



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 570

[Docket No. FR-5767-N-06]

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: Notification of fees.

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 2018.

DATES: Applicability 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 Transportation, Housing and Urban Development, and Related Agencies Appropriations Act, 2015 (division K of 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. Identical language was continued or included in the Department’s continuing resolutions and appropriations acts authorizing HUD to issue Section 108 loan guarantees during fiscal years 2016 and 2017 (Public Laws 114-53, 114-113, and 115-31). Section 101(a) of the Continuing Appropriations Act, 2018 (Division D of Public Law 115-56, approved September 8, 2017) includes the costs of HUD loan guarantees generally in its continuation of fiscal year 2017 programs. Additionally, the Senate appropriations bill under consideration (S. 1655) and the House omnibus bill (H.R. 3354) have identical language regarding the fees and credit subsidy cost for the Section 108 Program.

On November 3, 2015, HUD published a final rule (80 FR 67626) that amended the Section 108 Program regulations at 24 CFR part 570 to establish additional procedures, including procedures for announcing the amount of the fee each fiscal year when HUD is required to offset the credit subsidy costs to the Federal government to guarantee Section 108 loans. For fiscal years 2016 and 2017, HUD issued notices to set the fees¹.

II. FY 2018 Fee: 2.365 Percent of the Principal Amount of the Loan

This document sets the fee for Section 108 loan disbursements under loan guarantee commitments awarded for FY 2018 at 2.365 percent of the principal amount of the loan. 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 2018.

¹ 80 FR 67634 (November 3, 2015) and 81 FR 68297 (October 4, 2016), respectively.

For this fee notice, HUD is not changing the underlying assumptions or creating new considerations for borrowers. The calculation of the FY 2018 fee uses the same fee calculation model as the FY 2016 and FY 2017 final notices, 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 reduce the credit subsidy cost to the Federal government associated with making a Section 108 loan guarantee to the amount established by applicable appropriation acts. 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 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 2018 will be 2.365 percent, which will be applied only at the time of loan disbursements. Note that future notices 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, 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 2.365 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

² 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.

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 2.365 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 2012 through FY 2016, HUD expects that 30 percent of the Section 108 portfolio will be similar to general purpose municipal debt and 70 percent of the portfolio will be similar to industrial development bonds. In setting the fee at 2.365 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 2018. Note that the FY 2018 fee represents a 0.225 percent decrease from the FY 2017 fee of 2.59 percent. This is due primarily to updated loan repayment patterns and discount rates used in calculating the present value of cash flows. These are variables 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 12, 2017

Neal Rackleff
Assistant Secretary for Community Planning and
Development

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[FR Doc. 2017-20474 Filed: 9/22/2017 8:45 am; Publication Date: 9/25/2017]