



OFFICE OF COMMUNITY PLANNING
AND DEVELOPMENT

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-7000

Special Attention of:

All CDBG Grantees
All CPD Field Office Directors

NOTICE: CPD-17-014

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until amended, superseded, or
rescinded.

Subject: Lump Sum Drawdown Requirements in the Community Development Block Grant
(CDBG) Program

PURPOSE

HUD permits grantees to draw Community Development Block Grant (CDBG) funds in a lump sum to establish a rehabilitation fund in one or more private financial institutions to finance rehabilitation activities. The purpose of this Notice is to provide guidance to Entitlement and State grantees on the requirements governing lump sum drawdowns and revolving loan funds in Section 104(h) of the Housing and Community Development Act (HCDA) and 24 CFR 570.513.

OVERVIEW

Under 24 CFR 200.305, a grantee is prohibited from drawing funds down from its line of credit in advance of cash need, and must minimize the time elapsing between the transfer of funds from its line of credit, and the disbursement of the funds. Advance payment must be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the grantee or subrecipient carrying out an eligible activity. Notwithstanding this requirement, Section 104(h) of the HCDA authorizes CDBG grantees to carry out lump sum drawdowns to establish a revolving loan fund in a private financial institution to finance rehabilitation activities. The HCDA specifies that HUD shall establish standards for such cash payments that ensure that the deposits result in appropriate benefits in support of the grantee's rehabilitation program. The regulation that establishes these standards is found at 24 CFR 570.513. State grantees may permit units of general local government to establish local revolving loan funds under 24 CFR 570.489(f)(1). Both state grantees and units of general local government should also follow the standards at 24 CFR 570.513 when establishing revolving loan funds in a private financial institution to finance rehabilitation activities.

ELIGIBLE REHABILITATION ACTIVITIES

The rehabilitation fund financed with a lump sum drawdown must be used to finance the rehabilitation of privately owned properties eligible under 24 CFR 570.202, 570.203(a) or 570.203(b) of the Entitlement CDBG program regulations, and Section 105(a)(4), (a)(14) and

(a)(17) of the Housing and Community Development Act of 1974 (HCDA). This includes the rehabilitation of privately owned commercial or industrial buildings, and the rehabilitation of nonprofit-owned nonresidential buildings and improvements that are not public facilities or improvements. Where a property is owned by a for-profit entity, rehabilitation, under §570.202, is limited to exterior improvements of the building and the correction of code violations. For-profit owned properties that require more extensive renovations may be financed with a lump sum drawdown under §570.203 as a special economic development activity.

The fund may also be used for a variety of rehabilitation financing techniques, including loans, interest subsidies, loan guarantees, loan reserves, or other uses as may be approved by HUD. The fund may also be used to make rehabilitation grants but only when leveraging non-CDBG funds for the rehabilitation of the same property. If leveraging of non-CDBG funds will not occur and the grantee plans to offer a deferred payment loan as an alternative to a grant, then the financing must meet the criteria of a loan. A deferred payment loan is considered to meet the criteria of a loan when there is a trigger for eventual repayment (e.g., repayment of the loan balance upon sale of the property). The repayment criteria are also met when a loan is “forgivable” and has a fixed term (e.g. the balance is reduced by 20% per year over a 5-year period).

Under §570.513(b)(8), a grantee may use the lump sum deposit or the program income derived from the deposited funds to subsidize or guarantee repayment of rehabilitation loans made with non-CDBG funds. A grantee may also use CDBG funds to provide a supplemental loan or grant to the borrower of non-CDBG funds. In each of these situations, the rehabilitation activities are considered to be CDBG-assisted activities and are subject to program requirements. However, the repayment of non-CDBG funds is not program income.

AGREEMENTS WITH PRIVATE FINANCIAL INSTITUTIONS

A private financial institution must be able to accept deposits and, thus, must be a depository financial institution. Depository institutions are commercial banks, thrifts (which include savings and loan associations and savings banks) and credit unions. Grantees do not qualify as private financial institutions. Before entering into a lump sum agreement with a Community Development Financial Institution (CDFI), a grantee must confirm it is a depository financial institution.

A grantee may establish a rehabilitation fund in one or more private financial institutions for financing the rehabilitation of privately owned property. The grantee must execute a written agreement with each and every private financial institution involved in the operation of the rehabilitation fund.

The regulations at 2 CFR §200.302(b)(4) (Financial Management) require that a grantee “must adequately safeguard all assets and assure that they are used solely for authorized purposes.” Therefore, a grantee should give careful consideration to establishing a revolving loan fund in a private financial institution that is Federally regulated and insured in order to adequately safeguard the CDBG funds in that account.

The agreement between the grantee and the financial institution must specify the obligations and responsibilities of all parties, the terms and conditions on which CDBG funds are to be deposited and used or returned, the anticipated level of rehabilitation activities by the financial institution, the rate of interest, and other benefits to be provided by the financial institution in return for the lump sum deposit, as well as all other requirements as documented in this Notice for compliance with the provisions of §570.513. The agreement must provide that the rehabilitation fund may be used for authorized activities for no more than 2 years.

Upon execution of the agreement, a copy must be provided to the HUD field office for its record and use in monitoring. Any modifications made during the term of the agreement must also be provided to HUD. A State grantee must include a description of each of the local accounts including the name of the local entity administering the funds, contact information for the entity administering the funds, the amounts expected to be available during the program year, the eligible activity type(s) expected to be carried out with the program income, and the national objective(s) served with the funds.

In the event that additional funds are needed to carry out the program, a grantee may enter into a separate, new agreement with the financial institution to cover the additional funds. These agreements must meet all requirements in this Notice. Grantees with an audit or monitoring finding on a previous lump sum drawdown agreement that remains unresolved may not enter into a new lump sum agreement until all related findings are resolved.

If a private financial institution fails to substantially comply with the terms of a lump sum drawdown agreement, the grantee should terminate its agreement, provide written justification for the action, and withdraw all unobligated deposited funds and program income from the private financial institution. The grantee must return the grant funds to the grantee's line of credit and receipt the program income in IDIS. Depending on the amount of program income generated, the Entitlement CDBG requirements regarding excess program income at 24 CFR 570.504(b)(2)(iii) may also apply.

LUMP SUM DRAWDOWN REQUIREMENTS §570.513

The following requirements, under §570.513, must be included in all agreements with private financial institutions where a revolving loan fund is being established.

Limitation on Drawdown of Grant Funds & Time Period to Undertake Activities

Under §570.513(a), a deposit to a grantee's rehabilitation fund should not exceed an amount that the grantee reasonably expects will be required, together with anticipated program income from interest and loan repayments, for rehabilitation activities during the period specified in the agreement. The grantee should determine the amount of funding needed based upon either its prior level of rehabilitation activity, or its rehabilitation staffing and management capacity to undertake activities during the period of the agreement. The grantee should keep in mind that the rehabilitation program administrative costs and the administrative costs of the financial institution may not be funded through the lump sum drawdown or through the program income generated by the lump sum distribution. (§570.513(a)(3)). Another consideration in determining funding levels is

the requirement that the rehabilitation fund may only be used for authorized activities during a period of no more than 2 years. (§570.513(b)(3)). The lump sum deposit should only be made after the agreement is fully executed. Further, grant funds may not be deposited solely for the purpose of investment, notwithstanding that the interest or program income may be used for further rehabilitation activities.

Time Limit on Deposited Funds

A grantee must use the deposited funds for rehabilitation financing assistance within 45 days of the deposit. This means the first loan must be made, subsidized or guaranteed within this time period. In addition, substantial disbursements from the fund must occur within 180 days of the receipt of the deposit. When CDBG funds are used as a guarantee, the funds that must be substantially disbursed are the guaranteed funds.

For a grantee with an agreement specifying two years to undertake activities, the disbursement of 25 percent of the fund, including interest earned, within 180 days will be regarded as meeting the “substantially disbursed” requirement under §570.513(b)(4). If the grantee determines that it has had substantial disbursement from the fund within 180 days but did not meet the 25 percent threshold, the justification for the grantee’s determination must be included in the grantee’s program file. If the use of deposited funds does not start within 45 days, or substantial disbursement does not occur within 180 days, the grantee may be required by HUD to return all or part of the deposited funds to the grantee’s program account. The 45-day and 180-day disbursement rules are applicable to each individual agreement. This is designed to ensure timely use of drawn funds.

Program Activity & Return of Unused Deposits

In keeping with the time limit placed on deposited funds and to discourage the use of the lump sum deposit for the purposes of investment, a grantee must review the level of program activity on a yearly basis. When activity is substantially below anticipated levels, the grantee must return excess funds to its program account.

At the end of the time period specified in the agreement for undertaking rehabilitation activities, all unobligated deposited funds must be returned to the grantee’s program account unless the grantee enters into a new agreement that meets all of the requirements under §570.513. However, grantees with an audit or monitoring finding on a previous lump sum drawdown agreement that remains unresolved are reminded that they may not enter into a new lump sum agreement until the finding is resolved.

Any program income that will be included in the new agreement must be identified in the current program year Action Plan as required at §91.220(l). In addition, the grantee must reserve the right to withdraw any obligated deposited funds required by HUD to address any corrective or remedial actions.

Provisions of Consideration from the Private Financial Institution

Under §570.513(b)(9), a grantee must receive from the private financial institution both interest on the account and a program benefit that supports the grantee's local rehabilitation program in return for being the recipient of the lump sum deposit.

The financial institution must pay interest on the lump sum deposit at a rate that is at a minimum no more than three percentage points below the rate on the one-year Treasury obligations at constant maturity. For the last several years, application of this standard would have resulted in a rate on the deposit of zero or less. However, because the regulations require the private financial institution to pay some level of interest, the agreement with the private financial institution must provide that the rate paid be greater than 0%. The grantee is encouraged to negotiate a higher rate than this minimum to be paid by the financial institution in exchange for receiving the lump sum deposit. Yields on constant maturity Treasury obligations can be obtained through the Federal Reserve Statistical Release H.15(519), published at <https://www.federalreserve.gov/releases/h15/>.

If the agreement sets a fixed interest rate for the entire term of the agreement, the rate must be based on the rate at the time the agreement is executed. If the agreement provides for an interest rate that will adjust during the term of the agreement, then at no time should the rate be adjusted to 0% or less. A grantee must retain documentation in its files that the effective rate met the requirements in §570.513 and this Notice. For example, if an agreement stipulates quarterly (or monthly, semi-annual, etc.) interest rate adjustments, a copy of the Federal Reserve Statistical Release that covers the date of change must be referred to in order to establish a new rate in compliance with these requirements; and that documentation should be retained in the files to demonstrate compliance.

A rehabilitation program may be designed to break the lump sum deposit into sub-accounts (e.g., an "operating" account and a "holding" account). In these cases, the minimum rate of interest does not have to be earned on each sub-account, provided it is earned on the entire lump sum drawdown deposit. The overall interest earned on the entire deposit must be equal to or exceed the minimum earnings expected. In some states, the rate of interest that can be paid on certain types of accounts may be restricted and may be less than the required minimum rate. However, the requirement may still be met by ensuring that the interest rates paid on the other associated sub-accounts are sufficiently higher to compensate for the lower rate on an affected sub-account. The grantee and the financial institution are expected to maintain records that document and support overall compliance in these cases.

In addition to the payment of interest on the deposit, the private financial institution must provide at least one of the following benefits, as specified §570.513(b)(9)(ii), in return for the deposit. The grantee may also require additional consideration, if desired.

- Leverage of the deposited funds by committing private funds for loans in the rehabilitation program in an amount substantially in excess of the amount of the lump sum deposit;

- Commitment of private funds by the financial institution for rehabilitation loans at below market interest rates, at higher than normal risk, or with longer than normal repayment periods; or
- Provision of administrative services in support of the rehabilitation program by the participating financial institution at no cost or at lower than actual cost.

The grantee should maintain in its files a copy of the written agreement and related documents establishing compliance with all lump sum requirements, including the provisions of consideration provided and the performance by the financial institution in accordance with the agreement.

Program Income

During the period of the lump sum agreement, the interest earned on lump sum deposits before disbursement, and on borrowers' repayments of loans made from such deposits, is considered program income and must be used for rehabilitation activities under §570.513. Once the agreement has been closed out, program income in the account at the time of the closeout must be used for CDBG eligible activities and is subject to the program income requirements under §570.504 (Entitlements) or §570.489(e) (States). If a grantee's action plan does not specify the planned re-use of the funds, a substantial amendment may be required under 24 CFR 91.505. Program income not previously described in the action plan requires a substantial amendment to the grantee's action plan. The grantee will also need to adjust the activity funding for the rehabilitation activity in IDIS.

REQUIRED NOTIFICATIONS TO HUD

Grantees are required to notify HUD at various stages of implementing the lump sum drawdown:

- Upon execution, a grantee must submit a copy of the agreement and any subsequent amendments to the HUD field office for its record and use in monitoring. (§570.513(b)(2)); and,
- Before the distribution of funds to the financial institution, a grantee must notify the HUD Field Office in writing on the amount of the intended lump sum drawdown to be distributed. (§570.513(e)).

Additionally, a State grantee must include a description of each of the local accounts including the name of the local entity administering the funds, contact information for the entity administering the funds, the amounts expected to be available during the program year, the eligible activity type(s) expected to be carried out with the program income, and the national objective(s) served with the funds.

ENVIRONMENTAL REVIEW REQUIREMENTS

Under §58.1(c), when HUD assistance is used to help fund a revolving loan fund that is administered by a recipient or another entity, the activities funded are subject to the environmental review requirements at 24 CFR Part 58. The Responsible Entity must determine the appropriate level of environmental review, ensure that the project complies with applicable environmental laws and authorities, document any mitigation measures and conditions, and complete all required approvals. Under §58.1(c), future activities receiving assistance from program income are subject to the environmental review requirements at 24 CFR Part 58 if the rules of the HUD program that initially provided assistance to the fund continue to treat the activities as subject to the Federal requirements. More information about environmental review requirements can be found on the HUD Exchange at <https://www.hudexchange.info/programs/environmental-Review/>.

RECORD KEEPING REQUIREMENTS & GRANT CLOSEOUT

Field offices must maintain a log of lump sum drawdown agreements for each applicable grantee. The log should include a record of all agreements and modifications, the date of execution, the date of deposit, the expiration date of the agreement (or the length of the agreement) and the amount being deposited, the interest rate, and other benefits being provided. Recordkeeping for both the grantee and HUD is critical to the successful management of lump sum agreements and meeting CDBG compliance requirements at §570.513. Entitlement grantees are also reminded at grant closeout to follow the procedures under §570.509 in a timely manner.

ADDITIONAL INFORMATION

Grantees with questions concerning this Notice should direct their inquiries to their local HUD Field Office Community Planning and Development Division. Field Offices should direct their questions to the Office of Block Grant Assistance at (202) 708-1577 for the Entitlement CDBG program or (202) 708-1322 for the State CDBG program.