

# CDBG Program Income

3/12/90

MEMORANDUM FOR: Raymond A. Harris, Regional Director- Regional Housing Commissioner, 4S

ATTENTION: Charles N. Straub, Regional Director for Community Planning and Development, 4C

Thomas Ficht, Director, Program Management Division, 4CM

FROM: Anna Kondratas, Assistant Secretary for Community Planning and Development, C

**SUBJECT: Community Development Block Grant (CDBG) Program Income DeKalb County, Georgia**

This is in response to Thomas Ficht's request for guidance on the proper method for computing program income for the scenario described below.

The policy position taken by the Department is based on the definition of program income under 24 CFR 570.500(a) and the reversion of assets provision under 24 CFR 570.503(b)(8)(ii). These two regulatory provisions taken together establish the basis for the following discussion.

## SCENARIO

The Candler Road Redevelopment Corporation (CRRC), a neighborhood-based nonprofit organization in DeKalb County, Georgia, acquired a vacant building for \$250,000. The DeKalb County CDBG program provided 50 percent of the acquisition cost (\$125,000) and a local bank loaned the balance of the acquisition cost (\$125,000) and secured its loan through a first position mortgage lien on the property. CRRC presently leases the building for a monthly rent of \$3,000 to an organization which provides day care services to low- and moderate-income families. CRRC uses this income stream to make interest-only payments to the bank of \$1,000 per month on the outstanding loan balance and for monthly costs associated with the maintenance and operation of the building which is presently \$500 per month. CRRC has recently negotiated a purchase option agreement with the child care center that would enable the center to acquire the property at the end of its twelve month lease at a sales price of \$300,000. The child care center has paid CRRC a non-refundable \$10,000 option fee that will be applied to the purchase price if the option is exercised.

## ISSUE ONE

What is the acceptable method of computing program income which is received monthly by CRRC through the lease payments made by the child care center?

## DISCUSSION

The October 20, 1989 letter from the DeKalb County Community Development Director described her understanding of how program income should be computed as follows:

1. Amount received by CRRC from monthly lease payments.....\$3,000
2. Subtract the monthly amount that CRRC pays to the bank.....1,000
3. Subtract monthly expenses relating to the maintenance and operation of the building....500
4. Remaining income per month.....\$1,500
5. Since CDBG funds were used to acquire 50% of the acquisition cost for the property 50% of the remaining income is CDBG program income (50% of \$1,500).....\$750
6. The remaining 50% is "unregulated" income...\$750

We have determined that the Director's understanding of calculating the CDBG share of program income as set forth above is correct, except that the monthly interest amount paid to the bank is not part of the "cost incidental to the generation of the rental income under 24 CFR 570.500(a)(1)(iii). While the costs of operating and maintaining a rental property are deductible from the rental income, the phrase does not include the acquisition costs, i.e., the interest paid on the acquisition loan.

The CDBG regulatory definition of program income under 24 CFR 570.500(a) reads:

". gross income received by the recipient or a subrecipient directly generated from the use of CDBG funds. When program income is generated by an activity that is only partially assisted with CDBG funds, the income shall be prorated to reflect the percentage of CDBG funds used."

Under 24 CFR 570.500(a)(1)(iii), program income includes:

"Gross income from the use or rental of real or personal property acquired by the recipient or by a subrecipient with CDBG funds, less costs incidental to generation of the income;" (Emphasis added).

Based on the regulatory definition of program income and the illustration of what program income may include, the CDBG program income generated in the scenario above would be computed as follows:

1. Amount received by CRRC from monthly lease payments.....\$3,000
2. Subtract incidental expenses related to the operation and maintenance of the building.....500
3. Remaining income per month.....\$2,500
4. Since CDBG funds were used for 50% of the cost of acquisition, 50% of the remaining income is CDBG program income (50% of \$2,500).....\$1,250
5. The remaining 50% is "unregulated" income...\$1,250

This is the computation assuming that the \$1,000 monthly interest payments on the acquisition loan (i.e., the 50% non- CDBG acquisition) will be paid out of the "unregulated" funds. If the CDBG program income is used for this cost, we would view the entire acquisition as CDBG-assisted and consequently the entire income of \$2,500 as CDBG program income.

The preceding discussion on calculating program income is not intended as general policy guidance, but applies only to this particular scenario. Since a particular method for determining program income depends on the unique characteristics of a project and how it is structured, we would have to advise you of the procedure to be used on a case-by-case basis.

In any discussion of program income where a subrecipient is involved, the regulatory provisions under 24 CFR 570.503 "Agreements with Subrecipients" and the provisions under 24 CFR 570.504(c) "Disposition of Program Income Received by Subrecipients" are extremely important. These provisions ensure consistent administration of the CDBG program when subrecipients are involved in undertaking CDBG-funded activities. These regulatory provisions should be brought to the grantee's attention and monitored on-site during regularly scheduled monitoring visits to assure compliance with program rules.

### **ISSUE TWO**

What is the acceptable method of computing program income generated by the sale of real property when a net profit will be realized when the initial cost of acquisition was only partially assisted with CDBG funds?

### **DISCUSSION**

The proper method of computing program income generated by the sale of this particular property would be computed by subtracting costs incidental to the sale of the property from the sales price. The remaining revenue would then be prorated to reflect the percentage of CDBG funds used (50% again assuming CDBG funds are not used to pay the \$1,000 interest payment to the bank). This percentage of the remaining funds would be program income.

The option fee of \$10,000 should be handled no differently than funds that would be received upon sale of the property; i.e., the fee should be distributed in proportion to the CDBG and local shares of the acquisition cost.

Should you have any questions or concerns relative to this policy position on the specific scenario described above, please feel free to contact the Entitlement Cities Division at (FTS) 755-5977.

cc:

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