

Eligibility Determination on "Existing Indebtedness" Relating to the CDBG Entitlement Program

October 8, 1991

MEMORANDUM FOR: Harold Young, Director, Community Planning and Development Division, 3.1C

FROM: Randall H. Erben, Deputy Assistant Secretary for Grant Programs, CG

SUBJECT: Eligibility Determination on "Existing Indebtedness" 24 CFR 570.202(b)(3) Community Development Block Grant (CDBG) Entitlement Program

This is in response to your memorandum dated October 8, 1991, requesting an eligibility determination on the definition of "existing indebtedness" as it is used in the CDBG regulations at 24 CFR 570.202(b)(3). The case in question pertains to a community that would like to make a CDBG loan for the rehabilitation of a substandard residence on which there is no mortgage, but against which there are several recorded liens and a judgment totaling over \$8,000 from a bank, two credit cards and the State of Maryland. Further discussions with your staff reveal that the homeowner is not making any payments on these existing debts. This CDBG rehabilitation loan would pay off the liens and judgment and would be placed in first position. Payment of this loan would not be due until the property is sold or the owner dies. The question you have raised is whether the payment of retail debt through a CDBG rehabilitation loan is consistent with the intent of the above-cited regulation.

The regulation at 570.202(b)(3) states that CDBG funds can be used for "loans for refinancing existing indebtedness secured by a property being rehabilitated with CDBG funds...." Although the regulation does not specify the type of debt that can be refinanced through a rehabilitation loan, the clear intent of this provision is to permit the consolidation of any existing secured loans (typically a mortgage) with the rehabilitation loan so that the monthly payments would be an amount that the borrower could handle. That is, the CDBG assistance would allow the consolidation of the outstanding debt together with the CDBG loan debt service in order to make the rehabilitation financially feasible for the borrower.

cc:

CGBE GOLDBERG-NEWTON 7282 CGBE MAGUIRE-ZINNI 7282

CBGE BROUGHMAN 7282 CGBE CHRON 7282

CGBE FILES 7282 CGBE PATCH 7282

CU 7233 CPD FILES 7233

SC LINDA MARSTON

CGBE:Goldberg-Newtow:szm 12-10-91 708-1577 WGN11/91 "DEBT"

The use of CDBG funds in question does not appear to meet the intent of this rule. Since the homeowner is not making any payments towards the existing debts, refinancing them through this rehabilitation loan will not, in this case, affect the financial feasibility of the rehabilitation. Furthermore, the proposed CDBG loan is structured so that its repayment would not occur until the property is sold or the owner dies - no payments on it are due until either one of those occurrences. Accordingly, even if the CDBG loan were

for a mortgage requiring monthly payments, the refinancing would not bear on this owner's ability to repay it.

In addition, OMB Circular A-87 C.1.a. states that costs must "be necessary and reasonable for proper and efficient administration of the grant programs...." Since the loan recipient is not making any payments on the existing liens or judgment, refinancing the existing indebtedness is not "necessary and reasonable" in order to carry out the rehabilitation. In light of the intent of the regulation and this principle in OMB Circular A-87, this activity is not eligible in the CDBG program.

If you have any questions on this, please contact the Entitlement Communities Division on FTS 458-1577.

cc: Linda Marston, SC