

Prohibited CDBG Activities

August 9, 1993

Honorable Frank F. Fasi
Mayor of Honolulu
Honolulu, HI 96813

Dear Mayor Fasi:

This is in further response to your April 23, 1993, letter appealing the Department of Housing and Urban Development's (HUD) February 25, 1993, decision that the 80-unit Manoa Gardens project was ineligible for Community Development Block Grant (CDBG) assistance.

The CDBG legislation has consistently been interpreted not to permit CDBG assistance to be used to construct new housing. This is reflected in the prohibition on such activities, subject to the exceptions there listed, stated in the regulations in section 570.207(b)(3). Therefore, notwithstanding the otherwise eligible activity of property acquisition, HUD would deem a CDBG expenditure as being in violation of the prohibition where a CDBG-assisted acquisition commitment is made at the outset, as part of the new residential construction financing package, serving in effect as take-out financing for the interim construction lender. Since the material submitted with the City's appeal made apparent that this was not the case in the Manoa Gardens project, the Department has determined that the CDBG lease acquisition expenditures can be recognized as allowable costs.

The restriction on new construction of housing is considered to be violated in any case where the construction is carried out in whole or in part (1) with CDBG funds, or (2) with non-CDBG funds made available in reliance, in whole or in part, on written CDBG funding commitments from which repayments will be derived, e.g., commitments for permanent financing, purchase or leasing. It is irrelevant in such cases under (2) whether the CDBG funding commitment is made to the developer or directly to the interim lender, or whether it is made by the CDBG grantee, a subgrantee, or a third party such as a homebuyer under section 105(a)(20) who has a written commitment from the grantee or subgrantee.

Applying this policy to the case at issue, the City of Honolulu constructed multifamily dwellings with general obligation bonds. During or after construction the City funded a nonprofit subrecipient (not eligible under section 570.204) to acquire some of the units by long-term leasing at below-market rates for the provision of affordable housing. Since the facts presented by the City show that the construction financing was not provided in reliance on CDBG funding commitments, HUD does not believe that the use of CDBG funds for the leasing agreement with the nonprofit constitutes the financing of new housing construction prohibited under the CDBG program.

Note that, if the City had originally planned a residential new construction project to include CDBG acquisition of the units, and the bond package offered to investors had reflected a plan in the project budget that relied on the use of CDBG funds to repay the bonds in whole or in part, such a use of CDBG funds would be considered to be financing the construction and be therefore ineligible.

Thank you for your patience in presenting the City's views on this issue. The Department does agree that this issue merits additional consideration in the program regulations and will consider making revisions to this end. I hope this decision will forward the City's use of CDBG to meet the needs of its low- and moderate-income citizens.

Sincerely,

Henry G. Cisneros