the respondent may wish to provide; and

(6) That if a complaint is issued under § 30.85, the respondent may request a hearing before an administrative law judge in accordance with § 30.95.

(b) *Obligation to preserve documents.* Upon receipt of the prepenalty notice, the respondent is required to preserve and maintain all documents or data, including electronically stored data, within his or her possession or control that may relate to the violations alleged in the prepenalty notice. The Department shall also preserve such documents or data upon the issuance of the prepenalty notice.

8. Revise § 30.75 to read as follows:

§ 30.75 Response to prepenalty notice.

(a) The response shall be in a format prescribed in the prepenalty notice. The response shall address the factors set forth in § 30.80 and include any arguments opposing the imposition of a civil money penalty that the respondent may wish to present.

(b) In any case where respondent seeks to raise ability to pay as an affirmative defense or argument in mitigation, the respondent shall provide documentary evidence as part of its response.

9. Revise § 30.80 to read as follows:

§ 30.80 Factors in determining amount of civil money penalty.

After determining that a respondent has committed a violation as described in Subpart B of this part that subjects the respondent to liability under this part, the officials designated in subpart B of this part shall consider the following factors to determine the amount of penalty to seek against a respondent, if any.

(a) The gravity of the offense;

(b) Any history of prior offenses;

(c) The ability to pay the penalty, which ability shall be presumed unless specifically raised as an affirmative defense or mitigating factor by the respondent;

(d) The injury to the public;

(e) Any benefits received by the violator;

(f) The extent of potential benefit to other persons;

(g) Deterrence of future violations;

(h) The degree of the violator's culpability;

(i) With respect to Urban Homestead violations under § 30.30, the expenditures made by the violator in connection with any gross profit derived; and

(j) Such other matters as justice may require.

(k) In addition to the above factors, with respect to violations under §§ 30.45, 30.55, 30.60, and 30.68, the Assistant Secretary for Housing—Federal Housing Commissioner, or his or her designee, or the Assistant Secretary for Public and Indian Housing, or his or her designee, shall also consider:

(1) Any injury to tenants; and/or

(2) Any injury to lot owners.

(l) HUD may consider the factors listed in paragraphs (a) through (k) of this section to determine the appropriateness of imposing a penalty under § 30.35(c)(2); however, HUD cannot change the amount of the penalty under § 30.35(c)(2).

10. In § 30.85, revise paragraphs (b) introductory text, (c), and (d) and add paragraph (e) to read as follows:

§ 30.85 Complaint.

* * * * *

(b) If a determination is made to seek a civil money penalty, government counsel shall issue a complaint to the respondent on behalf of the officials listed at subpart B of this part or the Mortgagee Review Board for violations under § 30.35. The complaint shall be served upon respondent and simultaneously filed with the Office of Administrative Law Judges, and shall state the following:

* * * * *

(c) A copy of this part and of 24 CFR part 26, subpart B, shall be included with the complaint.

(d) *Service of the complaint.* The complaint shall be served on the respondent by first class mail, personal delivery, or other means.

(e) Before taking an action under §§ 30.35 for violation of 12 U.S.C. § 1735f–14(b)(1)(D) or (F), 30.36, or 30.50 for violation of 12 U.S.C. 1723i(b)(1)(G) or (I), the Secretary shall inform the Attorney General of the United States, which may be accomplished by providing a copy of the complaint. The Secretary shall include in the body of the complaint a statement confirming that this action was taken.

11. In § 30.90, revise paragraph (a), redesignate paragraph (b) as (c), and revise the new paragraph (b) to read as follows:

§ 30.90 Response to the complaint.

(a) *Request for a hearing.* If the respondent desires a hearing before an administrative law judge, the respondent shall submit a request for a hearing to HUD and the Office of Administrative Law Judges no later than 15 days following receipt of the complaint, as required by statute. This mandated period cannot be extended.

(b) *Answer.* In any case in which the respondent has requested a hearing, the respondent shall serve upon HUD and file with the Office of Administrative Law Judges a written answer to the complaint within 30 days of receipt of the complaint, unless such time is extended by the administrative law judge for good cause. The answer shall include the admission or denial of each allegation of liability made in the complaint; any defense on which the respondent intends to rely; any reasons why the civil money penalty should be less than the amount sought in the complaint, based on the factors listed at § 30.80; and the name, address, and telephone number of the person who will act as the respondent's representative, if any.

* * * * *

12. Revise § 30.95 to read:

§ 30.95 Hearings.

Hearings under this part shall be conducted in accordance with the procedures applicable to hearings in accordance with the Administrative Procedure Act, set forth in 24 CFR part 26.

13. Revise § 30.100 to read as follows:

§ 30.100 Settlement of a civil money penalty action.

The officials listed at subpart B of this part, or their designees (or the Mortgagee Review Board, or designee, for violations under § 30.35), are authorized to enter into settlement agreements resolving civil money penalty actions that may be brought under part 30.

Dated: September 23, 2008.

Roy A. Bernardi,

Deputy Secretary.

[FR Doc. E8–24574 Filed 10–16–08; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 570

[Docket No. FR–5181–P–01]

RIN 2506–AC22

State Community Development Block Grant Program: Administrative Rule Changes

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

ACTION: Proposed rule.

SUMMARY: This proposed rule would make changes to several sections of the regulations for the Community

Development Block Grant (CDBG) program for states (State CDBG). This proposed rule would streamline and update the regulations to reflect statutory changes, clarify the program income requirements, provide other clarifications to the State CDBG regulations, and make a conforming change to the regulations applicable to the CDBG Entitlement program. This proposed rule would also provide states additional flexibility in their administration of the program.

DATES: *Comment Due Date:* December 16, 2008.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410–0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410–0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at *http://www.regulations.gov.* HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the *http://www.regulations.gov* Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202–708–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800–877–8339. Copies of all comments submitted are available for inspection and downloading at *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Steven Higginbotham, Community Planning and Development Specialist, Office of Community Planning and Development, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 7184, Washington, DC 20410; telephone number 202–708–1322 (this number is not toll-free). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800–877–8339. FAX inquiries (but not comments on this proposed rule) may be sent to Mr. Higginbotham at 202–401–2044 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

This proposed rule would revise the regulations for the CDBG program for states (State CDBG) in 24 CFR part 570, subpart I, to respond to issues HUD has identified in the program, to conform the regulations to current statutory requirements concerning program income, and to provide additional flexibility to states in implementing their programs.

Specifically, this proposed rule would revise requirements related to the following matters: (1) Interest on federal grant payments to states; (2) program income, including the situations in which income earned on grant funds must be remitted to the Department of the Treasury; (3) flexibility for a state to use up to 3 percent of its allocation, program income, and recaptured funds for state administrative expenses and technical assistance; (4) revolving funds; (5) the use of CDBG funds outside the jurisdiction of the recipient; (6) states' administrative flexibility to impose additional requirements on recipients; (7) allowability of costs incurred by states prior to execution of a grant agreement; (8) audits; (9) states' disbursement of grant funds to units of general local government only; (10) applicability of cost principles and the requirement for prior approval of certain costs by HUD; (11) fiscal controls and administrative procedures; (12) exclusion from program income of amounts generated by certain activities financed with section 108 loan guarantees; and (13) reporting. HUD is also requesting public comments on whether HUD should promulgate State CDBG regulations that mirror existing CDBG Entitlement program regulations (24 CFR part 570, subpart J) on lump-sum drawdowns and the use of escrow accounts for rehabilitation of residential properties.

II. This Proposed Rule

Each of the proposed changes is described below.

A. Interest on Federal Grant Payments to States

Section 570.489(c) of the current regulations describes the requirements concerning federal grant payments to states. Section 570.489(c)(1) provides that states and units of general local government must minimize the elapsed time between receipt of federal funds from the state's line of credit and their disbursement for grant activities. Section 570.489(c)(2) provides that interest earned by units of general local government on funds held pending disbursement is not program income and must generally be returned to the Department of the Treasury. It further provides that states generally do not have to return interest earned during the time between receipt of funds and disbursement to local governments. These provisions of the State CDBG regulations were based in part on the Intergovernmental Cooperation Act (31 U.S.C. 6503) and pre-1993 implementing regulations at 31 CFR part 205.

The Cash Management Improvement Act of 1990 (CMIA) (31 U.S.C. 3335, 6503), as amended in 1992, made several fundamental changes to the manner in which payments between federal and state governments are made. The Treasury Department's regulations implementing the CMIA are located in 31 CFR part 205. Under the current regulations, states and the Treasury Department enter into agreements covering all federal programs over a certain funding level. Through these agreements, states select payment techniques that are designed to prevent delays between drawdown and disbursement of funds, and the agreements provide for the calculation at stated interest rates of states' net interest liabilities to the federal government. For programs whose funding levels are below the applicable threshold or otherwise not subject to an agreement, states and federal agencies

must comply with subpart B of 31 CFR part 205, which provides requirements for minimizing the time between drawdown and disbursement of funds.

The current requirements at 31 CFR part 205 render some aspects of § 570.489(c) obsolete. Therefore, rather than repeat the requirements for states in the State CDBG regulations, this proposed rule would revise § 570.489(c) by cross-referencing the requirements in 31 CFR part 205. This proposed rule would retain the existing requirement that units of general local government minimize the time between receipt of CDBG funds and their disbursement, and would clarify that the state is required to ensure that units of local government are in compliance with this requirement.

B. Program Income Requirements

The proposed changes to the program income provisions that are described in this section respond to the amendments made by the Housing and Community Development Act of 1992 (the 1992 Act) (Pub. L. 102–550, approved October 28, 1992) and an opinion issued by the Comptroller General of the United States.

1. Implementation of 1992 Statutory Amendments

The existing State CDBG regulations provide in § 570.489(e)(3)(ii)(B) that program income received by a unit of general local government after closeout of its grant from the state is generally not subject to the program income requirements in § 570.489(e). However, the 1992 Act amended section 104(j) (42 U.S.C. 5304(j)) of the Housing and Community Development Act of 1974 (the Act) to provide that the use of program income is governed by CDBG program requirements for as long as program income remains.

Several regulatory initiatives were reflected in the CDBG Program Economic Development Guidelines final rule, published on January 5, 1995 (60 FR 1922). At that time, HUD noted that further regulatory changes were forthcoming to implement fully the 1992 Act. However, HUD recognized the need to provide guidance to grantees in the interim. On October 27, 2004, HUD published CPD Notice 04–11, ''Program Income Requirements in the State CDBG Program.'' The notice described the changes that occurred in 1992 and provided guidance to states on how to deal with their increased record-keeping responsibilities.

A major challenge that states face in implementing the 1992 Act is that a unit of general local government may continue to generate and use program income long after the originally funded activities are completed and closed out. The statutory provision significantly extended states' responsibilities to track program income. To provide as much flexibility as possible within the constraints of the law, this proposed rule would revise § 570.489(e)(3)(ii)(B) by allowing states to demonstrate compliance with this requirement in any of the following ways:

(a) States may maintain contractual relationships with units of general local government for as long as there is program income to be tracked. Since, in some cases, receipts of program income by a local government may be sporadic, a state could craft its contractual agreements so that obligations would not be imposed once a local government has exhausted its program income and would arise again only upon receipt of new program income.

(b) States may require, as a condition of closeout, that local governments agree to obtain advance state approval of a local plan to expend program income, or of individual expenditures of program income, in the absence of a continuing contractual relationship. This arrangement may be beneficial to states that presently use a ''conditional closeout'' process, in which a grant recipient has program income on hand at the time of grant closeout or receives program income after closeout of the grant that generated the program income.

(c) States may require, as a condition of closeout, that the unit of general local government agree to notify the state when new program income is received by the unit of general local government. This option may be especially useful when dealing with local revolving loan funds, or when states and units of local governments are not able to project future needs to be addressed with activities funded by program income.

(d) States may seek HUD approval of an alternative method for demonstrating compliance. HUD intends that field offices, not Headquarters, would grant such approval.

States may select different approaches for different types of grant recipients. For example, a state that distributes some of its funds on a formula basis and some on a competitive basis might select option (a), above, for those units of general local government that receive funding every year, and option (c) for other grant recipients. A state might also blend the first two options by requiring a plan for the use of program income by local governments as part of its contractual agreement with units of general local government.

Program income is a significant resource in the State CDBG, and it constitutes a major multiplier of the benefits that the CDBG program provides to citizens and beneficiaries. For example, in Fiscal Year (FY) 2007, states cumulatively receipted $37.3 million in program income. The $37.3 million represents only that portion of program income that was returned to the states by units of general local government. Although HUD has issued guidance in the past on how to report on program income retained at the local level, many states have not complied with all of HUD's recommendations. This proposed rule would revise § 570.490(a)(3) to require reporting of data that will include program income retained at the local level. Also, consistent with the 1992 Act's requirement to account for program income as long as the program income remains, this proposed rule would revise § 570.489(e)(4) to require the annual Performance and Evaluation Reports (PERs) of states to include the use of program income retained by local governments.

2. Uniform Treatment of Program Income

Over the years, there has been a succession of regulatory changes to the State CDBG program income requirements. Program income received from grants made prior to December 9, 1992, was subject to the requirements in a final rule published in the **Federal Register** on November 9, 1992 (57 FR 53397). Program income generated from grants made by states with FY 1993 and later funds is subject to the requirements of the 1992 Act as well as the requirements of the November 9, 1992, final rule. Finally, the January 5, 1995, CDBG Program Economic Development Guidelines final rule included an expanded list of revenues that are not considered program income.

States have reported that tracking different requirements as they apply to different funding years is complicated and time-consuming, especially for program income retained at the local level. Repayments of loans made from one grant to a given community may be subject to different requirements than repayments of loans made from a subsequent year's grant to the same community. This results in an increased record-keeping burden on both the state and local governments. The complexity and burden are compounded when program income is used to make additional loans, which, in turn, generate more program income. Some states have expressed confusion about whether program income is subject to

the requirements in effect at the time the state awarded the initial grant to the locality, or to the requirements in effect when the program income is received.

This proposed rule would revise § 570.489(e)(1) to apply the tracking requirements to all program income received and retained by localities, regardless of the fiscal year in which the state grant funds that generate the program income were appropriated. HUD does not believe that significant amounts of program income are likely to be generated by funds appropriated before FY 1993, since in most cases the funded activities ended years ago. Furthermore, this proposed rule would also clarify in § 570.489(e)(2)(v) that proceeds received from the sale of real property acquired or improved in whole or part with CDBG funds would not be considered program income if the proceeds are received more than 5 years after expiration of the grant agreement. For these reasons, making all program income subject to post-FY 1992 requirements should have little effect on grantees. However, HUD specifically requests comment from grantees that might be adversely affected.

It is noted that for the purpose of determining the administrative expense, technical assistance, and public service caps, program income is counted in the year that it is received by the unit of general local government, or by the unit of general local government's subgrantee.

3. Miscellaneous Improvements and Updates

States have requested several clarifications of the program income requirements, and HUD has discovered other requirements that call for clarification. In substantially updating the program income requirements contained in § 570.489(e), this proposed rule would incorporate the following changes:

(a) Selling Off Loan Portfolios in Order To Expedite the Receipt of Program Income

In order to maximize available financial resources, communities are increasingly selling portfolios of loans on the secondary market or selling obligations secured by loan portfolios. Several communities have requested HUD's approval to ''net out'' of the proceeds from such sales the various legal and other costs that are incurred when a grantee sells or securitizes a portfolio. Exclusion of such costs from program income would be analogous to the current provision under which costs incidental to the generation of program income from the rental or use of CDBG-assisted real or personal property may be netted out of the gross income received. Therefore, this proposed rule would amend § 570.489(e)(1)(vi) and (vii) to allow legal and other costs associated with the sale or securitization of CDBG-funded loans to be netted out before the amount of program income is determined. This provision does not allow to be netted out those costs that are eligible as general administrative costs of either the state or the unit of general local government.

(b) Annual Threshold for Program Income

Section 104(j) of the Act allows HUD to promulgate regulations excluding from the program income requirements amounts that are so small that tracking them would pose an unreasonable administrative burden on the unit of general local government. In the CDBG Program Economic Development Guidelines final rule published on January 5, 1995, HUD raised the threshold in § 570.489(e)(2)(i) from $10,000 to $25,000 per year per unit of general local government. Income that would otherwise be considered program income, but which totals less than the current $25,000 threshold, is excluded from the definition of program income and is therefore not subject to CDBG requirements. If the total income that would otherwise be considered program income exceeds the threshold, then none of it is excluded from CDBG requirements. In order to account for inflation, this proposed rule would raise the threshold to $35,000 per year per unit of general local government.

In addition, this proposed rule would revise § 570.489(e)(2)(i) to match the language found in the Entitlement CDBG regulations at § 570.500(a)(4)(i). The Entitlement CDBG regulations exclude income that ''does not exceed'' the applicable threshold, while the State CDBG regulations exempt income ''which is less than'' the applicable threshold. This proposed rule would revise the State CDBG regulations so that total income that ''does not exceed'' the applicable threshold would be excluded from the definition of program income. The Entitlement threshold of $25,000 is not being proposed for change at this time.

This proposed rule would also revise § 570.489(e)(2)(i) to clarify that the exclusion of total income that does not exceed the threshold applies only to program income retained by a unit of general local government and its subgrantees, and that the threshold applies separately to each unit of general local government. As with the current regulation, the exclusion would not apply to program income that a unit of general local government earns but returns to the state. It is HUD's policy, communicated to states in the past, that the exclusion does not apply to program income received into local revolving loan funds (RLFs). The proposed rule would codify this policy. Income received into an RLF is always included in program income and subject to CDBG requirements.

This proposed rule would also codify HUD's policy that income received into an RLF is not added to ''regular'' program income received by the local government in applying the threshold, which this proposed rule would increase to $35,000. For example, assume that the proposed threshold increase becomes effective, and a unit of general local government maintains an RLF that receives $10,000 in one program year. In that same program year, it receives $30,000 in non-RLF income that, if not for the exclusion in § 570.489(e)(2)(i), would be considered program income. In this example, the $30,000 in non-RLF income would be excluded from program income (and, as a result, CDBG requirements would not apply to it), even though the total amount of program income under control by the local government is $40,000. The $10,000 that the RLF received would be considered program income. In another example, the unit of general local government maintains the same $10,000 in its RLF, but receives $35,001 in non-RLF program income. In this example, neither the RLF nor non-RLF program income would be exempted from CDBG requirements.

(c) Remission of Interest

This proposed rule would add § 570.489(e)(2)(iv), listing three types of interest income that are not considered program income and must be remitted to the Treasury Department. The first type, which would be defined in § 570.489(e)(2)(iv)(A), would respond to an opinion of the Comptroller General of the United States that income generated by an ineligible CDBG-assisted activity must be remitted to the U.S. Treasury. According to the Comptroller General opinion, eligibility includes meeting a national objective. Therefore, interest generated from CDBG-funded loans could be kept by the grantee only when the assisted activities meet the national objective requirements.

A second type of interest that is excluded from program income would be defined at § 570.489(e)(2)(iv)(B). Interest income on funds reimbursed to a state's CDBG program account prior to the state's disbursement of the funds for

eligible purposes would have to be returned to the Treasury Department.

A third type of interest that is excluded from program income and must be remitted to the U.S. Treasury would be defined at § 570.489(e)(2)(iv)(C). All interest in excess of $100 earned by units of general local government on grant advances prior to disbursement of the funds for activities must be returned to the Treasury Department under the current provision at § 570.489(c)(2). Consistent with the proposed revision of § 570.489(c), described above, this proposed rule would move the requirement to § 570.489(e)(2)(iv), in order to complete the listing of what is not program income.

HUD issued comparable provisions in a final rule for the Entitlement CDBG program, published on November 9, 1995 (60 FR 56892). In responding to public comments in that rulemaking, HUD provided guidance on the extent and applicability of those provisions. Readers with a particular interest in those provisions may wish to read the preamble to the November 9, 1995, final rule (60 FR 56892).

(d) Program Income Generated by Loans to State Grant Recipients

This proposed rule would add a provision in § 570.489(e)(2)(iii) to prevent double-counting of program income received by a subgrantee and subsequently used to make payments on a loan from a unit of general local government. To the extent that the funds used by a subgrantee to make principal or interest payments on a CDBG loan it received from a unit of general local government consist solely of program income received by the subgrantee, no amount of those payments represents ''new income'' to the unit of general local government's CDBG program as a whole. Since revenue is already counted as program income at the time it is received by the subgrantee, this provision would prevent double-counting of program income. To the extent, however, that the subgrantee uses non-CDBG funds to make the principal or interest payments, those payments to the local government are new program income to the CDBG program. This proposed rule would not affect the treatment of such payments under existing practice. HUD added a similar provision to the Entitlement program regulations in the November 9, 1995, final rule (60 FR 56893).

For example, if Apple Borough provided funds to the Apple Development Authority as a subgrantee to run its economic development loan program, and the Apple Development Authority provided a $50,000 loan to Apple Dairies for a business expansion, Apple Dairies' repayment of the $50,000 to the Apple Development Authority would be program income. The Apple Development Authority's repayment of the $50,000 to Apple Borough would not be program income, since it would be the same $50,000 transferred from Apple Dairies to the Apple Development Authority and such program income should not be counted twice.

(e) Program Income Retained at the Local Level

Section 104(j) of the Act allows a state to require that a unit of general local government return any program income that it collects to the state, to be used by the state to fund additional eligible community development activities. However, the state must waive this requirement ''to the extent such income is applied to continue the activity from which such income was derived.''

HUD gives states flexibility to determine whether program income received by a unit of general local government is being ''applied to continue the activity from which such income was derived.'' HUD is aware of situations in which states found that a unit of general local government failed to use program income in accordance with other program requirements or was not making sufficient efforts to expend its program income to continue the activity. HUD does not believe that the statutory language prohibits states from requiring a unit of general local government to return program income if it is expending the program income in violation of other CDBG requirements or delays expenditure for an unreasonable period of time. Inasmuch as local retention of program income is required only ''to the extent such income is applied to continue the activity from which such income was derived,'' HUD believes the statute necessarily contemplates that the funds will be used for eligible activities in a timely manner and in compliance with applicable requirements. This proposed rule would revise § 570.489(e)(3)(ii)(A) to provide that a state's determination of whether program income is being ''applied to continue the activity from which such income was derived'' can include consideration of whether the program income is not being used (or is unlikely to be used) within a reasonable time and in accordance with program requirements to continue the activity.

In some situations, a state may determine that a unit of general local government will apply program income to continue the activity from which the income is derived, but that the amount of program income on hand exceeds projected cash needs for the reasonably near future. For example, a community has a demand for two housing rehabilitation loans per month, but has enough program income on hand to fund 25 loans. A state could require the unit of general local government to return some or all of the program income to the state's CDBG program income account until such time as it is needed by the unit of general local government. The state could disburse these funds to other units of general local government in the meantime rather than drawing funds from its line of credit. When the local government needs its program income, the state could disburse the funds from the program income account or, as necessary, draw an equivalent amount from the state's line of credit for disbursement to the local government.

In other situations, a state may determine that a unit of local government is not likely to apply any significant amount of program income to continue the activity within any reasonable amount of time, or that it will not apply the program income in accordance with applicable requirements. In such cases, a state could require the unit of general local government to return all of the program income to the state's CDBG program income account for disbursement to other units of local government.

This proposed rule would increase the effective ''buying power'' of a state's CDBG funds, by making otherwise idle CDBG funds available to support current needs elsewhere in the state. Reduced interest costs to the Treasury Department from prematurely drawn funds would be another benefit, because states would need to draw funds from their line of credit somewhat less frequently. States would have the flexibility to define the time period over which cash needs for program income would be projected and the appropriate level of program income that could be retained in the local government's own program account. If a state plans to manage program income in this manner, its approach must be described in the state's action plan submitted in accordance with § 91.320 of this title.

(f) New Entitlement Grantees

This rule would clarify requirements for new Entitlement grantees that possess program income that they received when they were participating in the State CDBG program. Any such program income would continue to be treated as State CDBG program income, unless the state approves the transfer of

the program income to the Entitlement program. States and units of local government may prefer to transfer such State CDBG program income to the Entitlement program, since doing so would reduce states' monitoring burdens and require new Entitlement grantees to comply with only one set of program income requirements.

Conversely, on rare occasions a state may be faced with the return to the State CDBG program of a grantee that has recently lost or relinquished its Entitlement status. This proposed rule would provide that, in such a case, the unit of general local government may elect to transfer the program income to the State CDBG program. Program income that is not transferred would continue to be subject to Entitlement program requirements, and closeout of the community's Entitlement grants with HUD could be delayed. While guidance has been given to individual grantees on these issues in the past, HUD recognizes the need to provide for these options through regulations.

This proposed rule would add at § 570.489(e)(3)(iii) a list of conditions that must be met by a new Entitlement grantee before the state may approve the transfer of the State CDBG grant-generated program income to the locality's new Entitlement program. The grantee would have to elect to participate in the Entitlement program, agree to use the program in accordance with Entitlement program requirements, set up access to HUD's Integrated Disbursement and Information System (IDIS), and agree to enter the transferred program income into IDIS. The proposed rule would also add at § 570.489(e)(3)(iv) the options for a former Entitlement community's handling of program income when joining the State CDBG program. The proposed rule would also make a conforming change to the Entitlement program regulations by adding the same language at § 570.504(e).

(g) Administering the State CDBG Program

Section 106(d)(2)(A) of the Act (42 U.S.C. 5306(d)(2)(A)) provides that a state may elect to distribute State CDBG funds to its non-entitlement areas and also provides that any such election is permanent and final. Forty-nine states and the Commonwealth of Puerto Rico have elected to administer the State CDBG program, and only Hawaii's non-entitlement program is administered by HUD. The proposed rule would revise § 570.480(a) to clarify that, consistent with the Act, the requirements of subpart I of part 570 are applicable to states that have permanently elected to distribute funds to their non-entitlement areas. Revised § 570.480(a) would also cross-reference requirements outside of part 570, subpart I, that apply to the State CDBG program.

C. Flexibility for States To Allocate Funds for Administrative Expenses and Technical Assistance

This proposed rule would revise § 570.489(a)(1) to reflect a statutory amendment that provides states flexibility to allocate an increased portion of CDBG funds between state administrative expenses and costs of providing technical assistance to units of local governments and nonprofit program recipients. The 2004 Consolidated Appropriations Act amended section 106(d) of the Act to allow states to use up to 3 percent of their allocations on administrative expenses, technical assistance, or a combination thereof, in addition to the $100,000 base amount that states may use for administrative expenses. A maximum of 50 percent of administrative expenses in excess of $100,000 may be paid for with CDBG funds, and the remainder must be paid for with states' own funds. Prior to the amendment, states could allocate up to 2 percent of CDBG funds (in addition to the $100,000 base amount) for state administrative expenses, and up to one percent for technical assistance. This proposed rule would revise the corresponding regulation to reflect states' increased flexibility to allocate up to 3 percent of CDBG funds between administrative expenses and technical assistance according to the states' preferences.

For instance, a state could increase the percentage of CDBG funds for state administrative expenses to $100,000, plus 2.5 percent of its total allocation, in which case it would have only 0.5 percent available to use for technical assistance activities. Or the state could spend 2 percent of its allocation on technical assistance activities, leaving only $100,000 plus one percent of its total allocation to spend on state administrative expenses. In either case, the state will still have to match, dollar-for-dollar, any CDBG funds used for administrative expenses in excess of $100,000.

Under the current regulations, a state is allowed to add amounts reallocated by HUD to the state, as well as program income received by units of general local government, to the amount of the state's annual grant in calculating its state administrative expense cap. This proposed rule would provide in § 570.489(a)(1)(ii) that a state may make the same additions to the amount of the state's annual grant in calculating the technical assistance cap. This proposed rule would also add clarifying provisions at § 570.489(a)(1)(iv) to reflect that increased amounts of CDBG funds for state administrative costs are available only for periods following the enactment of the statutory amendment.

D. Determining Compliance With Administrative Expense Cap

This proposed rule would revise § 570.489(a)(1)(v)(A), which describes the cumulative accounting method to determine compliance with the administrative expense cap. The revisions would ensure that terms are used in a manner consistent with section 106(d) of the Act, as amended, and with § 570.489(a)(1)(v). This rule would also correct the description of the matching requirement to clarify that the amount the state must contribute is logically a minimum, rather than a maximum, amount. This proposed rule would also clarify that if a grant for any year during the Consolidated Planning period considered has been closed out, then aggregate amounts will be reduced by amounts attributable to the closed-out grant in order to make the required comparisons.

This proposed rule would also revise § 570.489(a)(1)(v)(B) to clarify the year-to-year accounting method for determining compliance with the administrative expense cap, which is an alternative to the cumulative approach for determining compliance. The current regulation refers to ''an accounting process developed and implemented by the state which provides sufficient information to demonstrate that the requirements of this subsection are met.'' This proposed rule would replace the current provision with a defined alternative to the cumulative approach. It would specifically describe the process for tracking administrative costs on a yearly basis, and permit a state to draw down funds for administrative expenses (after the expenditure of the initial $100,000 for state administrative expenses) only upon expending an equal or greater amount of its own funds for administrative expenses. HUD does not anticipate that this change will have any material effect on state CDBG grantees.

E. State Revolving Funds

Revolving funds are typically established and administered in the following manner: A loan is made by a unit of general local government with CDBG funds (e.g., to a business to expand). Payments on the loan (i.e., principal, interest, or both) are accounted for as CDBG program income

on the local government's books and held in a separate account independent of other program accounts. The program income in that account, including interest earned on the funds while on deposit pending their reuse, becomes the source of financing for additional loans of the same type. Hence, the term ''revolving fund'' has been used to describe such a fund. Revolving funds are used most frequently in connection with housing rehabilitation and economic development projects that involve loans.

A number of states have found regional revolving loan funds to be an efficient means of collecting and redistributing program income held at the local level. Such loan funds are often operated by a non- or quasi-governmental organization that administers programs as a subgrantee of several units of general local government to which the state awarded the grants. (Since these subgrantees are usually not units of general local government, they may not directly receive CDBG funding.) Any program income the subgrantee administers belongs to the unit of general local government whose grant generated the program income, and successive reuses of program income must be traceable back to an individual locality's grant. This presents an obstacle for regional loan fund operators that wish to use program income to fund activities anywhere in their service area, regardless of which community the program income belongs to. While a unit of general local government may use CDBG funds for activities outside its jurisdictional boundaries, it must first determine that doing so will meet its community development needs. It may be difficult for community A to reasonably conclude that its citizens benefit by having its program income used for an activity in community B, 60 miles away.

To address these obstacles, HUD supports efforts to establish regional state revolving funds (SRFs). Economies of scale can often be achieved in the administration of such programs. Regional economic development efforts may be more cognizant of the regional nature of rural economies and be better positioned to act accordingly. Assessing the benefits of individual economic development projects may also make sense from a regional perspective, because employees of businesses in rural communities frequently commute from residences in other communities that are a significant distance away from their jobs.

To provide administrative flexibility, the Act and current State CDBG regulations in § 570.489(f) offer three options regarding revolving funds. First, section 106(d)(4) of the Act provides that states may make awards to combinations of governments. Under such an arrangement, program income can be reused within the jurisdiction of any of the participating local governments. Second, if both the activities and the regional entity that carries out the activities qualify under section 105(a)(15) of the Act (42 U.S.C. 5305(a)(15)) (assistance to a neighborhood-based nonprofit organization), repayments generated from these activities are not within the definition of ''program income'' at § 570.489(e)(2)(ii) and thus are not subject to program requirements. Third, a state may operate a statewide revolving fund to redistribute program income returned to the state, in the form of grants to units of general local government, as provided at 570.489(f)(2).

This proposed rule would expand upon this third option by clarifying in § 570.489(f)(2) that a state may operate one or more revolving funds on a regional or statewide basis. Provided that the state determines that the program income will not be used to continue the activity that generated it, section 104(j) permits a state to require program income generated from grant-funded activities to be returned to the state, regardless of whether the amount falls below the $25,000 threshold (which this proposed rule would increase to $35,000). With the proposed change, a state could designate a regional revolving fund as an SRF and require units of general local government to pay their program income directly to it. The state could then contract with a regional entity to administer the fund (including the distribution of program income to local governments) on behalf of the state. Because the program income belongs to the state, the regional entity could distribute it to any other eligible unit of general local government covered by the regional SRF on behalf of the state and in accordance with the state's method of distribution. The community whose initial grant generated the program income would have no further responsibility for the program income, once the program income is paid into the regional SRF. Payments of program income to the regional SRF would belong to the state, rather than to a unit of general local government, and the regional SRF entity could award the funds, on behalf of the state, to units of general local government anywhere within the region. While this arrangement is similar to a revolving loan fund, it is important to note that the regional entity administering the SRF, as an agent of the state, could make grants only to units of general local government. Any state choosing this approach would be required to describe its process in the method of distribution contained in its action plan.

F. Spending Funds Outside the Jurisdiction of the Recipient

This proposed rule would revise § 570.486(b) and add a new § 570.486(c) to place conditions on CDBG-funded projects that benefit residents outside the recipient's jurisdiction. Under the existing regulations, CDBG-funded activities may serve beneficiaries living outside the jurisdiction of the unit of general local government that receives the grant, so long as the jurisdiction determines that the activity meets its community's needs, in accordance with section 106(d)(2)(D) of the Act. HUD has identified two emerging trends that require further regulation. In both situations, funds do not always benefit the community that received the grant.

First, states and units of general local government are increasingly using regional organizations to administer revolving loan funds on behalf of local governments. These regional entities, which may administer grants from multiple localities, often seek the flexibility to use program income generated from these grants anywhere within their service area, regardless of which community's grant generated the program income. As discussed above in section II.E, this presents a challenge for units of general local government, which are responsible for ensuring that program income generated from their grant is used to meet the community's needs. HUD has concluded that the current regulations should be revised to clarify the extent to which funded activities must benefit residents of the jurisdiction whose grant generated the program income.

Second, HUD is aware of a number of situations in which states awarded a grant to one community, but the benefits of the activities occurred in a different community or throughout a much larger area. In some cases, one small community would receive a grant for an activity that would be carried out on a regional or even statewide basis. In other cases, suburban communities would receive funding for projects that principally benefitted a nearby Entitlement community. HUD does not believe it is appropriate for one community to serve as a primary grant recipient when the funded activity will not provide a significant benefit to

residents of that jurisdiction. In such situations, the more appropriate approach is for a state to make a grant to a ''combination of governments,'' as is specifically provided for in the Act.

This proposed rule would add to § 570.486(b) the requirement that all State CDBG-funded activities must significantly benefit residents of the grant recipient's jurisdiction. HUD is aware that some projects (e.g., one that provides assistance to a business that will provide 200 jobs in a locality with a population of 500) will provide benefits to residents of surrounding jurisdictions. Because the project significantly benefits residents of the grant recipient's jurisdiction, the project would meet this proposed requirement of the proposed rule. (Another proposed requirement, described below in this section, would permit the expenditure of CDBG funds in this example only if it provides no more than an incidental benefit to any surrounding Entitlement jurisdictions.)

In making a determination that a project will ''significantly benefit'' residents of the recipient's jurisdiction, the community must determine that the benefits to its residents will be sufficient to justify the amount of CDBG funds it will expend on the project. HUD would not challenge the determination (or the state's acceptance thereof) unless it is clearly unreasonable. This proposed rule would not limit the amount or percentage of funds that may assist an activity in non-entitlement jurisdictions, so long as the magnitude of the benefit to recipient jurisdiction residents is not unreasonably outweighed by the recipient jurisdiction's expenditure of CDBG funds. HUD does not anticipate that this proposed rule would inhibit joint efforts by cities and counties to benefit their residents.

This proposed rule would also add a new requirement at § 570.486(c) that residents of Entitlement jurisdictions may not receive more than an incidental benefit from the state grantee's expenditure of funds. In situations involving activities located in or benefiting residents of Entitlement communities, HUD believes it is appropriate for Entitlement communities to participate in funding such projects at levels commensurate with the benefits their citizens receive, since Entitlement communities receive a separate source of funding. HUD realizes that addressing the community development and housing needs of nonentitlement area residents may necessarily involve serving residents of Entitlement communities. In some cases, the most feasible or practical location for an activity may be within the boundaries of an Entitlement community (such as for reasons of public transportation accessibility, maximizing accessibility to the greatest number of beneficiaries, operational cost-effectiveness, land/building availability, or engineering considerations). Also, state or local law may prohibit a nonentitlement county from limiting the benefits of an activity to residents of the nonentitlement area of the county. In such cases, the prohibition against using State CDBG funds to provide more than an incidental benefit to Entitlement area residents would apply. However, if the Entitlement community is participating financially in proportion to the share of expected benefits its residents will receive, it would be appropriate for the state to conclude that the Entitlement community residents are receiving no benefit, or only an incidental benefit, from the State CDBG funds contributed to the activity. The recipient would be responsible for determining the magnitude of the benefits in such cases and the appropriate financial contribution by the entitlement community. Comparable language is contained in the CDBG Entitlement program regulations at § 570.309.

G. Program Income Exclusion for Activities Financed by Section 108 Loan Guarantees in Areas That Meet Empowerment Zone Eligibility Requirements

This proposed rule would remove § 570.489(e)(2)(iii). This paragraph excludes from the definition of program income revenue generated from Section 108 loan guarantees that meet one or more of the public benefit standards of § 570.482(f)(3)(v) or that are implemented in conjunction with an Economic Development Initiative grant under Section 108(q) of the 1974 Act, as amended, and which are located in an area that meets the Empowerment Zone eligibility requirement from the definition of program income. It is HUD's belief that this paragraph has been of limited use by grantees.

H. State Authority To Impose Additional Provisions

This proposed rule would add a new provision at § 570.480(f) to expand states' administrative flexibility. This new provision would authorize states to impose on participating units of general local government additional requirements or requirements that are more restrictive than those established by HUD. Such authority is implied in the states' authority to administer the CDBG program, but HUD has never expressly provided for it in the regulations. States would not be authorized to impose requirements that would be inconsistent with the Act or with other statutory or regulatory provisions that apply to the State CDBG program. HUD proposes this provision to clarify states' responsibilities and authorities.

I. Pre-Agreement Costs

This proposed rule would revise § 570.489(b) to clarify that states may charge to the grant certain pre-agreement costs that they incur, to the extent that the activities that generate the costs are eligible. Such activities would have to be in conformance with the environmental review provisions of part 58 and the citizen participation requirements of part 91, as is the case for other costs incurred by a state. The current regulation provides that states may permit units of general local government to charge certain pre-agreement costs to the grant, but does not expressly state that states may also charge to the grant certain pre-agreement costs that they incur. As discussed below in section L, this proposed rule would also require states and their recipients of CDBG funds to comply with applicable cost principles. However, it would permit certain costs, including pre-agreement costs, to be charged to the grant without the prior approval by HUD that would otherwise be required under Appendix B of 2 CFR part 225.

J. Audits

This proposed rule would correct an outdated regulatory citation within § 570.489(m). Currently, the paragraph states that audits of the state and units of general local government must be conducted in accordance with 24 CFR part 44, which used to implement the Single Audit Act. However, the Single Audit Act requirements applicable to states and local governments are now at § 85.26. Although part 85 as a whole only applies to states that adopt it, this proposed rule would require states to adhere to one specific provision within that part. This proposed rule would revise § 570.489(m) to require that audits be conducted in accordance with § 85.26(a), which in turn incorporates by reference the provisions of OMB Circular A–133.

K. Grant-Making

This proposed rule would add a new paragraph at § 570.480(g) to clarify the long-standing statutory requirement, found at section 106(d)(2)(A) of the Act, that states must distribute CDBG funds in the form of grants only to units of general local government. Another

statutory provision, found at section 106(d)(3)(A) and (6) of the Act, permits states to deduct and expend limited amounts of CDBG funds for administrative expenses and technical assistance to local governments and nonprofit program recipients. States may find it necessary to procure such administrative services and technical assistance from third parties and, accordingly, to make payments to them. This proposed rule would clarify that the requirement for a state to disburse CDBG funds to units of general local government does not prohibit it from making payments to other entities to procure goods and services to support the state's administrative and technical assistance activities.

L. Cost Principles and Prior Approval of Certain Costs by HUD

This proposed rule would add a new paragraph (n)(1) to § 570.489 to require that State CDBG funds must be expended in compliance with applicable cost principles that are now codified in title 2 of the CFR. (Prior to codification, these cost principles were referred to by the name of the OMB circular through which they were issued.) The cost principles that apply depend on whether a given cost is incurred by a government entity, nonprofit organization, or educational institution. Application of the cost principles to expenditures would ensure that HUD bears its fair share of costs in a consistent manner across all states, thereby ensuring a level playing field.

The cost principles that apply to state, local, and Indian tribal governments are codified at 2 CFR part 225. Appendix B of part 225 provides that a number of cost items are allowable only if approved by the cognizant federal agency. For example, section 31 of Appendix B of part 225 requires prior approval of pre-agreement costs, which are further discussed in section I of this preamble. HUD's regulations for the Entitlement program provide at § 570.200(a)(5) that HUD's prior approval is not required to the extent that cost items otherwise comply with the cost principles and other requirements. This proposed rule would add a similar provision at § 570.489(n)(2) for the State CDBG program. Cost items that require federal agency approval under Appendix B of part 225 would be allowable without HUD's prior approval, so long as they otherwise comply with 2 CFR part 225 and subpart I of 24 CFR 570. Approval on a case-by-case basis would still be required under cost principles that are applicable to educational institutions and nonprofit organizations.

M. Fiscal Controls and Administrative Procedures

This proposed rule would also provide clarification at § 570.489(d)(2)(iii) for states that opt to apply part 85 in order to comply with the requirement at 570.489(d)(1) for fiscal controls and administrative procedures. Such states would be required to comply with all of the provisions of part 85, and would also be required to ensure that recipients of their State CDBG funds comply with part 84, ''Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-profit Organizations,'' as applicable. This requirement would ensure that there will be no inconsistencies or accountability gaps between the practices of those states that adopt HUD's administrative standards and the practices of their recipients.

N. Reporting

This proposed rule would add a new paragraph at § 570.490(a)(3) that would require states to make entries into the Integrated Disbursement Information System (IDIS) in a form prescribed by HUD, to accurately capture the state's accomplishment and funding data during each program year. It is recommended that the data be entered on a quarterly basis, and states would be required to enter the data at least annually. This change would better enable HUD and grantees to report accomplishments to community development stakeholders.

III. Request for Public Comments on Whether Other Changes Are Needed

HUD requests public comments on whether regulations are needed on the matters described below. Any such regulations would be published under a separate proposed rule.

A. Lump Sum Drawdowns

Section 104(h) of the Act allows units of general local government to make lump-sum drawdowns of CDBG funds to establish revolving loan funds for property rehabilitation activities. It also provides for HUD to establish standards governing lump-sum drawdowns. Such standards exist in the CDBG Entitlement program regulations in § 570.513, but HUD has not promulgated comparable regulations for the State CDBG program. HUD is inviting public comments on whether separate regulations are needed to address situations not covered by the Entitlement regulations.

B. Use of Escrow Accounts for Rehabilitation

Section 570.511 of the Entitlement program regulations allows Entitlement communities to establish escrow accounts for funding loans and grants for the rehabilitation of privately owned residential property. HUD has never created comparable regulations for the State CDBG program. HUD is inviting public comments on whether separate regulations are needed to address situations not covered by the Entitlement regulations.

IV. Findings and Certifications

Paperwork Reduction Act

The information collection requirements contained in this proposed rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a currently valid OMB control number.

The burden of the information collections in this proposed rule is estimated as follows:

Reporting and Recordkeeping Burden:

Section reference	Number of respondents	Number of responses per respondent	Estimated average time for requirement (in hours)	Estimated annual burden (in hours)
§ 570.489(e)(4)	550	Ongoing	27	15,000
§ 570.490(a)(3)	50	10	2	1,000
Totals	600	NA	29	16,000

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, *e.g.*, permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this rule. Comments must refer to the proposal by name and docket number (FR–5181–P–01) and must be sent to:

HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, Fax number: (202) 395–6947; and

Laruth Harper, Reports Liaison Officer, Office of Community Planning and Development, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 7233, Washington, DC 20410.

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The Finding is available for public inspection during regular business hours in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410–0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the Finding by calling the Regulations Division at 202–402–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800–877–8339.

Executive Order 13132, Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Order. This proposed rule does not have federalism implications and would not impose substantial direct compliance costs on state and local governments nor preempt state law within the meaning of the Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose a federal mandate on any state, local, or tribal government, or the private sector within the meaning of the Unfunded Mandates Reform Act of 1995.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. This rule would revise certain requirements that apply to the management of CDBG funds, program income, and other administrative matters by state governments. In many instances, the changes would codify existing HUD policy, update obsolete provisions, or revise regulations to reflect statutory language. Therefore, the undersigned certifies that this rule will not have a significant impact on a substantial number of small entities.

Notwithstanding HUD's view that this rule will not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives, as described in this preamble.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance (CFDA) program number for the State CDBG program is 14.228 and the CFDA program number for the Entitlement program is 14.218.

List of Subjects in 24 CFR Part 570

Administrative practice and procedure, American Samoa, Community Development Block Grants, Grant programs—education, Grant programs—housing and community development, Guam, Indians, Loan programs—housing and community development, Low and moderate income housing, Northern Mariana Islands, Pacific Islands Trust Territory, Puerto Rico, Reporting and recordkeeping requirements, Student aid, Virgin Islands.

Accordingly, for the reasons described in the preamble, HUD proposes to amend 24 CFR part 570 as follows:

PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS

1. The authority citation for 24 part 570 continues to read as follows:

Authority: 42 U.S.C. 5300–5320.

2. In § 570.480, revise paragraph (a) and add paragraphs (f) and (g), to read as follows:

§ 570.480 General.

(a) This subpart describes policies and procedures applicable to states that have permanently elected to receive Community Development Block Grant funds for distribution to units of general local government in the state's nonentitlement areas under the Housing and Community Development Act of 1974, as amended (the Act). Other subparts of part 570 are not applicable to the State CDBG program, except as expressly provided otherwise. Regulations of part 570 outside of this subpart that apply to the State CDBG program include §§ 570.200(j) and 570.606.

* * * * *

(f) In administering the CDBG program, a state may impose additional or more restrictive provisions on units of general local government participating in the state's program, provided that such provisions are not inconsistent with the Act or other statutory or regulatory provisions that are applicable to the State CDBG program.

(g) States shall make CDBG grants only to units of general local government. This restriction does not limit a state's authority to make payments to other parties for state administrative expenses and technical assistance activities authorized in section 106(d) of the Act.

3. In § 570.486, revise paragraph (b) and add paragraph (c), to read as follows:

§ 570.486 Local government requirements.

* * * * *

(b) *Activities serving beneficiaries outside the jurisdiction of the unit of general local government.* Any activity carried out by a recipient of State CDBG funds must significantly benefit residents of the jurisdiction of the grant recipient, and the unit of general local government must determine that the activity is meeting its needs in accordance with section 106(d)(2)(D) of the Act. For an activity to significantly benefit residents of the recipient jurisdiction, the CDBG funds expended by the unit of general local government must not be unreasonably disproportionate to the benefits to its residents.

(c) *Activities located in Entitlement jurisdictions.* State grant recipients may not expend State CDBG funds for activities located in or serving Entitlement jurisdictions, unless Entitlement residents receive only an incidental benefit from State CDBG expenditures for the activity.

4. Amend § 570.489 as follows:

a. Revise paragraphs (a)(1), (b), (c), (e)(1), (2), and (3)(i) and (ii), and (m);

b. Add paragraphs (d)(2)(iii)(A) and (B), (e)(3)(iii), (iv), and (4), and (n); and

c. Revise the first sentence of paragraph (f)(2), to read as follows:

§ 570.489 Program administrative requirements.

(a) *Administrative and planning costs*—(1) *State administrative and technical assistance costs.* (i) The state is responsible for the administration of all CDBG funds. The state shall pay from its own resources all administrative expenses incurred by the state in carrying out its responsibilities under this subpart, except as provided in this paragraph (a)(1)(i) of this section, which is subject to the time limitations in paragraph (a)(1)(iv) of this section. To pay administrative expenses, the state may use CDBG funds not to exceed $100,000, plus 50 percent of administrative expenses incurred in excess of $100,000. Amounts of CDBG funds used to pay administrative expenses in excess of $100,000 shall not, subject to paragraph (a)(1)(iii) of this section, exceed 3 percent of the sum of the state's annual grant, program income received by units of general local government during each program year (whether retained by units of general local government or paid to the state), and of funds reallocated by HUD to the state.

(ii) To pay the costs of providing technical assistance to local governments and nonprofit program recipients, a state may, subject to paragraph (a)(1)(iii) of this section, use CDBG funds received on or after January 23, 2004, in an amount not to exceed 3 percent of the sum of its annual grant, program income received by units of general local government during each program year (whether retained by units of general local government or paid to the state), and funds reallocated by HUD to the state during each program year.

(iii) The amount of CDBG funds used to pay the sum of administrative costs in excess of $100,000 paid pursuant to paragraph (a)(1)(i) of this section and technical assistance costs paid pursuant to paragraph (a)(1)(ii) of this section must not exceed 3 percent of the sum of a state's annual grant, program income received by units of general local government during each program year (whether retained by the unit of general local government or paid to the state), and funds reallocated by HUD to the state.

(iv) In calculating the amount of CDBG funds that may be used to pay state administrative expenses prior to January 23, 2004, the state may include in the calculation the following elements only to the extent they are within the following time limitations:

(A) $100,000 per annual grant beginning with FY 1984 allocations;

(B) Two percent of the sum of a state's annual grant and funds reallocated by HUD to the state within a program year, without limitation based on when such amounts were received;

(C) Two percent of program income returned by units of general local government to states after August 21, 1985; and

(D) Two percent of program income received and retained by units of general local government after February 11, 1991.

(v) In regard to its administrative costs, the state has the option of selecting its approach for demonstrating compliance with the requirements of this paragraph (a)(1) of this section. Any state whose matching costs contributions toward state administrative expense matching requirements are in arrears must bring matching cost contributions up to the level of CDBG funds expended for such costs. A state grant may not be closed out if the state's matching cost contribution is not at least equal to the amount of CDBG funds in excess of $100,000 expended for administration. Funds from any year's grant may be used to pay administrative costs associated with any other year's grant. The two approaches for demonstrating compliance with this paragraph (a)(1) of this section are:

(A) *Cumulative accounting of administrative costs incurred by the state since its assumption of the CDBG program.* Under this approach, the state will identify, for each grant it has received, the CDBG funds eligible to be used for state administrative expenses, as well as the minimum amount of matching funds that the state is required to contribute. The amounts will then be aggregated for all grants received. The state must keep records demonstrating the actual amount of CDBG funds from each grant received that were used for state administrative expenses, as well as matching amounts that were contributed by the state. The state will be considered to be in compliance with the applicable requirements if the aggregate of actual amounts of CDBG funds spent on state administrative expenses does not exceed the aggregate maximum allowable amount and if the aggregate amount of matching funds that the state has expended is equal to or greater than the aggregate amount of CDBG funds in excess of $100,000 (for each annual grant within the subject period) spent on administrative expenses during its 3- to 5-year Consolidated Planning period. If the state grant for any grant year within the 3-to 5-year period has been closed out, the aggregate amount of CDBG funds spent on state administrative expenses, the aggregate maximum allowable amount, the aggregate matching funds expended, and the aggregate amount of CDBG funds in excess of $100,000 (for each annual grant within the subject period) will be reduced by amounts attributable to the grant year for which the state grant has been closed out.

(B) *Year-to-year tracking and limitation on drawdown of funds.* For each grant year, the state will calculate the maximum allowable amount of CDBG funds that may be used for state administrative expenses, and will draw down amounts of those funds only upon its own expenditure of an equal or greater amount of matching funds from its own resources after the expenditure of the initial $100,000 for state administrative expenses. The state will be considered to be in compliance with the applicable requirements if the actual amount of CDBG funds spent on state administrative expenses does not exceed the maximum allowable amount, and if the amount of matching funds that the state has expended for that grant year is equal to or greater than the amount of CDBG funds in excess of $100,000 spent during that same grant year. Under this approach, the state must demonstrate that it has paid from its own funds at least 50 percent of its

administrative expenses in excess of $100,000 by the end of each grant year.

(b) *Reimbursement of pre-agreement costs.* The state may permit, in accordance with such procedures as the state may establish, a unit of general local government to incur costs for CDBG activities before the establishment of a formal grant relationship between the state and the unit of general local government and to charge these pre-agreement costs to the grant, provided that the activities are eligible and undertaken in accordance with the requirements of this part and 24 CFR part 58. A state may incur costs prior to entering into a grant agreement with HUD and charge those pre-agreement costs to the grant, provided that the activities are eligible and are undertaken in accordance with the requirements of this part, part 58 of this title, and the citizen participation requirements of part 91 of this title.

(c) *Federal grant payments.* The state's requests for payment, and the Federal Government's payments upon such requests, must comply with 31 CFR part 205. The state must use procedures to minimize the time elapsing between the transfer of grant funds and disbursement of funds by the state to units of general local government. States must also have procedures in place and units of general local government must use these procedures to minimize the time elapsing between the transfer of funds by the state and disbursement for CDBG activities.

(d) * * *

(2) * * *

(iii) * * *

(A) A state that opts to satisfy this requirement for fiscal controls and administrative procedures by applying the provisions of part 85 must comply with the requirements therein.

(B) A state that opts to satisfy this requirement for fiscal controls and administrative procedures by applying the provisions of part 85 of this title must also ensure that recipients of the state's CDBG funds comply with part 84 of this title, ''Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,'' as applicable.

(e) *Program income.* (1) For the purposes of this subpart, ''program income'' is defined as gross income received by a state, a unit of general local government, or subgrantee of the unit of general local government that was generated from the use of CDBG funds, regardless of when the CDBG funds were appropriated and whether the activity has been closed out, except as provided in paragraph (e)(2) of this section. When income is generated by an activity that is only partially assisted with CDBG funds, the income must be prorated to reflect the percentage of CDBG funds used (e.g., a single loan supported by CDBG funds and other funds; a single parcel of land purchased with CDBG funds and other funds). Program income includes, but is not limited to, the following:

(i) Proceeds from the disposition by sale or long-term lease of real property purchased or improved with CDBG funds, except as provided in paragraph (e)(2)(v) of this section;

(ii) Proceeds from the disposition of equipment purchased with CDBG funds;

(iii) Gross income from the use or rental of real or personal property acquired by the unit of general local government or subgrantee of the unit of general local government with CDBG funds, less the costs incidental to the generation of the income;

(iv) Gross income from the use or rental of real property, owned by the unit of general local government or other entity carrying out a CDBG activity that was constructed or improved with CDBG funds, less the costs incidental to the generation of the income;

(v) Payments of principal and interest on loans made using CDBG funds, except as provided in paragraph (e)(2)(iii) of this section;

(vi) Proceeds from the sale of loans made with CDBG funds, less reasonable legal and other costs incurred in the course of such sale that are not otherwise eligible costs under sections 105(a)(13) or 106(d)(3)(A) of the Act;

(vii) Proceeds from the sale of obligations secured by loans made with CDBG funds, less reasonable legal and other costs incurred in the course of such sale that are not otherwise eligible costs under sections 105(a)(13) or 106(d)(3)(A) of the Act;

(viii) Interest earned on funds held in a revolving fund account;

(ix) Interest earned on program income pending disposition of the income;

(x) Funds collected through special assessments made against non-residential properties and properties owned and occupied by households not of low and moderate income, if the special assessments are used to recover all or part of the CDBG portion of a public improvement; and

(xi) Gross income paid to a unit of general local government or subgrantee of the unit of general local government from the ownership interest in a for-profit entity acquired in return for the provision of CDBG assistance.

(2) ''Program income'' does not include the following:

(i) The total amount of funds, which does not exceed $35,000 received in a single year from activities, other than revolving loan funds that is retained by a unit of general local government and its subgrantees (all funds received from revolving loan funds are considered program income, regardless of amount);

(ii) Amounts generated by activities eligible under section 105(a)(15) of the Act and carried out by an entity under the authority of section 105(a)(15) of the Act;

(iii) Payments of principal and interest made by a subgrantee carrying out a CDBG activity for a unit of general local government, toward a loan from the local government to the subgrantee, to the extent that program income received by the subgrantee is used for such payments;

(iv) The following classes of interest, which must be remitted to HUD for transmittal to the Department of the Treasury, and will not be reallocated under section 106(c) or (d) of the Act:

(A) Interest income from loans or other forms of assistance provided with CDBG funds that are used for activities determined by HUD to be not eligible under § 570.482 or section 105(a) of the Act, to fail to meet a national objective in accordance with the requirements of § 570.483, or to fail substantially to meet any other requirement of this subpart or the Act;

(B) Interest income from deposits of amounts reimbursed to a state's CDBG program account prior to the state's disbursement of the reimbursed funds for eligible purposes; and

(C) Interest income received by units of general local government on deposits of grant funds before disbursement of the funds for activities, except that the unit of general local government may keep interest payments of up to $100 per year for administrative expenses otherwise permitted to be paid with CDBG funds.

(v) Proceeds from the sale of real property purchased or improved with CDBG funds, if the proceeds are received more than 5 years after expiration of the grant agreement.

(3) * * *

(i) *Program income paid to the state.* Except as described in paragraph (e)(3)(ii)(A) of this section, the state may require the unit of general local government that receives or will receive program income to return the program income to the state. Program income that is paid to the state is treated as additional CDBG funds subject to the requirements of this subpart. Except for program income retained and used by

the state for administrative costs or technical assistance under paragraph (a) of this section, program income paid to the state must be distributed to units of general local government in accordance with the method of distribution in the action plan under § 91.320(k)(1)(i) of this title that is in effect at the time the program income is distributed. To the maximum extent feasible, the state must distribute program income before it makes additional withdrawals from the Department of the Treasury, except as provided in paragraph (f) of this section.

(ii) *Program income retained by a unit of general local government.* A state may permit a unit of general local government that receives or will receive program income to retain the program income. Alternatively, subject to the exception in paragraph (e)(3)(ii)(A) of this section, a state may require that the unit of general local government pay any such income to the state.

(A) A state must permit the unit of general local government to retain the program income to the extent that the program income is applied to continue the activity from which it was derived. A state will determine whether a unit of general local government is likely to apply funds to continue the activity from which the funds were derived, and HUD will give maximum feasible deference to a state's determination, in accordance with § 570.480(c). In making such a determination, a state may consider whether the unit of general local government is or will be unable to comply with the requirements of paragraph (e)(3)(ii)(B) of this section or other requirements of this part, and the extent to which the program income is unlikely to be applied to continue the activity within the reasonably near future. When a state determines that the program income will be applied to continue the activity from which it was derived, but that the amount of program income held by the unit of general local government exceeds projected cash needs for the reasonably near future, the state may require the local government to return all or part of the program income to the state until such time as the program income is needed by the unit of general local government. When a state determines that a unit of local government is not likely to apply any significant amount of program income to continue the activity within a reasonable amount of time, or that it will not likely apply the program income in accordance with applicable requirements, the state may require the unit of general local government to return all of the program income to the state for disbursement to other units of local government. A state that intends to require units of general local government to return program income in accordance with this paragraph (e)(3)(ii)(A) of this section must describe its approach in the state's action plan required under § 91.320 of this title.

(B) Program income that is received and retained by the unit of general local government is treated as additional CDBG funds and is subject to all applicable requirements of this subpart, regardless of whether the activity that generated the program income has been closed out. If the grant that generated the program income is still open when the program income is generated, program income permitted to be retained will be considered part of the unit of general local government's grant that generated the program income. If the grant is closed, program income permitted to be retained will be considered to be part of the unit of general local government's most recently awarded open grant. If the unit of general local government has no open grants, the program income retained by the unit of general local government will be counted as part of the state's grant year in which the program income was generated. A state must employ one or more of the following methods to ensure that units of general local government comply with applicable program income requirements:

(*1*) Maintaining contractual relationships with units of general local government for the duration of the existence of the program income;

(*2*) Closing out the underlying activity, but requiring as a condition of closeout that the unit of general local government obtain advance state approval of either a unit of general local government's plan for the use of program income, or of each use of program income by grant recipients via regularly occurring reports and requests for approval;

(*3*) Closing out the underlying activity, but requiring as a condition of closeout that the unit of general local government notify the state when new program income is received; or

(*4*) With prior HUD approval, other approaches that demonstrate that the state will ensure compliance with the requirements of this subpart by units of general local government.

(C) The state must require units of general local government, to the maximum extent feasible, to disburse program income that is subject to the requirements of this subpart before requesting additional funds from the state for activities, except as provided in paragraph (f) of this section.

(iii) *Transfer of program income to Entitlement program.* A unit of general local government that becomes eligible to be an Entitlement grantee may request the state's approval to transfer State CDBG grant-generated program income to the unit of general local government's Entitlement program. A state may approve the transfer, provided the unit of general local government:

(A) Has officially elected to participate in the Entitlement grant program;

(B) Agrees to use such program income in accordance with Entitlement program requirements; and

(C) Has set up Integrated Disbursement Information System (IDIS) access and agrees to enter receipt of program income into IDIS.

(iv) *Transfer of program income of grantees losing Entitlement status.* Upon entry into the State CDBG program, a unit of general local government that has lost or relinquished its Entitlement status must, with respect to program income that a unit of general local government would otherwise be permitted to retain, either:

(A) Retain program income generated under Entitlement grants and continue to comply with Entitlement program requirements for program income; or

(B) Retain the program income and transfer it to the State CDBG program, in which case the unit of general local government must comply with the state's rules for program income and the requirements of this paragraph (e).

(4) The state must report on the receipt and use of all program income (whether retained by units of general local government or paid to the state) in its annual performance and evaluation report.

(f) * * *

(1) * * *

(2) The state may establish one or more state revolving funds to distribute grants to units of general local government throughout a state or a region of the state to carry out specific, identified activities. * * *

* * * * *

(m) *Audits.* Notwithstanding any other provision of this title, audits of a state and units of general local government shall be conducted in accordance with § 85.26 of this title, which implements the Single Audit Act (31 U.S.C. 7501–07) and incorporates OMB Circular A–133. States shall develop and administer an audits management system to ensure that audits of units of general local government are conducted in accordance with OMB Circular A–133, if applicable.

(n) Cost principles and prior approval. (1) A state must ensure that costs

incurred by the state and by its recipients are in conformance with the following cost principles, as applicable:

(i) ''Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A–87),'' which is codified at 2 CFR part 225;

(ii) ''Cost Principles for Non-Profit Organizations (OMB Circular A–122),'' which is codified at 2 CFR part 230; and

(iii) ''Cost Principles for Educational Institutions (OMB Circular A–21),'' which is codified at 2 CFR part 220.

(2) All cost items described in Appendix B of 2 CFR part 225 that require federal agency approval are allowable without prior approval of HUD to the extent they otherwise comply with the requirements of 2 CFR part 225 and are otherwise eligible under this subpart I, except for the following:

(i) Depreciation methods for fixed assets shall not be changed without the express approval of HUD or, if charged through a cost allocation plan, the cognizant federal agency.

(ii) Fines and penalties (including punitive damages) are unallowable costs to the CDBG program.

5. Add § 570.490(a)(3) to read as follows:

§ 570.490 Recordkeeping requirements.

(a) * * *

(3) *Integrated Disbursement and Information System (IDIS).* The state shall make entries into IDIS in a form prescribed by HUD to accurately capture the state's accomplishment and funding data, including program income, for each program year. It is recommended that the state enter IDIS data on a quarterly basis and it is required to be entered annually.

* * * * *

6. Add § 570.504(e) to read as follows:

§ 570.504 Program income.

* * * * *

(e)(1) *Transfer of program income to Entitlement program.* A unit of general local government that becomes eligible to be an Entitlement grantee may request the state's approval to transfer State CDBG grant-generated program income to the unit of general local government's Entitlement program. A state may approve the transfer, provided the unit of general local government:

(i) Has officially elected to participate in the Entitlement grant program;

(ii) Agrees to use such program income in accordance with Entitlement program requirements;

(iii) Has set up Integrated Disbursement and Information System (IDIS) access and agrees to enter receipt of program income into IDIS.

(2) *Transfer of program income of grantees losing Entitlement status.* Upon entry into the State CDBG program, a unit of general local government that has lost or relinquished its Entitlement status must, with respect to program income that a unit of general local government would otherwise be permitted to retain, either:

(1) Retain the program income generated under Entitlement grants and continue to comply with Entitlement program requirements for program income; or

(2) Retain the program income and transfer it to the State CDBG program, in which case the unit of general local government must comply with the state's rules for program income and the requirements of § 570.489(e).

Dated: September 23, 2008.

Susan D. Peppler,

Assistant Secretary for Community Planning and Development.

[FR Doc. E8–24572 Filed 10–16–08; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–103146–08]

RIN 1545–BH69

Information Reporting Requirements Under Internal Revenue Code Section 6039; Hearing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of public hearing on proposed rulemaking.

SUMMARY: This document provides notice of public hearing on a notice of proposed rulemaking relating to the return and information statement requirements under section 6039 of the Internal Revenue Code. These regulations reflect changes to section 6039 made by section 403 of the Tax Relief and Health Care Act of 2006. These proposed regulations affect corporations that issue statutory stock options and provide guidance to assist corporations in complying with the return and information statement requirements under section 6039.

DATES: The public hearing is being held on October 30, 2008, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by October 23, 2008.

ADDRESSES: The public hearing is being held in room 2116, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Send submissions to: CC:PA:LPD:PR (REG–103146–08), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–103146–08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit electronic outlines of oral comments via the Federal eRulemaking Portal at *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Thomas Scholz at (202) 622–6030 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst at *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION: The subject of the public hearing is the notice of proposed rulemaking (REG–103146–08) that was published in the **Federal Register** on Thursday, July 17, 2008 (73 FR 40999).

Persons who wish to present oral comments at the hearing that submitted written comments, must submit an outline of the topics to be discussed and the amount of time to be devoted to each topic (signed original and eight (8) copies) by October 23, 2008.

A period of 10 minutes is allotted to each person for presenting oral comments. After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing or in the Freedom of Information Reading Room (FOIA RR) (Room 1621) which is located at the 11th and Pennsylvania Avenue, NW., entrance, 1111 Constitution Avenue, NW., Washington, DC.

Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this document.

Cynthia Grigsby,

Acting Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

[FR Doc. E8–24653 Filed 10–16–08; 8:45 am]

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