

The Imposition of HUD Regulations on Participants in SBA Section 503 and 504 Loans

October 7, 1988

Honorable John Glenn

United States Senate
Washington, DC 20510-6250

Dear Senator Glenn:

This is in reference to your letter to Secretary Pierce, dated June 9, 1988, requesting our response to a resolution passed by the City Council of Cincinnati. Your letter describes the resolution as opposing "(1) the imposition of HUD regulations on participants in SBA Section 503 and 504 loan programs, and (2) the recordkeeping requirements placed on certified development companies."

While the letter states that a copy of the resolution is enclosed, it was not received. Repeated efforts to obtain a copy have been unsuccessful. Rather than further delay a reply to your letter, this response is based on the short description of the resolution quoted above. We assume it refers to the documentation requirements involved when Community Development Block Grant (CDBG) funds are used by certified development companies (CDCs) to pay for their administrative costs in processing and servicing loans made in conjunction with the SBA Section 503 and 504 loan programs.

We are aware that there has been confusion about whether the CDBG national objectives requirements must be met when CDBG funds are used by CDCs solely for administrative costs. It has been the understanding of some CDCs that administrative costs are not subject to the statutory and regulatory requirement that each CDBG assisted activity meet one of the program's three national objectives:

1. benefiting low and moderate income persons;
2. aiding in the prevention or elimination of slums or blight;
3. meeting other community development needs having a particular urgency. In fact, all activities supported with CDBG funds must meet one the national objectives. However, the requirements for documenting compliance with national objectives differ depending on whether administrative costs were incurred in carrying out a specific activity or in administering the local CDBG program as a whole.

For many years HUD has drawn a distinction between the costs of administering a grantee's overall CDBG program and the administrative costs directly involved in carrying out a specific activity. The latter costs are considered to be part of specific activities and are eligible only if the underlying activity being administered is eligible and meets one of the CDBG national objectives.

This is the rule that applies when a CDC uses CDBG funds to pay the administrative costs of providing loans to small businesses. The CDC's administrative costs are part of an economic development activity and may be paid with CDBG funds only if the businesses use the loans for purposes which address the CDBG national objectives.

In contrast, to qualify as overall administrative costs, costs must be incurred in carrying out the program as a whole. Expenditures for general management, oversight, and coordination of the local CDBG program are eligible under this category. Documenting how such overall administrative costs comply with the national objectives is not required because they are incurred in support of a program of activities in which each activity addresses a national objective. A CDCs administrative expenses clearly do not fall within this category.

We recognize that CDBG program requirements may be difficult to comply with for CDCs but we believe that the requirements are necessary based on the CDBG statutory provisions. We also recognize the substantial impact CDCs have had on the creation of employment nationally and the important role of CDBG funds in helping to defray CDCs' administrative expenses. Therefore, we have been working with the Small Business Administration to identify possible changes in CDBG regulations which would benefit CDCs without violating statutory provisions.

As a result of our joint efforts, a change has been made in the CDBG rules governing when job creation activities may be considered to benefit low and moderate income persons. In an effort to provide more flexibility to CDCs, new regulations now indicate that where CDBG funds are used to pay for the staff and overhead costs of a CDC making loans to businesses from non-CDBG funds, the requirement that 51 percent of the jobs be for low and moderate income persons may be met by aggregating the jobs created by all of the businesses receiving loans during any one year period. This is an exception from the general rule that each assisted business must independently meet the 51 percent requirement.

I hope you will find this information responsive to your request.

Sincerely,

(signed)

Jack R. Stokvis
Assistant Secretary