Fort Bragg Business Boost Loan Program Guidelines

I. PURPOSE

The Fort Bragg Business Boost Fund aims to strengthen the local economy by supporting business retention, expansion, and job creation. Leveraging $650,000 of the City's ARPA allocation, the program provides low interest loans to small and medium-sized businesses and addresses critical challenges city businesses often face in accessing capital. The program will provide loans up to $200,000 and not less than $50,000.

Small and medium sized businesses often face significant barriers when seeking financing, including high interest rates, stringent qualification requirements, and limited availability of traditional lending options. These challenges are exacerbated by the current economic climate, where rising costs and tightened credit markets disproportionality affect smaller enterprises. For many businesses, access to affordable capital is the determining factor between growth and stagnation or closure. The Business Boost Fund aims to fill this financing access gap, providing a much-needed resource for businesses to compete and succeed.

II. INFORMATION FOR LENDING DECISIONS

The information summarized and evaluated in the loan proposal for each loan is based on documentation provided by the applicant with the loan application and from applicant interviews. This includes the applicant's resume, financial statement, analysis of the market, management experience, sales strategy, two years month by month financial forecasts, personal credit report, past three years personal and business tax returns, business profit and loss statements and balance sheets, business and personal debt schedule, collateral for the loan, and the legal structure of the business. The purpose of gathering and analyzing this information is to provide the committee with enough information to determine if the business will generate adequate cash flow to service the debt for the term of the loan.

The committee considers the merits of the total loan and how the loan pieces fit together. That consideration is made up of five fundamental elements. These are,

1. Character

The borrower's reputation in the community and credit history are essential parts of the character test. A detailed credit report, compiled from Experian, Transunion, and Equifax information is obtained during the loan consideration process on the borrower and spouse. The report provides a credit score number rating the overall credit history, but more importantly provides an indepth detailed history of the applicant's credit history including current debts, past debts, liens, judgements, bankruptcies, and other related information. A credit score of **680** or more is desired. Character is a combination of honesty, integrity, responsibility, and financial management skills as measured by the applicant's credit history.

2. Capacity

Capacity measures the borrower's ability to repay the loan by comparing income against recurring debts and assessing the borrower's debt to income ratio. This is where the past financial history of the business and the two-year forecasts are so important to determining what the debt service coverage ratio will be. The **debt service ratio** is defined as net operating income divided by total debt. If there is net income of $125,000 and the debt totals $100,000, then the debt service ratio is **1.25**. And 1.25 or better is the target debt service ratio. Capacity also includes the applicant's ability by way of education and experience, to run the business successfully. An element of capacity also includes the personal financial status of the borrower which includes an understanding of their personal budget and business draw needs to meet their household budget requirements.

3. Capital

All lenders want to see that the applicant is putting some equity, preferably cash, into the business loan project. The goal is for the applicant to bring **20%** of the total project from their resources. This goal is often difficult to meet, so we look for other ways the applicant is contributing to the total project. The more the borrower has committed to the project, the more likely the loan will be paid back.

4. Collateral

Lending is inherently risky. Therefore, we need to have collateral in case the borrower does not repay the loan. Collateral can be equipment or inventory, but the best collateral is unencumbered land, valued at more than the loan amount, held in first deed position by the city. When considering a loan, we look at the net worth to asset ratio derived from both the business balance sheet and personal financial statement and the availability of real estate to determine if we will have adequate collateral. The willingness of the borrower to provide collateral is also a means to determine their commitment to repaying the loan.

5. Conditions

Business and economic conditions include general market/economic conditions, the size of the loan, the internal condition of the business, the structure of the loan itself, the use of the loan funds, and other concerns which come up during the loan underwriting process.

Loan Evaluation Matrix

To provide the committee with a tool to evaluate a loan proposal utilizing the five fundamental measurement considerations of business lending, the following chart is provided within each loan proposal.

Measurement	**Fair**	**Good**	**Very Good**	**Excellent**
Credit Scores				
Credit History				
Personal Financial Status				
Company Net Worth				
Net Worth to Asset Ratio				
Debt Service Coverage Ratio				
Capital Injection				
Collateral				
Conditions				
Recommendation				

III. PUBLIC BENEFIT & NEED FOR FUNDS

To determine whether city program funds are necessary, a gap must exist in the amount of existing capital available from the business or from conventional loan sources to meet the total project needs. A financial gap can include both the availability, and the cost of capital needed by the business. For example, a business may need $150,000 to cover expansion costs but only have $100,000 available, leaving a gap of $50,000. Also, if the cost of financing may stop the project from proceeding, financing costs may be decreased by reducing the interest rate, deferring principal payments, and/or extending the loan term based on an analysis of business debt service capacity, project needs, and a review of a reasonable return on investment to the borrower.

In addition to demonstrating financial need, each project should also demonstrate that it meets the overall goal of improving the economy of the city.

IV. PROGRAM PARAMETERS

The interest rate and length of the loans are determined within a range of favorable terms based on security and purpose of the loan, as described below. The interest base is 2.5% and will increase depending on the risk factors of each loan.

- A 2.5% loan origination fee, based on the loan amount, be charged to the borrower for the loan at closing.
- A $150 application fee, due at the time of application, will be paid by the applicant.
- A loan closing fee in the amount of $250 will be paid by the borrower at the time of loan closing.
- Loans are neither assumable nor assignable.
- In companion loans, positions may be taken behind a senior lien when the amount provided by the participating bank exceeds the program loan amount.
- The borrower must demonstrate the ability to repay the loan from the operation of the business.
- Loan interest rates will range between 2.5% to 5% depending on risk factors.

Interest Rates

Interest rates are initially based on whether a loan is unsecured or secured. After preliminary debt service payments are calculated, the interest rate may be modified by considering the debt service capacity of the business, the collateral position of the city, the company net worth, and personal financial status of the borrower. In general, the higher the risk, the higher the interest rate.

<u>Unsecured Loans</u>. An interest rate of 5% is initially recommended for all types of unsecured loans. Most loans provided through the program are for working capital, equipment, and/or inventory. Therefore, they are unsecured loans (even though they may be secured by UCC-1 filings and security agreements covering all eligible business assets). It is important to remember that the city should only consider loans of this nature when all other elements of the loan are very good to excellent. The two reasons for classifying these loans as unsecured are as follows:

1. During the loan term, the borrower has control of these business assets, and these assets may not be available to liquidate the loan if the business fails.

2. The city loan may be in a junior lien position behind a bank, vendor, leasing company, or other lender.

Secured Loans. An interest rate of 2.5% is initially recommended for secured loans. In the case of loans secured by real estate the value of the collateral is dependent on the equity in the property at the time of liquidation. Therefore, for purposes of pricing, the value of the collateral is analyzed based on the following criteria:

1. Lien position
2. Property equity
3. Appraised value
4. Environmental issues
5. Debt Coverage Ratio
6. Zoning requirements

For loans secured by real estate, where the city is in first lien position, a collateral analysis is completed to determine if the equity is sufficient to qualify the loan as secured. If the value of the real estate is less than 125% of the loan amount, the loan is classified as unsecured, and a higher interest rate is applied.

Length of the Loan

The length of the loan is based on its purpose and debt service capacity of the borrower. Loan funds are available for the following purposes: working capital and purchase of inventory, equipment, or real property. City loans can be made for construction purposes as well.

<u>Working Capital</u>. Loans for working capital should not exceed 5 years. Business cash flow should be adequate to service a loan for this purpose in 5 years or less.

<u>Inventory</u>. Loans for the purchase of inventory should not exceed 5 years. The borrower should be cautioned that future purchases of inventory should be made from business cash flow based on the average turnover rate for the specific business type. An exception may be considered for business expansion purposes.

<u>Equipment</u>. Loans for the purchase of equipment may be considered for up to 7 years, depending on the useful life of the equipment. The loan term should not exceed the term of depreciation reflected in the tax return schedule. If the equipment is the only collateral securing the loan, the borrower should be required to put a 20% down payment on the purchase price.

<u>Real Estate</u>. The amortization schedule for loans for the purchase of real property should not exceed 20 years, with the loan being due paid in full in ten years. Age and condition of the property are to be considered.

V. LOAN APPLICATION PROCESSING AND CLOSING

The City contracts with Community Development Services (CDS), program. CDS works with local organizations and institutions to implement this program. The other essential group in this program is the Loan Committee. The Loan Committee is comprised of City Manager, a representative from a local commercial lender and a consumer lender, who review the loan proposals and make recommendation to approve the loan proposals and set final conditions for each loan. Specific roles and responsibilities for each phase of the program are described below.

Marketing and Outreach

CDS, participating banks, and city staff will market the program at local business functions, with periodic flyers, presentations at evening workshops and in one-on-one consultations. Loan referrals are made primarily from the City Business to Business Network Program.

Screening Potential Applicants

CDS and bank staff screen for appropriate loan clients. The ultimate decision regarding appropriateness for further consideration is made by CDS. These determinations are reported to city staff during the underwriting process for their consideration.

Application Intake

The loan process begins by CDS requesting applicants to provide the following:

- Completed loan application form, identifying the amount of the loan requested and a description of the intended use of loan funds and other sources of funding.
- Financial statements of the business covering the last three years.
- Interim financial statement of the business from the start of the current fiscal year to the most recent date available.
- Realistic and reasonable business activity forecasts, cash flow projections, income and expense projections, and collateral value.
- Most recent personal financial statements of all owners or participants with a 20% or more interest in the business.
- Brief resumes of key management personnel and owners.

- Credit verification. Tax liens or charge-offs may invalidate an application.

- Business plan, if determined necessary.

- Release to obtain credit report.

Application Review Criteria

CDS provides the applicant with an indication of loan feasibility after a consultation and review of the preliminary loan application; the review each application based on the following criteria:

- Appropriateness of providing program funds to the project (reasonableness of project costs, existence of financial gap, etc.).

- Financial feasibility based on the loan evaluation matrix criteria.

- History of profitable operations, with a preference for expanding businesses which have been in business for over three years.

- Business activity forecasts, cash flow projections, income and expense projections, value of collateral.

- Experience of key management and owners.

CDS staff analyzes each application using several financial management ratios. The cash flow coverage is the primary consideration in the approval process. The other ratios listed below are also used as measurements:

- *Cash flow* coverage of 125% of debt service is used as a guideline.
- C*urrent* ratio (which is current assets to current liabilities) of 2:1 is considered secure.
- *Quick ratio* (cash and equivalents plus accounts and notes receivable to current liabilities) of 1:1 usually indicates ample liquidity.
- *Debt to* worth *ratio* (total liabilities to tangible net worth) ratio of 5:1 as the extreme high end.
- *Collateral coverage* of 125% of loan balance is considered standard.
- *Break even* analysis of the project's ability to support the projected labor costs and additional debt service.

Loan Committee Review

If appropriate, the loan request is then prepared in loan proposal format, in concurrence with bank staff, when applicable, and presented to the Loan

Committee. The Loan Committee reviews the loan proposal and determines whether to 1) approve the loan as recommended, 2) modify the terms and conditions of the proposed loan, 3) or deny the loan. The Loan Committee will meet to review and either approve or deny loan requests as needed.

Loan Conditions

- Program funds are loaned only to businesses located in the City of Fort Bragg.

- Any business wishing to receive a loan through the program is required to comply with all applicable City permit requirements and CEQA or NEPA requirements.

- Any business receiving a loan under this program shall not unlawfully discriminate against any individual seeking employment or already employed because of sex, race, color, ancestry, religious creed, national origin, physical disability (including HIV and AIDS), medical condition (cancer), age, marital status or any other arbitrary basis.

- If at any time during the term of the loan, it is discovered that a business is willfully out of compliance with any of these conditions, the City may require payment of any outstanding loan balances within ninety (90) days of the discovery of non-compliance.

- A business shall not be eligible for a second business loan until the first loan has been substantially reduced and the applicant has a history of timely loan payments.

- All loan information is maintained as strictly confidential.

- Loans shall become due and payable if the business receiving the loan moves from the City. Arrangements will be made on a case-by-case basis.

Closing Procedures

Each loan is closed by following the checklist below:

- ✓ Reviews borrowers debts and liabilities.
- ✓ Verifies asset ownership and proof of insurance.
- ✓ Requires personal references, when appropriate.
- ✓ Ensures borrower signs the loan agreement, including non-financial employment plan.
- ✓ Ensures borrower signs a promissory note that cites the amount, interest rate, and repayment schedule for the loan.

- ✓ Collects required security agreements for collateral.
- ✓ Collects personal guaranty (when appropriate).
- ✓ Collects corporate guaranty (when appropriate).
- ✓ Ensures subordination agreement is signed (when appropriate).
- ✓ Ensures lien is recorded on mortgage (when appropriate).
- ✓ Collects life insurance policy and assignment (when appropriate).
- ✓ Collects other documents as determined appropriate.

V. LOAN MONITORING AND SUPPORT

To ensure borrower success and maintain program integrity, we will implement the following measures:

Regular Loan Monitoring: Conduct financial reviews at least annually to assess borrower's financial health and identify potential issues early on.

Professional Assistance: Offer support through business advisors or consultants, payment restructuring, extensions, financial management classes, and industry-specific guidance.

Flexible Approach: Recognize that business may face temporary setbacks and be willing to adjust terms when appropriate.

Disciplined Collection

If a loan is in default, prompt collection action and pursuit of loan will be pursued will following the procedures outlined in the Problem Loans Administration section.

VII. APPEALS

Upon written request, applicants may appeal decisions made by the Loan Committee. Appeals shall only be considered where there exists a legitimate interpretation issue over the program guidelines, or it is unclear whether the spirit and intent of these guidelines cover a given applicant's business circumstance.