This document is scheduled to be published in the Federal Register on 10/04/2016 and available online at https://federalregister.gov/d/2016-23986, and on FDsys.gov

Billing Code: 4210-67

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 570

[Docket No. FR-5767-N-05]
RIN 2506-AC35

Section 108 Loan Guarantee Program: Announcement of Fee to Cover Credit Subsidy Costs

AGENCY: Office of the Assistant Secretary for Community Planning and Development, HUD.

ACTION: Announcement of fee.

SUMMARY: This document announces the fee that HUD will collect from borrowers of loans guaranteed under HUD's Section 108 Loan Guarantee Program (Section 108 Program) to offset the credit subsidy costs of the guaranteed loans pursuant to commitments awarded in FY 2017.

DATES: Effective Date: **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Paul Webster, Director, Financial Management Division, Office of Block Grant Assistance, Office of Community Planning and Development, Department of Housing and Urban Development, 451 7th Street, SW, Room 7180, Washington, DC 20410; telephone number 202-402-4563 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339. FAX inquiries (but not comments) may be sent to Mr. Webster at 202-708-1798 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

The Consolidated and Further Continuing Appropriations Act, 2015(Public Law 113-235, approved December 16, 2014) (2015 Appropriations Act) provided that "the Secretary shall collect fees from borrowers…to result in a credit subsidy cost of zero for guaranteeing" Section 108 loans. The Continuing Appropriations Act, 2016 (Public Law 114-53, approved September 30, 2015) continued the 2015 provision. This continued funding act was followed by The Consolidated Appropriations Act, 2016, Public Law 114-133, approved December 18, 2015) (2016 Appropriations Act), which had identical language regarding Section 108 credit subsidy to the 2015 Appropriations Act. The fiscal year 2017 HUD appropriations bills under consideration in the House of Representatives (H.R. 5394), and the Senate (S. 2844) also have identical language regarding the credit subsidy for the Section 108 Program, and it is expected that, when enacted, the final fiscal year 2017 appropriations act will as well.

On November 3, 2015, HUD published a final rule (80 FR 67626) following a February 5, 2015 proposed rule (80 FR 6470) that amended the Section 108 Program regulations at 24 CFR part 570 to establish additional procedures, including procedures for determining the amount of the fee and for a 30-day public comment process when HUD adopts changes to the assumptions underlying the fee calculation or if the fee structure itself raises new considerations for borrowers.

HUD is required to collect fees from Section 108 borrowers when necessary to offset the credit subsidy costs to the Federal government to guarantee Section 108 loans. Following consideration of the public comments submitted in response to HUD's February 5, 2015 proposed rule (80 FR 6469) that proposed the fee required to offset the credit subsidy costs, on November 3, 2015, HUD issued an announcement of fee (80 FR 67634) to set the fee for Section

108 loan disbursements under loan guarantee commitments awarded in FY 2016 at 2.58 percent of the principal amount of the loan.

II. FY 2017 Fee: 2.59 Percent of the Principal Amount of the Loan

This document sets the fee for Section 108 loan disbursements under loan guarantee commitments awarded in FY 2017 at 2.59 percent of the principal amount of the loan. This amount was proposed in the President's FY 2017 budget.[1] HUD will collect this fee from borrowers of loans guaranteed under the Section 108 Program to offset the credit subsidy costs of the guaranteed loans pursuant to commitments awarded in FY 2017, as authorized by the 2017 appropriations act.

For this fee document, HUD is not changing the underlying assumptions or creating new considerations for borrowers. The calculation of the FY 2017 fee uses the same fee calculation model as the FY 2016 announcement of fee, but incorporates updated information regarding the composition of the Section 108 portfolio and the timing of the estimated future cash flows for defaults and recoveries. The calculation of the fee is also affected by the discount rates required to be used by HUD when calculating the present value of the future cash flows as part of the Federal budget process.

As described in 24 CFR 570.712(b), HUD's credit subsidy calculation is based on the amount required to fully offset the credit subsidy cost to the Federal government associated with making a Section 108 loan guarantee. As a result, HUD's credit subsidy cost calculations incorporated assumptions based on: (i) data on default frequency for municipal debt where such debt is comparable to loans in the Section 108 loan portfolio; (ii) data on recovery rates on

[1] The FY 2017 President's Budget for HUD is available at: https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/hud.pdf. The fee is specified in table 6 of the Federal Credit Supplement to the 2017 budget and is available at: https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/cr_supp.pdf

collateral security for comparable municipal debt; (iii) the expected composition of the Section 108 portfolio by end users of the guaranteed loan funds (e.g., third party borrowers and public entities); and (iv) other factors that HUD determined were relevant to this calculation (e.g., assumptions as to loan disbursement and repayment patterns).

Taking these factors into consideration, HUD determined that the fee for disbursements made under loan guarantee commitments awarded in FY 2017 will be 2.59 percent, which will be applied only at the time of loan disbursements. Note that future documents may provide for a combination of up-front and periodic fees for loan guarantee commitments awarded in future fiscal years but, if so, will provide the public an opportunity to comment if appropriate under 24 CFR 570.712(b)(2).

The expected cost of a Section 108 loan guarantee is difficult to estimate using historical program data because there have been no defaults in the history of the program that required HUD to invoke its full faith and credit guarantee or use the credit subsidy reserved each year for future losses.[2] This is due to a variety of factors, including the availability of Community Development Block Grant (CDBG) funds as security for HUD's guarantee as provided in 24 CFR 570.705(b). As authorized by Section 108 of the Housing and Community Development Act of 1974, as amended (42 U.S.C. 5308), borrowers may make payments on Section 108 loans using CDBG grant funds. Borrowers may also make Section 108 loan payments from other anticipated sources but continue to have CDBG funds available should they encounter shortfalls in the anticipated repayment source. Despite the program's history of no defaults, federal credit budgeting principles require that the availability of CDBG funds to repay the guaranteed loans cannot be assumed in the development of the credit subsidy cost estimate (see 80 FR 67629,

[2] U.S. Department of Housing and Urban Development, Study of HUD's Section 108 Loan Guarantee Program, (prepared by Econometrica, Inc. and The Urban Institute), September 2012.

November 3, 2015). Thus, the estimate must incorporate the risk that alternative sources are used to repay the guaranteed loan in lieu of CDBG funds, and that those sources may be insufficient. Based on the rate that CDBG funds are used annually for repayment of loan guarantees, HUD's calculation of the credit subsidy cost must take into account the possibility of future defaults if those CDBG funds were not available. The fee of 2.59 percent of the principal amount of the loan will offset the expected cost to the government due to default, financing costs, and other relevant factors. To arrive at this measure, HUD analyzed data on comparable municipal debt over an extended 16 to 23-year period. The estimated rate is based on the default and recovery rates for general purpose municipal debt and industrial development bonds. The cumulative default rates on industrial development bonds (14.62 percent) were higher than the default rates on general purpose municipal debt (0.25 percent) during the period from which the data were taken. (The recovery rates for industrial development bonds and general purpose debt were 74.76 and 90.27 percent, respectively.) These two subsectors of municipal debt were chosen because their purposes and loan terms most closely resemble those of Section 108 guaranteed loans. In this regard, Section 108 guaranteed loans can be broken down into two categories: (1) loans that finance public infrastructure and activities to support subsidized housing (other than financing new construction) and (2) other development projects (e.g., retail, commercial, industrial). The 2.59 percent fee was derived by weighting the default and recovery data for general purpose municipal debt and the data for industrial development bonds according to the expected composition of the Section 108 portfolio by corresponding project type. Based on the dollar amount of Section 108 loan guarantee commitments awarded during the period from FY 2011 through FY 2015, HUD expects that 25 percent of the Section 108 portfolio will be similar to general purpose municipal debt and 75 percent of the portfolio will be similar to industrial development bonds. In setting the fee at 2.59 percent of the principal amount of the guaranteed loan, HUD expects that the amount generated will fully offset the cost to the Federal government associated with making guarantee commitments awarded in FY 2017. Note that the FY 2017 fee represents only a .01 percent increase over the FY 2016 fee of 2.58 percent. This is due primarily to updated loan repayment patterns and discount rates used in calculating the present value of cash flows. These are variable that ordinarily are modified in the credit subsidy calculation.

This document establishes a rate that does not constitute a development decision that affects the physical condition of specific project areas or building sites. Accordingly, under 24 CFR 50.19(c)(6), this document is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Dated: _September 28, 2016

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Harriet Tregoning, Principal Deputy Assistant Secretary for Community Planning and Development

[FR Doc. 2016-23986 Filed: 10/3/2016 8:45 am; Publication Date: 10/4/2016]