June 29, 2010

TO: Mayor and City Council

FROM: Gustavo A. Durán, Interim Director
Economic Development Department

SUBJECT: PUBLIC HEARING: PROPOSED SMALL BUSINESS MICRO LOAN PROGRAM AND AMENDMENT TO THE FISCAL YEAR 2010-11 FEE SCHEDULE

RECOMMENDATION

Public hearing to consider public comments/testimony regarding the proposed amendment to the Fiscal Year 2010-11 Fee Schedule to include a $25 fee for the proposed Small Business Micro Loan Program.

At the conclusion of the public hearing, it is recommended that the City Council adopt two resolutions as follows:

- Adopt resolution approving the Small Business Micro Loan Plan Program to assist local business owners and help stimulate economic development activity; and,

- Adopt a resolution approving an amendment to the Fiscal Year 2010-11 Fee Schedule and authorizing the City Manager to take appropriate actions to carry out the purposes and intent of these two resolutions.

Summary

In response to the City Council’s goal to promote economic development and stimulate job growth, staff developed the Small Business Micro Loan Program. The Program will be funded using Community Development Block Grant (CDBG) dollars. The maximum loan amount for each business is $30,000 and funding will be available to business owners city-wide. Businesses receiving financing will be required to create or retain jobs that must be made available to low and moderate income persons. Staff will review all applications, conduct the loan underwriting, and make the final determination for funding.

The Fiscal Year 2010-11 Fee Schedule was approved by the City Council on June 22, 2010. In light of the severe decline in revenues, departments were asked to use reasonable means to reduce their budgets, and also to review their fees and recommend any new fees or fee adjustments. It was further requested that the Economic Development Department develop strategies in which to encourage economic growth and job creation.

The amendment to the Fiscal Year 2010-2011 Economic Development Department Fee

AGENDA ITEM 9.03
June 29, 2010

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Schedule includes a new fee associated with the proposed Small Business Micro Loan Program to recover costs incurred by the City to process loan applications.

DISCUSSION

Background

Over the past several years, the City has experienced a rapid decline in the local economy. Unemployment rates in Stockton have been the highest seen in many years, with the rate for the month of March 2010 at 22%. Building permits for new construction are also down. In addition, local businesses have closed their doors directly impacting local revenues and employment opportunities.

As the City faces these fiscal challenges, one of the City Council's goals is to promote economic development and stimulate job growth in order to improve the living conditions of Stockton residents and increase revenues to the City. Further, interest has been expressed from the business community for financial assistance, indicating that it has been difficult to receive conventional financing through the banking industry or similar loan programs that implement more stringent underwriting standards.

Present Situation

In response to the City Council's desire for a proactive approach to economic development, staff began to review existing commercial loan programs offered by other jurisdictions and developed the Small Business Micro Loan Program ("Loan Program"). The Loan Program is designed to provide financial aid to businesses and entrepreneurs in an effort to stimulate the local economy and create new jobs. Funding would be available to businesses within the Stockton city limits.

The Loan Program, if approved, will be funded with Community Development Block Grant (CDBG) dollars. Per federal guidelines, CDBG funds may be used to assist cities in job creation so long as the activity meets one of three national objectives: 1) benefiting low and moderate income persons, 2) meeting an urgent need that is a health and/or safety issue, or 3) eliminating slum and/or blight. The primary public benefit in the proposed economic development Loan Program will be the creation and/or retention of jobs that will benefit low and moderate income persons. For every $35,000 in CDBG proceeds received, a business must create one full-time equivalent position, which equals 1,750 hours per year.

Following are details of the proposed Small Business Micro Loan Program (see Exhibit A for the complete program guidelines):
• Maximum loan amount is $30,000
• Interest rate for each loan will be no less than the Prime Rate plus 2%
• Maximum loan term of five (5) years
• $25 application fee
• Eligible use of loan proceeds:
  o Operating capital
  o Furniture, fixtures and equipment (FF&E)
  o Rehabilitation of buildings (interior and exterior)
  o Purchase of manufacturing equipment (including installation costs)

It should be noted that loans approved under the Small Business Micro Loan Program will carry a greater risk than conventional loans. The criteria for loan approval will be flexible and will be dependent upon a number of factors, including but not limited to, job creation, credit worthiness, character of the applicant, management capacity, collateral, and financial viability of the business. By gathering such information from the borrower, the City will have a good sense of how strong the business is and how successful the borrower will be if provided a loan. The terms of each loan will depend on the amount being financed, the borrower’s ability to repay the loan, and the collateral available to protect the City’s investment.

To help businesses succeed, the City will require that each applicant participate in up to five hours of business consultation with the San Joaquin Delta College Small Business Development Center (SBDC). All start-up businesses will be required to attend a “Start-up Workshop” hosted by SBDC to assist with business planning, regulations, and identifying funding needs.

City staff will review all loan applications, conduct the underwriting, and make the final determination on funding. Upon loan approval, City staff will prepare all necessary loan documentation. In most cases, loan proceeds will be disbursed incrementally on a reimbursement basis, or as a direct payment to vendor/contractor invoices, upon verification of eligible costs.

By offering a micro loan program to local businesses, the City is encouraging private sector job growth, public-private partnerships, increase in sales and property taxes, and providing an incentive to attract new business.

The amendment to the Fiscal Year Fee Schedule includes the addition of a new $25 application fee for the Small Business Micro Loan Program. This fee will recover the cost incurred by the City in paying for credit reports associated with businesses applying
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for a loan under the Micro Loan Program.

The amended Fiscal Year Fee Schedule for the Economic Development Department will become effective July 1, 2010.

PUBLIC NOTIFICATION

Notification was published in the The Record on June 17 and June 24, 2010. A copy of the proposed amendments to the 2010-2011 Fee Schedule has been available for public review in the City Clerk’s Office.

FINANCIAL SUMMARY

Community Development Block Grant (CDBG) funds were allocated in the 2010-2011 One-Year Action Plan for the Small Business Micro Loan Program. These funds are available in account number 054-8522-640 – Community Development Block Grant Loan Program, Small Business Micro Loans.

The new Economic Development Department Small Business Micro Loan Application Fee is a cost recovery fee and will be applied to the Community Development Block Grant Loan Program, Small Business Micro Loans 054 Fund.

Respectfully submitted,

GUSTAVO A. DURÁN, INTERIM DIRECTOR, ECONOMIC DEVELOPMENT DEPARTMENT

APPROVED BY

KEVIN O’ROURKE, INTERIM CITY MANAGER
Resolution No. ______________

STOCKTON CITY COUNCIL

RESOLUTION APPROVING THE SMALL BUSINESS MICRO LOAN PROGRAM
TO ASSIST LOCAL BUSINESS OWNERS AND HELP STIMULATE
ECONOMIC DEVELOPMENT ACTIVITIES

A goal of the Stockton City Council is to promote economic development and
stimulate job growth; and

The City of Stockton receives assistance in the form of Community Development
Block Grant (CDBG) funds, which may be used for economic development activities; and

In response to the City Council's desire for a proactive approach to economic
development, staff developed the Small Business Micro Loan Program. A portion of
CDBG funds will be used to provide loans to small businesses and entrepreneurs
located within the Stockton city limits; now, therefore,

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF STOCKTON, AS
FOLLOWS:

1. The City Council hereby approves the Small Business Micro Loan
Program, herein incorporated as Exhibit "A".

2. The City Manager is hereby authorized to take the appropriate actions to
carry out the intent and purpose of this resolution.

PASSED, APPROVED AND ADOPTED _______________________

ATTEST:

ANN JOHNSTON, Mayor
of the City of Stockton

KATHERINE GONG MEISSNER
City Clerk of the City of Stockton

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City Atty:  
Review  
Date  June 22, 2010
Guidelines

For

Small Business Micro Loan Program

Funded By

City of Stockton

With

Community Development Block Grant Funds

(CDBG)

Adopted by the Stockton City Council on___________
Council Resolution No.__________
CITY OF STOCKTON
COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)
SMALL BUSINESS MICRO LOAN PROGRAM GUIDELINES

1.0 INTRODUCTION
The City of Stockton has established a Small Business Micro Loan Program, hereafter called “the Program”. The Program is designed to stimulate economic growth and create jobs that will improve the living conditions of residents in the community. The Program provides affordable, non-conventional financing to eligible businesses and development projects that are not able to receive funding elsewhere. Businesses receiving these funds will in turn be required to produce a sufficient number of net new jobs, or in the case of business retention, retain existing jobs. These Program guidelines have been formally adopted by the City of Stockton and are in conformance with the U.S. Department of Housing and Urban Development (HUD) regulations pertaining to the use of Community Development Block Grant (CDBG) funds.

2.0 BUSINESS ASSISTANCE PROGRAM OVERVIEW

2.1 PROGRAM CITY OF STOCKTON
In general, the City of Stockton will market the Program, accept and process applications, underwrite and recommend approval of loans, ensure proper loan closing and disbursement of funds, maintain loan files and fiscal records and support the City of Stockton’s staff in administration of federal grants and program income used to fund this program. The City of Stockton will follow and ensure compliance with these guidelines.

2.2 PROGRAM SERVICE AREA
Financing under this Program is available to all eligible businesses located in the jurisdictional limits of the City of Stockton.

2.3 SOURCE OF PROGRAM FUNDS
The Program is capitalized with Community Development Block Grant (CDBG) funds provided by HUD to the City of Stockton. CDBG funds are federal funds and as such have a number of federal requirements that must be met, as described below.

2.4 ELIGIBLE LOAN APPLICANTS
Loan applicants for the Program must be existing legal businesses, located within the City of Stockton, with a proper local business license, insurance, and required permits per local, state and federal requirements. If an applicant is a new start-up business and does not have proper licenses or insurance, then these items can be made a condition of funding the loan. The business can be a tenant leasing space or an owner of property where the business is located. The existing business must create one or more new permanent full time equivalent (FTE) jobs. The business may also qualify by demonstrating job retention such that the business may be closing down or reducing staff if not for investment of CDBG funding.
3.0 CDBG PROGRAM REQUIREMENTS

3.1 ELIGIBLE ACTIVITIES

Funds under this program are restricted to certain eligible costs. Some common eligible costs are:

- Operating capital (including license and permit fees)
- Furniture, fixtures and equipment (FF&E)
- Rehabilitation of leased space or owned buildings (including engineering, architectural, and local permits or fees)
- Purchase of manufacturing equipment (with or without installation costs)

In most cases, loan funds will be disbursed incrementally on a reimbursement basis, or direct payment of vendor/contractor invoices, as eligible costs are verified.

Funds under this Program are provided to eligible businesses as loans. CDBG underwriting (see Exhibit A) can be more flexible than conventional loans in some instances, depending on the business and amounts requested. The terms of the loan are typically more favorable than conventional commercial lenders, with lower interest rates and longer terms for repayment. These more favorable terms must be balanced by the borrower and City of Stockton with the requirements to create jobs and meet other CDBG program requirements. The City of Stockton will work closely with the eligible businesses to ensure they understand the requirements of the Program and the benefits of participating.

3.2 INELIGIBLE USE OF FUNDS

- Projects that do not create permanent jobs
- Projects that are primarily housing in nature
- Projects not meeting a CDBG national objective or public benefit or federal CDBG underwriting standards
- Projects that are not located within the City of Stockton limits
- Subsidy of interest payment on existing loans
- Refinancing of existing debt
- Projects must have reasonable assurance of repayment of loan funds

Funds under this Program will not pay for reimbursement of expenses incurred prior to the City of Stockton’s formal loan approval and/or completion of project’s environmental review. Program funds will not be used to facilitate the movement of a business from one labor market area to another, as per job pirating restriction under HUD’s regulations. Once approved, loan funds cannot be shifted from one approved type of cost to another without formal written approval. Funds cannot be used to support other businesses in which the borrower may have an interest. Nonprofit organizations are not eligible for funding under this Program. Funding a project without City review of loan underwriting and formal written approval will make the project ineligible.

3.3 MEETING A NATIONAL OBJECTIVE

All CDBG funded loans must meet a CDBG “National Objective” as described in the federal regulations (24 CFR 570.208).
First, use of funds meeting the National Objective of “low and moderate job creation or retention” will require that the businesses receiving CDBG financing provide fifty-one percent (51%) of the jobs created to low and moderate income persons. In order to meet this requirement, the business must certify household income levels of newly hired or retained employees to document that over half of them are qualified as low or moderate income. To ensure this requirement is met, the City of Stockton will require low/moderate income job creation in the CDBG loan documents signed at loan closing. In order to report that low/moderate income jobs have been retained, the business must document that the jobs would have been lost without the CDBG assistance and that the job is known to be held by a low/moderate income person or that the job may be considered available to a low/moderate income person if it does not require any special skills or education. All employee information is confidential and will not be released.

Second, use of funds meeting the National Objective of “elimination of slums and blight on an area basis” must show that the business being assisted is located in a redevelopment agency project area (meets state redevelopment law definition of blighted area) or an area formally designated as blighted by the City of Stockton based on a survey of properties in the area. Documentation of meeting this national objective is done by providing a map of the redevelopment area or area designated locally as blighted and also showing the business’s address/location within the designated redevelopment or blighted area. In addition, as part of loan approval, CDBG assistance must be documented as directly assisting the project such that area blight is eliminated or prevented.

3.4 MEETING PROPER PUBLIC BENEFIT REQUIREMENT

Because a private business is receiving public funds, CDBG regulations require the creation of jobs by the business to show public benefit. Under the HUD federal regulations one full-time equivalent (FTE) job must be created for each $35,000 in CDBG assistance provided. Part-time staff may be combined to make up one FTE. One FTE consists of 1,750 staff hours per year.

As with the national objective requirement outlined above, the CDBG public benefit requirement will be enforced via a loan agreement that the borrower executes at loan closing. The loan agreement requires that the business provide payroll documentation to the City of Stockton showing job creation sufficient to meet the $35,000 per FTE requirement. Once sufficient jobs have been created and documentation is supplied to the City of Stockton then no more monitoring for jobs will be required. CDBG loans are meant to create long term employment opportunities but ongoing long term monitoring is not required.

Each person who is a new hire, or is in a position retained because of CDBG loan funds, must complete a Self-Certification Household Income Verification form. This form must be completed and provided to the City of Stockton so that the demographic and income information can be included in the annual report submitted to HUD. See Exhibit “B” - Self-Certification Household Income Verification form.

3.5 OTHER FEDERAL REQUIREMENTS

There are a number of other federal laws and requirements that are triggered by the use of CDBG funding. The City of Stockton will take the lead and ensure compliance with these CDBG regulations in conformance with standards set by HUD. Impacts these federal regulations will have on a proposed project will be explained to the borrower at the time of loan application.
National Environmental Policy Act (NEPA) regulations require an Environmental Review Record (ERR) to be submitted for each project/business funded with CDBG monies prior to award or approval of funds. The City of Stockton is required to complete the proper NEPA review, along with any state review under California’s Environmental Quality Act (CEQA) review. The ERR level of review is based on the type of project proposed and all aggregated activities to be undertaken.

Applicants will be informed of any additional time required for loan processing due to environmental review. The ERR will be done as soon as the City of Stockton determines that the project is eligible for funding. No costs will be charged to the borrower for this process. Once an application is submitted, no activities can be performed on the project until completion of the ERR as this would be a choice-limiting action under NEPA regulations.

Required DUNs number, verification of not being on federal debarred list, and insurance. All businesses who wish to receive funds under this Program will be required to obtain a DUN’s number. The DUN’s number is free and can be obtained online at www.dnb.com/us/duns_update. In addition, and prior to funding, the City of Stockton will require that each business be checked to confirm they are not on the federal debarred contractors list. As noted earlier, HUD also requires that the City of Stockton collect certain income and demographic data from the business and any new hires resulting from the investment of CDBG funds. Applicants will be required to obtain all proper licenses and insurance to operate legally within the community.

Federal and/or State Labor standards and provisions may apply for projects assisted with CDBG funds. The Borrower attests that all applicable standards and provisions will be strictly adhered to.

Other requirements related to CDBG funds: The Borrower agrees to comply with all other requirements associated with the use of CDBG funds, including but not limited to, Acquisition, Anti-Displacement, and Relocation provisions, Equal Opportunity and Section 3 regulations, Procurement regulations, and Contractor Eligibility and Certification provisions. See Exhibit “C” for a comprehensive list of federal requirements associated with the use of CDBG funds.

HUD Loan Underwriting Standards are required to be met by each CDBG loan. There is some flexibility in how the underwriting criteria are used so the funds under this program are more advantageous than commercial business loans. In addition to the commercial lending underwriting criteria, HUD requires that additional underwriting criteria be used because CDBG funds are public funds being provided to private for profit businesses. See Exhibit “A” of these program guidelines for a list of the additional criteria and how to comply with them.

4.0 LOAN PROCESSING AND APPROVAL

4.1 FAIR LENDING COMPLIANCE

This program will be implemented consistent with the City of Stockton’s commitment to fair lending laws. No person or business shall be excluded from participation in, denied the benefit of, or be subjected to discrimination under any program or activity funded in whole or in part with Program funds on the basis of his or her religion or religious affiliation, age, race, color, ancestry, national origin, sex, marital status, familial status (number or ages of children), physical or mental disability, sexual orientation, or other arbitrary cause. All personal information of loan applicants will be kept confidential.
4.2 LOAN APPLICATION PROCESSING

Loan applications will be processed on a first-come, first-served basis. The City will accept loan applications and review them for initial eligibility. Applications that do not meet basic requirements of the program will be returned with an explanation of requirements needing to be met. Applications that do meet basic eligibility requirements will be sent out with instructions including any requests for additional information. The City of Stockton will also meet with the business owners and visit the site of the business.

Once City staff has compiled a complete loan file with all the credit, financial, and underwriting information needed to show loan is eligible under these guidelines, then a loan advisory memo will be drafted recommending one of the following actions: 1) approve the loan application as submitted, 2) approve the loan application with special modification of loan covenants, or 3) deny the loan application. The loan advisory memo, with proper documentation, will be submitted to the City of Stockton’s Economic Development Director, and/or his designee, for review and approval/denial. If the loan is approved, then loan documents will be drawn for loan closing. Applications that do not meet the Program guidelines will receive a written denial letter explaining the reason(s) for the denial.

4.3 LOAN APPLICANT CONFIDENTIALITY

Persons serving as a City of Stockton representative for this Program will not disclose any of the Borrowers personal, confidential information as part of the loan approval process. All confidential information of businesses will only be disclosed to persons required to view the information as part of loan review and approval. If the City of Stockton receives a request for public records for a loan applicant then only non-confidential information, as verified by legal council, will be provided.

4.4 APPLICANT DISPUTE RESOLUTION/APPEALS PROCEDURE

Any business applying for assistance through this CDBG program has the right to appeal if their application is denied. The appeal must be made in writing to the City of Stockton within thirty (30) days of receiving notification that the loan was denied. All appeals will be directed to the City Manager for a final decision.

The City of Stockton is responsible to assure that the Program is implemented in compliance with state and federal regulations. In addition, loans must be underwritten in accordance with proper program guidelines in a timely and responsible manner. This includes developing accurate and professional files, work write-ups and contract documents. The City of Stockton or his/her representatives will ensure the funded activities are completed and the jobs are created in accordance with federal regulations.

4.5 NO CONFLICT OF INTEREST ALLOWED

In accordance with Title 24, Section 570.611 of the Code of Federal Regulations, no member of the governing body and no official, employee or agent of the local government, nor any other person who exercises policy or decision-making responsibilities in connection with the planning and implementation of the CDBG program shall directly or indirectly be eligible for this program. Exceptions to this policy can be made only after public disclosure and formal approval by the governing body and authorized in writing by the City of Stockton’s legal counsel.

4.6 EXCEPTIONS/SPECIAL CIRCUMSTANCES
Exceptions are defined as any action which would depart from policy and procedures stated in the guidelines.

The City of Stockton may consider an exceptional/special circumstance. A report on the situation will be prepared. This report shall contain a narrative, including the staff's recommended course of action and any written or verbal information supplied by the applicant. The City of Stockton’s Economic Development Director, and/or his designee, shall make a determination of the exceptional/special circumstances request.

Loan payments may, on a case by case basis, be deferred for a period of time to allow a start-up or expansion of a business to take place. This payment deferral determination is made by the City of Stockton based on the break-even point of the business in the future and the ability of the owner to pay his or herself for his or her efforts.

4.7 LOAN CLOSING PROCESS

Upon loan approval, City staff will prepare all documentation necessary for loan closing. The Borrower will sign all the necessary documents and agreements. The City of Stockton will prepare the loan closing documents; prepare title and lien searches, and UCC-1 filings, if appropriate. City of Stockton legal counsel will review all agreements and documents, as necessary. Escrow companies may be used to close loans and secure liens.

5.0 DESCRIPTION OF LOANS

5.1 DETERMINATION OF LOAN AMOUNT

The Program has a maximum loan amount of $30,000, but typical loans are anticipated to be below $20,000 per applicant. The minimum loan amount will generally not be less than $3,000.

Loan amounts will be determined based on number of jobs to be created or retained, the ability of the business to service the new CDBG loan payment, and the reasonableness of the costs to be paid for by the loan. If there are not sufficient CDBG funds for the project, then the City of Stockton may be able to assist in identifying other public or private funding to leverage the CDBG funding.

5.2 DETERMINATION OF LOAN TERM

The loan term is tied directly to what is being funded and what security is being pledged for the loan. A loan’s maturity should take into consideration the use of proceeds, the useful life of the assets being financed, and the borrower’s ability to repay the loan.

If a business only needs operating capital, then the term of the loan is normally two (2) to three (3) years, but in no case may it exceed five (5) years. If a business wishes to pay for equipment and supplies, then the term of the loan can be extended out to five (5) years. Staff will confirm that the proper term is given based upon the use of the funds and collateral being provided.

5.3 DETERMINATION OF LOAN INTEREST RATE

The loans will have a fixed interest of Prime Rate, as posted by the Federal Reserve Board, plus two percent (2%), determined at the time of loan approval. The loan’s interest rate will be determined based on the underwriting analysis done by the City of Stockton. Some of the factors that will drive the interest rate costs are: 1) amount of equity the business brings into the proposed project; 2) ability of business to service the loan; 3) the rate of return the borrower will
receive with a lower interest rate; 4) credit risk factors and management experience will also be used to determine what interest would best work for the business. To the extent practicable, the CDBG-funded loan should not provide more than a reasonable return on investment to the borrower. By allowing the interest rate to move and not be fixed, the City of Stockton can best tailor the loans under this program to meet the needs of different businesses in the community.

5.4 LOAN PROCESSING FEES

The CDBG program provides administration funds to pay for loan processing costs. No direct loan fees will be charged to the borrower other than the $25 application fee, which will cover the cost of a credit report. This amount will not pay for any costs already paid for by program activity delivery. There is no pre-payment penalty on the loans under this program.

6.0 LOAN UNDERWRITING STANDARDS

6.1 INITIAL LOAN EVALUATION

Each project/business will be evaluated based on how it has performed in the past and its future financial forecast. Specifically, the following questions will be asked upon receipt of a loan application:

- Will the business create or retain jobs?
- Will the project meet a CDBG national objective?
- Are the costs to be paid CDBG eligible?
- Are the business and all owners’ credit worthy?
- Do they have good “character” (pay bills on time, collect on time)?
- Does business have management capacity?
- Does start-up have solid business plan and document market demand?
- Does the business have financial expertise to expand or start-up?
- Is the owner(s) contributing a reasonable amount of equity?
- Is the owner able to get conventional bank financing, if not, why not?
- Was the business financially viable in the past (net income covers debt)?
- Are there reasonable financial assumptions for future viability/success?
- Is there enough collateral available to secure the loan funds?

By collecting enough initial application information from the borrower(s) to answer the above list of questions, the City of Stockton will have a good sense of how strong a borrower is and how successful they will be if given a CDBG loan. Most of this information is verbally collected at the initial site visit with the owner. By meeting the borrower and asking these questions the City of Stockton will know what additional information/documentation needs to be collected to provide a clear picture of how CDBG funds can be used to assist the applicant. These questions demonstrate the need for CDBG funds.

After the initial review, the City of Stockton will collect the proper information required for loan underwriting. The required documentation is listed in the City of Stockton Small Business Micro Loan Program Application, included as Exhibit “C”. The amount of documentation and detailed underwriting is based on size of the loan and type of business (existing or start-up) and whether job creation or retention is used. Additional documentation may be required to clarify special circumstances of the business. Below are some to the basic underwriting requirements for a typical loan applicant.

6.2 PERSONAL AND BUSINESS CREDIT REQUIREMENTS
Each applicant will have third party credit reports obtained for them. All owners of the business with twenty percent (20%) or more interest will have credit reports provided for them. The primary applicant business and all associated businesses of the owners (20% or more ownership) will have a Dunn and Bradstreet report obtained on them as well. Most credit reporting services will provide credit scores. For this program, credit scores of 550 and above are considered acceptable credit. If no credit scores are available, then a narrative must be summarized by the City of Stockton to give a justification for making a determination of good or bad credit. This same narrative process will be used for the business credit reports to demonstrate the good standing or poor standing of the business being evaluated.

6.3 PERSONAL AND BUSINESS FINANCIAL INFORMATION

Personal financial statements will be required for each person who owns 20% or more of the business. Financial statements need to show all assets and liabilities of the interest holder. In addition to these statements, federal tax return statements for owners and the business for the past two (2) years are needed to give a historic perspective of income.

For the business, historic financial statements will be required. These will consist of the most recent past year’s balance sheets and cash flow statements. These statements should be prepared by the person responsible for doing the bookkeeping and finance management for the business. Based on these statements, the City of Stockton can develop ratios for debt service and payment history.

The business will also need to provide future projected financials. These will consist of pro-formas showing projected revenue and costs for the business on a monthly basis for each fiscal year for three (3) years out. These pro-formas should include projected cash flows for the next three (3) years, as well as how the City’s loan will be repaid. This will provide evidence of the benefit/increased profit the business is receiving by using the more affordable CDBG loan. These pro-formas must also show the increased costs of the business due to the new jobs created and the additional CDBG debt service.

A project sources and uses form must be provided to show what funding is required to complete the proposed loan activity. This form will show the owners equity as well as private bank financing and any other investments from other sources. The sources and uses give a clear idea of what costs the CDBG loan will cover and its information must be reflected in the pro-formas as described above.

Using the information in these financial statements, along with any back up documentation required, will allow the City of Stockton to conduct the project’s underwriting analysis. This analysis will be conducted per HUD required underwriting guidelines as outlined in Exhibit “A”.

6.4 COLLATERAL REQUIREMENTS

All loans under this program that exceed $10,000 will be collateralized using normal commercial lending standards. Collateral coverage will be assessed based on assets available as security and the level at which liens already exist. CDBG funding is typically in a subordinate position to banks and other lenders. It is the goal of the Program to get the best lien position possible to ensure loan repayments and permanent job creation. Types of collateral may include:

- Secured liens on real property
- UCC liens on machinery, equipment, or other fixtures
• Lease assignments, as appropriate
• Personal and corporate guarantees, as appropriate
• Life insurance and other collateral, as appropriate

Appraisal of assets may be required as part of determining how to obtain the best lien positions for the CDBG loan. Combined loan to value ratio on collateral for the typical CDBG loan should not exceed ninety percent (90%). Equipment and inventory secured should be properly discounted to reflect actual resale value when doing loan to value calculations. As applicable, borrower shall provide and maintain hazard insurance on all real and personal property collateral for the loan.

6.5 BUSINESS EXPERIENCE AND MANAGEMENT CAPACITY

The City of Stockton will obtain resumes and management histories to show the experience of business owners and their management staff in successful operation of the existing business or a comparable business. This will be most important with start-up businesses or with applicants that wish to use CDBG funds to purchase an existing business that is closing.

All businesses will be required to receive up to five (5) hours of business counseling with the San Joaquin Delta College Small Business Development Center (SBDC). In addition, start-up businesses will be required to attend a “Start-up Workshop” hosted by the SBDC.

7.0 LOAN SERVICING

The City of Stockton has adopted a set of loan servicing policies that outlines how the City (or loan servicing agent) will proceed if payments are late or no payments are received. Servicing of loans will include monitoring payment performance, periodic reviews of the conditions of the loan approval, including but not limited to, financial data, job creation, collecting and posting payments, personal inspections and site visits, as deemed appropriate.

In addition, any loan servicing costs incurred by the City of Stockton may be charged to the borrower. Any such costs will be determined at the time of loan approval.

8.0 PROGRAM OVERSIE BY CITY OF STOCKTON

The City of Stockton’s Economic Development staff will serve as the primary contact for the Program.

Once a loan is at the point of approval, the City of Stockton’s staff will prepare the loan package and coordinate submittal for review and approval. City staff will ensure all loan documents are properly reviewed by legal counsel and meet CDBG requirements prior to signing by the Borrower.

In addition, the City staff will make the final decisions regarding loan collection, in the case of default, in conjunction with legal counsel.

City staff will complete required HUD CDBG financial reports for program income. City staff will complete the proper quarterly and annual reports for review, approval, signature and submittal by the City of Stockton to the appropriate HUD representative.
EXHIBIT “A”

GUIDELINES AND OBJECTIVES FOR EVALUATING A CDBG ECONOMIC DEVELOPMENT PROJECT

The U.S. Department of Housing and Urban Development (HUD) requires that the state or local government conduct basic financial and underwriting prior to the provision of CDBG financial assistance to a business (24 CFR Part 5, Appendix A). HUD has developed guidelines that are designed to provide grantees with a framework for financially underwriting and selecting CDBG-assisted economic development projects, which are financially viable and will make the most effective use of the CDBG funds. The City of Stockton requires that these HUD underwriting guidelines be utilized to determine whether a proposed CDBG subsidy is appropriate to assist a business expansion or retention project. In addition, the project must be reviewed to determine that a minimum level of public benefit will be obtained from the expenditure of the CDBG funds in support of the project.

HUD’s underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a micro enterprise or other small business, to take into account the differences in the capacity and level of sophistication among businesses of differing sizes.

The objectives of the underwriting guidelines are to ensure:

1. That the project costs are reasonable
2. That all sources of project financing are committed
3. That to the extent practicable, CDBG funds are not substituted for non-Federal financial support
4. That the project is financially feasible
5. That to the extent practicable, the return on the owner’s equity investment will not be unreasonably high
6. That to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the projected
7. That the projected level of public benefit is reasonable

Project Costs are Reasonable
Reviewing costs for reasonableness is important. It will help avoid either too much or too little CDBG assistance for the proposed project. Therefore, it is suggested that the grantee obtain a breakdown of all project costs and that each cost element making up the project be reviewed for reasonableness. The amount of time and resources expended evaluating the reasonableness of cost element should be commensurate with its cost.

For example, it would be appropriate for an experienced reviewer looking at a cost element of less than $10,000 to judge the reasonableness of that cost based upon his or her knowledge and common sense. For a cost element in excess of $10,000, it would be more appropriate for the reviewer to compare the cost element with a third-party, fair-market price quotation for that cost element. Third-party price quotations may also be used by a reviewer to help determine the reasonableness of cost elements below $10,000 when the reviewer evaluates projects infrequently or if the reviewer is less experienced in cost estimations. If a reviewer does not use
third-party quotations to verify cost elements, then the reviewer would need to conduct a cost analysis using appropriate cost estimating manuals or services.

Particular attention should be paid to any cost element of the project that will be carried out through a non-arms-length transaction. A non-arms-length transaction can occur when the business entity receiving the CDBG assistance procures goods or services or acquires property from itself or from another party with whom there is a financial interest or family relationship. If abused, non-arms-length transactions misrepresent the true cost of the project.

**Commitment of All Sources of Project Financing**

A review of all proposed sources of funding for a project should be conducted to evaluate whether the project is financially feasible given the availability and commitment of other proposed funding sources. This review is necessary to ensure that time and effort is not wasted on assessing a proposal that is not able to proceed.

To the extent practicable, prior to the commitment of CDBG funds to the project, the project review should verify that: sufficient sources of funds have been identified to finance the project; all participating parties providing those funds have affirmed their intention to make the funds available; and, the participating parties have the financial capacity to provide the funds.

**Avoid Substitution of CDBG Funds for Non-Federal Financial Support**

The proposed CDBG economic development project should be reviewed to ensure that, to the extent practicable, CDBG funds will not be used to substantially reduce the amount of non-Federal financial support for the activity. This will help the grantee to make the most efficient use of its CDBG funds for economic development.

To reach this determination, the reviewer should conduct a financial underwriting analysis of the project, including reviews of appropriate projections of revenues, expenses, debt service and returns on equity investments in the project. The extent of this review should be appropriate for the size and complexity of the project and should use industry standards for similar projects, taking into account the unique factors of the project such as risk and location.

Because of this high cost of underwriting and processing loans, many private financial lenders may not finance commercial projects that are less than $100,000. A reviewer should familiarize themselves with the lending practices of the financial institutions in the community. If the project’s total cost is one that would normally fall within the range within which financial institutions participate, then the project review should determine the following:

1. **Private Debt Financing:** Whether or not the participating business (or other entity having an equity interest) has applied for private debt financing from a commercial lending institution and whether that institution has completed all of its financial underwriting and loan approval actions resulting in either a firm commitment of its funds or a decision not to participate in the project; and

2. **Equity Participation:** Whether or not the degree of equity participation is reasonable given general industry standards for rates of return on equity for similar projects with similar risks and given the financial capacity of the entrepreneur(s) to make additional financial investments.
If the project involves providing assistance to a micro enterprise owned by a low or moderate income person(s), then the reviewer might only need to determine that non-Federal sources of financing are not available (at terms appropriate for such financing) in the community to serve the low or moderate income entrepreneur.

Financial Feasibility of the Project
The public benefit a grantee expects to derive from the CDBG assisted project (a separate eligibility requirement) will not materialize if the project is not financially feasible. To determine if there is a reasonable chance for the project’s success, the grantee should evaluate the financial viability of the project. A project would be considered financially viable if all of the assumptions about the project’s market share, sales levels, growth potential, projections of revenue, project expenses and debt service (including repayment of the CDBG assistance, if appropriate) were determined to be realistic and met the project’s break-even point (which is generally the point at which all revenues are equal to all expenses). Generally speaking, an economic development project that does not reach this break-even point over time is not financially feasible. The following should be noted in this regard:

1. Some projects make provisions for a negative cash flow in the early years of the project while space is being leased up or sales volume built-up, and the project’s projections should take these factors into account and provide sources of financing for such negative cash flow; and

2. It is expected that a financially viable project will also project sufficient revenues to provide a reasonable return on equity investment. The reviewer should carefully examine any project that is not economically able to provide a reasonable return on equity investment. Under such circumstances, a business may be overstating its real equity investment (actual costs of the project may be overstated as well), or it may be overstating some of the project’s operating expenses in the expectation that the difference will be taken out as profits, or the business may be overly pessimistic in its market share and revenue projections and has downplayed its profits.

In addition to the financial underwriting reviews carried out earlier, the reviewer should evaluate the experience and capacity of the assisted business owners to manage an assisted business to achieve the projections. Based upon its analysis of these factors, the reviewer should identify those elements, if any, that pose the greatest risks contributing to the project’s lack of financial feasibility.

Return on Equity Investment
To the extent practicable, the CDBG assisted activity should not provide more than a reasonable return on investment to the owner of the assisted activity. This will help ensure that the grantee is able to maximize the use of its CDBG funds for its economic development objectives. However, care should also be taken to avoid the situation where the owner is likely to receive too small a return on his/her investment, so that his/her motivation remains high to pursue the business with vigor. The amount, type and terms of the CDBG assistance should be adjusted to allow the owner a reasonable return on his/her investment given industry rates of return for the investment, local conditions and the risk of the project.
Disbursement of CDBG Funds on a Pro-rata Basis
To the extent practicable, CDBG funds used to finance economic development activities should be disbursed on a pro-rata basis with other funding sources. Grantees should be guided by the principle of not placing CDBG funds at significantly greater risk than non-CDBG funds. This will help avoid the situation where it is learned that a problem has developed that will block the completion of the project, even though all or most of the CDBG funds going into the project has already been expended. When this happens, a grantee may be put in a position of having to provide additional financing to complete the project or watch the potential loss of its funds if the project is not able to be completed. When the grantee determines that it is not practicable to disburse CDBG funds on a pro-rata basis, the grantee should consider taking other steps to safeguard CDBG funds in the event of default, such as insisting on securitizing assets of the project.

Standards for Evaluating Public Benefit
Besides reviewing a project under these underwriting factors, the project must be reviewed to determine that at least a minimum level of public benefit is obtained from the expenditure of the CDBG funds. The minimum standard of public benefit is as follows:

1. The project must lead to the creation or retention of at least one full-time equivalent (FTE) job per $35,000 of CDBG funds used. Part-time staff may be combined to make up one FTE. One FTE consists of 1,750 staff hours per year.
EXHIBIT “B”

CITY OF STOCKTON
SELF-CERTIFICATION HOUSEHOLD INCOME VERIFICATION

The company you are applying to for employment, or are currently employed with, was assisted under a Federal funding program which has, as one of its objectives, the creation of jobs for low and moderate income persons. Whether you are from a low/moderate-income family depends on the size of the household and your total household income.

Please check the income you estimate was your total household income and the number of persons residing in your household for the past 12-month period. Income is defined as the total annual gross income of all family and non-family members 18-years of age or older residing within the home.

<table>
<thead>
<tr>
<th>Check estimated household income for the past 12 months</th>
<th>Check the number of persons living in your household during the past 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>___ Below $35,350</td>
<td>___ 1 Person</td>
</tr>
<tr>
<td>___ $35,350 to $40,399</td>
<td>___ 2 Persons</td>
</tr>
<tr>
<td>___ $40,400 to $45,449</td>
<td>___ 3 Persons</td>
</tr>
<tr>
<td>___ $45,450 to $50,499</td>
<td>___ 4 Persons</td>
</tr>
<tr>
<td>___ $50,500 to $54,549</td>
<td>___ 5 Persons</td>
</tr>
<tr>
<td>___ $54,550 to $58,599</td>
<td>___ 6 Persons</td>
</tr>
<tr>
<td>___ $58,600 to $62,649</td>
<td>___ 7 Persons</td>
</tr>
<tr>
<td>___ $62,650 to $66,699</td>
<td>___ 8 Persons</td>
</tr>
<tr>
<td>___ Over $66,700</td>
<td></td>
</tr>
</tbody>
</table>

EMPLOYMENT STATUS
☐ Part-time or ☐ Full-time  POSITION CURRENTLY HELD: ____________________________

OTHER DEMOGRAPHIC INFORMATION
Ethnicity: ☐ Hispanic or ☐ Non-Hispanic

Race (please check one):
☐ White (Caucasian) ☐ Black/African American
☐ Asian ☐ American Indian/Alaskan Native
☐ Native Hawaiian/Other Pacific Islander ☐ American Indian/Alaskan Native & White
☐ Asian & White ☐ American Indian/Alaskan Native & Black
☐ Black/African American & White ☐ Other

Does your family have a Female Head of the Household? ☐ Yes or ☐ No

I hereby certify that the information on this form is accurate and complete. I understand that this self-certification may be subject to further verification by the agency providing services, the City of Stockton, or the U.S. Department of Housing and Urban Development. I, therefore, authorize such verification, and I will provide supporting documents, if necessary. Warning: Title 18, Section 1001 of the U.S. Code states that a person is guilty of a felony for knowingly and willingly making false or fraudulent statements to any department of the U.S. Government.

Participant/Employee Name (please print): ____________________________________________

Signature (Parent/Guardian if under 18 years old) ____________________________  Date ____________

Income levels current as published by HUD as of May 2010 (80% of median – low income) – 5/17/10
RESOLUTION AMENDING THE 2010-11 ECONOMIC DEVELOPMENT
DEPARTMENT FEE SCHEDULE

On June 22, 2010, the Stockton City Council approved a resolution adopting the
2010-2011 Fee Schedule; and

In response to the City Council's desire for a proactive approach to economic
development, staff developed the Small Business Micro Loan Program; and

An adjustment is needed to the Economic Development Department 2010-11
Fee Schedule to include a Small Business Micro Loan application fee to cover costs
incurred by the City in processing such loan applications; now, therefore,

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF STOCKTON, AS
FOLLOWS:

1. The City Council hereby approves the amendment to the Economic
Development Department Fiscal Year 2010-11 Fee Schedule to include the new Small
Business Micro Loan application fee in the amount of $25.00.

2. The City Manager is hereby authorized to take the appropriate actions to
carry out the intent and purpose of this resolution.

PASSED, APPROVED AND ADOPTED ____________________.

ANN JOHNSTON, Mayor
of the City of Stockton

ATTEST:

KATHERINE GONG MEISSNER
City Clerk of the City of Stockton