CHAPTER 21 BUSINESS ASSISTANCE ACTIVITIES

Introduction

Under the States' Community Development Block Grant (CDBG) Program, unlike the Entitlement Program, if an activity does not fall within a category of explicitly authorized activities in the CDBG statute, the activity is considered ***ineligible***. This Chapter describes one single, eligible activity under Housing and Community Development Act of 1974 (HCDA): 105(a)(17): *Economic Development Assistance to For-Profit Business.*

The Department provides funding under this section of HCDA under two separate methods of distribution:

1. Enterprise Fund, Business Assistance (BA)
2. Economic Development (ED) Over-the-Counter (OTC)

> Throughout this chapter the Department's use of the term "Grantee" includes the jurisdiction staff, subrecipients and program administrators.

The Department distinguishes these two methods of distributing these funds in the following way:

1. Enterprise Fund BA is a ***Program***, meaning at the time of application submission and at the time of awarding the grantee specific businesses and specific project addresses have not been identified in the jurisdiction's application. With approved BA guidelines, the grantee markets the program for eligible businesses.

2. ED OTC is a single ***Project*** meaning at the time of the application one single project (business) has been identified for funding. Unlike the BA program, the ED OTC Projects must be approved by the Department's Internal Loan Committee.

Both the Program (BA) and Project (ED OTC) provider direct financial assistance (loans) to private for-profit businesses and this Chapter outlines the policies and rules associated with both methods of distribution.

Note: The Chapter does not distinguish between the Department's grant funds (awarded contract funds) and all variations of the Department's allowable methods of using Program Income funds (Revolving Loan Funds, Waivers or Supplemental Activities). The process, rules, and policies within this chapter apply equally to all CDBG funds.

Both BA and ED OTC activities provide financial assistance to a business, typically by providing subsidized CDBG loan funds. The local business is able to access "flexible" financing to help them grow. In turn, the business must provide a *Public Benefit* (more later) to the local community and primarily to the Low and Moderate income citizens. This benefit is usually in the form of access to jobs or goods and services. And in turn, the grantee receives the benefit of a CDBG "performing" loan that gets repaid as CDBG Program Income (PI) for reuse in the community on eligible CDBG activities.

By successfully administering a BA program and/or the ED OTC projects, grantees will be able to help the local business community meet their need for access to capital for economic growth, or economic survival, and assist local residents by providing job opportunities or needed goods and services.

This Chapter will help grantees determine how CDBG funds can complement existing economic development activities being conducted in their community and fill in "gaps" where other programs are not able to fund certain ED project activities.

The Chapter focuses on CDBG compliance when operating a BA program, or implementing an ED OTC project. The Department also provides supporting documents for this Chapter to give more detail on documenting BA and ED OTC project compliance.

Eligible Activity

HDCA Section 105(a)(17) (In Part):

Activities assisted under this title may include only –

Provision of assistance to private, for-profit entities, when the assistance is appropriate to carry out an economic development project (that shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods) that—

A. creates or retains jobs for low- and moderate-income (LMI) persons;
B. prevents or eliminates slums and blight;
C. meets urgent needs;
D. creates or retains businesses owned by community residents; and
E. assists businesses that provide goods or services needed by, and affordable to, low- and moderate-income residents.

This Chapter ***does not*** discuss the other CDBG ED Activity: Microenterprise Assistance. Microenterprise Assistance (HCDA Section 105(a)(22)) can be found within the Grant Management Manual under Chapter 15.

In addition to a project meeting the above definition, each eligible project (BA or ED OTC) must be able to document meeting a CDBG National Objective, a public benefit standard, and the six underwriting standards. In addition, projects must be able document that CDBG funds were used to pay eligible project costs and met the applicable federal overlay regulatory requirements.

The following is a basic description of the two types of funding, under what is sometimes called *Special Economic Development*, which the Department divides into Programs (BA) and Projects (ED OTC):

Economic Development Over-the-Counter (ED OTC):

Projects funded under the ED OTC application process are between $300,000 and $5,000,000. As such, ED OTC projects are much larger and more complicated than BA projects (discussed next).

The ED OTC is available year-round (if funding is available), with applications submitted once the Department has reviewed the projects and determined it is eligible and will meet a National Objective.

ED OTC projects must be submitted for approval to the Department's Internal Loan Committee (ILC) prior to the Department awarding funds, if approved. Please see Economic Development Over-The-Counter (ED OTC) Application Process for a flow chart showing the process.

> ***Note:*** *There are other eligible ED OTC activities, not covered in this Chapter, which are identified and described in the CDBG annual Notice of Funding Availability (NOFA). These activities and their compliance standards are not discussed in this chapter because they are not covered under HDCA Section 105(a)(17).*

Enterprise Fund Business Assistance (BA):

Projects funded under a BA program have a maximum CDBG loan amount of $300,000.

BA requires approved Program Guidelines (see below) that must be approved by the Department and the grantee's governing board. The Department has developed a template for use by the grantee, available on this Chapter's web page.

For projects funded under a BA program, grantees are responsible for reviewing, approving, certifying and documenting eligibility, national objective, the six underwriting standards and federal overlay requirements as the Department will not review the projects except as part of the program's monitoring process.

Grantees must submit the required BA Certification form, after local loan approval, so the Department has documentation of all projects assisted. This will also include the submission of the BA Setup and Completion Report at the time of loan approval and once the individual projects are complete (or the project has met the National Objective).

This chapter contains guidance and required documents for BA program activities that will assist the grantee in administering their local program in compliance with CDBG requirements. The chapter's guidance will also assist grantees applying for and administering an award of funds for a Special Economic Development OTC project.

Ineligible Activity

CDBG federal statute Section 105(a) does not specify ineligible ED activities. However, the federal regulations provide guidance on eligible ED activities and what specific activities are not eligible. In general, the following activities and projects are not eligible for CDBG assistance:

- Any activity not authorized under the Housing and Community Development Act (HCDA) of 1974 is ineligible to be assisted with CDBG funds. The CDBG program for States relies on statutes in the HCDA 105(a) [42 USC 5305(a)] to describe eligible programs/activities. Under this Chapter, HCDA 105(a)(17) is the controlling statute citation.

Only for-profit businesses are eligible for assistance under the HCDA 105(a)(17).

- *Any eligible CDBG activity authorized under HCDA that does not successfully meet a National Objective (see the National Objective section below), is not permitted under the CDBG program and would therefore be considered ineligible.*

- Activities providing improvements or maintenance of public facilities used for the general conduct of government are ineligible. However, the removal of architectural barriers from government buildings, pursuant to the Americans with Disabilities Act (ADA), is CDBG eligible but not under any ED activities.

- Activities providing operational funding of the general conduct of government are ineligible.

- Activities providing funding for political activities or engaging in other partisan political activities are ineligible.

- Activities providing financial assistance to a professional sports team (fed. Reg. 570.482(f)(4)(ii)(B)) are not eligible.

- Activities providing financial assistance to a privately-owned recreational facility that serves predominantly higher-income clientele (fed. Reg. 570.482(f) (4)(ii) (C)) are ineligible.

- Activities providing financial assistance which lead to employment relocation from one labor market to another, (fed. Reg. 570.482(h)) are ineligible.

- Assistance to a for-profit business while that business or any other business owned by the same person(s) or entity is the subject of unresolved findings of noncompliance relating to previous CDBG assistance provided by the recipient (fed. Reg. 570.482(f)(4)(ii)(E)) is ineligible.

Grantees must use CDBG funds for the eligible activity under federal statute 105(a)(17) and follow federal regulations and Department requirements on meeting CDBG compliance standards, then the projects funded under a local BA program or ED OTC project will be eligible.

Eligible Business

Federal statute Section 105(a)(17), CDBG financial assistance can only be provided to a private for-profit entity. There are many different types of private for-profit entities that can request BA or ED OTC funding from a grantee.

For CDBG purposes an eligible business for BA or ED OTC project is:

- An existing private for-profit commercial enterprise that is legally operating,
- A person or persons with capacity to startup a private for-profit commercial enterprise,
- A person or persons with capacity to buy and continue operations of an existing business,
- A business which is not, neither the business nor owners, on the federal debarred list, and
- A business which has no, neither the business nor owners, outstanding / unresolved federal or state tax delinquencies.
- A business must substantially benefit a grantee's citizens. As such, the business operations must be physically located within the grantee's jurisdictional limits. Businesses located in HUD entitlement communities are not eligible under the State CDBG Program.
- A non-entitlement county Grantee may fund a business located in a non-entitlement city grantee with city authorization to do so. In addition, a business proposing to create jobs must make a substantial number of those new jobs available to residents living in the jurisdiction.
- A business must not request CDBG funding to conduct any of the ineligible activities listed above. For example, a business wishing to use CDBG funds to relocate an existing business operation, which has a large amount of jobs, from one labor market area to another, is not eligible.
- A business not meeting other federal overlay standards, such as conflict of interest and owner being on the federal debarred list, is not an eligible business.

Notes: *There is no restriction on number of owners or type of business ownership. A sole proprietorship may apply for funds the same as a multi-national corporation. Different types of ownership do require different levels of analysis of the project. A sole proprietorship typically has limited assets and simple cash flow analysis, whereas, a project with a large corporation that has multiple subsidiaries and owners with multiple business interests can make for much more challenging underwriting.*

An eligible business interest can be in any economic sector (manufacturing, distribution, services, etc.). Different types of businesses will require a different review depending on their operations. A small landscaping business loan proposal for expansion is very different than a struggling lumber mill which produces fencing materials and needs CDBG funds to stay open. The common factor for all eligible businesses is evaluating their ability to operate and produce cash. This documentation of "cash flow" is necessary to prove the CDBG assisted business will create or retain required jobs, or it will continue providing necessary goods or services for LMI residents of the grantee's jurisdiction. So there are lots of different eligible businesses that can be assisted, as long as they cash flow and meet all other CDBG compliance standards and requirements.

There is no restriction in assisting a business owner(s) with multiple businesses, but CDBG funds can only fund <u>one</u> eligible business interest. In the event there are multiple business interests, *the other business interests must be evaluated as part of the grantee's underwriting process in order to assess the risk and project financial viability, but cannot receive CDBG funds.*

Eligible Project Costs

This section briefly describes the eligible costs associated with eligible CDBG activities under federal statute HCDA 105(a)(17). In general, eligible costs under this CDBG eligible activity must be directly tied to meeting the National Objective: create or maintain jobs or provide goods and services to low and moderate income (LMI) citizens of the grantee's jurisdiction.

This section will address costs associated with the provision of assistance to an eligible business, which is divided into two categories: Activity (loan amount) and Activity Delivery (AD). However it is important to remember that both costs are only eligible if the project meets the identified National Objective. Under the federal CDBG Program, there are no separate categories of cost for Activity and AD costs. More information on the separation of these two cost categories can be found on the Chapter's web page under the Cost Categories Table. Generally, however, Activity costs are the costs associated with the projects scope of work, the amount inside the loan; and the AD is the cost associated with making loans under the BA or ED OTC projects.

For BA programs, the Department has template program guidelines that list eligible and ineligible costs associated with project activity costs. The grantee, in developing their BA guidelines from the Department's template should discuss with the Department any changes to this list prior to altering the template to ensure they stay in compliance with what is considered eligible for reimbursement.

For ED OTC, the Department will review the project's Sources and Uses to determine if CDBG funds can pay the costs identified by the applicant as CDBG eligible. For BA, the Loan Certification Form will be used to confirm the grantee will be reimbursed for eligible costs. In both cases, the Department will monitor for actual invoices to determine if the actual paid costs were eligible.

In some cases eligible costs are restricted by other criteria. For example, CDBG funds can be used to pay off existing business debt. However, this cost is only eligible, when there is debt restructure provided by other participating lenders. See, below, *Six Underwriting Requirements* for more detailed discussion on this subject.

General Administration (GA) is not discussed in this Chapter as it is consider a separate activity.

The most common CDBG costs associated with BA and ED OTC loans consist of the following:

- Working capital, supplies, and inventory;
- Furniture and fixtures;
- Equipment, with or without installation costs; and
- Interior and exterior improvements to real property (owner occupied or tenant).

Working capital is a "catch all" term that can mean different things to different lenders. For CDBG purposes these eligible costs are limited to monthly operations costs of the business, e.g. rent, utilities, employee wages (including employer benefits and taxes), property insurance, etc. Each of these items must be documented as reasonable at the application stage and *reimbursed* for actual costs as part of loan disbursement. The reimbursement process for operations costs should be done on a monthly reconciliation basis.

The Department operates on the basis of reimbursements. This means when a grantee submits funds requests, the work associated with the requested cost has been completed and the grantee has paid these costs. Without these two elements met, the funds request would be considered an advance and would need Department approval ahead of time.

BA loan funds cannot be used to pay for owner wages or draws and cannot pay off private debt or credit cards.

OMB 2 CFR 200 identifies, among other subjects, the federal allowable costs, cost reasonableness and other cost principles that the grantee should be familiar with when determining allowable costs for both the Activity and the AD for each loan.

Federal regulations prohibit providing CDBG funds to recipients as income, so although loan funds can pay for wages of employees of the business, the owners of the business cannot receive any wages or owner draws directly from CDBG loan proceeds.

Activity Delivery Costs for Business Assistance Program and ED OTC Project:

Because CDBG BA program funds are used for program marketing, application review and loan approval, the Department has set up a separate budget cost category called Activity Delivery. These are necessary costs, above the actual direct financial assistance (loan) amount. These funds are available for grantees to ensure the "project" is CDBG eligible and document that eligibility in the project file.

The Department will not reimburse the grantee for costs associated with AD until there is an identified business that has a loan *approved*.

- BA approval means the loan has been approved at the grantee level and the grantee has submitted a Loan Certification and Setup Report to the Department.
- For ED OTC, the grantee has received an executed Department Contract and all Special and General Conditions have been cleared.

AD is general costs associated with making loans (BA or ED OTC) under this Chapter's eligible activity; it is the cost outside of the actual loan to the project.

AD is limited to a percentage of the loan amount (amount is identified in the NOFA). To be eligible for reimbursement, under the BA program, AD costs must be directly related to working with for-profit businesses, within the grantee's community, but it is not required that each business receives a loan for those costs to be eligible. Also, the costs must be directly allocable to CDBG work. CDBG cannot pay the costs connected with underwriting a SBA loan, for example.

For AD within an ED OTC project, the AD amount is limited to eligible costs directly related to that one project, costs outside the project loan, up to the maximum identified in the contract and limited to actual costs.

National Objective

CDBG Statue 105(a)(17) states that, in order to be eligible for funding, *every* CDBG funded project activity *must* qualify as meeting a National Objective. Those national objectives are further defined in federal regulations 24 CFR 570.483. For both BA and ED OTC, this means that every business receiving CDBG loan funds must be documented by the grantee as meeting a national objective.

There are three national objectives that can be met by an eligible CDBG activity. An eligible activity may meet more than one of the three national objectives, in which case the grantee needs to choose the one which fits best. The three national objectives are:

1) Benefit to low-to-moderate income (LMI) persons;

2) Aid in the prevention or elimination of slums or blight (SBA); or

3) Meet a need having a particular urgency (referred to as urgent need).

Due to the federal regulatory requirement that mandates seventy percent (70%) of all CDBG funds be allocated to eligible activities using the national objective of LMI benefit, the two other national objectives (SBA and Urgent Need) are only used under limited circumstances.

For the purpose of the Chapter, LMI is further broken down into two allowable subcategories of LMI, as noted below.

The following are the limits related to the two methods of distribution under this Chapter:

BA:

- *Low Moderate Job Creation or Retention (LMJ):* the business provides a minimum of 51% of all new jobs to qualified LMI persons (at the time of hire), ***or*** ensures that over half of the retained existing jobs are held by LMI persons.

- *Low Moderate Area Benefit (LMA):* the business provides goods or services that benefit, within the business service area, the residents of the community which has a minimum of 51% low-moderate income (LMI) citizens.

ED OTC:

- *Low Moderate Job Creation or Retention (LMJ):* the business provides a minimum of 51% of all new jobs to qualified LMI persons (at the time of hire), ***or*** ensures that over half of the retained existing jobs are held by LMI persons.

- *Low Moderate Area Benefit (LMA):* the business provides goods or services that benefit, within the business service area, the residents of the community which has a minimum of 51% low-moderate income (LMI) citizens.

- Spot Blight (SBS) only.

Urgent Need is only allowed under special funding allocations / authorized by the Department. ***Slum and Blight Area*** is not eligible for either BA or ED OTC.

The LMI national objective is met when a CDBG funded activity benefits low or moderate income persons. An **LMI person** is defined by HUD as a person whose family income is at or below eighty percent (80%) of annual median income for the county.

The Department has provided a detailed overview of how to document national objective standards compliance. The document, National Objective Standards Compliance is posted on the BA chapter's webpage. Grantees must include this compliance document as an attachment to their BA program guidelines, for reference purposes. The national objectives standards compliance document should be used to ensure each project file originating out of a BA program or ED OTC project is in full compliance.

Note: *CDBG national objective standards are different from the public benefit standards. They are often confused because both involve analysis and compliance regarding jobs or goods and services. This chapter and its supporting documents separates these two standards out, as well as the required six underwriting standards, in order to remind grantees that compliance with each of the three standards is required under this Chapter.*

Standards for Meeting LMJ:

- To document individual income for all persons hired or retained, the grantee must use the Department's: *Business Assistance Staffing Self-Certification Form* (available on this Chapter's web page).
- A job is counted retained or hired if it meets the definition of *permanent*.
- A job is counted if it meets the full time equivalent (FTE) requirements: 1,750 or more hours of work per year (regardless of if the position is an hourly wage or straight salary).
- Per state regulations, Title 25 7054 Definitions, an FTE maybe no more than two part time positions that each work a minimum of 875 hours per year.
- A significant number of the positions must be hired from residents of the grantee's jurisdiction.
- The 51% LMJ National Objective test is based on the number of jobs actually created or retained not on the projected jobs created or retained.
- Eligible job position? The following list of job positions cannot be counted for national objective or public benefit standards compliance for job creation or retention activities:
  - Owners of the business (including legal ownership via California community property law);
  - Temporary workers (construction workers doing project improvements);
  - Third party contractors (receiving 1099 IRS statements, verses W-2 statements);
  - Persons working less than 875 hours annually (actual hours, not using overtime hourly value); and
  - Existing job positions that are moved to a new facility (job relocation).

*BA applicants and ED OTC applicants proposing to use LMJ must complete Department's **Jobs Tracking Form** to indicate sufficient LMI job beneficiaries.*

The following addresses LMJ standards divided into **Creation of Jobs** and then **Retention of Jobs.**

Providing (Creating) Job Positions for LMI Persons:

Under the LMI national objective umbrella, the Low-Moderate Income Job (LMJ) category is used to qualify most projects funded under a BA program and the ED OTC projects. At the application stage, the business must pledge to create permanent jobs and provide a minimum of 51% to LMI persons. The grantee is required document the proposed LMJ promised by the business and to track and document this compliance after approval and expenditure of CDBG loan funds. This is done using the Department's Job Tracking Form and business payrolls. The Job Tracking Form is posted on the BA chapter's webpage.

To meet the LMJ National Objective, the grantee for each BA or ED OTC loan, must document the number of jobs actually created, of which 51% must be Low/Mod and must document the number of FTE created at the project completion. If a business projects 11 jobs, but due to market conditions only 9 jobs were actually created, the National Objective test will be based on the 9 FTE positions created, 51% of which would be 5 FTE. This means 5 positions must be filled by persons, at the time of hire, self-certified as Low/Mod.

Guidance on National Objective Standards Compliance is on the chapter web page. It provides more detailed procedures for documenting actual LMI jobs using creation or retention or documenting LMA benefit for BA projects providing goods or services.

The verifying of job creation requires documentation both at the time of approving the loan and after the project is complete. This allows the grantee to determine how many jobs were actually created, of which 51% must be low/mod. It also allows the grantee to be able to monitor the business' new hires at the job application stage. Each job applicant / new hire must complete the Department's *Business Assistance Staffing Self-Certification Form* to document their family income level.

Typically the business will complete their hiring process over a period of time as project funds are disbursed and cash flow builds to support new job positions. Grantee and business must coordinate the income self-certification process of new hires as it only needs to be done once for each new position added to the payroll. The Department's Jobs Tracking Form for Actual Jobs will help keep all parties apprised of the project's LMJ status.

Once all project funds have been expended and the scope of work complete, and as many jobs as possible have been hired then the project is completed and the Project Completion Report must be submitted to the Department. The Project Completion Report documents the number of jobs created and of those jobs how many went to low/mod individuals. For the project to be eligible the grantee will need to document that the project met its National Objective by showing at least 51% of FTE job positions are filled by LMI persons.

Retaining Job Positions of LMI Persons:

In addition to the general LMJ National Objective requirements, businesses proposing to retain jobs, primarily held by LMI persons, require the grantee to first evaluate and sufficiently document that the jobs would be lost if CDBG financial assistance is not provided. Second, the business must provide documentation that over half of the permanent FTE job positions being retained are held by LMI Persons.

Documenting job retention means that the business must show it is subject to closure or failure, and at the same time, document that the use of CDBG funds will allow it to be financially viable after BA loan funds are disbursed and the project is completed. See the chapter's webpage for procedures on documenting compliance with public benefit standards for BA and ED OTC activities, which includes how to document eligible job retention.

Job retention requires specific documentation of potential job loss since it must meet the "but for" test, i.e. "but for" the investment of CDBG funds, the business will close and a significant number of LMI jobs (over 51%) will be lost. Documenting LMI jobs must be done at the application stage as "proposed", and then they must be documented again, after the CDBG funds are expended and project is completed. This second verification is needed to document "actual" LMJ positions retained.

__ED OTC__ projects that are qualified under the national objective of elimination of slums and blight on a spot basis must also meet the public benefit standard (jobs or goods or services).

As part of documenting business job retention, the grantee will complete the Department's Jobs Tracking Form and collect other documents from the business as described above for job creation projects. The major difference between job creation verses job retention project documentation is that retention projects must document that over half of existing job positions listed in the chart are held by LMI persons at BA loan application stage. The grantee must have all existing employees (except owners) complete the Department's income self-certification process before the infusion of the BA loan. If over half of all existing employees are documented as LMI persons, the business runs less risk of not meeting a national objective.

Low-Moderate Income Area (LMA) Benefit:

The area benefit category (LMA) is not commonly used for CDBG ED projects because its eligibility criteria allows for only a limited number of cases for its use. Like other CDBG eligible activities meeting the LMA national objective standard, BA or ED OTC projects must be located in communities that are primarily residential in nature. The service area of the business must be primarily within the jurisdictional boundaries. Most importantly, the neighborhood or small rural community being served must be made up of be LMI residents (at least 51% of the residents are LMI persons). In addition, the grantee must document that the business provides either a good or service to residents. Only businesses that provide goods or services to primarily LMA communities are eligible for funding under this national objective standard.

An example of an area benefit activity that expands economic opportunities would be the construction of a local market or financial assistance to a retail business that predominantly serves a LMI area. Grantees must use the Department's National Objective Standards Compliance document, posted on the BA chapter webpage, when proposing to use this standard.

Due to the above criteria, manufacturing facilities, wholesale or distribution facilities will not qualify under LMA. Typically, eligible businesses in a downtown or retail facility providing services like, grocery stores, laundry mats, dry cleaners, auto parts stores, or movie theaters may qualify. The Department does not allow for funding of liquor stores or bars, cigarette stores, payday loan services or medical marijuana clinics.

For LMA, the grantee is required to identify the use of this national objective in their BA program guidelines. The Department's "best practice" is to include this language per the template guidelines but grantees may choose to not use LMA and delete the language in their BA guidelines. A city grantee that has jurisdiction-wide LMA is more likely to use this standard than a county grantee that does not have any communities that qualify as LMA. Once documentation of the LMA national objective standards goods and services, public benefit standards and six underwriting standards have been secured, the grantee may approve the BA loan and submit the BA Loan Certification Form to the Department.

The Department does not require the use of the income self-certification process or payrolls for an activity qualifying under the LMA national objective. The business assisted must document the provision of goods, or services open to all residents in their service area and are used by LMI persons. The BA or ED OTC project is completed once all funds are disbursed and documentation of goods or services provided to LMI persons is provided by the business. Beneficiary information will be that of the residents of the jurisdiction / business service area. The grantee can then complete a project completion report and submit it to the Department for processing.

Public Benefit Standards

Since the CDBG BA program is implemented under the federal statute HCDA [105(a)(17)], public benefit standards must be used on each project. Grantees must ensure a minimum level of public benefit is obtained with each eligible BA project (loan) per federal statute and federal regulations 24 CFR 570.482(f).

The public benefit standard related to jobs is connected to the LMJ national objective. The public benefit standard related to goods or services is connected to the LMA national objective. Jobs and goods or services public benefit standards measure benefits of the BA or ED OTC project.

Public benefit standards are intended to provide maximum subsidy amounts to businesses. The standards set two different subsidy limits, one based on individual projects and one based on annual aggregate of all BA and ED OTC projects assisted. Public benefit subsidy amounts also adjust based on the public benefit standard being met (jobs verses area benefit for goods and services).

For public benefit standard of jobs, the maximum subsidy amount for a project is $50,000 per job created or retained, based on federal regulations but state regulations presently limit individual projects to $35,000. The annual aggregate standard is a project average subsidy of $35,000 per job created or retained.

For the public benefit standard of goods or services (Area Benefit National Objective), the individual project subsidy is $1,000 per LMI person within the service area and annual aggregate standard of $350 per LMI person within the service area. There is no reference to goods and services public benefit in state regulations so the Department uses the federal standard for compliance.

Grantees use these public benefit funding limits to ensure that businesses receiving CDBG funds as public subsidies provide a “return on investment” to residents of the community lending the funds, i.e. jobs for local residents or goods or services for local residents.

Grantees should not “max out” the CDBG subsidy amount on each project. Rather, a reasonable number of jobs must be proposed based on business’s ability to utilize the CDBG loan subsidy.

The statutes and regulations stipulate that one of the two public benefit standards (jobs or goods and services for low/mod individuals in the service area) must be met by CDBG BA and ED OTC projects. Like national objective requirements, an eligible project activity may meet both standards, in which case, the grantee must choose the standard that fits best. The most common public benefit met by a CDBG BA program activity or ED OTC project is creation or retention of full time jobs provided to residents of the grantee’s jurisdiction.

Furthermore, the Department does have a Public Benefit Standards Compliance guidance document posted on the BA chapter’s webpage. Like the national objective compliance document, the public benefit compliance document must be included in the grantee’s BA guidelines for reference and disclosure purposes. ED OTC projects should use the Department's public benefit guidance document to ensure compliance with CDBG standards.

Public Benefit Standard Based on Providing Job Positions:

The main difference between compliance with the LMJ national objective standard and jobs public benefit standard is that there is no specific requirement for the number of LMJ positions to be created or retained. A project only needs to create one FTE position that is LMJ eligible to meet this national objective standard. However, if that same business proposed to create three jobs and received $50,000 in BA loan funds, then it will not be in compliance with public benefit standards. In another case, the business may propose to create three new job positions and make two of those LMJ, but actually they create five new FTE positions, so they need to document that three of those five are LMJ. Thus, national objective standards do not impact the subsidy limits for CDBG ED funding, but LMJ standards increase or decrease based on the public benefit standard met.

In working with the business, a grantee should not allow them to propose an unreasonable number of jobs (so they can get more loan funds). Rather, at the project application stage the grantee and business must do a financial analysis (see Six Underwriting Standards) to verify ability of the business to support proposed jobs and create a timeline when it is reasonable for those jobs to be provided (created or retained).

> The funds used for AD costs ***are not*** included in the project's public benefit calculation.

If the project creates more jobs over the expansion period then that is a bonus to the program and the grantee. There is no eligibility issue with creating more ***or less*** jobs on an individual project basis, as determined by the underwriting of the project initially. The Department, however, will monitor the grantee for compliance. If the grantee continues to fund projects that do not meet the projected public benefit standards, the grantee's underwriting process will be reviewed to determine what corrective action may be needed.

If a grantee, for example, has most of their ED projects with lower numbers of actual jobs verse proposed, then the Department will monitor the program and review the underwriting standards of the grantee, as this lack of compliance with job public benefit standard indicates lack of loan underwriting at the application stage.

> ***Note:*** CDBG Statute requires that citizens within the grantee's jurisdiction be the primary beneficiaries of these public funds. The Department is addressing this requirement in two ways: 1) the funded business must be physically located within the grantee's jurisdictional boundaries; 2) a significant number of new jobs created and/or retained by the business must or should be filled by residents living within the grantees jurisdictional boundaries.

Public Benefit Standard Based on Providing Goods or Services:

A second public benefit standard is available for businesses providing goods or services. This standard is only available when the grantee can document LMA national objective standard is met. So a business must be able to show that it provides goods or services in an area of the grantee's community that is LMA. The Department has a guiding document on Public Benefit Standard Compliance posted on this chapter's webpage for this standard.

The first step in this process is documenting the service area of the business, which can be jurisdiction wide or in a neighborhood or unincorporated community. This can be a challenging process because it requires the grantee to verify the exact service area of the business. Most businesses do not have a distinct service area so the grantee and business must formulate a reasonable justification for their service area determination. Second challenge is to ensure / verify that the business service area is primarily within the jurisdictional limits. Lastly the grantee must verify that the service area, located primarily in the jurisdiction is qualified as LMI. It is recommended that grantees consult with Department staff if a BA project is proposing to use the goods and services public benefit standard and this standard must be included in the grantee's approved guidelines.

After project is completed and CDBG funds expended, then the business must be verified as still operating and providing the documented goods or services.

Six Underwriting Standards

Each eligible BA or ED OTC project (loan) funded under the CDBG program must be underwritten using the six HUD underwriting standards described in federal regulations 24 CFR 570.482(f). These six standards ensure that grantees conduct a sound financial review of each project (loan) to ensure that CDBG funds are not provided to speculative or non-viable businesses. The Department has adopted these six underwriting standards in CDBG regulations Title 25 7062.1(3).

The six underwriting standards are:

1) Document all project costs are reasonable,
2) Document all sources of project funding is committed,
3) Document CDBG funds are not substituted for non-federal funds,
4) Document that the project is feasible,
5) Document that owner's equity return is reasonable, and
6) Document that CDBG funds are disbursed on a pro-rata basis in proportion with other financing provided to the project.

These six standards are complementary to standard commercial underwriting standards and those proposed by grantees in their BA program guidelines. Grantees must include at a minimum the six underwriting standards within their CDBG BA program guidelines, but also include additional underwriting criteria and procedures above these. Underwriting standards assist grantees in evaluating and determining risk associated with a specific BA program borrower.

Specific procedures and suggested documentation for compliance with these six standards is provided in the Six Underwriting Standards Compliance support document on this chapter's webpage. This document must be included in BA program guidelines as an attachment for reference and disclosure. Documentation verifying the underwriting procedures have been followed must be kept in the project file. Disclosing these underwriting requirements, within the grantees program guidelines, to potential borrowers is beneficial so applicants are advised of documentation that will be required for the lending process.

For ED OTC, these Six Underwriting Standards are part of the ED OTC Application process and therefore will be reviewed by Department staff. Each ED OTC project, approved by Department staff will also have the underwriting standards reviewed by the Department's Internal Loan Committee (ILC). Approval of the project's underwriting, among other items, would need to meet the above standards for approval by the ILC before receiving an award letter.

Note: Regardless of the source of CDBG BA funds (grant awarded funds, RLF, or PI Waiver) or ED OTC, these Six Underwriting Standards are required.

ED OTC Project Application and Grant Administration

The ED OTC Application and grant administration process does not need to have as much description as BA program activity administration, because Department staff will be working closely with grantees during these two processes. A flow chart of the ED OTC application review and approval process is posted on the BA chapter's webpage. Specific information required for ED OTC project review is provided in the annual CDBG application forms, as part of the Notice of Funding Availability (NOFA).

During the ED OTC application preparation, the Department and grantee will plan for the project's compliance with national objective, public benefit and six underwriting standards, as well as any compliance required for federal overlay or other CDBG standards. Each ED OTC project, approved by Department staff, will also be reviewed by the Department's Internal Loan Committee (ILC) for compliance with this chapter's CDBG standards. Upon ILC approval, an award package will be prepared for Director's signature. Grantee will then receive an award letter.

Upon award and execution of the ED OTC grant agreement, the grantee will be required to comply with any special conditions listed in the agreement. The grantee will also be required to comply with all general conditions listed on the Department's ED OTC General Conditions Checklist, posted on the forms and reports page.

As with BA projects, the grantee must track ED OTC project compliance with public benefit, national objective, and disbursement of eligible loan costs. Work associated with monitoring of federal overlays like relocation compliance or labor standards compliance will also take place during this time of project's development.

Business Assistance Program Administration

Regardless of the source of CDBG BA funds (grant awarded funds, RLF, or PI Waiver activities), the grantee must have approval from the Department, in writing, before starting any project.

The two major requirements for the grantee to operate a BA Program are 1) approved program guidelines and 2) an agreement between the Department and the grantee (awarding contract, called a Standard Agreement or a Department Program Income Reuse Agreement). Without an executed agreement and approved Program Guidelines (see below), the grantee has no authority to operate a BA program.

Note: Within the two types of agreements, the Department will have conditions that will need to be met and the grantee will be held to meeting these conditions: Special Conditions and General Conditions.

In addition to these two conditions, there are a number of other steps that grantees should consider developing prior to starting a BA Program (or consider developing to improve their present BA program):

- Grantee should develop BA loan documents for securitizing the CDBG funding. CDBG loans should be collateralized (secured) as much as possible to ensure repayment of CDBG loans in the event of a default (business closure). These loan documents would need to be reviewed by grantee legal counsel.

- Grantee must adopt ED loan servicing policies and work with grantee's fiscal staff to set up loan payment receipt process and loan default procedures. Managing the grantees' ED loan portfolio is an important part of program administration.
- Grantee should evaluate their capacity to operate a BA program, internally, or with assistance externally. The evaluation should consider staff capacity to ensure compliance with the standards and requirements of this chapter and knowledge and capacity to address all potential federal overlay compliance items too.
- Grantees need to assess what work can be done with grantee staff and what work will require third party administrators: for example: who will develop a program marketing plan, who will complete loan application forms, loan disclosures, loan approval process, and who will manage the loan portfolio, to name a few subjects.

In most cases the grantees will require some, if not most, work by a third party. Thus the grantee as CDBG BA loan "lender" is responsible for overseeing the work of consultant staff. This oversight responsibility requires grantee staff to be thoroughly familiar with all the topics and compliance standards in this chapter. The more involvement and review grantee staff have in a BA program, the better likelihood that each project will be in compliance with CDBG standards and regulations.

Department Template BA Program Guidelines:

Program guidelines are used for the purpose of public disclosure, transparency and consistency in implementing a BA program. It informs grantee staff, governing body and most importantly BA loan applicants of the CDBG policies and procedures used in administering the grantee's program. The grantee cannot decline loans to applicants without being able to point to written statements within the guidelines or this chapter showing the authority for approval/denial, as required by Equal Opportunity law.

All grantees are required to use the current template program guidelines found on this Chapter's webpage. Any BA program guidelines, adopted prior to release of this Chapter are considered obsolete and the Department requires the adoption of this Chapter's new BA guidelines.

It is also required that grantees include all Department supporting documents as Attachments. The Department considers the sample program guidelines and Attachments provided to be best practices/safe harbor when administering a CDBG BA program. The chapter's sample guidelines include all the Department's required compliance standards reviewed in this Chapter. Edited draft versions of the program guidelines must be submitted to the Department for review and approval prior to formal adoption by the governing body.

All existing and new BA programs must use current template guidelines on the chapter webpage.

Here are some questions and situations to consider when editing the Department's template guidelines:

- Do you intend to foreclose on businesses, or accelerate loans, in the event projects do not meet a CDBG national objective?

- What process is in place when the grantees loan approval committee recommendation differs from grantee staff loan recommendation, in other words, the loan committee denies a loan that grantee staff approves.

Grantees that alter the template guidelines, *must submit them to the Department in Word track changes for review and approval* prior to the grantee formally adopting them. This process, including approval by the governing body, will be required each time the grantee changes its BA program guidelines.

Best Practice: *CDBG BA programs can work better and be more successful when supported with business technical assistance services. Unlike microenterprise activities, CDBG BA program activities do not pay for professional technical assistance. So the grantee should look for business development agencies in their area that have other local, state, or federal funds to provide technical assistance to BA program loan applicants and help in getting eligible BA applicants qualified.*

Department BA Program Restrictions:

Both federal and state regulations and policies place restrictions on BA program activities. The Department has chosen the most common and straightforward method for eligible funding of BA projects that can be used by all grantees. Discussions above reviewed some of the federal and state program restrictions for BA program activities. Below is a summary of Department restrictions:

- The Department has restricted the BA program to the one CDBG eligible activity of direct financial assistance to a private for-profit and limited the national objective for the eligible activity to LMI.
- The Department restricts the program to only providing financial assistance as loans (no grants) and not allowing BA funds for public improvement costs in support of a business.
- The Department limits grantee certified BA project loans to a maximum of $300,000 in CDBG funds.
- The Department requires projects using LMA and LMJ job retention be specifically called out as allowable in their guidelines for these projects to be eligible under the BA program.
- The Department restricts loan costs by not allowing CDBG to pay off personal debts or credit cards and does not allow for BA loan applicants with unresolved income tax obligations or those in bankruptcy process to participate.

Any change to the project's scope of work or financing after BA loan approval requires re-submittal of the Department's Loan Project Certification Form.

The Department believes these general program restrictions are reasonable and in the best interest of itself and grantees. By setting up these program restrictions, the Department is able to allow grantees to "certify" small BA loans without Department formal review and approval. See discussion below regarding BA loan certification in Reporting and Compliance Section.

Federal BA Program Restrictions:

Federal Statutes and regulations prohibit the use of CDBG funding to assist in relocation of jobs from one labor market area to another. To document compliance, grantees are required to have every BA loan applicant complete a Certification of No Job Pirating, which is posted on the BA chapter's webpage for use with BA programs and ED OTC projects.

BA programs may also be restricted by requirements, like Conflict of Interest compliance, per federal regulations 24 CFR 570.489(h) and others. It is good for grantees and their program administrators to understand how conflict of interest is triggered and how it causes program restrictions. This is a compliance requirement under both federal and state conflict of interest laws and regulations.

The list below illustrates how conflict of interest can trigger program restrictions:

- In smaller rural communities, elected officials are also strong local business leaders, so they or their relatives may have financial interest in some BA projects.
- In some cases, there may be a conflict of interest with the program administrator when they have a financial interest in the borrower applying for CDBG funding. For example, it is not allowable to use CDBG funding to pay off an existing private debt obligation of the BA program applicant, when the debt is to the program administrator. Or again, if the program administrator is using its own private funds along with CDBG funding in a project, care must be taken that the project's risk is NOT primarily placed on grantee's CDBG BA loan.
- Grantees can have a conflict of interest when they propose to use CDBG BA loan funds to help a borrower purchase property owned by the grantee itself. This is not an arm's length transaction.

The Department encourages grantees to use the sample Conflict of Interest Disclosure Form on the BA chapter's webpage. An early discussion of this requirement with BA loan applicants will allow any conflicts of interest to be identified early.

Federal overlays are a term that denotes all the common federal laws that apply to all federal funding. The three most common are federal environmental review laws, acquisition and relocation laws, and prevailing wage laws. Below are the common federal overlays that can restrict BA program activities:

- A BA applicant may have made an environmental "choice limiting" action which precludes the grantee from investing CDBG funds into the project. The Department encourages grantees to use the sample CDBG Environmental Review Disclosure form to protect the grantee in the case the applicant is not truthful about the project's scope of work or site condition.
- A BA applicant may trigger relocation compliance and add project costs that make the project infeasible.
- The project may trigger payment of prevailing wages, which increase the costs of the project beyond what the borrower feels is reasonable and they cancel their BA loan

application.

- Loan applicants are required to be checked for federal debarred status.

The Department encourages grantees to use the sample Federal Environmental Review Disclosure Form on the BA chapter's webpage to prevent choice limiting actions. The process for verifying non-debarred status is located in the CDBG website on Other Resources webpage. Like conflict of interest restrictions, federal overlays need to be addressed at the application stage of the BA loan process.

Reporting and Compliance Documentation

The Department has standard reporting which grantees must follow when administering a BA program or ED OTC project. Grantees are required to provide these reports under the legal authority of the Department's awarded grant contract and/or Program Income Reuse Agreement. There are three types of reporting: 1) fiscal; 2) performance; and 3) federal overlay. These reports and their completion instructions are found on the CDBG website on the Forms and Reports webpage. The discussion below provides context on how these reports are used when implementing a BA program or OTC project activity.

<u>Note:</u> *The Department requires that all projects, BA program projects and ED OTC projects be reported to the Department using the CDBG Setup and Completion Report. To be reimbursed using the CDBG Funds Requests, for each project, the project has to be set up for funding. If the grantee does not submit the Setup Report a project Funds Request will be returned unpaid.*

To close out each project (project has expended all funds, the scope of work is complete and the National Objective has been met) the grantee will submit the Completion Report.

Both the Setup Report and Completion Report are within the same Excel workbook so the grantee may complete each section as appropriate.

Fiscal reports (limited to the CDBG Funds Requests and the Semi-annual Program Income Report) are required to be submitted regularly when the grantee requires reimbursement.

Performance reports are the Completion Report by project. Without a project Completion Report showing the project met a National Objective, the project cannot be closed in the federal reporting system (IDIS) and will require either a return of funds or a written explanation, with a timeline, or the expected date the project will meet a National Objective.

The BA Loan Certification Form is a minimum review process established by the Department to provide on-going BA project guidance to grantees. Project Certification Form must be signed by the grantee's Authorized Representative.

To document actual project compliance, the grantee is required to use the Departments BA Self-Certification of Income, which is on the chapter's webpage. It will also give the grantee the needed demographic information that must be reported on the Project Completion Report. This form does not have to be submitted to the Department, but must be in the project file to document the national objective standard of LMJ is met.

Federal Overlay Reporting for Projects:

Responsibility for ensuring full documentation of compliance with federal overlays rests with the grantee as the legal responsible entity for CDBG funds. If there are problems with a project's NEPA review or relocation plan, or payment of prevailing wages on a construction project, the Grantee is financially responsible for correcting any problems with compliance. Therefore, it is imperative the grantee be knowledgeable on the requirements of federal overlays to ensure documents are in compliance.

These federal overlays do require some reporting to the Department. For example, if a BA or ED OTC project requires an Environmental Assessment, the grantee is required to submit their project's environmental review record to the Department to provide a review and issue an Authority to Use Grant funds. If a BA project triggers relocation, the grantee must submit a relocation plan for Department review and approval. If a BA project triggers labor standards compliance, the grantee must send in documentation designating a labor standards officer, submit for federal wage determination, and report on wage compliance until the project is closed. These required federal overlay reporting requirements need to be planned for at the start of a BA program.

Project File Documentation:

Grantees must ensure documentation for all BA program activities and their associated costs are included in the clients' project files. All program applications must be retained; including funded and unfunded. All applications and project files are assumed to contain personal confidential information, so they must be kept in a secured locked space until they can be destroyed. All funded BA project files must contain all the documentation needed to verify compliance with all the CDBG statutes, regulations and Department policies in this Chapter.

Records must be maintained for a <u>minimum</u> of 5 years beyond the grant closeout between the Department and HUD.

The Department will inform grantees as each grant year is officially "closed" to allow the grantee to start its 5 year clock.

Additionally, the grantee must maintain their Public Binder, showing all required documents within that binder.

A grantee, when administering a BA program, must document and maintain records of the following:

- Each project/loan meets a CDBG "national objective";
- Payment of only CDBG-eligible program and project expenses;
- Compliance with all applicable federal overlay requirements triggered by each project funded; and
- Client files showing applicant information (whether assisted or not) and loan information.

Things to Consider

- A market analysis to establish need for CDBG BA program activity funds is a very useful tool in determining the amount of CDBG funds to provide to the program and the length of time the program should be operated. It should not be left on the shelf, but rather referenced, evaluated and updated.

- The market study will help to determine credit needs in grantee's target market so local underwriting standards can be set to a level that makes the funds accessible to eligible businesses.
- Regular program evaluation will improve desired program goals and objectives. Annual reviews and amendments to program guidelines may be needed in the early part of administering a BA program.
- Do your BA Loan Activities have an initial inquiry document required from the business to determine project eligibility early? Do your BA loan activities have applications clients must complete? Does the application(s) collect all the needed information? Do you track all submitted inquiries and applications? Do you maintain the file of those not funded? Do you assist clients on a first come, first serve basis? Do you evaluate the program annually to identify any groups in the community not being served (ethnic, women, disabled, second language, etc.)
- If any groups within the community are identified as not being served, be mindful and plan for adequate and successful recruitment of those specific groups and LMI residents.
- Do you have goals and outcomes associated with your Program? How do you measure the outcomes? A successful BA program will require periodic evaluation and adjustments.
- Grantees may apply for CDBG Enterprise Funds to implement both a BA program and Microenterprise program. Administration of both programs provides flexibility for potential applicants that may be eligible under one program, but not the other.