

POLICIES AND PROCEDURES MANUAL

for the Section 108 Loan



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City of Fayetteville

Section 108 Loan Program

I. Purpose

To promote larger-scale economic development, housing, public facilities, infrastructure, and other physical development projects, the City of Fayetteville may consider projects with greater funding needs for financing based on the City's participation in the Department of Housing and Urban Development's Section 108 Loan Guarantee Program. The Section 108 Program enables the City to leverage portions of its Community Development Block Grant (CDBG) funding to obtain federally subsidized loans of up to five times the City's annual CDBG allocation. The City may then use those funds to assist with the financing of economic development projects which enhance the City's tax base, revitalize its business district, increase housing options, and offer greater employment opportunities. Any project receiving financing under the Section 108 Loan Program must include elements that principally benefit low- and moderate-income persons, aid in the prevention or elimination of slums or blight, or address conditions that pose a serious and immediate threat to the health and safety of City residents. The purpose of this policy is to establish guidelines for the City's consideration of projects for potential financing through the Section 108 Loan Program.

II. Program Description

When private developers are planning projects that will carry out one of the aforementioned objectives, the developers may apply to the City of Fayetteville for Section 108 Loan Fund financing. The City will consider applications based upon several factors described below. See Section III—Threshold Requirements.

The Section 108 Loan Guarantee Program is authorized under Section 108 of the Housing and Community Development Act of 1974 as part of the Community Development Block Grant Program. The Program offers the City a source of financing for economic development, large-scale public facility projects, and public infrastructure. The amount of federal loans available to the City for this purpose may be up to five times the City's annual allotment of CDBG funds. For example, in 2022, the City's annual CDBG grant was \$1,607,129, which would enable the City to apply for up to approximately \$8,000,000 in Section 108 loan assistance that it may dedicate to a qualifying project.

To receive Section 108 funds, the City must underwrite a project so that it ensures repayment of both principal and interest on the loan. The City will be required to pledge a portion of its future CDBG funds (both grants and program income) as well as other repayment sources, including tax increment revenues, third-party loan repayments, and liens on real property, as security for the City's repayment of the Section 108 loan. Once the City successfully applies for and receives Section 108 funding, the City may then loan the funds to third party developers to undertake eligible economic development activities. The City will then use the project owner's

loan payments as the primary or one of the primary sources of the City's repayment of its debt obligations under the HUD-guaranteed loan.

The Section 108 Loan Program is designed exclusively to bridge a "financial gap" in a development project that will deliver significant public benefits and serve the national objectives identified below. Any project qualifying for Section 108 financing must be supported primarily by non-federal funding sources, including private loans and equity investment. A loan awarded to a developer by the City pursuant to the Section 108 Program may not reduce or be a substitute for non-federal funds that could otherwise support the project.

The Section 108 Loan Program provides flexibility in how disbursement and repayment are structured to assist in the successful repayment of loans.

III. Threshold Requirements

All applications for Section 108 Loan Fund financing must meet the following threshold requirements:

A. National Objectives

The City may only consider projects for Section 108 Loan Fund financing that directly serve a public purpose and one of the following national objectives:

- a. Principally benefit low- and moderate-income persons;
- b. Aid in the prevention or elimination of slums or blight; or
- c. Meet an urgent need by addressing conditions that pose a serious and immediate threat to the health and safety of residents.

There must be a direct relationship between Section 108 funds dedicated to a project and the value of the qualifying public benefits assisted by those funds. Federal rules require that, in the aggregate, 70% of funds dedicated to a project from the Section 108 Loan Program should benefit low- and moderate-income persons as detailed in 24 C.F.R. § 570.208.

B. Necessity

The City will only consider a project for Section 108 funding if the project will not go forward – or will not go forward with the public benefits included – without receiving a Section 108 loan from the City. Federal rules mandate that the City must review a project's financing plan and projected revenues to ensure that Section 108 funds will not be used to substantially reduce the amount of available non-federal support for the project. Any "financing gap" used to justify an application for Section 108 funding should be supported by reasonable evidence that private debt financing and equity participation are not available to close that gap based on industry standards for the size and scope of the project under consideration.

C. Federal CDBG Requirements

Once the City and HUD determine that a project serves one of these national objectives and has a demonstrated financing gap, then the City must determine whether the project satisfies other federal requirements for the use of CDBG funds. 24 C.F.R. § 570.201. Examples of projects eligible to receive Section 108 loans (24 C.F.R. § 570.703) include:

- Real property acquisition as part of an otherwise eligible activity;
- Rehabilitation of publicly or privately owned real property;
- Housing rehabilitation or development eligible under the CDBG program and related relocation;
- Demolition, clearance, and site improvements for eligible CDBG activities;
- Public infrastructure; and
- Eligible economic development activities.

For example, in recent years, HUD has approved the use of Section 108 funds to provide loans for mixed-use new construction, adaptive reuse of existing structures, the redevelopment of a hotel in a downtown business district, shopping centers, industrial expansion, business relocation, warehouse facilities, public infrastructure, office buildings, retail stores, and affordable housing site development.

D. Eligible Economic Development Activities [24 CFR § 570.209]

Section 108 loan funds may be directed to private for-profit businesses involved in economic development projects that provide jobs or services for low- and moderate-income persons residing in the project area. With respect to any individual project assisted by financing under this policy, the amount of City funding shall not exceed either (1) \$50,000 per full-time equivalent, permanent job created or retained, or (2) \$1,000 per low- and moderate-income person to which goods or services are provided by the project. In the aggregate, and the City's funding of economic development projects using CDBG funds during a given year must not exceed either (1) \$35,000 of CDBG funds used for projects per full-time equivalent, permanent job created or (2) \$350 of CDBG funds used for projects per one low- and moderate-income person served by assisted businesses providing goods or services to residents of the area. This aggregate limit on the City's use of CDBG funding applies only to projects that do not meet one or more of the criteria for exclusion from aggregate standards found at 24 CFR 570.209(b)(2)(v).

The City shall not fund any activity under this policy that (i) promotes the City as a whole (as opposed to a specific area or program in the City); (ii) assists a professional sports team; (iii) assists a privately-owned recreational facility serving a predominantly higher-income clientele; (iv) acquires land for which the City has not identified or approved a specific proposed use; or (v) assists a business while that business, or any other business in which the owner has an ownership interest, is subject to unresolved findings of noncompliance with prior CDBG assistance.

IV. Security Requirements

The City will only consider projects for Section 108 loan financing if the private developer is able to pledge sufficient collateral to secure the full Section 108 loan amount requested. The City's loans under Section 108 are recourse loans and are not forgivable. Examples of collateral include, but are not limited to:

- Liquid Funds
- Real Estate (maximum loan-to-value 80%)
- Equity
- Investments
- Personal Guarantees
- Personal Property
- Accounts Receivable
- Machinery and Equipment
- Inventory

V. Loan Terms and Rates

Any loan issued by the City using Section 108 funds shall have a maximum term of no longer than 20 years. Based on the City's review of the project's revenue projections and other documents, the City will aim to set the interest rate for its Section 108 loan to the developer at a rate that ensures the developer's debt payments cover the City's debt obligation under the HUD-guaranteed loan without compromising the ability of the project to operate successfully. Generally speaking, the City will base the interest rate offered to the borrower on the interest rate of the HUD-guaranteed Section 108 loan. For interim borrowing, the interest rate will be based on the three-month Treasury Auction Bill rate plus 35 basis points. For permanent borrowing, the interest rate will be based on Treasury obligations of similar maturity to the principal amount. In cases where the HUD-guaranteed loan is funded by a public offering, the interest rate will be fixed and based on U.S. Treasury borrowing rates. In most cases, the City will add a small additional basis point spread on the HUD-guaranteed rate to determine the rate offered the borrower. However, the City reserves the right to set the interest rate of its loan at a rate commensurate with the public benefit of the project and the structure of the project's other financing, including, when appropriate, at zero (0) percent.

VI. Application Process

Private developers interested in pursuing Section 108 Loan Fund financing shall apply to the Director of the City's Economic and Community Development Department. Each application shall be accompanied by a nonrefundable application fee. The City will evaluate project proposals for Section 108 Loan Fund financing on a case-by-case basis based on the criteria set forth in this Policy as further described in the application. An application satisfying the threshold requirements described above is not a guarantee that the applicant will receive Section 108 Loan

Fund financing from the City. The City may deny an application for any reason, in its sole discretion, but not for an unlawful reason.

The application process for any City loan supported by the Section 108 program shall proceed through five (5) general phases.

A. Developer's initial application to the City

The private developer shall first develop and submit to the City an initial application for Section 108 Loan Fund financing that shall include the following items:

(1) The community development objectives the private developer proposes to pursue with the Section 108 Loan Funds. See Section III—Threshold Requirements.

(2) The activities the private developer proposes to carry out with the guaranteed loan funds. See Section V—Eligible Section 108 Loan Fund Activities. Each activity must be described in sufficient detail, including (i) the specific provision of C.F.R. § 570.703 under which it is eligible and the objective to be met, (ii) the amount of Section 108 Loan Funds expected to be used, and (iii) the project location. Specifically, this account should provide a detailed description of project activities which are expected to generate income. All descriptions of project location and activities must be sufficiently detailed to allow citizens to determine the degree to which they will be affected by the proposed project and identify where they may obtain additional information. See Section VII—Citizen Participation Plan.

(3) A description of the collateral the developer intends to pledge in support of the loan application. See Section IV—Security Requirements.

B. Developer's full application to the City

If the City approves the initial application from the developer, the developer shall then be required to submit a full application as detailed in the City's Section 108 Loan Program application. The City may amend the application process and application requirements for Section 108 loans from time to time by the City in a manner consistent with this Policy.

The developer's full application must be complete but will be potentially subject to modification based on the results of the citizen engagement process detailed below.

The City's approval of a developer's initial application, and its provisional acceptance of the developer's full application, are fully contingent upon the parties' successful completion of the steps detailed below. The City may withdraw its approval at any time, for any reason.

C. The City's proposed application to HUD and citizen participation plan

When the City has sufficient information from the developer, the City shall prepare its own proposed application for Section 108 funding from HUD which will be used to support the project loan. The City and the private developer shall then work together to develop and follow a detailed citizen participation plan and make the plan public in accordance with 24 C.F.R. § 570.704(a). See Section VII—Citizen Participation Plan. As a part of the citizen participation plan, the City's shall publish its proposed application for Section 108 funding from HUD to afford affected citizens an opportunity to examine the application's contents and to provide comments on the proposed application.

D. Citizen engagement

Once the steps above have been completed, the City and developer shall execute the citizen engagement plan as detailed below. Section VII—Citizen Participation Plan. The City must consider any public comments they receive and, if appropriate, modify the proposed application.

E. City's final application to HUD

Upon completion of the citizen engagement process, and any revisions to the City's proposed application based on that process, the City shall complete its final application to HUD. The City must make the final application available to the public. The final application must describe each project activity in sufficient detail to permit a clear understanding of the nature of each activity, as well as identify the specific provision of 24 C.F.R. § 570.703 under which it is eligible, the national objective to be met, and the amount of guaranteed loan funds to be used. The final application must also indicate which activities are expected to generate program income. The City will then submit the final application to the appropriate HUD Office for final approval.

F. Loan Documents and Closing

If HUD approves the City's application for loan funding under the Section 108 Program, then the City and developer shall execute all agreements and other documents necessary to effectuate the terms and conditions of the City's Section 108 loan to the project developer. If the City enters a development agreement with the developer, then the City shall comply with all requirements under N.C.G.S. § 160D-1001–1012, including by holding a public hearing pursuant to §160D-1005 and obtaining the approval of City Council. The City shall include any relevant requirements under N.C.G.S. § 160D as a part of the citizen engagement plan required by HUD. See Section VII—Citizen Participation Plan.

In addition to identifying adequate collateral to secure the City's funding, the City's loan documents shall include a provision permitting the City to monitor the project's compliance with CDBG and all other legal and regulatory requirements and a "clawback" provision requiring the borrower, in the event of noncompliance, to refund to the City any loan proceeds already paid to the borrower.

VII. Citizen Participation Plan

As noted above, the City and the developer must develop and follow a detailed citizen participation plan and make the plan public. The plan must be completed and available before the City's final application is submitted to HUD. The requirements for the Citizen Participation Plan are found fully at 24 C.F.R. § 570.704(a)(2), and include:

- Giving citizens timely notice of local meetings and reasonable and timely access to local meetings, information, and records relating to the proposed and actual use of Section 108 Loan Funds.
- Providing technical assistance to groups representative of persons of low- and moderate-income that request assistance in developing proposals. The level and type of assistance to be provided is at the discretion of the City. Such assistance need not include providing funding to such groups.
- Holding a minimum of two public hearings, each at a different stage, for the purpose of obtaining the views of citizens and formulating or responding to proposals and questions. Together the hearings must address community development and housing needs, development of proposed activities and review of program performance.
- Meeting the needs of non-English speaking residents in the case of public hearings where a significant number of non-English speaking residents can reasonably be expected to participate.
- Providing affected citizens with reasonable advance notice of, and opportunity to comment on, proposed activities not previously included in an application and activities which are proposed to be deleted or substantially changed in terms of purpose, scope, location, or beneficiaries. The criteria City and the private developer will use to determine what constitutes a substantial change for this purpose must be described in the citizen participation plan.
- Responding to citizens' complaints and grievances, including the procedures that citizens must follow when submitting complaints and grievances. The plan must provide for timely written answers to written complaints and grievances within 15 working days of the receipt of the complaint, where practicable.
- Encouraging citizen participation, particularly by low- and moderate-income persons who reside in slum or blighted areas, and other areas in which Section 108 Loan Funds are proposed to be used.

VIII. Application Review and Underwriting Standards

The City Section 108 Loan Fund standards for underwriting shall comply with the "Guidelines and Objectives for Evaluating Project Costs and Financial Requirements" found in Appendix A to Part 570 of the Federal Regulations governing Section 108 loan funds. The objectives of the underwriting guidelines are to ensure (i) project costs are reasonable; (ii) all sources of project financing are committed; (iii) to the extent practicable, Section 108 funds are

not substituted for non-Federal financial support; (iv) the project is financially feasible; (v) to the extent practicable, the return on the owner's equity investment will not be unreasonably low or high; (vi) to the extent practicable, Section 108 funds are disbursed on a pro rata basis with other finances provided to the project; and (vii) other considerations by the City are satisfied.

A. Project Costs Must Be Reasonable

The City will review all project costs for reasonableness. A breakdown of all project costs will be required in the City's Section 108 Loan Fund application. Examples of documentation required to support project costs include, but are not limited to, fair market price quotations; engineer and/or architect estimates; appraisals; etc. All quotations, estimates, appraisals, etc., must be provided by third parties.

B. All Sources of Project Financing Must Be Committed

All sources of project financing must be identified, committed, and sufficient to fund the proposed project. A breakdown of all project financing sources will be required in the Section 108 Loan Fund application. Examples of documentation required to support project financing, including, but not limited to: letters of intent from lenders providing the level of commitment of the lender, as well as the terms and conditions of said loan; copies of the loan package submitted to any lender; for any grant sources, letters of commitments outlining the level of commitment, any terms and conditions to the commitment, and the timing of receipt of the commitment; for any equity sources, evidence of the level of commitment, any terms and conditions to the commitment, financial statements verifying the availability of funds.

C. Section 108 Funds Are Not Substituted For Non-Federal Financial Support

All applicants must provide evidence that the Section 108 Loan Funds will be utilized to fill a financing gap, and not to replace private financing, in order to ensure that Section 108 Loan Funds will be utilized efficiently. Financial gaps may be caused by unavailability of capital, high costs of capital, or low projected returns on equity investment, among other causes.

D. The Project Is Financially Feasible

The City will review the project to determine its viability, to assure that the public benefit under which the project qualifies for Section 108 Loan Fund assistance will be realized, and to evaluate whether the project is likely to, at minimum, break-even financially.

As part of this review, the applicant will be required to submit current balance sheets, as well as historical balance sheets for the past 5 years, for both the applicant and its principals.

Furthermore, the applicant must provide estimates of the number of jobs created an estimate of how many jobs will be filled by low- and moderate- income persons, a breakdown of how many shall be full time vs. part time, and a breakdown of the yearly salary/hourly wage.

Past, present, and projected future financial data will be analyzed and compared to industry averages to determine if job estimates are reasonable and supportable.

E. The Return on The Owner's Equity Investment Will Not Be Unreasonably Low Or High

The Section 108 Loan Fund application will be used to determine whether the expected return on investment to the applicant will be reasonable and not be too low such that there is a risk that the applicant will abandon of the project. Accordingly, applicants must provide an estimate of projected revenues, expenses (including salaries), owner's draws, debt service, and net operating income.

F. Section 108 Funds Are Disbursed on A Pro Rata Basis with Other Finances Provided To The Project

To the extent practicable, Section 108 Loan Funds will be disbursed on a pro rata basis with other funding sources to avoid placing the City at a greater risk than other funding sources.

G. Other Considerations by The City

The City will review proposed projects to determine if the minimum level of public benefit will be accomplished for the expenditure of Section 108 loan funds consistent with Section III.D above and 24 C.F.R. § 570.209.

In addition to the financial feasibility of the project, the City will also analyze the feasibility of *the development*. The City may request documentation supporting the feasibility of the development such as market studies, real estate appraisals, engineering studies, architectural studies, and housing studies.

To ensure compliance with the underwriting guidelines, the City may retain professional service providers to review the developer's application materials. As noted below, the City shall assess reasonable fees to the developer to cover such costs.

IX. Program Limitations

The City's commitments to Section 108 Loan Fund financing throughout the City at any given time shall not exceed five (5) times the amount of the City's most recent annual CDBG allocation (the "Section 108 Aggregate Cap"). For each new project proposal seeking Section 108 Loan Fund financing, the City must assess whether Section 108 Loan Fund financing for a qualifying project will cause the City's financing in aggregate to exceed the Section 108 Aggregate Cap. The City shall review this program limitation annually to determine if an increase or a reduction to the Section 108 Aggregate Cap is warranted.

X. Fees

The City shall assess reasonable fees to the private developer for the development and implementation of the citizen participation plan, the review of developer's final application materials, the drafting of the final application submitted to HUD, legal fees, and the negotiation and drafting of all loan documents in relation to the proposed project, as well as for any costs to be incurred by the City in monitoring compliance with the provisions of C.F.R. § 570, Subpart M.