

Default Account for Housing Rehabilitation Loan Program Request for Waiver to Retain Interest Earned as Program Income

March 30, 1998

MEMORANDUM FOR: Jim Nichol, Director, Community Planning and Development Division, 4HDM

FROM: Kenneth C. Williams, Deputy Assistant Secretary for Grant Programs, DG

SUBJECT: Default Account for Housing Rehabilitation Loan Program Request for Waiver to Retain Interest Earned as Program Income Orange County, Florida

This is in response to your memorandum of December 30, 1997, regarding a request from Orange County, Florida, to permit the County to retain the interest earned on a default account as program income.

According to the information submitted, Orange County entered into an agreement with First Federal Savings and Loan Association of Orlando (now called Great Western Bank) on August 14, 1978, to use Community Development Block Grant (CDBG) funds to establish a Default Reserve Account for rehabilitation loans made by the bank to low- and moderate-income persons. The terms of the agreement required Orange County to deposit in the account CDBG funds equal to the full sum of the first loan amount and 10 percent of each loan thereafter. The agreement also stated that the County "may, but is not obligated to," use the funds in the Default Account to make monthly payments on behalf of any borrower who defaulted on his or her loan. However, the County could not withdraw the funds for any other purpose. The County has indicated that no defaults ever occurred and the account was closed on July 2, 1997. In addition to treating the \$16,058.55 in initial CDBG deposits as a return of grant funds, Orange County would like to retain the \$16,844.53 in interest earned on this account and treat it as program income.

The primary issue in this case is whether Orange County's drawdown and deposits of CDBG funds in the Default Reserve Account were necessary or whether such deposits violated letter of credit drawdown rules by being made in advance of need. The determination as to the necessity of the deposit does not center on the terms of the County's agreement with First Federal. Drawing funds from a letter of credit before such funds are needed to cover actual defaults must be supported by adequate justification to demonstrate that no financial institutions in the area would participate in the program and accept a payment guarantee without having funds on deposit. Orange County has not submitted any documentation to support that no other financial institutions in the area would have participated and assisted in the implementation of the program without funds actually being placed on deposit. There are no grounds for determining that there was an actual cash need at the time the County drew down the funds.

Based on the above information, it appears that Orange County violated letter of credit requirements when it established the subject Default Reserve Account by drawing down CDBG funds in advance of cash need. Thus, interest earned on this account should be returned to Treasury as interest earned on a grant advance, pursuant to 24 CFR 570.500(a)(2)(i). The recovery of the initial deposit of CDBG funds should be classified as a return of grant funds to Orange County's CDBG program. If you have any further questions regarding this matter, please contact the Entitlement Communities Division at (202) 708-1577.