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FEMA's Community Disaster Loan Program: Loan Forgiveness

Local governments often need financial assistance following major disasters. Such incidents can cause businesses to close, people to lose jobs, and other events that decrease tax revenue, making it difficult for local governments to perform critical functions, sometimes for years after the event. To assist in these scenarios, the Federal Emergency Management Agency (FEMA) has for several decades offered Community Disaster Loans (CDLs) to help local governments with disaster-related revenue shortfalls. The loans are available to local governments that have experienced a presidentially declared major disaster and apply through their state governor's office. CDLs are one component of the federal government's suite of emergency relief programs.

CDLs are typically capped by Congress at $5 million and are conditioned on five-year terms, with FEMA able to extend the term to 10 years based on the local government's financial condition. In some cases, FEMA may offer partial or full CDL forgiveness without legislative action. Congress may also choose to forgive the loans. Most recently, on September 30, 2021, Congress forgave all outstanding CDLs (totaling about $860 million) in a continuing resolution (P.L. 117-43). This action extended debate about the structure of the CDL program, which has continued disbursing funds since the forgiveness.

Types and Uses of CDLs

CDLs were originally authorized by the Disaster Relief Act of 1974 (P.L. 93-288). The program's authorizing language was amended in the Robert T. Stafford Disaster Relief and Emergency Assistance Act (P.L. 100-707), for example by adding the $5 million cap. In the years since, Congress has authorized different types of CDLs, increasing the dollar cap, adding eligible entities, and refining allowable uses.

Traditional CDLs (TCDLs) are five-year loans (which may be extended to 10 years) for either up to 25% of a local government's operating budget or $5 million, whichever is less. If a local government's revenue declines by at least 75%, it may receive 50% of its operating budget, up to $5 million. To qualify, local governments must:

- be in a presidentially declared disaster area;
- show a loss of greater than 5% of tax and other (such as administrative) revenues;
- not owe money on previous CDLs; and
- be permitted to take federal loans under state law.

TCDLs must be used on a local government's regular operating expenses or to expand operations in response to the disaster. They may not be used for capital expenditures.

In 2005 and 2006, after Hurricanes Katrina and Rita, Congress passed legislation (P.L. 109-88 and P.L. 109-234) to create "special CDLs" (SCDLs) and set aside $1 billion for loans. SCDLs were subject to the same rules as TCDLs, except for (1) an increased dollar cap (up to 50% of the local government's budget if revenue fell by at least 25%), (2) allowing use only for "essential services," primarily schools, police and fire, and sanitation, as opposed to all operating expenses, and (3) allowing local governments to apply for more than one loan at a time (local governments are limited to one TCDL). These provisions enabled the many impacted local governments to take out loans sufficient to meet greater financial needs.

In 2017, following Hurricanes Harvey, Irma, and Maria, Congress passed supplemental appropriations that transferred $4.9 billion to the CDL program (P.L. 115-72). Although originating from the CDL program, the loans made with the transferred funds differed in key ways. The law made U.S. territories eligible for the loans and lifted the $5 million cap, basing the loan amount on projected revenue losses for 180 days after the disaster. Congress included a similar provision in a consolidated appropriations act in 2020 (P.L. 116-260) after Typhoon Yutu hit the Northern Mariana Islands. The Yutu loans could be made up to three fiscal years later and were based on projected revenue losses up to a year after the event.

CDL Forgiveness

Forgiveness Eligibility

All types of CDLs are or have been forgivable.

FEMA determines TCDL forgiveness after a two-part analysis. First, independent auditors hired by FEMA look at a local government's financial statements for three fiscal years following the disaster. If the budget data shows revenues not matching expenditures over that time, auditors analyze whether existing revenue suffices to pay for the local government's operating expenses. If not, and if the auditors determine that the shortfall is due to the disaster, the local government may be eligible for partial or full forgiveness. FEMA includes unreimbursed disaster-related expenses (UDREs) in the total amount eligible for forgiveness. UDREs are general government services, such as garbage pickup, revenue collection, and police and fire services; they do not include spending on capital projects or large projects involving public facilities.

Regulations governing CDLs state that they are not to be used for pre-disaster budget shortfalls—a relatively common occurrence among local governments. For this reason, auditors adjust budget conditions during the three-year examination period by the amount of any pre-existing deficit. They also use actual revenues, rather than projections. Therefore, the earliest FEMA can grant loan forgiveness is three years after a disaster.

As opposed to TCDLs, SCDLs were initially ineligible for forgiveness. Some Members of Congress said making the loans ineligible for forgiveness was necessary to address legislative and executive concerns related to federal disaster spending. Others argued the lack of forgiveness amounted to unequal treatment, since TCDL recipients were eligible.

Congress amended the SCDL program in 2007 (P.L. 110-28) to make SCDLs forgivable. The basic conditions for SCDL forgiveness remained similar to TCDLs, but FEMA issued a rule with some clarifications and changes. For SCDLs, FEMA altered how auditors assessed property tax revenue loss after a disaster, allowing a broader scope of losses to be included in forgiveness determinations. This change potentially expanded the number of loan recipients eligible for forgiveness. FEMA also stated that different agency officials would rule on appeals of forgiveness denial than those who made the initial determination. Relatedly, FEMA imposed a 60-day deadline on itself to decide on forgiveness. The rule (44 C.F.R. §206) also allowed local governments, many of whom start their fiscal year on July 1 as opposed to the federal government's October 1, to submit financial information for a period of either three full fiscal years or 36 months following the disaster.

Congress made forgiveness of the loans made in 2017 subject to additional review, primarily a requirement that forgiveness could be granted only by the Secretary of Homeland Security, in consultation with the Secretary of the Treasury. Loans to the Northern Mariana Islands, which were issued in 2020 and 2021, were subject to the same forgiveness requirements as TCDLs.

Forgiveness History

On September 30, 2021, P.L. 117-43 forgave approximately \$860 million of CDLs. That included about \$311 million owed by the U.S. Virgin Islands from loans issued in 2017 and 2018 and nearly \$372 million of loans issued to Puerto Rico between 2018 and 2021. Of all the loans forgiven, governments had cumulatively made repayments equal to 1.8% of disbursed funds and interest accrued as of September 20, 2021.

Such forgiveness aligned with previous congressional action related to CDLs. For example, P.L. 113-6 forgave all existing SCDL balances.

News reports suggest that some local governments may rely upon the eventual forgiveness of CDLs. However, the recurring practice of loan forgiveness may not reflect the program's original intent, which seemed to make clear that forgiveness is not mandatory.

Policy Considerations

CDL forgiveness has periodically drawn Congress's attention. By design, CDLs are loans, not grants, meaning borrowers must demonstrate their ability to repay, despite the possibility of forgiveness. This has raised concerns from some Members, as borrowers may be subject to terms that are ultimately unnecessary, or must develop time-consuming, potentially superfluous repayment plans during periods of intense duress, hampering disaster recovery. Conversely, such requirements may help FEMA and Congress make determinations about forgiveness in terms of its impact on total federal disaster spending.

Interest rates on CDLs fluctuate, sometimes daily, which can make it difficult for a local government to predict the ultimate cost of the loan, which may impact program uptake and local government fiscal stability. FEMA sets the interest rate for CDLs based on five-year Treasury rates. Those rates are volatile; for instance, the rate was 1.552% on March 1, 2022, and 2.947% on April 22, 2022. But if CDLs may be likely to be forgiven, especially with little or no money repaid, the interest rate becomes less of a factor in a local government's decision to apply for a CDL. An alternative could be a standard interest rate for a period of time, such as a month or calendar year, with all loans approved during that time receiving that rate. That could provide an added measure of stability for local governments that are uncertain whether and when their loan will be forgiven.

Congress could discuss if CDLs may be better suited as grants. As mentioned in a 1996 Government Accountability Office report, FEMA itself noted the high forgiveness rate of CDLs and suggested converting them to grants. Such a change might structure the program closer to the way it is practically administered and potentially reduce some administrative requirements and costs of making loans, including determining an interest rate and evaluating forgiveness qualifications.

Conversion to a grant program would create new considerations for the CDL program. Recipients may risk duplication of benefits, as some allowable uses may duplicate relief provided by other federal programs. Grant programs also typically require more oversight than loan programs. Federal grants must be used for a specific purpose (unlike CDLs, which can be used more broadly on operating expenses) and are subject to financial audits. Some grant recipients may be uncomfortable with such federal involvement. Federal grants' non-supplanting restrictions may also restrict local governments from using grant funds for operating expenses, absent a change in law. Transforming CDLs into grants could also increase federal spending by guaranteeing non-repayment.

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