

Use of CDBG Funds to Reduce the Indebtedness of a Public Facility

January 8, 1998

Ms. Linda Peters
Chair, Washington County
Board of Commissioners
155 North First Avenue, Suite 300
Hillsboro, Oregon 97124

Dear Ms. Peters:

On behalf of Secretary Cuomo, thank you for your letter of October 20, 1997, in which Washington County requests HUD's concurrence on the County's interpretation of the Community Development Block Grant (CDBG) regulations and the Housing and Community Development (HCD) Act of 1974, as amended, in a manner that would permit the use of CDBG funds to reduce the indebtedness on a public facility that was completed in 1995.

In your letter, you indicate that the Washington County CDBG program endorsed a proposal by the Community Action Organization (CAO), a non-profit entity, to construct a Multipurpose Facility and Child Care Center that would provide "one stop shopping" for clients of the wide range of services provided by the CAO. Washington County provided \$1,257,500 in CDBG funds for the construction of the facility. The CAO also raised \$1,018,000 from community donors, and to ensure that there would be sufficient funds to complete construction, CAO obtained a \$1,245,000 line-of-credit from a bank. The facility was initially occupied in late 1995 and was officially completed in 1996. When construction was completed, the bank reappraised the facility and provided less long-term financing than the CAO had originally been promised, leaving a shortfall of \$230,000. Thus began a series of events that has left the Agency operating at a deficit. Additional CDBG funds are needed to further assist CAO with its multipurpose facility, and the County wishes to pay some of the CAO's debt service on its commercial loan..

Washington County has been in contact with the HUD Oregon State Office regarding possible additional CDBG assistance for the facility. In a letter dated August 22, 1997, the HUD Oregon State Office advised the County that CDBG funds could not be used to pay off debt incurred by CAO for the Multipurpose facility. The State Office indicated in its response that the CDBG regulations at 24 CFR 570.201, public facilities, does not provide for CDBG funds to be used for refinancing existing indebtedness on a public facility. This part of the regulations is based on Section 105(a)(2) of the HCD Act of 1974, as amended, and HUD does not interpret the statute as generally permitting refinancing of existing indebtedness on a public facility as an eligibility category. The State Office also advised the County that waivers of the regulations that would, in effect, create a new "eligibility category" are not permissible.

The County contends that HUD's interpretation of the term "acquisition" under the particular facts of the subject case was applied too narrowly and that the HCD Act permits the use of CDBG funds as the County proposes. The County noted that HUD's position is that the acquisition is substantially complete when the subrecipient take title to the property. The County's position is that under the circumstances of this transaction, acquisition was not complete when CAO came into possession of the property. The CAO obtained possession in July 1995, however, the Agency conveyed "legal title" to the property to U.S. Bank and Washington County to secure its indebtedness. The CAO executed a Deed of Trust for both U.S. Bank and Washington County to secure its financial obligations. By virtue of those conveyances, CAO conveyed an interest in the property to a Trustee to hold as security for the benefit of the creditors. Under the facts of this transaction, the County has indicated that CAO does not have complete "title" to the property and is therefore, still in the process of "acquiring" the property under the terms of its obligations under its Deeds of Trust. The County contends that this request, to reduce the indebtedness of the CAO, is an element of the CAO's acquisition of the property and is additionally authorized under the Act.

Upon reviewing the County's arguments, HUD stands by its position that retiring an existing debt on property does not constitute a bonafide acquisition of the property. No change in title will result from the proposed provision of approximately \$400,000 to reduce the CAO's debt service on its bank loan. Thus no "acquisition" occurs by that transaction.

However, based on the facts of this particular case, there may be another option for Washington County to provide CDBG assistance to the CAO in a manner similar to that which has been proposed. It is noted that the beneficiary of the CAO's Multipurpose Facility and Child Care Center has already been provided significant CDBG assistance. Such assistance would indicate that the construction of the facility has been carried out in compliance with all applicable CDBG requirements, such as citizen participation, the National Environmental Policy Act (NEPA), Davis-Bacon, etc. Correspondence from Washington County indicates that initial limitations on the amount of available CDBG funds was the only reason the County did not contribute more CDBG funds to the project from the start. Given that the County now proposes to use subsequent years' CDBG funding to assist the facility, it may be possible to provide additional CDBG assistance for the construction of the facility pursuant to the pre-award cost provisions of the CDBG regulations at 24 CFR 570.200(h). This section of the regulations authorizes the grantee to use CDBG funds to reimburse certain costs that are incurred prior to grant award. Using the noted pre-award cost provisions, the County may be able to use CDBG funds to reimburse the CAO for additional actual construction costs for the facility under the eligibility category of 24 CFR 570.201(c), public facilities. Note that such reimbursement would be considered assistance to the pre-award construction of the facility not as acquisition or paying debt service. Thus, the County would need to maintain construction cost documentation, along with the "carrying costs" (i.e., interest), demonstrating its eligibility under 24 CFR 570.201 (c) rather than documenting just how much of the loan would be paid off for the CAO.

In most cases, it is very difficult to use the pre-award option because grantees cannot show that the initial construction complied with all applicable CDBG requirements. What distinguishes this case from others, is the fact that in order to use the CDBG funds at the beginning of the construction of the Multipurpose facility, CAO had to comply with all Federal requirements which has been documented. Because of its compliance with all of the requirements, Washington County can use the option outlined in this letter. For additional assistance, it is suggested that Washington County contact the HUD Oregon State Office to discuss what documentation is needed to comply with the regulations at 24 CFR

570.200(h).

Thank you for your interest in the Department's programs.

Sincerely,

(signed)

Richard J. Kennedy
Director,
Office of Block Grant Assistance