MINIMUM UNDERWRITING STANDARDS

CDBG funds that are intended to be used for economic development financing must meet basic minimum underwriting standards that are based on the following criteria:

- HUD minimum standards for investments
- Business loan underwriting standards

CDBG funds are investments made by the public and as a result carries with them unique requirements and expectations that reflect a defined public policy value.

As a result, the statewide minimum standards defined in this document are used to evaluate all CDBG economic development investments.

These standards are constructed to provide regional underwriting autonomy at a local level while maintaining a statewide minimum standard.

HUD MINIMUM STANDARDS FOR INVESTMENTS

The Grantee is required to complete underwriting that proves the following guidelines as stated in HUD CFR 570.482 Appendix A, specifically that:

(i) That project costs are reasonable;

(ii) That all sources of project financing are committed;

(iii) That to the extent practicable, CDBG funds are not substituted for non-Federal financial support;

(iv) That the project is financially feasible;

(v) That the return on the owner's equity investment will not be unreasonably high; and

(vi) CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

The Grantee will determine that the project meets the above-mentioned standards using the following specifications about the minimum standards:

(i) Project Costs Are Reasonable

Review the project budget including detailed sources and uses of funds. If the budget is overinflated, there may be a waste of scarce public resources and a surplus can end up as an additional fee to a developer or entrepreneur; and conversely, if the budget is understated, the success of the project may be affected, which could reduce the income available for debt service. To determine whether the costs are reasonable the Grantee should compare the applicant's proposal with costs of comparable projects and industry standards.

(ii) Sources are Committed

HCD wants to avoid the risk of approving and disbursing funds to fund a portion of the project without sufficient funds from other sources to complete the development. Therefore, the Grantee must prove that all other sources of funds need to be in place prior to application.

(iii) CDBG Funds are Not Substituted for Non-Federal Funds

The Grantee needs to establish the need for public investment by,

- Demonstrating the owners limited personal equity,
- Demonstrating that a bank or private financing institution has reached their lending limit to the project or will not lend to the project.

(iv) Project Feasibility

The project or venture should be viable with the CDBG investment. The project should be able to achieve a level of operation that is successful in the near and long term. The project should provide sufficient cash flow to repay debt and provide a reasonable ROR on equity invested. Feasibility is a threshold, because an infeasible project will be unable to repay the public investment, or meet the community development objectives if the business fails or is foreclosed upon. Determination of feasibility requires an understanding of the industry, and the ability to test various assumptions about operations. Grantee's need to be concerned that the venture remains feasible or viable for at least the term of the loan.

(v) Owner's Equity Return is Reasonable

An owner strives to receive a market-rate ROR on their project. This varies by market and type of venture. However, the ROR should be reasonable given the equity invested and risk taken. Generally, the greater the risk the higher the ROR demanded. So ventures need to be examined in comparison to similar ventures in similar regions. For real estate ventures, the return on equity should come from cash flow of the project, not a developer's fee or other borrowed funds. Repayment terms are consistent with the use of funds and based on a proper financial structure.

(vi) CDBG Funds Disbursed Pro Rata

CDBG funds should be disbursed in proportion to the percentage of the project they fund. One exception is where CDBG funds are allocated for an acquisition activity. The Grantee should prepare a draft disbursement plan.

The Grantee will be required to summarize each of their calculations/ determinations of the HUD minimum standards in the Grantee underwriting summary.

BUSINESS LOAN UNDERWRITING STANDARDS

The Grantee will collect information to determine that the project and owner meet the above-mentioned standards:

INCOME

- Owner/s must provide 3 years demonstrated history
  3 years of historical financial statements including income statement, balance sheet & cash flow statements. In the case of a start-up enterprise provide pro-forma balance sheet at time of funding as well as projected income statement and cash flow statement for at least the first 2 years.

  - Detail of existing debt (payments, rate, term, collateral, etc.) to determine debt capacity

  - Debt Coverage Ratio = Cash Flow Available for Debt Service / Debt Service
    - Minimum DCR of 1.25 before investment of CDBG
    - Minimum DCR of 1.05 after investment of CDBG

BORROWERS CREDIT HISTORY AND ANALYSIS

- Dun and Bradstreet minimum score

- Review and analyze creditworthiness of owner by reviewing the credit report of the owner and/or developer
  The owner must have a minimum credit score of 650 to be eligible for financing.

- Evaluate project and company's strengths and weaknesses

- Borrowers/Guarantors Personal Financial Statement (PFS)- Attachment A

- Income Tax Returns – 3 years personal and business returns (if applicable)

- Review of other business entities to determine that the other entities will not have adverse effect on the owner's ability to meet company's obligations.

BUSINESS PLAN AND PROJECTIONS REVIEW

- Obtain 3 years of historical and/or projected financial statements

- Profit and Loss statement, Accounts receivable and payable aging analysis

  The financial statements must be sound before a loan is made. Soundness is determined by using the credit indicator checklist, attachment B. An average score above 1.5 on the credit indicator checklist is the minimum standard.

- Minimum of 24 Month Projected Cash Flow statements to analyze cash flow management

DEAL STRUCTURING REVIEW

- Full detailed business plan review for feasibility

  Plan must include a market analysis

- Review of Sources & Uses of Funds

  The reviewer has already determined above that the sources and uses of funds are reasonable. Use this section to analyze the risks associated with the sources and uses of funds. Ask questions such as,

  - Do any of the funding sources have specific criteria that will difficult for the project to meet?
  - Are there any funding sources that the reviewer does not have history working with?

- Review of project readiness
  - Proof of zoning and planning approvals (required)
  - Permit status
  - Construction cost analysis

- Review of project team

  The project must have an experienced management team must have experience in all areas of running the business: sales, finance, operations, personnel, etc. The management team includes the principals, directors, senior management, and consultants.

  If this is a construction project, confirm that there is appropriate oversight of construction and budget.

- Review of proposed loan Collateral by calculating a loan-to- value (LTV)

  LTV ratios will vary as to the nature of the asset being financed. Provide information on the ratios the review used and justify. The following are generally accepted loan-to-value standards (maximums):

Real Estate	80%
Machinery & Equipment	50-75%
Inventory	50-60%
Receivables	75%

- Review of ability of borrower to provide personal guarantee

  A guarantee should be provided by all owners with more than 20% ownership interest in company. The guarantees should be "unlimited" (i.e. guaranteeing full repayment of the loan, irrespective of percentage of ownership or personal net worth).

  Net Worth should be Analyzed and determined to be adequate.

Break even analysis