Lending Agreement for Property Rehabilitation Loan Program

August 26, 1988

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-7000

OFFICE OF THE ASSISTANT SECRETAPY FOR

CDP,COMMUNITY PLANNING AND DEVELOPMENT

Mr. Steve Young
Continental Community Funding
P.O. Box 6069
Anaheim, CA 92806

Dear Mr. Young:

This letter serves as a follow-up to the meeting of August 25, 1988 to discuss the proposed "Lending Agreement For Property Rehabilitation Loan Program" a revised version of which we received for review on August 24, 1988.

There are some discrepancies between the August 24 revised agreement and the arrangement presented by Continental Community Funding (CCF) at the August 25 meeting. The revised agreement, while characterizing CCF as "the Lender," clearly indicated that Manufacturers Hanover Trust Company (MHT) would originate and receive all payments on each loan. At the meeting CCF indicated that it would originate and receive all payments on each loan. The revised agreement vaS Between the grantee, CCF, and MHT, while at the meeting CCF left the impression that only CCF would be a party to the agreement with the grantee. Nevertheless, this letter responds to either of these two variables.

At the meeting, HUD representatives clarified, and this letter confirms, that under our interpretation of the new Lump Sum Regulation, 24 CFR 570.513, effective October 1, 1988, the "private financial institution" entering into a lump sum agreement with the grantee must be the institution in which the lump sum is deposited. Since MHT is the proposed depository under the August 24 agreement, it is therefore the "private financial institution" which must be party to any agreement with the grantee. HUD agreed at the meeting to determine the permissibility of also including CCF as a third (but not substitute) party to the agreement.

We have subsequently determined that CCF could be a third party to the agreement. However, it must be clearly understood that as the 11 private financial institution," MHT must pay the minimum interest on the lump sum deposit in accordance with 24 CFR 570.513 (b)(9)(i) of the new regulations for any agreement entered into on or after October 1, 1988, and has the obligation and responsibility to assure that at least one of the benefits required by 24 CFR 570.513(b)(9)(ii) of the new regulations is provided. While CCF

may be a party to the agreement, MHT is accountable for insuring compliance with all provisions of the lump sum regulations applicable to private financial institutions.

A second issue raised in the August 25 meeting was whether the "private financial institution" in a lump sum agreement--in this case MHT--had to be the lender, or whether another organization, such as CCF, could perform this function. The statute and regulations governing lump sum agreements would not appear to prohibit CCF from making rehabilitation loans under a revised agreement.

Nevertheless, even if CCF is the lender, i.e., originates the loans and receives repayments, MHT as the private financial institution would retain primary responsibility for insuring compliance with the agreement and for providing the additional benefits required by the regul a ti on s.

Although it is our understanding that based on information provided to you at the August 25 meeting you are in the process of further revising the agreement, we will take this opportunity to summarize for you the areas of the August 24 revised agreement that fail to conform to the regulatory provisions under 24 CFR 570.513, which are effective October 1, 1988.

Agreement 24 CFR 570.513
Part I first paragraph After October 1, 1988 grants
1.3 (a) of regulation text will only be permitted as part of a
lump sum agreement if they are used
for the purpose of leveraging
non-CDBG funds for the
rehabilitation of the same
property.

Part I 570.513(a)(3) Neither the grantee's
1.3 (b) rehabilitation program
administrative costs nor the
administrative costs of the
financial institution may be funded
through lump sum drawdown.

Part I 570.513(b)(7) Grantees cannot extend
1.7 existing agreements at the end of
the agreement term but must enter
into a new agreement.

As mentioned above, the new regulations require that in consideration for lump sum deposit by the recipient in a private financial institution, the private financial institution must, in addition to paying the minimum required interest on the deposit, provide at least one of the benefits required by 24 CFR 570.513 (b)(9)(ii) of the new regulations. In our judgment, the August 24 agreement, which we understand is being revised, does not, as currently structured, provide appropriate benefit in support of a recipient's local rehabilitation program in any of the three areas of poten;ial benefit. Our comments with respect to the current agreement vis-a-vis the three areas of potential benefit are as follows:

A. Leverage of the deposited funds so that the financial institution commits private funds for loans in the rehabilitation program in an amount substantia y in excess o@tne amount of the lump sum depoSIt--A grantee entering into the current agreement who wished to make low-interest loans will not effect leveraging of private funds exceeding its public dollar commitment under the participation loan arrangement. While the lender may make "available" an amount equal to twice the local agency deposit, and a grantee might theoretically leverage twice its deposit amount, this will occur only if all loans are made at near market interest rates to higher income-borrowers. Publicly funded rehabilitation programs serving lower income persons, and therefore charging below market interest rates (e.g. three or four percent interest rate loans), are much more likely to leverage one private dollar for every two dollars of public participation.

B. Commitment of private funds by the financial institution for rehabilitation loans at below marke interest rates, at Fi-gher than normal risk, or with longfr-than norma repayment periods--The provision of rehabilitation loans to property owners at a rate of at least .5 percent below prevailing market interest rate is not a sufficient benefit. The agreement also does not provide for underwriting loans at higher than normal risk. The revised agreement specifies that "established," "normal" underwriting standards will be applied. In fact, Part II of the revised agreement, under the heading of "Respective Liabilities", has the effect of guaranteeing to th2 lender 100 percent of the public agency's amount of participation in the loan in the event of a net loss arising from the loan. Not only are the loans not going to made at higher than normal risk, the requirements are more rigorous than they would be for loans made without public participation, even though normal under-writing standards would be applied.

C. Provision of administrative services in support of the institution at no cost or at lower than actual cost--The agreement requires the grantee to pay a fee to @to cover services and hence it is not clear what services the private financial institution would be providing. The agreement would have to provide for MHT to either perform these rehabilit ;@T ram by the participating financial services itself or pay CCF to perform them at no cost to the grantee, or at significantly below actual cost.

Since we understand that the agreement we reviewed is undergoing a revision, our comments on the current agreement are offered in order to delineate those areas which potentially will not satisfy the provisions of the new regulation unless revised. Please be clear that our comments extend only to the documents submitted to us for review and should in no way be construed as a Departmental endorsement of the services being offered either by Continental Community Funding or Manufacturers Hanover Trust Company.

Sincerely,

Nancy C. Ivers

Deputy Assistant Secretary
for Program Management