

NCDA Winter 2017 Conference

HUD's CDBG & Section 108 Loan Guarantee Programs – Tools for Economic Development

City Market
Onion River Co-op



City Market

City Market

Presentation Topics



- **Key Considerations**
- **Why Use Section 108?**
- **Comprehensive Approach to Economic Development**
- **Employing CDBG & Section 108 as E.D. tools**
 - The Big 3 (requirements)
 - Underwriting
 - Partnerships for Implementation
 - NRSA's as a tool
- **How Section 108 financing works and how to apply**



“While perceived to be ‘high risk,’
economic development investments*
have the **highest yield.**”

-attributed to Hugh Allen

* After good underwriting

Be honest when you evaluate **your in-house expertise & capacity** to perform economic development ... if you don't have the capacity, consider:

- Developing a partnership with a CDFI, economic development agency/redevelopment authority, or CDC to administer an entire program or just assist with a specific deal
- Partnering with a neighboring community or regional entity that does have in-house capacity or existing partners
- Coordinating with your other local partners (other agencies, small business development centers) to market/develop pipeline/deploy program
- Contracting an underwriter (local bank, consultant)



Whenever possible, try to **conserve limited grant funds** for use on non-revenue generating uses (i.e. public services) and use Section 108 for those activities that will generate revenue.



An aerial photograph of a residential construction site. The scene shows several multi-story buildings under construction, with some roofs partially completed. In the foreground, there is a construction yard with a white trailer, a green container, and several orange and white portable toilets. A silver car is parked on the left, and a black SUV is on the right. The background features more residential houses and trees under a cloudy sky. The entire image is overlaid with a semi-transparent dark grey layer, and the text "Why use Section 108?" is centered in white, flanked by two horizontal white lines.

Why use Section 108?

Communities who use Section 108...



< \$4 million

Average Annual CDBG Allocation (of Section 108 Borrowers) over the last 20 yrs

Maximize the Impact of CDBG Funds

> \$10 million

Combined CDBG + 108 Funding for Projects



Low-Cost + Flexible Repayment Terms

- Gives States and local governments access to the capital market while also:
 - Providing a Federal loan guarantee to attract long-term (up to 20 years), reasonably-priced debt.
 - Saving them the transaction costs (e.g. bond counsel, administrative costs) associated with going to the market directly.
 - Eliminating the need for a general obligation debt that could affect their bond rating.
 - Enabling them to structure their repayment terms to meet project-specific needs. (e.g. delaying principal repayments until Year 3 when the project will begin to generate revenue or front-loading cost of essential project to be repaid over extended term with annual grant funds)

Low-Cost + Flexible Repayment Terms

- Interim financing is available at 3-month LIBOR + 20 basis points
- Permanent rates are determined through public offering
 - Typically occurs every 12- to 18-months
 - For most recent public offering (May 2015), all-in interest rate for a 20-year loan with equal installments was 2.85%
- Option exists to pre-pay/defeas and refinance loan, with certain restrictions

Acceptable Sources of Repayment + Collateral

- Applicants can elect to repay the loan with CDBG funds or with other sources.
- HUD can accept less conventional sources of repayment and collateral
- Section 108 funds guaranteed funds could be used as the upfront capital used to launch Pay-for-Success projects (e.g. agreed upon outcome = long-term reduction in flood insurance premiums due from LMI households)

Acceptable Sources of Repayment + Collateral

- Current and future CDBG funds are required to be pledged as collateral.
- While additional collateral is also required, HUD will work closely with applicant to determine and underwrite potential sources.
- HUD is able to accept sources of repayment and collateral that may not be accepted by conventional lenders, such as:
 - Unlike most conventional lenders, HUD can often accept a subordinate position.
 - Revenues generated by special taxing districts (e.g. TIFs and single purpose districts)
 - Repayment of 3rd party loans financed with Section 108 loan (or other loan portfolios)
 - Liens on other types of revenue available (e.g. parking or casino revenues)

How much Section 108 can my community access?

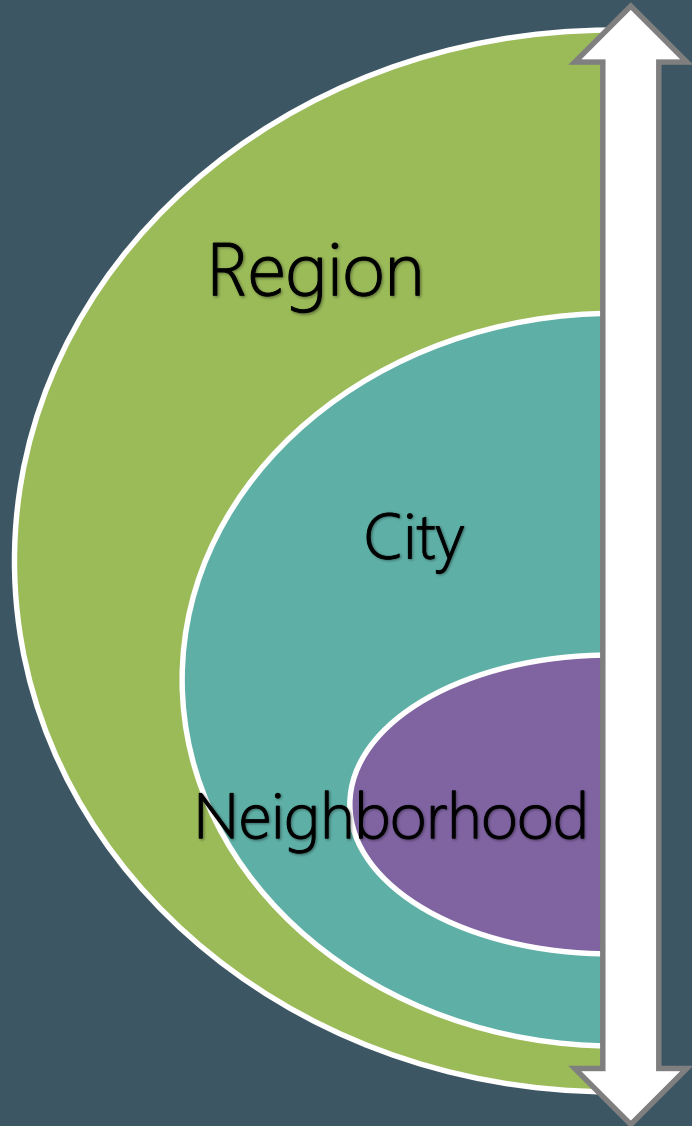
| | |
|-------------------------------------|---------------------------|
| Annual CDBG Allocation | \$3,000,000 |
| Max available borrowing capacity | <u>x 5 = \$15,000,000</u> |
| Outstanding 108 commitments | - \$800,000 |
| Outstanding 108 loan balance | <u>- \$2,000,000</u> |
| Available borrowing capacity | = \$12,200,000 |

In addition, Congress sets an annual fiscal year commitment level for the program as a whole.

A large industrial warehouse with a yellow forklift in the foreground. The warehouse has a high ceiling with a complex steel truss structure. The floor is polished and reflective. In the background, there are various pieces of industrial equipment and materials. The overall scene is brightly lit, suggesting a modern and well-maintained facility.

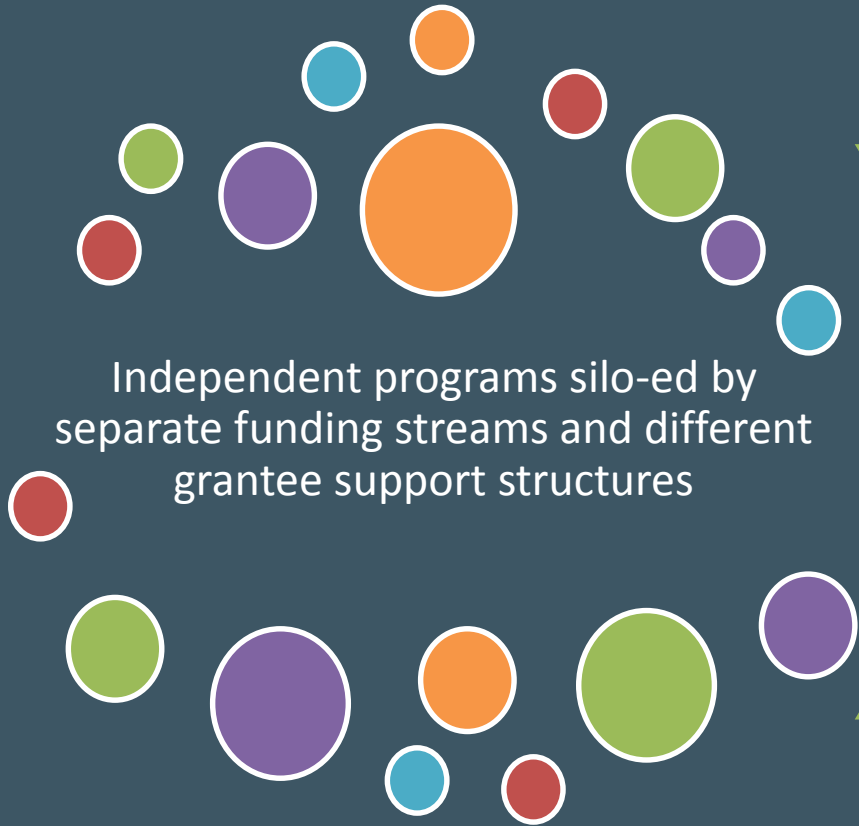
Comprehensive Approach to Economic Development

Comprehensive approach to economic development



- Housing
- Education
- Skilled Workforce
- Job Opportunities
- Water & Sewer Infrastructure
- Transportation System
- Emergency Preparedness/Recovery/Resilience
- Land Use/Zoning
- Healthy Community (including healthcare)
- Parks, Neighborhood & Recreational Facilities
- And more...

“Place-based” approach to economic development



Independent programs silo-ed by separate funding streams and different grantee support structures

**Program-Focused
Strategy**



**Community-Focused
Strategy**

What is economic development?



**Real Estate Investment
(commercial/industrial)**



Business Assistance

What is economic development?



Broadband access



Single family rehab & infill program




Flood mitigation



Economic Development Outcomes



Employing CDBG & Section 108 as Economic Development Tools

- 
- A photograph of a modern, multi-story residential building with a courtyard. The building features a mix of brick and glass facades, with balconies and large windows. The courtyard is paved and has some greenery. In the foreground, several people are walking, including a man in a white shirt and a woman with a bag. The sky is clear and blue.
- Non-competitive resources
 - Awarded to states and local governments but able to be re-granted or re-lent to other entities (non-profits, businesses, developers)
 - Wide-range of uses
 - Primary focus is benefit to low- and moderate-income persons

Key Program Requirements

- Is an **Eligible Activity**
- Meets a **National Objective**
- Meets the **Public Benefit Standards**, if applicable



Types of Eligible Activities

Primary *categories* of eligible activities:

Economic Development

Housing

Public Facilities + Improvements

Public Services*

Planning/Admin*

* These are only eligible under the CDBG Program

Examples of activities in each category

Rehab of a historic hotel

Microenterprise assistance

Multi-family, mixed-income development

Flood mitigation

Water + Sewer

Business incubator space

Fresh food retailer

Supportive housing construction

Street improvements

Broadband access

Business loan fund

Single family rehab & infill program

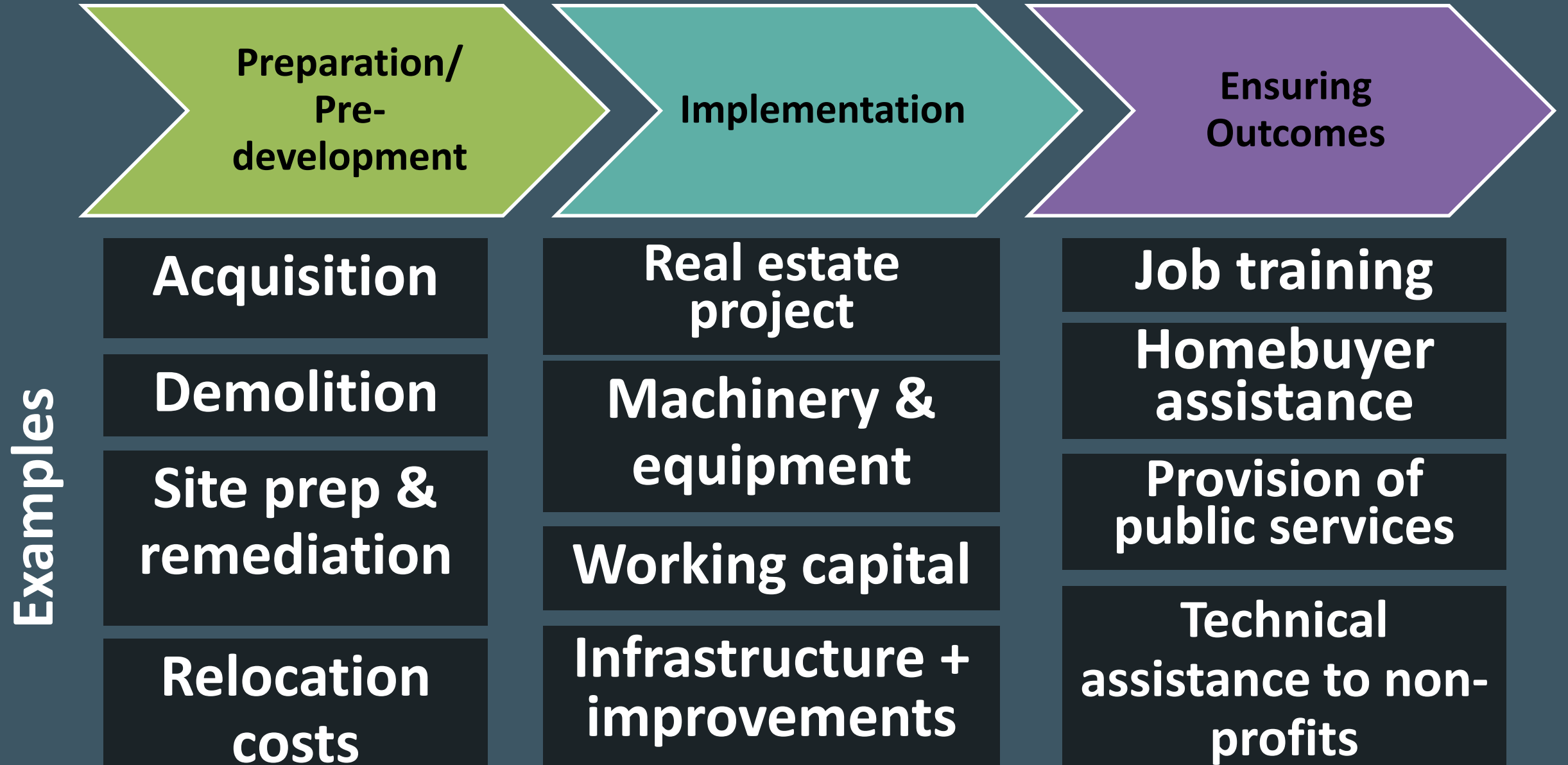
Industrial expansion

Adaptive reuse/mixed-use

Home energy efficiency improvements

Healthcare facility

Stages in which CDBG & Section 108 funding can be deployed



**But what about the
HUD regulations??**



DEPARTMENT
OF
HOUSING
AND
URBAN
DEVELOPMENT

How to correctly classify your activity under the regs

Key considerations:

- What is the use of the HUD funds?
- What entity will own the property while the activity is taking place?
- What is the end use of the property?
- What entity is responsible for performing the activity?
- **Characteristics of the entity:**
 - Is it the grantee?
 - Is it another entity?
 - Non-profit/for-profit
 - Another public agency
 - Relationship to grantee: subrecipient, developer/business, or contractor

Example: Commercial Real Estate Development



- Rehabilitation of commercial or industrial structures – §570.202(a)(3)
 - If a private, for-profit owner is carrying out the activity, rehabilitation limited to exterior building and correction of code violations
 - Not subject to public benefit standards
- Special Economic Development Activities – §570.203 (& §570.703(i)(1))
 - Under §570.203(a): Acquisition, construction, reconstruction, rehabilitation, or installation of commercial or industrial buildings, structures, and other real property improvements by the grantee or a public or non-profit subrecipient
 - Under §570.203(b): Private, for-profit business or developer can receive assistance (grant, loan, loan guarantee, technical assistance) to carry out real estate development activities (from acquisition to construction)
 - Subject to public benefit standards



Purpose (National Objectives)



**Benefit to Low- and Moderate-
Income Persons**



**Elimination of
Slum & Blight**



**Urgent
Need**



Examples of how projects can meet a national objective:

Business or real estate development will create (or retain) jobs primarily for LMI persons ($\geq 51\%$ jobs)

Business providing key service or goods to primarily LMI area ($\geq 51\%$ population)

Infrastructure or facility serving primarily LMI area ($\geq 51\%$ population) or specific LMI clients

Real estate loan to develop a vacant site - prevention of slum or blight on a spot or an area basis

Provides permanent housing to primarily LMI households ($\geq 51\%$ units)

Housing units rehabbed under urgent need scenario (e.g. disaster)

**Create (or retain) jobs
primarily for LMI
persons ($\geq 51\%$ jobs)**

- **Be sure to document:**
 - How jobs will be created or jobs will be lost without CDBG (retained jobs)
 - How at least 51% of the jobs were made available to or held by LMI
- Remember to track jobs for reasonable period of time (not defined in regulations) as long as jobs are still being created

How to count jobs as held by a LMI person:

Create (or retain) jobs primarily for LMI persons ($\geq 51\%$ jobs)

- **Document:** current income information of the LMI household, not salary or wages of the individual job.
- **Use Presumption:** LMI individual is filling the job in question because of the nature or location of the job.

**Create (or retain) jobs
primarily for LMI
persons ($\geq 51\%$ jobs)**

May presume a person is LMI if:

- Lives in Census tract with 70% LMI
- Lives in Census tract within EZ/EC
- Lives in Census tract area with poverty rate of 20% and no CBD (unless 30% poverty) and evidences pervasive poverty and general distress
- Business/job is located in EC/EZ; OR area with poverty rate of 20% and no CBD (unless 30% poverty) and evidences pervasive poverty and general distress

**Business providing
key service or goods
to primarily LMI area
(≥ 51% population)**

Documenting service area:

- Must be primarily residential in nature
- Use most recent available HUD data or survey method
- Be reasonable ---Keep in mind existing businesses providing similar services, typical market area of business type, nature of business
- Does not need to be coterminous with census tracts or other officially recognized boundaries



Public Benefit Standards (if applicable)

Individual activity standards

- May not exceed \$1,000 per LMI person to which goods or services are provided

OR

- May not exceed \$50,000 per permanent FTE job created or retained



*Use jobs created/retained standard when assisting a job-training-only activity

Aggregate activity standards

- Create or retain at least one full-time-equivalent (FTE) permanent job per \$35,000 of CDBG funds

OR

- Provide goods and/or services to at least one LMI person per \$350 of CDBG funds





Underwriting Economic Development

Why is Underwriting so essential?

Underwriting is a critical component for economic development projects, especially for Section 108 loans

- Identifies risks involved in a particular loan
- Establishes suitable loan terms and conditions designed to mitigate those risks
- Minimizes risk to grant funds (both for CDBG & Section 108 projects)
- For Section 108 loans, underwriting is also essential to ensure HUD's acceptance of the grantee's loan to a 3rd party (business/developer) as collateral on the loan guarantee
- Currently, the underwriting guidelines at 24 CFR Appendix A to Part 570 are required for all 'special economic development' projects

Real Estate Loans

(Income-Producing Properties)



Borrower
Evaluation

Market Analysis
Property Appraisal
Project Readiness

Project Financial
Analysis

Collateral
Analysis

Business Loans



Borrower
Evaluation

Market/Industry
Analysis

Financial
Statement
Analysis

Projected
Cash Flow
Analysis

Collateral
Analysis

Underwriting Considerations

- **Project Feasibility**

Can borrower build what they want, where they want?

- **Financial Feasibility**

Does borrower have enough committed sources to cover all uses? Will the activity generate sufficient cash flow **to repay the loan?**

- **Market Feasibility**

Is there economic demand for the activity being funded with CDBG/the 108 loan?

Underwriting Considerations

- **Management Capacity**

What are skills and experience of borrower to manage the proposed project funded with CDBG/the HUD 108 loan?

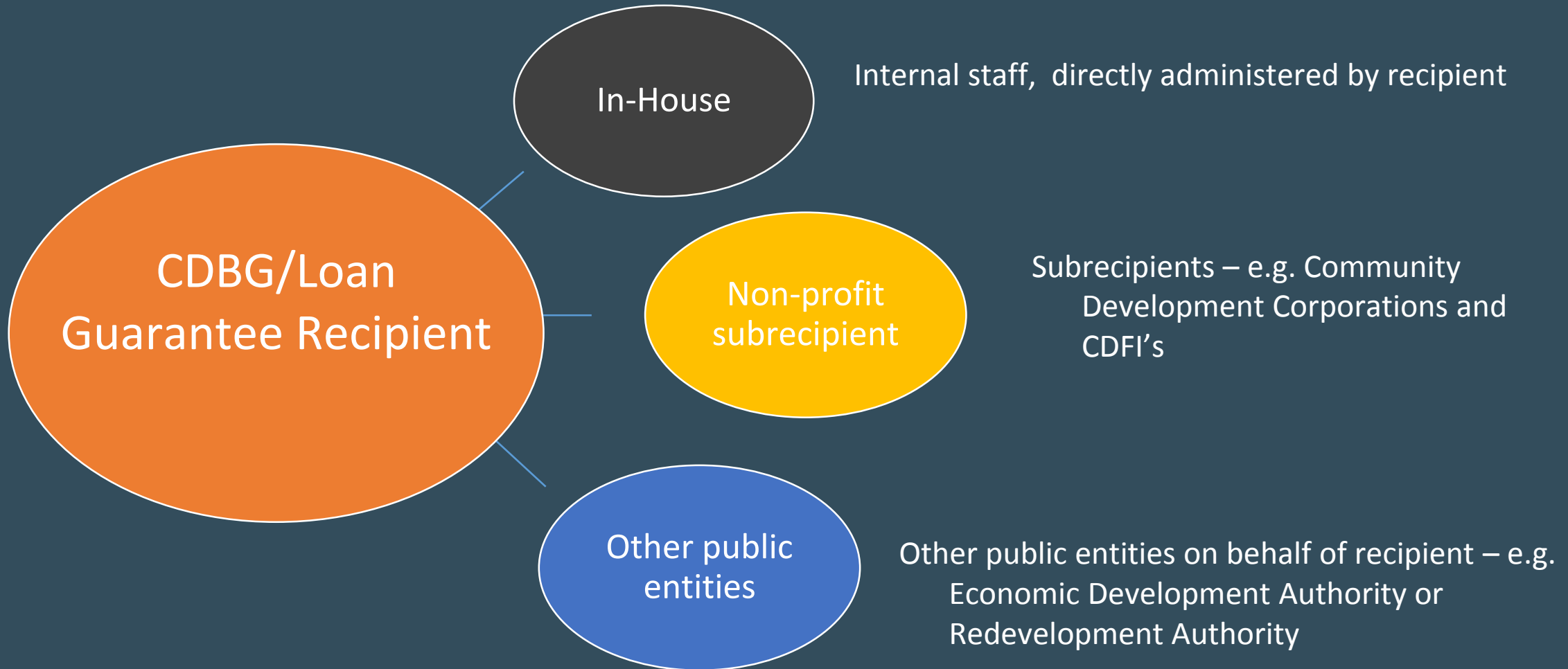
- **Collateral**

Is it of sufficient value to secure the loan?



Partnerships for Economic Development

Partnerships for Administering E.D.



Community Based Development Organizations

- **CBDOs may carry out three kinds of projects:**
 - Community economic development
 - Neighborhood revitalization
 - Energy conservation
- **If job training done through a CBDO, doesn't count against public services cap**
- **CBDO economic development activities do trigger public benefit standards**

Community Based Development Organizations

CDBO Requirements

- **Organization must:**

- Be organized under state/local law for specific community development activities
- Operate in specific geographic area within grantee's jurisdiction
- Have as its primary focus the improvement of economic/ physical/social aspect of service area, particularly for low/mod persons
- Have a governing body of at least 51% low/mod rep's

Community Development Financial Institutions

- A community-based lending institution
- CDFI fund managed by the Department of Treasury
- CDFIs have these characteristics:
 - Promote community development
 - Serve an investment area or targeted population
 - Provide loans or development investments and development services
 - Maintain accountability to residents
 - Are not an agency of government

Community Development Financial Institutions

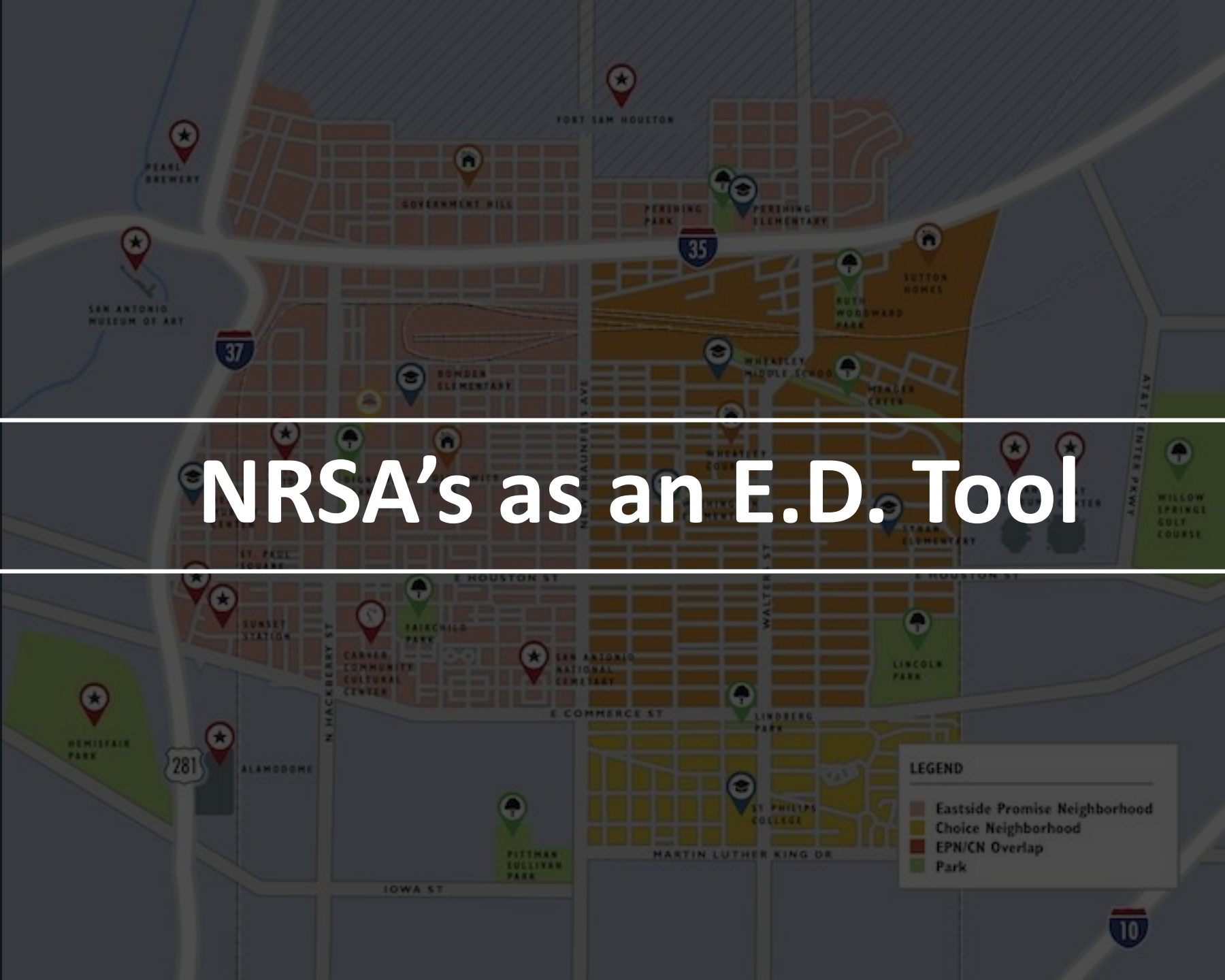
CDFI Flexibilities

- Special consideration for CDFI activities under CDBG regulations
- Flexibilities apply regardless of whether CDFI funded by Treasury program or not
- For any CDFI, may aggregate jobs created/retained by all businesses for determining low/mod benefit

NRSA's as an E.D. Tool

LEGEND

- Eastside Promise Neighborhood
- Choice Neighborhood
- EPN/CN Overlap
- Park



Neighborhood Revitalization Strategy Area

A locally designated area where geographically targeted revitalization efforts are carried out through multiple activities in a concentrated and coordinated manner.

- Designation lasts for 5 years, but can be renewed
- Provides greater flexibility of CDBG & Section 108 requirements to facilitate deployment of these resources
- Required components for application:

Neighborhood Size & Demographics

Stakeholder Involvement

Neighborhood Assessment

Housing and Economic Opportunities

Performance Measures

Leverage



CPD Notice 16-16 Neighborhood Revitalization Strategy Areas in the CDBG Entitlement Program

Aggregating Housing

Benefit: Single family housing units can be aggregated for an overall 51% low to moderate income benefit, not 100%.

Regular CDBG Rule: 100% of single family homes must be occupied by low-mod households

In a NRSA: During each program year, housing units assisted in in an NRSA may be considered a single structure. This means only 51% of the units completed must be low-mod households.

Relaxed Area Benefit Standard

Benefit: Job creation/retention can meet the area benefit standard, avoiding income verification

Regular CDBG Rule: Businesses must document personal income and maintain records for each job created or retained.

In a NRSA: Full time jobs created or retained are reported through the area benefit standard. The business does not need to document the annual income for jobs held by or made available to low-mod persons residing within the NRSA

Aggregate Public Benefit Standard

Benefit: The aggregate public benefit standard is not required for economic development projects

Regular CDBG Rule: All business loans made during the program year must average out to no more than \$35,000 per job.

In a NRSA: The grantee can exclude loans made to NRSA businesses from the average calculation. This means the grantee can exceed the \$35,000 aggregate limit within the NRSA.

Public Services Cap

Benefit: Public services undertaken by a community based development organization (CBDO) can be excluded from the 15% cap.

Regular CDBG Rule: 15% public service cap in place

In a NRSA: CBDO's carrying out neighborhood revitalization, community economic development or energy conservation in a NRSA are excluded from the 15% calculation.

NRSA Submission & Approval Process

- **CDBG grantee submits NRSA plan as a component of new consolidated plan or as an amendment to a current plan**
 - NRSA review is separate from consolidated plan review
- **Review is completed by local CPD field office**
 - Grantee capacity
 - Stakeholder involvement
 - Performance Measures – Outcomes & Outputs
 - Likelihood proposed actions will result in housing and economic opportunities
 - Level of coordination
 - Ability to leverage funding

NRSA Submission Requirements

Neighborhood Size & Demographics

- Must be primarily residential
- Contain low- and moderate-income residents
 - 70% or highest quartiles percentage (but not less than 51%)
- Grantee must define geographical area that makes up the neighborhood and its distinguishing characteristics
- Area must be contiguous.
- Grantee must define NRSA by its census tracts and block groups.
- Advisable to reduce size of the NRSA or divide into smaller NRSA to increase likelihood of achieving meaningful change.
- Grantee submits individual strategies for each proposed area

NRSA Submission Requirements

Stakeholder Involvement

- Must document active stakeholder engagement from beginning of planning process and throughout implementation
- Stakeholders include affected residents, those that reside in public and assisted housing, owners/operators of businesses, financial institutions, CBDOs, CDFIs, nonprofits, community groups serving the area.
- Must hold public hearing in proposed NRSA

NRSA Submission Requirements

Neighborhood Assessment

- This is the needs assessment part of the plan
- **NRSA strategy must include:**
 - an assessment of housing market and economic conditions of the area,
 - examination of housing and economic opportunities
 - and the problems likely to be encountered in the pursuit of these goals.

NRSA Submission Requirements

Housing & Economic Opportunities

- Focus on activities benefitting the low and moderate income
- Grantee are encouraged to develop housing for a broad range of incomes
- Job creation and retention is focused on full-time permanent positions

NRSA Submission Requirements

Performance Measures

- Grantee must identify performance measures in terms of measurable outputs and outcomes for housing and full time permanent job creation and/or retention
- Grantee's performance will be based on their ability to annually document progress made on the performance measurements
- Examples include: jobs created, housing rehabilitated

NRSA Submission Requirements

Leverage

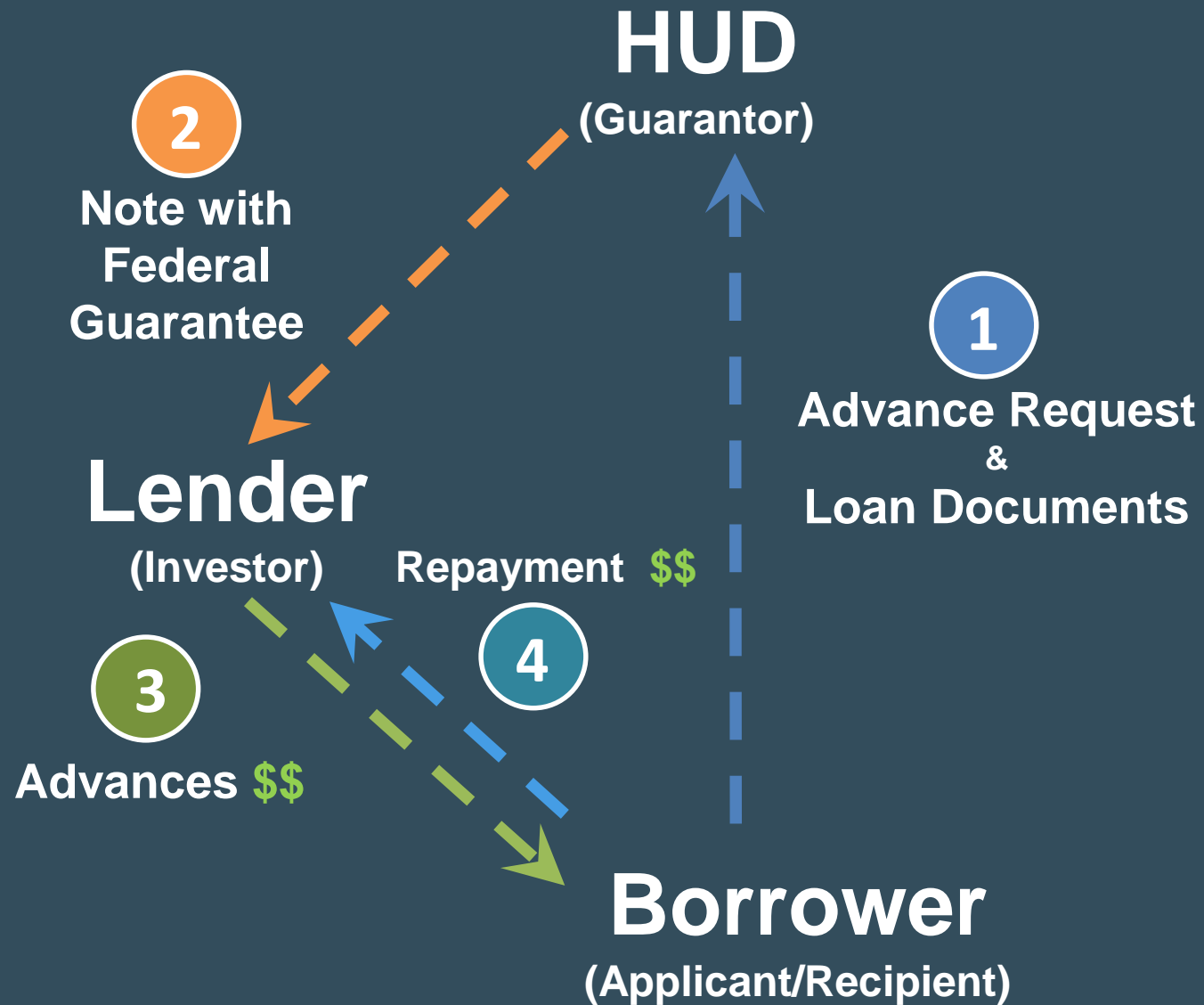
- Considered critical element of neighborhood revitalization
- CDBG should not be the only funds committed to the NRSA.
- CPD funds should not be the only funds committed to the NRSA
- Can be cash or in-kind
- Grantees must report their progress with leverage annually.

Placed-Based Alignment

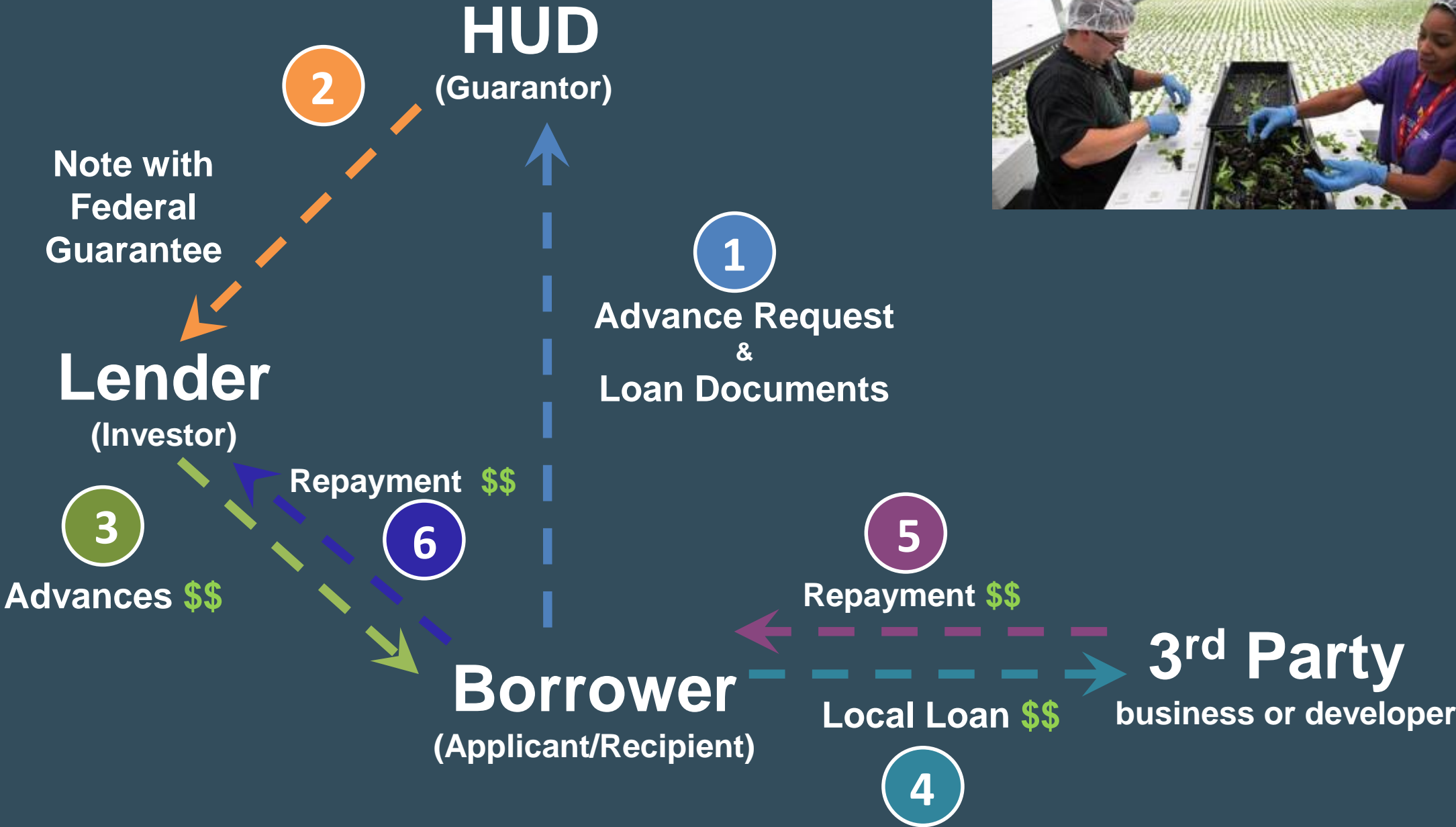
| | NRSA | Choice Neighborhoods | Promise Zones |
|---|---------|----------------------|---------------|
| A plan to transform the area | X | X | X |
| Physically targeted | X | X | X |
| High level of stakeholder participation | X | X | X |
| Wide range of activities: | X | X | X |
| Resulted Expected | 5 Years | 6 Years | 10 Years |

What's Behind the Section 108 Curtain?

Flow of Funds: Project by the Applicant



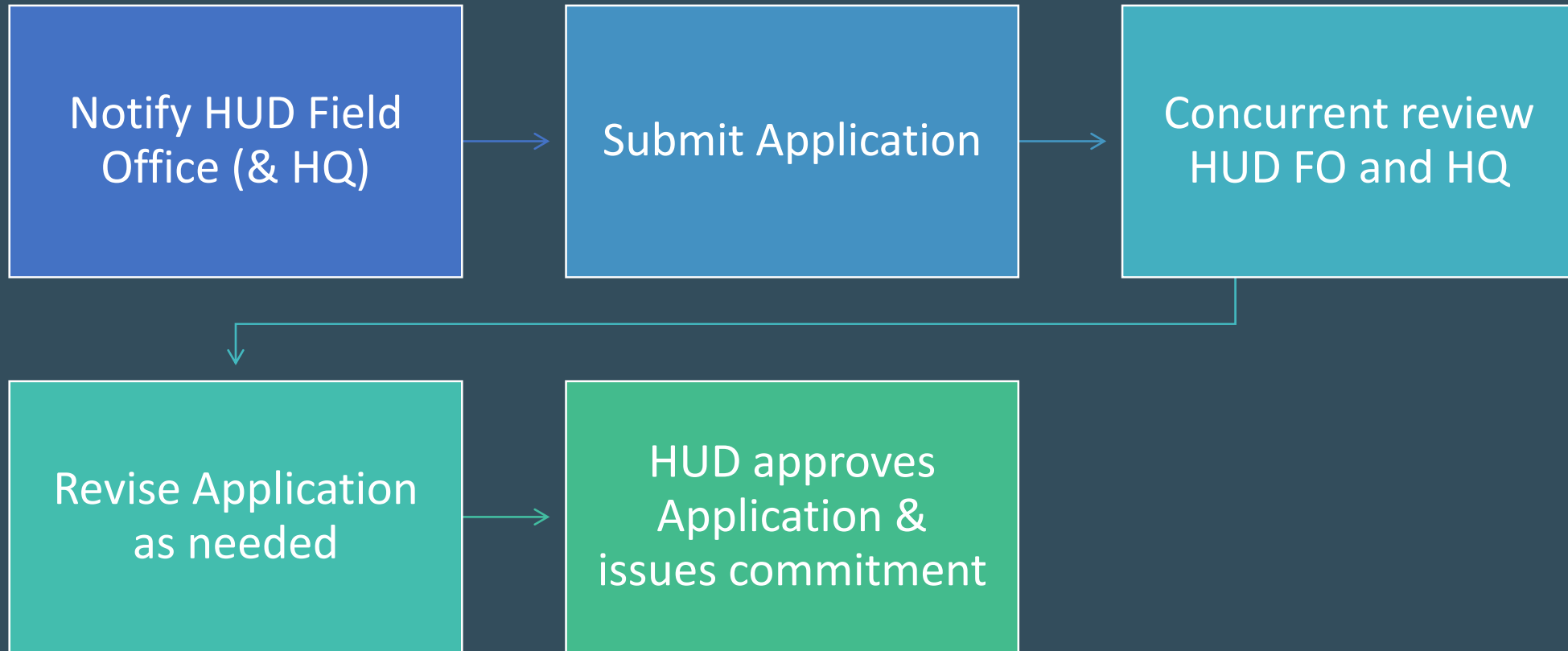
Flow of Funds: Project by a 3rd Party



Approach to using Section 108

- Project Specific
- Loan Fund
 - Better fit for when a pipeline of projects exists or community is target resources within a specific geographic area or with specific E.D. goal in mind
 - Enables grantee to weight a portfolio of loans so there is a balance of large, solid loans and smaller loans designed for entrepreneurs and/or projects that are higher risk but have a high social impact value
 - Streamlines Headquarters approval process

Application Submission & HUD Approval



Individual Project Application

- Proposed community development objectives
- Project Description, including:
 - Organizational Arrangements/Key Participants
 - Project Timeline/Development Phases
- Project Financial Information
- Repayment Schedule
- Pledge of CDBG Funding
- Description of Additional Collateral
- One Year Action Plan Amendment/Citizen Participation Comments
- Certifications



[See full list of requirements at 24 CFR 570.704]

Loan Fund Application

- Loan Fund Description (including the funding amount and community development objectives)
- Eligible Activities (including citation)
- CDBG National Objective(s) (including citation)
- If applicable, Public Benefit Standard information
- Administrative Capacity/Identification of Partners
- Description of Underwriting Process and Criteria
- Loan Terms
- Pipeline of Potential Projects (highly encouraged)
- Collateral for Section 108 financing
- Repayment Schedule
- Certifications

Loan Fund- Eligibility Determination Process

The following information is submitted to the field office about each individual transaction under the Loan Fund:

- Project Description
- Eligible Activity or activities
- National Objective
- If applicable, Public Benefit Standard information

Soon-to-be-released resources

Real Estate Loans

Section 108 Underwriting Guidelines
for Income-Producing Projects



Business Loans

Section 108 Underwriting Guidelines
for Business Credit Loans



Resources & Next Steps

- HUD Section 108 Program Information and Project Profiles: <https://www.hudexchange.info/programs/section-108/>
- Program Design & Application Process Webinar: <https://www.hudexchange.info/training-events/courses/targeted-community-reinvestment-hud-s-section-108-loan-guarantee-program-as-a-financing-tool-program-design--application-process-webinar/>
- Current Availability of Section 108 financing (by State/Entitlement): <https://www.hudexchange.info/news/current-availability-of-section-108-financing-cdbg-entitlement-and-state-grantees/>
- CPD NRSA Notice: <https://www.hudexchange.info/resources/documents/Notice-CPD-16-16-NRSAs-in-the-CDBG-Entitlement-Program.pdf>

