

U.S. Department of Housing and Urban Development

Special Attention of:**NOTICE:** CPD 04-10

All CPD Office Directors

Issued September 29, 2004

All CPD Field Office Directors

All CPD Formula Grantees

Expires September 29, 2005

All HOPWA, Supportive Housing, Shelter Plus Care,
and Youthbuild Grantees

SUBJECT: Guidelines for Ensuring Equal Treatment of Faith-based Organizations participating in the HOME, CDBG, HOPE 3, HOPWA, Emergency Shelter Grants, Shelter Plus Care, Supportive Housing, and Youthbuild Programs

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I. Purpose:

The purpose of this Notice is to provide guidance to HOME, CDBG, HOPE 3, HOPWA, Emergency Shelter Grants, Supportive Housing, Shelter Plus Care, and Youthbuild grantees covered by the September 30, 2003 final rule on ensuring equal treatment of Faith-Based organizations in CPD programs. This Notice will provide guidance to CPD field staff and grantees on their responsibilities, answer some questions raised, and provide direction on how HUD will administer its responsibilities under this regulation.

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II. Background:

On December 12, 2002, Executive Order 13279 was issued, requiring federal departments to treat all organizations fairly and without regard to religion in federal programs. It is HUD policy that, within the framework of constitutional church-state guidelines, faith-based organizations should be able to compete on an equal footing with other organizations for federal funding. Accordingly, organizations that are faith-based are eligible, on the same basis as any other organization, to participate in HUD's programs and activities. Neither the federal government nor a state or local government receiving funds under a HUD program or activity shall discriminate against an organization on the basis of the organization's religious character or affiliation. HUD supports the participation of faith-based organizations in its programs.

III. General Guidance:

The new rule revises HUD regulations to remove barriers to the participation of faith-based organizations in the programs listed above. In doing so, the preamble to the regulation stresses that all program participants should compete on equal footing and be subject to the same requirements. In implementing this regulation, HUD and grantees in the formula programs—HOME, CDBG, ESG, and HOPWA, should be conscious that requirements for documentation, reporting, monitoring, and use should be applied to all entities across the board. If a formula grant recipient has procedures in place, these procedures should be applied to all subrecipients without regard to their religious or secular status. Equality of treatment should be the guiding principle in implementing the regulations.

As with any regulatory change, the new rule requires clarification on several fronts in order to ensure a uniform and accurate implementation in the affected programs. The purpose of this notice is to provide guidance on certain aspects of the September 30, 2003 final rule. The guidance contained in this notice applies to all eight of the CPD programs covered by the September 30, 2003 final rule. HUD may issue additional guidance, as it determines necessary, and as it receives questions and requests for clarification on the new regulatory requirements.

IV. Applicability:

On September 30, 2003 (68 FR 56396), HUD issued a final rule requiring equal treatment of faith-based organizations for eight HUD programs administered by its Office of Community Planning and Development (CPD). In addition, HUD published a final rule on July 9, 2004 (69 FR 41712) requiring, among other things, that states under the CDBG program to provide equal treatment of faith-based organizations. Copies of the rules are attached as Appendix A or can be accessed online at <http://www.hud.gov/initiatives/fbci/finalrule.pdf> and <http://www.hud.gov/offices/fbci/finalfr070904.pdf>. These programs are:

1. HOME Investment Partnerships (24 CFR part 92);
2. Community Development Block Grants (CDBG) for Entitlements, States and HUD-Administered Small Cities and Insular Areas (24 CFR part 570). Including Economic Development Initiative (EDI), Brownfields (BEDI), and Section 108 Loan Guarantees
3. Hope for Homeownership of Single Family Homes (HOPE 3) (24 CFR part 572)
4. Housing Opportunities for Persons With AIDS (HOPWA) (24 CFR part 574);
5. Emergency Shelter Grants (ESG) (24 CFR part 576);
6. Shelter Plus Care (24 CFR part 582);
7. Supportive Housing (24 CFR part 583); and
8. Youthbuild (24 CFR part 585).

The amendments made by the September 30, 2003 final rule provide policy on the following:

- *Faith-based organizations are eligible for HUD funding on an equal footing with any other organization.*

Organizations competing for HUD funding, including faith-based organizations, should be assessed on their merits and how well they perform eligible activities, not on their religious or secular character.

- *Faith-based organizations retain their independence.*

The rule provides that a faith-based organization that receives HUD funds will retain its independence from federal, state, and local governments, and may continue to carry out its mission, including the definition, practice, and expression of its religious beliefs, provided that it does not use direct HUD funds to support any inherently religious activities, such as worship, religious instruction, or proselytization. Among other things, a religious organization retains its authority over internal governance, may constitute its board on a religious basis, may display religious symbols and icons, and retains its Title VII exemption, which permits it to hire only employees that share its religious beliefs without incurring liability under the Civil Rights Act.

A faith-based organization's exemption from the federal prohibition on employment discrimination on the basis of religion, set forth in section 702(a) of the Civil Rights Act of 1964 (42 U.S.C. 2000e-1(a)), is not forfeited when the organization receives HUD funding. However, a faith-based organization, like any other entity participating in a HUD funded program, must comply with all the statutory requirements of that program. Both the CDBG and HOME programs contain statutory provisions imposing nondiscrimination requirements on all grantees and their recipients, subrecipients, subgrantees, and contractors. Section 109 of the Housing and Community Development Act of 1974 as implemented at 24 CFR Part 6 and 24 CFR Part 570.602 and Section 282 of the HOME

Investment Partnership Act as implemented at 24 CFR 92.350 provide that “no person in the United States shall on the grounds of race, color, national origin, religion, or sex be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity funded in whole or in part with funds made available under this title.” In light of prior court decisions regarding similarly broad language, one interpretation of this provision is that it means that any entity being assisted with CDBG or HOME funds may not treat employees or job applicants differently on a religious basis. Religious organizations that believe that this substantially burdens their religious freedom may be entitled to additional protection under the Religious Freedom Restoration Act (42 U.S.C. 4000bb-3, 4000bb-2(1)), which applies to all federal law and its implementation. Grantees should also be aware that the provisions of Section 109 and Section 282 may pose questions of conformance with Title VII of the Civil Rights Act of 1964 and future court rulings could define more specifically the application of these laws to faith-based organizations.

Since the provisions of Section 109 or Section 282 apply to activities funded through CDBG or HOME programs, faith-based organizations administering CDBG or HOME funded activities should be aware that the nondiscrimination provisions normally apply to employees administering the activities but clearly not to employees not involved in the activity. To the extent that a faith-based organization uses an indirect cost method to allocate CDBG or HOME expenses across the organization, they should be aware that doing so may trigger nondiscrimination provisions of Section 109 or 282 for the whole organization. The statutory and regulatory coverage is the “program or activity (funded in whole or in part)” (see 24 CFR § 6.3).

- *Organizations may not use direct HUD funds to support inherently religious activities such as worship, religious instruction, or proselytization.*

In the context of the regulation, “direct HUD funds” means that the state or local government, grantee, or an intermediate organization with similar duties as a governmental entity under a particular HUD program selects an organization and purchases needed services straight from the organization (e.g., via a contract or cooperative agreement). “Direct funds,” then, applies as a term both to HUD funds received by an organization as a competitive grant award and to HUD funds received through a governmental entity such as an entitlement community, participating jurisdiction, etc. In contrast, “indirect funding” means that the choice of service provider is determined by a beneficiary, who pays for the cost of that service through a voucher, certificate, or other similar means of payment.

An organization that is awarded direct HUD funds may still engage in inherently religious activities providing they are voluntary for participants in HUD-funded activities and occur separately in time or location from the HUD-funded activities. For example, a Bible study that is conducted by a faith-based organization operating a HUD-funded “soup kitchen” must be separate in time or

location from the meal service and must be voluntary for any recipients of the meal service. Prayers offered before meals are acceptable so long as they are voluntary and understood to be voluntary by those receiving meal services.

When a grantee's or subgrantee's HUD funded program provides a voucher, certificate or similar means of payment to a program beneficiary and permits the beneficiary to choose from among a range of service providers, such a program is typically a form of "indirect" aid. If the beneficiary then chooses a faith-based provider, the faith-based service provider is exempt from the prohibition against incorporating inherently religious activities into their provision of HUD funded services.

- *Faith-based organizations, like all organizations implementing HUD-funded programs, must serve all eligible beneficiaries without regard to religion.*

An organization receiving HUD funds may not restrict HUD-funded services or housing to people of a particular religion or religious denomination. For example, a church-run community center improved with HUD funds may not restrict use of the center to members of the church. Likewise, organizations may not require a particular religious belief or activity as a condition of receiving benefits or participating in activities provided with HUD funds. Both the CDBG and the HOME program statutes and regulations prohibit any person from being denied the benefits of, or being subjected to discrimination, on the basis of religion under any activity funded in whole or in part with CDBG or HOME funds. This prohibition would also prevent, for example, an organization from marketing or advertising housing, facilities or services exclusively to members of a particular faith. In addition, participating jurisdictions (PJs) should note that the affirmative marketing requirements of 24 CFR 92.351 apply to HOME-assisted housing containing five or more assisted units, including the requirement for outreach to persons in the market area that are "least likely to apply."

- *Faith-based organizations, like other organizations, may receive HUD funds to acquire, construct, or rehabilitate buildings and other real property as long as the funds only pay the costs attributable to HUD activities.*

Faith-based organizations are no longer required to form a separate, secular organization to receive HUD funds for real property as they were under HUD's former regulations. However, an organization that engages in inherently religious activities must allocate its costs so that HUD funds are used only for eligible HUD activities. (Further guidance on cost allocation is provided below.) Additionally, HUD funds may not be used to acquire or improve sanctuaries, chapels, or any other room that faith-based entities receiving HUD funds use as their principal places of worship.

- *The statutory provisions defining eligible program applicants remain the same and are not affected by this rule change.*

Grantees are reminded that statutory and regulatory provisions that define eligible applicants still apply. ~~Of particular note~~ For example, to be certified as a community housing development organization (CHDO) by a participating jurisdiction (PJ), faith-based organizations must meet the same requirements as any other entity as described in 24 CFR 92.2. This includes the requirement that the faith-based organization be a Section 501(c)(3) or 501(c)(4) organization. A faith-based organization that is not organized as a 501(c)(3) or 501(c)(4) organization would not qualify as a CHDO. However, it may create a separate 501(c)(3) or 501(c)(4) organization that would be eligible to qualify as a CHDO. Similarly, in the CDBG Entitlement program, community based development organizations (CBDOs) must meet certain qualification requirements described in 24 CFR 570.204(c). The regulation states that a CBDO must be organized under state or local law to engage in community development activities, or under Section 301(d) of the Small Business Investment Act of 1958, or under Sections 501, 502, or 503 of the Small Business Investment Act of 1958.

- *The final rule applies to state or local funds if a state or local government chooses to commingle its own funds with the HUD funds covered by the rule.*

V. Effective Date for Grant Agreements:

The new rule is applicable to all future grant agreements, and grant agreements executed with organizations following the effective date of the final rule (October 30, 2003) must be consistent with the new regulatory provisions. Organizations with previously executed grant agreements may request that the grantor agency amend those agreements to reflect the new regulatory provisions, in accordance with the same procedures applicable to amendments.

For formula grantees, including states under the CDBG, HOME, ESG and HOPWA programs, the final rule applies to all funds committed, including amendments, after the effective date of the final rule, October 30, 2003. Grantees under the CDBG, HOME, ESG and HOPWA programs should review their guidance, procedures, contracts, agreements, and documents for recipients, subrecipients, subgrantees, and contractors to be sure that all documents and agreements are in compliance with the new regulations. In order to ensure equal treatment, grantees should revise guidance where necessary to remove barriers to the participation of faith-based organizations.

For grantees of competitively awarded programs, the final rule applies to any subgrants or contracts advertised, competed, or awarded after October 30, 2003, including any continuing transactions or amendments with subgrantees or contractors.

VI. Cost Allocation:

Each grantee, particularly the formula program grantees, should establish a policy for determining cost allocation between eligible and ineligible activities for all capital improvement projects that is consistent with the applicable program rules. The policy should be applied to all recipients and subrecipients in an equal, impartial manner. The policy should include record-keeping requirements, fair market value, reporting requirements, and any procedures for terminating participation in the program.

- The new rule introduced a significant change to the use of HUD funds for the acquisition and improvement of physical property by eliminating the requirement that faith-based grantees and subrecipients establish a separate, secular nonprofit organization to receive funding for the acquisition, construction, reconstruction, or rehabilitation of buildings. Faith-based organizations may now receive HUD funding for structures in which both eligible activities and inherently religious activities occur so long as the costs are allocated according to the extent of the eligible activities.
- Funds awarded for social services activities may be allocated according to space or time. Allocating funds by space is relevant in circumstances in which individual rooms or other discreet areas within a larger structure are used solely for ineligible activities (i.e., inherently religious activities). Allocating funds by time is relevant when individual rooms or structures are used for both eligible and ineligible activities.
- When allocating funds according to time, the proportion of total cost borne by HUD funding shall be no greater than the proportion of time the space is used for eligible activities. For example, the total cost to rehabilitate two rooms is \$10,000 and the rooms are used for eligible activities 50% of the time (total hours used per week is 40, and 20 hours each week is for eligible activities). In this example, no more than \$5,000 of HUD funds may be used for the proposed rehabilitation.
- When allocating funds according to space, whether for acquisition, rehabilitation, or social service activities, important measures such as square footage and numbers of rooms should be used in the calculation. The cost of space used for eligible activities should be subtracted from the total cost. Improvements that benefit the entire building, such as a boiler or roof repairs, should be allocated accordingly.

Special Considerations:

The CDBG program represents a special case on the topic of allocating funds on any basis other than religious use. The CDBG Entitlement regulation at 24 CFR 570.200(b) is the only HUD regulation that speaks to allocating costs of eligible public facilities, and it limits cost allocation to considerations of space, but not time.

~~HUD will work in coming months to address this issue by publishing a proposed rule~~

~~that would permit time proration for CDBG-funded acquisition, rehabilitation, reconstruction, and construction. In the meantime, For this reason,~~ HUD will consider waivers to permit cost allocation by time with CDBG Entitlement funds.

HOME program funds may only be used to assist affordable housing. The HOME program does not fund social services or space used by social service programs.⁵ Therefore, a cost allocation method based on time is not applicable to the HOME program. The HOME regulations at 24 CFR 92 .205(d) address the issue of cost allocation in multi-unit housing projects with both eligible and ineligible units or space. Additional guidance is provided in Notice CPD 98-02 “Allocating Costs and Identifying HOME-Assisted Units in Multi-Unit Projects” (March 18, 1998). HOME-assisted common space must be reserved for the general use of the residents on a non-discriminatory basis. The HOME rule does not define how residents may use this space. If residents wish to use the common space for activities of a religious nature, this is permissible as long as this is not the only use of the common space, preference is not provided for religious uses, participation is voluntary, and participation is limited to residents and their guests. In addition, just as equipment and artifacts used for any activity organized in common spaces must be removed after the activity has terminated, any religious, artifacts, or equipment placed in the common area for religious activity must be removed at the conclusion of the activity.

- The new rule clarifies that religious congregations may not receive HUD funds for improvements to sanctuaries, chapels, or any other room that the congregation uses as its principal place of worship, even if the room is used for eligible activities during non-worship times. Organizations that lease space to a religious congregation to use as its principal place of worship, however, may receive HUD funds for improvements to the structure, provided (1) the space is leased at fair market rent, and (2) the funds are allocated by time according to the eligible activities for which the space is used.
- The following provide examples of the application of the new rules regarding capital expenditures:

Example 1 (ineligibility of a room used as a principal place of worship). A one-room church applies for CDBG funds to make several necessary repairs. On Sunday morning, the church serves as a place for congregational worship. During weekdays, the church is used to operate a “soup kitchen” for homeless individuals. Accordingly, except for the few hours on Sunday morning when the church holds worship services, the one-room church is used for the purpose of providing meals to homeless individuals—a purpose that is eligible for HUD assistance. However, the one-room church is ineligible for CDBG-funded improvements because it is the congregation’s principal place of worship.

Example 2 (eligibility of rooms located within a building that includes the principal place of worship). A synagogue with several rooms applies for CDBG funds to do necessary rehabilitation only to its “soup kitchen,” which is operated from two rooms located within the synagogue basement. The congregation does not use

these rooms as its principal place of worship; they are used exclusively for the “soup kitchen.” Accordingly, the rehabilitation of the two rooms is eligible for CDBG assistance.

Example 3 (eligibility of structure formerly used as a principal place of worship). A mosque purchases an abandoned church and applies for HUD funding to renovate it and use it as an elderly daycare center. The planned renovation will retain the existing exterior facade of the former church, including the stained-glass windows. The mosque will not conduct inherently religious activities within the new daycare center. Although the proposed rehabilitation involves a building formerly used as a church, the entire renovation is eligible for HUD funding because the building will be used solely for eligible HUD activities.

Example 4 (cost allocation based on space). A church applies for HUD funding to construct a homeless shelter, which will contain several rooms for use as a shelter as well as a one-room chapel to be used for weekly religious services and nightly prayer meetings. With the exception of the chapel, the homeless shelter will be used exclusively for eligible HUD-funded activities; no inherently religious activities, such as worship or religious instruction, will be conducted outside of the chapel. Homeless individuals staying at the shelter will be offered the opportunity to participate in the religious services, but attendance will be voluntary. HUD may assist the construction on an allocated basis by excluding the costs of the chapel.

Example 5 (cost allocation based on time). A church applies for ~~HUD~~-CDBG funding to make repairs to a gymnasium within a larger building complex that also contains its sanctuary and offices. The gymnasium is in use 40 hours a week. For four hours each weekday (20 hours per week), the gymnasium is used to operate a nonreligious recreation center for at-risk youth, a program that is otherwise eligible for HUD assistance. For the remainder of time during which the gymnasium is in use (20 hours per week), the congregation uses the gymnasium for a variety of activities, including religious programs that are ineligible for HUD assistance. While the gym is a discrete space in the complex, because it is used for both eligible and ineligible activities, the costs must be allocated based on time, should the church secure a waiver to the CDBG space cost allocation requirements (see note 4 above).

VII. Disposition of Property:

Under the new rule disposition by a faith-based organization of real property after the term of the grant, or any change in the use of the real property during the term of the grant, is subject to the government-wide regulations governing real property disposition. These general regulations are found at 24 CFR part 84 (for institutions of higher education, hospitals, and other nonprofit organizations) and 24 CFR part 85 (for state, local, and federally recognized Indian tribal governments). Pursuant to § 84.37, real property, equipment, intangible property, and debt instruments that are acquired or improved with federal funds must be held in trust by the faith-based organization as

trustees for the beneficiaries of the project or program under which the property was acquired or improved. The faith-based organization will record liens or other appropriate notices of record to indicate that personal or real property has been acquired or improved with federal funds and that use and disposition conditions apply to the property.

With regards to the acquisition and disposition of real property, parts 84 and 85 generally require that, except as otherwise provided in federal statute, the faith-based organization must use the real property for the originally authorized purpose as long as needed for that purpose. The faith-based organization may not dispose of, or encumber, its title or other interest in the property. When the real property is no longer needed for the originally authorized purpose, the faith-based organization must request disposition instructions from HUD or the grantee. HUD or the grantee may authorize the faith-based organization to sell or retain title to the real property, but only after compensating HUD for the federal assistance. Alternatively, HUD or the grantee may require the faith-based organization to transfer title to HUD, the grantee, or an eligible third-party, and compensate the faith-based organization for its attributable percentage of the current fair market value of the property. Faith-based organizations should refer to 24 CFR parts 84 and 85 for more specific requirements regarding the disposition of property (see § 84.32 and § 85.31).

Special Considerations:

The regulatory requirement subjecting property disposition to Parts 84 and 85 applies when some part of the assisted property has been used by the recipient for inherently religious activities (such as worship or religious instruction) or when the owner of the property is a religious or faith-based organization.

While many of the covered CPD programs have statutory or regulatory provisions governing change of use and disposition of assisted properties, these provisions are not necessarily sufficient to satisfy constitutional safeguards required by the Supreme Court when a faith based organization receives HUD assistance. Therefore, the September 30, 2003 regulations make the provisions of Parts 84 and 85 governing property disposition and change of use applicable to these programs along with the program-specific provisions. Note that while § 84.32 only relates to disposition of property, § 84.37 permits HUD to apply use and disposition requirements to properties acquired or improved with Federal funds. In practice, this means that at the time of a change in use or disposition of HUD-improved property, HUD will apply the analysis of § 84.32 in permitting the disposition or change of use of the improved property. Conveyance of homeownership units to private families does not pose a risk of violation of the separation of church and state, so there are no additional requirements imposed for conveyance homeownership properties by faith-based organizations to eligible homebuyers.

ESG: While section 415(c) of the McKinney Vento Homeless Assistance Act requires the grantee to certify that the assisted property will be used for at least 10 years in the case of major rehabilitation assistance or 3 years for other rehabilitation assistance, when

a faith-based organization holds title to property acquired or improved with ESG funds, Part 84.32 applies as well.

SHP: Section 423(b) of the McKinney Vento Homeless Assistance Act requires that property acquired, constructed, or rehabilitated with grant funds will be used for supportive housing for at least 20 years (unless HUD permits the conversion of the property to another use benefiting low-income persons). If the property is used for less than 20 years, the statute requires repayment of up to 100 percent of the original assistance provided. When a faith-based organization holds title to property acquired or improved with SHP funds, the amount to be repaid to the program account will be the greater of either the statutorily-derived amount or the amount determined under 84.32.

Youthbuild: Part 84.32 governs the change of use or disposition of properties acquired or improved with Youthbuild funds.

HOPWA: Section 858(b) of the AIDS Housing Opportunity Act requires that certain HOPWA-assisted property will be used for AIDS short-term supportive housing for at least 10 years if acquired or substantially rehabilitated with HOPWA funds or at least three years if leased, renovated, converted, or repaired with HOPWA funds (unless HUD permits the conversion of the property to another use benefiting low-income persons). When a faith-based organization holds title to property acquired or improved with HOPWA funds, disposition and change of use is governed by 84.32.

HOME: The affordability period for rental housing required by section 215(a)(1)(E) and implemented at 24 CFR 92.252 is not necessarily sufficient to satisfy the constitutional safeguards required by the Supreme Court. Therefore, when a faith-based organization holds title to property acquired or improved with HOME funds, it is subject to the requirements of 84.32 after the affordability period.

CDBG: Properties owned by faith-based organizations are subject to the requirements of 84.32, not the general CDBG subrecipient property disposition requirements of 24 CFR 570.503(b)(7) or 570.489(j).

VIII. Monitoring Faith-Based Organizations' Activities:

- Like any recipient of HUD funds, faith-based organizations are responsible for complying with HUD regulations. Therefore, they must carefully account for the use of those funds and ensure that funds are used only for eligible activities. They should be monitored with no more or no less scrutiny than any other HUD-funded organization to ensure compliance with program requirements.
- HUD funded grantees should make faith-based organizations aware of the conditions pertaining to the use of HUD funds through the same common and regular procedures used to advise all recipients, subrecipients, subgrantees and contractors of funding availability and program requirements.