Frequent Asked Questions:

Section 108 Loan Guarantee Program – Financing Fee

OVERVIEW

On November 3, 2015, the Department of Housing and Urban Development (HUD) issued a final rule in the *Federal Register* (80 FR 67626) amending HUD's Section 108 Loan Guarantee Program (Section 108) regulations to permit HUD, in accordance with statutory authority, to collect fees from Section 108 recipients in order to offset the cost of Section 108 loan guarantees.

To provide a loan guarantee under Section 108, HUD must receive either an annual budget appropriation covering the credit subsidy cost of that transaction —the expected long-term liability to the Federal Government of issuing the loan guarantee –or, alternatively, receive payment of that cost by the borrower.

HUD issued this rule in anticipation of future annual appropriations that do not include budget authority for a credit subsidy, thereby ensuring that it is able to continue making Section 108 loan guarantee commitments in absence of an annual appropriated subsidy. The Department of Housing and Urban Development Appropriations Act, 2014, was the first appropriations act to authorize HUD to collect fees from borrowers for this program.

In anticipation of further appropriations acts authorizing the collection of fees for Section 108 loan guarantees, HUD added a new section, 24 CFR 570.712, to its current regulations. This section outlines the procedures that HUD will use when appropriations for credit subsidy costs, as authorized by Congress, are either not available or insufficient to offset program costs and HUD has statutory authority to collect fees. Under this regulation, HUD will impose a fee on Section 108 Program borrowers and explain how it determined the amount of the fee. Additionally, the new regulatory section requires that HUD announce the fee, the effective date of the feed, and any other necessary information regarding fee payment in a *Federal Register* notice.

Additionally, as provided for above, HUD published a *Federal Register* (80 FR 67634) notice on November 3, 2015, announcing the fee to be established for the fiscal year 2016.

THE BASICS

1. What is the Section 108 financing fee?

HUD is authorized to charge a fee to cover the long term cost to the Federal Government of a Section 108 loan guarantee. The amount of the fee will be determined annually by HUD. The fee charged to communities receiving Section 108 represents a percentage of the principal amount of the Section 108 guaranteed loan.

2. When does the fee requirement take effect?

HUD will collect the fee for all loans for which a commitment was approved after September 30, 2015.

3. How much is the fee?

For loans approved in Fiscal Year 2016, the credit subsidy fee is 2.58 percent of the principal amount of the guaranteed loan. For example, the credit subsidy fee for a Section 108 guaranteed loan of $10,000,000 approved in FY 2016 would be $258,000.

4. When is the fee charged?

The fee is only applied at the time of loan disbursement so if a community elects to advance $1,000,000 of a 10,000,000 commitment, it will only be charged a fee of $25,800 at the time of the advance.

5. Will the fee amount change from year to year?

Yes. HUD will announce the fee amount annually in a *Federal Register* notice.

6. Does the fee need to be discussed in the application for Section 108 assistance?

Yes, borrowers must include information on how they plan to pay the fee within their application and, for project-specific applications, include the fee within the Sources and Uses summary they submit.

OPTIONS FOR PAYMENT

7. Can the credit subsidy fee be rolled into the 108 loan?

Yes, borrowers may pay the fee from the guaranteed loan proceeds. If the fee is paid for with the loan proceeds, it will in effect be part of the loan balance from which interest will be paid over the life of the loan.

8. If the fee is included as part of the guaranteed loan amount, will the borrower be paying interest on the fee as part of the loan repayment?

Yes, financing the credit fee as part of the loan will increase the face value of the loan, and, therefore, it will increase the amount of the interest that the borrower will be paying over the life of the loan.

9. Can the credit subsidy fee be paid with HUD CDBG or HOME funds?

Yes, borrowers may pay the fee with CDBG or HOME program funds. Fees that are paid with these funds must be identified in the Consolidated Plan as part of project costs. Moreover, if a borrower uses HOME funds, the project must meet all HOME program requirements.

Keep in mind these considerations when using CDBG or HOME:

Since HUD has made a provision that the payment of the fee is treated as part of the cost of carrying out the activity, if the borrower elects to pay the fee with CDBG funds, the fee will only need to be considered once when calculating the overall benefit requirement that no less than 70 percent of a grantee's aggregate CDBG expenditures over time benefit low- and moderate-income persons.

The payment of the credit subsidy fee from CDBG or HOME funds should also be included as a grant expenditure in HUD's Integrated Information and Disbursement System (IDIS).

10. Is the credit subsidy fee required for third party loans (when the community or State re-lends the loan proceeds to a third party, such as a business or a developer)?

The borrower may elect to pass the cost of the fee along to a third party by including the cost of the fee in the third party loan. It may, of course, also choose to pay the fee outside of the third party loan.

11. Are there underwriting guidelines to help determine the feasibility of a third party loan including the fee as part of the project's financial expenses?

Yes. HUD is preparing Section 108 Underwriting Guidance to be used by the borrower when considering proposals that will use the 108 program and require the pledge of CDBG funds or the repayment of the loan from project revenue. HUD is offering a Section 108 webinar series that includes the credit subsidy fee, underwriting 108 loans, and the 108 application process.

BACKGROUND

12. What is the purpose of the Section 108 financing fee?

Historically, Congress has annually appropriated funds to cover the credit subsidy costs of the Section 108 Guaranteed Loan Program. These costs are the estimated long term cost to the federal government of the loan guarantee, excluding administrative costs and incidental effects on government receipts or outlays. (These appropriations by Congress effectively funded a loan loss reserve to cover the future cost of any loan defaults under the Section 108 Program.)

In 2014, however, the credit subsidy costs were not appropriated, and the fee was proposed to offset the costs of offering the loan guarantees.

The fee eliminates the need for credit subsidy appropriations, and therefore, ensures HUD can continue to provide assistance to communities when credit subsidy costs authorized by Congress are either not available or insufficient.

13. How is the fee amount determined?

The basis for the credit subsidy cost is the net present value of estimated payments by the government to cover defaults and delinquencies, interest subsidies, or other payments, offset by any payments to the government, including origination and other fees, penalties, and recoveries.

As outlined in 80 FR 67634, credit subsidy costs incorporate assumptions based on a) data on default frequency for municipal debt where such debt is comparable to loans in the Section 108 loan portfolio, b) data on recovery rates on collateral security for comparable municipal debt; c) the expected composition of the Section 108 portfolio by end users of the guaranteed loan fund (e.g., third party borrowers and public entities, and d) other factors that HUD determines may be relevant to the calculation.

14. Where can I get more information on the Section 108 Loan Guarantee Program?

Visit https://www.hudexchange.info/section-108/