CHAPTER 8: ECONOMIC DEVELOPMENT & SECTION 108

CHAPTER PURPOSE & CONTENTS

This chapter covers economic development activities that are eligible for assistance under the CDBG Program. The chapter provides information on and the economic development underwriting guidelines and the public benefit standards requirements applicable to certain economic development projects. The Section 108 loan guarantee program is also reviewed.

SECTION TOPIC
8.1 Eligible and Ineligible Activities
8.2 Meeting and Documenting a National Objective
8.3 Underwriting Guidelines and Public Benefit Standards
8.4 Section 108 Loan Guarantee Program

8.1 Eligible and Ineligible Activities

Creating economic opportunities and jobs are among the key CDBG activities funded by many grantees. This section highlights the ways that economic development projects can be funded under CDBG.

Key Topics in This Section: Eligible Activities, Key ways to undertake economic development activities
Ineligible Activities

Regulatory/Statutory Citations: Section 105(a)(2), Section 105(a)(4), Section 105(a)(14), Section 105(a)(15), Section 105(a)(17), Section 105(a)(19), 570.201(c), 570.201(o), 570.202, 570.203 (a), (b) and (c), 570.204

Other Reference Materials on This Topic Guide to National Objectives and Eligible Activities for Entitlement Communities, Chapter 2

8.1.1 Eligible Activities

The CDBG program recognizes several key ways that economic development may be undertaken.

Special economic development. CDBG funds may be used to undertake certain economic development activities. 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. These are economic development projects undertaken by nonprofit entities and grantees (public entities).
- Assisting a private, for-profit business. Assistance may include grants, loans, loan guarantees, and technical assistance; and
- Providing economic development services in connection with otherwise eligible CDBG economic development activities.
Economic development undertaken by community based development organizations (CBDOs). These are activities designed to assist in neighborhood revitalization or community economic development and are carried out by an organization that qualifies as a CBDO under the regulations at 24 CFR Part 570.204. See chapter 2 for more information about CBDOs.

In addition to meeting one of the organizational types listed above, the entity must be carrying out neighborhood revitalization, community economic development or energy conversation projects.

Technical assistance to businesses. This activity involves providing technical assistance and training directly to businesses on topics such as business planning or accounting. This activity may be undertaken under several different eligibility categories, assuming that the activity will meet a national objective:

- As a part of a special economic development project;
- To the owner of a microenterprise;
- As a public service; and
- By a CBDO as a part of an eligible project.

Microenterprise development. These are activities designed to foster the development, support, and expansion of microenterprise businesses.

A microenterprise is defined as a commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise.

A “person developing a microenterprise” refers to a person who has expressed an interest and who is, or after an initial screening process is expected to be, actively working toward developing a business that will be a microenterprise at the time it is formed.

Eligible microenterprise activities include the provision of:

- Grants, loans, loan guarantees 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 including child care, transportation, counseling and peer support groups; and
- Training and technical assistance, or other support services to increase capacity of grantees or subrecipients to carry out microenterprise activities.

Commercial rehabilitation. These are activities that are designed to bring commercial structures up to code or improve their facades.

If the commercial structure is owned by a private, for-profit entity, the following limitations apply:

- Rehabilitation is limited to the exterior of the building and the correction of code violations; and
- Any other improvements are carried out under the special economic development activities category discussed above.
Public facilities and improvements. These are public works that support economic development endeavors. Public works facilities and improvements includes infrastructure projects such as off-site water, sewer, roads, drainage, railroad spurs and other types of public facilities or improvements.

Job training. Job training involves providing skill building classes to employees or potential employees and can be an important part of an economic program. This activity can be undertaken:

- As a part of a special economic development project;
- As a public service;
- By a CBDO as a part of an eligible project; or
- As a part of microenterprise assistance package to the owner of a micro business for his or her employees.

8.1.2 Ineligible Activities

Activities not described above are generally ineligible; however, Community Based Development Organizations (CBDOs) can undertake many otherwise ineligible activities when they retain direct and controlling involvement in a qualified project.

The following restrictions apply when a CBDO undertakes an activity:

- CBDOs may not carry out otherwise ineligible activities (i.e., general government buildings or expenses, or political activities); and
- CBDOs cannot carry out special economic development activities that do not meet the grantee’s underwriting guidelines for such projects and HUD’s mandatory public benefit standards.

CBDOs are authorized to carry out public services that exceed the 15 percent public services cap when the services are specifically designed to increase economic opportunities through job training/placement and other employment support services.

CBDOs may also provide public services of any type outside of the public services cap if the services are undertaken as part of a HUD-approved Neighborhood Revitalization Strategy Area (NRSA).

CBDOs may not carry out program administration or planning activities that would result in the grantee exceeding the 20 percent limit on such expenditures.

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.
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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 three 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 programmatic clauses, the written agreement shall include:

- 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.

8.2 Meeting and Documenting a National Objective

This section describes the national objectives that may be used for economic development activities.

Key Topics in This Section: LMI Benefit, LMI Area Benefit, LMI Limited Clientele
Job Creation/Retention, Slum/Blight

Regulatory/Statutory Citations: Section 101(c), Section 104(b), Section 105(c), 570.208, 570.506
8.2.1 National Objective Summary Chart

The following chart summarizes the national objective options related to economic development. The text below provides additional details. For a complete copy of the matrix codes and national objectives chart, please see the IDIS chapter of this manual.

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<th>LMC</th>
<th>LMH</th>
<th>LMJ</th>
<th>SBA</th>
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8.2.2 LMI Benefit National Objective

Economic activities that benefit an LMI area may qualify under the Area Benefit category of the LMI benefit national objective. For example if the grantee is funding a grocery store in a neighborhood that is at least 51 percent LMI, the activity may qualify as an area benefit.

If this criterion is used to qualify the activity, the grantee must document the service area of the business and then demonstrate through Census or survey data that 51 percent of the residents are LMI.

Additionally, the LMI Limited Clientele category may be used to qualify certain economic development activities under the LMI Benefit national objective.

For example, microenterprise activities may be undertaken under the LMI Limited Clientele category if the owner of the business is LMI. If this criterion is used, then the grantee must document the income of the business owner.
Also, job training and placement or other employment support services such as peer counseling, child care and transportation may qualify under the LMI Limited Clientele category if at least 51 percent of the persons benefiting from the activity are LMI.

Finally, economic 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 may qualify under the Job Creation or Retention category of the LMI Benefit national objective.

The following requirements must be met for jobs to be considered created or retained.

If grantees 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.

For funded activities which 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:

(a) 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

(b) The grantee 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.

In determining whether a job is made available to or held by a LMI person, grantees may presume that a person is LMI if:

- He/she resides in a Census tract that meets certain requirements (see below); or
- He/she resides in a Census tract with at least 70 percent LMI persons; or
- The assisted business is located in an eligible Census tract (see below) and the job will be located within that same Census tract.

An eligible Census tract is one that is located within a Federally-designated Empowerment Zone or Enterprise Community or a Census tract that:

(a) Has a poverty rate of at least 20 percent;

(b) Does not include part of a central business district (unless the Census tract has a poverty rate of at least 30 percent); and
(c) Evidences pervasive poverty and general distress by meeting at least one of the following criteria:

(i) All block groups in the Census tract have 20 percent or greater poverty rates;

(ii) The activity is undertaken in a block group with a 20 percent or greater poverty rate; or

(iii) HUD determines that the tract shows other signs of distress (e.g., crime, homelessness, deteriorated housing, etc.)

For job training, job placement and other employment support services, the CDBG regulations provide certain circumstances in which these activities can be considered to meet the LMI limited clientele national objective even when the percentage of persons assisted is less than the 51 percent threshold. The special circumstances under which this is allowed are:

Where job training or the provision of supportive services is used to assist businesses, the only use of CDBG funds in the activity is for the job training and/or supportive services; and

The proportion of the total cost of the job training or supportive services to be paid with CDBG funds is not greater than the proportion of the total number of assisted LMI persons.

As a general rule, each assisted business shall be considered to be a separate activity for purposes of determining whether the activity qualifies.

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 one-year period.

### 8.2.3 Slum/Blit National Objective

Economic development activities, such as commercial rehabilitation, which aid in the prevention or elimination of slums or blight in a designated area may qualify under the Area Slum/Blit national objective.

In order to qualify under this national objective category, the economic development activity must take place in an area that:

- 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:
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(a) Physical deterioration of buildings/improvements;

(b) Abandonment of properties;

(c) Chronic high occupancy turnover rates or chronic high vacancy rates in commercial or industrial buildings;

(d) Significant declines in property values or abnormally low property values relative to other areas in the community; or

(e) Known or suspected environmental contamination.

Documentation must be maintained by the grantee 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.

Under the Spot Basis category of the Slum/Blight national objective, activities such as acquisition, clearance and building rehabilitation may be undertaken.

When rehabilitation is categorized under the Spot Basis category, it must meet the following requirements:

The rehabilitation must eliminate specific conditions of blight or physical decay on a spot basis, i.e., not be located in a designated slum and blight area; and

The rehabilitation must be limited to only those conditions that are detrimental to public health and safety.

8.3 Underwriting Guidelines and Public Benefit Standards

Economic development project must demonstrate a sufficient benefit in return for the CDBG investment. This section highlights these requirements, as well as the voluntary underwriting standards.

Key Topics in This Section: Guidelines and Objectives for Evaluating Project Costs and Financial Requirements, Public Benefit Standards, Individual standards, Aggregate standards

Regulatory/Statutory Citations: Section 105 (a)(14) – (17), 570.209

Other Reference Materials on This Topic: Guide to National Objectives and Eligible Activities for Entitlement Communities, Chapter 2: Categories of Eligible Activities, Appendix B: Public Benefit Standards

8.3.1 Voluntary Project Guidelines

HUD has established guidelines for selecting special economic development projects. The guidelines have two parts:

570.209 (a) - Guidelines and Objectives for Evaluating Project Costs and Financial Requirements, and

570.209 (b) - Standards for Evaluating Public Benefit.
**Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.**

These underwriting guidelines are designed to assist grantees to select economic development projects that are financially viable and will result in the most effective use of CDBG funds.

The use of these guidelines is *voluntary*; however, grantees electing not to use the following guidelines are expected to conduct basic financial underwriting of projects funded under this eligibility category.

There are six criteria that have to be evaluated:

- Project costs are reasonable;
- All sources of project financing are committed;
- To the extent practicable, CDBG funds are not substituted for non-federal financial support;
- 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 committed to the project.

These guidelines do not apply to public facilities or microenterprise activities.

The guidelines are included in the regulations as Appendix A to Part 570.

**8.3.2 Aggregate and Individual Public Benefit Standards**

**Standards for Evaluating Public Benefit.** The use of these standards is *mandatory*. Grantees are responsible for ensuring that a minimum level of public benefit is obtained when CDBG funds are used for special economic development projects and when used for public facilities and improvements projects undertaken for economic development purposes. The standards have two levels: standards for individual activities and aggregate standards.

**Standards for Individual Activities**—An activity is considered by HUD to provide *insufficient* public benefit and can *not* be assisted with CDBG funds if:

- The amount of CDBG assistance exceeds $50,000 per full-time equivalent (FTE), permanent job (created or retained) *or* $1,000 per LMI person to which goods and services are provided by the activity;

In addition, an activity would be considered to have an insufficient benefit if it 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
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Assistance to a for-profit business owner that 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 FTE, permanent job per $35,000 of CDBG funds used;
  or
- 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.

Certain activities can be excluded from the aggregate standards (as discussed below and in 570.209(b)(2)(v)).

### 8.3.3 Applying the Public Benefit Standards

As discussed previously, when CDBG funds are used for special economic development projects and/or public facilities and improvements projects undertaken for economic development purposes, grantees must ensure that a minimum level of public benefit is obtained.

Note: the public benefit standards do not apply to microenterprise assistance provided under 570.201(o).

The individual *and* aggregate activity standards must be used as follows in order to make this determination.

**Applying the standards for individual activities:**

If an activity both creates/retains jobs and provides goods/services to LMI residents of an area, the activity is ineligible only if it fails both standards (i.e. it must meet one);

The standards are applied to the number of jobs projected or LMI 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;

Grantees may elect to apply the standards to the creation/retention of jobs or to the provision of goods and services to LMI residents, but cannot count an activity under both standards;

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 are provided exclusively for unemployed persons or participants of JTPA, JOBS or AFDC programs;
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Jobs are provided predominantly for residents of public or Indian housing units;
Jobs are provided predominantly for homeless persons;
Jobs are 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 are provided predominantly for persons residing in a Census tract with at least 20 percent of the residents in poverty;
Assistance is provided to businesses that operate in a Census tract with at least 20 percent of the residents in poverty;
The activity stabilizes or revitalizes a neighborhood that has at least 70 percent low- and moderate-income residents;
Assistance is provided to a CDFI that serves a predominantly LMI area;
Assistance is provided to a CBDO that serves a neighborhood that has at least 70 percent LMI residents;
Provides services or creates/retains jobs in a HUD-approved Neighborhood Revitalization Strategy Area; or
With prior HUD approval, represents some other innovative approach with substantial benefits to LMI residents.

8.4 Section 108 Loan Guarantee Program

Section 108 is a significant resource that can be used to create community and economic development projects. This section summarizes the Section 108 Program.

Key Topics in This Section: Program Parameters, The Loan Process
Players and Their Roles, Typical Uses of Section 108, Advantages of Using Section 108

Regulatory/Statutory Citations: 24 CFR 570, Subpart M –Loan Guarantees

Other Reference Materials on This Topic: Guide to National Objectives and Eligible Activities for Entitlement Communities, Chapter 2: Categories of Eligible Activities, Appendix F: Making the Most of your CDBG Resources, Appendix G: Selling or Securitizing CDBG-funded Loans Using the Section 108 Program and Other Secondary Markets, CPD Notice 01-10

The Section 108 Program is a loan guarantee program, which enables CDBG grantees to borrow up to five times their annual entitlement grant.

Entitlement communities pledge future CDBG funds as security for the loan. Non-entitlement communities may participate if their State is willing to provide the pledge of future CDBG funds.

HUD acts as the guarantor of a 108 loan made from private market funds, promising investors that the loan will be repaid.

Being able to borrow large sums of money helps grantees undertake large scale, capital-intensive projects and provides a mechanism for grantees to extend the impact of their CDBG Program.
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This chapter provides an overview of Section 108 basics and its advantages.

8.4.1 **Advantages to Using Section 108**

Grantees take on the risks of borrowing Section 108 funds because the program provides the following significant advantages:

- **Potential leverage**—A community has access to funds totaling up to five times its annual CDBG entitlement while retaining the use of its entitlement.

- **Avoid referendum**—Since Section 108 borrowing is not ordinarily a general obligation, the community can avoid a referendum and the Section 108 indebtedness does not affect the debt limit of the community.

- **Accelerate CDBG activities**—Instead of “paying as you go,” communities can complete needed projects now by utilizing Section 108.

- **Spread Costs Over Time**—The costs for 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.

- **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 an AAA rate**—Despite the premium over Treasuries 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 non-rated and privately held, can access financing at significantly lower rates than would be otherwise be available to small businesses.

- **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 its future obligations.

These advantages are substantial enough that many communities have accepted the risks of Section 108 borrowing and successfully expanded their economic opportunities.

8.4.2 **Program Parameters**

The following basic parameters apply to the Section 108 program:

- **Maximum loan amount**—up to five times a community’s annual CDBG entitlement.

- **Loan Terms**—interest rates and repayment schedules can vary on a case-by-case basis, but the maximum loan term is 20 years.

- **Eligible Applicants**—Entitlement communities, non-entitlement communities that are assisted by State grantees, and non-entitlement communities eligible under the Small Cities Program.

- **Eligible Activities**—Eligible Section 108 activities are different than those under the regular CDBG program. Section 108 can fund the following activities (NOTE: consult the regulations for a more complete description of these requirements):

  - Acquisition;
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Rehabilitation of publicly-owned property;
Clearance, demolition, removal and site preparation related to acquisition or rehabilitation;
Economic development activities;
Housing rehabilitation;
Payment of issuance and finance costs associated with 108 loans;
Relocation assistance necessitated by a 108 project;
Acquisition, construction, reconstruction, rehabilitation or installation of public facilities;
Site preparation, including construction, reconstruction, and installation of public and other site improvements, facilities and utilities (see the regulations for additional requirements).

Program Requirements—With its origin derived from CDBG legislation, Section 108 is subject to CDBG requirements. The following criteria are the same for both CDBG and Section 108:

- Compliance with national objectives;
- Davis-Bacon labor standards;
- Environmental review requirements;
- Underwriting guidelines;
- Compliance with the primary objective (i.e., 70 percent of expenditures benefit LMI persons);
- Public benefit standards; and
- CDBG certifications.

Ineligible Activities—Several activities that are eligible under CDBG are not eligible under Section 108, including public services, payment of the non-Federal share of other Federal grant programs, and long-term planning.

8.4.3 Typical Uses of Section 108

Although CDBG is more inclusive, the activities that are eligible under Section 108 are quite broad. Communities can finance: operating costs for businesses and developers; micro loan funds and Fortune 500 companies; machinery, equipment and working capital; and leasehold improvements, furniture and fixtures. While some of these categories may carry burdens relating to additional security, all are eligible.

Examples of completed Section 108 projects include:

- Industrial expansion;
- Capitalization of a revolving loan fund;
- Construction of a neighborhood shopping center;
- Expansion of an accounting practice;
- Construction of a warehouse facility and industrial park;
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Funding a business incubator;
Creation of a retail business;
Constructing an office building; and
Housing rehabilitation carried out by a nonprofit organization.

8.4.4 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 future CDBG entitlements, program income, and provide 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 national brokerages, which 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.

Fiscal Agent—The Fiscal Agent manages Level #1 transactions. It acts as a trustee for the investors and manages disbursements to communities and repayments from the project that are conveyed back to the investors.

Private Investors—Private investors fall into two major groups: (1) individuals; or (2) institutions. The investors are buying paper, which has fixed rates and has nominal credit risk (due to the full faith and credit guarantee). The Section 108 notes 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 note.

Third Party Borrowers—If the community chooses, it can re-loan 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 may be difficult to obtain conventionally.

8.4.5 The Loan Process

The basic steps of a typical Section 108 transaction work as follows:

The grantee applies to HUD for a Section 108 Loan Guarantee.

The grantee pledges a portion of its future CDBG entitlement grants plus any needed additional security to ensure that the notes will be repaid in the event of a project default.

Notes are sold to investors in a public offering to raise funds for the grantee’s approved project.

The community uses the funds raised by the sale of the notes to undertake the approved project.
Chapter 8: Economic Development & Section 108

The loan repayments are used to repay investors. Funds to repay the note can come from future CDBG funds, program income generated by the project, or other revenue sources that the grantee has available.

Depending on the type of project that is financed, grantees may have from one to twenty years to repay the Section 108 notes.

In summary, Section 108 consists of two levels:

**Level # 1**—Eligible communities borrow money from private investors (which the financial underwriters find).

**Level # 2**—Communities either carry out activities, which are eligible under Section 108 or, alternatively, re-loan the funds to third parties (entrepreneurs, developers, nonprofits, etc.) who undertake eligible activities.

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 defaults, the community must repay the loan.

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 comply with the Credit Reform Act of 1992, HUD cannot rely solely on the pledge of future CDBG entitlement funds to repay the Section 108 loan. Accordingly, the community must prove to HUD that either:

The project being financed with Section 108 funds has sufficient collateral and satisfies sound underwriting; or

The community pledges other assets that provide additional security beyond CDBG funds to bridge any repayment shortfalls.