CITY OF PORTERVILLE
CDBG SMALL BUSINESS REVOLVING LOAN FUND

PROGRAM GUIDELINES

INTRODUCTION

The City of Porterville's Revolving Loan Fund (RLF) is designed to meet the capital needs of new or existing small businesses located in the City of Porterville. The RLF is capitalized with funds from the repayment of principal and interest from existing loans. The funding originated from the U.S. Department of Housing & Urban Development (HUD) under the Community Development Block Grant (CDBG) Program. Federal requirements therefore apply and become part of any loan agreement.

- The intent of the RLF is to provide assistance to small businesses, which in turn will create full time jobs while increasing the overall economic base of the community.
- The RLF will only provide the funds necessary to bridge the "financial gap" that allows the business to move forward.
- The RLF is designed to provide no more than one-half of a small business's total financing requirements.
- RLF assistance is a minimum of $1,000 and a maximum of $50,000 will be directed towards businesses that have the greatest potential for long-term job creation. Jobs must be created and reported as a condition of RLF assistance.

All outreach efforts will be done in accordance with state and federal fair lending regulations to assure nondiscriminatory treatment, outreach and access to the Program. No person shall, on the grounds of age, ancestry, color, creed, physical or mental disability or handicap, marital or familial status, medical condition, national origin, race, religion, gender, sexual orientation, or other arbitrary cause be excluded, denied benefits or subjected to discrimination under the Program. The City will ensure that all persons, including those qualified individuals with handicaps have access to the Program

LINKING JOBS WITH TARGETED INCOME GROUP PERSONS

The City works closely with the Tulare County Workforce Investment Department (WID), Employment Development Department (EDD), Proteus, Community Services Employment Training (C-SET), Porterville Chamber of Commerce, along with other area groups which are part of the Porterville Partners to support the Workforce Investment Act (WIA) programs and services that provide assistance to the unemployed and low and moderate-income persons. With the assistance of the EDD and WID, all agencies regularly promote training activities and the labor market to potential employers in the area.

The training, recruitment, and placement activities currently operating in the community constitute the primary vehicle for insuring that the unemployed, underemployed, and low and moderate-income persons are linked with the jobs created through the RLF Program. These programs provide training and can be custom tailored specifically to meet an applicant's needs. Recipients of RLF assistance will be provided with a detailed description of the services and benefits of participation in the WIA program and will be referred to the Tulare County WID. The City will use cooperative agreements with the WID to refer all applicants to the WIA programs as prospective employers.

Job Creation/Retention: The City's aggregate job creation portfolio must maintain a 1: $35,000 job creation ratio. At least 51% of jobs created by the City's assistance and held in the City's portfolio must be made available to or held by low to moderate income persons.

Employment Plan Agreement and Three-Party Employment Agreement

The Employment Plan Agreement is required where jobs will be created. The Employment Plan Agreement is between the applicant and the Tulare County Workforce Investment Board (WIB), which is the employment screening and referral agency, and outlines the role of each party in insuring that the national objective (51% benefit to the TIG (Target Income Group); slum and blight) is met.

DOCUMENTING JOBS

For purposes of meeting the CDBG public benefit requirement, all jobs should be created or retained by a reasonable term agreed to by the grantee and the business. A typical term would be to create or retain a job 24 months after the provision of CDBG assistance to the business.

A. JOB CREATION

For job creation, it is required that a recipient (the business) demonstrate that CDBG assistance resulted in the creation of permanent, full-time (or full-time equivalent) private-sector jobs.

B. JOB RETENTION

For job retention, the grantee should document that the jobs would actually be lost without the CDBG assistance. There should be evidence in the public record that prior to providing CDBG assistance, it was clearly and objectively demonstrated that without CDBG assistance, the jobs would be lost. Examples of clear and objective evidence include: a notice issued by the business to affected employees; a public announcement by the business to affected employees; financial records or other records provided by the business or other entities that clearly indicate the need for CDBG assistance to continue the business's operations in the jurisdiction. The grantee should maintain documentation that supports the conclusion that without the infusion of the CDBG funds, the jobs would be lost.

If the national objective is being met is through benefit to low- and moderate-income persons, an income survey of current employees must document that at least 51 percent of the jobs retained with CDBG dollars are held by low- and moderate-income persons.

However, if the survey cannot support 51 percent benefit, there are other options to qualify under job retention. For example: based on historical data on job turnover rate, the business can stipulate to a hiring plan over the next few months that will provide new jobs primarily for low- and moderate-income persons. Together, the number of actual low- and moderate-income jobs retained, plus the number of projected low- and moderate-income hires may achieve the 51 percent eligibility threshold.

A self-certification sample form may be used to survey the incomes of the current employees to determine their low- and moderate-income status prior to making a funding decision. If funding is approved, a representative number of the retained employees must be income-screened for low- and moderate-income eligibility to document the reliability of the survey results.

C. <u>Permanent Jobs</u>

Only permanent jobs directly related to the assisted activity are considered for purposes of determining whether the project generated the requisite amount of public benefit. Note the business owner can count themselves as an employee if they are working full time in the business. A permanent job is defined as a job classification that provides 2,080 hours a year employment. Full time equivalent jobs (FTE) are considered toward establishing a final job count. Two part time jobs of at least 1040 hours per year each can count as one FTE job. However, fractions of full-time employment (e.g. 0.5 FTE) are not considered in meeting the program's public benefit standard.

NATIONAL OBJECTIVE ISSUES RELATED TO BUSINESS ASSISTANCE ACTIVITIES

Each Business Assistance activity funded under the CDBG program must meet at least one of the three federally mandated national objectives.
These national objectives are:

<u>National Objective #1: Expanding economic opportunities, principally for low-and moderate-income persons.</u>

Most projects funded under the Business Assistance category will meet the national objective of expanding economic opportunities, principally for persons of low- and moderate-income. This is accomplished by documenting that at least 51 percent of the jobs that are created or retained by the CDBG-assisted business expansion or retention project will be filled by or made available to persons of low-and moderate-income.

Ultimate benefit to low- and moderate-income persons is documented by screening the income of the persons hired for the jobs. However, a person may be presumed to be low- and moderate-income if either of the following situations are documented:

a. the person filling the job resides within a census tract (or block numbering area) that either: 1) has at least 70 percent of its residents who are low- and moderate-income; or 2) the business being assisted is located within a qualifying census tract;
b. the person or business is within a census tract that is part of a federally-designated Empowerment Zone or Enterprise Community or the census tract meets the following criteria: a) a poverty rate of at least 20 percent; b) and no portion of the

census tract includes a central business district unless the tract has a poverty rate of 30 percent; and, c)the census tract evidences pervasive poverty and general distress as measured by the poverty rates of the block groups or by other HUD-approved measures of distress.

National objective #2: Activities which aid in the prevention or elimination of slums or blight.

In general, this national objective is met if the CDBG-assisted activity will directly remedy a slum or blighted condition that is within a designated area that meets a definition of a slum, blighted, or deteriorated area under State or local law. The project being funded must specifically remedy a condition that has been identified in a redevelopment plan as a blighted or slum condition and the CDBG-funded activity should be related to one of the projects specifically identified in an implementation plan as being necessary to remedy an identified slum, blighted or deteriorated condition. Under specific criteria, this objective can also be met on a spot basis.

National objective #3: Activities designed to meet community development needs having a particular urgency.

A CDBG-assisted activity will meet this national objective if the jurisdiction certifies that the activity is necessary to alleviate existing conditions which pose a serious and immediate threat to the health or welfare of the community which are of recent origin and the jurisdiction is unable to finance the activity on its own. A condition will be considered to be of recent origin if it developed or became critical within 18 months of the certification by the jurisdiction.

ELIGIBLE APPLICANTS

Eligible applicants include on-going and start-up private, for profit businesses, that are classified as industrial, commercial, service or retail business, and that are located in or expanding to the City of Porterville. The project to be financed with the RLF Program must be located within the incorporated area of the City of Porterville.

Eligible applicants must have a minimum credit score of 600 unless compensating factors are provided and/or justifiable evidence is provided that reduces risk. A twelve (12) month history of on-time payments for revolving accounts or alternative forms of credit (i.e. rent history, cell phone, gas or electricity account) is also required.

No outstanding unpaid judgments or involuntary liens at the time the City's loan is recorded.

No bankruptcies, which have not been dismissed prior to the recordation.

ELIGIBLE COSTS

Eligible costs include:
1. Working Capital (Capital for day to day operations of the firm, acquisition of assets, or payment of obligations).
2. Purchase of inventory, furniture, fixtures, machinery and equipment related to the business.
3. Tenant Improvements

INELIGIBLE APPLICANTS

RLF Loans shall not be available for the following business:

1) Speculative investment companies
2) Real estate investment companies
3) Lending institutions
4) Gambling operations
5) Other businesses not serving the interest of the City

INELIGIBLE ACTIVITIES

1) Refinancing or consolidating existing debt.
2) Reimbursement for expenditures prior to loan approval.
3) Routine maintenance.
4) Professional services such as feasibility and marketing studies, accounting services, etc.
5) Other activities that the City may identify as inappropriate for the RLF program or not consistent with City's Economic Development Plan and five year Consolidated Plan.
6) Projects where there is not reasonable assurance of repayment of the loan.
7) **Business operating out of a private residence (Home Occupancy Permit) where services will be performed at home. Businesses operating under a Home Occupancy Permit (HOP) for office purposes only, but not providing services from the residence may be eligible for funding on a case by case basis. An example of business that may qualify are those that perform repairs, maintenance, or professional services in a client's home or business (such as a home remodel contractor, plumber, traveling notary services, etc).**
   The business HOP address must be located within the Porterville city limits. A funded business that operates under a HOP will be monitored on an annual basis to ensure that the business address remains within the city limits, even though the actual performance of services may be outside the city limits, the then current loan amount, plus any interest due, shall become due and payable to the City.

Projects are not eligible if they create conflict of interest pursuant to California Government Code Section 887100 et seq. for any current City elected official, appointed official, or employee.

SPECIAL CONSIDERATIONS

Although all loans that meet the minimum requirements will be considered, preference will be given to applicants that meet one or more of the following:

1) have demonstrated funds are not available from other sources (SBA 504 or exclusive bank financing)
2) have shown they will exceed the minimum requirements of job creation while maintaining the ability to meet debt service
3) have shown that RLF funds are fully secured by property or personal guarantee. The greater the security of RLF funds, the higher the priority given to the applicant
4) have successfully completed an approved Entrepreneurial training course.

APPLICATION PROCESS

1) Project Application: Staff shall review the application for completeness and verify that the proposed project meets the minimum requirements. Included in the application will be current credit report, business plan, background inquiry form, and financial statements. If the application is not complete, staff will inform the applicant of the deficiencies within two weeks.
2) Background and Credit Check: Staff will submit a request to an outside agency for a background and credit check of all applicants stated on the loan. The information received from the reports will be used as part of the Loan Review process to determine risk to the City.
3) Review of Loan: Prior to presentation to the Community Development Finance Assistance Review Committee, staff shall contact the business to review and explain the loan terms (interest rate, monthly payments, and term of loan) Interest rate is set at 2% or current Local Agency Investment Fund (LAIF), which ever is greater, at time of loan.
4) Application Review: The Community Development Finance Assistance Review Committee shall meet to review an application within 30 days of the receipt of completed application. Upon the Community Development Finance Assistance Review Committee's review of the project the recommendation shall be determined.
5) Approval of Award: Upon application approval, a closing shall be scheduled to execute the necessary loan documents.
6) Rejection of Award: If the application is not approved, staff shall notify the applicant in writing of the reasons for rejection and offer to meet with the applicant to explore ways to strengthen the loan request or to identify alternative funding sources.

APPEALS PROCESS

- The Community Development Financial Assistance Review Committee will serve as an appeals board for staff rejected loans and review other policy and procedures as necessary.

- The acts of the majority of the members present at a meeting at which a quorum is realized shall be the acts of the Committee. Each member shall be entitled to one vote and a majority vote is needed to approve or deny. The Committee's Decision shall be final.

LOAN PROCEDURES

Prior to releasing funds, the following documentation shall be in place or provided at appropriate time during the term of the loan.

1) Promissory Note. A promissory note shall be prepared by the Community Development Director, or designee, and signed by the authorized representatives of the business at the time of loan closing. The note shall be dated, reference the agreement between the City and the business and specify the amount and terms of the loan funds to be delivered.
2) Security. Mortgage and or lien instruments and personal guarantees provided as security for all loans shall be prepared by the City Attorney, or designee, and signed by the authorized representatives of the business at the time of loan closing. The City

Attorney, or designee, shall record all security instruments and place copies in the project file, as applicable, to include: a) mortgage and/or security agreement; b) guarantee agreement; c) title insurance commitment and policy; d) assignment of life insurance; e) property-casualty insurance binder; f) personal guarantee; g) other documentation as may be appropriate.

3) Amortization schedule. An amortization schedule shall be prepared by staff and reviewed with the loan recipient prior to executing loan documents.
4) Evidence of Program Expenditures. Documentation shall be provided by the applicant to evidence RLF program expenditures prior to the release of funds. Documentation includes invoices or receipts for materials and supplies, final bills of sale, letters from lenders, and/or canceled checks. All documentation shall be reviewed and approved by staff. Staff shall also verify the installation of all fixed equipment.
5) Other Documentation. Documentation shall be provided by the applicant to evidence that all required permits, licenses, and registrations have been obtained prior to the release of RLF funds. As appropriate or necessary, the borrower may also be asked to provide the following documentation: a) articles of incorporation and by-laws; b) a resolution or agreement to borrow funds; c) current financial statements; d) evidence of having secured other funds.

LENDING CRITERIA

The following guidelines have been adopted to clarify the program basis for making loan commitment decisions.

Loan Terms: No RLF will have a term exceeding ten years. The term of the loan will be established on a case by case basis.

Loan Fee: None

Prepayment Penalty: None

Collateral Requirements: All RLF loans shall be fully secured for 100% collateral coverage to maintain the RLF Program. No unsecured loans shall be made. Types of collateral may include one or more of the following:

- Real Estate – liens on real property supported by appraisals establishing sufficient equity generally utilizing a 100% loan to value ratio.
- Liens on RLF financed machinery, equipment, or other fixtures, generally at a 95% loan to value ratio.
- Assignment of Rents
- Personal and/or Corporate Guarantees
- Cosigners and other collateral such as insurance on principals

LABOR STANDARDS NOTE:

Prevailing Wages are required to be paid on any construction work that is over $2,000 financed by CDBG funds.

LOAN UNDERWRITING GUIDELINES

The City is prohibited from providing RLF assistance unless that assistance is appropriate as defined by HUD. These loan underwriting policies are designed to assist businesses that could not proceed without the RLF assistance and to ensure that the RLF assistance is appropriate.

HUD UNDERWRITING GUIDELINES

The City uses the HUD underwriting guidelines to determine whether proposed RLF assistance is appropriate. In addition, each proposed project will be reviewed to determine that the required level of public benefit will be obtained from the requested expenditure of RLF funds.

The objectives of the underwriting guidelines are to ensure that:

1. Project costs are reasonable.
2. All sources of project financing are committed.
3. RLF funds are not substituted for non-Federal financial support.
4. The project is financially feasible.
5. The return on the business owner's equity investment will not be unreasonably high RLF funds are disbursed on a pro rata basis with other financing provided to the project
6. Sufficient public benefit will be received from the expenditure of RLF funds

Project Costs: Each cost element of a project will be reviewed for reasonableness, and to avoid providing either too much or too little RLF assistance. The amount of time and resources expended evaluating the reasonableness of a cost element shall be commensurate with its costs. In some instances, the City may require third-party fair-market price quotations or cost estimates. Any transactions which are not arm's length will require that the cost elements be thoroughly documented and supported.

Commitment of All Sources of Project Financing: Prior to the commitment of RLF funds to the project, a review shall be conducted to determine if: sufficient sources of funds have been identified and committed to the project; the applicant and the participating lenders have the financial capacity to provide the funds; and the project is viable and will move ahead in a timely manner. In certain circumstances, RLF funds may be committed in advance of final commitments from other funding sources. Nonetheless, the underwriting analysis requires that the approximate terms and conditions of the other funding sources be provided. Final commitments from the other funding sources will be required, with substantially similar terms and conditions as used in the underlying analysis, prior to any loan closing or disbursement of funds.

Avoid Substitution of RLF Funds for Non-RLF Financial Support**:** The project will be reviewed to ensure that, to the extent practicable, RLF funds will not be used to substantially reduce the amount of non-RLF financial support for the project. In order to receive RLF funds, a project must have a "financial gap." This gap must be documented. There are three types of financial gaps, two are discussed below, and the third is discussed under the criterion "Return of Equity Investment." One project may have two different gaps. The types of gaps are as follows:

Unavailability of Capital: The project can afford the cost of financing, but is unable to obtain the funds from either debt and/or equity sources. In regard to debt, the gap may be a result of a lender's loan to value requirements or the inherent risk of the industry or project.

For example, the lender will only loan 70% of the project's cost. In this case, the business may not have the cash to bridge the gap, or if the business bridges the gap, its cash flow may be so restricted as to jeopardize the business. In order to document this gap, several steps need to be undertaken. The lender needs to be contacted to determine if there is any ability to increase the size of their loans. Finally, in addition to looking at the business and personal financial statements and tax returns, a proforma cash flow analysis needs to be prepared and analyzed, with and without RLF funds, to demonstrate the gap. The terms and conditions of a loan under this gap analysis should be comparable to the market.

Cost of Capital: The project cannot support the interest rate, loan term and/or collateral requirements of a lender. In analyzing this gap, discussions with the lender are important to determine any flexibility in terms. A project may not be able to support the rate, terms and collateral requirements, or may just face a single hurdle. In addition, the gap may only exist in the early years of the project. To determine the gap, business and personal financial statements and tax returns shall be analyzed. Sources of equity shall be explored. Public and private funding sources that would bridge the gap shall be evaluated. Proforma cash flow analysis shall be developed with and without the RLF funds to demonstrate the gap. Depending on the gap, the terms or rate shall be adjusted to a rate that allows the project to proceed but are not too generous. Terms can be adjusted to allow for deferrals of principal and or interest, or to allow loans to be amortized over a longer period. Interest rates can be adjusted, including increases in the rate over time as cash flow allows.

Financial Feasibility of the Project: Each project will be examined to determine the financial viability of the project, and thus the reasonable assurance that the public benefit will be realized. The current and past financial statements for both the business and individuals must be analyzed, along with tax returns and projections. The assumptions behind the projections must be critically analyzed. Income and expense costs shall be evaluated and compared historically, where applicable, and compared to industry averages (using guides such as Robert Morris Annual Financial Statements). Project costs, including both hard and soft costs, must be determined to be reasonable. Accurate project costs are vital to determining project feasibility. As part of the financial analysis, the past, current, and projected financial data shall be analyzed to determine if the job estimates are reasonable and supportable. Labor costs shall be gauged at the break-even point. In addition, labor costs shall be checked against industry averages. Any variations shall be explained in the loan analysis.

The terms and conditions of the RLF loan must be "appropriate." In general, the term shall be set to assure enough cash flow to operate successfully.

Each loan shall include a written explanation of the "appropriate" analysis that was undertaken, and the reason the terms and conditions of the loan were approved. Each loan decision shall also contain a certification statement by **CDFARC** that the loan has been reviewed according to all underwriting guidelines and regulations and that the loan is appropriate by state/federal definition.

Financial Analysis: Historical and projected financial statements will be subject to financial analysis to determine the gap, and structure the terms and conditions of the RLF loan, as discussed above, but also to determine that the project is feasible. In addition, using prudent underwriting guidelines, demonstrate that the proposed loan is of sound value and that past earnings and future prospects indicate an ability to meet debt obligations out of profit.

Information required to be submitted by the applicant will depend on the project, ownership structure and whether it is an ongoing or start-up business. In general, the information required is outlined in the RLF checklist that will be provided.

The financial analysis will be designed to evaluate the business. The analysis will include a spread sheet of the current and past financial statements to determine trends. The proforma statements will then be compared to these statements. Key financial ratios will be analyzed. The statements and key ratios will be compared to industry averages. Key ratios that will be analyzed include:

Current Ratio: current assets/current liabilities. The ratio is a rough indication of a firm's ability to service its current obligations. A ratio of 2:1 will be considered secure.

Quick Ratio: cash and equivalents plus accounts & notes receivable/current liabilities. This ratio is a refinement of the current ratio. A ratio of 1:1 will be used to demonstrate ample liquidity.

Cash Flow Coverage: Net profit and depreciation and depletion-amortization expenses/current portion of long-term debt. This ratio will be used to measure the ability to service long term debt. This ratio is a measure of a firm's ability to meet interest payments. A cash flow coverage of 1.25 times debt service shall be used as guideline.

Collateral Coverage: The value of collateral is compared to the amount of the loan. Typical underwriting guidelines suggest that 125% of loan balance be used. This ratio is highly dependent on the quality and security of the collateral. The Porterville RLF shall use 100% as a guideline, which shall only be lowered with specific and detailed analysis and explanation.

Break-even Analysis: The analysis of the project's ability to support the projected labor costs and additional debt service at its break-even point (BEP) will be analyzed to determine what proportion of the jobs can be supported at that BEP. This will serve as a worst case look at the business prospects for success, ability to service new debt, and meet job creation/retention obligations.

The financial and ratio analyses must be supported by the business plan. The business plan must provide a clear understanding of the project, competition, market strategy, sales estimates, management capacity and other factors.

Lastly, to ensure project feasibility, an evaluation will be conducted of the experience and capacity of the business principals to manage the business and achieve the projections.

Return on Equity Investments: The return on equity investment is the amount of cash that the investor/business owner is projected to receive in relation to their initial equity. For a sole proprietor, this equates to salary plus net income. The RLF should not provide more than a reasonable return on investment to the business owner. This will help ensure that the RLF will maximize the use of RLF funds and not unduly enrich the business owner(s)/investor(s). However care shall be taken to ensure that the rate of return will not be too low so that the business owner's motivation remains high to pursue the business with vigor.

If the project's financial returns are projected to be too low to motivate the business and/or investor to proceed with the project, the risks of the project may outweigh the returns. An inadequate rate of return adjusted for industry and location risks, is a third method used to determine the gap does exist then the RLF financing rate and terms must be set at a rate which provides a return equal to the “market rate.” Real estate appraisers and lenders will be used as a source of information on “market rate” returns.

ATTACHMENT A

TARGET INCOME GROUP (TIG) INCOME LIMITS 2011

County	INCOME CATEGORY	1	2	3	4	5	6	7	8
Tulare County	**"30%" Limit**	12,050	**13,750**	15,450	**17,150**	18,550	**19,900**	21,300	**22,650**
	"50%" Limit	20,050	**22,900**	25,750	**28,600**	30,900	**33,200**	35,500	**37,800**
	"80%" Limit	32,050	**36,600**	41,200	**45,750**	49,450	**53,100**	56,750	**60,400**

References:

The federal Consolidated Plan regulations Section 91.305 Subpart D refer to the extremely low-income target group, the 30 percent level, used in both HOME and CDBG programs. For CDBG, 24 CFR 570.3 describes the HUD’s income limits for the 50 percent and the 80 percent income levels are CDBG’s Low – and Moderate-income limits, respectively. For HOME, 24 CFR 92.216 establishes what is called the “60% limit”. HOME’s income limits for the 50 percent and 80 percent levels are called Very Low –and Low-income, respectively.

The members of the “Target Income Group” are those persons whose family/household income does not exceed 80% of Tulare County’s Median Household Income. The figure is calculated each year.

For the purposes of the Porterville Business Revolving Loan Fund, Family/Household Income is:

The sum of money income received during the 12 months prior to hiring, from all sources: wage or salary income; net self-employment income; interest, dividends; net rental or royalty income or income from estates and trusts; Social Security or Railroad Retirement income; Supplemental Security Income (SSI); public assistance or welfare payments; retirement, survivor or disability pensions; and all other income.

EQUAL HOUSING LENDER