Leveraging HUD's Section 108 Loan Guarantee Program for Equitable Development

An Implementation Guide

February 2025

Enterprise

Contents

Disclaimer: This Guide is not intended to be a technical review of HUD's Section 108 Loan Guarantee Program or the program's regulatory requirements. Users should consult relevant regulations, existing guidance, and their HUD representatives when pursuing Section 108 and applying the recommendations outlined below. Given the release of the 2024 CDBG Proposed Rule, careful consideration of any new guidance is essential to ensure compliance and implementation of the program.

Introduction

Overview

Leveraging HUD's Section 108 Loan Guarantee Program for Equitable Development: An Implementation Guide is a resource and roadmap for grantees and their partners to understand, secure, and leverage the Department of Housing and Urban Development's (HUD) Section 108 Loan Guarantee Program (Section 108) for transformative and equitable development. **This Guide highlights strategic equity-driven approaches that result in broader access to financing, better alignment with community goals, and greater impact on equity outcomes.**

Audience

The primary audience for this Guide is Community Development Block Grant (CDBG) grantees that are eligible to borrow money under Section 108, including entitlement communities, states and smaller cities, as well as insular areas. This Guide is designed for government leaders and staff but is also useful for partner organizations, prospective borrowers, banks, and philanthropies that seek to collaborate with the public sector on impactful projects.

Chapter Summary

This Guide provides essential information on Section 108 and lessons learned from experience, complemented by case studies, frameworks for key decisions and implementation steps. Each chapter also includes recommendations for HUD to improve access to Section 108. The chapters build upon each other, beginning with an overview and continuing through program design and implementation.

Chapter 1: Learning About Section 108 and Leveraging the Benefits for Your Community
Chapter 1 provides an overview of Section 108 and how it contributes to community goals for equitable development. It also addresses common questions related to the program.

Chapter 2: Deciding to Pursue Section 108 Loan Pool Financing
Chapter 2 discusses key considerations for government leaders and staff as they decide whether to pursue Section 108 financing and how to effectively leverage it.

Chapter 3: Building Internal and External Capacity to Support a Section 108 Loan Pool
Chapter 3 describes the roles and skills required to successfully implement a Section 108 loan pool and provides guidance on assessing existing capacity. The chapter then offers recommendations on how to build capacity with the support of government staff, partner agencies, third-party consultants or a loan committee of community stakeholders.

Chapter 4: Establishing a Strategy-Driven Section 108 Loan Program
Chapter 4 provides a framework for a strategy-driven Section 108 loan program that maximizes the potential for equitable development. It discusses an equity-based approach to community development and Section 108. Then it provides steps to build a program based on equitable community planning efforts, potential partnerships, and existing resources, as well as a project pipeline that is supported by residents and stakeholders.

Chapter 5: Accessing Section 108 Financing
Chapter 5 describes the process for applying to HUD for access to Section 108 financing. It clarifies the differences between a loan pool application and a project-specific application. It then describes the components of a loan pool application with recommendations based on experience with the application process.

Chapter 6: Creating an Effective Delivery System for a Section 108 Loan Pool
Chapter 6 describes the components of an effective Section 108 loan pool delivery system, including marketing, screening, packaging and approval, loan closing, disbursement, and portfolio management. Each section includes basic information and key decisions or lessons learned from experience.

Chapter 7: Leveraging Section 108 with Other Common Sources of Financing
Chapter 7 discusses opportunities to pair Section 108 with other common sources of public finance, including New Markets Tax Credits, Low-Income Housing Tax Credits, Historic Tax Credits, and HOME funds, as well as bank loans backed by guarantees from the Small Business Administration (SBA). For each source, it highlights key opportunities as well as considerations, especially related to eligibility, collateral, and reporting requirements.

Chapter 8: Conclusion and Recommendations for HUD
Chapter 8 concludes the Guide by offering strategic recommendations for HUD to enhance access, streamline processes, and ensure the program remains responsive to community needs, ultimately empowering grantees to achieve their development goals and promote equitable outcomes.

Authors

This guide, developed by Enterprise Advisors to expand access to underutilized federal resources and leverage them for transformative equitable development in communities nationwide, was supported by the Robert Wood Johnson Foundation. The views expressed do not necessarily reflect those of the Robert Wood Johnson Foundation.

Enterprise Advisors

Enterprise Advisors (Advisors) is Enterprise's mission-driven consultancy providing support to communities, local governments, and national and local partners across the country. With hundreds of engagements over the past 14 years, Advisors offers a unique blend of national know-how, technical expertise, and place-based experience to help our local partners shape inclusive visions and implement equitable programs. Advisors assists local governments, non-profit organizations, and philanthropies to apply a dual people-based and place-based approach to solutions. Our vision is to establish more inclusive, equitable, and resilient communities in which all people have agency and improved life outcomes. Our approach is founded on the belief that cities can promote inclusive and equitable development without displacement, create pathways towards economic security and mobility, empower local stakeholders, and develop healthy communities.

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Enterprise Community Partners

Enterprise is a national nonprofit that exists to make a good home possible for the millions of families without one. We support community development organizations on the ground, aggregate and invest capital for impact, advance housing policy at every level of government, and build and manage communities ourselves. Since 1982, we have invested $72 billion and created 1 million homes across all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands - all to make home and community places of pride, power, and belonging.

Robert Wood Johnson Foundation

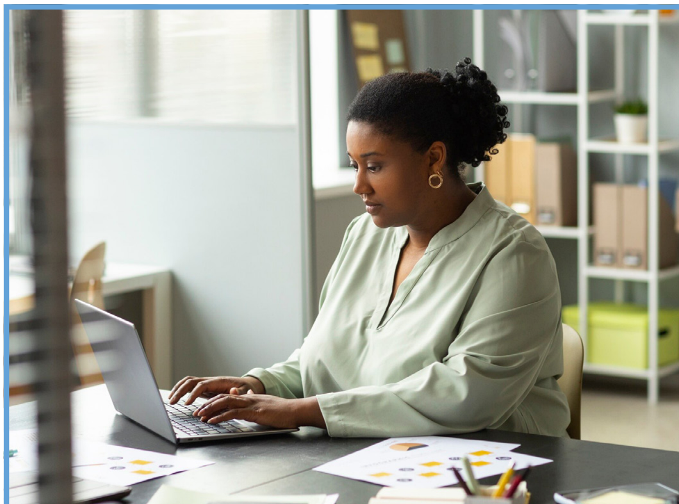
RWJF is a leading national philanthropy dedicated to taking bold leaps to transform health in our lifetime. To get there, we must work to dismantle structural racism and other barriers to health. Through funding, convening, advocacy, and evidence-building, we work side-by-side with communities, practitioners, and institutions to achieve health equity faster and pave the way, together, to a future where health is no longer a privilege, but a right.

Chapter 1: Learning About Section 108 and Leveraging the Benefits for Your Community

Introduction

HUD's Section 108 Loan Guarantee Program (Section 108) is an effective tool to facilitate large scale investments in neighborhood revitalization, housing rehabilitation, and economic development. It can also be a critical tool to advance equitable development in your community. With Section 108 loans, Community Development Block Grant (CDBG) Entitlement Communities can build more housing, support more businesses, and create more jobs that benefit residents and neighborhoods. This Guide helps CDBG grantees and communities learn how to undertake these efforts with an equitable lens and approach.

This chapter provides an overview of Section 108 and its role in contributing to community goals for equitable development. It also addresses common questions related to the program.



RESOURCE

Section 108 Eligibility

HUD annually posts the list of jurisdictions that are eligible for Section 108, including the total amount available to each jurisdiction on their Section 108 program website under "Current Availability of Section 108 Financing."

- **Current Availability of Section 108 Financing on the program website**

Photo by freepik courtesy of Freepik.

Overview of Section 108

Section 108 is a loan guarantee program that allows states and entitlement communities, including states, counties and cities, to borrow up to five times their annual CDBG allocation. Non-entitlement communities that receive CDBG funds under the HUD-administered Small Cities CDBG Program or that receive support from their state CDBG program are also eligible. This Guide focuses on CDBG entitlement communities and refers to them as entitlement communities or grantees throughout.

Program Structure

Section 108 is a loan product that must be repaid through cash flow or other sources. For the program, HUD serves as the loan guarantor. The grantee's CDBG funds are pledged as security for the loans and serve as a backstop in case of a default; however, depending on the nature of the transaction, other forms of security may be required. The financing for the loans comes from private investors that purchase notes through a public offering. The financing can be loaned to a grantee for public projects in a Level I transaction or loaned to a third-party organization, developer, or business in a Level II transaction. Chapter 6 provides more information on the different types of transactions.

Section 108 can finance the following:

- Economic development activities
- Property acquisition
- Rehabilitation of publicly-owned property
- Acquisition, construction, reconstruction, rehabilitation or installation of public facilities
- Housing rehabilitation
- Clearance, demolition, removal, and site preparation related to acquisition or rehabilitation
- Relocation assistance necessitated by a Section 108 project
- Payment of issuance and finance costs associated with Section 108 loans

See Table V in Chapter 6 for more details on eligible activities.

Federal Requirements

Projects that receive Section 108 loans must follow CDBG regulations and HUD guidelines for Consolidated Plans, eligible activities, and national objectives, as well as applicable cross-cutting federal requirements. The Section 108 guidelines on eligible activities and specific requirements are enumerated in 24 CFR Part §570.703 and generally mirror those for CDBG but with a few key differences. Grantees should also review the new changes that HUD is proposing through the 2024 CDBG Proposed Rule for updates on applicable requirements.

There are several activities that are eligible under CDBG but are not eligible under Section 108. These include microenterprise development, public services, long-term planning, and payment of the non-Federal share of other Federal grant programs.

In addition to eligible activity and national objective requirements, special economic development activities financed with Section 108 must follow other CDBG program requirements, including public benefit standards and underwriting requirements found under Appendix A of the CDBG regulations.

Application Process

Grantees must apply to HUD to access Section 108 financing. Grantees can either apply for a specific project with a project-specific application or for a pipeline of projects with a loan pool application. For project-specific applications, grantees must include the project in their Consolidated and Annual Action Plan and submit a credit memo or similar document that provides detailed information on the project to HUD. Loan pool applications are intended to support multiple projects based on the community and economic development goals included in the grantee's Consolidated Plan and Annual Action Plan. For loan pool applications, grantees must submit an application to HUD that describes their loan pool approach, including the types of priority projects that they will pursue. This Guide focuses on the loan pool approach, as reflected throughout the following chapters and described in detail in *Chapter 5: Accessing Section 108 Financing.*

RESOURCES

Overview of Section 108

For an overview of the Section 108 program, HUD offers the following resources:

- **About the Section 108 Loan Guarantee Program on the program website**
- **Chapter 8: Economic Development & Section 108 in the Basically CDBG Manual**

Table I. Loan Profile for Section 108 Transactions

Loan Details	Description
Loan Amount	The maximum loan amount is five times the grantee's annual CDBG award minus any outstanding commitment minus any outstanding principal
Loan Term	The maximum term is twenty years. For permanent financing, prepayment before ten years is permissible through a defeasance provision in the loan agreement. For interim financing, prepayment is permissible anytime.
Interest Rates	Fixed Rates (for Permanent Financing): • Calculated based on the rates on Treasury obligations of similar maturity to the principal amount. A small additional basis point spread, based on maturity, is added to the Treasury rate. • These are established at public offerings of Section 108 notes. Variable Rates (for Interim Financing): • Calculated based on the three-month Treasury Auction Bill High rate plus 35 basis points. • Rates are offered in between public offerings.
Fees	The Loan Guarantee Fee is a one-time, upfront fee payable when loans are disbursed (and can be financed). The fee is adjusted every fiscal year. This fee covers the long-term costs incurred by HUD for accessing the financing calculated as a percentage of the loan amount. The percentage is determined annually by HUD.

Note: Grantees can set specific loan amounts, terms, rates, and fees for third-party borrowers within these parameters.

Figure I. Calculating your Section 108 Allocation

Your CDBG allocation for the prior Fiscal Year **x** 5 **=** Your total Section 108 loan authority **-** Any outstanding Section 108 loan balance **-** Any Section 108 commitment **=** Your total available Section 108 loan authority

Advantages of Section 108 Loans

Fundamentally, Section 108 supports grantees to advance goals for equitable development more quickly by providing access to capital on favorable terms.

With Section 108, grantees can leverage limited CDBG funds. The Section 108 program allows grantees to access up to five times their annual CDBG award, while continuing to receive their annual CDBG allocation. For example, the city of Birmingham's CDBG allocation for FY 2022 was $5,913,735, and five times their allocation was $29,568,675. However, the city had an outstanding Section 108 loan for $4,276,000, so their available loan authority was reduced to $25,292,675. In addition to approximately $25 million in loan authority, the city still had full access to their nearly $6 million in CDBG funds for that year and subsequent years.

With Section 108, grantees can raise capital for critical projects quickly. Rather than pay-as-you-go with annual CDBG or other funds, grantees can complete large capital-intensive projects more quickly by utilizing Section 108 loans. In addition, grantees can attract other partners and funders by leveraging the lower-cost financing available through Section 108.

With Section 108, grantees and their partners can access long-term, fixed-rate financing at favorable rates. Section 108 loan terms can extend up to 20 years. The long-term repayment schedule lessens the annual debt burden for public projects and is more favorable than typical bank loans for businesses and developers. The fixed interest rates remove uncertainty over the term of the loan. Further, the interest rates are similar to what AAA-rated publicly-held companies pay for debt and so they are especially advantageous for smaller businesses and developers.

Common Questions About Section 108 Loans

This section addresses common questions about the Section 108 program.

Is Section 108 a loan or a grant?

Section 108 is a loan that requires repayment. This is distinct from CDBG, which is a grant.

Section 108 loans can be made to income-producing projects that generate revenue to repay the loan; or they can be made to projects that do not generate revenue but can pledge other sources of funds for repayment.

An example of an income-producing project is the rehabilitation of a former hotel into affordable housing, which can then repay a Section 108 loan with cashflow from rent over time.

An example of a project that does not generate revenue is the construction of a new public playground. A grantee may decide to repay the Section 108 loan with CDBG funds, general funds or other funding sources over a term of up to 20 years at a fixed interest rate. Other potential repayment sources are described below.

Do Section 108 loans impact CDBG grant funds?

Section 108 is a source of financing that is made available to grantees in addition to their annual CDBG allocation. Grantees that access and use Section 108 financing still receive their annual CDBG award. However, grantees may choose to use their CDBG funds to repay debt service on Section 108 loans, as in the playground example above; or they may be required to use their CDBG funds to repay Section 108 loans in the case of default. We describe the role of CDBG as collateral for Section 108 loans in the next question.

Is CDBG the collateral for Section 108 loans?

As part of the Section 108 program, grantees must pledge CDBG funds as the backstop in the case of a loan default. But per the Credit Reform Act of 1992 grantees must pledge other sources of collateral, in addition to CDBG, for each Section 108 loan that they make. There are many ways to mitigate the risk of a loan default, including by identifying alternative sources of collateral and funds for loan repayment.

In addition, grantees mitigate risk by adhering to the underwriting criteria established for their Section 108 loan pool, as described in Chapter 5 and Chapter 6.

During the underwriting process, grantees identify additional sources of collateral beyond CDBG funds for each Section 108 loan.

> Typical sources include the land, buildings, or equipment associated with the project that receives the loan; but it could also be land or other assets that are owned by the city or a partner and not directly associated with the project. In addition, grantees can identify locally-derived funding sources as collateral, such as revenue from a local Housing Trust Fund, Tax Increment Financing (TIF) district, franchise fees, taxes or levies, or income generated through parking or traffic-related fees or fines.

Grantees may also establish a loan loss reserve for Section 108 loans through a spread on the interest rate or through interest earned on monthly loan payments from third-party borrowers (in between the semi-annual payments to investors). In Level II transactions, grantees can also transfer risk to third-party borrowers by requiring personal guarantees, especially from established developers or businesses.

In the case of missed payments or a loan default, grantees can develop workout strategies with HUD, such as interest-only periods and extended repayment periods, that can reduce the impact on CDBG or other local funding streams in any given year.

CASE STUDIES

Alternative Sources of Collateral

Besides collateral associated directly with the project, the most common alternative sources of collateral for Section 108 loans are locally-derived funds and public assets.

Locally-Derived Funds: The city of Toledo, Ohio established a franchise fee as a source of repayment for a Section 108 loan more than twenty years ago. That loan has since been repaid, and now the revenue from the franchise fee is available for future loans. To commit the franchise fee as an alternative source of collateral for a civic infrastructure project, the city reviewed the history of income from the fee, calculated the net present value over the term of the Section 108 loan, and then calculated the amount that the city would need to commit to the project in order to achieve the underwriting standards for the loan.

Public Assets: In partnership with the Birmingham Land Bank Authority, the city of Birmingham, Alabama owns and manages hundreds of publicly-owned properties. When appropriate, the city plans to use publicly-owned properties as collateral for Section 108 loans. If a loan defaults, the city commits to sell properties to continue servicing the debt. The city of Birmingham also lists additional alternative sources of collateral in their Section 108 application, including personal and corporate guarantees as well as converting the loan to become a general obligation of the city.

Photo ("Cropped photo of the Toledo skyline along the Maumee River.") by MrJacoon000 courtesy of Wikipedia used under the CC BY-SA 4.0 license
Photo ("Birmingham, Alabama from Vulcan Park.") by Polk450 courtesy of Wikipedia used under the Public Domain

Chapter 2: Deciding to Pursue Section 108 Loan Pool Financing

Introduction

Section 108 financing offers significant benefits to communities seeking additional capital for transformative development projects; however, it also requires a significant commitment from grantees, particularly when pursuing the loan pool approach.

In this chapter, we cover key considerations for government leaders and staff as they decide whether to pursue Section 108 financing and how to effectively leverage it.

Benchmarks to Assess Readiness

Consider the following four key benchmarks to assess readiness for a Section 108 loan pool:

1. a community's vision for equitable development
2. internal or external administrative capacity
3. local market conditions
4. current leadership's familiarity with federal programs

VISION: Does your community have a vision or strategy for equity and equitable development?

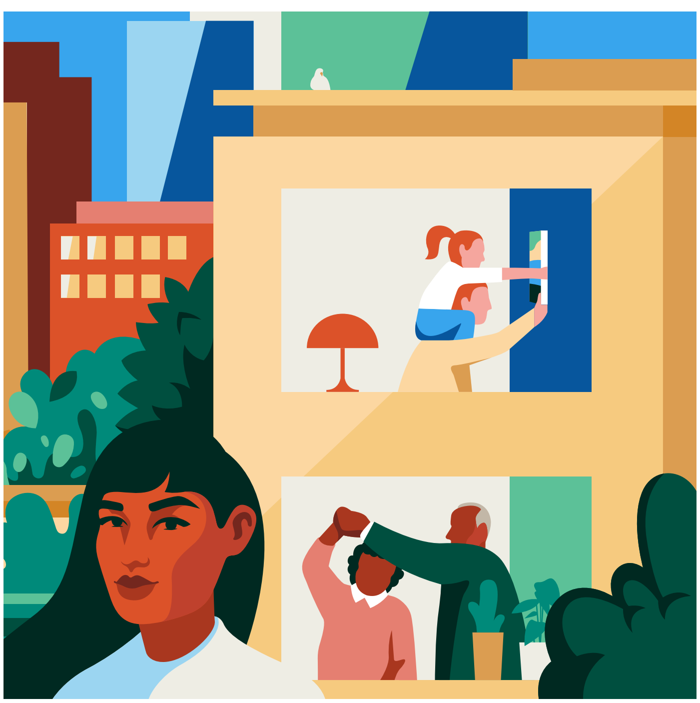
Section 108 financing can play a key role in advancing goals and implementing strategies that align with your community's vision for equity and equitable development. Chapter 4 offers a framework on how to do this. Additional questions to assess readiness include:

- Has your community done an analysis of access to affordable housing, workforce and economic development opportunities, and other community assets based on race, income, and geography? Has your community developed goals or strategies to address disparities in access?
- Is local leadership excited about neighborhood-scale revitalization opportunities that can have catalytic impact on underserved communities and communities of color? In partnership with community residents, have you identified long-term equity outcomes that you would like to achieve?

CAPACITY: Does your community have the capacity to administer Section 108 loans?

Grantees have the flexibility to administer the loans through various means, including existing staff, newly hired personnel, partner agencies, third-party consultants, a loan committee of community stakeholders or a combination thereof. Many cities have leveraged existing staff capacity or hired new personnel and established the necessary administrative infrastructure while applying for access to Section 108 financing. Chapter 3 discusses the key roles and skillsets, methods to assess capacity, and options for additional capacity in more detail. Questions to quickly assess staff capacity include:

- Do your staff (or staff at partner agencies) have experience administering loans or loan pools using either federal or local funds? Does your community have underwriting and loan servicing experience and infrastructure?
- Does your community consistently expend CDBG funds in a timely manner? Is your community in good standing with your HUD field office and related reports?



MARKET: Can your local market absorb additional Section 108 financing, considering the potential demand for projects and the availability of alternative financing locally?

Engaging local developers and financing institutions is key to understanding the potential demand for Section 108 loans compared to other financing options. With local developers, you should clarify that the loans are fixed-rate with flexible terms but still include administration costs and they come with specific program and reporting requirements. Chapter 4 offers more detailed recommendations on how to engage partners and conduct a developer focus group. Questions to quickly assess market conditions include:

- Does your community already have a pipeline of projects that are requesting funding or financing support and that could potentially leverage Section 108 or other public sources?
- Is it currently a down or up market? In other words, are interest rates higher or lower than normal? If interest rates on commercial loans are higher than normal, then Section 108 will likely be attractive to local developers.
- Does your community have other assets like land or buildings that can be paired with Section 108 financing to further incentivize development? Your community can issue a Request for Proposals for development of the assets that includes access to Section 108.

QUICK TIP

Market Assessment

Prior to applying for Section 108 financing and establishing your loan pool, scan the pipeline of potential projects in your community. Are there projects that have identified funding gaps? Do these projects comply with CDBG eligible activity and national objective requirements? Are there broader redevelopment opportunities available that could leverage Section 108?

Photo by DC Studio courtesy of Freepik

LEADERSHIP: Do community leaders understand Section 108 and how to market and leverage it appropriately?

Local leaders should understand that Section 108 is a loan program, not a grant program, and that projects must either generate revenue to pay back the loan or the community must find alternative sources of revenue for loan repayment. Leaders should also understand the requirements for CDBG, which are largely applicable to Section 108. Undertaking a Section 108 program requires buy-in and support from leaders throughout government, including the mayor, city council, and departmental directors, as applicable. The section below offers recommendations on how to engage civic leaders in assessing the potential for a Section 108 loan pool. To quickly assess your leaders' readiness:

- Are your leaders familiar with the CDBG program? Have they shown an understanding of CDBG program objectives and requirements? Is there a nexus between their vision for housing and community development and potential capital products?

Section 108 for Community Leaders

When communicating about Section 108 to civic leaders, advocates should focus on the ways in which Section 108 can advance the leadership's vision for the community and especially goals that improve equity outcomes and uplift low-income people and neighborhoods. Advocates should use specific examples to illustrate how Section 108 financing can support priority projects and neighborhoods. Advocates should also highlight the benefits of the financing, including flexible terms and lower interest rates.

In addition to advocating for the benefits of Section 108 with leaders, it is important to understand the potential risks. Prepare to address scenarios of default on loan repayment and familiarize leadership with the processes to address default, including HUD's workout strategies. To facilitate these discussions, consider reviewing the project underwriting process outlined in Chapter 5 and Chapter 6, and the options for internal or external capacity to support underwriting detailed in Chapter 3. Additionally, examine alternative sources of collateral beyond CDBG, as outlined in Chapter 1.

Finally, clarify with community leaders that Section 108 loans do not constitute a general obligation of debt and, therefore, do not impact the city's bond rating or debt limit. Furthermore, emphasize that public referendums are not required to issue Section 108 loans.

CASE STUDY

Leadership Priorities and Section 108

In Birmingham, Alabama, the Mayor and city government have specific priorities for equitable development that can be facilitated with Section 108 financing. One priority is to build the capacity of local BIPOC developers, with the city allocating a portion of Section 108 loans to support their projects. Another priority is to redevelop city-owned parcels and buildings, including shuttered public schools. The city plans to leverage Section 108 as an added incentive for developers to undertake these catalytic projects.

Chapter 3: Building Internal and External Capacity to Support a Section 108 Loan Pool

Introduction

To effectively manage a Section 108 loan pool, grantees need to assemble the necessary capabilities to ensure compliance with federal regulations, complete underwriting and loan packaging responsibilities, and steward the program in alignment with the community's vision for equitable development.

This chapter describes the specific roles and skills that are needed to successfully administer a Section 108 loan pool and includes guidance on assessing existing capacity. It then provides recommendations on how to build capacity among staff or with the support of partner agencies, third-party consultants, or a loan committee of community stakeholders.

Roles and Skillsets

A successful Section 108 loan pool requires the capacity to facilitate the program's broader vision and strategy and to administer the loan delivery system, from marketing and screening to portfolio management. Various skills and experiences are required across these roles, including familiarity with the community, knowledge of federal grant programs, and lending experience. Most communities have resources that can contribute these skills and experiences, whether from existing staff, partners, consultants, community members, or a combination of resources.

Figure II. Building a Section 108 Team

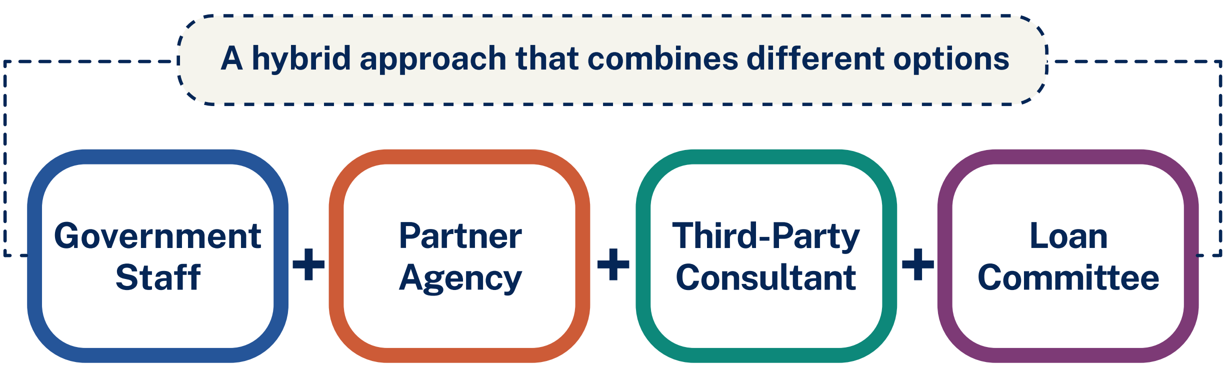


Table II describes the roles, responsibilities, skills and experiences necessary for a successful Section 108 loan pool. Grantees should begin by assessing whether or not current staff can fill the roles. Grantees should then consider how to fill any gaps with additional resources like partners, consultants or community members.

Table II. Section 108 Roles, Responsibilities, Skills and Experiences

Role	Responsibilities	Skills and Experiences
Project Management	• Oversee the Section 108 loan program • Steward the vision and track the equitable development goals and outcomes for the program • Monitor and facilitate the loan delivery system • Develop program materials and protocol as needed • Train staff and partners	• Experience managing programs for local government agencies • Experience supervising and coordinating with other staff • Familiarity with community planning and equitable development goals
Marketing	• Develop and implement a marketing plan for the program • Build and maintain relationships with developers, businesses, community organizations, and other partners	• Excellent marketing and communication skills • Familiarity with the community
Screening for Eligibility	• Assess each loan application for compliance with federal requirements • Determine the eligible activity, national objective, and allowable expenses for the project • Prepare an eligibility determination for the project submission narrative	• Knowledge of CDBG program requirements and other federal cross-cutting requirements
Screening for Credit (Underwriting)	• Analyze project financial statements and projections, project plans, leadership experience, and creditworthiness • Recommend loan amount and other loan terms • Prepare credit memo for the project submission narrative	• Experience with underwriting
Loan Packaging, Approval and Closing	• Prepare project submission narrative • Present recommendations to decisionmakers • Request HUD approval • Engage a lawyer to negotiate and prepare contracts	• Experience with lending and closing processes
Portfolio Management	• Monitor all projects for compliance with contractual agreements and federal requirements • Support processing of loan repayments and related reporting in IDIS	• Knowledge of CDBG program requirements and other federal cross-cutting requirements • Experience with federal reports and IDIS

Many communities use multiple types of resources, and some even combine all of them. For example, one grantee contracts with a partner agency to administer the loan pool. The agency hired a staff person for project and portfolio management and contracted a third-party consultant for screening and loan packaging. The agency presents all loan packages to a loan committee comprised of community and staff representatives of the grantee for approval.

Grantees should consider each of the options for program capacity and determine what is best for their program.

In addition to selecting resources to administer the Section 108 program, grantees must also determine how to fund those resources. Fortunately, there are many ways to fund capacity for a Section 108 loan pool. To begin, grantees can use CDBG planning and administration funds to cover the costs of administering Section 108. Alternatively, grantees may have other funds available for community development purposes that they can use.

Many grantees choose to fund administration of the loan pool by adding a spread on the interest rate for third party borrowers, usually of 1% or less. However, grantees must decide whether it is better to apply the interest from the loans to program administration or to a loan loss reserve, depending on their other funding options.

Finally, grantees should explore partnerships with philanthropic organizations that may be interested in leveraging federal resources like Section 108 to advance equitable development projects.

Government Staff

Assessing Existing Staff Capacity

To assess staff capacity, grantees should review each role and determine if current staff have the appropriate skillsets and potential availability. The staff that are most likely to have applicable skills and experiences are in the community development, economic development and finance departments. Grantees should engage staff to determine their availability in hours per week or as a fraction of a full-time equivalent (FTE) position. Grantees should then compare the availability of current staff to the total number of hours that will likely be required for the role and determine what the gap is between available and needed hours.

If there is sufficient capacity among current staff or if there is an opportunity to hire new staff for the roles, then grantees should refer to the next section on how to harness staff capacity for a Section 108 program. For grantees interested in adding capacity with other resources, please refer to the subsequent sections in this chapter on partners, consultants, and loan committees.

Building Staff Capacity

With staff, grantees can either integrate administrative responsibilities into existing staff roles, or they can build a program team dedicated to Section 108 with existing or new staff, depending in part on the size of the loan program. Regardless, it is likely that multiple staff will be involved in program administration because there are few individuals that have all of the necessary skills and experiences to administer the program alone.

RESOURCES

Staffing Analysis Worksheet

HUD offers an Excel worksheet that can be easily adapted to analyze staff capacity for a Section 108 program:

- **CDBG-DR Staffing Analysis Worksheet**

Connecting with Other Grantees

Grantees can utilize HUD's list of jurisdictions that are eligible for Section 108 to connect with staff at peer cities that have utilized the financing:

- **Current Availability of Section 108 Financing**

Section 108 Training Opportunities

Grow America, formerly the National Development Council (NDC), offers online courses on economic development finance, including the credit review process, that can prepare staff to administer a Section 108 program:

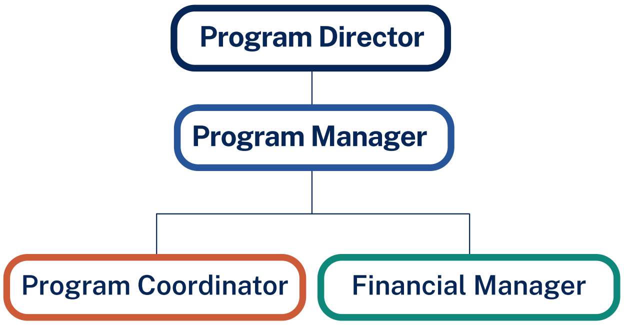
- **Grow America's Professional Education and Training on the Grow America website**

Subrecipient Resources

HUD offers resources to support grantees that partner with subrecipients:

- **Managing CDBG: A Guidebook for Grantees on Subrecipient Oversight**
- **Subrecipient Agreement Template**

Figure III. Section 108 Program Team



For a program team, consider the following roles:

Program Director

- This is typically the director or assistant director of the community or economic development department. The Director provides oversight and strategic direction and helps to build key partnerships, market the program, and engage developers. They may also supervise the Program Manager, review, and approve loan packages. This role requires minimal hours.

Program Manager

- This is typically a staff person with federal grant management or loan program management experience, such as a CDBG program manager. The Program Manager manages the loan delivery system and may also contribute to specific aspects, such as marketing, screening, credit review, loan packaging, and approval.

Program Coordinator

- It may be helpful to include a staff person with administrative experience, who can support the Program Manager with portfolio management or other responsibilities. This role requires minimal hours.

Financial Manager

- It may also be helpful to include staff with finance and accounting experience to assist with loan closing and portfolio management responsibilities. If there are staff with lending experience, then they can also support the underwriting (credit review) process.

CASE STUDY

Staffing Decisions and Section 108

The city of Birmingham, Alabama decided to manage their loan program through a combination of existing and new staff. The city identified the Deputy Director of the community development department to provide program oversight, market the program, and build the project pipeline; a Senior Project Manager to coordinate internally with staff and externally with developers; and the department's Chief Administrative Analyst to develop and oversee the loan delivery system. The city also engaged a staff member from the accounting department to complete portfolio management activities.

Photo ("Birmingham Railroad Park") by Jrbawden courtesy of Wikipedia used under the CC BY_SA 4.0 license

Training Staff on Section 108

Based on Advisors' work with cities across the country, grantees identified screening for eligibility and credit for Section 108 loans as a primary challenge. For example, for projects that include the new construction of affordable housing, the process of determining which portion of the project Section 108 can finance, how it fits into the capital stack and is securitized, and then selecting the eligible activity and national objective can be complex.

The grantees suggested that additional training, tools, and peer learning opportunities would enhance their ability to administer Section 108. As part of ongoing training, Section 108 program managers should consider hosting an annual orientation on the program for all city staff, as well as community partners and developers. They should also engage in informal peer learning opportunities by connecting with similar or nearby cities that have active Section 108 programs.

Partner Agency

Another option for grantees is to enter into subrecipient agreements with other organizations for all or a portion of Section 108 program administration. Most often, the organization will be a public or quasi-public economic development corporation or redevelopment authority with experience managing loan funds and with strong connections to the local development project pipeline. In some cases, the grantee may consider partnering with a local community development financial institution (CDFI) or community-based development organization (CBDO) to administer the loan pool.

CASE STUDIES

Potential Partner Agencies

Grantees may decide to partner with public or quasi-public economic development agencies or with community-based organizations or financial institutions to administer a Section 108 Loan Program.

Redevelopment Authority: The city of Philadelphia, Pennsylvania contracts with the Philadelphia Industrial Development Corporation (PIDC), a publicly-chartered redevelopment authority, to manage its Section 108 loan program. The PIDC has experience administering state-funded loan programs and federal grants, including CDBG. Their staff include HUD-certified underwriters, and they already have an established loan review committee. In addition to the organization's experience and capacity, the PIDC also provides continuity during city leadership transitions. However, the city remains involved in the Section 108 loan pool, with leadership providing final approval for all loans and staff contributing to portfolio management tasks.

Community Development Financial Institution: The city of Cincinnati, Ohio contracts with the Cincinnati Development Fund (CDF), a non-profit community development financial institution, to manage its Section 108 loan program. The city has prioritized the production and preservation of affordable housing for its Section 108 funds and CDF specializes in affordable housing finance. As part of their agreement, CDF completes screening, underwriting, loan packaging and servicing, while the city and CDF jointly monitor projects. CDF also works to leverage Section 108 funds and attract additional philanthropic resources for local affordable housing projects.

Source(s):
2007 Section 108 Guaranteed Loan Program Overview from the HUD Exchange program; Duff, Hillary. Reviving Philadelphia: Using the Hud Section 108 Program to Create a Loan Pool for Economic Development, 1993 – 2000 available on Princeton University's webpage, *Innovations for Successful Societies*; Section 108 Loan Pool Guarantee Application from Cincinnati Ohio; Section 108 Loan Guarantee Program Project Summaries – Fiscal Year 2022 from the HUD Exchange program

Photo ("Daytime shot of the Philadelphia City Hall.") by Leo SERRAT courtesy of Unsplash used under the Unsplash license
Photo ("Over-the-Rhine neighborhood in Cincinnati, near Findlay Market.") by EEJCC courtesy of Wikipedia used under the CC BY_SA 4.0 license

Assessing Partner Agencies

When assessing potential partner agencies, grantees should prioritize partners that have a mission and vision in alignment with the goals for their Section 108 program and that have the experience and capacity to manage it. Even if partners need additional capacity to support a Section 108 program, it may still be easier for them to onboard and train new staff than it would for grantees. It is also important that partner agencies are familiar with cross-cutting federal grant requirements and specific CDBG program requirements.

Grantees should assess potential partners based on their existing knowledge and relationships, recommendations from current staff or partners, and direct conversations with the partners' leaders and staff.

Questions to Assess Potential Partner Agencies

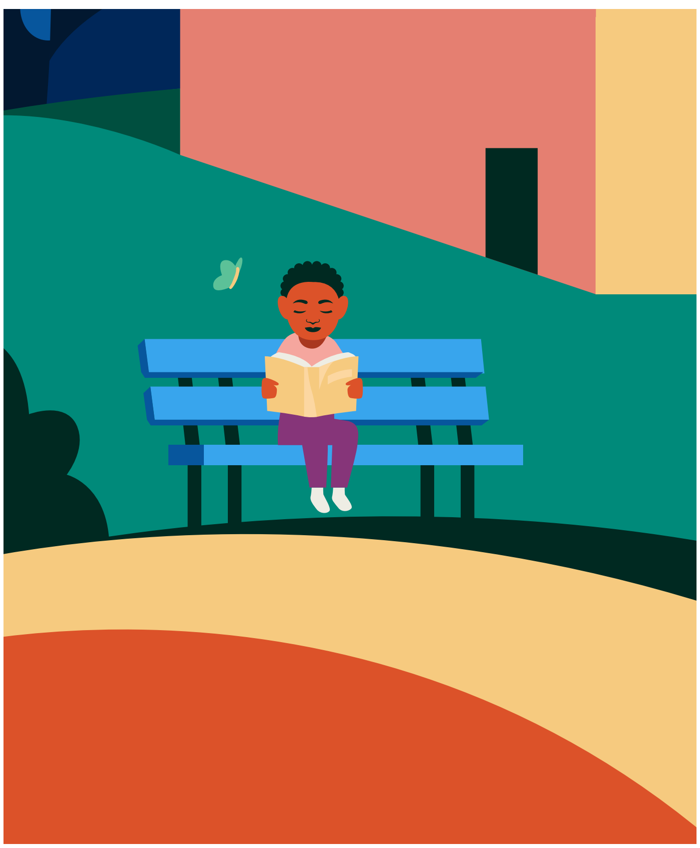
- Does their mission and vision for the community align with the grantee's? Do they understand and support the equity goals for the fund?
- Do they already manage loan funds?
  - What size loans do they offer (preferably $150,000 and up)?
  - How many loans do they close each year?
  - What is their success or default rate?
  - What are their underwriting and portfolio management policies and procedures?
- Are they familiar with CDBG eligibility and reporting requirements?
- Do they have staff or consultants that can fill the roles described in this chapter? Or do they intend to hire new staff or contract for services?
- Are they connected to the development project pipeline?

Contracting with a Partner Agency

The first step towards contracting with a partner agency is to build a relationship with their leaders and staff and a shared understanding of the Section 108 program's vision and goals. Chapter 1 of this Guide provides an overview and talking points on the program that may be helpful for those conversations.

Ultimately, grantees must enter a formal subrecipient agreement with the partner agency for the required services. The subrecipient agreement specifies the responsibilities of the partner agency and the role of the grantee, especially regarding loan review and approval. The agreement provides budget detail and any flow-down provisions from the grantee, including standard legal terms and conditions.

The subrecipient agreement also states the goals for the loan pool, eligible activities, and national objectives. Chapter 4 and 5 of this Guide help identify these elements of the program and agreement, as applicable.



Subrecipient Agreements for Section 108 programs typically include:

- Program and eligibility requirements for the loan pool
- Activities that the subrecipient will undertake, including marketing, screening, loan packaging and approval, and portfolio management (as applicable)
- Mechanism for the grantee to review and accept or reject potential loans
- Instructions on repayment processing and program income
- Recordkeeping and reporting requirements
- Staffing details
- Budget for services provided
- Marketing, origination, and servicing fees
- Performance measures and monitoring
- Other terms of the agreement

RESOURCES

Subrecipient Resources

HUD offers resources to support grantees that partner with subrecipients:

- ***Managing CDBG: A Guidebook for Grantees on Subrecipient Oversight***
- **Subrecipient Agreement Template**

Third-Party Consultant

Based on the assessment of capacity at either the grantee or the partner agency, a third-party consultant may be helpful with screening, packaging or other tasks for the loan program. Consultants can fill a gap in skills and experience, and they can help to accommodate the ebb and flow of the project pipeline, providing support only as needed for new loan opportunities.

Some consultants specialize in screening for eligibility with knowledge of CDBG and cross-cutting federal requirements, while others specialize in screening for credit, underwriting, and loan packaging tasks. Often local staff are equipped to manage the eligibility and compliance tasks but need support with the underwriting and packaging tasks. In addition to relevant expertise, consultants may also bring familiarity with HUD staff and processes that can support loan approval and closing activities.

HUD provides a sample scope of work for a third-party consultant to compete underwriting and loan servicing for a Section 108 loan program (see resource box on page 20 for link).

CASE STUDY

Third-Party Consultants

The Atlantic County Improvement Authority (ACIA), the subrecipient and program administrator for Section 108 funds in Atlantic City, New Jersey and Atlantic County, New Jersey, hired the consulting firm Community Initiatives Development Corp (CIDC) to complete screening and loan packaging tasks for Section 108 loans. CIDC staff have prior experience working for HUD on the Section 108 loan program. In addition to hiring CIDC, the ACIA hired a project manager to join their staff and market the program locally, manage developer relationships and applications, and complete long-term portfolio management tasks. Because the consultants primarily support the project review process, their services have been needed less and less by the ACIA as most of their Section 108 loan authority has now been utilized.

Photo ("Boardwalk in Atlantic City.") by Shinya Suzuki courtesy of Wikipedia used under the CC BY 2.0 license

Loan Committee

A loan committee is another option to bring additional capacity to a Section 108 program, presenting an opportunity to formally invite members of the broader community with relevant skills, experience and networks to participate in the loan program. A loan committee can directly support the loan delivery system by completing screening tasks, for example, or they can serve to review and approve the loan packages compiled by staff, partners, or consultants.

Assessing a Potential Loan Committee

When deciding whether to form a loan committee, grantees should first consider the existing policies and procedures that guide Section 108 loan approval in their community, including any existing city or county council approval processes. Depending on the local context and expectations, a loan committee can facilitate the loan approval process and make recommendations to the council.

A second consideration is whether committee members can bring skills, expertise, or connections that complement those of the staff, partners, or consultants that are managing the Section 108 program. For example, committee members may be able to bring additional experience in commercial lending to review and validate loan recommendations from program staff or they may be connected to a pipeline for priority projects, like minority business associations.

Finally, grantees should consider the potential challenges of including a loan committee as part of the Section 108 program. Even as committees bring capacity, they also require additional capacity by staff or partners to coordinate. Committees may also lengthen the timeline to approve loans, potentially impacting the viability of projects in the pipeline.

Building a Loan Committee

To build the loan committee, grantees should consider potential members with skills, experiences and relationships that are relevant to their Section 108 program. For example, community members that bring skills for eligibility review include staff from government agencies.

Meanwhile, community members that bring skills to support credit review include lenders, accountants, and other real estate and business professionals. For programs that require underwriting and financing skills, grantees should check that potential committee members have experience with the appropriate type of loans, for example, if the grantee's Section 108 program focuses on business loans.

For relationships, loan committees benefit from including members that are connected to the development pipeline, as well as members that are connected to the communities that are meant to benefit from the development. Community members with connections to the development pipeline include banks or non-profit financial institutions, realtors, and other real estate and business professionals.

Members with connections to specific neighborhoods may include elected officials, leaders of CBDOs, neighborhood associations, and others. Often there will be overlap with individuals that can bring both skills and relationships to the loan committee.

Chapter 4: Establishing a Strategy-Driven Section 108 Loan Pool

Introduction

Section 108 loan pools are most effective when they align with existing plans, build on key partnerships, leverage physical assets, and attract a robust pipeline of projects that benefit underserved communities. This chapter provides a framework for communities to develop a strategy-driven program. It begins with a discussion on equity-based approaches to community development and Section 108. Then it outlines steps to build a Section 108 program that brings together plans, partnerships, and physical assets to create a project pipeline that is supported by residents and stakeholders. This chapter also draws connections between program design and Chapter 3 on program capacity, Chapter 5 on the loan pool application, and Chapter 6 on the loan delivery system.

A strategy-driven Section 108 loan program maximizes the potential for equitable development by:

- Setting goals that advance equity in alignment with existing plans
- Focusing on specific geographies to increase impact
- Strengthening partnerships with public and private sector stakeholders
- Leveraging physical assets
- Attracting additional resources and capital
- Building a robust project pipeline

An Equity Lens for Section 108 Programs

To achieve equitable outcomes with Section 108 financing, Enterprise Advisors facilitates planning processes that center equity and include meaningful engagement in loan program design. This approach includes:

- Engaging those most impacted by inequities in program design and supporting their leadership and ongoing efforts
- Developing clear goals and targeted strategies that address race- and income-based disparities, including by reducing barriers to access resources
- Establishing metrics and evaluation methods to assess the impact of our strategies and investments on equity outcomes

For Section 108 programs, grantees can apply this approach to develop goals, strategies, and metrics for their loans, whether the local priorities are related to housing, business, or infrastructure. To develop goals, grantees should consider existing plans, potential partners, physical assets, and pipeline projects with an equity lens.

- **Plans:** Review plans that have an equity-driven and community-engaged approach to their goals and strategies
- **Partners:** Collaborate with partners that are accountable to underserved communities
- **Physical Assets**: Inventory existing assets, including land and buildings, and seek to understand their current or potential impact on underserved communities
- **Pipeline:** Identify projects that advance equitable goals and strategies, leverage assets, build on potential partnerships, and align with Section 108 program requirements

In this chapter, we provide a framework to guide grantees in considering their plans, partners, physical assets, and pipeline and to develop goals around each. This framework encourages grantees to **identify** key community needs and opportunities, **assess** through an equity lens to ensure that their programs address disparities and promote inclusive growth, and **make connections** between identified goals, available resources, and broader community development strategies. For each selected goal, grantees should develop a clear and actionable strategy for deploying their Section 108 loans and establish outcome metrics to measure the program's impact over time. This approach helps ensure that Section 108 investments are intentional, equitable, and aligned with the unique needs of the communities they serve.

For example, if a goal is to spur commercial development in low-income neighborhoods by minority-owned enterprises, the following bullets outline a potential strategy and metric:

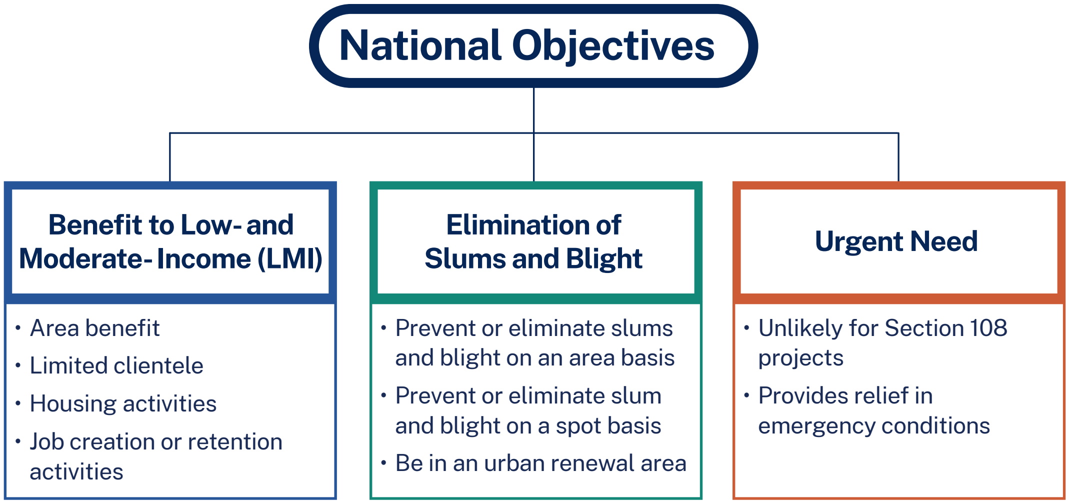
- **Goal:** Spur commercial development in low-income neighborhoods by local minority-owned enterprises
- **Strategy:** Provide Section 108 loans for commercial real estate acquisition and development as well as for business equipment and furnishings with a preference for projects in low-income neighborhoods and led by minority-owned enterprises
- **Metric:** $3,000,000 in Section 108 loans distributed to at least 1 development project and at least 3 businesses located in low-income neighborhoods over 5 years

In addition to your community's goals, federal requirements also set a baseline for equity outcomes for Section 108 programs. As described in Chapter 1, projects that receive Section 108 loans must follow HUD's guidelines for eligible activities and national objectives.

Section 108 projects qualify for financing under three different national objectives: benefit to low- and moderate-income persons or households (LMI Benefit), elimination of slums and blight, and urgent need. Because Section 108 follows the CDBG requirement that grantees allocate 70% of funds to projects that meet LMI Benefit, that is the most common national objective.

The four categories of LMI Benefit are Area Benefit, Limited Clientele, Housing, and Job Creation or Retention. Each of these require that at least 51% of the beneficiaries of the project be low- and moderate-income individuals or households.

Figure IV. National Objectives



See **CDBG Chapter 3: National Objectives (hudexchange.info)** for information on national objectives

Table III. LMI National Objectives*

Term	Definition
LMI Area Benefit (LMA)	At least 51% of the residents of a geographic area that benefits from a project must be LMI persons. • *The grantee must maintain records of the service area boundaries and associated income characteristics.*
LMI Limited Clientele (LMC)	At least 51% of the direct beneficiaries of a project must be LMI persons. • *The grantee must maintain records documenting that: the activity is designated for LMI persons; or it is in a location that principally benefits LMI persons; or LMI persons directly receive benefits from the activity; or the activity removes accessibility barriers to aforementioned activities.*
LMI Housing (LMH)	At least 51% of units must be occupied by LMI households. • *The grantee must demonstrate that the landlord agrees to LMI occupancy requirements, maintains records of rental prices, and maintains records of occupant information such as ethnicity, family size, and income.*
LMI Job Creation or Retention (LMJ)	At least 51% of permanent jobs that are created or retained must be made available to or held by LMI persons. • *The grantee must clarify whether jobs will be made available to LMI persons or if LMI persons will hold the jobs directly.* • *If the grantee intends to make 51% of jobs available to LMI persons, they must maintain documentation with each specific assisted business detailing which jobs are to be made available and how first consideration is given to LMI persons.* • *If the grantee intends for 51% of jobs to be held by LMI persons, they must document a commitment by the assisted businesses that the LMJ requirement will be maintained, as well as job descriptions and demographic information of those employed.* • *In the case of job retention, the grantee must document that without assistance, the jobs would not exist.*

*NOTE: While the LMI National Objectives outlined above apply to most cases, there may be exceptions.

CASE STUDY

LMI Job Creation or Retention

The city of Austin, Texas launched the Family Business Loan Program (FBLP) in 2012 to offer local businesses below-market interest rates and more flexible repayment terms compared to traditional lenders. As part of the program, in 2014, the city leveraged $519,000 in Section 108 loan funds to fill a financing gap in the redevelopment of an iconic East Austin eatery. The redevelopment project met the Section 108 national objective requirements through the creation of jobs for low- and moderate-income (LMI) individuals. Since the Census tract where the restaurant is located qualified as a high-poverty Census tract, the 19 full-time equivalent (FTE) jobs were automatically classified as LMI jobs under HUD's presumptive benefit criteria without requiring income documentation from those hired. As of June 2018, the project had exceeded expectations and reported creating 45 new FTE jobs.

Source(s):
Small Business Case Study: Sawyer and Co. from the HUD Exchange program

Photo ("View of Downtown Austin from Pfluger Pedestrian Bridge October 2022.") by Jouaienttoi courtesy of Wikipedia used under the CC BY-SA 4.0 license

Plans

A strategic Section 108 program bolsters equitable community planning efforts. Grantees should review and assess the connections between key planning initiatives to understand how Section 108 can advance projects and expand opportunities in low-income neighborhoods. A Section 108 applicant should have a clear understanding of existing plans to inform their loan pool application described in Chapter 5, particularly the Loan Fund Description.

IDENTIFY

Identify your community's key planning initiatives

Grantees should begin by reviewing recent planning documents that address issues of equity and economic development. These can include neighborhood, citywide, as well as county and regional plans, along with federal reports. Grantees should prioritize documents that actively guide local stakeholders' work

In addition to reviewing existing plans, communities should also consider including Section 108 in any ongoing or upcoming planning processes. For example, prior to applying for access to Section 108 financing, the city of Toledo completed a comprehensive housing plan and identified multiple strategies that Section 108 could support.

For many communities, other relevant planning processes include the Comprehensive Economic Development Strategy (CEDS) and the Consolidated Plan. Grantees that apply for access to Section 108 financing must include a description of the program in their Consolidated Plan and Annual Action Plan. While it can be included as an amendment, it is best to integrate it into the initial planning and community engagement efforts.

For communities that do not have a robust set of planning documents, it is especially important to integrate Section 108 into these cyclical planning processes. Section 108 can also be an impetus to develop a simple and focused neighborhood plan in a priority geography.

CASE STUDY

Document Review

In assisting St. Louis County, Missouri with the development of a Section 108 program, Advisors reviewed key planning documents for the region, the county and the city. These included the region's CEDS as well as plans that focus on neighborhoods and populations that experience inequities, such as a Choice Neighborhoods plan, a Promise Zone application, a transit-oriented development plan, and plans from local community-based organizations and community foundations. There was emphasis especially on plans that guide the work of potential partner organizations for the Section 108 program to ensure familiarity and alignment.

Photo ("Runner Fountain and Old Courthouse and Arch.") by Jefferson National Expansion Memorial, NPS courtesy of Wikipedia used under the CC BY 2.0 license

ASSESS THROUGH EQUITY LENS

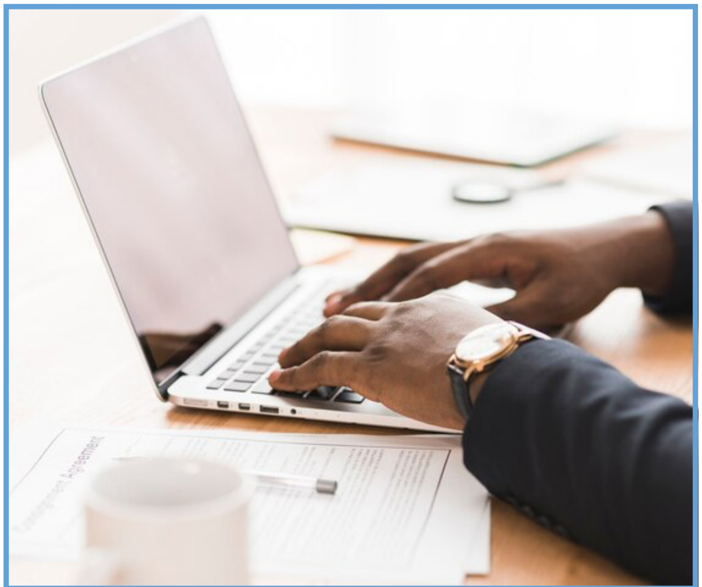
Review the planning documents and highlight the goals and strategies that can benefit from Section 108 loans and meaningfully address equity

Once the key planning initiatives are identified, grantees should assess how each incorporates equity. Grantees should prioritize plans that meaningfully engage residents by uplifting resident voices and by creating positive feedback loops of further community engagement and participation.

Grantees should review the plans for their assessments of existing disparities and their strategies to address them. The assessments likely follow both the lived experiences of residents as well as analyses of available data. Grantees should note which issues are the highest priority for residents and the most significant according to the data. Grantees should then analyze the strategies that address the most important issues to understand which can potentially benefit from Section 108 financing.

To amplify the impact of Section 108 loans, grantees should prioritize strategies that leverage other resources and opportunities. For example, in St. Louis County, the Promise Zone and Choice Neighborhoods designations created opportunities for local partnerships as well as federal grant awards and incentives that complement Section 108 loans.

Grantees should note the geographies of current planning initiatives and review other geographic designations that can bring resources or development incentives. These include Neighborhood Revitalization Strategy Areas (NRSAs), Opportunity Zones, and designated areas with redevelopment plans that may qualify for Section 108 financing under the Slum and Blight national objective.



RESOURCE

Community Engagement Strategies

HUD offers a toolkit that describes community engagement strategies to inform public investments:

- ***Community Engagement Toolkit: Building Purpose and Participation***

Photo by freepik courtesy of Freepik

Slum and Blight National Objective

Under the Slum and Blight National Objective, there are two common qualifying categories: Slum Blight Area Basis (SBA) and Slum Blight Spot Basis (SBS). Projects may also qualify for Slum Blight Urban Renewal Area (SBR) if located in an area covered by an approved Urban Renewal Plan.

To qualify for SBA, public improvements in an area must be in a state of deterioration. HUD considers an area as "deteriorated" if at least 25% of the properties in an area exhibit physical deterioration, abandonment, high turnover, declining property values relative to surrounding areas, or environmental contamination. Grantees must maintain documentation of the conditions and reassess them every 10 years.

SBS qualifies single blighted buildings that are not located in a blighted area to receive Section 108 financing. Eligible activities under this category are limited to acquisition, clearance, relocation, rehabilitation, historic preservation, and environmental remediation. As examples, under this category Section 108 may be used for the acquisition of a dilapidated property, the rehabilitation of public facilities that are in violation of building codes, the preservation of historic buildings, or the demolition of a decayed structure.

RESOURCE

Slum and Blight National Objective

HUD provides further information on the Slum and Blight national objective in Chapter 3 of the *Basically CDBG Manual*:

- ***Chapter 3: National Objectives in the Basically CDBG Manual***

CASE STUDY

Slum and Blight National Objective

The city of Springfield, Massachusetts created a $5 million Section 108 loan pool for the redevelopment of vacant and blighted buildings in the downtown area. The loans were designated for the acquisition of vacant, abandoned, or foreclosed properties, which would then be sold to developers for use in accordance with the city's downtown redevelopment plan. The loans qualify under the Slum and Blight national objective, as over 25% of the properties in the area met the blight definition.

Source(s):
Main Street / Convention District Overlay Zone Property Acquisition Fund (Section 108 Application Form) from City of Springfield, Massachusetts

Photo ("Springfield, Ma, USA skyline.") by Ironass courtesy of Wikipedia under the Public Doman license

MAKE CONNECTIONS

Highlight connections between the different plans and their strategies

Grantees should compare geographies and strategies across plans to determine which were repeatedly prioritized and which have strong and reinforcing connections. In St. Louis County, Advisors supported the city by identifying strategies and connections across five categories:

- **Economic Development:** workforce development, local industries, business development, commercial and industrial real estate, financial tools, and incentives
- **Housing:** for specific populations, priority locations, strategies like housing type and tenure, or infill development
- **Health and Safety:** health facilities, recreational facilities, community-supported agriculture, brownfield remediation, and redevelopment of “hot spots” for neighborhood crime
- **Transportation:** public transit and active transit infrastructure, transit-oriented development
- **Education:** educational facilities, workforce development

Following this approach, grantees can begin to identify goals and strategies that have the potential for transformative impact on specific issues and geographies.

Partners

A strategic Section 108 program strengthens existing partnerships and forges new ones. As part of the loan program design process, grantees should identify partners that can attract and vet projects, bring resources to increase impact, and potentially add capacity to fill gaps in the loan delivery system.

Partners can bring capacity for managing the loan program as described in Chapter 3. When developing their loan pool applications, grantees must describe their partners and outline the roles that they will play in relation to the loan pool, as detailed in Chapter 5.

IDENTIFY

Identify the stakeholders that are driving equitable development strategies in your community

Grantees should consider partnerships with both established organizations and organizations that represent marginalized communities and may not have prior experience working with local government or federal programs. In addition to reviewing the stakeholders involved in the planning efforts described above, grantees should consider the following categories of stakeholders for potential partnerships:

- Public and quasi-public agencies that focus on economic development
- Community-based organizations and non-profit developers
- Anchor institutions, such as hospitals and universities, especially if they own and develop land
- Banks, community development financial institutions, and philanthropic organizations

ASSESS THROUGH EQUITY LENS

Evaluate potential partners with an equity lens

It is important to understand how potential partners approach equity in their work and whether it drives their goals and strategies or is secondary to other goals. Grantees should prioritize partners that pursue equity as a primary goal and that directly serve marginalized communities.

Grantees should also consider how the organizations operate and prioritize partners that engage and empower residents through their programming and that are accountable to residents through their governance models. Ideally, organizations also include residents on their staff.

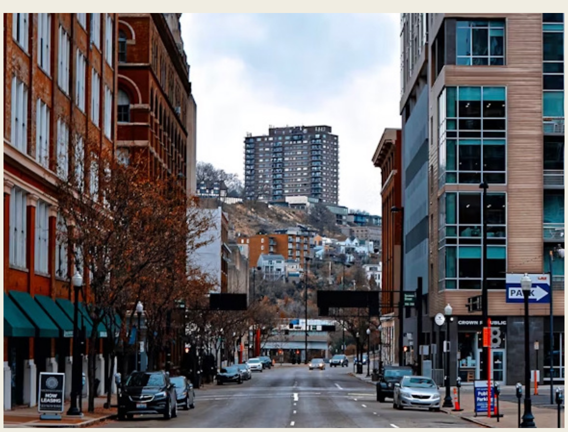
MAKE CONNECTIONS

Identify the initiatives, resources and capacities that potential partners can bring to the Section 108 loan program

In addition to equity considerations, grantees should assess the current initiatives, resources, and capacities of potential partners. Grantees should prioritize partners that are involved in initiatives that can benefit from Section 108 loans, such as real estate or small business development. Promising potential partners also bring resources like networks of relevant stakeholders, such as developers, minority-owned businesses, or community organizations. Or they may bring resources like additional financing, grant funding, or development assets, such as land or buildings. Grantees should also evaluate partners based on their capacity to deliver loan products, move projects through a pipeline, engage stakeholders, or leverage resources, as evidenced by prior work.

In addition to individually engaging potential partners, we recommend convening stakeholders to learn about Section 108 and identify potential projects, resources, and capacities. For more intensive engagement, grantees can invite stakeholders to join an advisory committee that further evaluates opportunities for Section 108 financing and aligns initiatives and resources.

CASE STUDY



Advisory Committee

The city of Cincinnati, Ohio formed an Affordable Housing Subcommittee, composed of partner organizations that brought together various stakeholders to address affordable housing challenges, including hosting public forums. One of the Subcommittee's key recommendations was to create an Affordable Housing Loan Pool, utilizing Section 108 as a source of financing. The process also resulted in a partnership between the city and the Cincinnati Development Fund (CDF) to manage the Section 108 loan delivery system.

Photo ("Cincinnati.") by Jordan Allen Walters courtesy of Unsplash under the Unsplash license

Physical Assets

A strategic Section 108 program should take into consideration physical assets that can be leveraged to meet project demands or serve as collateral for Section 108 loans. Grantees should conduct a thorough inventory of existing assets in target geographies, including land, buildings, infrastructure, and community facilities, and assess their potential for driving equitable development.

IDENTIFY

Identify physical assets for development

Grantees should conduct a thorough inventory of existing physical assets that can be utilized for development projects or serve as collateral for Section 108 loans. Chapter 1 highlights a case study on using landbank properties as collateral. The inventory should evaluate assets for their potential to generate revenue, facilitate development projects, or serve as collateral for Section 108 loans.

Grantees should evaluate publicly- and privately-owned land, vacant properties, and underutilized buildings in priority neighborhoods. By engaging with government staff, local property owners, developers, and community organizations, grantees can identify assets that are ready for redevelopment or repurposing and can benefit from Section 108 financing.

To support the identification process, grantees should consider the following:

- **Publicly-Owned Assets:** Review municipal, county, and state inventories of public land and buildings. Identify any surplus or underutilized properties that can be repurposed in the target geography.
- **Privately-Owned Assets:** Engage with local property owners and real estate professionals to identify vacant or underused land or properties that may be prime candidates for redevelopment.
- **Community Facilities:** Consider publicly-owned community centers, schools or other facilities that can be upgraded or repurposed to serve broader community needs.

ASSESS THROUGH EQUITY LENS

Evaluate physical assets with an equity lens

Some physical assets, like community centers or parks, enhance historically underserved neighborhoods, contributing to a more equitable distribution of resources; but other physical assets, like foreclosed homes, may detract from neighborhoods and aggravate inequities. Grantees should seek to understand how physical assets intersect with equity in priority neighborhoods by meeting with residents and community organizations. Residents should help to prioritize assets for redevelopment and provide input on what kinds of development would benefit their neighborhoods.

MAKE CONNECTIONS

Make connections between physical assets, neighborhood plans, and potential pipeline projects

Grantees should map physical assets or otherwise analyze their locations, focusing on assets that are in priority neighborhoods or in proximity to pipeline projects. Grantees should analyze assets for the potential to bolster existing projects and initiatives and for the potential to have transformative impact on underserved neighborhoods. For pipeline projects that are still in the planning stage, physical assets such as publicly-owned land can address financial gaps and spur development. Grantees should also note concentrations of physical assets and, alongside residents and community organizations, evaluate the potential for larger development projects or systemic strategies that address underutilized land and buildings.

Pipeline

A strategic Section 108 program responds to current market conditions and ensures that Section 108 loan products meet the demand from local projects. To assess market conditions, grantees should identify projects that may be eligible for Section 108 loans that are currently experiencing funding gaps or challenges, and that have the potential to maximize impact in underserved communities. Chapter 5 explains how pipeline projects inform the loan fund application, specifically the Loan Fund Description, Loan Portfolio Information, Requirements for Program Compliance, and Underwriting Criteria. HUD may also request a description of pipeline projects as an attachment to the application. Chapter 6 discusses how pipeline projects influence the loan delivery system, particularly in terms of marketing and screening.

IDENTIFY

Identify ongoing and future projects that will drive equitable development in underserved communities and benefit low-income residents

As described above, grantees should identify projects through the process of reviewing plans and engaging partners. In addition, grantees should connect directly with local developers to understand how Section 108 loans can support their project pipelines and capital stacks.

An efficient way to connect with developers is to organize a focus group. The focus group should include both for-profit developers and community-based non-profit developers as well as major businesses or other institutions that have significant footprints and engage in ongoing development projects.

For the focus group, grantees should provide an overview of the Section 108 program, including the loan profile and eligible activities, as described in Chapter 1. Grantees should then facilitate a conversation to understand whether developers would use the loan product, if offered; how it compares to other loan products available locally; and what projects are currently in the development pipeline that could benefit from Section 108 loans.

Sample questions for a developer focus group:

- How does this loan product compare to others locally?
  - Are there less expensive financing options? Are there less restrictive financing options?
- Do you have projects in the pipeline that could benefit from this loan product?
  - If yes: What financing challenges have you experienced with the projects? Do the projects benefit low-income neighborhoods or households?
  - If no: What kinds of projects would this loan product help you to pursue?

ASSESS THROUGH EQUITY LENS

Evaluate potential projects with an equity lens

If there is a pipeline of potential projects for Section 108 loans, or even just a few projects that could soon be shovel-ready, grantees should assess their potential to address equity and their level of support from residents. Grantees should also consider the geographies of the pipeline projects, alongside the geographies of physical assets, and assess the potential for transformative impact on underserved neighborhoods if resources were more targeted.

MAKE CONNECTIONS

Engage in more in-depth conversations about promising projects

Before submitting a formal loan pool application to HUD, grantees should begin to evaluate pipeline projects for eligibility. Grantees should speak directly with developers and potentially request documentation to determine if the projects meet national objective, eligible activity, and other federal requirements. Grantees should also ask about current funding gaps for the projects and determine if a Section 108 loan is sufficient to fill the gap or if additional resources are needed.

Section 108 Goals and Strategies

Grantees should develop their Section 108 program based on the most promising opportunities from their review of plans, partners, physical assets and pipeline projects. Some communities may have strengths and opportunities in each of these areas. Other communities may have an exciting opportunity in one area and leverage it to strengthen others.

Ultimately, grantees should articulate the goals, strategies, and metrics for their Section 108 program, including specifically how the loan pool builds on established plans, strengthens partnerships, leverages existing assets and opportunities, and advances equity. Grantees should prepare a written description both for internal purposes and for external communication with residents and HUD as part of the loan fund application process, which is described in more detail in Chapter 5.

CASE STUDY

Pipeline of Projects

Prior to submitting their loan pool application to HUD, the city of Birmingham, Alabama identified a pipeline of projects and began to assess priority projects for compatibility with Section 108 requirements. Ultimately, their list of pipeline projects helped to facilitate their application process with HUD by demonstrating demand for Section 108 loans locally.

Chapter 5: Accessing Section 108 Financing

Introduction

To access Section 108 financing for a loan pool, grantees must apply to HUD and effectively communicate their goals for the financing, their alignment with program requirements, and their readiness to manage a pipeline of Section 108 projects.

This chapter clarifies the differences between a loan pool application and a project-specific application and then describes the components of a loan pool application with recommendations based on Advisors' experience with the application process.

Project-Specific and Loan Pool Applications

HUD accepts two different types of applications from grantees for access to Section 108 financing: project-specific applications and loan pool applications.

Grantees submit a project-specific application to access Section 108 financing for a single project. Alternatively, grantees can submit a loan pool application to access financing for multiple projects. For example, a grantee that has $16 million in Section 108 loan authority may apply for access to up to $16 million for a loan pool that can support a pipeline of affordable housing developments over several years.

Because a loan pool encourages and supports more projects, it can have a more transformative impact on communities. The following sections highlight the benefits of applying for a loan pool.

Faster access to financing

Once a loan pool is established, HUD's screening process for each project is less intensive than for a project-specific application. HUD completes a full credit review for project-specific applications; whereas, with a loan pool, the grantee completes the eligibility and credit review, and then HUD confirms eligibility and verifies that the grantee followed the underwriting guidelines described in their loan pool application. If the grantee provides adequate documentation for both the eligibility and credit review, HUD typically approves the Section 108 loan guarantee within two or three months of submission of the project narrative.

For project-specific applications, HUD requires an amendment to the grantee's Consolidated Plan and Annual Action Plan for each project; whereas, amendments are only required for the initial loan pool application and not for individual projects under the loan pool.

EXPLAINER

Loan Pool Extension

Under a loan pool application, grantees are given a year to submit a project under the loan pool. If a project is not identified within the first year of authority, grantees must request an extension from HUD. This is the only extension request required. Previously, grantees were given five years of authority to spend down their Section 108 funds, but the expiration condition is no longer applicable.

QUICK TIP

Local Requirements for Project Approval

Grantees may have local requirements for project approval, which typically mirror the review processes for HOME or CDBG-funded development projects. Before submitting a loan pool application, grantees should clarify the local approval process for Section 108 financed projects and include it in their loan delivery system and timeline for borrowers to access project financing.

Incentives for third-party borrowers

Unlike project-specific applications, project financing is already committed for a loan pool. With this commitment, grantees can market the available financing to developers, businesses, and partners, attracting a pipeline of projects, and increasing the opportunities to leverage other resources.

Flexibility in the use of the loan pool

Grantees can select a single strategy or multiple strategies for a loan pool. For example, a loan fund can focus on revitalizing a particular neighborhood, encouraging business development and job creation, increasing the supply of affordable housing, converting office buildings, or any combination of eligible activities.

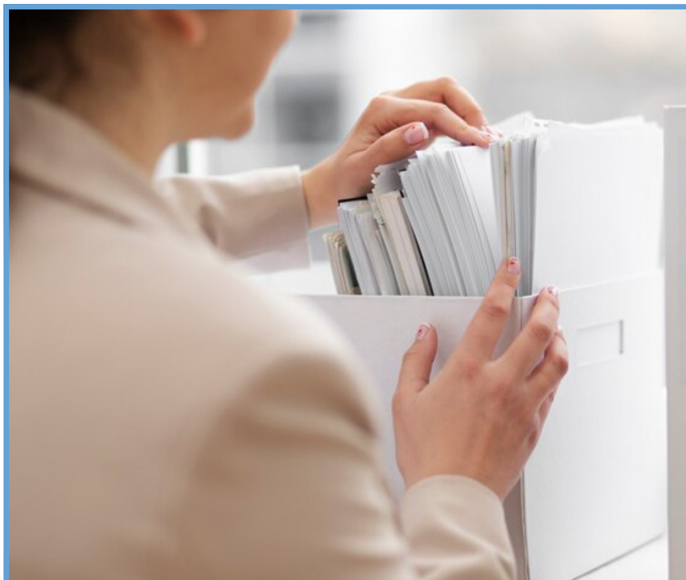
Impact on equity outcomes

Grantees can align the strategies for a loan pool with existing plans, potentially realizing multiple projects and advancing equity.

The Loan Pool Application

HUD does not have a standard format for a loan pool application. Instead, HUD provides an application tool with a list of topics that grantees should cover in their application package. As a result, applications vary in structure for each community.

The loan pool application generally includes an executive summary, a loan pool description, information on program requirements, loan portfolio information as well as a description of the underwriting process, including the organizational structure and the underwriting criteria.



RESOURCE

Section 108 Application Tool

HUD provides an application tool with a list of topics that grantees should cover in their application package:

- HUD Section 108 Application Tool

Photo by freepik courtesy of Freepik

EXPLAINER

The Loan Pool Application

An effective loan-pool application should include the following elements:

- **Executive Summary**
  - Amount of requested Section 108 financing
  - National objectives and eligible activities
  - Objectives of the loan pool
- **Loan Pool Description**
  - Goals for the loan pool based on equitable plans and partnerships
  - Sources and uses of loan pool funds
- **Program Requirements**
  - National objectives and eligible activities
- **Loan Portfolio Information**
  - Loan amounts, terms, and interest rates
  - Repayment schedule
- **Delivery System**
  - Summary of delivery system
  - Organizational chart including the staff or partners responsible for managing the loan delivery system
- **Underwriting Criteria**
  - The criteria for credit review
  - Additional security
  - Conformance to public benefit, as applicable
- **Certifications**
  - Confirmation that the application is valid and follows federal requirements

Executive Summary

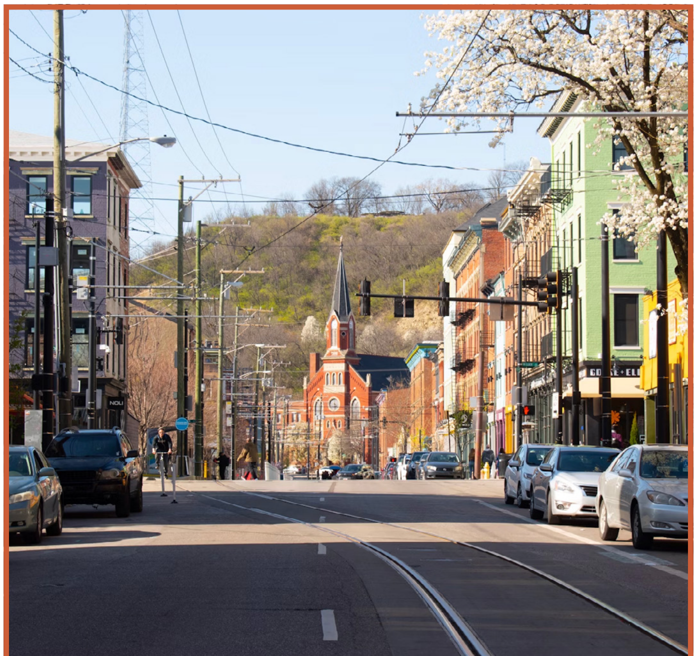
Most application packages begin with an executive summary that specifies the requested amount of Section 108 financing for the loan pool. The executive summary may also briefly describe the goals for the loan pool as well as the applicable national objectives and eligible activities.

The requested amount of financing must be equal to or less than the grantee's total available Section 108 authority and in increments of $1,000. The grantee's Section 108 authority is calculated as five times their annual allocation of CDBG funds less any currently outstanding Section 108 loans or commitments. See Chapter 1 for a sample calculation and the link to HUD's report on the "Current Availability of Section 108 Financing". Most grantees request the full amount of their Section 108 authority for their loan pool because they can use less than the full requested amount without negative consequences.

Loan Pool Description

The loan pool description provides detail on the grantee's goals for the loans. Chapter 4 offers guidance on developing goals based on equitable community planning efforts, partnerships, physical assets, and pipeline projects. Accordingly, the description should explain how the projects funded by the loan pool will build on existing plans, strengthen partnerships, leverage assets and opportunities, and advance equity. The description should specify the types of projects or activities that the loan pool will support, and the proposed allocation of loan pool funds to the eligible activities. It should also identify any targeted geographies.

Grantees should include additional information that supports the loan pool description as attachments or appendices. Common attachments include the amendments to the Consolidated Plan and Annual Action Plan, excerpts from planning documents, and descriptions of the project pipeline or other market analyses.



CASE STUDY

Loan Pool Description

The city of Cincinnati, Ohio requested $34 million to finance affordable housing developments. In the 'Loan Pool Description' section of their application, the city outlined their equity goals, including the need for affordable housing and the importance of providing financing to overcome barriers to entry and fill capital gaps for non-profit and community-based developers. In this section, the city also detailed their public planning process, led by the city Council's Affordable Housing Subcommittee, as well as their partnership with the Cincinnati Development Fund to administer the loan pool and leverage additional resources. Finally, the city highlighted the demand for financing based on the pipeline of projects that responded to their most recent Notice of Funding Availability (NOFA) for affordable housing.

Source(s):
[Draft Section 108 Loan Pool Application.pdf (cincinnati-oh.gov)]

Program Requirements

For program requirements, the application should specify which eligible activities and national objectives are allowable for projects financed by the grantee's loan pool, with the appropriate citations from the Code of Federal Regulations.

Chapter 1 lists the eligible activities for Section 108 loans, which are the same as CDBG with a few differences. As an example, for their loan pool, the city of Toledo prioritized the following eligible activities: Special Economic Development activities (24 CFR 570.703(i) and 24 CFR 570.203-204), Housing Rehabilitation (24 CFR 570.703(h)), Public Facilities (24 CFR 570.703(l)) and Acquisition of Real Property (24 CFR 570.703(a)). The city also included a breakdown of approximately what portion of the loan pool financing they expect to allocate to each activity.

Chapter 4 explains that grantees most often select national objectives under the category of Benefit to Low- and Moderate-Income Persons or Households (LMI Benefit). For national objectives, the city of Toledo selected LMI Housing (24 CFR 570.208(a)(3)), LMI Job Creation or Retention (24 CFR 570.208(a)(4)), and Area Basis for the Elimination of Slums and Blight (24 CFR 570.208(b)(1)).

RESOURCE

National Objectives and Eligible Activities

Further information about eligible activities and national objectives can be found in the Basically CDBG Manual:

- Basically CDBG Manual for entitlement grantees

Loan Portfolio Information

The loan portfolio information outlines the loan amounts, terms and interest rates that the grantee intends to offer. The framework should be compatible with the kinds of projects that the grantee expects to finance and with a low-risk credit profile balanced by equity goals.

The interest rate is based on the variable and fixed rates assigned to Section 108 loans during the interim and permanent financing periods, respectively. Chapter 1 describes the calculations for the variable and fixed interest rates. Grantees may want to add a spread on the interest rate of 0.25% to 1% for administrative costs or a loan loss reserve.

Within these terms, grantees can be flexible by offering interest-only periods, by decreasing the spread on the interest rate and by accepting alternative sources of equity for the loan-to-value ratio. Grantees should explore these options in conversation with HUD.

Grantees approach loan portfolio information differently in their applications. For example, the city of Toledo summarized their terms through a series of tables. Their Sources and Uses table includes the maximum loan amount and minimum loan-to-value ratio; and the Repayment Schedule table shows an example interest rate, loan term, and amortization schedule. Meanwhile, the city of Cincinnati describes their terms in a narrative that details how they determine the loan amounts, terms, and interest rates specifically for affordable housing developments, which is the focus of their loan pool.

EXPLAINER

Loan Loss Reserve

Some grantees dedicate a spread on the interest rates for Section 108 loans to a loan loss reserve that becomes additional security for late payments or loan defaults. A 1% spread across a portfolio of Section 108 projects typically results in a loan loss reserve of 7% to 8% of the total value of the loan pool.

Delivery System

In the application, grantees must provide an overview of the delivery system for the loan pool, highlighting the grantee's organizational capacity. Chapter 3 describes the options for building capacity for a Section 108 program and Chapter 6 describes the loan delivery system. The delivery system should include processes for marketing, screening, packaging, approving, closing, and disbursement, as well as long-term monitoring and reporting.

The organizational capacity may include grantee staff, partner agencies, third-party consultants, a loan committee of community residents and stakeholders, or a combination. For programs that are led by staff, grantees often provide an organizational chart and resumes to illustrate staff roles, responsibilities, and qualifications. If a partner agency is selected to manage all or part of the Section 108 loan pool as a subrecipient, then grantees should include information on the agency's capacity as well as their responsibilities within the delivery system.

Underwriting Criteria

Like the loan portfolio information, the underwriting criteria should be compatible with the type of projects that the grantee expects to finance and with the grantee's level of risk tolerance. The most common types of projects include public infrastructure, real estate development, and business development. Typically, public infrastructure is a Level I transaction with the grantee or a related public agency as the borrower, while real estate and business loans are Level II transactions with third-party borrowers. Chapter 6 details Level I and Level II transaction types.

HUD has developed comprehensive guides on underwriting real estate loans and business loans to third-party borrowers. In general, real estate loans support the development or improvement of real estate for rent; and the loan payments come from the property's operating income. Business loans support working capital for business growth, the acquisition of machinery or equipment, or the acquisition of commercial property for business operations; and the loan payments come from the operations of the business.

There are a few differences between underwriting real estate and business loans. For real estate loans, underwriters review the real estate market conditions that support the revenue, expense and occupancy projections for the property; while for business loans, underwriters review the business model and the market conditions that support the growth and profitability projections for the business.

The DSCR and LTV calculations are also distinct. For example, for real estate loans, the city of Toledo requires a minimum DSCR of 1.20 based on the net operating income of the property and a maximum LTV of 80% based on the property's appraised value. For business loans, the city requires a DSCR of 1.20 based on the net cash flow of the business in the prior year and an LTV between 60% and 80%, depending on whether the collateral is real estate, equipment, receivables, or inventory.

RESOURCES

Guidelines for Underwriting Section 108 Business and Real Estate Loans

HUD offers multiple resources for grantees on underwriting:

- **Underwriting Income-Producing Real Estate Projects: Section 108 webinar**
- **Section 108 Underwriting Guidelines for Income-Producing Projects**
- **Underwriting Guidelines for Business Loans for Section 108 Loan Guarantee Recipients**

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Table IV. Underwriting Criteria	
Criteria	**Details**
Project Feasibility and Readiness	Assess the market conditions for the project as well as key documents and procedures • For real estate loans, include permitting, site control, title insurance, land survey, and environmental assessment • For business loans, include sales growth and operating cycle
Project Financial Analysis	Review the financials for the project and confirm the accuracy of the projections • Determine the amount of the loan based on the DSCR, LTV, and public benefit standards, if applicable • Grantees often use a minimum debt service coverage ratio (DSCR) of 1.2 and a maximum loan-to-value (LTV) ratio of 80% based on common standards for low-risk loans.
Collateral and Loan Repayment Guarantees	Ensure that the value of the collateral is sufficient to cover the loan payments in case of default
Borrower Experience and Management Capacity	Review the qualifications of the leadership team and key staff
Borrower Financial Capacity and Creditworthiness	Analyze the company's financial statements and review business and personal credit reports

Citation:
https://files.hudexchange.info/resources/documents/Section-108-Undewriting-Manual-Income-Producing-Properties.pdf

Certifications

In the application, grantees must include specific Section 108 certifications and other CDBG certifications. The certifications confirm that the application is true and valid and that it follows federal requirements, including the citizen participation process and the pledge of CDBG funds.

RESOURCE

Certifications for Entitlement Grantees

HUD has a certification form for entitlement grantees and offers individual guidance on certifications for states and non-entitlement communities:

- Certifications to Accompany HUD Section 108 Loan Guarantee Program Applications for Entitlement Public Entities

The Application Process

Application Development

The timeline to prepare the application depends on the grantee's capacity to draft it as well as to gather and respond to feedback from HUD. Grantees should consider Consolidated Planning and/or Annual Action Planning processes to synchronize citizen participation processes where possible.

To apply for access to Section 108 financing, grantees must include a description of their proposed Section 108 program in their Consolidated Plan and Annual Action Plan, either as part of developing those documents or as substantial amendments to existing documents. In either case, a public comment period is required, so grantees should initiate it early in the application development process.

For the call, grantees should be prepared to speak about the overall objectives of their Section 108 loan pool; priority activities or projects in the pipeline and how they align with existing plans; the internal or external capacity that will implement the loan delivery system; and any new or existing partnerships with local lenders and other stakeholders. HUD will likely provide recommendations during the call that grantees should incorporate into their application development process.

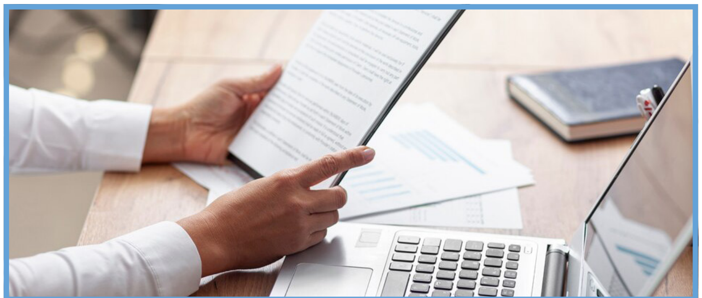
In addition, HUD encourages grantees to submit their draft applications during the citizen participation period to get early feedback and then incorporate any suggestions prior to formal submission, speeding up the process.

QUICK TIP

Loan Guarantee Fee

The Loan Guarantee Fee is an additional percentage of each Section 108 loan that is paid to HUD for the agency's costs to administer the program. The percentage changes each year; but for Section 108 loan pools, the percentage for the year that the application is submitted applies to all future loans. Grantees should consider current market conditions and potential changes to the fee as they develop their applications and timelines for submission.

Grantees should begin to communicate with HUD as they develop their applications and prior to submission. Grantees should schedule a call with both their HUD Field Office staff and HUD's Financial Management Division staff to speak with representatives of both offices together.



RESOURCES

Section 108 Application Development

HUD has recorded a workshop on the Section 108 program application process:

- **HUD's Section 108 Loan Guarantee Program webinar**

HUD also offers technical assistance on the Section 108 application process and other aspects of the program:

- **Section 108 Technical Assistance**

Photo by freepik courtesy of Freepik

Application Approval

Once the application is submitted, HUD typically approves it within three months. However, HUD's approval depends upon the quality and completeness of the application. Grantees should respond in a timely manner to any feedback or requests from HUD to continue advancing the process.

Following HUD's approval, the grantee's borrowing authority is valid for five years. If a grantee has issued loans consistently during the five-year period, but funds remain available, HUD typically grants an extension of the borrowing authority for another five years.

Grantees should maintain consistent communication with their HUD Field Office during the launch of the program to demonstrate progress and discuss any delays.

QUICK TIP

Timeline for Approval

Grantees should communicate the likely timeline for approval of the loan pool application, as well as the timeline for individual project submissions and approvals, with partners and prospective borrowers to set appropriate expectations.

Photo by ijeab courtesy of Freepik

Chapter 6: Creating an Effective Delivery System for a Section 108 Loan Pool

Introduction

To successfully administer Section 108 loans, grantees should develop a loan delivery system that supports each step in the process from marketing to long-term portfolio management.

In this chapter, we describe the components of an effective delivery system, including marketing to prospective borrowers, screening potential transactions and conducting rigorous underwriting, packaging the loans for HUD approval, closing and disbursement procedures, as well as the ongoing management of the loan portfolio.

The Loan Delivery System

For each component of the loan delivery system, grantees should carefully determine the capacity they will bring and the procedures they will follow. Grantees should document the procedures, both with internal checklists and with a summary in the Underwriting Process section of the loan pool application, as described in Chapter 5. All procedures must align with Section 108 and other federal requirements.

After the loan delivery system is established, grantees should closely monitor its implementation for any issues that arise.

Figure V. Section 108 Loan Delivery System

STEP 1	Marketing
STEP 2	Screening
STEP 3	Packaging
STEP 4	Approval
STEP 5	Closing
STEP 6	Disbursement
STEP 7	Portfolio Management

Marketing

With a loan pool, grantees should market the available financing in order to build a pipeline of projects. In marketing materials, grantees should highlight the advantages of Section 108 loans, including the longer terms and fixed interest rates. Grantees should also note the program requirements, including the eligible activities.

QUICK TIP

Program Requirements

Third-party borrowers are likely not familiar with the details of Section 108 requirements. Rather than attempt to make an eligibility determination themselves, potential borrowers should be encouraged to submit information about their projects early in the process so that knowledgeable program staff or partners can make the determination. If the project is eligible, then potential borrowers should proceed with additional conversations or application materials.

We also recommend that grantees describe their goals for the program in marketing materials, including their priorities for project types, targeted geographies and desired equitable outcomes. Chapter 4 provides guidance on developing equitable program goals and strategies.

The marketing should be directed to potential borrowers as well as local stakeholders that are connected to borrowers. Depending on the program, potential borrowers may include community-based development organizations, community development finance institutions, real estate developers or commercial businesses. Other stakeholders may include bankers, attorneys, commercial realtors, philanthropic funders, and economic and business development organizations.

Open Solicitations

Most grantees market their programs as open solicitations for potential borrowers to present projects. This supports a robust pipeline with borrowers presenting qualified projects based on their development timelines.

Often open solicitations are posted on websites with other public funding and financing opportunities. For grantees, this includes the websites for their community and economic development departments or the websites of partner agencies, such as redevelopment authorities or regional planning commissions.

CASE STUDY

Section 108 Program Website

The city of Toledo, Ohio maintains a webpage on their site to promote their Section 108 loan pool to prospective borrowers. The webpage provides a brief overview of the benefits of Section 108 loans, outlines eligible activities, and offers examples of eligible projects. It also features a series of questions and an interactive map to help prospective borrowers determine whether Section 108 financing is a good fit for their projects. For those interested in pursuing Section 108 financing, the page includes a link to a pre-application form where prospective borrowers can introduce themselves and their projects to the city.

Source(s):
Section 108 Financing on the City of Toledo's website

To enhance the open solicitation process, we recommend that grantees host an annual forum for potential borrowers and other stakeholders to learn about the Section 108 program and any project highlights from the previous year.

Requests for Proposals

Grantees may also solicit projects for Section 108 loans through a Request for Proposals (RFPs) or a similar process. RFPs are useful tools for specific opportunities or strategic priorities. For example, a grantee may issue an RFP to redevelop a large publicly-owned commercial lot in a low-income neighborhood, offering both the land and a Section 108 loan as incentives to potential developers.

RFPs limit the types and timelines of potential projects, so grantees should consider limiting the Section 108 loan funds dedicated to RFPs so that the remaining funds are available for other project opportunities as they arise.

Screening

The screening process involves a detailed review of project eligibility and creditworthiness. The eligibility review confirms compliance with Section 108 and other federal requirements, while the credit review confirms compliance with the underwriting criteria, as described in the loan pool application. To successfully screen projects, grantees should have the capacity to complete both types of review.

We recommend that the screening process begins with a pre-application or a conversation with the prospective borrower. Through the pre-application, grantees should attempt to quickly identify issues related to eligibility or credit. Grantees should also determine if the project advances the goals of the loan pool and the desired equity outcomes. Based on the program's goals and any eligibility or credit issues, grantees should decide whether to invite the borrower to submit a full application for project financing.

As part of the full application, the prospective borrower should submit any additional information that is needed to demonstrate conformance with the loan pool's eligibility and credit requirements. The level of detail should be proportional to the project's size, scope, and complexity. For example, in Toledo, the city requests additional documentation for projects that request more than $1 million in Section 108 financing, such as financial statements completed by a certified public accountant and appraisals by an independent qualified appraiser.

Credit Review

Chapter 5 describes key underwriting criteria in more detail. To summarize, grantees should review documentation on project feasibility, project finances, sources of collateral, the borrower's management experience, and the borrower's financial capacity and creditworthiness to ensure it complies with the underwriting criteria established in the loan pool application.

Eligibility Review

For eligibility, grantees should determine whether the project meets the requirements of an eligible activity and national objective listed in the loan pool application. If the eligible activity is a Special Economic Development activity, then the project must also conform with HUD's "Guidelines and Objectives for Evaluating Project Costs and Financial Requirements" in Appendix A of 24 CFR Part 570, as well as HUD's public benefit standards, a maximum dollar amount in Section 108 financing per job created or retained or per LMI person served.

Further, based on the eligible activity and the category of borrower, grantees should determine what types of expenses are allowable for Section 108 financing. For example, for new construction of mixed-use development led by a for-profit developer, Section 108 can only support the vertical construction of the commercial component of the development. Table V provides guidance on eligible costs and offers other key considerations when determining the eligible activity for a project. Please refer to CDBG Eligible Activities Guide for more information.

Table V. Section 108 Eligible Activities			
Eligible Activities	**Requirements***	**National Objectives**	**Considerations***
Acquisition of Real Property	• Land, air rights, easements, water rights, rights of way, buildings, and other real property, improvements, interest in other real property • By **grantee or a public or private nonprofit entity** (purchase, long-term lease (15 years), donation, etc.) • If new construction, must be already constructed and for sale on open market • Eligible costs include costs necessary to affect acquisition (i.e., soft costs and related fees), but do not include costs for moveable equipment, furnishings, or machinery (eligible under Special ED)	• Qualifies based on the use of the property following acquisition • For example, if acquiring an existing multifamily property and the property remains housing, use the LMI Housing national objective • Slums and Blight could also apply, if in locally designated redevelopment area	• If property acquired is transferred to another entity, the property must be sold to the entity at the current market value, unless the property will continue to meet a national objective • Displaced persons subject to uniform relocation assistance • Additional rehabilitation may be required for the property, which could be eligible under another activity (i.e., housing rehabilitation) • Underwriting guidelines apply
Housing Rehabilitation	• Privately-or publicly-owned buildings and improvements for residential purposes, including low-income public housing and manufactured housing (if part of permanent housing stock) • Assistance to **for-profit or non-profit** entities • Eligible costs include acquisition costs, soft and hard costs, refinancing (if necessary), systems and structural fixtures (heating, sprinkler, etc.), conservation, water and sewer, accessibility, incidental infrastructure, conversions, and historic preservation	• LMI Housing (rents must be affordable) • Slums or Blight Area • Slums or Blight Spot	• 8+ units triggers Davis Bacon • If mixed-used, decide how to support the project: commercial, housing, or both • 51% of units occupied by LMI households • Affordable rents, typically Fair Market Rents • Underwriting guidelines apply

Table V. Section 108 Eligible Activities			
Eligible Activities	**Requirements***	**National Objectives**	**Considerations***
Special Economic Development	• Acquire, construct, rehabilitate, reconstruct or install commercial/industrial buildings or equipment **by recipient or subrecipient** – 24 CFR 570.203(a) ◦ Must be non-profit or public entity, and cannot fund fixtures, furnishings or equipment (FFE) • Assistance to **for-profit businesses** (hotel, grocery store, factory, etc.) – 24 CFR 570.203(b) ◦ Must be **for-profit entity** with confirmed ownership structure, and FFE costs are eligible	• Typically LMI Jobs and grantee must monitor for a reasonable timeframe (even if target jobs were met), but may qualify for presumption which reduces documentation requirements • Potentially Slums and Blight	• Triggers public benefit and voluntary underwriting requirements (24 CFR 570 Appendix A) • Davis Bacon applies to construction contracts over $2,000
Public Facilities / Improvements	• **Grantee or non-profit** can acquire, construct, reconstruct, rehab or install public facilities and improvements • Must be open to the public	• LMI Service Area (primarily residential and 51% LMI households) • Must document nature, location, accessibility, comparable facilities, and boundaries of the facility service area	• Davis Bacon applies to construction contracts over $2,000 • Infrastructure improvements must be in public ownership at the time they are funded/completed • General maintenance or operating costs are ineligible

* Other requirements and considerations apply.

RESOURCE

Section 108 Eligible Activities

The *Basically CDBG Manual* provides more information on eligible activities:

- Chapter 8: Economic Development & Section 108

Packaging

For each project that passes the screening process, grantees must prepare a credit memo or similar document that demonstrates the project's compliance with the eligibility and credit requirements. HUD outlines the key components of the credit memo in the guides on underwriting real estate loans and business loans to third-party borrowers, linked in Chapter 5.

In addition to the determinations for eligible activity and national objective, the package must also include documentation of compliance with other federal requirements, such as environmental review, labor standards, relocation assistance, and fair housing. For the credit requirements, the package must include financial statements that demonstrate compliance with the underwriting criteria. Finally, it should include all other relevant attachments, such as appraisals and design schematics.

Closing

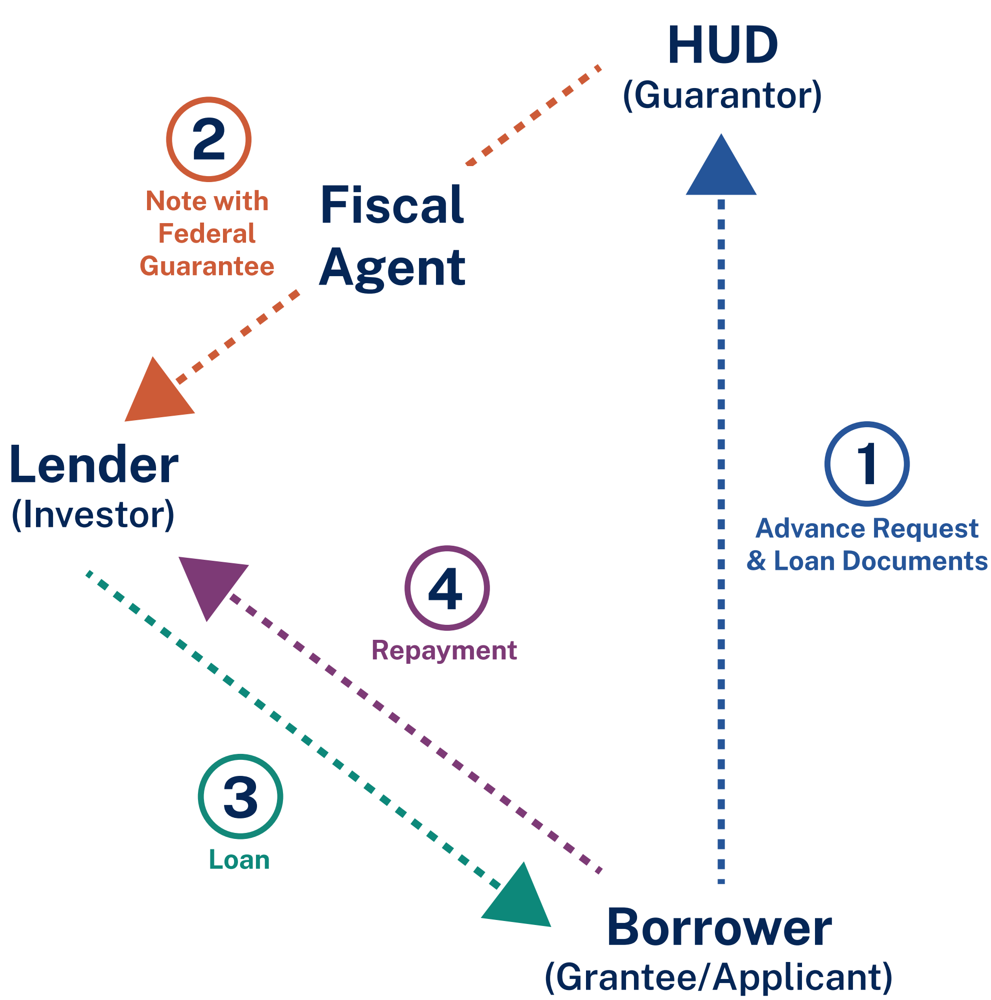
The loan closing procedures vary depending on whether the grantee borrows the funds for projects led by a public entity in a Level I transaction or loans the funds to a third-party organization, developer, or business in a Level II transaction.

Level I Transactions

In a Level I transaction, the grantee borrows funds. In the graphic, the grantee is the borrower that requests a guarantee from HUD. HUD provides the guarantee to the fiscal agent, which coordinates with the investors. The fiscal agent issues loan funds to the borrower and the borrower repays the loan to the fiscal agent, according to the amortization schedule.

Once approved, HUD manages the closing for Level I transactions for both the interim financing and the conversion to permanent financing at the next public offering. HUD prepares boilerplate Level I closing documents, while the grantee provides an opinion of counsel and, depending on local requirements, a council resolution.

Figure VI. Level I Transactions - Flow of Funds: Project by the Applicant



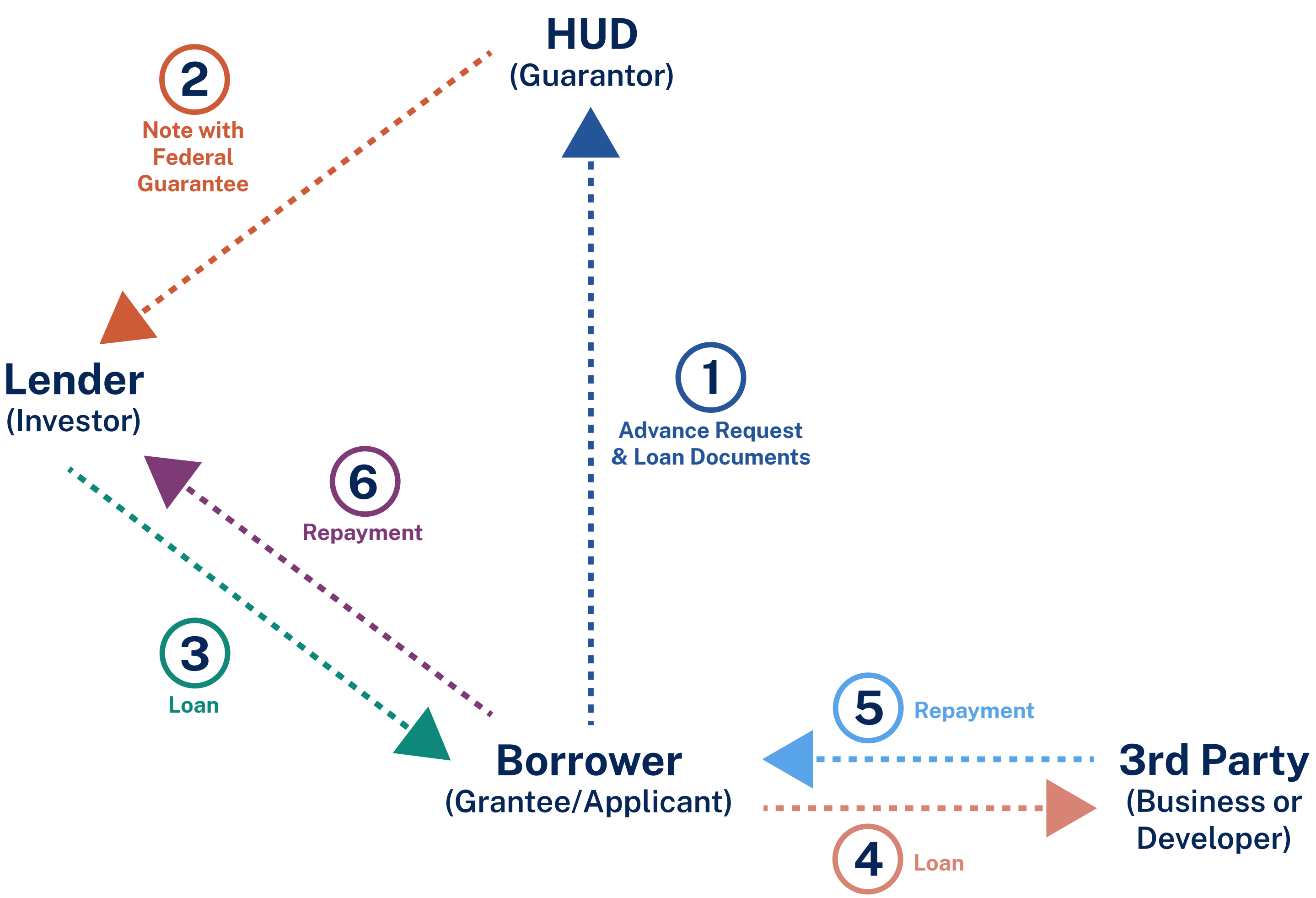
Adapted from HUD's Basically CDBG Slides

Level II Transactions

In a Level II transaction, the grantee is still the borrower that follows the same process with HUD, the fiscal agent and the investors as in a Level I transaction. However, there is an additional step in a Level II transaction in which the grantee lends the funds to a third party, the third party repays the grantee, and then the grantee repays the fiscal agent.

To prepare the closing documents for a Level II transaction, the grantee should use their in-house counsel or an outside attorney. Depending on the type of project, the documents vary but often include a Loan Agreement, a Note, a Jobs Agreement, a Deed of Trust or Mortgage, a UCC filing, and a form of General Lien or Guarantee.

Figure VII. Level II Transactions - Flow of Funds: Project by Third Party



Adapted from HUD's [Basically CDBG Slides]

Approval

Prior to submitting the package to HUD, grantees should follow their internal approval process for Section 108 loans. The process may involve staff, elected officials, a loan committee, or a combination of those. Grantees should determine the local requirements and include the internal approval process in the procedures for the loan delivery system.

Once the package is prepared and approved internally, submit the package to HUD for review and approval. Typically, HUD Field Office staff review both the eligibility and credit determinations for the project. However, the national HUD Section 108 staff often also contribute to the review. Grantees should submit the package to both the field office and the national HUD office to ensure coordination.

Depending upon the quality of the screening by the grantee and the completeness of the loan package, HUD typically approves projects for loan pools within two or three months.

QUICK TIP

Communication with HUD

Like the loan pool application, grantees should communicate with HUD field office staff and HUD headquarters staff in advance of submitting the credit memo for a project. The communication should begin during the screening process, especially if the grantee has questions or anticipates questions from HUD on eligibility or credit requirements. It should also occur during the packaging process to inform HUD about an upcoming project that aligns with the grantee's goals for the loan pool.

Disbursement

Grantees should procure the services of a custodial lender to disburse the loan funds for Level I and Level II transactions. The custodial lender establishes and manages the custodial accounts, which include the Loan Guarantee Account, the Loan Repayment Account and, for Level II transactions, the Reserve Account.

Loan Guarantee Account

The Loan Guarantee Account receives disbursements from the fiscal agent and then disburses the funds to the borrower.

Loan Repayment Account

The Loan Repayment Account handles the reverse cash flow as the Loan Guarantee Account. The borrower places repayment funds in this account and then the custodial lender wires them to the fiscal agent, according to the amortization schedule.

For Section 108 loans, there are typically two payments each year. The first includes principal and interest and the second is interest-only.

Reserve Account

Also known as a sweep account, the Reserve Account is typically established for a Level II transaction to receive any spread on the interest rate that the grantee has included in the loan terms. The Reserve Account may also hold monthly payments from the third-party borrower to accumulate interest for the grantee in between semi-annual payments to the fiscal agent. The grantee typically uses the interest to fund Section 108 program administration or a loan loss reserve.

Portfolio Management

Grantees should develop procedures for long-term portfolio management. For each loan, grantees must document conformance with federal requirements, including the eligible activity, national objective and public benefit standards. They must also collect and account for loan repayments and monitor the value of the collateral that secures the loan.

We recommend that grantees complete an annual review and inspection for each loan to ensure that the funds are used as intended; the project is on track to meet any public benefit requirements; and the collateral has maintained its value, with updated appraisals as needed.

Programmatic File Close-Out

Programmatic files include documentation that the project met eligibility and public benefit requirements. Once the project meets these, the grantee can close the programmatic file.

RESOURCE

Public Benefit Standards

Grantees can learn more about Public Benefit Standards in:

- **Guide to National Objectives and Eligible Activities for State CDBG Programs, Appendix C: Public Benefit Standards from the HUD Exchange program**

Financial File Close-Out

Financial files include accounting and financial statements, documentation of collateral, and any workout or foreclosure documents. The financial files remain open until the loan is fully repaid up to the twenty-year term.

EXPLAINER

Public Benefit Standards Requirements

Like CDBG, Section 108 public benefit standards apply to projects that qualify as special economic development activities. As grantees project the public benefit for a given project, they should document the method or rationale for the projection. For example, a borrower expects that the development of 10,000 square feet of retail space will create twenty jobs, or two jobs per 1,000 square feet. If, at the end of the loan repayment period, the retail space only creates fifteen jobs, or 1.5 jobs per 1,000 square feet, HUD will likely not impose a penalty because both the original projection and the final outcome are reasonable and demonstrate good faith effort. Grantees should also document any external factors, such as a natural disaster, that impact public benefit outcomes and communicate those promptly to HUD.

Chapter 7: Leveraging Section 108 with Other Common Sources of Financing

Introduction

Section 108 loan pools are most effective when they leverage other sources of capital to advance transformative and equitable development projects. When deployed effectively, Section 108 loan pools can be a catalyst in leveraging private and public resources toward transformative projects.

In this chapter, we discuss opportunities to pair Section 108 with other common sources of financing, including the New Markets Tax Credit, Low-Income Housing Tax Credit, Historic Tax Credit, and HOME program, loans backed by guarantees from the Small Business Administration (SBA), and private financing. For each source, we highlight opportunities for leveraging as well as important considerations. It is important to note that several of the sources explored in this chapter offer tax advantages to investors (i.e., NMTCs), while some provide direct funding to projects (i.e., HOME).

Sources of Public Financing

Public financing and funding often come with eligibility and reporting requirements, application and development timelines, and structures for securing collateral and repaying loans that may or may not be compatible with the Section 108 program. This section provides an overview of several common sources of public financing to inform grantees' decisions about how to leverage Section 108 loan funds.

EXPLAINER

Tax-Exempt Financing Sources

Section 108 loans cannot be subordinate to tax-exempt financing; and so this Guide does not provide detail on tax-exempt public financing sources such as municipal bonds, tax-increment financing (TIF) bonds (that are not taxable) or the 4% Low-Income Housing Tax Credit (LIHTC).

However, Section 108 can leverage tax-exempt public financing by contributing to related projects. For example, a grantee may use TIF financing to develop public infrastructure in a TIF district and then a Section 108 loan to support construction of an office building in the district.

The city of Sacramento used the Section 108 loan guarantee program to provide gap financing for a major housing redevelopment that utilized the 4% LIHTC. Section 108 was used to cover the infrastructure costs associated with the development including site work, a public park, community garden, utility coordination, offsite permits, and oversight of all the improvements.

Source(s):
https://files.hudexchange.info/course-content/section-108-loan-guarantee-program-webinar-series-leveraging-section-108-with-lihtcs/Leveraging-Section-108-with-LIHTCs-Case-Study-1.pdf

New Markets Tax Credit Program (NMTC)

The New Markets Tax Credit program (NMTC) provides federal tax credits to investors that make investments in eligible economic development projects in low-income communities or benefitting low-income populations. Like Section 108, NMTCs can serve as gap financing for projects that advance equitable outcomes and are less likely to receive conventional financing.

NMTC Structure

Most NMTC transactions are structured as leveraged investments. Grantees should become familiar with the key stakeholders and basic structure for the leveraged model.

The key stakeholders are the Community Development Entity (CDE) that receives the NMTC allocation from the federal government and stewards the transaction; the Tax Credit Investor that makes an equity investment and receives tax credits; the Leverage Lender that combines multiple sources of capital (loans, investments, grants and donations) into a single Leverage Loan that enters the transaction; the Qualified Active Low-Income Community Business (QALICB) that ultimately uses the funds for an eligible project; and the Project Sponsor that represents the QALICB in the transaction and may be the QALICB or a partner non-profit or developer.

The pillars of the structure include the Investment Fund, which is owned and controlled by the Investor and combines the leverage loan and the equity investment as the basis for the tax credits, and the Sub-CDE, which is a legal subsidiary of the CDE, but with a 99.99% ownership interest by the Investor. The Sub-CDE receives the funds from the Investment Fund and disburses them to the QALICB.

Table VI. NMTC Stakeholders

Term	Description
Community Development Entity (CDE)	The CDE is typically a non-profit financial institution, such as a CDFI. The CDE receives an NMTC allocation from the federal government and then further allocates the tax credits to projects. The CDE also participates in the NMTC structure as an intermediary between the Tax Credit Investor and the Project Sponsor.
Tax Credit Investor (Investor)	The Tax Credit Investor is typically a bank. The Investor makes an equity investment in a project in exchange for tax credits.
Leverage Lender	The Leverage Lender is typically a bank or CDFI. The Leverage Lender makes the Leverage Loan. Grantees may decide to participate in an NMTC transaction as the Leverage Lender by using Section 108 financing for the Leverage Loan.
Qualified Active Low-Income Community Business (QALICB)	The QALICB is typically a business. The QALICB is effectively the borrower that receives the Leverage Loan and the equity investment.
Project Sponsor (Sponsor)	The Project Sponsor is typically a business, developer, or non-profit. The Sponsor is effectively the guarantor that represents the QALICB in the NMTC structure and manages the transaction on behalf of the QALICB.

Table VII. NMTC Structure	
Term	**Description**
Leverage Loan	Except for the equity investment from the Tax Credit Investor, all of the other sources of capital, including loans, investments, grants, and donations, enter the Investment Fund as a single debt instrument called a Leverage Loan.
Investment Fund	The Investment Fund is owned and controlled by the Investor. The Investment Fund includes both the Leverage Loan and the equity investment from the Investor; it serves as the basis for the tax credits.
Sub-CDE	The Sub-CDE is a legal subsidiary of the CDE that is typically 99.99% owned and controlled by the Investment Fund. The Sub-CDE receives the combined equity investment and Leverage Loan from the Investment Fund and then disburses it to the QALICB.

RESOURCE

Section 108 and New Markets Tax Credits

HUD offers several resources on pairing Section 108 with New Markets Tax Credits (NMTC):

- Leveraging Section 108 with NMTCs

Considerations for NMTC

Eligibility

NMTC provides financing for operating businesses, commercial or industrial real estate developments, or mixed-use real estate developments with commercial income that exceeds 20% of the gross income of the property. All these types of projects are eligible for Section 108 loans.

Further, NMTC investments must benefit populations and geographies with metrics similar to the CDBG LMI Benefit national objective. For example, for projects that receive NMTC and provide services, one qualifying metric requires that at least 50% of the services benefit LMI individuals.

While the two programs have compatible eligibility requirements, grantees should clarify the specific requirements for Section 108 loans with all NMTC stakeholders and ensure that the requirements are met.

Reporting

Both programs require reporting on metrics related to the eligibility requirements. However, depending on how a Section 108 loan enters the NMTC structure, the business or developer that is directly responsible for meeting the requirements may not be a party to the loan agreement. Grantees may need to prepare a separate agreement specifically for Section 108 project reporting.

Collateral

Like the reporting requirements, the leveraged NMTC structure complicates the opportunities for collateral for Section 108 loans. Again, depending on how a Section 108 loan enters the structure, the options for collateral may be limited. Grantees should balance risk tolerance with equity outcomes and determine what level of security is necessary to participate in the transaction.

On the other hand, Section 108 together with NMTC can improve a project's loan-to-value ratio for a private lender. The equity from the NMTC and the Section 108 loan, when subordinate, can address financing gaps while meeting the LTV and other requirements of a private lender.

Repayment

The repayment of the leverage loan is typically structured as seven years of interest-only payments, often with a balloon payment at Year 7, although there is no requirement to structure it this way. This does not align with common practice for Section 108 loans. Typically, Section 108 loans require both principal and interest payments from the beginning. Furthermore, Section 108 loans have a ten-year lockout period during which the borrower cannot repay the loan.

HUD has supported grantees to address these issues by approving seven years of interest-only payments for NMTC projects that also qualify for Section 108 loans and then allowing the loan to amortize over the remainder of the term (up to Year 20). Through a defeasance provision, HUD has also allowed projects to make balloon payments before Year 10 to an account that then pays principal and interest for the remainder of the loan term.

Timeline

Because of the complicated structure, NMTC transactions require substantial involvement from lawyers and accountants. To avoid costly delays, grantees should ensure that the Section 108 loan is properly structured and approved before service providers are engaged to develop the NMTC documents.

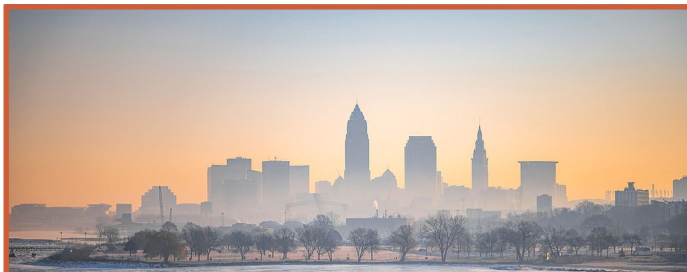
Three Scenarios for NMTC Transactions

There are three ways for Section 108 loans to participate in a leveraged NMTC transaction. Section 108 loans can enter the NMTC structure as a direct loan (or Leverage Loan) to the Investment Fund or as a source loan to the Leverage Loan and Investment Fund. Or grantees may offer Section 108 as a direct loan to the QALICB outside of the NMTC structure. We discuss each scenario and the implications for project reporting, collateral and repayment.

Direct Loan to NMTC Investment Fund

In this first scenario, the Section 108 loan is the Leverage Loan that packages all of the other capital into a single loan to the Investment Fund, where it joins the equity investment from the Tax Credit Investor as the basis for the tax credit. This scenario is advantageous for the project because the leverage structure requires a Leverage Loan and Section 108 likely offers better terms than other sources of financing.

However, this scenario comes with more risk for the grantee. As part of providing the Leverage Loan to the Investment Fund, the grantee takes an interest in the Sub-CDE as collateral, but the Investor still controls the majority interest. Then when the NMTC structure unwinds at Year 7, the grantee must ensure that an alternative source of collateral is assigned to the Section 108 loan.



CASE STUDY

Direct Loan to New Market Tax Credit Investment Fund

The city of Cleveland, Ohio provided an $8 million Section 108 loan as the leverage loan for a New Markets Tax Credit deal to develop Green City Growers, a hydroponic greenhouse operation under the Evergreen Cooperatives umbrella. As collateral, the Investment Fund assigned a portion of its interest in the Sub-CDE to the city. The city then engaged the Project Sponsor in a Collateral Agency Agreement to ensure that the project would meet Section 108 reporting requirements (the CDEs were the National Development Council and PNC Bank, and the Investor was PNC Bank.)

Source(s):
Combining NMTCs and Section 108 Loans, pg. 9 from the HUD Exchange program;
NMTC Project Descriptions, pg. 22 from the New Markets Tax Credit Coalition;
Green City Growers Cooperative on the Berusch Development Partners website;
Green City Growers on the New Markets Tax Credit Coalition website

Source Loan to NMTC Investment Fund

In this scenario, the Section 108 loan is made to the Project Sponsor or an affiliate. The loan becomes part of the capital that is packaged into the Leverage Loan and then enters the Investment Fund. This scenario still allows the project to include the Section 108 loan as part of the tax credit basis, but the project must find an alternative Leverage Lender.

For the grantee, this scenario is less complicated. The Project Sponsor or affiliate is responsible for reporting and provides security for the loan. But the grantee still needs to structure the Section 108 loan to conform with the NMTC repayment timeline.

CASE STUDY

Source Loan to New Market Tax Credit Investment Fund

In 2013, the city of Boston, Massachusetts provided a $3.2 million Section 108 loan for a New Markets Tax Credit (NMTC) deal to develop the Bornstein and Pearl Food Production Center, a food manufacturing facility and kitchen incubator. The city made the loan to the master tenant, CommonWealth Kitchen, an affiliate of the Project Sponsor and building owner, Dorchester Bay Economic Development Corporation (DBEDC). The city's loan was combined with other loans and grants for a $9.8 million Leverage Loan to the Investment Fund, which was packaged by the first mortgage lender, BlueHub Capital. Because the Section 108 loan was made to the master tenant, the collateral included a security interest in the tenant's leasehold mortgage in addition to an interest in the Sub-CDE. In 2020, following the seven-year NMTC compliance period, DBEDC sold the building to CommonWealth Kitchen, which will repay the Section 108 loan principal and interest over the remaining 13-year term of the loan (the CDEs were LISC and PNC Bank, and the Investor was PNC Bank.)

Source(s):
Combining NMTCs and Section 108 Loans, pg. 10 from the HUD Exchange program, **Unlocking the Power of NMTC, slides 5-6** from HUD; **Abello, Oscar. A Recipe to Build Accessible Space for Food Business in a Redlined Neighborhood** available on Next City, **New Markets Tax Credits** on Klein Horning website; **Redream, Build, Plan: Restoring America's Local Food Systems** from the Council of Development Finance Agencies; **Advancing Local Food Systems Through Development Finance** from the Council of Development Finance Agencies

Direct Loan Outside of NMTC Structure

In this scenario, the Section 108 loan is made directly to the qualifying business, or QALICB, outside of the NMTC structure. This is less advantageous for the project because the loan cannot be leveraged within the NMTC structure, reducing the tax credit basis and the equity investment from the Investor.

For grantees, this scenario is similar to Section 108 loans. The QALICB provides security for the loan, which is usually a lien on property or assets. The QALICB is directly responsible for project reporting as part of the Section 108 loan agreement. The loan terms can also follow typical Section 108 repayment schedules.

Low-Income Housing Tax Credit Program (LIHTC)

The Low-Income Housing Tax Credit program (LIHTC) provides federal tax credits to investors that make investments in eligible affordable housing developments that benefit low-income households. Aligned with the goals of Section 108, LIHTC provides gap financing to projects that improve housing opportunities for low-income residents and advance equity.

The competitive 9% LIHTC is distributed by states to developers through an annual application process. The 4% LIHTC is paired with tax-exempt public bonds and is not covered in this chapter.

RESOURCE

Section 108 and Low-Income Housing Tax Credits

HUD offers several resources on pairing Section 108 with Low-Income Housing Tax Credits (LIHTC):

- Leveraging Section 108 with LIHTCs

CASE STUDY

Direct Loan outside of New Market Tax Credit Investment Fund

In 2016, the city of Lexington, Kentucky provided a $6 million Section 108 loan directly to a developer for the conversion and redevelopment of the historic First National Bank Building in downtown Lexington. Originally built in 1913, the building is a national landmark in Lexington. After sitting vacant for decades, in 2016, the building was converted to a museum hotel with 88 guest rooms, a museum space, and a restaurant.

The project utilized a combination of financing vehicles in addition to the Section 108 loan, including private financing, federal Historic Tax Credits, New Markets Tax Credits, state tourism incentives, and tax-increment financing. As collateral, the city pledged CDBG funds in addition to 80% of new property tax and payroll-tax revenues for 20 years. Following a brief hotel closure during the COVID-19 pandemic, HUD offered the city a refinancing option of interest-only payments for several years, delaying principal payments. This ultimately prevented the grantee from defaulting on the Section 108 loan.

Source(s):
Adaptive Reuse p. 8–9 from Enterprise Community Partners: Section 108 Loan Guarantee Program Project Summaries - FY 2014 from HUD (pg. 5); Garcia, Teresa. Four Reasons HUD's Section 108 Program Works with Historic Tax Credits on the Novogradac website; Fortune, Beverly. Lexington council approves $1 million loan for 21c Museum Hotel from the Lexington Herald Leader.

Photo ("Downtown Lexington, Kentucky. The Lexington Financial Center (blue building) is the city's tallest") by Madgeek1450 courtesy of Wikipedia under the Public Domain license

Considerations for LIHTC

Eligibility

LIHTC has specific eligibility requirements that differ from but can align with Section 108 requirements. The minimum criteria is that 20% of the units are rented to LMI households; however, projects that receive the competitive 9% LIHTC allocations often meet the Section 108 minimum of 51% of units. For LIHTC, affordable rents are determined by a calculation based on the Area Median Income. Section 108 has flexible standards for affordable rents and so can adopt the LIHTC standards.

While the affordability requirements are compatible with Section 108, the most common type of project is new construction of affordable housing, which is only eligible for Section 108 under certain circumstances. If the new development is mixed-use, then Section 108 can finance the commercial component. Section 108 loans can also directly support the new construction of affordable housing if the project is led by a non-profit community-based development organization (CBDO) as part of a broader neighborhood revitalization, community economic development, or energy conservation effort.

For new housing developments led by for-profit developers or by non-profits for other purposes, Section 108 can finance site acquisition, site clearance, site improvements, nearby public infrastructure improvements, and the soft costs associated with those activities. For site acquisition, clearance, and improvements, the grantee must purchase and own the site and direct the work. Local land disposition regulations may then complicate the sale of the site to a specific affordable housing developer. Grantees should review local policies and requirements in this regard.

CASE STUDY

Low-Income Housing Tax Credit Program

The city of High Point, North Carolina provided a $650,000 Section 108 loan to develop a new 72-unit apartment complex, with 100% of units affordable to LMI households. The city used the Section 108 loan to acquire the site and complete site improvements. The city then conveyed the property to the developer. In the transaction, the Section 108 loan was in third position, after the commercial mortgage and a state affordable housing loan product. HUD agreed to this order of priority because all of the loans were at or under 80% loan-to-value ratio.

Because the project was a high priority, the city initially provided a letter of intent to commit HOME funds as part of the state's competitive annual application process for LIHTC and other housing finance programs. After the development received a LIHTC award, the city decided to offer a Section 108 loan of the same amount for the project to preserve HOME funds for other projects.

Source(s):
Section 108 Loan Guarantee Program Case Study: Avondale Trace Apartments - Section 108 and LIHTCs from the HUD Exchange program

Photo ("Downtown High Point") by Exwhysee courtesy of Wikipedia under the CC BY-SA 3.0 license

For any of the activities related to new construction, grantees must document the eligible activity and national objective; show that the allowable uses are reflected in the project budget; and then ensure that the construction draws follow the budget, with invoices that match the eligible activity. Even if a Section 108 loan can only support a limited aspect of a project, the loan can still be included in the tax credit basis, increasing the amount of potential equity in the project.

While it is more common for LIHTC to finance new affordable housing projects, it is more common for Section 108 to finance housing rehabilitation projects, including the conversion of buildings from commercial or industrial uses to residential use. Rehabilitation projects can and do receive LIHTC, and there are examples of these types of projects leveraging both LIHTC and Section 108.

Repayment

LIHTC brings significant equity to affordable housing development projects. On average, equity from LIHTC amounts to 50% of the total project cost[1]). Because LIHTC projects are more likely to have sufficient cashflow, grantees can support them with Section 108 loans while preserving CDBG, HOME, Housing Trust Fund (HTF) and other grant funds for projects that do not receive LIHTC.

Collateral

Section 108 is often subordinate to private sources. While this is typically allowed by HUD, the project must still conform to the Section 108 underwriting thresholds for repayment and security.

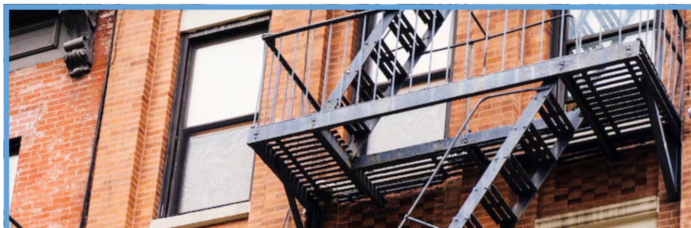
Timeline

LIHTC are generally awarded by states once per year through a competitive process. Projects that receive local financial support are often viewed favorably. If the project is a priority, based on the goals for the grantee's Section 108 program, then the grantee should seek HUD approval for the Section 108 loan prior to the annual application process. If the project is awarded LIHTC, then it must follow state and federal requirements for the development timeline.

Historic Tax Credit Program (HTC)

The Historic Tax Credit program (HTC) provides federal tax credits to investors, including owners and developers, that make investments in the preservation and rehabilitation of historic buildings. Eligible projects can claim up to 20% of qualified expenses for tax exemption. For example, if a qualified project has $1,000,000 in qualified expenses, they can offset $200,000 in federal tax obligations. In addition to the federal program, many states also offer HTC, which can add to the cost savings for investors.

There is a significant opportunity to pair HTC and Section 108. The tax credits are widely available and the structure is straightforward. Furthermore, the potential pipeline for projects continues to grow as buildings that are 50 years old or older become eligible for historic designation.



RESOURCES

Historic Tax Credits

HUD offers several resources on Historic Tax Credits (HTC):

- Leveraging Section 108 with OZ and HTC Financing
- Using the Historic Tax Credit for Affordable Housing

Photo by freepik courtesy of Freepik

[1] How the 9 Percent Tax Credit Program Works from the National Housing Conference.

Considerations for HTC

Eligibility

HTC projects may be industrial, commercial, residential, or mixed-use. Projects using HTC may qualify for Section 108 loans under the Rehabilitation or the Special Economic Development eligible activity in support of housing, mixed-use or commercial projects. If a project is categorized as a special economic development activity it will trigger public benefit and Appendix A underwriting criteria.

HTC does not have requirements for target populations or geographies, so projects only need to consider Section 108 requirements in this regard. However, HTC does have historic designation requirements. HTC only applies to buildings registered as historic or located in a designated historic district. If the designation is pending, then the grantee should include a contingency in the Section 108 loan agreement to withdraw the loan if the building or district is not approved as historic.

Repayment

HTC projects are required to generate revenue, so they should have cashflow to repay a Section 108 loan.

CASE STUDY

Historic Tax Credit Program

The city of Indianapolis, Indiana provided a $4,650,000 Section 108 loan to rehabilitate a former Ford factory into 132 residential units with 51% affordable to LMI households as well as 36,000 square feet of office and retail space. The Section 108 loan was used for site acquisition to purchase the factory building from Indianapolis Public Schools, an adjacent building from Ivy Tech Community College, and other smaller properties in the area. In addition to Section 108, the project benefited from federal HTC, state industrial revitalization tax credits, and a developer-backed TIF bond.

Source(s):
Ford plant redevelopment may get even bigger from the Indianapolis Business Journal; **Using Section 108 as a Financing tool with HTCs and OZ Equity slide 33** from the HUD Exchange program

Photo ("Aerial looking east northeast across downtown Indianapolis. The Indiana Statehouse is visible in the foreground.") by **tpsdave** courtesy of Wikipedia under the **CC0** license

HOME Investment Partnerships Program (HOME)

The HOME Investment Partnerships Program (HOME) provides grants to participating jurisdictions on a formula basis that can be used to support affordable housing in a variety of ways. HOME funds can be used as grants, direct loans, and loan guarantees for affordable homeownership and rental opportunities, as well as rental assistance.

RESOURCES

HOME Investment Partnerships Program

HUD offers resources on pairing HOME with other sources of funding:

- **HOME and CDBG Guidebook**
- **Using HOME and HTF Funds within Opportunity Zones**

Considerations for HOME

Eligibility

Like Section 108, the HOME program can fund affordable rental housing developments, including site acquisition, site improvements, rehabilitation, and new construction. Section 108 can also support these activities; but, as we discussed above for the LIHTC program, it can only contribute to new construction in limited ways.

A key difference between the programs is that HOME can support rental housing developments regardless of the number or percentage of affordable units; but it can only provide funds in proportion to the number of affordable units, with a funding cap per unit. Section 108, on the other hand, requires that at least 51% of the units are affordable; and it does not have a lending cap per affordable unit. As such, Section 108 can provide gap financing above and beyond the HOME cap.

HOME has an additional requirement that projects include a 25% match from non-federal sources for all HOME funds. Section 108 cannot provide the match as it is considered a federal funding source.

For HOME, affordable rents are determined by a calculation based on the fair market rent and applicable rent limits. Section 108, like CDBG, has flexible standards for affordable rents and grantees may choose to adopt HOME standards, use the fair market rent or determine reasonable rents based on a local market study.

RESOURCE

HOME REQUIREMENTS

HUD offers more information on applicable HOME requirements:

- **HOME Rental Housing on HUD Exchange**

Reporting

Like Section 108, projects that receive HOME funds must comply with annual monitoring and reporting requirements.

Collateral

HOME can be a grant, but more often it comes into development projects as a soft loan. Like Section 108, as a loan, the HOME program requires underwriting, which grantees can complete for both programs through the same process or loan delivery system. As soft loans, HOME funds can easily be subordinate to Section 108 loans.

CASE STUDY

HOME Investment Partnerships Program

The city of Kansas City, Missouri provided a $1,300,000 Section 108 loan to rehabilitate a former school into 46 residential units, with 100% affordable to LMI households. The city also provided $266,026 in HOME funds to subsidize six of the units. In addition, the project received LIHTC and HTC. The Section 108 loan served as the irst mortgage on the property, with a private lender providing a subordinate loan.

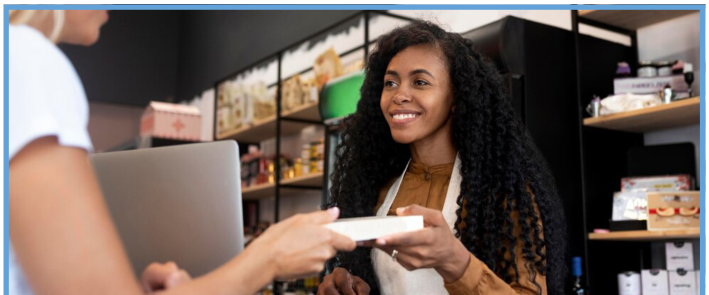
Source(s):
Section 108 Loan Guarantee Program Project Summaries – Fiscal Year 2015 pg. 22 from the HUD Exchange Program; **Faxon School Apartments** on the Sunflower Development Group website

Photo ("Downtown") by Stephen Edmonds courtesy of Wikipedia under the **CC BY-SA 3.0** license

Small Business Administration 7(a) Loan Guarantee Program (SBA 7(a))

Successful Section 108 loan programs partner with local banks to build a pipeline and finance projects. Often the bank loans that complement Section 108 loans are guaranteed by the Small Business Administration through the 7(a) Loan Guarantee Program (SBA 7(a)). As the largest SBA loan program, 7(a) guarantees billions of dollars in loans to small businesses each year.

The SBA 7(a) program provides guarantees for loan amounts up to $5 million; however, most of the loans that the program supports are less than $500,000.[2] For loans less than $150,000, the SBA guarantees 85% of the loan amount; and for larger loans, 75% up to a maximum guarantee of $3.75 million. Similar to Section 108, these guarantees are intended to facilitate financing for projects that cannot attract sufficient debt from conventional loan products.



RESOURCE

SBA 7(a) Loan Program

For more information on the Small Business Administration's 7(a) loan program, grantees can review the SBA website:

- 7(a) Loan Program

Photo by freepik courtesy of Freepik

Eligibility

The SBA 7(a) program supports operating small businesses and not developer-led real estate projects. Like Section 108, SBA 7(a) can finance working capital; furniture, fixtures and supplies; machinery and equipment; and the acquisition or improvement of real estate for business operations. Both Section 108 and SBA 7(a) can help refinance existing debt, with some caveats. For example, under CDBG, refinancing of existing debt is eligible as part of a rehabilitation project, however a project that only involves refinancing is not allowed.

A key difference between Section 108 and SBA 7(a) is that the SBA program only supports small businesses up to a certain size, whereas Section 108 can support businesses of any size. The size standards for SBA loan guarantees are specific to each industry and calculated as either a maximum amount of annual revenue earned by the business or a maximum number of employees at the business.

Collateral

The SBA 7(a) program has specific collateral requirements based on the amount of the loan and the value of the financed assets or other fixed assets. The SBA-backed loan cannot take a subordinate position on the collateral, so grantees may need to find other sources of collateral or negotiate other forms of security for Section 108 loans.

[2] SBA Announces End-of-Year Capital Benchmarks Showing Historic Support for Small Businesses Under Administrator Guzman from the Small Business Administration.

CASE STUDY

SBA Loan Guarantees

The Section 108 loan program for Atlantic City and County, New Jersey developed a partnership with a local bank. The Section 108 loans are limited to $400,000 or 40% of total project costs, whichever is lower. Most developers cannot contribute 60% of the total project cost as equity, so the bank provides SBA-backed loans for the other portion of the project cost.

Photo ("Atlantic City in the fall.") by Kealan Burke courtesy of Unsplash under the Unsplash license

Private Financing

Most Section 108 projects have private financing that is typically in first mortgage position and Section 108 is commonly in second position. Section 108 can help attract additional private financing in part because private lenders do not share the risk of loss from default, due to the pledge of CDBG funds, which can encourage riskier investment by private lenders. A 2012 study of the Section 108 Loan Guarantee Program noted that private financing represented the largest source of leverage for projects financed using Section 108.[3]

Considerations for private financing

Underwriting

Grantees should confirm if the applicant or developer has applied for private financing from a commercial lender and if the commercial lender has completed its underwriting review and has issued a firm commitment to lend to the project. For projects with multiple sources of financing, including private financing, grantees should seek a lien position on collateral that is senior to all other financing sources, where possible. However, Section 108 can subordinate to private financing if the project conforms to the underwriting criteria established for the loan pool in terms of debt coverage and loan-to-value.

Inter-Creditor Agreements

The senior lender may require an "inter-creditor agreement" which imposes restrictions on the subordinate lenders ability to act on collateral. Grantees should review these agreements carefully to ensure it can protect its interest in the event of default by requesting advance notification of actions by the senior lender and an opportunity to cure default, etc.

[3] Study of HUD's Section 108 Loan Guarantee Program from the HUD Exchange.

Chapter 8: Conclusion and Strategic Recommendations for HUD

This Guide serves as a roadmap for utilizing HUD's Section 108 Loan Guarantee program to foster equitable and transformative development, equipping CDBG grantees and their partners with the necessary tools to understand, secure, and leverage Section 108 financing.

By following the frameworks, strategies, and lessons presented in this Guide, grantees can better navigate the complexities of the Section 108 program, maximize the potential for equitable outcomes, and align their projects with broader community goals. The case studies and practical examples highlighted throughout the Guide underscore the transformative potential of Section 108 when leveraged effectively.

As a conclusion, this Guide offers recommendations on the future of the Section 108 program, recognizing that continuous improvement and adaptation are essential for program success. The following recommendations for HUD are aimed at enhancing access, streamlining processes, and ensuring that the program remains responsive to the needs of communities. They are designed to support HUD in fostering more equitable and impactful utilization of the Section 108 Loan Guarantee Program.

Chapter 1: Learning About Section 108 and Leveraging the Benefits for Your Community

- Encourage grantees to pursue Section 108 financing by:
    - Adding specific questions on Section 108 to eCon Planning Suite and Consolidated Plan and Annual Action Plan templates
    - Providing tools or other support for HUD field office staff to identify grantees that can benefit from Section 108 and connect with them
- Provide routine trainings or webinars during Annual Action Plan and/or Consolidated Planning cycles to educate grantees on Section 108 and available TA services
- Market the HUD Section 108 website, educational resources, and technical assistance
- Create additional tools, templates, or guides:
    - Provide resources on alternative sources of collateral for Section 108 loans other than CDBG funds
    - Develop sample application templates for both project-specific and loan pool approaches
    - Create tools for developers to consider project-specific requirements (e.g., a decision tree of key considerations per activity type)

Chapter 2: Deciding to Pursue Section 108 Loan Pool Financing

- Create informational guides and other resources specifically for civic leaders to learn about the benefits of Section 108, and its uses in specific market dynamics

Chapter 3: Building Internal and External Capacity to Support a Section 108 Loan Pool

- Offer training and peer learning opportunities for staff that administer Section 108 programs at grantee or partner agencies
    - Develop a specific Section 108 curriculum based on HUD's existing Section 108 resources
    - Establish a Section 108 peer network or online forum for grantees to share their lessons learned as well as tools and processes that they have developed
    - Offer Section 108 peer cohort opportunities based on region, eligible activities, or other commonalities
- Create resources for grantees that decide to partner with other agencies as subrecipients, lenders, or philanthropic funders
    - Create a template for Section 108 subrecipient agreements
    - Develop case studies on best practices for engaging subrecipients for Section 108 program administration
    - Create toolkits to help grantees engage financial institutions or philanthropic funders

Chapter 4: Establishing a Strategy-Driven Section 108 Loan Program

- Develop case studies on Section 108 programs that have supported equitable development plans, engaged in strategic partnerships, and built robust project pipelines
- Add a question to the Section 108 loan fund application tool that helps grantees assess equitable development opportunities

Chapter 5: Accessing Section 108 Financing

- Standardize the requirements and expectations for the Section 108 application among HUD staff and offices
- Establish transparent application and project approval systems, such as an online portal that tracks submissions and HUD internal reviews and approvals

Chapter 6: Creating an Effective Delivery System for a Section 108 Loan Pool

- Publish and share the standard level 1 closing documents and consider collecting level 2 closing documents from grantees to share as a resource
- Create tools to facilitate project screening, including both eligibility and credit review by project type
- Standardize the requirements and expectations for the credit memo for individual projects within a Section 108 loan pool
- Create a quick guide or similar resource that illustrates the proposed CDBG rule changes and how they impact Section 108
- Maintain an updated list and set of forms required to close on Level I and Level II transactions

Chapter 7: Leveraging Section 108 with Other Common Sources of Financing

- Create resources, such as quick guides, that provide clear and comprehensive information on pairing Section 108 with other sources of public financing
- Create resources that provide in-depth information on common structures for the capital stack for Section 108 projects

About Enterprise Community Partners

Enterprise is a national nonprofit that exists to make a good home possible for the millions of families without one. We support community development organizations on the ground, aggregate and invest capital for impact, advance housing policy at every level of government, and build and manage communities ourselves. Since 1982, we have invested $72 billion and created 1 million homes across all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands – all to make home and community places of pride, power, and belonging. Join us at enterprisecommunity.org.