

CHAPTER 5

Revolving Loan Fund Administration

(CDAP RLF)

SECTION 1

Executive Summary

The Illinois Department of Commerce and Community Affairs (DCCA) administers the Community Development Assistance Program (CDAP). Through the economic development component of (CDAP), grants are awarded to units of local government on behalf of businesses either for infrastructure improvements in support of a business or as a loan to the business for machinery and equipment, building construction and renovation, or working capital. When the loan is repaid to the local government, a revolving loan fund is created. The first eligible use of a CDAP RLF is that funds can be used as a loan to companies to encourage investment and job creation/retention. Local governments, utilizing CDAP-RLF loan proceeds, may lend to for-profit and not-for-profit businesses. The second eligible use of these recaptured funds is that local governments may construct public infrastructure improvements that directly support private capital investment and job creation from identifiable, non-speculative projects.

For practical purposes, both loans and infrastructure construction will be described here as uses of a CDAP RLF. There are two reasons for this. The first is for fund accounting purposes. In order to track job creation and investment and meet a periodic reporting requirement, the local government is required by the State of Illinois to segregate from its General Fund the recaptured principal and interest from both original CDAP loans and follow-up RLF lending. Consequently, both loans and public infrastructure expenditures must come from the same fund. The second reason is that local governments often include both RLF lending and public infrastructure construction that supports economic development in the CDAP recapture strategies which the State requires them to prepare.

A. Purpose of the CDAP RLF

1. CDAP RLF lending is intended to increase capital availability to projects that create/retain jobs by spreading the risk among lenders and by reducing the cost of capital to the borrower. CDAP RLF participation may overcome the reluctance of private bankers to participate in a project where they see some risk. CDAP RLF lending, typically set at a below-market interest rate, also can be good for borrowers because it will reduce their debt service and increase cash flow availability for other

business purposes. In most instances, CDAP RLF funds "fill the gap" between project costs and conventional financing.

To ensure that CDAP RLF use is necessary, DCCA expects the RLF administrator to put in place procedures which ensure that its funds will not be used to substantially reduce the amount of non-RLF financial support for the project. The RLF administrator is expected to conduct a financial analysis of the project, including review of the appropriate projections of revenue, expenses, debt service and return on equity investments. The extent of the review must be appropriate for the size and complexity of the project and use industry standards for similar projects, taking into account the unique factors of the project such as risk and location. To the extent practicable, the RLF assisted activity shall not provide more than a reasonable return on investment to the owner of the assisted project.

2. CDAP RLF lending is intended to retain/create jobs that benefit persons who have been in low-to-moderate income circumstances.

3. **A Short Example of CDAP RLF Lending**

Bankers tend to have quite conservative tests of collateral and debt service adequacy that sometimes lead to denying loans for good projects. CDAP RLF participation can turn those situations into bankable deals. An example would be as follows: A small manufacturer wants to buy \$200,000 worth of equipment. The local bank from which the manufacturer is seeking the financing determines that the company's debt repayment ability and available collateral do not meet bank standards. The bank is, therefore, only willing to lend \$150,000 or 75 percent of the project's cost. Local CDAP revolving loan funds of \$50,000, however, "fill the gap" between available conventional financing and project costs.

As this example suggests, CDAP RLF will be somewhat more risk-oriented than private bank lenders, but it is this factor that often helps to close deals. The risks can be minimized if the CDAP RLF lender negotiates a first security interest for the collateral position.

B. Programmatic Requirements for Operating a CDAP RLF

1. **The Recapture Strategy**

A Recapture Strategy is required for all original CDAP grants that involve economic development loans. The Recapture Strategy outlines the detailed policies and procedures of RLF use. The Recapture Strategy must be approved by DCCA. The strategy states RLF goals and objectives, outlines a strategy for achieving them, develops a RLF management plan, and provides assurances that the local government

will not exceed a specified percentage of RLF program income (10 percent) for administrative purposes, and that all loans entered into will result in at least 51 percent benefit to persons of low-to-moderate income (LMI).

In this section are DCCA's recommended components for a recapture strategy (Appendix 5-1-A) together with a sample recapture strategy (Appendix 5-1-B).

2. **Reporting Requirements**

CDAP RLFs must submit to DCCA on a semi-annual basis a standard report on the status of every outstanding loan and the use of RLF program income for loan administration purposes (Appendix 5-1-C).

3. **Title I Requirements**

Title I refers to the federal requirements which generally apply to all RLFs, though not necessarily to every loan that is made by an individual RLF.

Any program income that DCCA has permitted a grantee to retain and that is realized while the grantee has an open CDAP grant is subject to the requirements of the Housing and Community Development Act of 1974 and 24 CFR 570.

Program income retained by the grantee and generated from a grant award prior to October 28, 1992 is not subject to Title I requirements under the following conditions:

- The program income was earned after the CDAP grant which generated the program income is closed.
- All concurrent CDAP grants were closed at the time the program income was earned. This includes public facilities, removal of architectural barriers, planning, economic development, etc.

Program income retained by the grantee and generated from a grant awarded after October 28, 1992 is subject to Title I.

If the grantee's CDAP grant records are not sufficient to determine when program income was earned in relation to close-out of the grantee's CDAP projects, those RLF funds shall be considered subject to the Act.

Regardless of when the program income is earned, the RLF shall always be subject to the requirements of the approved Recapture Strategy, and each beneficiary of funds through the RLF shall benefit at least 51 percent low-to-moderate income persons.

In cases where Title I applies, there is an environmental review requirement to be met. Before the CDAP RLF loan closes, the following steps must be completed: preparation of an environmental review for the entire project; concurrence with its findings received from specified state agencies; public legal notice given that the project poses no threat to the environment; followed by 15 days for local public comment. This process will require at least 45 days to complete. In addition, no monies other than administrative may be spent on the project until the environmental review is substantially complete.

In cases where Title I applies, any construction work that is to be funded in whole or in part with a CDAP RLF loan will be subject to the federal prevailing wage (Davis-Bacon and Related Acts).

Where loans are subject to Title I, a longer time frame to loan closing, a greater expense in loan administration, and other factors will apply.

C. Basic Rules of Thumb of CDAP RLF Lending

1. CDAP RLF may provide no more than 50 percent of the overall project, exclusive of any refinancing of existing bank debt.
2. The amount lent by an RLF may not exceed the current DCCA limit of \$10,000 loaned for every full-time-equivalent (FTE) job created / retained by the project.
3. No speculative project financing (jobs must be created or retained in a timely manner as a result of RLF investment in a specific, identifiable project).
4. At least 51 percent of the jobs created or retained as a result of the project must meet the U.S. Department of Housing and Urban Development (HUD) Section 8 family income guidelines (**Section 4**). These are published annually and indexed by county. Currently applicable Section 8 guidelines may be found in DCCA's CDAP grant application package for the current program year.
5. When a community with an existing RLF applies to DCCA for a new CDAP economic development grant, their grant request will be reduced by the amount of the balance of the fund. It is therefore advantageous to the community to substantially draw down their fund (make several loans) prior to submitting their new application, or plan to contribute the local balance to the project.

D. Designing, Organizing and Operating the RLF

Section 3 of this chapter summarizes organizational and operational matters. For a detailed guide to the “nuts and bolts” of RLF portfolios, see Appendix

5-3-A, CDAP Revolving Loan Checklist, Appendix 5-3-D, CDAP Revolving Loan Documents (particularly the Introduction section), and Section 5, State Regulations Governing CDAP Capitalized Revolving Loan Funds.

SECTION 2

Programmatic Requirements

A. National Goals and Objectives of the CDAP RLF Program

CDAP RLF lending is governed by the May 19, 1987 HUD memorandum on necessary or appropriate use of federally originated funds in conformity with a national objective determination. Put simply, the national objective of CDAP RLFs is to assist in building the financial and operational capacity of communities to carry out local economic development in ways that will expand economic opportunity, primarily for persons from low-to-moderate income households. In making a determination of the appropriateness of CDAP RLF assistance, it is helpful to review the request in terms of the following three types of financing needs:

1. Gap Financing

The business can raise only a portion of the financing necessary to complete a project.

2. Locational

When a business is considering multi-state location options, CDAP RLF may be used to equalize cost factor variations between sites.

3. Rate of Return

If a developer's rate of return on a project is inadequate, CDAP RLF may be used to finance a portion of the project in order to induce development to proceed.

B. The RLF Recapture Strategy Must Reflect the National Goals and Objectives

The recapture plan must contain these elements:

1. CDAP RLF Goals and Objectives

Goals and objectives should address the improvement of the community's economic base, the need to encourage investment in job creation, and the intent of the community to target businesses that have some potential for

improving the economic circumstances of persons of low-to-moderate income.

2. RLF Strategy

Achieving those goals requires a strategy. This should address: the description of the eligible uses of the RLF funds; the geographic area within which the funds will be loaned; and a statement of how funds will be targeted. For example, a strategy could target (either singly or multiply) the retention of traditional industrial base, start-up firms, technology-oriented firms, etc.

3. An Example of a CDAP RLF Recapture Strategy

DCCA's recommendations for the components of a good sample recapture strategy are found in Appendix 5-1-A.

C. Eligible Uses of the CDAP RLF

Use of CDAP RLF funds must meet the following requirements. Note also these requirements will not necessarily apply to RLF funds from non-CDAP sources such as U.S. Economic Development Administration (EDA) or U.S. Dept. of Health and Human Services (HHS).

1. CDAP RLF funds can always be used within the grantee local government's jurisdictional area. The RLF community may use these funds in other non-entitlement areas provided you can prove there is a benefit to the RLF community.
2. Eligible loan activities include loans for the start-up and expansion or retention of private, for-profit or not-for-profit businesses. Generally, businesses relocating jobs from one area of the State of Illinois to another are not eligible for CDAP RLF funds. The exception would be a business whose *only* choice is moving to another location within the state, or moving to an out-of-state location, or going out of business. This would require some supporting documentation.
3. Eligible public infrastructure improvements must directly result in job creation/retention. RLF funds may not be used for speculative developments.
4. When a community with an existing RLF applies for a new Economic Development CDAP, the request will be reduced by the amount of the balance of the fund. It is therefore advantageous to the community to substantially draw down its fund (make several loans) prior to submitting the new application, or plan to contribute the local balance to the project.

D. Job Creation Time Frame

Job creation attributable to RLF funds generally should take place within 12 months.

E. Minimum RLF Leverage Ratio

1. Each RLF funded project should create or retain at least one full-time equivalent (FTE) job for every \$10,000 of RLF investment (up to a maximum loan amount set in the recapture strategy). Note: A full-time equivalent job (FTE) is an employee or combination of employees who work 1,950 hours/year.
2. RLF funds should in no case exceed 50 percent of the overall permanent financing (i.e., cash equity plus term debt financing) for projects, excluding any refinancing.

F. Limit on Use of RLF Funds for Administration

RLF funds may be used for necessary administrative costs of the RLF, but not for general marketing activities nor for the costs of preparing new CDAP applications. Grantees may expend up to 10 percent of the income (e.g., CDAP principal and interest repayments, RLF loan principal and interest repayments, and bank interest) received each calendar year for administrative expenses. Costs must be documented through timesheets, invoices, receipts, etc. To determine the amount eligible for administrative expenses, the CDAP RLF administrator should figure the annual revenue of the fund. Up to 10 percent of the revenue may be used.

G. Financial, Programmatic, and Compliance Recordkeeping Requirements

CDAP RLF administrators must maintain all records of financial, programmatic and compliance activities. All loan review documents must be maintained on file by the grantee.

CDAP RLF reports must be submitted to DCCA on a bi-annual basis, July 15th and January 15th.

H. Low-to-Moderate Income Determination Compliance Requirements

Both loan applications and loan agreements must address the 51 percent low-to-moderate income (LMI) requirement. For projects involving job creation, the employer can meet the requirement either through JTPA hiring or through using the employee income certification form (See Appendix 5-2-A). For job retention projects, prior to the disbursement of RLF funds, the employer must submit completed employee certification forms showing that the 51 percent LMI requirement has been met (See Appendix 5-2-B). LMI benefit is determined from HUD Section 8 income guidelines for Illinois counties, which can be found in the

most current CDAP grant application guidelines. **Note:** since these income figures change annually, the RLF administrator should update the income certification form each year from the current HUD guidelines contained in the most current CDAP application guidebook.

As a practical matter, the business of securing completed employee income certification forms can be handled most efficiently if the employer follows this procedure. First, the employer tells employees the purpose of the income certification. Second, the employees complete and return the certification forms in blank sealed envelopes that the company will not open. Third, the forms are opened and tabulated by the RLF administrator under the proviso that the information on individuals will be kept fully confidential by the RLF administrator and DCCA.

I. Documentation of Appropriateness

There are many different situations when RLF assistance is appropriate, from the need of a community to offer financial incentives to forestall the planned relocation of a company (and its jobs), to the need of a company to secure additional financing of a project where the bank lender is unwilling to extend the full amount. In the first instance, the RLF loan would provide incentive financing; in the second instance, gap financing. There will be less extreme cases in between as well.

For any given loan request, it is the responsibility of the RLF administrator to make a determination that assistance is appropriate. This determination should be reflected in the loan memorandum that typically leads up to the actual credit decision. Also, the determination to loan or grant RLF funds needs to be prudent and to be based on full information concerning a project. With respect to RLF lending, this includes both the way the credit decision is made and the documentation required of the loan client.

In CDAP RLF lending, sometimes the actual credit decision is made by legislative resolution of the city council, village board, township board, or county board. In this context, there should be some staff capability in financial analysis. Another review alternative is the establishment of a separate loan review committee (preferably with some private sector banking representation) that makes a credit recommendation to the local legislative body, or has been delegated the responsibility to make the final credit decision. While bank loans are required to be made “at arms length,” the amount of information CDAP RLF requires of a loan client sometimes will exceed the information required by some bank lenders as banks know their local customers’ businesses. For CDAP RLF to make the credit decision, DCCA requires the RLF to have complete historical financial information on the company plus performance information. The required documentation for credit analysis will be addressed in Section 3.

J. Monitoring of RLF Activity

DCCA will monitor RLF programs using on-site visits, progress reports submitted by the grantee, monitoring findings, disbursement transactions, and other contact with the grantee as necessary. Although many grantees will be subcontracting RLF administration to a local bank or regional planning commission (RPC) or similar organization to track RLF finances, the grantee ultimately is responsible for the actions, compliance and record keeping of its administrator. The RLF administrator should perform, minimally, a semi-annual visit to each borrower to verify job certifications, information on low-to-moderate income percentages, documentation of cost/expenditures, etc. before closing out a project (See Appendix 5-3-A for RLF Monitoring Checklist).

K. When Title I Applies to the RLF

Areas subject to Title I include compliance with specified project environmental review procedures as well as compliance with the federal prevailing wage on construction and the installation of equipment funded by CDAP RLF. **Title I may not apply to all CDAP RLF lending, but it is extremely important to know when it does apply.**

Title I requirements will apply to CDAP RLF's under certain conditions. **All CDAP RLF lending made from original grant funds awarded prior to October 28, 1992 is exempt from the requirements described here, providing the loans are made with program income obtained by the community after the grant was closed out and all concurrent CDAPs were closed out (i.e. no contractual relationship existed between the community and DCCA at the time the program income was earned). All CDAP RLF lending made from grant funds awarded after October 28, 1992 is subject to these requirements.** Where an RLF has both loans not subject to Title I and loans subject to Title I, Illinois DCCA will require it to maintain two separate fund accounts, one for Title I loans, the other for loans not subject to Title I.

L. Environmental Review Procedural Requirements When Title I Applies

Where Title I compliance is required, CDAP RLF environmental clearance procedures duplicate the environmental review requirements outlined in Chapter 2, Section 1. You will be required to follow those procedures carefully.

M. Compliance with the Federal Prevailing Wage When Title I Applies

If the CDAP RLF funds are subject to Title I and the RLF proposes to fund the construction of a new physical plant or the acquisition of machinery requiring installation by craft workers, the federal prevailing wage will apply (Davis-Bacon and Related Acts). In this circumstance, the RLF administrator must comply with the federal labor standards requirements as set forth in the CDAP Grants Management Handbook, Chapter 2, Section 3. These include securing

contractor certifications, conducting job site interviews to determine compliance with the federal prevailing wage, and maintaining the contractor's certified payrolls in the RLF project file.

The above requirements are also detailed in Appendix 5-5-A, (State Regulations Governing CDAP RLFs).

CHAPTER 5

PROGRAMMATIC REQUIREMENTS APPENDICES

Appendix

Employee Income Certification Form - Job Creation	5-2-A
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Employee Income Certification Form - Job Retention	5-2-B
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EMPLOYEE INCOME CERTIFICATION

Please refer to the following web-site to retrieve the latest edition of the Employee Income Certification forms and instructions for HUD Income Limit Retrieval.

http://www.illinoisbiz.biz/dceo/Bureaus/Community_Development/Community+Programs/RLF.htm

RF Report Forms

[Employee Income Certification](#)
[HUD Income Limit Retrieval](#)

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