CHAPTER 4: HOUSING ACTIVITIES

CHAPTER PURPOSE & CONTENTS

This chapter provides detailed information on CDBG eligible homeownership and rental activities and guidance for states on documenting national objectives.

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4.1 Homeowner Rehabilitation

Homeowner rehabilitation is one of the most common community development programs administered nationwide. CDBG funds provide a wide range of flexibility with rehabilitation of projects and design considerations. States can choose to do emergency repair programs, spot rehabilitation or full house rehabilitation. This section reviews the eligible and ineligible activities under the CDBG program for homeowner rehabilitation.

- Eligible homeowner rehabilitation activities
- Guide to National Objectives and Eligible Activities for States - Chapter 2: Categories of Eligible Activities
- HOME and CDBG Model Guide

- CDBG funds may be used to assist existing homeowners with the repair, rehabilitation, or reconstruction of owner-occupied units.
- States and UGLG have the flexibility under the CDBG Program to design repair and rehabilitation programs that meet the needs of their residents. Examples of the types of local programs that may be funded include:
  - General programs aimed at rehabilitation of existing structures, including substantial rehabilitation programs, which typically bring the property up to local codes and standards.
  - Special purpose programs, including:
    - Energy efficiency programs aimed at improving the energy efficiency of homes through additional insulation, new windows and doors and other similar improvements;
Handicapped accessibility programs through which improvements, such as installation of ramps and grab bars, are made to homes of persons with disabilities to make the home more accessible;

Emergency repair programs that provide for the repair of certain elements of a housing unit in emergency situations, such as repairs to a roof that is leaking, but the whole house is not rehabilitated; and

Weatherization programs aimed at improving a home's ability to withstand the elements, including insulation and weather-stripping.

Rehabilitation to a single-family residential property that is also used as a place of business and is required to operate the business may be considered homeowner rehabilitation (as opposed to commercial rehabilitation) if the improvements provide general benefit to the residential occupants of the building.

NOTE: Assistance to microenterprises for the establishment, stabilization, and expansion of microenterprises, which might include rehabilitation of a home that contains a microenterprise, may be eligible under the separate microenterprise activity category.

Reconstruction is an eligible activity. While the CDBG regulations have not yet been amended to reflect this change, it is generally defined as follows:

- Reconstruction means demolishing and re-building a housing unit on the same lot in substantially the same manner.
- The number of housing units on the lot may not be increased as part of a reconstruction, however, the number of rooms in a unit may be increased or decreased.
- The number of housing units on the lot may be decreased to reduce density.
- Decreasing units may trigger the one-for-one replacement of L/M income dwelling units at 24 CFR part 42, subpart C (see the Relocation Chapter for additional guidance).
- Reconstruction also includes replacing an existing substandard manufactured housing unit with a new or standard manufactured housing unit.

Homeowner counseling programs for LMI persons may be funded by CDBG. A state may use CDBG to pay for homeowner counseling related to a HOME or CDBG homeowner rehabilitation program.

CDBG can be used for grants, loans, loan guarantees, interest subsidies, or other forms of assistance to homeowners for the purpose of repairs, rehabilitation, or reconstruction.

CDBG-eligible costs include:

- Labor and materials,
- Replacement of principal fixtures and components of existing structures;
- Water and sewer connections;
- Installation of security devices, including smoke detectors; and
- Initial homeowner warranty premium;
- Hazard insurance premium (except when a grant is provided);
- Flood insurance premium;
Chapter 4: Housing Activities

- Conservation costs for water and energy efficiency;
- Landscaping, sidewalks, garages, and driveways when accompanied with other rehabilitation needed on the property; and
- Evaluating and treating lead-based paint.

✓ Loans for refinancing existing debt are eligible under CDBG if the state determines that this type of assistance is necessary to achieve local community development objectives. This refinance must be part of a rehabilitation project -- CDBG does not permit refinance only projects.

4.2 Home Purchase Activities

Owning a home is part of the American dream. CDBG funds can help support this dream by providing funds to income eligible households to purchase an existing or newly constructed home. This section reviews the eligible activities under the CDBG program for home purchase activities.

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✓ CDBG funds may be used to provide direct homeownership assistance to LMI households in two ways. Both options are described below.

- As direct homeownership assistance under 105(a)(24), a separate and permanent eligibility category that allows CDBG funding to:
  - Provide up to 50 percent of required down payment;
  - Pay reasonable closing costs;
  - Provide principal write-down assistance;
  - Subsidize interest rates;
  - Finance acquisition; and
  - Acquire guarantees for mortgage financing from private lenders (i.e., assist homebuyers with private mortgage insurance).

- As a public service activity; however, this eligibility category is limited to down payment assistance only and would count towards the 15 percent public services cap.

- For downpayment assistance to be provided as a public service to non-LMI households, it must be located in a state-approved community revitalization strategy area (CRSA). This is because in a CRSA, the units for which assistance is obligated during a state grantee’s program year may be aggregated and treated as a single structure for purposes of determining compliance with the housing national objective. Therefore, only 51% of the units in a CRSA need to be occupied by LMI households to meet a national objective if the...
home purchase activity is funded as a public service. Homeowner assistance located in an CRSA and carried out as a public service by a 105(a)(15) organization can also be excluded from the 15 percent public services cap.

✓ Activities that support development of housing for LMI persons such as acquisition, clearance, and site improvements (when the land is in public ownership) are eligible for CDBG assistance.

✓ Acquisition costs, providing assistance to private individuals and entities to acquire for the purpose of rehabilitation and to rehabilitate properties for use or resale for residential purposes is also eligible.

✓ Individual Development Accounts (IDAs), dedicated savings accounts providing start up funds to assist low-income persons purchase a home can be supported with CDBG funds.
  - CDBG funds may be deposited in an IDA to capitalize the account or as matching deposits over the course of the household’s participation in the program.
  - If the individual does not complete the requirements of the IDA program, the CDBG funds must be returned to the state and any interest earned returned to the U.S. Treasury.

✓ Homebuyer counseling programs for LMI income persons may be funded by CDBG. A state may use CDBG to pay for housing counseling related to a HOME or CDBG homebuyer program.

✓ Nonprofit development organization working under 105(a)(15) of the statute may use CDBG funds to construct housing for sale to LMI homebuyers in conjunction with a neighborhood revitalization or community economic development project.

4.3 Rental Housing Activities

Many communities struggle with providing decent safe and sanitary affordable rental housing to their residents. CDBG funds can be used to acquire, rehabilitate or construct rental housing. There are tenant income requirements and rent restrictions for projects. This section reviews the eligible activities under the CDBG program for rental housing activities.

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- Chapter 2: Categories of Eligible Activities  
✓ HOME and CDBG Model Guide  
✓ CPD Notice 03-14 |

✓ CDBG funds may be used for acquisition of property for an eligible rental housing project. CDBG may also be used to rehabilitate rental housing.

✓ In Rem housing—CDBG funds may also be used to make essential repairs and payment of operating expenses needed to maintain the habitability of housing units acquired through tax foreclosure proceedings in order to prevent abandonment and deterioration of such housing in primarily LMI neighborhoods.
  - Note the LMI benefit national objective is met through the Area Benefit subcategory.
Conversion of a closed building from one use to residential use (such as a closed school building to residential use) is also eligible.

States may provide assistance in the form of loans, grants, loan guarantees, interest subsidies and other forms of assistance for rental housing rehabilitation and acquisition/rehabilitation projects.

- Eligible properties may be:
  - Publicly- or privately-owned; and
  - Residential or mixed use.
- Eligible expenditures include:
  - Labor, materials and other rehabilitation costs;
  - Refinancing, if necessary and appropriate;
  - Energy efficiency improvements;
  - Utility connections;
  - Evaluating and treating lead-based paint; (NOTE: This is also eligible as a separate activity);
  - Conservation costs for water and energy efficiency;
  - Landscaping, sidewalks, and driveways when accompanied with other rehabilitation needed on the property;
  - Rehabilitation services (loan processing, work write-ups, inspections, etc.); and
  - Handicap accessibility improvements.

States may also develop facilities for persons with special needs and homeless shelters. However, in general, these facilities are categorized under CDBG as public facilities and not housing.

New construction of rental housing by a 105(a)(15) nonprofit is eligible provided the construction activity is carried out as part of a community revitalization, community economic development, or energy conservation project.

States may provide support for the development of new rental housing as an eligible activity. See the new construction section below for more information.

CDBG funds can be used to compensate property owners for the loss of rental income incurred while holding, for temporary periods, housing units for the relocation of households displaced by CDBG activities.

### 4.4 New Construction

CDBG funds can be used for new construction but only in very limited circumstances. This section reviews the eligible activities under the CDBG program for new construction housing activities.

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Generally, new construction of housing is not eligible under the CDBG program. However, the regulations allow for certain eligible entities to carry out this activity on behalf of the state grantee.

- This entity is known as a Nonprofit Development Organization.
- The eligible groups include nonprofits serving the development needs of non-entitled areas, which might include but are not limited to section 301(d) Small Business Investment Companies (SBICs), local development corporations (LDCs), and Community Housing Development Organizations (CHDOs).
- These development organizations must meet the definition outlined in Section 105(a)(15) of the Housing and Community Development Act to be considered to undertake such activities.
- These organizations must be undertaking a neighborhood revitalization, community economic development or energy conservation project in order to use CDBG for new construction. Note that new housing construction carried out by an eligible 105(a)(15) organization must be part of a larger effort to revitalize the neighborhood (i.e., a plan for the community’s revitalization efforts based on a comprehensive plan, not just for the sake of the CDBG project).
- See chapter 2 for more information about the types of organizations that qualify as 105(a)(15) organizations.

States may also provide support for the development of new housing as an eligible activity. “Support” refers to:

- Acquisition by public or nonprofit entities;
- Site clearance and assemblage; and
- Site improvements (if in public ownership).

Finally, states may use CDBG funds to construct new housing under the last resort provisions of the URA (24 CFR Part 42, subpart I). This is housing that the state has determined must be constructed in order to provide suitable replacement housing for persons to be displaced by a contemplated CDBG project, subject to the Uniform Act, and where the project is prevented from proceeding because the required replacement housing is not available otherwise.

### 4.5 Services in Connection with Housing

CDBG is flexible in allowing services to be provided to persons and households. CDBG funds may be used to pay costs in support of activities eligible for funding under the HOME program. This section details the services that provided in connection with housing activities.
Services that are related to housing activities may qualify under several eligibility categories of the CDBG regulations, including:

- As a public service activity (e.g., a housing counseling program) if the activity meets the public service eligibility criteria. (Note, however, the amount of CDBG funds used for public service activities may not exceed the 15 percent cap.);
- As part of a CDBG-funded housing activity (e.g., preparing work specifications for CDBG-funded rehabilitation projects), generally referred to as a program delivery cost; and
- CDBG funds may be used to pay for program administration of the HOME program, subject to the state grantee’s administrative cap.
- As a separate eligible category when the housing activities are linked to providing services to owners, tenants, contractors or other entities participating in or seeking to participate in the state grantee’s HOME Program. Eligible services under this category include:
  - Housing counseling;
  - Energy auditing;
  - Preparation of work specifications;
  - Loan processing;
  - Inspections;
  - Tenant selection; and
  - Management of tenant-based rental assistance (TBRA) programs.

### 4.6 Ineligible Activities

Although CDBG is very flexible in its approach to housing activities, some activities cannot be funded. This section highlights ineligible activities related to housing.

- In general, any activity not described in the HCDA statute is ineligible.
- The state CDBG regulations do not specifically list ineligible activities but states may refer to the entitlement regulations for guidance.
✓ CDBG funds cannot be used to subsidize or assist the new construction of housing, unless carried out by a 105(a)(15) nonprofit, as part of certain kinds of projects. Note that activities, which support the development of housing for LMI persons (e.g., clearance, site improvements, and public facilities), are eligible for CDBG assistance under other eligibility categories.

✓ CDBG may not be used to guarantee mortgage financing directly, and states may not provide such guarantees directly.

✓ CDBG funds may not be used to provide on-going income payments such as paying for a tenant’s rent or a household’s mortgage. The only exceptions to this are:
  - Income payments that are provided as a loan; or
  - Income payments that are emergency in nature and do not exceed three consecutive months.

✓ The purchase of construction equipment is generally ineligible. However, the purchase of tools to be part of a “tool-lending” rehabilitation program is eligible. Compensation for the use of construction equipment through leasing, depreciation or other use allowances (described in the OMB circulars) is allowable provided the activity is otherwise eligible.

### 4.7 National Objectives for Housing Activities

All CDBG activities must meet a national objective in order to be eligible to use CDBG funds. This requires that all housing activities must qualify as meeting one of the three national objectives of the program and meet specific tests for benefiting LMI persons, preventing or eliminating slums or blight and meeting other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community and other financial resources are not available to meet such needs. This section is set up by national objective and then lists the different housing activities that are applicable to that particular national objective.

#### Key Topics in This Section
- LMI Area Benefit
- LMI Limited Clientele
- Slum/Blight Area and Spot Basis
- Urgent Needs

#### Statutory Citations
Section 101(c)(2), 104(b), 105(c)

#### Other Reference Materials on This Topic
- Guide to National Objectives and Eligible Activities for States
  - Chapter 3: Meeting a National Objective

### 4.7.1 National Objective Summary Chart

✓ The following chart summarizes the national objective options related to housing activities. The text below provides additional details. For a complete copy of the matrix codes and national objectives chart, please see the IDIS chapter of this manual.
## 4.7.2 LMI Benefit National Objective

- **If a state wishes to qualify a housing rehabilitation, acquisition or construction activity under the LMI national objective, the housing national objective must be used.** The state may not use LMI area, LMI limited clientele or LMI job creation for these activities.

- **Homeowner rehabilitation and new construction single family housing activities conducted by 105(a)(15) nonprofits that provide or improve permanent residential structures to be occupied by low income persons qualify under the Housing criteria of the LMI benefit national objective.**
  - A LMI household must occupy a structure with one unit. Two-unit structures must have at least one unit occupied by a LMI household. If the structure contains three or more units, at least 51 percent must be LMI occupied.
When housing rehabilitation or new construction single family housing activities are conducted by a CDFI or as part of a state-approved Community Revitalization Strategy, multiple units (e.g. scattered site housing) may be aggregated for the purposes of meeting the LMI benefit national objective.

- Home Purchase assistance qualifies under the Housing criteria of the LMI benefit national objective.
  - LMI persons must occupy structures with one unit. If the structure contains more than one unit, at least 51 percent must be LMI occupied. (Two-unit structures must have at least one unit occupied by a LMI household.)
  - NOTE: Due to statutory requirements related to the eligibility category, when direct homeownership assistance is provided under 105(a)(24), the flexibility offered when the assistance is provided by a CDFI or as part of an approved Community Revitalization Strategy to aggregate units to meet the Housing National Objective is NOT allowed.

- Rental housing (both new construction and rehabilitation) activities that provide or improve permanent residential structures can only qualify as benefiting LMI households under the Housing criteria of the LMI benefit national objective, which deals with the occupancy of units by LMI persons.
  - The general rule is that 51 percent of the units in each assisted structure are to be occupied by LMI households. However, when rental housing activities are carried out by a CDFI or as part of an approved Community Revitalization Strategy, multiple units (e.g. scattered site housing) may be aggregated for the purposes of meeting the LMI Benefit National Objective.
  - When less than 51 percent of the units in a structure will be occupied by LMI households, CDBG assistance may be provided in the following limited circumstances:
    - The assistance is for an eligible activity to reduce the development cost of the new construction of a multifamily, non-elderly rental housing project;
    - Not less than 20 percent of the units will be occupied by LMI households at affordable rents; and
    - The proportion of the total cost of developing the project to be borne by CDBG funds is no greater than the proportion of units in the project that will be occupied by LMI households.
  - In order to meet the LMI housing national objective, rents in CDBG-assisted rental projects must be set at levels which are affordable to LMI persons.
    - States and UGLG are required to adopt and make public their standards for determining “affordable rents.”
    - The generally accepted affordability standard is that households pay no more than 30 percent of income for rent and utilities. However, use of this standard is not required by CDBG regulations.
    - States and UGLG may want to establish rent limits or ceilings based on local LMI limits and bedroom sizes, similar to those used for the HOME Program. However, each project must be undertaken in such a manner as to ensure that rents are truly affordable to LMI persons.
Housing services provided in connection with a CDBG-funded housing activity (generally as a program delivery cost) or in connection with a HOME-funded program qualify under the Housing criteria of the LMI benefit national objective.

- The general rule is that 51 percent of the units in each assisted structure are to be occupied by LMI households. Some housing activities, when carried out by a CDFI or as part of an approved Neighborhood Revitalization Strategy, may be aggregated for the purposes of meeting the LMI benefit national objective.

### 4.7.3 LMI Limited Clientele National Objective

Housing counseling services provided as a public service activity must qualify under the LMI limited clientele national objective.

- LMI limited clientele national objective activities benefit a limited number of people as long as at least 51 percent of those served are LMI persons. These activities must:
  - Benefit a clientele that is generally presumed to be principally LMI (abused children, battered spouses, elderly persons, severely disabled adults, homeless persons, illiterate adults, persons living with AIDS and migrant farm workers); or
  - Require documentation on family size and income in order to show that at least 51 percent of the clientele are LMI; or
  - Have income eligibility requirements limiting the activity to LMI persons only; or
  - Be of such a nature and in such a location that it can be concluded that clients are primarily LMI.

### 4.7.4 Slum/Blight National Objective

If a housing rehabilitation or acquisition activity does not directly benefit LMI persons, it may qualify under the Slum/Blight National Objective. However, the use of this category should be limited due to the fact that states must ensure that 70 percent of CDBG funds benefit LMI persons.

- The requirements for meeting the Slum/Blight National Objective under the Area Basis criteria include:
  - The area delineated by the state in which the activity occurs meets a definition of a slum, blighted, deteriorated or deteriorating area under state or local law:
  - Additionally, the area must meet either one of the two conditions specified below:
    - Public improvements throughout the area are in a general state of deterioration; or
    - At least 25 percent of the properties throughout the area exhibit one or more of the following:
      - Physical deterioration of buildings/improvements;
      - Abandonment of properties;
      - Chronic high occupancy turnover rates or chronic high vacancy rates in commercial or industrial buildings;
(d) Significant declines in property values or abnormally low property values relative to other areas in the community; or
(e) Known or suspected environmental contamination.

- Documentation must be maintained by the state on the boundaries of the area and the conditions that qualified the area at the time of its designation. The designation of an area as slum or blighted must be re-determined every 10 years for continued qualifications.
- The activity addresses one or more of the conditions that contribute or contributed to the deterioration of the area. **CAUTION:** Residential rehabilitation meets this requirement only if the building to be rehabilitated is considered substandard under local definition (at least Section 8 Housing Quality Standards). In addition, if non-critical items will be addressed through the rehabilitation then all deficiencies making the building substandard must be eliminated.

- To meet the Slum/Blight National Objective under the **Spot Basis** criteria:
  - The rehabilitation activity must eliminate specific conditions of blight or physical decay on a spot basis (i.e., not in an area meeting the Area Basis criteria);
  - The rehabilitation must remove only those conditions that are detrimental to public health and safety; and
  - If acquisition or relocation is undertaken, it must be a precursor to another eligible activity (funded with CDBG or other resources) that directly eliminates the specific conditions of blight or physical decay, or environmental contamination.

✓ New construction housing may qualify under the Slum/Blight National Objective under the **Area Basis**. However, the new housing only qualifies if the following conditions are met:
  - The new housing is located with a designated slum or blighted area; and
  - Development of new housing addresses one of the conditions which contributed to the deterioration of the area.

✓ Some rental rehabilitation activities may qualify under the Slum/Blight National Objective.
  - Rehabilitation of residential buildings carried out in an area meeting the slum and blight area criteria will be considered to address the area’s deterioration only if the following criteria are met:
    - Each building rehabilitated is substandard under local definition before rehabilitation; and
    - If less critical work on the building is undertaken, all deficiencies making a building substandard have been eliminated.
  - Some rental rehabilitation activities may qualify under the Slum/Blight National Objective under the **Spot Basis** criteria if they eliminate specific conditions of blight or physical decay on a spot basis not located in a slum or blighted area. Rehabilitation under these criteria is limited to the extent necessary to eliminate specific conditions detrimental to public health and safety.
4.7.5 Urgent Needs National Objective

New construction housing may qualify under the Urgent Needs National Objective. However, the new housing is needed to respond to a threat to the health or welfare of the community of recent origin and no other funding is available to meet the threat and the new construction is eligible (or the statutory waiver authority for Presidentially-declared disasters is exercised). A condition will generally be considered to be of recent origin if it developed or became critical within 18 months preceding the state grant recipient’s certification – 24 CFR 570.483(d).

4.8 Drawing Down Funds

There are a number of different ways that states may draw down their CDBG funds for projects. This section discusses three ways, escrow accounts, lump sum drawdowns and revolving loans.

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Escrow Accounts

States and UGLG may draw down CDBG funds from HUD to set up escrow accounts for the housing activities. UGLG may use this type of account for paying contractors on behalf of homeowners under CDBG single-family rehabilitation programs.

The state regulations do not address escrow accounts so states may refer to the entitlement rules. Under those rules, the escrow accounts are subject to the following limitations:

- Escrow accounts must be used for loans and grants for the purpose of rehabilitating primarily residential properties with no more than four units.
- Deposits to escrow accounts must not take place until a contract has been executed between the property owner and the contractor.
- The contract between the property owner and the contractor must specify that an escrow account will be used for payment purposes and that the state or a subgrantee will maintain the escrow account.
- All CDBG funds drawn down from HUD for escrow must be deposited into one interest bearing account.
- The amount of funds deposited into an escrow account must be limited to the amount expected to be disbursed within 10 working days from the date of deposit (any excess funds must be transferred to the state grantee’s program account).
- Funds deposited in an escrow account must be used only to pay the actual rehabilitation costs incurred by the owner under contract with a private contractor. Other costs may not be paid from escrowed funds.

Interest earned on escrow accounts must be **remitted to HUD at least quarterly.**
Lump Sum Drawdowns and Revolving Loan Funds

✓ Lump sum drawdowns and revolving loan funds may be used for housing programs.

- Lump sum drawdowns refers to the process of drawing down CDBG funds in a lump sum in order to establish a housing fund in one or more private financial institutions for the purpose of financing eligible housing activities. The fund may be used in conjunction with various financing techniques, including loans, interest subsidies, loan guarantees, loan reserves, or other uses approved by HUD.

- The state regulations do not cover lump sum draw downs so states defer to the entitlement rules on this topic.

- A revolving fund is a separate fund (independent of other CDBG program accounts) set up for the purpose of carrying out specific activities. These activities generate payments to the revolving loan fund for use in carrying out the same types of activities. Revolving loan funds are often set up for housing rehabilitation loan programs.

✓ The rules governing lump sum drawdowns and revolving loan funds are found in Chapter 16: Financial Management.