



Legislation Text

File #: 16-068, **Version:** 1

ACTION REQUESTED:

Communication from the City Manager with a Request to Approve Updated Guidelines for the City's REVOLVING LOAN FUND.

BACKGROUND: The City's Revolving Loan Fund (RLF) Program is guided and administered through a RLF Plan that is approved by the City Council and the Economic Development Administration. Below is a summary of the program and proposed changes.

The purpose of the City's RLF Program is to preserve and create jobs by making capital more accessible. The role of the RLF Program is to provide "gap financing," in the form of debt, on projects determined to be financially viable through a due diligence process known as loan underwriting. Gap financing is intended to provide funds in cases where there is a lack of equity or debt financing from other sources. Below is a financial overview, an operational overview, and proposed changes to the RLF Plan.

RLF PROGRAM - FINANCIAL OVERVIEW

The City's RLF Program was initially capitalized in 1988 with \$769,232 - \$500,000 from the EDA and \$269,232 in matching funds from the City. As of September 2015 the capital base has grown to \$1.2 million through interest revenue (\$864,129.18) minus losses (\$427,145.67).

In total, the RLF Program has loaned over \$3.8 million to 43 different projects in the industrial, commercial, and service industries and has assisted with the creation/attraction of 1,947 jobs. City loans of \$3.8 million were leveraged with \$45.5 million of other funds and has resulted in an overall investment of \$49.3 million. The six loans written off represent a loan default rate of 14% in projects and 11% in value.

On average a RLF loan project represents an investment of \$1.15 million, 45 jobs, and a City loan of \$86,000. For every \$1.00 loaned by the City an additional \$12 was leveraged.

As of November 30, 2015, \$983,032.09 was available for new loans, and a principal balance of \$224,498.98 was dispersed over six loans. A loan commitment of \$135,300 was earmarked for Centre State International on November 10, 2015. Prior to that, the last loan was made in August 2011.

RLF PROGRAM - OPERATIONAL OVERVIEW

The RLF Program operates under a RLF Plan which specifies the strategy and procedures for operating the RLF Program. The parameters of the RLF Plan must be within the regulatory limits set by EDA and in accordance with "Prudent Lending Practices." Such practices include loan processing, documentation, loan approvals, servicing, administrative procedures, collateral protection, collections, recovery action, legal compliance, and filing requirements.

EDA's policy is that 75% of the RLF capital base be loaned or committed, otherwise such funds are sequestered and interest earned on EDA's share is remitted. If the capital utilization is persistently below 75%, such funds may be subject to suspension or termination. If default rate exceeds 20% a corrective action would be required.

The RLF Plan specifies maximum and minimum loan size, loan dollars per job ratio, owner equity requirements, and a variety of other parameters. In addition, the City is required to submit a report every six

months (March and September) to EDA showing loan activity and account balances. EDA also encourages loan grant recipients to update their RLF Plans every five years. The last time the City updated its RLF Plan was 1998.

The RLF Program is marketed by the City, its partners, and through private banks. Upon receiving a loan application, the loan is reviewed and underwritten by staff and presented to a loan review panel for advisement. A recommendation is then made to the City Council for final approval. After a loan is approved by the City, a loan agreement and closing documents are executed, funds are disbursed, and filings are made to perfect and maintain security interest in the pledged collateral.

RLF PROGRAM - PROPOSED CHANGES

City Staff has prepared the RLF Plan for Council consideration. The basis and guiding principles for the proposed changes are to:

- a) make capital more accessible;
- b) encourage startup businesses;
- c) target underserved markets and/or the socio-economically disadvantaged;
- d) streamline the approval process; and,
- e) promote and develop a strong entrepreneurial ecosystem with other partners.

Key targets for the City's RLF Program include:

- a) Minority Business Enterprise (MBE) - a business that is 51% owned by a minority group;
- b) Small Disadvantaged Business Enterprise (SDBE) - defined by the Small Business Administration 8a program; and
- c) Disrupted Business Enterprise (DBE) - a business, determined by City Council, that has or will be disrupted due to disasters, street reconstruction, or other forms of disruption within a particular geography.

The full RLF Plan is attached. The substantive changes to the RLF Plan, shown in red, are provided below:

REVOLVING LOAN FUND PLAN - PROPOSED CHANGES				
Ref.	Subject	1998 RLF Plan (Current)	2015 RLF Plan (Proposed)	RLF Plan
PART I - REVOLVING LOAN FUND STRATEGY				
1	Financing Niche	Subordinate Debt	Also to include Single Source Borrowing	City - n
2	Loan Size	Lesser of: a) \$150,000 33% of project cost c) \$10,000 per job created/retained	Lesser of: a) \$250,000 33% of project cost to 50% if MBE, SDBE, and DBE job created/retained up to \$35,000 for MBE, SDBE and DBE	D.5. - pg 10
3	Fees	None	City may elect to charge application underwriting/closing fee	D.8. - pg 11
4	Private Equity	10% of total project cost	10% of total project cost 5% for MBE, SDBE and DBE	D.9. - pg 11
5	Credit Not Otherwise available	Lead lender certification City loan is critical to project.	Applicant to document that private financing otherwise available through: a) "conditional approval letter" to fund a portion of the project, b) "turn down letter", c) applicant certification, or d) applicant justification that private financing is not feasible and City loan is critical to project.	D.13. - pg 12
6	Private Sector Leverage in Portfolio	For every \$1 of RLF, need \$3 of "Private Investment"	For every \$1 of RLF, need \$2 of "Private Investment" in portfolio clarified, includes: a) unencumbered assets, b) SBA guarantees, and c) other government funds. Does not include equity on assets	E.2. - pg 12
7	Job Cost Ratio	\$10,000 per FTE job retained/created	\$25,000 per FTE job retained/created \$35,000 for MBE, SDBE and DBE	E.3. - pg 12
PART II - REVOLVING LOAN FUND OPERATIONAL PROCEDURES				
8	Loan Administration Board	5 members of the Designated Zone Organization	Creation of adhoc Loan Review Panel to advise City Manager (CM). LRP composed of 5 individuals. Loans under \$15,000 to be approved by CM. Loans \$15,000 and over recommended to City Council for final approval	A.2. - pg 14
9	Administrative Costs	None	City may elect to cover loan administration expenses through interest income	E.2. - pg 21

FINANCIAL IMPACT: There is no direct financial impact to the City's general fund. All funds from the RLF Program are set-aside in a separate account. These funds cannot be used for any other activity. If the City is unable to lend funds, corrective action might be taken by the Economic Development Administration.

NEIGHBORHOOD CONCERNS: The proposed RLF Plan was presented to the City's ad hoc Incentive Policy Group on February 11, 2016. The group was comprised of representatives from banking, small business, the trades and minority business. The group supported most of the changes except for charging administrative costs from the loan pool. The group recommended administrative cost for marketing and staffing be covered in part by:

- a) a loan application fee between \$50 to \$100;
- b) a loan underwriting fee between 0.75% to 1.0% of principal loan amount; and,
- c) loan closing fees equal to the cost of filings and reports. The fees could be paid at closing or added to the principal balance of loan.

Staff agrees with charging the applicant for loan servicing fees and costs rather than drawing funds away from the loan pool or the general fund. The RLF Plan reflects this aspect.

IMPACT IF APPROVED: More capital in the form of gap financing will be available for growing jobs through business startup and expansion. Also, the City would be in a better position to meet EDA's goal of loaning 75% of the RLF capital base. The City would also have a greater capacity to support social and economically disadvantaged business enterprises. EDA has provided preliminary approval of the suggested changes but will need to officially approve the RLF Plan after Council approval.

IMPACT IF DENIED: The capacity to grow jobs and drive investment would be reduced.

ALTERNATIVES: No alternatives are recommended.

EEO CERTIFICATION NUMBER: Not Applicable