

Disbursement of Funds for Economic Development Loans

May 7, 1991

MEMORANDUM FOR: Virginia E. Peck, Director, Community Planning and Development Division, 4.7C

FROM: Russell K. Paul, Deputy Assistant Secretary for Grant Programs, CG

**SUBJECT: Community Development Block Grant (CDBG) Program
Disbursement of Funds for Economic Development Loans**

This is in response to your memorandum of March 12, 1991 about a question raised by the City of Memphis on the disbursement of funds for economic development loans.

The guidance provided by the Financial Management Division was correct: the requirements of 24 CFR 85.21 regarding the payment of funds are applicable because the grantee must comply with the requirements in Part 85 even though the businesses receiving economic development loans under the City's CDBG program are not subject to those requirements. Therefore, Treasury rules governing cash advances for grantees at 31 CFR 205.4 (which are applicable pursuant to 85.21) are to be followed when disbursing economic development loans. This provision requires that cash advances be limited to the minimum amounts needed and be timed with actual and immediate cash requirements of the approved project.

Based on the regulations cited above, the full amount of an economic development loan should not be disbursed when the promissory note (or other evidence of indebtedness) is signed unless the loan funds are needed by the business to carry out the economic development project. For example, if the project provides for construction financing, the loan funds should not be disbursed to the business until needed to pay the contractor. As an additional example, a loan to finance the purchase of machinery and equipment should not be disbursed until needed by the business to pay the vendor in accordance with the terms of the purchase agreement.

Similarly, if the project provides for working capital financing, the amount of the loan that could be disbursed at any one time would depend upon the working capital needs of the business (including the maintenance of a minimum cash balance).

Each disbursement of loan funds by the grantee should be supported by appropriate documentation of working capital needs.

Use of this policy, in conjunction with prudent lending practices, should serve to protect the grantee's investment and ensure that the project is carried out in a manner that will provide for successful completion and permit a national objective to be met. This is also consistent with 24 CFR 85.20(b)(3) of

the Common Rule pertaining to internal control, which requires the grantee to have effective control and accountability over all grant cash to assure that it is used solely for authorized purposes.

A grantee should not disburse funds for economic development loans merely as a method of reducing the amount of funds in its line-of-credit, nor should a grantee disburse the entire amount of a loan at one time merely to avoid the inconvenience of more frequent payments.

Finally, the City has expressed some concern about the difficulty of establishing an amortization schedule when loan funds are disbursed in incremental amounts rather than as a lump sum. In response to this, attached is an example of how interest on incremental loan advances may be accrued and amortized with the loan proceeds over the period of the loan. While this is only one example, it should be useful to the City.

If you have additional questions regarding this matter, please contact the Entitlement Communities Division.

Attachment

cc: Linda Marston, SC