## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## Office of the Assistant Secretary for Community Planning and Development

## 24 CFR Part 570

**[Docket No. R–95–1773; FR–3787–I–01]**

**RIN 2506–AB70**

## Section 111(a) of Housing and Community Development Act of 1974; Interpretive Rule

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

**ACTION:** Interpretive rule.

**SUMMARY:** This interpretive rule sets forth HUD's interpretation of section 111(a) of the Housing and Community Development Act of 1974 (the HCDA of 1974), as to whether this section's procedural protections apply when HUD terminates a city's Urban Development Action Grant (UDAG) agreement prior to final approval and funds disbursement. The United States Court of Appeals for the District of Columbia Circuit instructed HUD to provide a reasonable construction of this statute. HUD determines that section 111(a) does not mandate procedural protections when a UDAG grant is terminated prior to final approval and funds disbursement.

**EFFECTIVE DATE:** February 27, 1995.

**FOR FURTHER INFORMATION CONTACT:** Roy O. Priest, Director of the Office of Economic Development, Department of Housing and Urban Development, Room 7136, 451 Seventh Street, SW., Washington, DC 20410. Telephone number (202) 708–2290. The TDD number is (202) 708–2565. (These are not toll-free telephone numbers).

**SUPPLEMENTARY INFORMATION:**

### Background

The Urban Development Action Grant (UDAG) program, which was enacted in 1977 under a Congressional amendment to the Housing and Community Development Act of 1974 (HCDA of 1974), was designed to encourage new or increased private investment in cities and urban counties experiencing severe economic distress. The availability of UDAG funds permitted local officials to capitalize on opportunities to stimulate economic development activity to aid in economic recovery. UDAG funds, awarded on a competitive basis, were available to carry out projects in support of a wide variety of economic development activities that involved the private sector. UDAG grants could be used in the form of equity funding, loans, interest subsidy, or other forms of necessary financing. Although Congress has not appropriated any new funds for the UDAG program since Fiscal Year 1988, many grants preliminarily approved by HUD pursuant to—or even prior to—the last funding competition still have not reached the final close-out stage. The termination of the grant agreements of recipients who fail to submit acceptable evidentiary materials or amendments to their grant agreements will be subject to the determination set forth herein regarding the opportunity for a formal hearing under section 111(a) of the HCDA of 1974.

Section 111 of the HCDA of 1974 is entitled ''Remedies for Noncompliance,'' and applies both to the Community Development Block Grant program created in 1974 and the subsequently created UDAG program. Section 111(a) provides as follows:

> If the Secretary finds after reasonable notice and opportunity for hearing that a recipient of assistance under this title has failed to comply substantially with any provision of this title, the Secretary, until he is satisfied that there is no longer any such failure to comply, shall—
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> (1) terminate payments to the recipient under this title, or
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> (2) reduce payments to the recipient under this title by an amount equal to the amount of such payments which were not expended in accordance with this title, or
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> (3) limit the availability of payments under this title to programs, projects, or activities not affected by such failure to comply.

(This provision is codified at 42 U.S.C. 5311(a), and applicable regulations are contained in 24 CFR 570.913, which also describe the notice and hearing proceedings.)

The United States Court of Appeals for the District of Columbia Circuit found that section 111(a) of the HCDA of 1974 is unclear and ambiguous as to whether HUD, before such time as any grant funds have been disbursed, must provide an opportunity for a formal hearing to a city or urban county that has a grant agreement with HUD under the UDAG program, when HUD has decided to terminate the grant agreement due to failure to comply substantially with the HCDA of 1974, applicable regulations, or the grant agreement itself. *City of Kansas City, Missouri* v. *HUD,* 923 F.2d 188, 191 (D.C. Cir. 1991). The court also found that the HCDA of 1974 contains an implicit delegation of authority to HUD to interpret the applicability of section 111 under these circumstances. *Id.* at 191–92.

### The Interpretive Rule

Under its implied interpretive authority as delegated by the HCDA of 1974, HUD interprets section 111(a) of the HCDA of 1974 as not requiring HUD to provide an opportunity for a hearing to a recipient under the UDAG program pertaining to the recipient's failure to comply substantially with any provisions of the HCDA of 1974, the regulations, or the grant agreement, which results in the termination of a grant agreement by HUD before final grant approval and payment of the grant funds to a recipient under its line of credit.

HUD has consistently maintained this interpretation of this section since the inception of the UDAG program in 1977. Accordingly, HUD has not voluntarily offered an opportunity for a formal section 111(a) hearing under the HCDA of 1974 to any recipient before acting to terminate a grant agreement. By judicial direction, HUD has now reconsidered the reasonableness of its construction of the HCDA of 1974, and has concluded that its long-standing interpretation remains correct and reasonable.

It is HUD's position that the reference in the HCDA of 1974 to HUD's ''terminat[ion of] payments'' to the recipient due to the recipient's failure to comply substantially with the provisions of Title I of the HCDA of 1974 means that the opportunity for a hearing before HUD acts to terminate a UDAG grant agreement shall be given to a recipient only after such time as funding has been finally approved and released (i.e., after payments have been made) to a recipient under its line of credit. In other words, the actual language of the statute has been interpreted by HUD not to require a formal hearing in order to effectuate HUD's termination of a grant agreement prior to such time as the recipient obtains from HUD an increase in the amount of money available under its line of credit. The primary basis for this position is the simple logic that HUD cannot possibly ''terminate payments'' that HUD has not yet made. Since entitlement to the use of grant funds is dependent upon satisfactory performance by the recipient in providing HUD with legally binding commitments that comply with the requirements of the grant agreement, there is no need to impose the procedural burden of a formal hearing upon HUD in order to terminate a grant agreement when the recipient, due to its failure to submit acceptable and timely legally binding commitments, has not become entitled to the funds by having its line of credit increased.

The use of the word ''recipient'' in the HCDA of 1974 and the UDAG regulations, beginning at 24 CFR 570.460(c), does not endow a grant applicant who receives preliminary grant approval with an unconditional entitlement to payment of the grant funds. Rather, the term ''recipient'' is intended merely to describe cities and urban counties that have entered into a grant agreement with HUD under the UDAG program. The term does not signify any absolute right to, let alone actual receipt of, the grant funds; it merely evidences conditional authority for the funds. Indeed, the regulations specifically provide at § 570.460(c)(5) that:

> Preliminary approval does not become final until legally binding commitments between the recipient and the private and public participating parties have been submitted and approved by HUD. Release of grant funds is contingent upon the recipient's meeting each and every condition set forth in the grant agreement.

Approved legally binding commitments, as required by the regulations and the grant agreement, are the touchstone that the project is fully financed and has met all conditions necessary for it to move forward to completion with the assistance of the grant funds. In other words, the recipient has no authority or right to receive any grant money until and unless it submits on a timely basis acceptable legally binding commitments that HUD approves.

Also supporting HUD's position is the fact that recipients knowingly invest in a UDAG project at their peril with regard to receiving federal grant funds until legally binding commitments are approved and their line of credit is funded. Each recipient is afforded every opportunity to know that its investment in the project in connection with an activity to be paid for, in whole or in part, with grant funds may not be recoverable if the recipient incurs costs before HUD's approval of the legally binding commitments and the funding of the recipient's line of credit. The regulations at 24 CFR 570.462(b) specifically state that:

> The recipient and participating parties may voluntarily, at their own risk, and upon their own credit and expense, incur costs as authorized in paragraph (a) of this section, but their authority to reimburse or to be reimbursed out of grant funds shall be governed by the provisions of the grant agreement applicable to the payment of costs and the release of funds by the Secretary.

The regulations, as well as the grant agreement, thus make it clear that any authorized costs incurred by a recipient or by a participating party to the project that is the subject of the grant shall be incurred at the risk of the recipient or other party, without any assurance of reimbursement out of grant funds. Accordingly, every reasonable effort should be made by a recipient to submit acceptable evidentiary materials in order that the grant funds contingently set aside at the time of preliminary approval of the grant may expeditiously be provided to the project and not remain dormant and unavailable for use by HUD. HUD's experience clearly indicates that the primary cause of recipients' failure to comply with the provisions of the HCDA of 1974, the regulations, and the grant agreement has been their failure to submit satisfactory legally binding commitments to HUD within the time agreed under their grant agreements.

The fact that termination of grants is more likely to occur before disbursement of the funds, rather than after, does not serve to alter HUD's determination in this interpretive rule. A potential practical effect cannot undo HUD's reasonable interpretation of Congress' chosen statutory language, made in light of the overall program operation discussed above. Moreover, even as to practical considerations, there have been, to date, more than 263 terminations of grants for cause before the legally binding commitments have been approved and the recipient's line of credit funded. Requiring a formal hearing prior to termination would thus be extremely burdensome upon HUD's limited resources.

While HUD determines that recipients lack a formal hearing right under section 111(a) prior to final approval of the grant, it is significant that HUD nevertheless provides extensive notice and opportunities to resolve the problems. HUD consistently makes every effort to resolve problems that a recipient is experiencing in its attempt to comply with requirements of the HCDA of 1974, the regulations, or the grant agreement before giving final notice of termination to the recipient. Efforts include an invitation to the recipient's representatives to meet with HUD officials to discuss the issues and attempt to correct the problems that may be causing noncompliance. It has been HUD's practice to afford a recipient every reasonable opportunity to comply substantially with the requirements of the HCDA of 1974, the regulations, and the grant agreement. Only after HUD has exhausted all available means to resolve the issues has it been compelled to advise the recipient that its failure to correct the default may result in termination of a grant agreement by HUD. Often a recipient has responded favorably to HUD's efforts to assist in clearing the noncompliance and the project has been timely funded.

If HUD's attempts to work with the recipient to resolve the issues ultimately do not succeed, HUD will provide the recipient a written notice of its intention to terminate the grant agreement at least 35 days before taking action to terminate the grant agreement. Often this period of time is extended by HUD to provide additional opportunities to the recipient to remedy the noncompliance. Thus, recipients are not, in fact, deprived of procedural protection at the stage when, according to the U.S. Court of Appeals for the District of Columbia Circuit, it is arguably most needed. *City of Kansas City, Missouri* v. *HUD,* 923 F.2d 188, 193 (D.C. Cir. 1991). To the contrary, HUD provides extensive notice and opportunities to resolve the dispute, albeit not through a formal hearing.

Accordingly, this interpretive rule sets forth HUD's determination that, before such time as the UDAG grant has received final approval by HUD and the grant funds have been paid to the recipient under its line of credit, the HCDA of 1974 does not require that a UDAG recipient be entitled to an opportunity for a hearing concerning the recipient's failure to comply substantially with any provision of the HCDA of 1974, the regulations, or the grant agreement that HUD has decided to terminate. In addition, it has been determined that an opportunity for a hearing will be available to a recipient with regard to the termination of a grant that has been partially funded, but only with regard to the grant funds covered by legally binding commitments that HUD approved before the termination of a grant (or part of a grant) due to the failure of a recipient to comply substantially with any provision of the HCDA of 1974, the regulations, or the grant agreement.

This interpretive rule shall not apply to recipients who have received grants in states under the jurisdiction of the U.S. Court of Appeals for the First Circuit. In *City of Boston* v. *HUD,* 898 F.2d 828 (1st Cir. 1990), the court held that the recipient City of Boston was entitled to notice and opportunity for a hearing prior to termination of its UDAG grant, even though the City of Boston had not received final approval by HUD for its grant, let alone received any disbursement of funds.

Authority: 42 U.S.C. 3535(d).

Dated: February 17, 1995.

Andrew Cuomo,

*Assistant Secretary for Community Planning and Development.*

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