

THE CITY OF AUSTIN

SECTION 108

FAMILY BUSINESS LOAN PROGRAM

CRITERIA

A Program Financed Under the U.S. Department of Housing & Urban Development Section 108 Loan Program in Association with the U.S Small Business Administration and Private Banks and Credit Unions

Administered by the:

The City of Austin Office of Economic Growth and Redevelopment Services

This program is being carried out under Section 108 of Title I of the Housing and Community Development Act of 1974, as amended. The 108 loans are intended to support and stimulate business development and investment by the private sector. The Program Criteria applies to all sources of 108 loans funding from the U.S. Department of Housing and Urban Development (**HUD**).

I. MISSION STATEMENT AND PROGRAM OBJECTIVES, FAMILY BUSINESS LOAN PROGRAM,

The Mission of the City of Austin Section 108 Family Business Loan Program is to enable existing family owned small businesses and in the micro loan section of the program to provide existing family owned small businesses or start up businesses to implement business ventures that will create jobs, revitalize communities, increase the tax base of the City, and enhance the overall quality of life for all City of Austin residents. It is designed to leverage 108 funds with SBA 504 funds and funds from a Private Bank and/or Credit Union

The objectives of the Program are to:

- Provide subordinated financing to eligible borrowers to fill a financing gap beyond the amount of private participation and equity investment that can be raised.
- Provide long term, fixed or variable rate financing at interest rates lower than conventional financing.
- Provide a means for revitalizing disadvantaged areas.
- Create sources of new jobs
- Assist family owned businesses in the City of Austin
- To leverage 108 funds with funds from the U.S. Small Business Administration's 504 Program and funds of a Private Bank and/or Credit Union

II. PROGRAM REQUIREMENTS

A) Guidelines

The City of Austin Section 108 Family Business Loan Program will follow the HUD and the Small Business Administration (**SBA**) guidelines for eligibility and underwriting criteria.

B) National Objectives

Each activity assisted with a Section 108 Loan must meet the following CDBG Program National Objectives:

- Benefiting low and moderate-income persons. Fifty one percent (51%) of new jobs created under this program must be offered to City of Austin residents that have a low and moderate income; or be located in a census tract having a poverty rate of 20% or higher (**HUD Presumption Rule**)

C) Loan Review Committee

A Loan Review Committee (**LRC**) comprised of 2 representatives from the City's Economic Growth and Redevelopment Services Office (**EGRSO**), 1 representative from the Financial Services Department and 1 representative of the Department of Neighborhood Housing and Development, will review all of the Section 108 loan applications presented by the Loan Administrator and make the recommendation to approve or disapprove the loan application. The following criteria are in full alignment with federal guidelines and will be the benchmark for approval or denial of loans. A quorum of the LRC shall be fifty-one percent (51%) or two (2) of the appointed members. A quorum must be present to review and act upon any application.

The LRC will review each application with the required financial information to determine:

- Number of jobs to be created
- Amount of Section 108 loan fund participation necessary
- Amount of Federal Home Loan Bank and SBA loan match
- Ability of loan applicant(s) to repay the loan
- Collateral or security available

No loan shall be made without the favorable recommendation of the LRC.

III. PROGRAM DETAILS

A) Eligibility

1. Area

The municipal boundaries of the City of Austin.

2. Eligible Applicants

- Private, for-profit businesses that have been engaged in industrial, retail or distribution activities for at least two (2) years and are able to demonstrate sufficient profitability. An applicant must be a sole proprietorship (Micro loan applicant only) or any other legally organized business registered with the State of Texas. The business must meet the size standards of the U.S. Small Business Administration and be a closely held entity.

B) Loan Amount and Required Owner's Equity

- The maximum loan amount for any given project is forty percent (40%) of the total project cost or up to \$1,000,000; whichever is lower. The maximum job-cost ratio for the project is \$35,000 per full-time equivalent job to be created.
- Projects require LRC and HUD approval.
- The maximum loan amount and term for working capital will be evaluated on an individual basis. Factors to be considered may include but not limited to the project size, nature of the project, and public benefits.
- The applicant must commit a minimum of ten percent (10%) of the total project cost. The applicant will be required to provide proof of equity availability. Equity shall be as defined within the Regulations of the SBA 504 SOP.
- Applicants will be encouraged and required whenever possible to leverage 108 funds with the SBA 504 Program, and programs of the Federal Home Loan Bank through its member banks.

C) Loan Interest Rate

The City of Austin rate will be 120 basis points (1.2%) above the rate that HUD charges the City during the interim or permanent financing period. During the City's interim financing period, HUD uses the three-month London Inter Bank Offered Rate (**LIBOR**), adjusted monthly, plus 20 basis points (0.2%) or any other basis points amount HUD chooses to apply. During the permanent financing period, HUD uses the yields on U.S. Treasury obligations of similar maturity to the City's HUD 108 loan principal amount to set the rate, plus HUD adds a small additional basis point spread.

To the extent possible, Borrowers are given the opportunity, typically once each year or at other times determined by HUD and EGRSO, to convert a floating rate loan to a fixed rate.

D) Terms of Loans

- Working Capital – Up to a maximum of ten (10) years.

- Machinery and Equipment – Up to a maximum of the economic life of the machinery and equipment or twenty (20) years, whichever is less.
- Renovation – Up to a maximum of twenty (20) years.
- Acquisition of land, buildings or new construction – Up to twenty (20) years.

E) Eligible Uses

- Working capital for labor and moving costs associated with the expansion or relocation of a project, inventory, receivable financing, and expenses related to training and marketing. Working capital expenses will only be considered in conjunction with the total project and will not be financed independently.
- Renovation and new construction of commercial/industrial buildings.
- Acquisition of commercial/industrial land and buildings.
- Acquisition and installation of machinery and equipment.
- Refinancing of existing debt to an independent institutional lender (as part of a new project creating new job opportunities.)
- Funds cannot be used to reimburse for costs incurred prior to EGRSO completing a HUD Environmental Review, except for planning costs of the project.

F) Job Creation

- Only those applicants proposing to create new jobs will be considered for funding under the Section 108 Loan Program.
- The job creation period begins with the issuance of a certificate of occupancy, or when all funds are disbursed, whichever is first.
- The time frame to create the new jobs will be from one (1) to five (5) years. If EGRSO considers that additional time is necessary, it will request approval from the Austin City Council.
- Where required, borrowers shall enter into a “First Source Agreement” with the local workforce organization for the hiring of employees, for the purpose of assuring that a best faith effort will be made to hire 51% of the new hires from the low and moderate income labor pool.

G) Underwriting

In considering an application for a Section 108 loan, the following procedure is used for all applicants:

1. Financial Analysis

Site Visitation – A site meeting with the applicant at its location will occur early in the process to gain insight into the business, answer the applicant’s questions and request any needed information. The meeting should take place prior to submission of an application for the purpose of helping the applicant determine whether or not the applicant can meet the Section 108 guidelines.

History and Business – An evaluation will be made on how long the applicant has been in business and the type of goods or services provided by the applicant. It is critical to analyze the request in respect to the

specific type of industry since not all industries have the same financing needs and payment terms to suppliers, and from customers. The balance sheet and operating ratios vary considerably from industry to industry.

Project Description – The applicant is required to provide a detailed description of the proposed project including:

- Benefits to be derived by the applicant.
- The impact the project will have in creating new jobs within HUD guidelines.
- A detailed breakdown of the use of the requested loan proceeds.
- Management and control.

Resume – Resumes will be analyzed. The resume(s) will provide insight into the background and qualifications of the principals and key management personnel. For example, someone who has been successful in running a delicatessen may not have the abilities to operate a totally unrelated business such as a manufacturing concern.

Financial Statements – Historical financial statements, when available and Federal Income tax returns are required. If the most recent annual statement is more than two months old, an interim statement not more than 60 days old is also required. Statement analysis should include:

- Trend analysis
- Ability to repay debt – both short and long term.
- If EGRSO deems it necessary, comparison to peer group companies as provided by the Robert Morris Association (**RMA**) studies or other similar companies within the City's existing loan portfolio. Any significant variation from the industry comparison is discussed with the applicant to ascertain the reasons for the variance(s).
- Adequacy of working capital.

Projected Financial Statements – Three year projections will required, which include balance sheets, and a Profit and Loss Statement. The projections must include the impact of the proposed financing and the underlying assumptions used to create the projections:

- Examine the probability of achievement given the underlying assumptions.
- Determine if projected cash flow will service proposed debt.

Personal Financial Statements – Personal Financial Statements are required from everyone having twenty percent (20%) or more ownership of the business along with personal Federal Income tax returns for the most recently filed three years. Personal guarantees are generally required from principals of the applicant. If no member of the Company has an interest of more than 20%, the analyst shall determine from which stockholders and members of management personal financial statements will be required. All Personal Financial Statement shall be on SBA Form 413.

2. Financial Ratios

Loan to Value Ratio (taking into account all loans for the project):

Land and building: 80%

Used machinery and equipment: 80%

New machinery and equipment: 80%

Receivables: 70%

Inventory: 50%

Debt service coverage ratio: 1.20:1.00

3. Appraisal

Appraisal reports will be required for projects involving acquisition and construction. EGRSO will request from the applicant a copy of the appraisal ordered by the participating lender (bank, SBA, or independent institutional lender). If there is not participation of another lender, EGRSO will provide the applicant a list of City-approved appraisers. The applicant will order the appraisal and have it also addressed to the City of Austin, Attn: EGRSO.

4. Credit History

- Independent credit investigations are conducted on the applicant and the principals. This includes real estate searches, Uniform Commercial Code (**UCC**) searches with the Secretary of State and personal credit reports on the principals. This credit investigation is used, in part, to verify the accuracy of the information provided by the applicant and the principals and to find out if there are any undisclosed judgments, liens, etc.
- The credit investigation will be run by the primary lender when participating in the project and by EGRSO when the Section 108 loan is the only source of funding.

H) Collateral Evaluation

Collateral Type	Advance Rates	Value Determined By
<u>Real Estate</u>		
1. Commercial Owner Occupied	Up to 80%	Appraisal
2. Income Producing Non-Owner Occupied	Up to 80%	Appraisal
3. Raw Land	Up to 80%	Appraisal

Collateral Type	Advance Rates	Value Determined By
<u>Equipment</u> (includes vehicles)	Up to 80% of Liquidation Appraisal on used and up to 80% of invoice on new equipment. If liquidation appraisal is not available, use 80% of book value.	Appraiser, Balance Sheet, Machinery/Equipment quotes
<u>Stock Securities</u>		
1. Highly Marketable	Up to 100% of good grade listed in the NYSE, American or NASDAQ Exchanges.	NY Times or Wall Street Journal
2. Less Marketable	Up to 50% of thinly traded under \$10.00 value listed on an exchange.	NY Times or Wall Street Journal
<u>U. S. Government or Municipal Securities</u>	Up to 100% of listed and traded bonds.	NY Times or Wall Street Journal
<u>All Other Bonds</u>	Up to 80% of listed and traded bonds.	NY Times or Wall Street Journal
<u>Accounts Receivable</u>	Up to 80% of eligible accounts receivable. Advance rates on accounts are a function of dilution rate, turnover, quality of customer sold, industry characteristics, warranty liabilities, and any unusual contractual obligations.	Accounting methods

I) Fees and Costs

- 1. Processing fee**
A non-refundable fee of \$200 is payable at the time an application is submitted
- 2. Section 108 Loan Fee**
The applicant will pay 2%-5% of the total Section 108 loan amount due at the time of closing.
- 3. Other Fees**
The applicant will be responsible for all other fees, including bank, SBA, and institutional lender fees, appraisal and environmental fees, legal fees from outside firms, and any other fees. Applicants will receive a Good Faith Estimate of the projected City of Austin fees, which may or may not be adjusted at closing.

J) Environmental Assessment

All proposed projects are subject to an environmental review. The environmental submission will be the same as required by the first lender or in compliance with the SBA criteria. For projects that do not require the participation of another lender, EGRSO will request from the applicant an Environmental I Assessment and, if needed, an Environmental II Assessment. The applicant will pay for the environmental assessment(s) and, if acceptable to EGRSO, the applicant may include the cost of such assessment(s) with the loan proceeds at closing.

- Projects that require funding for land and building pursuant to HUD guidelines will be required to have a Phase I Environmental Assessment and, if applicable, a Phase II Environmental Assessment.
- Projects that require funding for machinery/equipment and working capital pursuant to HUD guidelines are exempt from the Phase I and Phase II Environmental Assessments.

K) Procurement

In accordance with HUD regulations, Section 108 financed projects for private, for-profit businesses are exempt from HUD procurement policies.

L) Other Program Information

All Section 108 funded projects are required to comply with federal, state and local statutes, regulations and requirements, including but not limited to the Davis-Bacon Act, Workers Compensation, Section 3 of the Housing and Community Development Act, and insurance requirements.

M) Relocation

Section 108 funded activities that result in the displacement of persons or businesses will trigger the Uniform Relocation Act compliance requirements.

IV. PROGRAM ADMINISTRATION

A) Choosing a Project

Initial Meeting and Site Visitation

EGRSO staff will meet with the applicant(s) to discuss the project and make a visit to the business and/or site location as necessary. Staff will explain the program and provide the applicants with a checklist of required information. The visit should provide an opportunity for staff to explain the program to the applicant for the purpose of helping the applicant determine whether or not the applicant can meet Section 108 guidelines.

B) Choosing a Project

Preliminary Review of Information

EGRSO staff and the City's outside Program Consultant, if applicable, will perform a preliminary analysis of the interim financial statements, tax reports, payroll information, debt schedule, business plan, copies of agreements, and any

other required documentation. This preliminary review will reveal if (a) the project meets the HUD guidelines and at least one of the national objectives, (b) the applicant has the capacity of paying the debts to a first lender, the SBA and the Section 108 loan, and (c) the applicant has the capacity of fulfilling all of the requirements of the Section 108 Loan Program. If the preliminary review is acceptable to EGRSO, the applicant may submit a Loan Application Form.

C) Seeking Lenders' Participation

After determining that the project and the applicant qualify for the Section 108 Loan Program, EGRSO (which may include assistance from the City's outside Program Consultant) will prepare a Section 108 Loan Package that will include all supportive documentation for underwriting and collateral, and a Project Summary and Analysis. EGRSO (which may include assistance from the City's outside Program Consultant) will seek the participation of a Private Bank and/or Credit Union in the project. EGRSO may also work with SBA approved Certified Development Corporations to also include SBA 504 funds into the project.

Any Private Bank and/or Credit Union and 504 CDC who decides to participate in the project must issue a Letter of Commitment to the applicant with a copy to the City Attn: EGRSO. The applicant will be responsible for submitting all of the required documentation requested by any other lenders to assure their participation

D) Obtaining Loan Review Committee Approval

After determining that the project and the applicant qualify for the Section 108 Loan Program and receiving a firm Letter of Commitment from the other participating lenders for the project, EGRSO (which may include assistance from the City's outside Program Consultant) will prepare a Section 108 Loan Package for the LRC with all of the supportive documentation. The LRC shall either approve or disapprove the loan application. If approved and, when applicable, following City Council approval, the loan package shall be filed for HUD review.

E) Obtaining Final Loan Approval

After the LRC approves a loan application, final loan underwriting and HUD eligibility approval requires the following actions:

- When the project requires expenditure of Section 108 loan match exceeding the City Manager's administrative contracting authority (currently \$55,000), EGRSO will request the approval of the City Council.
- Unless waived by HUD, the City Manager or the City Manager's designee will submit a loan eligibility request to HUD for approval of HUD eligibility requirements..

F) Loan Acceptance

- Upon receipt of HUD eligibility approval, EGRSO will submit the City of Austin's Loan Commitment Letter to the applicant.

- The applicant will review the terms and conditions of the City's Loan Commitment Letter and, if accepted, will sign the letter and returning it to EGRSO by the date indicated.

G) Closing

The City's Law Department (or outside counsel hired by the Law Department) shall close all loans in coordination with HUD's Counsel and the Borrower's Counsel. EGRSO, and the City's Law Department will be responsible for supervising compliance with the loan closing documents.

H) Servicing

EGRSO will carry out loan servicing regarding payments and submission of reports and financial statements.

I) Supervision and Reporting

EGRSO shall review on a yearly basis all financial statements of the borrower, and compliance reports for compliance with Davis Bacon, Section 3, and the National Objectives of the program. EGRSO will make a field visit to the borrower's location at least once a year.

Borrowers in default or who cannot be brought into compliance shall be referred to the City's Law Department for corrective action, including foreclosure when necessary.

SECTION II FAMILY BUSINESS LOAN PROGRAM

MICRO-LOAN PROGRAM

POLICIES AND PROCEDURES

A. INTRODUCTION

A micro-loan program by its very nature must have a certain amount of flexibility to it to be successful, and should not, because of overly rigorous underwriting criteria, deter the entrepreneurship necessary for the success of the Program.

The intent of the Program is to provide low interest loans, to assist businesses, meeting the size standards of the U.S. Small Business Administration, to grow and thrive. Wherever possible the loans should encourage innovative businesses or those showing great promise to grow and flourish.

Nevertheless, the Program should have certain principles, which guide its lending policy. These are:

1. Character – Many experts in the lending field have pointed out that character may be the most important of the “c’s” in lending. While somewhat subjective in nature, certain steps can be taken, in an objective fashion, to gauge the character of a borrower. The credit history of a borrower will be evaluated as part of these criteria.
2. Cash Flow – The measurement of cash flow is the primary tool to measure the repayment ability of a business to repay a loan. In these evaluations, historical financial records are important in gauging success. However in Micro-loan lending, Projections in many instances become as important.
3. Collateral – Collateral requirements provide the escape mechanism to recapture principal in the event of a default. In traditional lending, rigorous ratios are frequently used to provide a degree of comfort in providing the loan. In the case of micro-loans, collateral, while still important, must provide some flexibility so that rigorous ratios are not always applied, if there is compelling evidence for the success of the business.
4. Least Amount Necessary - The Program should not provide funds to replace traditional conventional financing, or the use of the personal resources of the borrower and his family members and supporters. It should provide the funds necessary to make the project work.
5. Education – Borrowers should clearly demonstrate that they have the skill sets necessary to make the business a success. In those instances in which this is clearly not demonstrated, arrangements for technical assistance must be made available and used prior to the issuance of a loan. Ongoing technical assistance may also be needed, and the willingness of a borrower to accept such assistance is also crucial.

B. ELIGIBILITY REQUIREMENTS

1. A business must meet the size standards of the U.S. Small Business Administration.
2. A business must be located in, and continue to be located in the City of Austin.
3. Businesses involved in any type of gambling, pornography, illicit activities or affiliated with such activities, are prohibited from applying for the program.
4. Preference to borrowers will be given in the following order:
 - (a) Borrowers with at least one year’s experience.
 - (b) Borrowers with at least six months experience
 - (c) Start-ups.

5. Businesses must meet the following HUD Criteria:
 - (a) Low and moderate-income persons wishing to start a business or businesses.
 - (b) Other businesses located in or wishing to locate in the City of Austin who will hire 51% of their new workers from the low and moderate income labor pool. Under Section 3 of the Regulations low and moderate-income persons residing in the City will be given priority.
 - (c) Businesses located in areas meeting HUD's Presumption Rule.

C. LOAN CRITERIA

1. The maximum amount of a loan shall be \$50,000 and the minimum amount of the loan shall be \$1,000.
2. A borrower is only eligible to receive loans from the Micro Loan fund once. The intent of the program is to enable a business to provide for their future financing needs through conventional lending or traditional government lending sources.
3. Funds shall be available for working capital and fixed asset financing including land and building, renovation and machinery and equipment.
4. Each loan shall require an equity contribution, determined by the loan officer.
5. Evidence to obtain other financing will be required, and preference will be given to loans that provide gap financing.
6. An administrative fee of \$250, non-refundable shall be due from each borrower at the beginning of loan processing.
7. The interest rate shall be as described in Section III (C.)
8. Working capital loans shall not exceed a term of seven years; machinery and equipment loans shall not exceed 10 years or the economic life of the machinery and equipment to be purchased, whichever is less.
9. Fixed asset loans for renovations, acquisition or new construction shall not exceed 10 years or the life of a lease. In the cases of leases, all extensions on a lease must be solely at the discretion of the tenant.
10. In all instances a personal guarantee of the borrower shall be required.

D. UNDERWRITING CRITERIA

May 24, 2012

1. Cash Flow:

- (a) Borrowers shall be required to furnish the last three years financial statements in the form of income tax statements to the lender. In the case of a business that has been in business for less than three years, all of the income tax returns as filed, must be submitted.
- (b) Borrowers shall be required to furnish an interim statement, not less than 90 days old, internally prepared.
- (c) All borrowers must present projections for a period of three years.
- (d) In the case of a start-up, projections must be supplied for three years, and on a monthly basis up to 90 days beyond break even. In the case of a start-up a technical assistance provider recognized by the lender must have assisted in preparing all projections.
- (e) In the case of all projections provided by others than a start up, the Loan Officer may require the borrower to seek the assistance of a technical assistance provider recognized by the Lender.
- (f) Projections should also include balance sheets and a sources and uses statement of cash flow.
- (g) In the case of a start-up, considerations of outside income, such as the income of a spouse will be considered in making a credit recommendation. This may also be the case of an existing business.
- (h) All projections must include the assumptions made. Purchase orders, or letters from potential customers will buttress assumptions.
- (i) While not required, those achieving a 1.2 coverage will receive preference. All projections must show how 1.2 coverage will be achieved in a reasonable period.

2. Credit

- (a) Credit reports are required for each borrower.
- (b) Credit reports that reveal open bankruptcies, a large number of past dues, and large numbers of derogatories shall be rejected.

- (c) The amount of debt and the amount of bad debt will have to be considered. Borrowers will be given the opportunity to explain extenuating circumstances and to reach agreements with creditors. However these shall be dealt with on a case-by-case basis by the Loan Officer and reviewed by the Loan Review Committee.
- (d) Each borrower shall be required to submit Form SBA 413.
- (e) In many instances of poor credit or inferior collateral, the provision of a guarantor of sound financial means can increase the likelihood of the approval of a loan.

3. Collateral

- (a) All loans shall be collateralized by liens against the fixed assets and liens on the receivables and inventory of the business.
- (b) The Lender may require the pledge of certain personal assets such as personal vehicles, stocks and bonds, and outside real estate.
- (c) Personal Guarantees shall be required of all owners of a business, no matter their percentage of ownership in the business.
- (d) In the case of fixed asset financing a 1:1 coverage shall be required. In the case of working capital 50% coverage ratio shall be required. In compelling circumstances these ratios may be waived by the Loan Committee.

4. Character:

- (a) Each borrower shall be required to submit SBA Form 912.
- (b) Each borrower shall provide a statement, which can be punishable by fine or imprisonment, regarding any open lawsuits and past lawsuits, regarding personal or business matters.
- (c) A list of personal and business references shall be submitted with each loan request.
- (d) Resumes on all owners in the business shall be required.
- (e) A history of the business shall be required.

5. Least Amount Necessary:

- (a) Each borrower shall provide at least one decline letters from a bank, or a letter from a bank indicating that gap financing is needed.
- (b) Potential borrowers shall be given a list of banks interested in participating in the program.
- (c) The Loan Officer shall take into account personal resources such as cash that can be contributed into the project.

6. Education

- (a) Any start-up business shall be required to receive technical assistance from a source recognized by EGRSO, prior to submission of the Loan Application. If the Loan is approved, that business shall be required to receive technical assistance for one year after loan approval.
- (b) At the discretion of the Loan Officer, any business may be required to receive technical assistance, from a Source recognized by the City, prior to the submission of the loan request and as a condition of the loan the borrower may be required to receive technical assistance for a period of up to one year.
- (c) The educational background and the employment history of the business should be taken into accounts. The borrower should have a history in that business and familiarity with that business. In the case of businesses involving trades, such as an electric business, evidence of the proper licensing must be submitted. There may be instances where the Lender may counsel the Borrower to obtain additional technical education prior to receiving a loan, and a list of institutions and tuition assistance programs shall be provided to the potential borrower.

7. Loan Administration

The Micro-Loan program shall be administered in accordance with Section IV. The Loan Review Committee described in Section II (C) shall serve as the Loan Committee for the Micro-Loan Program.

CONTACT INFORMATION

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