

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 states. This section highlights the ways that economic development projects can be funded under CDBG.

Key Topics in This Section	<ul style="list-style-type: none"> ✓ Eligible Activities <ul style="list-style-type: none"> – Key ways to undertake economic development activities ✓ Ineligible Activities
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)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> ✓ Guide to National Objectives and Eligible Activities for States <ul style="list-style-type: none"> – 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 UGLG (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 nonprofit development organizations under 105(a)(15) of the statute.** These are activities designed to assist in neighborhood revitalization or community economic development and are carried out by an organization that qualifies as a nonprofit development organization under the HCDA statute at 105(a)(15). See chapter 2 for more information about these organizations.
- In addition to meeting one of the organizational types listed above, the entity must be carrying out neighborhood revitalization, community economic development or energy conservation 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 nonprofit development organization as a part of an eligible 105(a)(15) 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.
 - Under the entitlement regulations, which states may use as guidance, 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 states or subgrantees 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 nonprofit development organization as a part of an eligible 105(a)(15) 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, nonprofit development organizations under 105(a)(15) can undertake many otherwise ineligible activities when they retain direct and controlling involvement in a qualified project.
- ✓ The following restrictions apply when a nonprofit development organization under 105(a)(15) undertakes an activity:
 - They may not carry out otherwise ineligible activities (i.e., general government buildings or expenses, or political activities); and
 - They cannot carry out special economic development activities that do **not** meet the state's underwriting guidelines for such projects **and** HUD's mandatory public benefit standards.
- ✓ Nonprofit development organizations 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.
- ✓ Nonprofit development organizations may also provide public services of any type outside of the public services cap if the services are undertaken as part of a state-approved Community Revitalization Strategy Area (CRSA).



- ✓ Nonprofit development organizations may not carry out program administration or planning activities that would result in the state 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. (See exhibit 8-1 below for further information)



EXHIBIT 8-1:

SUMMARY OF ANTI-PIRATING RULE

In 1998, Section 105 of the HCDA was amended by section 588 of the Quality Housing and Work Responsibility Act, which added Subsection (h) titled Prohibition on Use of Assistance for Employment Relocation Activities to the HCDA. This provision was added to address a number of concerns raised over the expenditure of federal funds.

- Subsection (h) of the statute indicates that CDBG funds may not be used “to assist directly the relocation of any industrial or commercial plant, facility, or operation, from one area to another area, if the relocation likely to result in a significant loss of employment in the labor market area from which the relocation occurs.”
- The statute did not clearly define several items, which HUD has addressed in an interim rule published in the Federal Register on December 23, 2005 (note that this rule follows publication of an October 24, 2000, proposed rule and takes into consideration comments made by the public). The interim rule took effect on February 21, 2006 (which is also the end of the public comment period) and the rule was finalized on May 24, 2006.

Rule clarifications:

- **Direct Assistance** – The HCDA authorizes direct assistance to for-profit businesses, for-profit businesses, CBDOs, and other non-profit entities that target economic development activities. The interim rule:
 - Prohibits the provision of CDBG assistance to for-profit businesses and CBDOs (does not apply to non-profit entities), if the relocation of a plant or facility resulted in a significant loss of jobs in the area from which the relocation occurs.
 - Some exceptions as explained in the rule, including.
 - Public facilities; and
 - Indirect assistance that will provide benefit to multiple businesses unless it includes the provision of infrastructure to aid a specific business.
- **Significant loss of employment** – The statute did not define the term “significant job loss”.
 - The interim rule establishes a de minimis definition of job loss – a loss of 25 or fewer jobs would not constitute a significant job loss.
 - The loss of 500 jobs or more would constitute a significant job loss and would invoke job pirating rule.
 - Job losses between 25 - 500 must be less than 0.1 percent of the areas labor force, (i.e. the area losing jobs) to avoid being counted as significant.



EXHIBIT 8-1: CONTINUED

- **Labor Market Area (LMA)** – The statute did not define who determined the labor market area.
 - States may define their LMA using the following:
 - Area defined as LMA based upon Bureau of Labor Statistics (BLS) data; or
 - Combine non-metropolitan LMAs.
 - States are required to define or reaffirm prior definitions of their LMAs on an annual basis and retain records to substantiate such areas prior to any business relocation that would be impacted by this rule.
- **Company Relocation** –The rule indicates that:
 - Any relocation that results in less than 25 jobs would not invoke the rule and any relocation over 500 jobs would automatically invoke the rule.
 - Measures would have to be taken to determine percentage of jobs lost would invoke rule—must be less than 0.1 percent of LMA.
- **Infrastructure** - Infrastructure improvements are considered same as direct assistance under certain conditions. See section above on direct assistance for further information.
- **Time limits** -- The final rule establishes time limits on the applicability of the anti-piracy requirements. Generally, a job will be considered to be relocated if positions are eliminated at an existing operation within 3 years after the provisions of CDBG assistance to the operation.



- ✓ 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.
- ✓ 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 state and UGLG 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	<ul style="list-style-type: none"> ✓ LMI Benefit <ul style="list-style-type: none"> - LMI Area Benefit - LMI Limited Clientele - Job Creation/Retention ✓ Slum/Blight
Statutory Citations	Section 101(c), Section 104(b), Section 105(c)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> ✓ Guide to National Objectives and Eligible Activities for States <ul style="list-style-type: none"> - Chapter 3

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.

National Objective Codes (N = Not Allowed)								
HUD Matrix Code	Activity	LMA	LMC	LMH	LMJ	SBA	SBS	URG
14E	Rehab; Publicly or Privately-Owned Commercial/Industrial			N				
17A	CI Land Acquisition/Disposition			N				
17B	CI Infrastructure Development			N			N	
17C	CI Building Acquisition, Construction, Rehabilitation			N				
17D	Other Commercial/Industrial Improvements			N				
18A	ED Direct Financial Assistance to For-Profits		N	N			N	
18B	ED Technical Assistance		N	N			N	
18C	Micro-Enterprise Assistance			N			N	

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 state and UGLG are 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 state must document the service area of the business and then demonstrate through Census data/American Community 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 UGLG 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 states 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 state 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, states and UGLG may presume that a person is LMI if:



- He/she resides in a Census/American Community Survey tract that meets certain requirements (see below); or
- He/she resides in a Census/American Community Survey tract with at least 70 percent LMI persons; or
- The assisted business is located in an eligible Census/American Community Survey tract (see below) **and** the job will be located within that same Census/American Community Survey tract.
 - An eligible Census/American Community Survey tract is one that is located within a Federally-designated Empowerment Zone or Enterprise Community **or** a Census /American Community Survey 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/American Community Survey 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/American Community Survey 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/Blight 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/Blight 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:
 - (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 state 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;
 - Rehabilitation must be limited to only those conditions that are detrimental to public health and safety; and
 - If acquisition or relocation is undertaken, it must be a precursor to another eligible activity (funded with CDBG or other resources) that directly eliminates the specific conditions of blight or physical decay, or environmental contamination.



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	<ul style="list-style-type: none"> ✓ Guidelines and Objectives for Evaluating Project Costs and Financial Requirements ✓ Public Benefit Standards <ul style="list-style-type: none"> – Individual standards – Aggregate standards
Statutory Citations	Section 105 (a)(14) – (17)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> ✓ Guide to National Objectives and Eligible Activities for States <ul style="list-style-type: none"> – 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:
 - Guidelines and Objectives for Evaluating Project Costs and Financial Requirements, and
 - Standards for Evaluating Public Benefit.
- ✓ **Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.** These underwriting guidelines are designed to assist states and UGLG 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, states 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.

8.3.2 Aggregate and Individual Public Benefit Standards

- ✓ **Standards for Evaluating Public Benefit.** The use of these standards is *mandatory*. States and UGLG 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
 - 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 570.482(f)(3)).

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, states must ensure that a minimum level of public benefit is obtained.
- ✓ Note: the public benefit standards do not apply to microenterprise assistance provided under the applicable section of the statute.



- ✓ 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:
 - States must apply the aggregate standards to all activities for which funds were first obligated from any given year's CDBG allocation;
 - States 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;
 - 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/American Community Survey tract with at least 20 percent of the residents in poverty;
 - Assistance is provided to businesses that operate in a Census/American Community Survey 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. States can use Section 108 loan guarantees to assist non-entitlement jurisdictions for eligible CDBG activities. This section summarizes the Section 108 Program.

Key Topics in This Section	<ul style="list-style-type: none"> ✓ Program Parameters ✓ The Loan Process ✓ Players and Their Roles ✓ Typical Uses of Section 108 ✓ Advantages of Using Section 108
Statutory Citations	
Other Reference Materials on This Topic	<ul style="list-style-type: none"> ✓ Guide to National Objectives and Eligible Activities for States <ul style="list-style-type: none"> – Chapter 2: Categories of Eligible Activities – Appendix F: Making the Most of your CDBG Resources ✓ CPD Notice 01-10

- ✓ The Section 108 Program is a loan guarantee program, which enables the state to authorize UGLG to borrow funds. The maximum that can be borrowed statewide is five times the state annual allocation.
 - The state pledges future CDBG funds as security for the loan.
 - 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 may help UGLG undertake large scale, capital-intensive projects and provides a mechanism for states to extend the impact of their CDBG Program.
- ✓ If a state allows Section 108 loan guarantees, it must be described in the state's method of distribution (MOD) including amounts to apply for and how applications will be selected.
- ✓ It is important to note that an interim rule was published on August 21, 2009 expanding the eligibility of Section 108 for states. The interim rule was issued in response to Section 222 of the Omnibus Appropriations Act, 2009. This interim rule authorized the following flexibilities:
 - States may now directly borrow Section 108 funds on behalf of local governments in non-entitlement areas. Prior to the enactment of Section 222, HUD could not guarantee notes issued directly by states on behalf of UGLG. Non-entitlement areas may also continue to apply for state-supported Section 108 loan guarantees (rather than the guarantee being issued via the state);
 - If a state elects to undertake this new process, it must distribute all guaranteed funds to UGLG in non-entitlement areas. In its application to HUD, the state must identify the local governments that will be eligible to be assisted by the state with the Section 108 guaranteed funds. States can:



- List the specific UGLG that are eligible for the funds; or
 - Describe that all or a specific subset or type of UGLG that are eligible for the funds. For example, the state could dictate that only UGLG with a poverty rate of great than 20% are eligible for assistance;
 - The activities undertaken by the state must be eligible under the existing Section 108 regulations at 570.703. The state can directly use Section 108 proceeds to: pay for interest on the guaranteed obligation; pay for issuance, underwriting, servicing, trust administration and other costs allowed under 570.703(g); and for debt service reserves as allowed under 570.703(k). These costs are allowed be directly paid by the state because they are related to financing the UGLG Section 108 activities.
 - If the state wishes to participate in the Section 108 program under this new flexibility, it must describe its planned approach and the eligible UGLG in its Consolidated Plan MOD.
 - State applications for Section 108 assistance may either directly identify eligible projects in selected UGLG or may describe the types of projects and indicate how it will determine the eligibility and national objective of these projects. If the second, more general type of application is submitted, the state has to get HUD approval of any specific project that is later chosen.
 - State Section 108 projects are subject to all of the other applicable CDBG and other federal rules, as outlined below.
- ✓ This chapter provides an overview of Section 108 basics and its advantages.

8.4.1 Advantages to Using Section 108

- ✓ States take on the risks of borrowing Section 108 funds because the program provides the following significant advantages:
- **Potential leverage**—A state has access to funds totaling up to five times its annual grant while retaining the use of its funds. The maximum Section 108 loan guarantee is the five times its annual CDBG allocation minus any outstanding Section 108 commitments and/or principal balances on Section 108 loans for which the State has pledged its CDBG funds as security. Each individual UGLG can borrow up to \$7,000,000. HUD will be publishing a revised CDBG rule which will state these limitations.
 - **Avoid referendum**—Since Section 108 borrowing is not ordinarily a general obligation, the UGLG can avoid a referendum and the Section 108 indebtedness does not affect the debt limit of the UGLG.
 - **Accelerate CDBG activities**—Instead of “paying as you go,” UGLGs 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, UGLGs 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 UGLG. Thus, the community is able to make long-term plans with certainty about its future obligations.
- ✓ These advantages are substantial enough that many UGLGs 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 state’s annual CDBG grant.
 - **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**—States, non-entitlement communities that are assisted by states, and non-entitlement communities eligible under the State CDBG 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;
 - 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. UGLGs 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;
 - 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 state incurs the ultimate risk of the Section 108 debt. If the state manages risk prudently and transfers the risk and cost to the third parties, the state can accelerate CDBG activities and achieve tremendous leverage. To secure Section 108 debt, the state pledges future CDBG allocations, program income, and provide additional security as HUD deems necessary.
 - **HUD**—HUD reviews the 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 UGLGs 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 state allows, and the non-entitlement 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 state and/or UGLG apply to HUD for a Section 108 Loan Guarantee.
 - The state pledges a portion of its future CDBG 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 state’s approved project.
 - The UGLG uses the funds raised by the sale of the notes to undertake the approved project.
 - 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 state has available.
 - Depending on the type of project that is financed, states may have from one to twenty years to repay the Section 108 notes.
 - The notes may be repaid with future CDBG grants; or
 - The UGLGs may transfer the risk and cost (interest) by lending Section 108 proceeds to third party borrowers. If the third party repays this loan the state/UGLG may never have to dip into its CDBG funds to repay the notes. However, if the third party defaults, the UGLG is typically required to repay the loan to the state (or if unfeasible, the state must repay the loan to HUD).
- ✓ In summary, Section 108 consists of two levels:
 - **Level # 1**—UGLGs borrow money from private investors (which the financial underwriters find).
 - **Level # 2**—UGLGs 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.



- ✓ 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 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.