

Float Loans in the CDBG Program

March 4, 1993

Mr. Norris V. Bacho
Director
Planning and Development Services Department
747 Market Street, Room 1036
Tacoma, Washington 98402-3793

Dear Mr. Bacho:

Thank you for your letter to Secretary Cisneros dated February 5, 1993. As Director of the Office of Block Grant Assistance I have been asked to respond to your letter concerning the use of Float Loans in the Community Development Block Grant (CDBG) program. The letter expresses your concern that the requirements outlined in CPD Notice 92-29 will limit the City of Tacoma's ability to use this financing tool.

Specifically, you object to the portion of the Notice that requires either that float loans be limited to a term of not to exceed one year or that the grantee identify the activities to be deleted or reduced in the event the loan is not repaid in accordance with the established schedule. Further, you suggest structuring float loans as demand notes, backed by letters of credit issued by financial institutions with credit ratings of A and above to eliminate the need for the limitations outlined in the Notice.

The purpose of CPD Notice 92-29 is to ensure that all required information is provided in the final statement and citizen participation is followed. The requirements concerning float funded activities are meant to give citizens an opportunity to review and comment on such activities, while providing an accurate accounting of these projects. We believe that the law authorizing the CDBG program concerning the final statement, and the associated presubmission requirements, requires that it deal only with how a grantee expects to use CDBG funds it will receive in the next program year. The sources of these funds would include both the new CDBG grant and any program income expected to be received during that year. In this single-year final statement context, the principal problem with float-funded activities is that repayment of a multi-year float loan (even if derived by calling a back-up letter of credit) will be made after the next program year. This means that to include activities in

the current final statement that will receive funding from the float repayment, a grantee is, in effect, committing funds that are to be received in the future. Such a commitment does not appear to me to be within the current statutory and regulatory framework for the final statement.

Some grantees apparently do not see a problem with carrying out additional activities with the float because they assume that they will receive sufficient additional CDBG grant funds in future years to continue funding previously budgeted activities until the float-funded activity generates program income. One problem with this approach is that there is no guarantee of such future funding of the CDBG program, nor that the program can avoid a substantial funding reduction. Even if there were a guarantee of future funding, we believe such an approach also has the effect of placing limitations on the

choices that the grantees and their citizens will have in planning for the use of those future funds. For example, a grantee relying on the availability of the float in the succeeding year to provide funding for activities in the current or earlier final statements might not be able to select new activities that would require more rapid outlays for that succeeding year. The Section 108 loan guarantee program is the only method currently authorized by statute for making commitments that are binding on future grant funds.

The Notice does not effectively limit CDBG float loans to one-year terms; longer term loans can be made. However, since the monies will not be available for use during the program year in which the loan is made, the grantee must delete or reduce other activities in its final statement by the forgone program income in that and subsequent years. In subsequent final statements, the grantee would have to identify the anticipated program income from such loan repayments until it was totally repaid and would only be allowed to identify activities covered by such program income (and the CDBG grant for that year).

The Notice also allows grantees to fund an activity with the float even if it is close to the end of a program year, provided the repayment terms are less than one year. Should a grantee choose this option, it would not have to decrease or reduce activities to balance the amount of the float funded activity in that same program year, as long as the anticipated program income is identified in the program year in which the float loan was made. As described above, the guidance provided in the Notice is meant to provide maximum citizen participation and still allow the use of float loans. Should an activity arise during the

course of a program year, I believe a grantee would still be able to fund it through a float, regardless of repayment terms determined by the grantee.

Your suggestion regarding reducing the risk of float loans by structuring loans as demand notes, backed by letters of credit by financial institutions is a worthy one, but it does not dismiss the one-year timing issue discussed above. Moreover, it has been HUD's experience with grantees acquiring letters of credit for this purpose that either unexpected legal issues arise making it impossible for the grantee to call the loan or that the cost or other implications of calling the loan result in the grantee avoiding doing so.

Thank you for your interest in the CDBG program.

Very Sincerely Yours,

(signed)

Don I. Patch
Director, Office of Block
Grant Assistance