San Bernardino County loan program celebrates 20 years of success

BY THOMAS R. LAURIN

Twenty years ago, the County of San Bernardino won CSAC's Partnership Award for its innovative Business Expansion Revolving Loan Program (BusEx), which provides direct "gap" financing to creditworthy businesses expanding or relocating within the county. The program uses federal Community Development Block Grant (CDBG) funds to capitalize business-loans to for-profit enterprises for the express purpose of creating jobs for low- and moderate-income households.

Although a time-proven economic development tool for many larger city and county governments now, the concept of actually using local public dollars to lend directly to businesses was just emerging 20 years ago. With only two loans under its belt at that time, the program's only accomplishment was that the deals were "closed" and the businesses were in full operation, had hired additional employees and were making their first payments on time.

Since then, the BusEx Program has loaned more than $13 million and leveraged nearly $57 million in private funds to create or save approximately 1,300 jobs. This equates to a ratio of only $10,000 of CDBG funds per job as compared to a U.S. Department of Housing and Urban Development (HUD) program requirement of $35,000. Additionally, of the 1,300 jobs created or saved, 877 or 68 percent were filled by members of low- and moderate-income families.

San Bernardino County Board Chair Dennis Hansberger (left) with Glen Moss, owner of Moss Brothers Ford, Inc. The county provided a short-term loan to the company allowing a consolidation that retained and created jobs in the City of Colton.

How the program works

The program lends from $50,000 to $500,000 to creditworthy businesses at below market interest rates, with loan terms of typically 10 years, though amortization may be extended for up to 20 years, depending on the needs of the businesses. The business owner must demonstrate equity participation of not less than 10 percent of the total project cost, and at least 50 percent of the total loan package must be provided by private lenders and/or investors, with the county's BusEx program funding the remaining "gap." All loans are secured by real property, business assets and personal guarantees. In addition, all borrowers commit to the creation or retention of jobs at the ratio of at least one job per $35,000 of public funds injected, which justifies public purpose and accountability.

Today, the county's business lending activity has expanded into five direct loan programs ranging from $5,000 microloans to $20 million taxable bond financings of major developments. However, the BusEx Program was the county's first foray into public lending and remains its primary tool for business lending for job creation.

The Business Expansion Loan Program was originally capitalized by an annual injection of up to a million dollars until the

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program generated adequate program income to sustain growth and administrative costs. Due to the revolving nature of the BusEx program, the county has received payments and pay-offs totaling $12,349,329 in return for its loans of $4,667,815 in CDBG funds. The payments and loan payoffs are recorded as program income and provide capital for new loans, allowing the fund to realize almost a 3 to 1 return.

Why has the BusEx Program been successful?

The BusEx program has performed well overall due to several factors and policies to ensure consistency and stability. Some major determinants for a successful business financing — such as the general condition of the economy, product obsolescence and the business acumen of the borrower — are not within the county's power

In 1983, San Bernardino County won this CSAC Partnership Award for its innovative Business Expansion Revolving Loan Program (BusEx). Providing direct "gap" financing for business expansion or relocation, the program is still a success 20 years later.

to control. However, adhering to these time-tested guidelines listed below will more often than not result in a job producing public/private partnership:

- **Maintain focus on public purpose and benefit of loan program** — We never lost sight of our primary goal and objective, which was to increase employment for low- and moderate-income households and increase capital investment in the community.
- **Don't finance "start ups" or be a lender of last resort** — Lend to businesses with a proven track record and the ability to expand and create more jobs.
- **Conduct in-house credit analysis** — Ensure that current cash flow will equal or exceed projected debt service by analyzing their previous three years of financial statements, tax returns, payment schedules, receivables, personal and business credit reports.
- **Make loan decisions based on under-**

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writing results — Positive future growth projections and projected increases in returns should be expected on all prospective loans, but not used to make the basic lending decision.

• **Match sources and uses of funds** — Matching the term and amortization schedules of the loan repayment with the useful life of the asset provides the foundation for a strong loan portfolio.

• **Require owner equity injection** — Past experiences and recent surveys show that loan packages requiring the owner to participate through capital injection have a lower default rate, while also leveraging public funds.

• **Require private lending institution's participation in the loan package** — Including other non-public sources of financing adds another layer of review, leverages the public dollars and decreases the risk factors.

• **Review both personal and corporate income tax returns** — This review is especially important when public tax dollars are being used to capitalize the loan program.

• **Require sufficient collateral to secure loan** — Hopefully, the loan principle and interest will be repaid through the course of the term of the financing; however, being able to recover some portion of the loan goes a long way toward damage control, especially when public dollars are used. Always require current appraisals and maintain a loan to value ratio of less than .8 to 1.

• **Assign full-time staff and retain services of an attorney specializing in small business financing** — Their costs are paid for by the loan proceeds and program income and are absolutely necessary for a successful loan program. Proficiency in CDBG regulations and business credit analysis are a must for program staff, as is past experience in small business financing for the attorney.

• **Connect loan program to other county economic development activities** — Plan for and require connectivity of the loan program to your job training and employment programs, small business development centers, county vendor opportunities and redevelopment/base re-use programs if applicable in your area.

• **No raiding** — Any relocation of businesses from one jurisdic-

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How San Bernardino County measures up

Comparing County of San Bernardino figures to those recently published by the U.S. Department of Housing and Urban Development (HUD) from nationwide survey of similar loan programs:

Percent of Borrowers that met or exceeded their job creation or retention targets:
Nationwide: 56%
San Bernardino County: 61%

Government funds leveraged for each $1 CDBG loaned
Nationwide: $2.69 in private funds
San Bernardino County: $4.39 in private funds

Cost-per-job
Nationwide: $11,615
San Bernardino County: $10,202

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tion to another requires written approval from the top elected official from the original location prior to funding consideration. This is a sensitive issue for counties that have more than one cooperating city in their program.

• **Do not compete with private financial institutions** — Do not substitute public funds for private funds, instead leverage them to the program's benefit. Coordinate funding with them and take subordinate positions on loans and collateral. Once relationships with private lending institutions develop, they become leading advocates for the program and a major source of future loans and other business activities.

• **Confidentiality is a must** — A certain amount of information on a county's loan transactions will be part of the public record as they should be due to the tax dollars used for these programs. Besides the name/address of the participant, loan amount, terms, purpose and public benefit identification, the financial information, credit analysis and pro formas must be kept confidential and not released to the public.

• **"Relationship underwriting"** — Experience, integrity and character do count when lending public dollars to private businesses. Although these attributes are hard to quantify, visit the business site and spend time looking around trying to get a feel for the business and its operations before the loan decision is made.

Thorough underwriting keeps defaults low

A recent study has shown that California jurisdictions utilized three percent of their CDBG funds during the 1990s for economic development activities, the highest ratio nationwide. Third-party loans made up only 14 percent of that total — a higher percentage by far of any other state, but lower than one would expect taking into consideration the continuing financing needs of local small businesses. These overall figures reflect the complexity of operating a public lending program.

Those communities that have discontinued their financing programs report it was due to high rates of default. Default rates can be mitigated by a thorough credit analysis at the beginning of the review process and by requiring sufficient collateral to cover the public funds. In addition, should the business begin to reflect problems with payments, communicating with the borrower and providing technical assistance where necessary has proven invaluable in preserving the loan and the business.

The underwriting process reviews the previous three years of financial statements and tax returns, payment schedules, receivables, personal and business credit reports and additional pertinent information to assist the decision process. It is also important to ensure that all taxes have been paid and are current prior to lending of public funds. It is imperative that the borrower be informed of any discrepancies and findings. In many cases, the borrower is unaware of the financial issues of their operation.

The county works closely with borrowers, and when the first signs of problems arise, staff contacts the borrower, identifies the problems, refers technical assistance where necessary and provides workout solutions when appropriate. However, there are instances where no amount of assistance can save the company. In those cases, the only recourse is foreclosure on the collateral, and as a lender usually in the subordinate position, this can be expensive with no guaranty of full recovery. The benefits of business expansion and job growth, however, outweigh the risks.

Secondary markets possibilities

The county loan programs generate considerable cash flow and the county is exploring possibilities for selling these loans on the secondary market to raise additional capital for future loans. The county has found that maintaining standardized underwriting criteria and reliable information on loan performance is necessary to ensure investor interest in the purchase of these loans. However, deep discounts of the loan value and loss of local control to "work out" a repayment plan for businesses experiencing short-term problems may outweigh the benefits of infusing the loan program with additional capital.

In closing, policy direction from your county board of supervisors is crucial for public involvement in areas historically

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San Bernardino County

Profiles of Recent Program Loans

BUSINESS EXPANSION LOAN
Borrower: Manufacturing Company
City: Town of Yucca Valley
Service/Product: Manufacturer of custom-designed office and residential furnishings
Background: Company had outgrown capacity at its original site and needed to expand to accommodate growth in sales and employees. Total project was worth $1.5 million. The owner had injected 28 percent equity during the past year, he had obtained an SBA loan and the property seller was carrying the note on the property. However, there remained a gap in financing and the borrower was unable to obtain financing through conventional resources. Based on the county's analysis, this was a strong company and there was adequate equity remaining. However, the security was in a junior position, and therefore, not attractive to conventional sources. The expansion project has been completed, and the borrower has created 20 new, well-paying positions as the business has expanded.

BUSINESS EXPANSION LOAN
Borrower: Manufacturing Company
City: San Bernardino
Service/Product: Manufacturer's post-press handling equipment
Background: The original owners had contemplated closing the facility and relocating to another state. The business manager at this facility offered to purchase the business and retain its current location. The county was part of the $6.7 million financing package, in coordination with the City of San Bernardino, investors and a bank. This project was able to retain a manufacturing facility in the city and save 52 well-paying jobs. The company has also created an additional 10 positions as the business expanded, has used the job placement services of the county and enjoyed the benefits of state employment tax credits.

BUSINESS EXPANSION LOAN
Borrower: Automobile Repair Business
City: Barstow
Service/Product: Automotive collision repair business and auto detailing
Background: Having outgrown its original location, the borrower required affordable financing to purchase a larger facility, purchase equipment and inventory, and for working capital. After a thorough credit analysis, a loan for $316,000 was structured using 10 percent owner equity, 30 percent Grow America Funds and 60 percent County BusEx funds. Lower debt service payments have allowed the business to expand and have created 21 new jobs.

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reserved for the private sector. There must be a clear purpose and public benefit that is readily identifiable to their constituents. A well-trained professional staff working in cooperation with the area's financial institutions will go a long way toward successful and productive "partnerships" with growing businesses in your county. Â

Thomas Laurin is director of the Department of Economic and Community Development for San Bernardino County. He has worked for the county for 25 years and is a past National Association of Counties (NACo) Board of Director and past president of NACCED (National Association for County Community and Economic Development), an affiliate of NACo.