

SECTION 108 LOAN GUARANTEES

Section 108 is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 provides communities and states with a means of leveraging their CDBG funds to obtain additional financing resources for economic development, public facilities, large-scale physical development projects and housing rehabilitation. Regulations governing the Section 108 program may be found at Title 24 Code of Federal Register Part 570, Subpart M “Loan Guarantees”.

ELIGIBLE APPLICANTS AND ACTIVITIES

Eligible Applicants. Eligible applicants include the following public entities:

- CDBG entitlement jurisdictions, and
- Nonentitlement jurisdictions that are assisted in the submission of applications by States that administer the CDBG program.

Eligible Activities. Activities eligible for Section 108 financing include:

- Economic development activities eligible under CDBG;
- Acquisition of real property;
- Rehabilitation of publicly-owned real property;
- Related relocation costs;
- Clearance, demolition, and removal on acquired or rehabilitated public property (including environmental cleanup);
- Site preparation including construction, reconstruction, or installation of public facilities related to property acquired or rehabilitated using Section 108 funds or for economic development purposes;
- Payment of interest on the guaranteed loan and issuance costs of public offerings;
- Debt service reserves;
- Housing rehabilitation eligible under CDBG; and
- In limited circumstances, housing construction as part of community economic development.

Public entities may directly use the funds or may re-loan funds to businesses, non-profits or other third parties to undertake eligible activities. All CDBG regulations apply. As with the CDBG program, projects and activities must either principally benefit low and moderate income persons, aid in the elimination or prevention of slums and blight, or meet urgent needs of the community. Section 108 loan guarantee funds are included in the requirement that 70% of all CDBG expenditures must benefit persons of low and moderate income.

HOW THE PROGRAM OPERATES

Maximum Commitment Amount. Commitments are limited as follows:

- An entitlement entity may apply for up to five times the public entity’s latest CDBG entitlement amount, minus any outstanding Section 108 commitments or principal balances on Section 108 loans.
- A nonentitlement entity may apply for up to five times the latest CDBG amount received by its State, minus any outstanding Section 108 commitments or principal balances on Section 108 loans for which the State has pledged its CDBG as security. State programs may apply additional restrictions.

Financing Source. Section 108 obligations are financed annually through underwritten public offerings in which fixed rate notes are sold to private investors. To ensure the marketability of Section 108 notes,

HUD provides a 100 percent full faith and credit guarantee to investors. Financing between public offerings is provided through an interim lending facility established by HUD. Although HUD coordinates the funding process, it does not have a direct role in the flow of funds. The interim lender and investors provide funds, underwriters and the Fiscal Agent manage the transactions, and the locality and any third party participants borrow the funds.

Security. Security for the loan guarantee includes a pledge by the public entity or State (in the case of nonentitlement entities) of its current and future CDBG funds. The CDBG funds are not escrowed and may continue to be used as planned. Additional security is also required, which provides a safeguard to reduce the risk to CDBG funds. The additional security requirements will be determined on a case-by-case basis, but could include assets financed by the guaranteed loan.

Loan Repayment. The maximum repayment period for a Section 108 loan is 20 years. Interim loan interest payments are due quarterly on the first day of the months of February, May, August, and November. On permanent loans, principal payments are due once a year on August 1 and interest payments are due twice a year on August 1 and February 1. Principal payments must be made in increments of \$1,000. Interest begins accruing from the date the funds are deposited in the entity's account. HUD has the ability to structure the principal amortization to match the needs of the project and borrower.

Prepayment. Investors buying the Section 108 notes are guaranteed the timely payment of principal and interest for a ten-year period. Technically, the borrower cannot prepay the loan during this period. However, by guaranteeing the income stream to the investor through a deposit of funds with a Fiscal Agent, the borrower is defeasing or voiding the Section 108 obligation. Interim loans may be prepaid at any time without penalty. Jurisdictions do have the option of remaining in the interim financing facility for the term of the loan.

Interest Rates. Interest rates on interim borrowing are priced at the three-month London Interbank Offered Rate (LIBOR) plus 20 basis points (0.2%). Interest rates on obligations sold in public offerings will be determined by market conditions at the time but generally will be slightly lower than yields on Federal agency securities with comparable terms.

Financing Fees. The only financing fees of the Section 108 program are those related to issuance of the Section 108 notes, such as fees to the underwriters and the Fiscal Agent and any other expenses related to the offering. Total financing fees will generally be one-half to one percent (0.5% - 1.0%) of principal. Other than these up-front fees, no additional maintenance fees are charges for permanent Section 108 notes. Interim loans are charged a \$100 quarterly fee.

Regulations. All CDBG program regulations such as citizen participation, Davis-Bacon, and relocation/displacement compliance must be met. The environmental assessment must be completed prior to incurring or expending any project costs.

Developing an Application. Applications for Section 108 guarantees are accepted throughout the year. Public entities wishing to apply for Section 108 loan guarantee assistance are advised to contact HUD in advance for guidance in preparing an application.