the ways that economic development projects can be financed?
- How do revolving loan funds work and how can a recipient set one up?
- What other economic development financing programs are available?
- What role can Community Development Financial Institutions (CDFIs) play in a CDBG economic development program?

Overview

- There are a wide variety of ways that recipients can use CDBG to finance economic development projects.
- Project financing mechanisms include grants, loans, loan guarantees, and many other tools. As noted above, the choice of mechanism depends upon the use of funds and the needs of the user.
- The choice of financing mechanism is perhaps one of the most important in the effective design of an economic development program.
 - Each of the mechanisms involves different trade-offs for the recipient and the business owner or borrower.
 - For example, while a grant is very low risk to the business owner, it may be considered “high risk” by the recipient. Without repayment or replenishment of the CDBG funds, the grantee’s prospect for funding future development activities is more uncertain.
 - In addition, it is critical that the chosen mechanism match the market and/or financing needs of the project.
 - For example, a very small business may only need a few thousand dollars to get its new product started. Most private lenders will not make loans of this size because it is not cost effective for them to do so. Thus, offering a loan guarantee in this example may not be the best match between the business’ needs and the financing tool.
- These financing mechanisms may also be administered in many ways. One of the most common ways of administering economic development loans is through a revolving loan fund.
 - Revolving loan funds can be generic—serving any economic development use—or can be targeted (e.g., microbusinesses or for businesses in a given industry).

- Revolving loan funds are permitted under the CDBG program, although there are several requirements.
- CDBG financing is frequently combined with other available financing—both public and private.
 - It is important that recipients understand the other types of economic development financing that might be available within their jurisdiction and the program requirements (if any) that are generally attached to this financing.
 - Often, the CDBG financing is “gap” financing—filling voids where the other financing is not available. See the underwriting chapter of this guide for more information about gap financing.
- One of the newest forms of community and economic development financing is the Community Development Financial Institutions (CDFI) Fund.
 - This fund, run by the Department of the Treasury, provides assistance to qualified CDFIs, which in turn fund community-based projects; and
 - CDFIs get a number of regulatory flexibilities under the CDBG regulations, in order to encourage grantee partnerships with these community-based organizations.
- The remainder of this chapter further explores the financing options and decisions to be undertaken by recipients.

Financing Tools

- When most people think of financing tools or techniques, they think of below-market-rate interest bearing loans. While these loans are certainly an important part of the overall mix of financing tools, they are not the only type.
- Financing tools are generally in one of three types:
 - Equity (with or without ownership interest);
 - Debt; and
 - Credit enhancement.

Equity (with or without ownership)

- Equity is the investment of funds in a venture that is not subject to repayment as a loan, but is treated as an ownership investment that may receive dividends or returns through the profits of the venture. Grantees may take an “equity position” or an ownership position in the venture.
- The range of tools used to provide equity in a project varies widely. For some of these equity tools, the recipient (or the subrecipient on the recipient’s behalf) may elect to take an ownership position in the project. For other projects, the recipient merely provides cash infusion into the project.

- For example, assume that the recipient is funding the development of a hotel. The recipient could use a grant to the developer as an equity investment in the project and share in the gains and losses of the project. The city would thus be a partial owner of the hotel. Under this scenario, the city might then get a portion of the proceeds from the hotel (this would be program income under the CDBG program); and
- Alternately, the recipient could give the grant to the developer without any ownership position required, but require other community benefits as a condition of the grant.
- Equity investment: Funds are invested with an expectation of return on the investment out of the profits of the venture.
 - Pluses:
 - Business is not saddled with debt or repayment in the near term; and
 - The grantee may recover the investment over time if the venture is successful.
 - Minuses:
 - Higher risk that funds might not be able to be repaid;
 - Lower security than debt; and
 - Delay in recovery of the CDBG investment.
- Grants: Grants are cash infusions into a project that may or may not require repayment.
 - Cash grants are generally only offered by public programs such as those funded with CDBG or by nonprofits/foundations. Small grants provide *access to capital* without a cost;
 - Grants are offered when either the amount of the grant is small or when the project's cash flow cannot support any additional debt;
 - Grants may be given as:
 - Cash to a project (usually for smaller businesses for smaller amounts); OR
 - As principal reduction on a loan (i.e., the CDBG grant writes down the principal on the business' private lender loan from \$X to \$Y, which enables the business to afford the loan's monthly payment).
 - Pluses:
 - Generally easy to administer; and
 - May be the only source of financing possible for a project, such as a small startup business or a costly, complicated deal that the community believes it must undertake to receive its intrinsic benefits.
 - Minuses:
 - Lack of repayment means that scarce resources are not replenished; and
 - May lead to lack of commitment by the business since it is not liable for repayment.

- **In-Kind Contributions:** In-kind contributions are the donation of goods or services to a project in order to reduce costs that must be incurred by the business owner.
 - Examples of in-kind contributions include donated or reduced costs for professional services such as accountants or lawyers, equipment or inventory, commercial space, or supplies.
 - It is important to address legal liability issues with donated professional services.
 - In-kind contributions are not a common method of CDBG project financing. However, they may accompany the CDBG financing.
 - For example, the CDBG program might give a business owner a low-cost loan and the business owner might team this with donated professional services from his/her local Chamber of Commerce.
 - **Pluses:**
 - Good way of getting low- or no-cost investment into a business;
 - Typically gets community organizations involved in the business development process.
 - **Minuses:**
 - Donated materials may not be what the business needs (i.e., last year's computer equipment or 1,000 erasers when what the business really wants is 20 staplers); and
 - May be insufficient to help the project get started.

- **Purchase and Low-Cost Sale or Lease:** Under this option, the recipient purchases land or property and then sells or leases it to the project at a substantially reduced cost.
 - Keep in mind that acquisition through eminent domain is limited. See the section in Chapter 2.
 - **Pluses:**
 - Can be a way for recipients to easily invest existing resources (i.e., land already owned by the recipient);
 - Can also enable the recipient to help direct the location of the economic development activity by selecting the parcel or property to be sold or leased; and
 - When applicable, enables the recipient to use any necessary and available public means to obtain and/or clear the site.
 - **Minuses:**
 - May have limited applicability depending upon available land and structures and the cost of those structures in a given community (i.e., it may simply be cost prohibitive for a recipient to purchase such properties); and
 - Requires that the recipient be skilled in land and/or property acquisition and/or leasing.

Debt

- Debt financing usually involves the provision of a loan to a business or project; and a specified timeframe (term) and/or conditions for repayment.
- Each of the key debt instrument types is described below.
- Amortizing Direct Loans: Under this standard option, the recipient provides a loan to the project or business that is paid back over time.
 - Amortizing direct loans may be interest bearing or principal only. Typically business loans have an interest rate, regardless of how small.
 - The term of the amortizing loan may be shorter for loans on items such as equipment or inventory and longer on real estate. See the underwriting chapter for more information on this.
 - Direct loans are usually secured by the project, by additional/alternate collateral, or a personal guarantee from the owner. Again, the underwriting chapter discusses these options.
 - Pluses:
 - Repayment helps to ensure that the business is fully committed to the project.
 - Provides repayment of the expended resource (CDBG) that can be lent out again.
 - If interest is charged, this interest income can help increase and multiply the overall level of funding available for economic development activities (particularly if the loan repayment is placed in a revolving loan fund dedicated to similar uses).
 - Minuses:
 - Requires risk taking and the means to process and service the loans;
 - May, if the loan defaults, require that the recipient have procedures and skills for loan foreclosure and collection;
 - For some businesses, an amortizing loan will not be financially feasible, regardless of the interest rate. This is most likely to be true for very small startup companies.
- Contingent Payment (“Deferred Payment”) Loans: Under this option, the recipient makes a direct loan but its repayment is not amortized over time. Rather, its repayment is deferred and contingent upon an event (such as the sale of the company, the business reaching a particular level of profitability, or a particular number of years that have elapsed.)
 - Contingent payment loans may require repayment of only the principal, or, at the time of repayment, may require some amount of accrued interest to be paid;
 - Recipients may also mix the contingent-payment loan with an amortizing loan in order to require part to be paid periodically and part paid at a set point in time:

- An example is a forgivable deferred-payment loan for façade improvements that requires no repayment unless the business leaves the area before a certain timeframe (e.g., five years.);
 - Finally, recipients may forgive a portion of a contingent-payment loan. For example, if the loan is worth \$20,000, the recipient may require repayment of \$10,000 at year five and permit the remaining \$10,000 to be forgiven based on other benefits received by the recipient.
 - Pluses:
 - Permits the loan to function like a grant in the short term and yet allows for the option of eventual repayment; and
 - May be relatively easy to administer since no monthly loan servicing is required.
 - Minuses:
 - Loan repayment may not occur if the contingent event does not happen. For example, if the business never reaches its intended level of profitability, the loan is not repaid. Grantees should anticipate non-payment;
 - The lack of a required monthly payment may inhibit some of the incentive for the owner to be fully dedicated to the project's success; and
 - The recipient's loan-servicing procedures would need a method for indicating when the scheduled time for loan payment has arrived.
- Co-Lending: Co-lending occurs when the recipient is only one of the lenders on a given project.
 - The public co-lending loan may be made in two ways:
 - Subordinate financing: Under this option, the CDBG loan and the private loan share the same collateral from the business but the right of repayment on the CDBG loan or share first position is placed behind the loan made by the private lender. Thus, if the project fails, the private lender is repaid first and the CDBG loan is repaid with whatever proceeds remain; and
 - Tandem loan: Under this option, the private lender's loan is secured by different collateral than the recipient's CDBG loan. For example, the private lender might lend funds for the construction of a facility and that loan might be collateralized by the building. Simultaneously, the recipient might make a CDBG loan for a new piece of equipment and the CDBG loan would be collateralized by that equipment (and maybe some additional collateral from the business owner).
 - Generally, the interest rate on the loan from the public entity is lower than the interest rate on the loan from the private lender(s). Thus, it is less expensive for the business to have multiple loans, rather than one larger loan from the private lender.
 - Pluses:
 - Co-lending allows flexibility by mixing and matching financing types;

- In addition, co-lending helps ensure that there is repayment of the CDBG funds to be made available for future activities; and
- Subordinated loans may entice private lenders to participate in the project by reducing their risk and level of financing.
- Minuses:
 - Subordinated loans cause greater risk for the recipient since they are last in line when a default occurs and collateral is sought for repayment;
 - Establishing the proper interest rate on a public loan can be complex; and
 - Underwriting using co-lending loans can be complicated and requires a thorough understanding of collateral, security, and private lender expectations, as well as the potential for the business to succeed in achieving the desired public benefit.

Credit Enhancement

- Credit enhancement makes it easier for a business to borrow funds from a private lender by making that loan more attractive to make from the lender's perspective.
- This is generally done in one of two ways:
 - Interest subsidies; OR
 - Loan guarantees.
- Interest Subsidies: Under this option, the recipient makes a payment to a lender which is used to buy down the interest rate to a rate which is more affordable to the business or project.
 - For example, if the market interest rate is 8 percent, but the borrower can only afford the principal with interest at 5 percent, an interest subsidy payment can be made to cover the 3-percent gap (usually by making a principal reduction grant that reduces the payment to the equivalent of the larger loan at the lower interest rate).
 - Pluses:
 - Makes private financing more feasible for borrowers; and
 - Negates the need for the recipient to do loan servicing (the lender does this).
 - Minuses:
 - Functions like a grant in that there is typically no requirement for the borrower to repay the interest subsidy.
- Loan Guarantees: Loan guarantees induce private lending by pledging that the lender's loan will be repaid (percentage negotiated) with CDBG funds, should the borrower default.
 - The purpose of the loan guarantee is to reduce risk to the lender and thus make them more willing to make the business loan.

- Loan guarantees may be structured to cover 100 percent of the outstanding indebtedness on the loan or for a portion of this debt.
- In return for the guarantee, the grantee requires the lender to relax some of their normal underwriting standards in order to address the credit needs of smaller or more “risky” businesses.
- Pluses:
 - Induces lenders to make loans to a wider variety of borrowers; and
 - Does not require significant expenditure of CDBG funds unless the business defaults.
- Minuses:
 - Can be very difficult to structure. It is imperative that the recipient have clear guidelines on what the guarantee covers and when/how it will be paid out if a collateral default occurs.
 - If the criteria for when and how guarantees will be made are at all vague or unmonitored, it is possible that shoddy underwriting will result, particularly if a 100 percent guarantee is offered (remember that under these types of guarantees, the lender has very little risk). Consider providing a guarantee of the top 20-30 percent of a loan to discourage this, so that the lender retains some risk.

Revolving Loan Funds

- Economic development financing may be administered in a variety of ways. Many grantees use revolving loan funds (RLFs) in conjunction with business and economic development programs.
 - These are called revolving loan funds because, as loans are repaid, the funds are “revolved” through the institution to be reinvested into other community-based development projects.
 - RLFs are often described as “gap financing” mechanisms, in that they provide the critical missing pieces to a community economic development project. Coupled with technical assistance, these funds can be a significant factor in a successful project because they often provide financing on more flexible terms than private lenders.
 - RLFs are diverse. Some serve a single neighborhood, commercial district, or are administered citywide, while others serve larger rural regions, and still others are national in scope. While they vary widely in size, almost all funds are administered by nonprofit organizations.
 - Revolving loan funds can be generic—serving any economic development use—or can be targeted (e.g., micro businesses or for businesses in a given industry).
- Revolving loan funds are permitted under the CDBG program, although there are some requirements.

- Under CDBG, a revolving fund is a separate fund (independent of other CDBG program accounts) set up for the purpose of carrying out specific activities. These activities then generate repayments to the account for use in carrying out similar types of activities;
 - Federal cash management requirements prohibit lump-sum drawdowns of CDBG funds to capitalize an RLF;
 - RLFs are usually capitalized by CDBG program income;
 - CDBG-funded RLFs must comply with CDBG requirements (i.e., fund an eligible activity, meet a national objective, meet the public benefit standards, and meet HUD requirements regarding interest earned on balances);
 - Interest paid by borrowers on CDBG-funded RLF loans is considered program income and subject to the CDBG program income requirements.
 - States cannot directly operate RLFs under the State CDBG program. Rather, the fund is operated by a UGLG as a State program recipient.
- Typical borrowers are:
 - Small businesses;
 - Microenterprises;
 - Minority and women-owned businesses;
 - Nonprofit housing developers, including commercial and mixed use developers;
 - Worker-owned businesses;
 - Consumer cooperatives;
 - Limited equity housing cooperatives;
 - Community land trusts;
 - Sometimes RLFs are set up as intermediaries, funneling Federal and private dollars to neighborhood-based groups that then lend directly to local borrowers in support of local initiatives. Revolving loan funds can raise lending capital from a variety of sources.
 - The Department of Agriculture offers programs that can be used for RLFs. See the description of the Department of Agriculture's programs in the next section of this chapter for more information.
 - One of the Community Reinvestment Act (CRA) tests for regulated banks examines "investment" in their service areas. Many banks invest in community-based RLFs as a way to meet this requirement. The RLF then re-lends the money to neighborhood-based projects.
 - The Treasury's Community Development Financial Institution (CDFI) Fund provides millions in Federal funds to existing and new community development loan funds to reinvest in their service areas. See Chapter 2 for more information on CDFIs.
 - Foundations, churches, corporations, and private individuals interested in making an investment in their community often make grants or low-interest loans to RLFs.

- Although they are committed to social outcomes, successful RLFs are also, in every respect, disciplined lenders. RLFs underwrite projects rigorously, demand financial feasibility as well as social benefit in projects, require and document adequate collateral, monitor their borrowers' progress closely, and provide technical assistance before and during the loan term.
- Whether making direct loans or acting as an intermediary, RLFs usually provide technical assistance to borrowers to assist them in reaching their community development goals. Technical assistance may include:
 - Business or project planning;
 - Financial packaging;
 - Accounting and legal support; and
 - Marketing assistance.
- Key steps in establishing an RLF include:
 - Identify the RLF market;
 - Conduct a "scan" of clients, funds, and administrators;
 - Make key decisions about the attributes and funding sources (see below);
 - Select an administering entity;
 - Develop and/or adopt lending policies and administrative procedures;
 - Market the program; and
 - Make and service loans.

Other Sources of Economic Development Financing

- In addition to the CDBG and Section 108 Programs, there are a number of other Federal agencies that offer economic development related assistance.
- Economic development and/or business programs are offered by:
 - The Small Business Administration;
 - The Economic Development Administration;
 - The Department of Agriculture;
 - The Department of Labor; and
 - The Treasury Department through a CDFI.

Small Business Administration

- The Small Business Administration (SBA) funds a number of business development programs*, including:

- 7(a) Loan Guarantee: Under this program, private-sector lenders provide small business loans which are 90-percent guaranteed by SBA. These are often used in tandem with CDBG loans;
- Specialized 7(a) Programs: SBA offers specialized versions of the 7(a) program, including the following programs: LowDoc (a streamlined lending process); FA\$TRAK (a pilot program); CAP-lines (working capital program); International Trade; Export Working Capital; Pollution Control; DELTA (loans to small firms adversely affected by defense cutbacks); Minority and Women's Prequal; Disabled Assistance; Qualified Employee Trusts (assistance to employee stock ownership plans); and Veterans' Loans;
- 504 Certified Development Company Program: This program provides long-term financing for land; buildings; machinery; and equipment and for building, modernizing, or renovating existing facilities and sites;
- Microloan Program: Under this program, SBA-funded intermediaries provide TA and financing of \$100 to \$25,000 to microenterprise owners; and
- Small Business Development Centers (SBDCs), Service Corps of Retired Executives (SCORE), Business Information Centers, One Stop Capital Shops. These programs provide small businesses with training and technical assistance.

*Note: Some of the programs noted above may not be operational at the time this manual was published.

Economic Development Administration

- The Economic Development Administration (EDA) is a part of the Department of Commerce. Although rural in nature, it offers a number of economic development programs:
 - Public Works and Development Facilities Program: This program funds: water and sewer projects facilities serving industry and commerce, access roads to industrial parks or sites, port improvements, and business incubator facilities;
 - Trade Adjustment Assistance Program: This program funds firms that can demonstrate they have been negatively impacted by import competition;
 - National Technical Assistance Program: This program funds economic impact analyses, examples of effective practices in economic development, and demonstrations of national significance;
 - Local Technical Assistance Program: This program focuses on technical or market feasibility studies of economic development projects or programs;
 - Planning Program for Economic Development Districts, Indian Tribes, and Redevelopment Areas: Under this program, EDA provides planning grants covering administrative expenses of establishing economic development programs;
 - Economic Adjustment Program: This program helps State and local areas design and implement strategies for adjusting to changes in their economic circumstances due to corporate restructuring, new Federal requirements, reductions in defense expenditures, and depletion of natural resources or natural disasters;

- Planning Program for States and Urban Areas: Under this program, economically distressed States, sub-State planning regions, cities, and urban counties can receive financial support for economic development planning; and
- University Centers Program: This program helps colleges and universities to address the economic development problems of their service area.

Department of Agriculture

- The Department of Agriculture offers a very large number of economic and business development programs under its Rural Business Cooperative Service, including:
 - Rural Economic Development Grants: Under this program, grants are provided to rural communities for RLFs to assist community facilities and infrastructure and for assistance in conjunction with the Department's Rural Economic Development Loan Program;
 - Rural Economic Development Loans: This program provides loans and grants to Rural Utilities Service-financed telephone and electric utilities to promote rural economic development and job creation;
 - Business and Industry Direct Loans: This program provides loans to public entities and private parties who cannot obtain loans from other sources. Private party loans can be used to finance businesses, create jobs, and improve the environment in rural communities;
 - Business and Industry Guaranteed Loans: This program guarantees up to 90 percent of a loan made by a commercial lender to rural businesses;
 - Intermediary Relending Program: This program finances business facilities and community development projects in rural areas through loans made to intermediaries. The intermediaries then establish a RLF and relend the funds for business facilities or community development purposes;
 - Business Enterprise Grants: This program makes grants to public entities, nonprofits, and Indian tribes to finance the development of small and emerging private businesses located outside of cities; and
 - Rural Business Opportunity Grants: This program provides for training, technical assistance, and planning activities that improve economic opportunity in rural areas.

Department of Labor

- The Workforce Investment Act (WIA) programs, operated by local workforce investment boards, offer training and retraining to eligible people. Services provided include:
 - Employment services such as career counseling;
 - Vocational training in classroom or on-the-job settings;
 - Job search allowances for eligible individuals who are looking for work; and
 - Relocation allowances for moving expenses.

Community Development Financial Institutions

- The Community Development Banking and Financial Institutions Act of 1994 created a CDFI Fund to “promote economic revitalization and community development through investment in and assistance to community development financial institutions.”
- The CDFI Fund is a government corporation that is a subsidiary of the U.S. Treasury Department. The purpose of this fund is to provide capital to organizations qualifying as CDFIs. The funding is competitive and based upon periodic application rounds. The CDFI regulations may be found at 12 CFR Part 1805.
- The CDFI Fund may provide assistance to approved CDFIs in a number of forms, including:
 - Equity investments;
 - Deposits;
 - Credit union shares;
 - Loans; and
 - Grants.
- Local CDFIs in turn provide funds to community and economic development projects in accordance with their mission, including:
 - Commercial facilities that promote revitalization, community stability, or job creation/retention;
 - Businesses that provide jobs for low-income persons, are owned by low-income persons, or enhance the availability of products for low-income persons;
 - Community facilities;
 - Financial services;
 - Housing that is affordable to low-income persons;
 - Consumer loans; or
 - Other activities approved by the fund.
- Financial assistance from the CDFI Fund requires a match of \$1 of non-Federal money for each \$1 received from the fund. The local match must be in the same form as the award from the CDFI Fund (e.g., equity matched with equity).
 - CDBG funds are considered Federal funds for this purpose and cannot be used as a match. This is true regardless of the fact that regulations permit CDBG funds to be used as payment for non-Federal share in many other circumstances.
- In order to apply for CDFI status, an organization must:
 - Have a primary mission of promoting community development;
 - Serve an investment area or targeted population (see below);

- Provide development services and equity investments or loans; and
- Maintain accountability to residents within its investment area or targeted population (see below).
- An investment area is defined by the CDFI Act as an area that either:
 - Meets the objective criteria of economic distress developed by the Fund and has significant unmet needs for loans or equity investments. Economic distress may be evidenced by: 20 percent or greater of the population is in poverty and the median income of the area is at or below 80 percent of area or national median income (whichever is greater); the unemployment rate is at least 1.5 times the national average; the percentage of occupied distressed housing is at least 20 percent; in areas outside of a metropolitan area, the county has had a population loss between 1980 and 1990 of at least 10 percent. Unmet need is an area where studies have shown that there is a pattern of unmet needs for loans and equity investments; or
 - Is located in a federally designated EZ or EC as identified by HUD.
- A targeted population is defined by the CDFI Act as individuals, or an identified group of individuals, including an Indian tribe, who:
 - Are low-income; or
 - Otherwise lack adequate access to capital.
- There are many types of organizations that may meet these criteria, including:
 - Community development banks;
 - Community development credit unions;
 - Community development loan funds;
 - Microenterprise loan funds;
 - Community development corporation (CDC)-based lenders; and
 - Venture capital organizations.
- A depository institution holding company (or any of its subsidiaries or affiliates) can only qualify as a CDFI if the entire family of institutions together meets the definition of a CDFI noted above. Regular commercial banks generally do not qualify.
 - In addition, any CDC that is a subsidiary of a regular bank is also generally disqualified. A CDC is considered a subsidiary if it is more than 25 percent owned by a single bank.
- Applications for CDFI certification are submitted to the Department of Treasury's Community Development Financial Institutions Fund. Check for application timing and requirements.
- CDFIs receive special flexibilities under the CDBG regulations. CDFIs can undertake many of the economic development activities that CDBG grantees wish to conduct. Some CDFIs may

be able to contribute additional funds toward economic development activities, thus stretching CDBG dollars. Activities carried out by a CDFI receive special CDBG consideration regardless of whether the CDFI is actually receiving assistance from the CDFI Fund. The additional CDBG flexibility authorized for such activities includes:

- For a CDFI whose charter limits its investment area to a primarily residential area consisting of at least 51 percent LMI persons:
 - Job creation/retention activities may be qualified as meeting area benefit requirements;
 - Housing activities assisted with CDBG, with the exception of direct homeownership assistance under 24 CFR 570.201(n), and located in a CDFI area, may be considered to be a single structure for purposes of applying the LMI housing national objective criteria; and
 - Economic development activities may be exempt from the aggregate public benefit standards.
 - For any CDFI, regardless of the investment area, job creation/retention national objective requirements may be met by aggregating the jobs created or retained by all businesses for which CDBG assistance is obligated for such activities during the program year.
- Check with www.cdfifund.gov for more information about CDFIs.

9. Underwriting

This chapter addresses the following questions:

- What is underwriting?
- How does public underwriting differ from conventional underwriting?
- What are the major concepts of underwriting?
- How are startups loans and microloans different?
- What constitutes a financial analysis?

What is Underwriting?

- Underwriting is associated with risk. Underwriting is the disciplined process an analyst pursues in determining risk, in establishing procedures which enable a lender or investor to take only "reasonable" risks, and in evaluating rewards so that they are commensurate with the risks incurred.

Public vs. Private Underwriting

- A private underwriter has a clear goal. He/she has a fiduciary responsibility to maximize returns (for a given risk level) and, if employed by a corporation, maximize shareholder value.
 - Although the private lender may have other legitimate concerns (development of distressed areas, job creation, entrepreneurship, etc.), these concerns should not materially compromise his fiduciary obligations.
 - Moreover, the private lender has only one source of return, namely repayment from a loan transaction.
- Public underwriters have multiple goals. Not only must the underwriter satisfy criteria concerning social goals (job creation, national objective, Davis-Bacon, etc.), the public underwriter also has a financial responsibility to utilize the scarce public funds wisely.
 - The public lender can incur more risk and accept less return on investment than the private lender since its source funding is interested as much in the social benefits of a loan program as a return on investment and preservation of capital.
 - The return to the public lender is multiple. In addition to principal and interest payments, the public lender (if a public entity) can collect various taxes (ad valorem, wage, sales, business license, etc.), depending on the local tax structure.
 - Accordingly, the total return to the public lender on a transaction with a relatively low interest rate may be enhanced significantly by a loan which generates increased investments, jobs, and business activities and thus increased tax revenues.

- Public lenders should understand their niche—to be compatible with conventional lenders by providing loans that conventional lenders would not accept, not to compete with or displace them. Public lenders should be prepared to take on more risk than conventional lenders, but that additional risk should be reasonable and related to the public purpose the funds are intended to accomplish.

Overview of Economic Development Underwriting

- In general, there are two basic types of underwriting: business loans and real estate loans.
 - Business transactions involve operating companies that provide services or produce goods. Payment of debt service is a function of cash flow generated by operations of the company. Examples of operating companies are retail businesses, industrial concerns, wholesalers, law firms, contractors, etc.;
 - Real estate transactions are also referred to as developer or investor deals. Cash flow for repayment of debt service is derived from leases to third-party tenants. Examples of real estate transactions are shopping centers, industrial parks, office buildings, incubators, etc.; and
 - Business loans tend to be analyzed in one way and real estate loans in another way. Both will be discussed in later sections of this chapter. Before general underwriting criteria are discussed for each area, the Federal regulatory context and requirements will be explained.

HUD Guidelines for Evaluating and Selecting Economic Development Projects

- In 24 CFR 570.209, and in Appendix A to the regulations, HUD provides guidelines for financial analysis and public benefit standards. The guidelines are for are applicable to activities that are eligible for CDBG assistance under Sec. 570.203 and activities carried out under the authority of Sec. 570.204 that would otherwise be eligible under Sec. 570.203, were it not for the involvement of a Community-Based Development Organization (CBDO).
 - Although the suggested financial guidelines and objectives are voluntary, they are recommended as a “best practice.”
 - The standards for evaluating public benefit, however, are mandatory.
- In addition to the CDBG guidelines, Office of Management and Budget (OMB), provides guidance on cost principles that apply to all uses of Federal funds.
- Furthermore, some HUD programs trigger subsidy layering analysis requirements, which requires underwriting to consider all public subsidies in the project to avoid over-subsidizing through the blending of public subsidies. Whether or not formal subsidy layering analysis is a requirement, consideration of all public subsidies to avoid undue enrichment is fundamental to good public underwriting.

- Together, these standards and guidelines require jurisdictions to determine reasonable public assistance and benefit based on general cost principles and specific program standards. They apply to economic development activities funded through Section 108 as well.

Public Benefit Standards

- Recipients making loans for special economic development projects (570.203) must comply with the public benefit standards (570.209), as introduced earlier in Chapter 2. 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.
- Unlike the underwriting guidelines, the public benefit standards are mandatory.

Financial Guidelines

- 570.209 outlines six objectives for economic development underwriting (and additional details are provided in Appendix A to the rule):
 - 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.
- Although not mandatory, 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.

Project Costs Are Reasonable

- The budget is a logical starting point in the analysis.
 - If the budget is overinflated, there may be a waste of scarce public resources and a surplus can end up as an additional fee to a developer or entrepreneur; and
 - Conversely, if the budget is understated, the success of the project may be affected, which could reduce the income available for debt service. In extreme cases, the project may go unfinished or fail before repayment has occurred.

- Public lenders can control these risks in the following ways:
 - Where construction costs are involve, require quotes from independent, third parties. (In general, a contractor's estimate is more reliable than an architect's, but there are many caveats.);
 - Compare the applicant's proposal with costs of comparable projects;
 - Use guaranteed contracts, performance bonds, or letters of credit;
 - Retain a contractor's fee for a period after completion, or retain the developer's fee or the leasing reserve; and
 - Require costs to be certified by a third party.

Sources are Committed

- The public lender wants to avoid the risk of approving and disbursing funds to fund a portion of the project without sufficient funds from other sources to complete the development.
- All other sources of funds do not have to be in place prior to application. However, the authorization of the public loan may be made contingent upon conventional financing, and the closing of the public loan should be simultaneous with other loans.
- Before HUD funds are disbursed, ensure that all debt is firmly committed to the project, and all equity is in place.

CDBG Funds are Not Substituted for Non-Federal Funds

- In general, the public lender should clearly establish that there is a need for the investment of public resources. Incentive funds are far too scarce and valuable to waste.
- Historically, public lenders have established the need for public investment if a project has one or two types of funding gaps:
 - Financing gap; or
 - Rate of return (ROR) gap.
- **Financing Gap**—A financing gap is determined by calculating the amount of debt the project can support, and computing the amount of equity the project can generate or the owner has available. If the budget is greater than/equal to the sum of debt plus equity, then there is a financing gap. Public funds should be invested. If the budget is less than the sum of the debt and equity, there is no financing gap and, therefore, no need for public investment.
 - The concept sounds complicated but is quite simple. Assume you contract to buy a house for \$100,000. You go to your lender who will loan you \$80,000 based on your income. You have \$12,000 in equity. Since your budget of \$100,000 (ignoring closing costs for simplicity) is greater than the sum of debt and equity (\$92,000), the transaction cannot occur since there is a financing gap. If you access an additional \$8,000, you can complete the deal.

- **Rate of Return Gap** — The rate of return (ROR) gap is a variation of the financing gap. The ROR method is more applicable to real estate transactions than business deals, particularly for smaller projects.
 - The rate of return gap is the ratio of income received by the owner to the equity invested by the owner. It is determined by calculating the debt the project can support, computing the amount of equity necessary to complete the project, and comparing the rate of return based on the equity invested.
 - If the market rate is greater than/equal to the rate of the prospective project, a gap exists; and an investment of public funds is warranted.
 - If the market rate is less than the rate of the prospective project, there is no gap and thus no need for public investment.
 - The benefit stream can be simple (pre-tax cash flow) or complex (after-tax, discounted, with appreciation). For example, a rental property:
 - \$100,000 cost
 - Debt: \$80,000
 - Equity Required to Complete: \$20,000
 - Benefits: \$1,000/ Year
 - Market return: 10 percent
 - An investor's return on the subject project is 5 percent ($\$1,000 / \$20,000$). If the market is demanding a 10-percent return, why would a rational investor accept a prospective project with a 5-percent return? Thus, a ROR gap exists and public funds can be injected into the project, thereby pushing the ROR to a market rate that will entice an owner to invest his or her equity in the deal.

Project Feasibility

- The project or venture should be viable with the public assistance. In other words, it should be able to achieve a level of operation that is successful in the near and long term. A venture should provide sufficient cash flow to repay debt and provide a reasonable ROR on equity invested. Feasibility is a threshold, because an infeasible project will be unable to repay the public investment, or meet the community development objectives if the business fails or is foreclosed upon. In a co-lending opportunity, the private lender can be a resource for conducting the feasibility analysis.
- Determination of feasibility requires an understanding of the industry, and the ability to test various assumptions about operations. Working with lenders who have this experience will be helpful to Grantees.
- Feasibility is a threshold, because a project that is not feasible will be unable to repay the public investment, but it is also an important criterion because the community development objective cannot be met by a failed business or foreclosed project.
- Viability or sustainability is achieving feasibility over the long run. Public underwriters need to be concerned that the venture remains feasible or viable for at least the term of the loan.

- Repayment terms are a part of feasibility because if the terms are too harsh, the survival of the venture or project is jeopardized.
- Calculating the financing gap determines the least amount of public funds needed to complete the project. However, keep in mind that that addition of public debt, particularly amortizing public debt, may cause the other lenders to reduce their loan amounts. Adding public debt can affect the conventional debt and equity and public lenders must find the proper combination which closes the gap.

Owner's Equity Return is Reasonable

- An owner strives to receive a market-rate ROR on their project. This varies by market and type of venture. However, the ROR should be reasonable given the equity invested and risk taken. Generally, the greater the risk the higher the ROR demanded. So ventures need to be examined in comparison to similar ventures in similar markets.
- It is often difficult to compute the return on equity for small business projects. The use of standardized publications to calculate RORs for small businesses is not recommended. There are significant variations in the data and there are many anomalies associated with small businesses that skew the results. Such an approach is more applicable to publicly traded companies or real estate projects in general.
- For real estate ventures, the return on equity should come from cash flow of the project, not capital sources.
- Repayment terms are a part of feasibility because, if the terms of repayment are too lenient, the borrower may receive an excessive ROR – one above the going market rate.

CDBG Funds Disbursed Pro Rata

- As a general rule, CDBG funds should be disbursed in proportion to the percentage of the project they fund. For example, if CDBG funds are 20 percent of the project, each dollar of CDBG funds disbursed for the project should be matched by four dollars from other funding sources. One exception is where CDBG funds are allocated for an acquisition activity.

OMB Cost Principles

- OMB cost principles apply to all CDBG activities (through 570.200(a)(5) & .502(a), which apply A-87 to public entities and A-122 to nonprofit subrecipients).
- The cost principles provide guidelines concerning reimbursement requirements, uniform standards of allowable and allocable costs.
 - Allowability of costs – Costs are allowable if they are reasonable, allocable to the program, treated consistently (following GAAP & agency procedures), allowed by program regulations (and OMB Circulars) and by terms of written agreement, and documentable; and

- The OMB cost principles do not supersede limitations imposed by the program statute, dictate how a grantee should use the funds, or relieve State/local governments of stewardship responsibilities for Federal funds.
- Reasonableness of costs: Costs are reasonable if they:
 - Are ordinary & necessary for the completion of the project;
 - Reflect an arm's length transaction with an unrelated third party;
 - Meet the standard of due prudence (that is, a prudent person would incur the cost); and
 - Are consistent with established policies/practices across the agency and program.
- Allocability of costs: Costs are considered allocable to a Federal program when they are:
 - Incurred directly for the purposes of the program;
 - Are reasonably allocated (if costs benefit multiple activities);
 - Indirect costs necessary to the overall operation of the agency; and
 - Equipment items budgeted and benefiting the project may be charged entirely to project regardless of its useful life.
- Unallowable costs: Costs are unallowable if they:
 - Are specifically identified in the program regulations as being unallowable;
 - Are specifically identified in the OMB Circular as being unallowable; and
 - Do not meet the "allowability" criteria in the Circular, which is that the cost be necessary and reasonable for proper and efficient performance and administration of the Federal award activity (for example, the purchase of a piece of equipment that is not needed for performance of the activity.)

Additional Guidance for Section 108

- The following thresholds may serve as general rules of thumb:
 - A loan-to-value (LTV) ratio of no more than 80 percent (for real estate).
 - A debt coverage ratio (DCR) of at least 1.15-1.25.
- A community with a transaction satisfying these thresholds would still have to pledge its current and future CDBG entitlement allocation and its program income.
- The security requirement may be satisfied by a specific lien on the real estate (mortgage or deed of trust) or a UCC filing on personal property, plus some form of other collateral (personal, corporate guarantee, etc.).
- If the transaction does not conform to the underwriting thresholds, the community must pledge additional security that will compensate HUD for the increased level of risk.

- As described in this chapter, using prudent underwriting standards and risk management techniques can help communities reduce risk to an acceptable level.

Underwriting Business Loans

- Professional credit analysis is beyond the limited scope of a chapter in a manual of this nature. Accordingly, this chapter identifies the primary concepts of credit analysis and financial underwriting but does not try to replace a credit course.
- The main criteria for underwriting business loans are:
 - Ability to repay;
 - Collateral;
 - Commitment;
 - Balance sheet analysis;
 - Management experience; and
 - Credit history.
- Of the six credit criteria concerning business loans, the ability to repay is generally the most important to public lenders. However, all are important and the absence of any one may be sufficient to decline a loan request.

Business Loan Criteria

The Ability to Repay

- The ability to repay is usually expressed in a simple calculation called the debt coverage ratio (DCR). It is defined as follows:

$$\text{Debt Coverage Ratio} = \text{Cash Flow Available for Debt Service} / \text{Debt Service}$$

- In general, private lenders look for a minimum DCR of 1.25. This translates into a project having \$1.25 of cash flow available for every \$1 of new and existing debt service. Many public lenders accept a ratio of 1.1 to 1.15. Although the calculation is simple, determining the cash flow available for debt service can require judgment and experience.
- If the analyst knows two of the variables in a three variable equation, he can solve the unknown. For example, if a private lender has a DCR of 1.25 and there is \$100,000 of cash flow available for debt service, debt service cannot exceed \$80,000.

Collateral

- If the project cannot repay the loan from cash flow, the lender attempts to collect payment by liquidating the asset pursuant to the specific lien securing the loan. This ability is measured by a ratio called loan-to-value (LTV). It is expressed as follows:

Loan to Value = Loan / Lesser of (1) Cost or (2) Value

- LTV ratios will vary as to the nature of the asset being financed. The following are generally accepted loan-to-value standards (maximums):

| Asset | LTV |
|-----------------------|--------|
| Real Estate | 80% |
| Machinery & Equipment | 50-75% |
| Inventory | 50-60% |
| Receivables | 75% |

- As with the DCR, an analyst can solve for the unknown if two variables are identified. For example, if a lender's LTV is 80 percent (real estate) and desired loan is \$100,000, the appraisal must equal or exceed \$125,000.

Commitment

- If the methods of repayment are insufficient, the lender must attempt to collect on other collateral, generally in the form of personal and corporate guarantees. Owners must guarantee the loan although the guarantee may be proportionate to their ownership interests. For example, an owner with 20 percent interest in a company borrowing \$100,000 would guarantee \$20,000 personally although the company would be liable for the entire loan.

Balance Sheet Analysis

- The balance sheet must be sound before a loan is made. Soundness is determined primarily by analyzing the following:
 - Does the company collect its receivables? An inability to collect receivables will hamper cash flow;
 - Does the company pay its bills? Late or missed payments may indicate poor cash flow or unreliable character;
 - Is the company managing its inventory? Sloppy inventory practices may be indicative of overall management deficiencies;
 - Does the company generate sufficient cash relative to its cash needs?
 - Is the owner paying himself/herself a reasonable salary or charging reasonable fees?
- An affirmative answer to these five questions probably means the balance sheet is in sound condition.

Experienced Management

- The management team must have experience in all areas of running the business: sales, finance, operations, personnel, etc. The management team includes the principals, directors, senior management, and consultants.

- The management team should have direct experience in these areas or have comparable businesses skills that can be transferred.

Credit History

- The owners and management should have favorable credit histories, a reputation for treating customers fairly, no bankruptcy in the past five years, and a clean criminal record. In most cases, a credit report and a Dun & Bradstreet check are sufficient.

Evaluating Startups/Small Loans

- The credit criteria enumerated above reflect professional standards. Startups or small loans (under \$15,000) may have trouble satisfying all of these criteria. In general, these classes of loans are high risk. Accordingly, public lenders will probably have to allocate disproportionate staff time in monitoring and servicing these loans and increase reserves when compared to a portfolio reflecting professional standards.
- A widely disseminated statistic indicates that only one business out of every five is in existence 5 years after its inception, although these statistics may also reflect businesses that are bought out or go public as no longer in existence. Recent research is beginning to explore this more and challenge the reliability of this statistic. For example, a BLS study showed 66 percent of business startups still in business after 2 years, and 44 percent in business after 4 years.
 - Regardless of which statistic is more accurate, a portfolio focusing on startups must address high risk factors and plan for loss rates which far exceed a portfolio targeted to existing and expanding businesses.
- One tool that can help reduce the risk associated with lending to such businesses is the provision of business training and ongoing technical assistance to businesses receiving loans. Recipients should investigate options for providing this assistance, such as:
 - Small Business Administration (SBA) Business Centers;
 - Local educational institutions; and
 - Business mentoring through institutions such as the local Chamber of Commerce.
- In addition to the conventional criteria, a public lender should consider the following four additional factors;
 - Business plan;
 - Borrower commitment;
 - Personality; and
 - Niche.

Business Plan

- A business plan can identify obviously worthy or unworthy ventures; however, an analyst should not over rely on a business plan. The worth of a business plan is increased greatly if the entrepreneur does it personally. Remember, you are financing the entrepreneur, not the accountant or consultant who writes the plan. Of particular importance is monthly cash flow statement for the first year. A handwritten cash flow statement prepared by the entrepreneur can be far more relevant than the fanciest computerized spreadsheet.
- It is difficult for a small firm to compete with much larger companies on price. Is the entrepreneur committed to customer service? A startup or small business needs to understand the market in order to create a market niche or offer a unique product or service to differentiate itself.

Borrower Commitment

- How much money the borrower commits is generally not as important as having the borrower put everything he has into the deal. Although there are many caveats, a borrower injecting most of his assets into a potential transaction is less likely to let the deal fail than someone injecting a fraction of their net worth. The borrower should sign personally for the loan and should be prepared to take out a minimum salary until the business is established.

Underwriting Real Estate Transactions

- Real estate transactions are also called developer or investor deals. Cash flow for repayment of debt service is derived from leases to third party tenants. Examples of real estate transactions are shopping centers, industrial parks, office buildings, incubators, etc.
- Despite the range of properties, all real estate deals are analyzed in essentially the same manner.
 - Larger transactions may include a developer, a syndicator, multiple investors and property manager; and
 - An example of a smaller project is a three-unit building where an owner lives in one unit and leases out the remaining two units.
- Real estate transactions are expressed as the following:

| | |
|---------------------------------|-----------------|
| Gross Rent | \$250,000 |
| - Vacancy and Uncollected Rents | -\$20,000 |
| <hr/> Effective Gross Rents | <hr/> \$230,000 |
| - Operating Expenses | -\$120,000 |
| <hr/> Net Operating Income | <hr/> \$110,000 |

- Net operating income (NOI) pays claims in the following priority:
 - Mandatory debt service;
 - Replacement reserves;

- Non-mandatory or cash flow loans; and
- Distributions to owners.
- This is a cash definition. The owners collect cash (rents) and pay out cash (operating expenses). The remaining cash is the NOI and pays lender debt, funds the replacement reserves, and provides a return to investors.
- Underwriting analysis is only as sound as the quality of the information an analyst uses.
 - The proper way to determine rents, operating expenses (taxes, utilities, maintenance, insurance, management, etc.) is to observe the market. Find comparable properties to the subject and adjust accordingly.
 - It is also important to identify any tenant contributions. For example, if a property leases for \$10 per square foot with the tenant paying all operating expenses and a "comparable" property leases for \$15 per square foot with the landlord paying all expenses, the amount of the tenant contribution is important in comparing the two properties.

Real Estate Loan Underwriting Criteria

- Business loans and real estate loans have similar underwriting concepts, but each transaction is analyzed differently. Relevant criteria for real estate underwriting include:
 - Ability to repay;
 - Collateral;
 - Commitment to project; and
 - Experience of development team.
- All of these criteria are important and rejecting only one may be cause to reject the loan.

Ability to Repay

- A lender is concerned with the ability of the project to repay the existing and proposed debt service. The primary ratio lenders utilize to determine this capacity is the debt coverage ratio, defined as follows:

$$\text{DCR} = \text{Net Operating Income} / \text{Debt Service}$$

- Although the math is simple, determining NOI can be involved. Finding comparable properties and making adjustments to the subject property to establish rents, vacancy rates, and operating expenses requires experience and judgment.
- In using NOI, the lender uses a stabilized year. For example, if a project takes 2 years to lease-up, the lender utilizes the stabilized vacancy beginning in year 3 but does not inflate the rents in calculating DCR.

- Most conventional lenders have a threshold for DCR in the range of 1.20 to 1.3 with public lenders accepting a range of 1.1 to 1.15. In general, the lender wants a high probability of leasing (if not signed leases) and tenants of acceptable credit quality. For larger projects, a market or feasibility study or appraisal is often required.
- In general, the lender wants a high probability of leasing (if not signed leases) and tenants of acceptable credit quality. For larger projects, a market or feasibility study by an independent third-party professional is often required.

Collateral

- The second means of repayment is liquidating the mortgage or deed of trust which secures the real estate loan. Lenders measure this capacity with the loan-to-value (LTV) ratio, defined as follows:

$$\text{LTV} = \text{Loan} / \text{Value}$$

- An appraiser normally determines value.
 - The appraiser should have experience with comparable projects and have the necessary State certifications;
 - It is important not to open the first pages of the appraisal, note the reconciled value and ignore the remainder of the document; and
 - If properly prepared, the appraisal should have a wealth of information concerning rents, vacancy and operating expenses. In general, the purpose of the appraisal should be to determine fair market value with fee simple ownership.
- Other questions to ask:
 - What is the purpose of the appraisal?
 - Has the appraiser valued similar projects as to type and scale?
 - Are the comparables really "comparable"?
 - What are the assumptions and limiting conditions?
- The threshold LTV for conventional lenders for real estate projects is generally in the range of 75 percent to 80 percent. Public lenders will usually go as high as 90 percent.

Commitment to Project

- For large real estate projects, it is difficult for a general partner of a limited partnership development to sign a recourse note for the mortgage due to complicated tax issues. However, a developer can show commitment in other ways:
 - Completion guarantee;
 - Recourse during the construction period;

- Deferral of development fee until construction is finished and project leased; or
- Guarantee cash flow shortfalls.
- For smaller projects without these issues, the owner can sign personally and/or corporately. In addition to the equity injected into the project, commitment by the owners and the developer reduce the risk to the lender and enhance the success of the venture.

Experience of the Development Team

- It is critical to the success of the transaction that the development team has experience in completing projects of similar type and scale. The development team includes the developer, architect, contractor, property manager, syndicator, leasing agents, mortgage banker, etc. In smaller projects, the owner may perform all of the roles listed above.
- The developer of the project should have a good credit history and be reputable.
- All the criteria are important and any may be sufficient to refuse a loan request. Business loans and real estate loans have similar underwriting concepts, but each transaction is analyzed differently. For a real estate project involving business tenants, two levels of analysis are needed: (1) to determine the feasibility of the real estate project; and (2) to determine whether the project will generate the projected rents.
- The following thresholds may serve as general rules of thumb:
 - A loan-to-value (LTV) ratio of no more than 80 percent (for real estate).
 - A debt coverage ratio (DCR) of at least 1.15-1.25.
- Using prudent underwriting standards and risk management techniques can help communities insulate risk to an acceptable level.

Exhibit 9-1: Risk Continuum

| LOAN CHARACTERISTIC | Lower Risk ← | → Higher Risk |
|------------------------------------|---|--|
| Debt Coverage Ratio | 1.25+ | 1.15 1.00 |
| LTV Ratios | 0.5 | 0.8 1.0+ |
| Structure of Loans | Approximates an installment loan with even payments, includes a debt service reserve in the loan amount | Interest only payments with balloon payment due at end of the term |
| Structure of Third Party Portfolio | Numerous borrowers and projects, none of which account for more than 20-33% of total portfolio | Majority of funding allocated to one borrower or project |
| Leverage | Private lender participation | Solely financed with CDBG funds |

- The security requirement would be satisfied by a specific lien on the real estate (mortgage or deed of trust) or a UCC filing on personal property, plus some form of general lien (personal, corporate guarantee, developer completion, etc.).
- If the transaction does not conform to the underwriting thresholds, the borrower should pledge additional security. Examples of additional security pledged include the following:
 - Income stream from a “seasoned” loan portfolio;
 - Parking revenue;
 - Pledge of tax increment from a tax increment financing district;
 - Pledge of land or property (must have value); or
 - General obligation of the community.

10. Section 108, EDI & BEDI

This chapter addresses the following questions:

- What is Section 108?
- What are the terms of financing for a Section 108 transaction?
- What are the key implementation steps in the Section 108 process?
- What are EDI and BEDI?

Section 108 Overview

- The Section 108 Program is a loan guarantee program which enables recipients to apply for a loan equal to an amount up to five times their annual CDBG grant for certain types of economic development activities.
- Examples of Section 108 projects include:
 - Industrial expansion;
 - Capitalization of a small business revolving loan fund;
 - Construction of a neighborhood shopping center;
 - Construction of a warehouse facility and industrial park;
 - Funding a business incubator;
 - Constructing an office building; and
 - Housing rehabilitation by a nonprofit organization.
- Eligible communities include:
 - 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 (Hawaii).
- If approved by HUD, notes are sold to investors in a public offering to raise funds for the recipient's approved project. HUD acts as the guarantor of the section 108 obligations, promising investors that the loan will be repaid.
- Entitlement communities pledge future CDBG funds as security for the loan, plus any needed additional security to ensure that the notes will be repaid in the event of a project default.

- Nonentitlement communities may participate if their State is willing to provide the pledge of future CDBG funds.
- The community uses the funds raised by the sale of the notes to undertake the approved project.
- The notes are repaid by the borrower/or the project funded with the Section 108 proceeds over a period of up to 20 years. Funds to repay the note can come from program income generated by the project, future CDBG funds, or other revenue sources that the recipient has available.
- Being able to borrow large sums of money helps recipients undertake large-scale, capital-intensive projects and provides a mechanism for recipients to extend the impact of their CDBG Program. The potential advantages include:
 - **Accelerate CDBG activities** – Instead of “paying as you go,” communities can complete needed projects now by utilizing Section 108.
 - **Potential leverage** – A community has access to funds totaling up to five times its annual CDBG entitlement while retaining the use of its entitlement.
 - **Spread costs over time** – The costs of these needed projects can be spread out over long periods of time—the maximum loan term is 20 years. Long-term repayment schedules lessen the yearly debt burden.
 - **Not a general obligation** – Since Section 108 borrowing is not ordinarily a general obligation, the Section 108 indebtedness does not affect the debt limit of the community.
 - **Avoid private benefit restrictions** – Most State constitutions prohibit the use of tax-generated funds to benefit private interests. Since Section 108 generally encumbers Federal entitlements and not tax revenue, communities can avoid this restriction.
 - **Access funds at AAA rate** – Despite the premium over the U.S. Treasury securities associated with Section 108 debt, the rate is approximately equal to what AAA-rated publicly-held companies pay for its debt. Consequently, a third-party borrower, who is typically nonrated and privately held, can access financing at significantly lower rates that would be otherwise be available.
 - **Access long-term funds at a fixed rate** – The fixed rate eliminates the risk of future rate changes to the community. Thus, the community is able to make long-term plans with certainty about interest rates, a rare luxury.
- These potential advantages are substantial enough that many communities are willing to assume the risks of Section 108 borrowing. Further, by using the risk management techniques described in this chapter, recipients can greatly reduce the uncertainty of Section 108 borrowing. Thus, when properly administered, the Section 108 Program provides recipients with a valuable tool to accomplish economic development goals that otherwise might be unmet or deferred.

History

- When CDBG legislation was created in 1974, it combined several categorical programs into one “block grant” instead of funding each program separately.
- “Section 108” of the original legislation provided communities with the opportunity to continue urban renewal, which was one of the categorical programs merged into CDBG, through borrowing. Original terms included:
 - The maximum loan term was 7 years;
 - Only entitlement communities could participate;
 - The Federal Financing Bank acted as underwriter and fiscal agent; and
 - The maximum loan was three times a community’s annual CDBG entitlement.
- Reflecting its urban renewal bias, the program was limited to activities related to real estate (acquisition, rehabilitation of publicly-owned property and demolition and site improvements related to acquisition).
- The Section 108 Program has evolved over the years to bring in private underwriters, add economic development as eligible, increase the maximum term to 20 years and maximum borrowing to five times a grantee’s annual entitlement, and require additional security.

Eligible Activities and Requirements

- Eligible Activities – The list of Section 108 eligible activities is narrower than those provided for the regular CDBG program. 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 Requirements – For purposes of determining eligibility, the CDBG rules and requirements apply. As with the CDBG program, all projects and activities must either

principally benefit LMI persons, aid in the elimination or prevention of slums and blight, or meet urgent needs of the community. The following criteria, discussed in detail in Chapter 2, are the same for both CDBG and Section 108:

- Compliance with national objectives;
- Davis-Bacon labor standards;
- Environmental review requirements;
- Underwriting guidelines;
- A written determination as a condition of eligibility [24 CFR 570.200(e)];
- Compliance with the primary objective (i.e., 70 percent of funds benefiting LMI persons);
- Public benefit standards;
- Antipiracy provisions;
- Restrictions on projects involving eminent domain; and
- CDBG certifications (with few exceptions).

Players and Their Roles

- The typical Section 108 transaction has the following players:
 - **Eligible Community** — The borrowing community incurs the ultimate risk of the Section 108 debt. If the community manages risk prudently and transfers the risk and cost to the third parties, the community can accelerate CDBG activities and achieve tremendous leverage. To secure Section 108 debt, the community must pledge its future CDBG entitlement funds, program income, and additional security as HUD deems necessary.
 - **HUD** – HUD reviews the community's application to see if the proposed activities comply with Section 108 regulations and are underwritten in a prudent manner. If the application is approved, HUD provides a 100 percent full faith and credit guarantee, which is the cornerstone of the program.
 - **Underwriter** – The underwriter is a consortium of several firms that sell the Section 108 notes to private investors. The underwriters receive a fee for their services. HUD competitively procures the underwriting services on a periodic basis.
 - **Trustee/Fiscal Agent** – The Trustee/fiscal agent manages disbursements to communities and repayments from communities which it then conveys back to the investors.
 - **Private Investors** – Private investors purchase the guaranteed obligations. The Section 108 obligations are roughly equivalent to Treasury issues but carry a slight premium to Treasuries, ranging from one-eighth of a percent in the shorter maturities to six-tenths of a percent in the longer terms. To date, no investor has ever incurred a loss from buying a Section 108 obligation.
 - **Third-Party Borrowers** – If the community chooses, it can reloan Section 108 proceeds to third-party borrowers. The third-party borrowers accept some portion of the risk and cost

from the community. Section 108 can provide such borrowers with fixed-rate, long-term, and reasonably priced financing that is difficult to obtain conventionally.

Terms of Section 108 Financing

- Section 108 consists of two levels of borrowing or lending:
 - Level # 1 — Eligible communities borrow money from private investors (which underwriters find).
 - Level # 2 – Communities either carry out activities that are eligible under Section 108 or, alternatively, re-loan the funds to third parties (entrepreneurs, developers, nonprofits, etc.) who undertake eligible activities.

Level #1 Terms of Financing

- Amount – For Level #1, the maximum aggregate lending is:
 - Entitlement public entities – 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;
 - State-assisted (nonentitlement) public entities, Hawaii, and Insular areas – 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; and
 - Non-entitlement public entities eligible under the HUD administered Small Cities Program (Hawaii) – up to five times the public entity's latest grant under 24 CFR 570, Subpart F, minus any outstanding Section 108 commitments and/or principal balances on Section 108 loans.
- Term – For Level #1, the maximum term is 20 years.
- Rates – There are two types of interest rates associated with Level #1 of the Section 108 Program:
 - **Permanent Financing Rate** – This is the interest rate at which the community borrows from the private investors. 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. Each annual principal amount will have a separate interest rate associated with it; and
 - **Interim Loan Rate** – Section 108 notes are sold in a public auction generally once a year. To allow communities to access funds for approved transactions prior to a public sale, HUD provides an interim credit facility. Interest rates on interim borrowing are priced at the 3-month London interbank offered rate (LIBOR) plus 20 basis points (0.2 percent). To access interim funds, the community must complete a Level # 1 closing. In general, the interim loan is taken out by permanent financing at the next public offering.

- Fees – There are no annual fees. Upfront fees for the underwriting process are approximately 0.5 percent and can be financed in the loan amount.
- **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 guaranteed obligations. The additional security requirements will be determined on a case-by-case basis, but could include assets financed by the guaranteed loan or other assets.
 - Examples of additional security pledged include the following:
 - Income stream from a “seasoned” loan portfolio;
 - Parking revenue;
 - Pledge of tax increment from a tax increment financing district;
 - Lease revenue;
 - Pledge of fees/licenses;
 - Pledge of tolls;
 - Pledge of land or property (must have value); or
 - General obligation of the community (Although Section 108 is usually not a general obligation of the community; the community may elect to agree to a general obligation status in order to address additional security requirements.)

Level #2 Terms of Financing

- Although HUD provides the structure concerning Level #1 transactions, communities have significant discretion regarding Level #2 transactions (with the exception of additional security). However, discretion does not mean communities can ignore and minimize the importance over the financing choices made in Level #2 transactions. These choices have significant and lasting impact.
- **Maximum amount** – For Level #2, HUD has no formal rules. However, communities should consider spreading their risk over multiple projects and business classifications to avoid concentrating exposure in any one area.
- **Term** – For Level #2, HUD has no specific rules. However, the term of the loan should be consistent with the economic life of the asset being financed and balloon repayments should be utilized judiciously.
- **Interest Rate** – Level #2 rates are negotiated between the community and the third party borrower. The community can re-loan the Section 108 funds at a rate which is less than, equal to, or more than its cost of funds. If the community subsidizes the Section 108 interest rate to the third party, the community will incur additional security concern.

Key Program Design Consideration: Charging Interest

When relending to third-party borrowers, communities must decide how much (if any) interest to charge. The community may subsidize the interest rate by relending the money at a lower rate than that charged on the 108 notes, or they can make a spread by relending the money at a higher rate than the 108 note. Communities chose between these two tactics based upon the individual needs of the project and their own tolerance for risk.

Implementation

The Section 108 Process

- Communities that are successful in implementing the Section 108 Program tend to have two common characteristics:
 - They establish systems for delivery; and
 - They manage risk.
- Each of these components is discussed in detail in the following section.

Step One: Screening

- For efficiency, communities should only allocate a significant amount of time to those transactions which have a reasonable chance of success. Accordingly, it is critical to screen potential projects early to determine their probabilities of success. There are essentially two screens: (1) credit; and (2) CDBG eligibility.
- Screening for credit requires that local practitioners receive financial information on the project and the principals early in the process.
- Examples of the type of information needed may include (but is not limited to): independent cost estimates (hard and soft costs); projections; historical financials (if a user deal); personal financials; appraisals; credit history; comparable properties regarding rents, vacancies, and operating expenses (if a developer deal); evidence of site control; business plan; market study; etc.
- Concurrent with credit review, the recipient should also screen the project for adherence to CDBG and Section 108 regulations.
 - Does the proposed project meet a National Objective; and
 - Are the proposed activities eligible Section 108 activities?

Meeting the 70 Percent Requirement

For budget purposes, Section 108 loans are considered an expenditure of CDBG funds and are added to the base for the 70 percent low/mod benefit calculation (recall also that the CDBG public benefit standards described in chapter one apply to Section 108 activities as well). Level #1 transactions are treated as a note payable. A third-party loan is a note receivable and repayments are considered program income.

Thus, recipients should be careful that large Section 108 projects do not skew CDBG budgets such that less than 70 percent of total CDBG expenditures benefit low/mod persons. This requirement is especially difficult to meet if the Section 108 activity qualifies under the Slum/Blight National Objective. Recall, however, that recipients are able to aggregate the benefit calculation over a period of one to three years, depending upon the certification included in the Consolidated Plan Action Plan.

- As the developer or entrepreneur receives more definitive information (more refined budget, completion of feasibility studies, etc.), the recipient will have to reconfirm the feasibility of the project.
- Prudent screening requires more time upfront but will save time ultimately for the community, the third party borrower and HUD.

Step Two: Application

- After the project is screened and deemed to have a reasonable chance of success, the community packages the Section 108 loan application.
- Pre-submission requirements — As a CDBG expenditure, communities must comply with the CDBG citizen participation plan (for its ConPlan or specially developed in compliance with 570.704), including publication and public hearings prior to submission to HUD.
- The recipient applies to HUD for a Section 108 Loan Guarantee by separate application or ConPlan submission, following the guidelines for 108 at 570.704(a), including:
 - Description of project/activities;
 - Compliance with CDBG National Objectives and Eligible Activities;
 - Schedule for repayment and pledge of grant; and
 - Required certifications.
- Depending on how they plan to use the Section 108 funds, communities may submit either detailed or generic applications.

- A “generic” application is one where a program is described, but individual transactions are not identified. (An example is a revolving loan fund. The community describes the program and enumerates the specific criteria the community will employ to underwrite the subsequent loans.) Once the HUD Headquarters approves the underwriting criteria, the community only has to apply to the Field Office for an eligibility determination as individual projects materialize.
- In contrast, a “detailed” application is one where the funds are earmarked for a specific project(s). In this instance, the HUD Headquarters will review the specific details of each project being financed.

Step Three: Approval

- Field Office Review – After completion of the application, the package is submitted to the Field Office for review. The Field office is primarily concerned about eligibility and the completeness of the application.
- Headquarters Review – After the Field Office review, the application is forwarded to HUD Headquarters. Headquarters verifies the recommendation of the Field Office and determines any additional security requirements.
- HUD may disapprove per 570.704(c) on the basis of unacceptable risk, exceeding allowable limits, or unavailable funds.
- HUD will notify the community in writing of their decision on the loan application.
- Communities should be careful not to incur costs related to the proposed project prior to Headquarters approval -- unless they comply with the pre-award requirements at 24 CFR 570.200(h) and the environmental review requirements of Part 58.

Step Four: Closing

- Since each level is a separate transaction, each level of a Section 108 loan has a separate closing.
- In general, HUD will provide the structure for a Level #1 closing. The closing documents for Level #1 are as follows:
 - Funding Form HUD-7082;
 - Contract for loan guarantee assistance;
 - Trustee/Fiscal Agency agreement;
 - Promissory note; and
 - Opinion of counsel.
- Among the issues communities should account for in closing are:
 - Adequately addressing collateral requirements;

- Passing the cost of Section 108 costs (e.g., interest costs) to third-party borrowers; and
- Making the attainment of a National Objective part of the obligations of the borrower and establishing penalties (where appropriate) and workout procedures if the objective is not met.

Step Five: Disbursement

- After the loan is closed and the Section 108 notes are sold at public auction, the Trustee/Fiscal Agent wires the proceeds to the custodial lender.
- The custodial lender is a local depository institution. The custodial lender must adhere to the requirements in the HUD proscribed letter agreements which stipulate how the funds are invested until utilized by the community.

Step Six: Servicing

- The Trustee/Fiscal Agent services Level #1 transactions.
 - If the Section 108 borrower fails to make timely payment of the amount due in the guaranteed loan, the Trustee/Fiscal Agent alerts HUD who has the authority to tap the community's CDBG line of credit and make payment on the borrower's behalf.
- Due to the fact that the Trustee/Fiscal Agent is only involved with Level #1 transactions, the community must establish its own system of servicing Level #2 transactions.
 - Given the considerable effort required to service a Section 108 loan, many communities chose to contract out the servicing function to a more experienced local lender.
- **Level #2 loan servicing** – The community should create a loan portfolio system which incorporates the following elements:
 - **Collections** – the actual collection of the third-party payment. Although the community's payments to the Trustee/Fiscal Agent are due quarterly, the community should insist on monthly payments from the third-party borrower. Funded projects can deteriorate quickly, and a monthly schedule provides an early warning system;
 - **Monitoring & Accounting** – recording transactions for each individual loan and for the loan fund as a whole (e.g., fund balance, loans 30/60 days past due, losses, total disbursements and payments, etc.) and using this information to produce monthly management reports;
 - **Collateral Preservation** – In addition to requiring monthly payments, the community should enact and enforce penalties for late payments—not enough to harm the project's feasibility but enough to incentivize timely payment (where possible, communities should arrange for automatic withdrawal agreements from third-party bank accounts). If real property secures the loan, communities should monitor payment of property taxes and hazard insurance and require an assignment of insurance indemnities. If the loan is secured by personal property, the community should confirm that the UCC filing is current;

- **Anticipating Problems** – By the time a late payment triggers attention, a project may already be severely troubled. To prevent such surprises communities should periodically visit the project they have funded to check for problems (e.g., is the property leased-up? Is inventory piling up?). Communities should also require annual financial statements from third-party borrowers which may point up changes in creditworthiness. Many lenders use a “tickler file” to remind them of important monitoring dates (e.g., financial statements due);
- **Dealing with Problems** – In the case of problem loans, early intervention is vital. In the **workout stage**, communities work with the third-party borrower to identify the cause of the problem (e.g., is the problem a temporary cash flow issue or a long-term structural problem?) and, to the extent possible, restructure the loan according to the borrower’s ability to repay. For example, interest may be deferred or converted into a residual (i.e., some form of ownership by the community); and
- **Foreclosure** – As a last resort, communities may foreclose on the loan and seek repayment through whatever options are available under the loan agreement (e.g., liquidating property, pursuing personal or corporate guarantees, etc.).

Underwriting and Risk Management

- Some form of risk is unavoidable for communities which utilize Section 108. **It is imperative that communities acknowledge that risk exists, assess the extent of risk and take prudent measures to mitigate and manage the risk.**
- However, using prudent underwriting standards and risk management techniques can help communities insulate risk to an acceptable level.

Key Program Design Consideration: Balancing Program Needs

One analytical tool for communities who are trying to weigh risk of Section 108 borrowing is to compare the need for the 108 project with the need for ongoing CDBG activities. Does the limited but real possibility of loss of future CDBG funds (and subsequent reduction in program activity) outweigh the need for the 108 project? This is not necessarily a “yes” or “no” question. In instances where the ongoing CDBG program activity is especially important, the community may decide to use more conservative guidelines in underwriting the 108 project. In instances where there is greater need for the 108 project, the community may be more willing to put future CDBG funds at risk.

Underwriting

- The most effective way for a community to manage risk is to institute professional guidelines for underwriting potential projects.
 - These guidelines are developed during the program design stage and used throughout the life of the Section 108 activity.

- Different communities will have different tolerances for risk, resulting in different underwriting guidelines.
- HUD has provided underwriting guidelines for economic development activities in the regulations (570.209). Economic development underwriting principles include the following:
 - Project costs should be reasonable;
 - All sources of project financing (beyond the Section 108 loan) should be committed to the project;
 - CDBG funds should not be substituted for non-Federal financial support;
 - The project must be financially feasible;
 - Return on the owner's equity investment should not be unreasonably high; and
 - Funds should be disbursed on a pro rata basis with other finances provided to the project.
- The following thresholds may serve as general rule of thumb:
 - A loan-to-value (LTV) ratio of no more than 80 percent (for real estate).
 - A debt coverage ratio (DCR) of at least 1.15-1.25.
- A community with a transaction satisfying these thresholds would still have to pledge its future CDBG entitlement and program income, and may have to provide additional security.
 - The security requirement could be satisfied by a specific lien on the real estate (mortgage or deed of trust) or a UCC filing on personal property, plus some form of other collateral (personal, corporate guarantee, developer completion, etc.).
 - If the transaction does not conform to the underwriting thresholds, the community must pledge additional security which compensates HUD for the increased level of risk.
- Additional underwriting guidance is provided in Chapter 9.

Other Risk Mitigation

- Other ways to mitigate risk include the following:
 - **Diversify the portfolio** – Communities should limit the amount of 108 proceeds that are allocated to one project or borrower, so that one loan or business failure will not doom the entire 108 transaction. Consider limiting projects to 20-33 percent of total loans funded to lessen the chances of a large failure and increase the chances of having at least one success.
 - **Establish loss reserves** – Just as a private lender would, communities should allocate funds for losses from nonperforming loans. The level of loss reserves will vary with the type of projects being financed.

- **Require leverage** – Require that projects be able to provide a minimum percentage of private financing (e.g., 50%). This helps to spread project risk, stretches 108 funds further, and ensures that the project will also be reviewed by a private-sector lender.
- **Limit balloon payments** – Balloon payments add another layer of risk and should be used judiciously. If interest rates are high when the balloon comes due, it may be difficult to obtain refinancing, or if the value of the assets being financed have significantly depreciated they may not provide adequate security for the refinancing.
- **Certify costs** – Make sure that proposed project costs are reasonable and do not contain any padded costs which mask developer profiteering.
- **Avoid construction financing** – Many things can go wrong during construction, and the collateral value of a half-finished building is nearly worthless. Therefore, communities should consider requiring the projects obtain a private construction loan and only offer permanent “take-out” financing.
- **Conduct cost benefit analyses** – Do the potential benefits of the project (job creation, increased taxes, etc.) outweigh the potential costs of the project (public funds used to repay project costs, possible risk of assets pledged as additional security, etc.)
- **Require letters of credit** – Provide insurance that third-party borrowers will be able to overcome short-term credit needs that may arise during the project.
- **Limit high-risk loan categories** – Loans to startups and for working capital are especially risky. Balance the portfolio with other less risky loans.
- **Allow for changes in rates** – Considerable time may elapse between the time that a project is obtained and the time that final approval is granted. In the meantime, interest rates may increase. Thus, communities should estimate project costs at a spread over current Treasury yields to compensate for the potential of such increases.

Loan Servicing

Repayment

- The community assumes the ultimate risk of paying back the Section 108 notes.
 - The notes may be repaid with future CDBG grants; or
 - The community may transfer the risk and cost (interest) by lending Section 108 proceeds to third-party borrowers. If the third party repays this loan the community may never have to dip into its CDBG funds to repay the notes. However, if the third party does not pay the community, the community must repay the loan.
- HUD has the ability to structure the principal amortization to match the needs of the project and borrower. The community has discretion in structuring the terms of repayment. Among the options a community can chose are:
 - Adding a debt service reserve to the loan amount;
 - Structuring interest-only payments for a reasonable amount of time;

- Creating balloon payments (with caution);
 - Approximating an installment loan with roughly equal payments; and/or
 - Structuring level principal payments with add-on interest.
- To ensure the marketability of Section 108 notes, HUD provides a 100 percent full faith and credit guarantee to the private investors who purchase the notes at the public offering. To date, there has been no default under Section 108 resulting in a repayment 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 U.S. Treasury if the pledged funds are insufficient.

Brownfields

- **Definition of brownfields:** Abandoned, idled or under-used real property where expansion, redevelopment or reuse is complicated by the presence or potential presence of environmental contamination.
- Once thriving areas of economic activity, today brownfields lie abandoned often contaminated from past uses. Sitting unused or under-utilized, brownfields are impediments to economic development in rural and urban communities across our Nation. But redeveloped, brownfields can be catalysts for community revitalization.
- HUD is working with community organizations, the private sector, local and State governments, and other Federal agencies to stimulate reinvestment in communities by restoring brownfields to productive use. HUD's economic development activities have increasingly emphasized on addressing brownfields and using these former polluted sites as potential development sites.

Brownfields Economic Development Initiative (BEDI)

- HUD created the Brownfield Economic Development Initiative (BEDI) program to provide funding to address the environmental issues associated with brownfields so that economic development can occur.
- BEDI funds can be used for any project assisted with Section 108 funds.
- HUD will publish a Notice of Funding Availability (NOFA) to inform potential applicants about the availability of BEDI assistance.
- The purpose of BEDI funds is to minimize the potential loss of future CDBG allocations used to secure Section 108 loan guarantees:
 - By strengthening the economic feasibility of the projects financed with Section 108 funds (increasing the probability that the project will generate enough cash to repay the guaranteed loan);
 - By directly enhancing the security of the guaranteed loan; or

- By combining these or other risk mitigation techniques.
- **BEDI and Section 108:**
 - BEDI and Section 108 must be used together on same project.
 - It must be a new Section 108 activity.
 - A request for new Section 108 loan guarantee authority must accompany each BEDI application. BEDI and Section 108 funds must be used in conjunction with the same economic development project.
- Eligible Applicants and Activities are the same as CDBG.
- Uses of BEDI Grant Funds include:
 - Land write downs,
 - Site remediation Costs,
 - Funding reserves,
 - Over-collateralizing the Section 108 Loan,
 - Direct enhancement of the security of the Section 108 Loan, and
 - Provisions of financing to for-profit businesses at a below market interest rate.
- Compliance with National Objectives: the same requirements apply as CDBG.
- Each BEDI NOFA will specify thresholds and rating factors. However the following are common:
 - Limitations on Grant Amounts:
 - The minimum BEDI to Section 108 ratio is 1:1; and
 - The Maximum grant amount is \$2 million.
- Rating factors typically used to review applications:
 - Capacity of the applicant and relevant organizational experience,
 - Distress/extent of the problem,
 - Soundness of the approach,
 - Leveraging of resources and financial need, and
 - Achieving results and program evaluation.
- Monitoring Section 108/BEDI – The Section 108/BEDI projects must be monitored as all CDBG activities. Specific resources to assist a jurisdiction with monitoring include:

- "Section 108 Loan Guarantee Program Reporting of Actual Accomplishments" (memorandum from Nelson Bregon dated October 30, 2002).
- HUD Handbook 6509.2 , issued September 2005, Chapter 5, Section 108 Loan Guarantees, Economic Development Initiative (EDI) and Brownfields Economic Development Initiative.
- There are several other reports, studies and guides that have been published over the last decade on brownfields and BEDI. They include:
 - CPD Notice 01-10: Section 108 Program – Clarifying Guidance on Certain aspects of the Section 108 Loan Guarantee Program.
 - "Redeveloping Brownfields: How States and Localities use Community Development Block Grant Funds," prepared by Research Triangle, Inc., October 1998.
 - "An Assessment of State Brownfields Initiatives," Office of Policy Development and Research, U.S. Department of Housing and Urban Development, December 1999.
 - "Mining Community Tackles Brownfields," *Fieldworks*, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, June 2000 (a case study of Bonne Terre, Missouri).
 - "Public-Sector Loans to Private-Sector Businesses: An Assessment of HUD-Supported Local Economic Development Lending Activities," Urban Institute, December 2002.
 - "Revitalizing Neighborhoods by Redeveloping Brownfields: The HUD Brownfields Economic Development Institute, *ResearchWorks*, Volume 1, Number 3, April – May, 2004, and HUD's Office of Policy Development and Research.

11. Program Development & Administration

This chapter addresses the following questions:

- Who should undertake economic development projects?
- What are the key set-up tasks?
- How should recipients evaluate and monitor their programs?
- What records must be kept?
- How can and should communities measure progress in achieving strategic goals and objectives?

Overview

- As recipients begin their economic development programs, they need to consider which types of programs they wish to fund and how these programs will be administered.
- Some of the key administrative questions to consider include:
 - Who should undertake the programs?
 - How much will the program cost, both in terms of delivery and administration?
 - Where and how will marketing and outreach take place?
 - What records must be kept?
 - How well did we do in meeting our objectives?
- Much of this analysis may have been conducted as a part of the strategy development process in Chapter 1. As a result of this strategy development process, the recipient will have determined which types of economic development activities to fund.
- The recipient then needs to make decisions about how to implement these programs. While many of these questions are answered when the economic development program is initially set up, it is also important for recipients with existing programs to periodically revisit these.
- This chapter highlights the key administrative concepts of program development.

Entities Involved in Economic Development Activities

- The CDBG Program does not dictate the kind of activities or the kind of organizations grantees can work with to implement their economic development programs. Instead, grantees must

make choices about who will administer and implement the CDBG program. Options for implementation are briefly described below.

- Grantee staff – Staff of the recipient may directly oversee the management of the economic development program;
- Unit of General Local Government (UGLG) staff – local governments participating in State CDBG programs;
- Subrecipients – A subrecipient is a public or private nonprofit agency or organization receiving CDBG funds from a grantee or another subrecipient to undertake eligible activities, and also public and private for-profit organizations providing assistance to microenterprises.
- Community Based Development Organizations (CBDOs) –
 - In order to qualify as a CBDO, an organization must have the following characteristics:
 - ~ Is organized under State or local law to engage in community development activities in a specific geographic area within the community;
 - ~ Has as its primary purpose the improvement of the physical, social, and economic environment of its service area by addressing one or more critical problems in the area, with particular attention to the needs of LMI persons;
 - ~ If a for-profit organization, the profits to shareholders or members are incidental to its operations;
 - ~ The governing body's membership consists of 51 percent LMI residents of its service area or owners or officers of entities located in the service area or representatives of LMI organizations in the service area;
 - ~ Is not an agency or instrumentality of the grantee, and no more than one-third of the board is elected or appointed public officials or employees of the grantee; and
 - ~ The governing body is nominated by the general membership of the organization.
 - Certain types of organizations organized approved by the Small Business Administration (SBA), as well as Community Housing Development Organizations (CHDOs) designated by the grantee under the HOME Program, may qualify as a CBDO. (NOTE: CHDOs only automatically qualify as CBDOs if that CHDO serves a specific geographical area.)
 - CBDOs that do not meet the above requirements may be determined to qualify if HUD determines, based on information provided by the grantee, that the organization is sufficiently similar in purpose, function, and scope to the above criteria.
 - CBDOs are not automatically designated as subrecipients; the grantee may elect whether or not to consider the CBDO as a subrecipient.
 - Note that the assets of a CBDO do not revert back to the grantee (as is required with subrecipient organizations) and that CBDOs are free to contract for goods and services. For CBDO assets paid for by the grantee under CDBG, the grantee may elect to require reversion of assets. It is good practice for the grantee to develop policies about the

types of CDBG-funded assets that will be subject to reversion from CBDOs. If the grantee elects to designate the CBDO as a subrecipient, all of the rules regarding subrecipients will also apply to that CBDO, including the requirement for the reversion of assets.

- Contractors – A contractor can be either a for-profit or a nonprofit entity that is paid CDBG funds by the grantee (or subrecipient/CBDO) in return for specific services, where payment is made to the contractor as compensation for such services. A contractor is different than a CBDO and/or subrecipient in the following ways:
 - A contractor must be procured competitively according to the OMB rules; and
 - Most of the uniform administrative requirements do not apply to contractors (once the procurement process is complete).
- Community Development Financial Institutions – A community development financial institution (CDFI) is a community-based lending institution.
 - As defined in the Community Development Banking and Financial Institutions Act of 1994, CDFIs have the following characteristics:
 - ~ Primary mission of promoting community development;
 - ~ Serve an investment area or targeted population;
 - ~ Have as its predominant business the provision of loans or development investments and provides development services in conjunction with such loans and investments;
 - ~ Maintains accountability to residents of its investment area or targeted population through representation on its governing board or some other means; and
 - ~ Is not an agency or instrumentality of the government (Federal, State, or local).
 - CDFIs are not considered subrecipients or contractors.
 - A nonprofit development organization under 105(a)(15) of the statute may qualify as a CDFI. Other types of organizations that may meet these criteria include community development banks, community development loan funds, microenterprise loan funds, and venture capital organizations.
 - The Community Development Banking and Financial Institutions Act of 1994 also created a CDFI Fund to promote economic revitalization and community development through investment in and assistance to CDFIs. The CDFI Fund is managed by the Department of Treasury and provides assistance to qualified organizations.
 - Activities carried out by CDFIs receive special consideration under the new CDBG regulations regardless of whether or not the CDFI is actually receiving assistance from the CDFI Fund. For a CDFI whose charter limits its investment area to a primarily residential area with 51 percent LMI persons:
 - ~ Job creation/retention activities may be qualified as meeting area benefit requirements;

- ~ Scattered-site housing activities may be considered to be a single structure for the purposes of applying the LMI benefit national objective (housing) criteria; and
 - ~ Economic development activities may be exempt from the aggregate public benefit standards.
- For any CDFI, regardless of its investment area, job creation/retention national objective requirements may be met by aggregating the jobs created/retained by all businesses for which CDBG assistance was obligated during the program year.
- Some communities' CDBG programs are run with few staff and a large number of subrecipients while others are administered primarily by recipient staff and few subrecipient organizations. Factors which tend to affect the degree to which recipient staff are relied upon more heavily for all CDBG functions include:
 - Size of the community and grant amount;
 - Types of programs undertaken;
 - Local politics;
 - Capacity of in-house staff; and
 - Capacity and availability of subrecipient organizations.
 - Before undertaking any CDBG-funded activity, recipients should consider the following issues:
 - Is there political will to carry the program/project through the development, approval, and implementation phases?
 - Does the required staffing experience currently exist?
 - Is there sufficient time to take on new or expanded work?
 - Are there adequate and appropriate administrative resources (e.g., legal, financial, etc.)?
 - Are there subrecipients with the capability to assist with the program/project?
 - Will consultants be needed?
 - Are there sufficient funds to carry out the program/project and/or to invest the level of effort necessary for its implementation?
 - Staffing for CDBG programs and activities generally requires:
 - Conducting a skills inventory of staff members;
 - Developing a list of required skills;
 - Assessing where gaps exist between existing staff skills and required skills; and
 - Undertaking the appropriate training, capacity building, and staff expansion necessary to administer the programs/activities.
 - Based upon the recipient's analysis of staffing capacities and upon programmatic needs, the recipient must determine whether and/or to what extent it will work with various entities.

Economic Development Program Set-Up Tasks

- As recipients begin to set up economic development programs, a number of key tasks must be accomplished, including:
 - Administrative plans and procedures;
 - Establishing the budget for the program;
 - Making choices about loan servicing and packaging (if the program will offer loans);
 - Developing an implementation or roll-out schedule; and
 - Creating a marketing or outreach program to reach potential participants.

Administrative Plans and Procedures

- One of the first program set-up tasks that should be accomplished is the development of written administrative guidelines and operating procedures for the program.
- Guidelines and procedures are internal documents to be used by recipient and/or subrecipient staff to help guide program decisions and ensure accuracy and consistency in processing applications.
- Key elements in an administrative plan include:
 - Overview of program goals and objectives;
 - Description of eligible participants/borrowers and projects;
 - Description of services or funding offered;
 - Overview of the underwriting and/or selection criteria; and
 - Overview of the selection process such as: decision-making bodies; application timing and content; and restrictions such as conflict of interest or overlaying other Federal requirements such as Davis-Bacon or environmental.
- This document may be developed by the recipient or by the subrecipient (with recipient input when a subrecipient is used).
- This plan may also form the basis for a shorter, less administrative document, which is used to describe the program to the public.

Projected Operation Budget

- Once the recipient has decided which types of economic development programs it wishes to establish and who will undertake those programs, it must develop an operating budget for those programs.
- The basic arithmetic of an operating budget is this:

Projected income
minus Projected operating expenses
equals Projected operating surplus or deficit

- What is included in a projected operating budget?
 - Operating income includes:
 - Revenues from loan proceeds or fees charged plus CDBG investment.
 - (Less) returns or refunds or vacancy factor (as applicable to a given project).
 - Grants earmarked for operations, as opposed to capital projects like a real estate development.
 - Net loans received - these should be in a capital budget or a cash flow projection.
 - Operating expenses include:
 - So-called operating expenses are often called "overhead costs." These are expenses related to normal operations, and not an investment (like loans made to microenterprise) or a development activity (like buying and rehabbing commercial buildings).
 - Also included are depreciation expenses. These are non-cash or "paper" expenses that relate to the decline in value of property you may propose to purchase.
 - Interest paid on loans, such as a working capital loan or a mortgage loan for purchasing your office or other real estate.
 - Net loan principal repayments. These are considered capital expenses (an investment) not related to operating costs.
 - Here is an example of a projected annual operating budget for E.D., Inc.

E.D., INC. PROJECTED OPERATING BUDGET

Projected for Period 06/01/XX to 5/31/XX

| | |
|----------------------------|-------------------|
| Projected Income: | |
| Loan Repayments | \$50,000 |
| Interest Income | 150 |
| Total Income | \$50,150 |
| Projected Expenses: | |
| Executive Director | \$30,000 |
| ED Specialist | 18,000 |
| Administrative Assistant | 9,600 |
| Fringe (25%) | 14,400 |
| Reserve: Verifying Amount | 1,200 |
| Office Utilities | 1,200 |
| Telephone | 600 |
| Supplies and Postage | 480 |
| Startup Expenses | 10,000 |
| Total Expenses | \$85,480 |
| Surplus (DEFICIT) | \$(35,330) |

Loan Servicing and Administration

- Another key administrative task is the establishment of a system for managing loans (for lending programs) for each project, including documentation to meet HUD's, et.al., compliance requirements.
- Managing a loan includes:
 - Packaging the loan and obtaining qualifying documentation;
 - Documenting the financial analysis and loan underwriting;
 - Obtaining legal counsel to prepare and/or review loan closing documents;
 - Determining disbursement and loan servicing requirements; and
 - Setting up business technical assistance or other means for managing loan default or workout issues.

Roll-Out Strategy and Schedule

- Roll-out strategies provide a schedule for how and when you will get started
- Roll-out strategies vary with the program type.
 - Big splash strategies go all out to promote and generate interest in products/programs.
 - But they can backfire by creating too much demand and cause disappointment to your customers.

- Gentle movement into the market allows you to test the waters and experiment but it may not create the momentum you need to reach desired production/program goals.
- Factors beyond your control can impact your startup strategy:
 - Funding cycles: Public funds are received on a particular cycle.
 - The Seasons: Some ventures have better chances of succeeding at different times of the year. Holidays, weather conditions and vacation schedules all affect the time of startup.
 - Politics: Elections, political change and local politics may affect your timing. You may want to give a newly elected council member the privilege of kicking off your new venture; alternatively, you may want to see how the "winds are blowing" after a major political upheaval.
- Good roll-out strategies include:
 - Step-by-step timetables for bringing your product to the market.
 - Careful assignment of marketing responsibilities.
 - Identification of any hurdles which might affect your game plan.
 - Milestones for accomplishing the tasks.

Marketing the Program

- Once the budget is established and the program designed, it is time to market the program.

- Promotional techniques might include:

| | |
|------------------------------|------------------------------|
| Advertising | News releases |
| Public service announcements | Newsletters |
| Posters | Billboards |
| Brochures | Direct mail |
| Special events | Presentations |
| Talk Shows | Trade Fairs |
| Videos | News Conferences |
| Ground breakings | Contact with banks, realtors |

- Things to think about when selecting marketing tools:
 - Use: Tools may have more than one use and be distributed in different ways; decide in advance how they will be distributed to the intended audience and how they will be used.
 - Mix and match: People learn and pick up information in different ways; use several, complimentary techniques to reach the intended audience.
 - Repetition: Say it and then say it again over an extended period of time.
 - Persistence: Successful marketing takes time; don't bail out too soon.
 - Budget: Creative attention to all of the above is more important than big bucks.

- Audiences: Where do they live; how do they receive information; what do they read, listen, and respond to?
- Management: Certain promotions require more work to implement than others: flyers have to go up and come down and special events must be promoted.

Recordkeeping

- Accurate recordkeeping is crucial to the successful management of CDBG-funded activities. Insufficient documentation is likely to lead to monitoring findings, and these findings will be more difficult to resolve if records are missing, inadequate, or inaccurate.
- To assess strengths and weaknesses in this area, recipients should think about the following:
 - Is there a clearly defined process for acquiring, organizing, storing, retrieving, and reporting information about CDBG-funded activities?
 - How can the documentation and reporting systems be strengthened to meet the HUD requirements?
 - Who is responsible for the majority of the recordkeeping and reporting tasks, and are they properly trained and supported?
 - How can the recordkeeping and reporting process be streamlined by standardized written procedures and the removal of duplicative records?
 - What types of records and reports could be automated (i.e., computerized) that are not now?

General Administrative Records

- Recipients must maintain files and records that document the overall administration and compliance with the CDBG Program. These records will include the following:
 - ConPlan submission to HUD, which includes the application, program descriptions, certifications, etc.;
 - Executed grant agreement;
 - Description, geographic location and budget of each funded activity;
 - Eligibility and national objective determinations for each activity, as well as applicant qualification for assistance;
 - Personnel files;
 - Property management files;
 - HUD monitoring correspondence;
 - Citizen participation compliance documentation;
 - Fair Housing and Equal Opportunity records;
 - Lump sum agreements (if applicable);

- Environmental review records; and
- Documentation of compliance with other Federal requirements (e.g., Davis-Bacon, Uniform Relocation Act and lead-based paint).

Financial Records

- Financial recordkeeping is one of the primary areas subject to HUD reviews and one in which inadequate recordkeeping can lead to serious problems.
- Financial records to be maintained include:
 - Chart of accounts;
 - Manual on accounting procedures;
 - Accounting journals and ledgers;
 - Source documentation (purchase orders, invoices, canceled checks, etc.);
 - Procurement files (including bids, contracts, etc.);
 - Real property inventory/inventory/personal property;
 - Bank account records (including revolving loan fund records, if applicable);
 - Drawdown requests;
 - Payroll records and reports;
 - Financial reports;
 - Audit files; and
 - Relevant financial correspondence.
- The financial functions of a recipient's CDBG Program operations are handled by staff with accounting skills, but not necessarily with a CDBG Program background, or are shared with staff from other departments outside of the administering agency. To ensure proper financial recordkeeping and reporting, recipients should help their financial staff understand:
 - What information needs to be kept and why;
 - When information should be collected and how often;
 - How the information should be acquired, organized, and stored;
 - How the information should be reported; and
 - How long the records must be kept.

Project/Activity Records

- For each type of activity undertaken, the recipient should determine what data must be maintained in individual case files and establish a system for ensuring that every file contains the necessary information. (Note: Consider a Table of Contents and Checklist for every file.)

- The list will vary from activity to activity, but each project/activity file should include the following documentation:
 - Eligibility of the activity;
 - Evidence of having met a national objective;
 - For example, some of the required records for the jobs national objective should include the following information:
 - ~ A copy of a written agreement containing a commitment by the business that it will make 51 percent of the jobs available to LMI individuals; job announcements by title of position; and description ensuring that LMI individuals will be considered first for at least 51 percent of the jobs IF the recipient has chosen to document that 51 percent of the jobs would be made available to LMI individuals.
 - ~ Where the recipient has chosen to fill at least 51 percent of the jobs with LMI individuals, there should be a written agreement committing 51 percent of the jobs to LMI individuals, listing by job title all permanent jobs noting which ones are part-time, and comparing which jobs were filled and which were already held by LMI individuals. Also, for each job filled by a LMI individual, the business should have a statement of the size and income of the person's family prior to being hired.
 - ~ How, without CDBG funding jobs would be lost or just not created.
 - ~ Address of the individual, as well as the business, at the time the person was hired.
 - If applicable, subrecipient agreement;
 - Any bids or contracts;
 - Characteristics and location of the beneficiaries
 - Documentation that the business created the positions and LMI persons filling them;
 - Compliance with special program requirements;
 - Budget and expenditure information (including draw requests); and
 - The status of the project/activity.

Records on Subrecipients

- As discussed previously, recipients are responsible for ensuring that subrecipient activities are carried out in compliance with all applicable program requirements and that the performance of subrecipients is on track with objectives set forth by the recipient. The following is an overview of the types of records that must be maintained by recipients for each funded subrecipient activity:
 - Subrecipient application;
 - Written agreement [24 CFR 570.503];
 - Financial statements and records;

- Audits;
 - Progress reports;
 - Drawdown requests (with supporting documentation); and
 - Monitoring reports and correspondence.
- While recipients maintain certain records pertaining to subrecipient activities, subrecipients must also maintain detailed records on its organization, financial, and administrative systems of each CDBG-funded project or activity.

Record Retention Period

- Under the uniform administrative requirements of the CDBG regulations, recipients and subrecipients are required to retain CDBG records for a period of not less than **four years** from the date the activity was assisted. (NOTE: This is a new requirement; the retention period was previously three years.)
- However, the ConPlan regulations require that recipients maintain information and records relating to the jurisdiction's ConPlan and the use of funds under the programs covered by the Consolidated Plan, including CDBG, for a period of not less than **five years**.
- Due to the ConPlan requirement, recipients are advised to maintain all CDBG and related records for at least five years.

Access to Records

- HUD and the Comptroller General of the United States, or their authorized representatives, have the right to access all recipient and subrecipient program records.
- Public Access to Records -
 - CDBG recipients are required to provide citizens with reasonable access to records regarding the past use of CDBG funds, consistent with applicable State and local laws regarding privacy and confidentiality.
 - The ConPlan regulations require that recipients provide citizens, public agencies, and other interested parties with reasonable and timely access to information and records relating to the jurisdiction's ConPlan and the use of assistance under the programs covered by the Consolidated Plan. (NOTE: This requirement must be made a part of recipients' Citizen Participation Plans.)

Program Evaluation

Program "Success" & the Government Performance and Results Act (GPRA)

- In 1993, Congress enacted the Government Performance and Results Act, more commonly referred to as "the Results Act" or "GPRA."

- The purpose of the Act is to move Federal government agencies away from their historical focus on “process-oriented” measures of program effectiveness, such as internal staffing, the number of clients served, or program budget levels.
- The Act seeks to ensure that agencies become “results-oriented,” by focusing on how to best produce and measure real, cost-effective changes for the intended beneficiaries of their programs. Federal agencies (including HUD) have now begun to execute their performance plans under GPRA.
- It is important that CDBG recipients (and subrecipients) measure local program success within the spirit and framework of GPRA, for two reasons:
 - Unless local program managers and staff have identifiable goals, a set of outcome benchmarks, and systems for measuring change, they will not be able to identify, report, or improve the performance of the CDBG program in their community, and;
 - With both Federal and State-level administrators adopting GPRA-type evaluation systems, local staff will increasingly be held accountable to clear and identifiable results for program beneficiaries.
- The following discussion briefly outlines the steps in establishing a program performance and reporting system.

Steps in Measuring and Reporting Program Performance

- There are three major steps for a public agency to take in order to accurately measure and report on the results of its programs:
 - Define Mission and Desired Outcomes
 - Gather and Maintain Data; Measure Performance
 - Use Performance Information for Decision-Making
- Step One: Define Mission and Desired Outcomes
 - A clear public mission and set of strategic outcome goals serve as the roadmap for a successful evaluation of performance. These are the ultimate results that the agency is working to achieve, and should have been defined prior to implementing the program. See Chapter 1: Economic Development Strategies for more information.
 - The mission statement is meant to be a concise description of the purposes underlying the agency/program’s existence. For example, the overriding mission of the CDBG program is the “development of viable urban communities, principally for persons of low- and moderate-income, by providing decent housing, a suitable living environment, and expanding economic opportunities.”
 - Since mission statements can be rather vague, it is important to distill mission statements into more concrete strategic objectives or goals. The CDBG National Objectives are:
 - Benefit to persons of low and moderate income;

- The prevention or elimination of slums and blight; and
- Meeting an urgent community need.
- Within the above national objectives framework, each community must decide its own specific outcomes to be achieved. Local outcomes might include:
 - A cleaner and safer community;
 - Increased employment among residents; and
 - Affordable housing opportunities for all LMI residents.
- For this step to be successful, three approaches are often critical:
 - Involve all stakeholders in the process;
 - Assess the environment; and
 - Align activities, core processes, and resources with the mission and goals.
- Stakeholders of local CDBG programs include city administrators and elected officials, citizens, program clients, businesses, community entities, subrecipient organizations, and State and Federal regulators. Obviously, not all these stakeholders will totally agree on the mission and outcome goals for a local CDBG program. Their involvement and participation will, however, provide a foundation upon which to eventually construct a balanced set of priorities.
- No program or agency exists within a vacuum. External and internal forces play a significant role in whether it achieves its strategic goals. For this reason, it is important for a local CDBG program to continually assess its operating environment, including:
 - The needs of the community;
 - The level of resources available, and
 - Opportunities for targeted intervention.
- The program's resources, key methods of doing business, and individual activities must conform to the mission and goals outlined previously. Otherwise, success is virtually impossible.
 - For example, if the CDBG program has no *internal* monitoring system, local officials will be unable to determine if and how benefits for program clients have been achieved. If strategic goals include diversifying the local economy, dedicating large amounts of CDBG funds for public facilities will not be an effective activity.
- Step Two: Gather and Maintain Data; Measure Performance
 - In order to measure whether agencies are making progress in attaining strategic goals, agency management must adopt a set of "performance measures," or indicators by which to compare actual results against intended outcomes.
 - Translating general goals and objectives into easily-understood and quantifiable performance measures is one of the most difficult steps in this process.

- Generally, performance measures should be limited to those deemed critical to measuring program success, and should be clearly linked to program management to ensure accountability.
 - As an example, the objective of increased employment could be separated into several quantifiable outcomes, including:
 - A 5% reduction in unemployment over the next three years; and
 - A 10% increase in business ownership rates among minority persons over the next five years.
 - These variables then serve as progress performance indicators.
 - Accurate measurement, of course, depends heavily upon the *quality of the data* collected and the methods (e.g., surveys, interviews) used to collect and analyze it. These factors must be balanced against the time and cost involved in data collection and analysis.
- Step Three: Use Performance Information for Decision-Making
- Perhaps the most important step in the evaluation process is to actively use the performance information collected to support program improvement;
 - Clearly, actual performance may differ substantially from strategic goals. It is important to identify where “performance gaps” exist, and how significant these gaps are. Identifying and quantifying performance gaps can be a major tool in deciding how to re-direct resources to those areas most in need of improvement and successfully achieved;
 - One common method of quantifying performance gaps is “benchmarking.” By comparing performance data against that of similar programs or agencies, or more commonly, the best programs and agencies, management can determine the extent to which actual results differ from goals or ideals;
 - Decision-making can be improved by analyzing the unit cost of producing a certain outcome. For example, the CDBG Public Benefit Standards (at least one FTE job created or retained for every \$50,000 of CDBG funds obligated, or, at least one LMI person served for every \$1,000 of CDBG funds obligated) are a way to assess whether the costs of producing desired outcomes are reasonable for the benefits realized; and
 - Program managers and agency leaders must complete the process of results-oriented performance measurement by documenting the outcomes achieved, the extent of any performance gaps, and plans for modifying activities or redirecting resources so as to better achieve the mission of the program and agency.

Reporting on HUD CPD Objectives & Outcomes

- When grantees set up an economic development activity in IDIS, they will need to identify the activity purpose, using the objectives and outcomes defined by HUD for all activities. The **objective options** are: suitable living environment, decent housing, or economic opportunities. The **outcome options** are: availability/accessibility, affordability, or sustainability. Grantees should consider the intent of the activity before making a determination about the objective and outcome for an activity. For nearly all types of economic development activities, the objective

is to create economic opportunity. However, in some limited circumstances, an economic development activity may be undertaken for the purpose of a suitable living environment, such as a commercial revitalization program in a concentrated geographic area.

- Once the grantee has selected objectives and outcomes for the activity, IDIS generates the *outcome indicators* (see the HUD IDIS website) that must be reported for that activity. For reporting purposes, economic development activities are categorized as:
 - Activities that create or retain jobs; and
 - Activities that assist businesses.
- The grantee reports on the applicable outcome indicators, which are determined by certain types and certain characteristics of the assisted activity. For example, using CDBG funds for infrastructure to a new manufacturing plant that commits to providing LMI jobs would report on its commercial or industrial character and its job creation results. Activities that provide direct financial assistance to businesses, such as for the purpose of commercial rehabilitation or for buying additional equipment or inventory, would report on the type and certain characteristics of the assisted businesses. Both of these types of reporting are described in detail below.

Reporting on Job Creation & Retention Activities

- For economic development activities that use the LMI jobs national objective, jurisdictions must report certain data on the jobs that are created or retained as a result of those activities.
- This reporting will be according to matrix codes that are referenced in this section and also included as an attachment to this chapter.

Data Required

- The reporting requirements vary just slightly depending upon whether the activity creates or retains jobs. For activities that involve the creation of jobs, grantees are required to report the following information:
 - The total jobs created for the program year;
 - The number of jobs with employer sponsored health care benefits;
 - The number of persons who were unemployed prior to taking jobs created by the activity; and
 - The number of jobs created for each job type, using the Economic Development Administration (EDA) classifications of:
 - Officials and managers;
 - Professional;
 - Technicians;
 - Sales;
 - Office and clerical;

- Craft workers (skilled);
 - Operatives (skilled);
 - Laborers (unskilled); and
 - Service workers.
- For activities that involve the retention of jobs, grantees are required to report the following information:
 - The total jobs retained for the program year;
 - The number of jobs with employer sponsored health care benefits; and
 - The type of jobs retained by the EDA classifications, using the same categories as above for job creation.
 - Note that some of the indicators will not apply if the grantee is doing the economic development activity under the LMI job creation/retention national objective when the LMI presumption is used. When a series of criteria established under the CDBG regulations are met, including the location of the job or employee, the grantee may presume that the employee is LMI. In these instances, the grantee is not required to collect specific demographic data on the employees and thus the general indicator data regarding levels of LMI beneficiaries will not apply. However, the indicators related to the total number of jobs created, whether those jobs offered health benefits, and the job classification will apply, as will the common indicator related to leverage.

Key Issues in Data Collection

- In the past, CDBG grantees have been required to report on the number of jobs created/retained but not on the other categories described above. Grantees will need to change reporting systems to ensure that the required data is collected in a standardized way.
- Grantees need to identify and define the data elements that need to be collected and conduct outreach to make sure their subrecipients, UGLGs, and business partners understand the new reporting requirements.
 - Providing specific guidance to partners helps ensure that the data collected is accurate and that the variety of staff involved in collecting data are adequate;
 - Grantees should share the definitions of the EDA classifications, as they may be unfamiliar with this information; and
 - For activities that create jobs, assisted businesses may need to change their job application form(s) to capture data about whether or not individual job applicants were previously unemployed.
- Grantees may need to revise program documents and forms to ensure that the required data elements are included.

- Any and all documents and materials that discuss program requirements, capture information about applicants and proposed activities, and/or inform the public and prospective applicants about the program and types of assistance available should be reviewed and revised as needed; and
- Reporting and/or data collection forms provided for businesses should be revised to capture the new data elements.
- Agreements with all entities should be revised to reflect the new reporting requirements.

Reporting on Assistance to Business Activities

- When economic development activities are undertaken that provide assistance to businesses, grantees will have to report on certain types and certain characteristics of the assisted business outcome indicators. These reporting requirements apply regardless of the objective and outcome chosen for the activity.
- Any of the following activities are considered “assistance to businesses.” When the grantee sets up any of these activities in IDIS, it will be required to report on the specific indicators for this activity type:
 - Commercial or industrial improvements by a grantee or nonprofit (HUD IDIS Matrix Codes 17A, 17B, 17C, and 17D) which cover:
 - Commercial/industrial land acquisition/disposition;
 - Commercial/industrial infrastructure development;
 - Commercial/industrial building acquisition, construction, and/or rehabilitation; or
 - Commercial/industrial improvements.
 - Rehabilitation for a publicly or privately owned commercial or industrial building (HUD IDIS Matrix Code 14E).
 - Direct economic development assistance to private for-profit companies (HUD IDIS Matrix Code 18A, 18B, and 18C), including:
 - Direct financial assistance to for-profit businesses;
 - Direct technical assistance to for-profit businesses; or
 - Microenterprise assistance.
- The IDIS screen called “Assistance to Businesses” will require the grantee to provide the following information for any of the economic development activities listed above:
 - Of the total number of businesses assisted:
 - Number of new businesses assisted;
 - Number of existing businesses assisted;
 - Of the total number of existing businesses assisted, the number of businesses expanding;

- Of the total number of existing businesses assisted, the number of business relocations;
 - Number of businesses assisted with commercial façade treatment/business building rehabilitation;
 - Number of businesses assisted that provide goods or services to meet the needs of a service area, neighborhood, or community; and
 - The Data Universal Numbering System (DUNS) number for each business assisted. (If the new business will be created as a result of the CDBG assistance then the business will need to get a DUNS number once it is set up and the grantee should enter that DUNS number into the system.)
- If the financial or business support assistance is direct to an existing or startup business, the grantee must provide the DUNS number. However, if the assistance is for general training/TA for an entrepreneur who wants to start a business (e.g., microenterprise assistance) but where no business exists, then the grantee is not required to fill in the DUNS number.
- A DUNS number is now a requirement for any business that receives Federal assistance. If a business does not have one, it should call the DUNS number request line at 1-866-705-5711 to obtain a number. The process is free and takes about 10 minutes. More information can be found at http://www.whitehouse.gov/omb/grants/duns_num_guide.pdf.

Key Issues in Data Collection

- The performance measurement data required to report on activities involving assistance to businesses, as outlined above, should be available to the grantee at the time of project commitment or when the written agreement is signed with the business owner. In cases where the economic development activity is carried out by a UGLG, the grantee will need to include this information on the UGLG reporting form so the State can then enter it into IDIS.

Timing of Economic Development Activity Data Entry

- Jurisdictions must enter the outcomes and objectives at activity set-up in IDIS. If the activity is part of a Revitalization Strategy Area, local target area, or Community Development Financial Institution (CDFI) area, the grantee will be required to so indicate at activity set-up in IDIS.
- The timing for collecting reporting indicator data will depend, in part, on when the data is available to the grantee. For example:
 - Data for the jobs created and jobs retained outcome indicators will need to be completed both:
 - Annually for annual program reporting purposes; and
 - When the planned number of jobs to be created or retained has been achieved (cumulative to both demonstrate the full outcome of the activity and to ensure compliance with the CDBG national objective).

- Data for the assistance to businesses indicators may be entered at activity set-up, or on a periodic basis as this information is made available to the State (not less than annually).
 - For some activities, the data should be easily available from application documents or written agreements.
 - The State should ensure that it is collecting this data on a regular basis either when funds/payments are requested/drawn down, or on a predetermined schedule (e.g., quarterly reporting from the UGLG to the State).

Recipient Monitoring of Subrecipients and Beneficiaries

- If CDBG funds are allocated to subrecipients or beneficiaries to carry out activities or projects, recipients are responsible for:
 - Ensuring that these entities comply with all regulations and requirements governing their administrative, financial, and programmatic operations and/or project; and
 - Ensuring that subrecipients achieve their performance objectives on schedule and within budget—and take appropriate actions when performance problems arise—all of which should incorporate training and technical assistance as appropriate.
- Monitoring should not be a “one-time” event. To be an effective tool for avoiding problems and improving performance, monitoring must be an ongoing process of planning, implementation, and follow-up.
- Steps in the monitoring process:
 - Develop a Monitoring Plan – Recipients should develop a monitoring plan at the beginning of each program year in order to match available resources with the needs and capacity of funded subrecipients and beneficiaries. Recipients may need to decide which entities are likely to have the most serious problems, or to rotate those selected for in-depth reviews.
 - Standardize Monitoring Procedures – To ensure consistency and thoroughness in monitoring reviews, recipients should use standardized monitoring checklists or guidebooks. Monitoring procedures should also specify the steps to be followed for monitoring visits (see “Conduct the Monitoring Visit” below).
 - Identify “Risky” Entities – Recipients should perform a risk assessment to identify which recipients or beneficiaries require comprehensive monitoring. High risk entities might include those who are:
 - New to the CDBG program;
 - Have experience turnover in key staff positions;
 - Past compliance or performance problems;
 - Carrying out high-risk activities such as acquisition, housing, and economic development; and
 - Undertaking multiple CDBG-funded activities for the first time.

- Establish a Monitoring Schedule – Once the risk assessment has been conducted, recipients should establish a schedule that identifies when subrecipients and beneficiaries will be monitored by recipient staff. Recipients should allow for ample notice of planned monitoring visits.
- Prepare for the Monitoring Visit – Before beginning the monitoring visit, recipients should ensure that their staffs are adequately trained for the task. Staff should be thoroughly familiar with the applicable program rules and the established monitoring protocol. In addition, staff persons assigned to monitor a particular subrecipient or beneficiary should review the following types of in-house data prior to the visit:
 - Application for funding;
 - Written agreement;
 - Progress reports;
 - Drawdown requests;
 - Correspondence;
 - Previous monitoring reviews; and
 - Copies of audits.
- Conduct the Monitoring Visit – There are five basic steps to any monitoring visit. These are outlined below.
 - Notification Letter: Recipients should begin the monitoring process by calling subrecipients to explain the purpose of the visit and to agree upon dates for the visit. A formal notification letter should follow at least several weeks before the planned visit.
 - Entrance Conference: Entrance conferences are held at the beginning of monitoring visits, usually with the director or other top official of the organization, to make sure the entity has a clear understanding of the purpose, scope and schedule for the monitoring.
 - Documentation and Data Gathering and Analysis: Recipients should keep a clear record of information reviewed and conversations held with subrecipient staff during the monitoring visit. The most efficient and effective way to review all the necessary documentation and data is to utilize a checklist. The information reviewed and obtained will serve as the basis for conclusions drawn from the visit. Subrecipients or beneficiaries may request that sources be identified if any of the conclusions are disputed.
 - Exit Conference: At the end of the monitoring visit, the reviewers should meet again with key representatives of the organization to:
 - Present preliminary results of the monitoring;
 - Provide an opportunity for the subrecipient to correct any misconceptions or misunderstandings;
 - Secure additional information to clarify or support their position; and

- If applicable, provide an opportunity for the subrecipient to report on steps the organization may already be taking to address areas of noncompliance or nonperformance.
- Follow-up Letter: At the end of the process, the recipient should provide the subrecipient with formal written notification of the results of the monitoring review. The purpose of this letter should not only be to point out problem areas, but also to recognize success. In addition, the monitoring letter creates a permanent written record of what was observed during the review. The letter should outline any concerns and findings (see above) as well as deadlines for a written response and corrective actions, as appropriate.
- Standardized language set forth in the monitoring procedures often helps recipients to develop monitoring letters in a reasonable timeframe and with consistency from entity to entity.
- Follow-up to Ensure Problems are Addressed – Recipients are responsible for ensuring that subrecipients and beneficiaries correct problems found as a result of monitoring. Effective follow-up procedures adhere to four basic principles:
 - The accountability of subrecipients to the recipient;
 - The clarity and consistency of performance standards and corrective actions;
 - The continuous provision of feedback and assistance from the recipient to the subrecipient; and
 - Timely communications with subrecipients and beneficiaries.
- Intervention and Sanctions – There are basically three increasingly serious stages recipients should utilize for addressing problem areas.
 - Stage 1 - Early Intervention:
 - ~ Plan a strategy with the subrecipient or beneficiary that includes additional training or technical assistance;
 - ~ Require more frequent or more thorough reporting by the subrecipient; or
 - ~ Conduct more frequent monitoring reviews of the subrecipient.
 - Stage 2 - Intervention for More Serious or Persistent Problems:
 - ~ Restrict the subrecipient's payment requests;
 - ~ Disallow subrecipient expenses (or require repayment); or
 - ~ Impose probationary status.
 - Stage 3 - Sanctions:
 - ~ Temporarily suspend the subrecipient;
 - ~ Do not renew the subrecipient the next program year;
 - ~ Terminate the subrecipient's or beneficiary's activity for the current program year; or

- ~ Initiate legal action.

HUD Review of Recipient Performance

- HUD has issued a CPD Grantee Monitoring Handbook covering all CPD Grantees. (See <http://www.hud.gov/offices/cpd/library/monitoring/handbook.cfm>.) The handbook includes guidance and lists of exhibits that are to be used as checklists in monitoring recipients. The relevant chapters for CDBG are:
 - Chapter 3. CDBG Entitlements (and HUD-administered Small Cities and Insular Areas)
 - Chapter 4. CDBG State programs
 - Chapter 5. Section 108, EDI and BEDI
- While oversight detail is in the Monitoring Handbook, generally HUD will review four primary areas for recipient compliance with CDBG and other Federal requirements:
 - Review for compliance with the primary and national objectives and other program requirements.
 - Review to determine if CDBG-funded activities are being carried out in a timely manner:
 - Review to determine if the recipient is meeting its ConPlan responsibilities.
 - Review for equal opportunity and fair housing.
- Performance monitoring reviews typically result in a formal written report from HUD summarizing the monitoring review and indicating whether or not the recipient was found to be in noncompliance with any applicable regulations or requirements. Generally, noncompliance issues are presented in one of two ways:
 - Findings: An instance of noncompliance with the rules and regulations of the CDBG program. Findings are specific violations of law and/or regulation and can result in sanctions (see below).
 - Concerns: Instances where a deficiency is not a finding, or where noncompliance may occur in the future because of a weakness in the recipient's operations.
- If findings are presented in a HUD monitoring report, recipients are given a specific timeframe in which to respond to the reported deficiencies. In addition, HUD may either provide recipients with recommended corrective action, or may require recipients to submit proposals for corrective actions to clear a finding.
- Other methods HUD may utilize to deal with noncompliance include:
 - Advising recipients that a certification will no longer be acceptable and additional assurances are necessary;
 - Advising recipients to suspend disbursements of funds for particular activities;
 - Advising recipients to reimburse its program account or its letter of credit for funds improperly used;

- Change the method of payment from HUD from the letter of credit basis to reimbursement basis; or
- Condition the use of funds from the next year's allocation.
- Worst-case scenarios involve actions from HUD such as:
 - Limiting the availability of payments to programs or activities not affected by the area of noncompliance;
 - Reducing payments to the recipient;
 - Terminating payments to the recipient; or
 - Referral to the Attorney General of the United States.

NATIONAL OBJECTIVES MUST CORRESPOND TO MATRIX CODES

Effective with the 4.8 Release of IDIS, for CDBG activities the National Objective Code that you enter on the CDBG Activity screen, CDBG01, will be matched to the Matrix Code that you entered on the Process Activity screen, C04MA03. Only certain combinations of NOC/Matrix Code will be permitted.

If you enter an NOC that doesn't apply to the Matrix Code, the system will display the message, "Enter right value of National-Obj corresponding to Matrix-Code."

As before, no CDBG completion path is required for administrative activities. If you accidentally enter an NOC for an administrative activity and get an error message, blank out the NOC field and press Enter. This will return you to the Setup Activity "Money" screen, C04MA08.

The following table provides valid matches for NOC and Matrix Code. Please discard all older copies of the old chart.

| | | National Objective Codes (N = Not Allowed) | | | | | | | | | | | | | | |
|-----------------|--|---|-----|-----|-----|-----|-----|-----|-----|-------|-------|-------|-------|-------|-------|------|
| HUD Matrix Code | Activity | LMA | LMC | LMH | LMJ | SBA | SBS | SBR | URG | LMAFI | LMASA | LMCMC | LMCSV | LMHSP | LMJEI | LMJF |
| 01 | Acquisition of Real Property | | | | | | | | | | | N | N | | N | |
| 02 | Disposition | | | | | | N | | | | | N | N | | N | |
| 03 | Public Facilities and Improvements (General) | | | | | | | | | | | N | N | | | |
| 03A | Senior Centers | N | | N | | | | | | | | N | N | N | | |
| 03B | Handicapped Centers | N | | N | | | | | | | | N | N | N | | |
| 03C | Homeless Facilities (not operating costs) | N | | N | | | | | | | | N | N | N | | |
| 03D | Youth Centers | N | | N | | | | | | | | N | N | N | | |
| 03E | Neighborhood Facilities | | | N | | | | | | | | N | N | N | | |
| 03F | Parks, Recreational Facilities | | | N | N | | | | | N | N | N | N | N | | N |
| 03G | Parking Facilities | | | N | | | | | | | | N | N | N | | |
| 03H | Solid Waste Disposal Improvements | | | | | | | | | | | N | N | | | |
| 03I | Flood Drainage Improvements | | | | | | | | | | | N | N | | | |
| 03J | Water/Sewer Improvements | | | | | | | | | | | N | N | | | |
| 03K | Street Improvements | | | | | | | | | | | N | N | | | |
| 03L | Sidewalks | | | | | | | | | | | N | N | | | |
| 03M | Child Care Centers | N | | N | | | | | | | | N | N | N | | |

| | | National Objective Codes (N = Not Allowed) | | | | | | | | | | | | | | |
|-----------------|---|---|-----|-----|-----|-----|-----|-----|-----|-------|-------|-------|-------|-------|-------|------|
| HUD Matrix Code | Activity | LMA | LMC | LMH | LMJ | SBA | SBS | SBR | URG | LMAFI | LMASA | LMCMC | LMCSV | LMHSP | LMJFI | LMJP |
| 03N | Tree Planting | | | N | | | | | | | | N | N | N | | |
| 03O | Fire Station/Equipment | | N | N | N | | | | | N | N | N | N | N | | N |
| 03P | Health Facilities | | | N | | | | | | | | N | N | N | | |
| 03Q | Abused and Neglected Children Facilities | N | | N | | | | | | | | N | N | N | | |
| 03R | Asbestos Removal | | | N | | | | | | | | N | N | N | | |
| 03S | Facilities for AIDS Patients (not operating costs) | N | | N | | | | | | | | N | N | N | | |
| 03T | Operating Costs of Homeless/AIDS Patients Programs | N | | N | N | | N | N | | N | N | N | N | N | N | N |
| 04 | Clearance and Demolition | | | | | | | | | | | N | N | | N | |
| 04A | Cleanup of Contaminated Sites | | | | | | | | | | | N | N | | N | |
| 05 | Public Services (General) | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05A | Senior Services | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05B | Handicapped Services | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05C | Legal Services | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05D | Youth Services | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05E | Transportation Services | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05F | Substance Abuse Services | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05G | Battered and Abused Spouses | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05H | Employment Training | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05I | Crime Awareness | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05J | Fair Housing Activities (Subject to Pub. Serv. Cap) | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05K | Tenant/Landlord Counseling | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05L | Child Care Services | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05M | Health Services | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05N | Abused and Neglected Children | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05O | Mental Health Services | | | N | N | | N | N | | N | N | N | | N | N | N |
| 05P | Screening for Lead Based Paint/Lead Hazards | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05Q | Subsistence Payments | N | | N | N | | N | N | | N | N | N | | N | N | N |
| 05R | Homeownership Assistance (not direct) | N | N | | N | | N | N | | N | N | N | | | N | N |
| 05S | Rental Housing Subsidies | N | N | | N | | N | N | | N | N | N | | | N | N |

| | | National Objective Codes (N = Not Allowed) | | | | | | | | | | | | | | |
|------------------------|--|--|------------|------------|------------|------------|------------|------------|------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|
| HUD Matrix Code | Activity | LMA | LMC | LMH | LMJ | SBA | SBS | SBR | URG | LMAFI | LMASA | LMCMC | LMCSV | LMHSP | LMJFI | LMJP |
| 05T | Security Deposits | N | N | | N | | N | N | | N | N | N | | | N | N |
| 06 | Interim Assistance | | N | N | N | | | N | | N | N | N | N | N | N | N |
| 07 | Urban Renewal Completion | | | | | N | N | | N | | | N | N | | N | |
| 08 | Relocation | | | | | | | | | | | N | N | | N | |
| 09 | Loss of Rental Income | | | | | | | | | | | N | N | | N | |
| 10 | Removal of Architectural Barriers (This matrix code should not be used anymore.) | N | | | N | | | N | | N | N | N | N | | N | N |
| 11 | Privately Owned Utilities | | | | | | | | | | | N | N | | N | |
| 12 | Construction of Housing | N | N | | N | | N | | | N | N | N | N | | N | N |
| 13 | Direct Homeownership Assistance | N | N | | N | N | N | N | N | N | N | N | N | | N | N |
| 14A | Rehab; Single Unit Residential | N | N | | N | | | | | N | N | N | N | | N | N |
| 14B | Rehab; Multi-Unit Residential | N | N | | N | | | | | N | N | N | N | | N | N |
| 14C | Public Housing Modernization | N | N | | N | | | | | N | N | N | N | | N | N |
| 14D | Rehab; Other Publicly-Owned Residential Buildings | N | N | | N | | | | | N | N | N | N | | N | N |
| 14E | Rehab; Publicly or Privately-Owned Commercial/Industrial | | | N | | | | | | | | N | N | N | N | |
| 14F | Energy Efficiency Improvements | N | N | | N | | | | | N | N | N | N | | N | N |
| 14G | Acquisition for Rehabilitation | N | N | | N | | | | | N | N | N | N | | N | N |
| 14H | Rehabilitation Administration | | | | | | | | | | | N | N | | N | |
| 14I | Lead Based Paint/Hazards Test/Abatement | N | N | | N | | | | | N | N | N | N | | N | N |
| 15 | Code Enforcement | | N | N | N | | N | | | N | N | N | N | N | N | N |
| 16A | Residential Historic Preservation | N | N | | N | | | | N | N | N | N | N | | N | N |
| 16B | Non-Residential Historic Preservation | | | N | | | | | N | | | N | N | N | N | |
| 17A | CI Land Acquisition/Disposition | | | N | | | | | | | | N | N | N | N | |
| 17B | CI Infrastructure Development | | | N | | N | | | | | | N | N | N | | |
| 17C | CI Building Acquisition, Construction, Rehabilitation | | | N | | | | | | | | N | N | N | N | |
| 17D | Other Commercial/Industrial Improvements | | | N | | | | | | | | N | N | N | N | |
| 18A | ED Direct Financial Assistance to For-Profits | | N | N | | | N | | | | | N | N | N | N | |
| 18B | ED Technical Assistance | | N | N | | | N | | | | | N | | N | N | |
| 18C | Micro-Enterprise Assistance | | | N | | | N | | | | | | N | N | N | |
| 19A | CDBG Funding of HOME Admin. | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |

| | | National Objective Codes (N = Not Allowed) | | | | | | | | | | | | | | |
|------------------------|---|--|------------|------------|------------|------------|------------|------------|------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|
| HUD Matrix Code | Activity | LMA | LMC | LMH | LMJ | SBA | SBS | SBR | URG | LMAFI | LMASA | LMCMC | LMCSV | LMHSP | LMJFI | LMJP |
| 19B | CDBG Funding of HOME CHDO Operating Costs | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 19C | CDBG Non-profit Organization Capacity Building | | | | | | | | | | | | | | | |
| 19D | CDBG Assistance to Institutes of Higher Education | | | | | | | | | | | | | | | |
| 19E | CDBG Operation and Repair of Foreclosed Property | | N | | N | N | N | N | N | N | N | N | N | | N | N |
| 19F | Planned Repayments of Sec. 108 Loans | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 19G | Unplanned Repayments of Sec. 108 Loans | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 19H | State CDBG Technical Assistance to Grantees | | | | | | | | | | | | | | | |
| 20 | Planning (CDBG Entitlement Communities Grantees) | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 20 | Planning (State-Administered CDBG Grantees) | | | | | | | | | | | | | | | |
| 21A | General Program Administration | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21B | Indirect Costs | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21C | Public Information | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21D | Fair Housing Activities (subject to Admin. cap) | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21E | Submissions or Applications for Federal Programs | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21H | CDBG Funding of HOME Admin. | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 21I | CDBG Funding of HOME CHDO Operating Costs | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| 22 | Unprogrammed Funds | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |