Chapter 3
CDBG Loan Program

Introduction
This chapter describes the CDBG Loan Program (CLP), and outlines the specific requirements that apply to it. While activities supported through the CLP must follow all of the basic CDBG rules described in the other chapters of this manual, CLP activities are also subject to a number of special requirements. The MEDC has developed specific policies and protocols for the operation of a CLP. These policies are outlined in this chapter.

The intended purpose of the CLP is to provide loans to eligible small businesses, or UGLGs, to meet a National Objective by either creating job opportunities for Low to Moderate Income (LMI) individuals, or funding the rehabilitation or emergency repair of LMI homeowner occupied, single family residential units. As such, the use of proceeds of the loans should fall into the following categories:

1. Financing and/or refinancing of real property occupied by a small business where the definition of “occupied” and “small business” meet federal Small Business Administration defined standards.

2. Financing and/or refinancing of equipment used for business purposes.

3. Financing and/or refinancing of inventory and receivables.

4. Financing of working capital, including costs associated with activities such as engineering, sales, leasehold improvements, installation expenses, technology acquisition and enhancement activities, etc.

5. Financing and/or refinancing of debt used to exit or transition ownership into or out of the company.

6. Financing the rehabilitation and/or emergency repair of owner occupied, single family residential units via the Housing Emergency Loan Program (HELP). See HELP Overview (Form 3-A) and HELP Loan Exhibit and Program Guidelines, (Form 3-B).

Types of CDBG Loan Funds

CDBG Revolving Loan Fund (CRLF): A community that has entered into First Restated Grant Agreement with the MSF, and is administering its CDBG RLF locally.

CDBG Loan Fund (CLF): A community that has entered into a Subrecipient Agreement with a Regional Loan Fund Administrator, and has sub-granted its program income.

Regional Loan Fund Administrator (RLFA): A MSF designated non-profit lender that has entered into a Repaid Funds Agreement, and is administering program income sub-granted by CDBG Loan Funds.

All of the above types of Funds are required to follow CDBG Laws, Rules, Policies and the content of this manual and specifically of this chapter.
Section 1 – CDBG Loan Fund Requirements

Special Conditions for CLPs
As noted previously, federal law places restrictions on the use of CDBG funds, which also apply to all CLP activities. In addition, the MEDC has instituted the following additional restrictions on CLP Funds:

1. Program funds may not be a grant under any circumstances.
2. Program funds may not provide assistance to a borrower or project while that business or any other business concern owned by the same person(s) or entity(ies) is the subject of unresolved findings of non-compliance related to previous CDBG assistance.
3. Program funds may not be used for the construction of new housing unless it is part of a mixed use redevelopment project.
4. Program funds may not be used for political activities.
5. Program funds may not be used for the general promotion of a community.
6. Program funds may not be used to pay for obligations which are general fund obligations of a UGL.
7. Program funds may not be used on any speculative project. Speculative means a project for which an end user meeting the job creation National Objective has not been identified.

Special Restrictions on Passive Real Estate
The program defines Passive Real Estate (PRE) as a facility that is less than 51% occupied, based on leasable non-common area square feet, by a company whose ownership is related. Related ownership means a corporation or individual who owns at least a 20% interest in both a real estate holding company and an occupying tenant.

PRE projects will not become a majority (defined as 51% of all loan outstanding's measured at the time of issue of the PRE loan) of a CLP portfolio.

The MEDC desires to provide flexibility in this area, but reserves the right to restrict, through administrative notification, the ability of an CLP Fund to underwrite PRE transactions.

Limitations on Loans to Instrumentalities of Government
Downtown Development Authorities, Local Development Finance Authorities and other similar government entities are permitted to obtain a loan, provided:

- The risk is prudent.
- The project is non-speculative.
- The loan is secured by the assets being financed.

Special Conditions for Loans for Public Infrastructure
At times it may be appropriate for projects meeting National Objectives which require public infrastructure to be provided CDBG funds in the form of a loan rather than in the form of a grant. An UGL, or an instrumentality of local government, may be the borrower. Such an entity must agree to all potential recourse should the project fail to meet a National Objective, in the determination of the MEDC. Such loans are subject to the approval of a CRLF or RLFA.
CDBG Project Close-Out
Notwithstanding any other guidance offered in this manual, this section discusses the process for closing a CDBG Project when it is connected to a loan. Borrowers receiving CDBG dollars have two main obligations (i) a financial obligation to repay the lender and (ii) a project performance obligation to the program which requires the borrower to meet a National Objective. A CRLF or RLFA must complete a close-out package, containing the following forms:

- Final Progress Report (Form 1-A)
- Final Job Creation Summary Report, if applicable (Form 2-C)
- Related Income Certification Forms
- Verification of the “Use of Funds”
- Documentation that funds were spent according to project approval (included in the Loan Approval Memo)
- Verification that the Closeout Public Hearing was held
- Copy of the public hearing notice
- Brief description of the public hearing

Once the required information is submitted and deemed complete, the Loan Program Specialist will complete the Closeout Review Worksheet, and email the final National Objective Closeout Letter to the RLFA or CLF. The Fund should keep the National Objective Closeout Letter with the project file as confirmation of National Objective attainment, and overall project success. The RLFA or CLF would continue to record repayments and include them in the quarterly financial reporting until the loan has been paid off.

Failure to Meet National Objective
If a project fails to demonstrate that it has met or made satisfactory progress toward meeting a National Objective, the project will undergo a formal review by the U.S. Department of Housing and Urban Development (HUD). If the project was appropriately underwritten, documented and managed, and it is determined by HUD that the project as underwritten had a reasonable chance of meeting the intended National Objective, then the project may be declared a failed project without repayment and the project obligations may be written off.

If it is determined that the project was improperly underwritten or could not have been reasonably expected to meet a National Objective at the time the loan was made, then the loan must be repaid. The UGLG, which is the original grantee, is the obligor under this recourse event. The UGLG may look to the RFLA as a sub-recipient. However, for purposes of the MSF, recourse will be required of the UGLG.

Obligations of the Borrower
Notwithstanding obligations of the UGLG and Fund related to the attainment of a National Objective, the success or failure of a project does not supersede or stand still the legal obligations of the note, loan agreement, guarantee agreement or any other financial instrument in place between the CLP and the borrower. In the event of a failed project, then borrowers are obligated to make all repayments per the loan agreement.

Reporting
Funds are required to complete financial accounting reports on a quarterly basis. Such reports will be supplied by the program in an electronic format and may be submitted electronically. Both RLFAs and CRLFs are required to submit quarterly reporting through the Portal.

Additional reporting required of all projects that receive CDBG funding may also be needed. Such other reporting is described throughout the GAM.
Items included on Required Reports include but are not limited to:

- Origination date, amount, purpose or use of proceeds, interest rate, term, amortization, fees charged and collected, borrower’s name and address, contact information, collateral or security, projected number of jobs, actual jobs, cash balance of the Fund, outstanding’s of the Fund, transactions in process, and the status of the existing loan portfolio.

**Administrative Expenses**

The use of CDBG Funds to reimburse for reasonable and allowable administrative expenses is governed by HUD and the MSF, and is described in detail throughout this Manual. Notwithstanding any state or federal law or administrative policy, the allowance for and use of CDBG Funds for the reimbursement of administrative expenses by a Regional, Local, or Regionalized Fund is provided as follows:

**Regional Loan Fund Administrators**

1. **18% of the initial amount of local program income entered into IDIS in June 2013 (minus approved UGLG administrative costs disbursements). May be drawn upon until June 2018.**

2. **8% of the program income generated by an CLF’s loan portfolio sub-granted to the RFLA. All draws must be completed within 2 years of the end of the Program Year that generated the program income.**

3. If a draw is not taken within the guidelines outlined above, the original amount allocated will be returned to the general RLFA account and made available to the to relend under the Subrecipient Agreement.

   The RLFA will need to provide a separate reimbursement request for each CLF for which administrative costs were incurred.

   For administrative costs incurred by the RFLA that are not attributable to any one CLF, it will be at the discretion of the RLFA to determine the breakdown of costs incurred per CLF, and include those costs in the appropriate reimbursement request.

4. No loan application or closing fees can be charged to a borrower on a CDBG Loan program loan.

**CDBG Revolving Loan Funds**

1. **18% of the program income generated by a CRLF’s loan portfolio:**
   - *Must have taken a draw within 1 year of entry, or allocated amount returned to RLF account.*
   - *All draws must be completed within 2 years of the end of the Program Year which generated the program income.*

2. If a draw is not taken within the guidelines outlined above, the original amount allocated will be returned to the general account and made available to the CRLF to relend under the First Restated Grant Agreement.

3. All funds generated by a CRLF are considered program income.

4. No loan application or closing fees can be charged to a borrower on a CDBG Loan program loan.
CDBG Loan Funds
1. None of the program income generated by an outstanding loan portfolio can be used to reimburse administrative costs.

2. All program income generated by an existing loan portfolio after July 1, 2015 will need to be sub-granted to the RLFA.

Quarterly Reimbursement Requests
All reimbursement requests need to be submitted quarterly in order to be considered for approval, and are based on when the costs were incurred, see below:

<table>
<thead>
<tr>
<th>Costs Incurred Between</th>
<th>Reimbursement Request Submitted By</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1 - March 31</td>
<td>April 30</td>
</tr>
<tr>
<td>April 1 – June 30</td>
<td>July 30</td>
</tr>
<tr>
<td>July 1 – September 30</td>
<td>October 30</td>
</tr>
<tr>
<td>October 1 – December 31</td>
<td>January 30</td>
</tr>
</tbody>
</table>

On-going Loan Servicing and Portfolio Management
In addition to the reimbursable activities listed above, a RLFA may elect to allocate the interest income generated by 2% of the standard interest rate charged per CDBG loan it issues on an annual basis for the term of the loan, pursuant to the terms of the loan agreement. The remaining interest income generated will be treated as principle and made available to relend under the Repaid Funds Agreement.

This interest income generated is to be used by the RLFA to offset loan servicing costs associated with its loan portfolio management costs.

Loan Approval Committee Composition
As provided in the RFA for Regional Loan Fund Administrators, below are the composition requirements for Loan Approval Committees which will operate at the RLFA Level. The committee must be comprised of no less than 5 individuals with the following attributes:

1. One **attorney** with experience in the practice of providing legal advice related to loans and lending;

2. One individual who has in the past or who is currently engaged in the business of **commercial banking**;

3. At least one individual engaged in the professional practice of **economic or community development** for at least 5 years;

4. One seat shall be provided for an **elected local community representative** from where the loan project is located which participant shall change for each loan considered based upon the location of the project under consideration; and

5. One seat shall be provided for an **economic development professional** active in the geographic area where the loan project is located that is selected by the local community representative who is part of the Loan Approval Committee. This participant will also change for each loan considered based upon the location of the project under consideration.
Additionally, the **MSF shall have one non-voting seat** on the Loan Approval Committee.

The Loan Approval Committee will review all loan recommendations forwarded to it by program staff of the Subrecipient. No loan will be made under the economic development loan program without the approval of a majority of the members of the Loan Approval Committee.

**Disbursements**

Any disbursement from a LRLF or RLFA must be approved in writing by the State’s CDBG Loan Program Specialist in advance of the disbursement.

The Fund requesting a disbursement from the MEDC must use the CDBG Payment Request (PR) form. The blank form and instructions may be found as attachment 8-A to this chapter.

**Section 2 – Loan Policy and Credit Risk Management**

**Collateral Standards and Unsecured Lending**

Credit risk underwritten by the program will be secured by borrower assets at reasonable advance rates, as determined by a CRLF or RLFA. Advance rates in excess of industry norms, but at or below 100% of the value of the asset established by a CRLF or RLFA, must be addressed in the underwriting document and mitigating factors, if any, shall be described.

Credit underwritten by the program for which no security exists is allowed, but must not become a majority of the credit underwritten within a loan portfolio. CRLFs and RLFAFs are required to provide mitigating factors that justify unsecured lending, such as long-term business success, unsecured position is temporary, sponsor strength not being available to secure the loan, or other appropriate factors.

The MEDC reserves the right to restrict the ability of a CRLF or RLFA to underwrite credit with little or no security via written administrative notification. The MEDC is looking for responsible CLP policies that are administered with consistency and prudently.

**Guarantee Policy**

The program requires a CRLF or RLFA to obtain an unlimited and unsecured personal guarantee of any owner (corporate or natural person) who holds 20% or more of a borrower. CRLFs and RLFAFs should have evidence of a policy and consistent implementation of the policy with respect to securing guarantees.

In a case where a CRLF or RLFA desires to use a guarantee as a mitigating factor for not securing collateral, the CRLF or RLFA should look to a secured guarantee.

In the case where the CRLF or RLFA is entering into a pari passu participation agreement, it may utilize the same guarantee structure as the lead lender. Guarantees are required when the participation is subordinated with respect to collateral or payments or both.

In the instance a CRLF or RLFA desires to limit a guarantee, it should specifically discuss and address the reasons why the guarantee must be limited. Likely acceptable reasons would be:

- An unlimited guarantee impacts the ability of the business or sponsor to secure additional debt or equity.
An unlimited guarantee provides excessive risk mitigation given the size of the loan as compared to the resources incorporated by the guarantee.

The MSF reserves the right to restrict through administrative notification the ability of a CRLF or RLFA to underwrite credit with limited or no guarantee of the owners of a borrower.

**Interest Rate Policy**
The program will charge interest rates commensurate with the level of risk of the credit that it is underwriting, but will not exceed legal limits and will not compete with traditional lending institution rates. The MEDC reserves the right to require justification that the program is not in rate or fee competition, and make such a determination in its sole discretion.

- Regardless of the security position and financial health of the company, a direct loan's interest rate must be 2% over the prime rate as published in the Wall Street Journal, with a floor of 5.99% per annum.

The MEDC maintains the ability to approve exceptions to the rate policy on a case by case basis, or reject a proposed rate. Pricing is required to be included in the CDBG Loan Financial Review memo submitted by a CRLF or RLFA.

**Term and Amortization Policy**
Terms and Amortizations are traditionally linked to the useful life of the assets that are being financed as well as the rate and re-pricing environment. Generally, term loans do not exceed 5-year terms, although they may have 20- or 30-year amortizations. A CRLF or RLFA is required to develop and implement a consistent policy on the Term and Amortizations subject to the following conditions:

1. **Working Capital**: Maximum term of 18 initial months followed by 12 months (in order to time renewal with the availability of company financial statements).
2. **Permanent Working Capital**: Maximum term and amortization of 60 months.
3. **Equipment**: Maximum term of 10 years or the appraised useful life, whichever is shorter. Maximum amortization of 10 years.
4. **Real Property**: Maximum term of 7 years; maximum amortization of 30 years.
5. **Construction/Permanent**: Maximum of 12-month construction term followed by a maximum of 6-year permanent debt term. Maximum amortization of 30 years. HELP: Maximum 15 years, with the option to defer repayments based on end homeowner terms, and repayments.

Exceptions to this section require pre-authorization by the MEDC, and such requests will be made in writing and accompanied by a description of risk mitigation factors. Exceptions shall require unanimous support by the Loan Approval Committee of the CRLF or RLFA.

**Permanent Working Capital**
Permanent Working Capital (PWC) is identified as capital used to fund current assets which are paid back as a “long term liability” (essentially repaid on a schedule exceeding 12 months). Generally, PWC is provided as a fully amortizing term loan over the course of 2 to 5 years. The use of proceeds can be to pay down a traditional working capital revolving line or can be a direct spend on current assets and immediate expenses necessary to facilitate growth in business activity.
PWC requests are frequently of a subordinated or unsecured nature and represent significant risk. These credit facilities should be as short term as possible while maintaining adequate debt service coverage ratios and, if subordinated to other lenders, should have broad rights to all business assets behind the senior lender.

**Subordination**

Subordination of both payments and collateral are allowed under the program. At all times, a CRLF or RLFA should seek the best possible position with respect to both payments and collateral. The best possible position for the CDBG Loan Program is a *pari passu* participation in which the interests of the private lender and the program are most closely aligned. In such cases, the program benefits from the lender’s involvement in the management of the asset and the lender benefits from the reduced exposure taken on by the program.

**Troubled Asset Management**

All CRLFs and RLFAs are required to have a Troubled Asset Management Plan (TAMP) which addresses the policy for managing defaults under its loan, collateral, and security agreements. The plan should include steps the institution will follow once it identifies defaults including the use of forbearance, the waiving of defaults, its restructuring standards and its standards for carrying loans to non-accrual and charge off.

In the event that a borrower fails to make a regularly scheduled payment for a period of 6 months, such a loan should be moved to “non-accrual” whereby its interest rate is reduced to zero but the Fund’s counsel believes the loan can be collected or rehabilitated in the near future.

In the event that a loan in non-accrual is determined to have a low likelihood of collectability, the loan should be charged off.

**Amendments**

Any amendment to a loan agreement, or to the scope of an individual project, utilizing CDBG funds requires written authorization by the MEDC. To request a loan amendment a CRLF or RLFA must submit:

1. A letter and completed Grant Amendment Request (Form 12-B) from the authorized official to the Program Specialist outlining the proposed changes.
   
   The letter should include: a description of the new or existing activities that are being altered or eliminated; why they are being proposed; the effect of the change on the number and percentage of low- and-moderate income persons benefiting; the effect of the change on the number and percentage of minorities benefiting; and any change in resource leveraging.

2. Revised Application Budget form, if applicable.

**Section 3 - Repaid Funds**

Per HCDA 105(a)15, certain qualified organizations, which include designated RLFA, which issue loans and extensions of credit with CDBG grants and PI and then receive repayment of such funds may re-issue loans and other extensions of credit subject to a “Repaid Funds Agreement” between the RLFA and the MSF. Repaid Funds Agreements are subject to certain conditions which may change from time to time, in the sole discretion of the MSF or designee and which are described herein.

**Excess Cost Rules**

A RLFA will seek the written authorization of the Program Manager under the following conditions:
1. Fee's to be charged is in excess of 5% of the amount of Repaid Funds provided to a borrower to be billed and collected in 12 months or less.

2. Interest and fees (excluding other profit participation) together to be charged result in an “all in cost” in excess of 15% on an annual basis.

3. Warrants/Profits in Kind/Royalties/ Other Profit Participation are contemplated as part of the agreement with a borrower.

**Recognition of Repaid Funds**

Funds are considered Program Income until the MSF has issued the RLFA written notice that the project to which they were connected has met its National Objective and has been determined by the MSF to be a Successful Project. At such time, Program Income governed by various CDBG agreements becomes Repaid Funds and is governed by a Repaid Funds Agreement.

**Section 4 – Continuing Activity**

**Continuing Activity Policy**

Only a CDBG RLF, CDBG Loan Fund, or Regional Loan Fund Administrator that meets the definition of a Continuing Activity is eligible to apply for CDBG Grants or administer CDBG Program Income. The MEDC defines a “Continuing Activity” as the successful funding of a CDBG eligible loan or extension of commercial credit within the CDBG Program Year (July 1 through June 30) or, in cases in which the Fund had insufficient program income to advance on a proper loan request the Fund must document the request and why the funding it had on hand was not sufficient for the project. Additionally, the MEDC includes within its definition of Continuing Activity that the Fund must perform such activity as described above such that normal monitoring of the Fund resulted in no major findings or issues which remain unresolved.

**Discharge of Debt Request**

A discharge of debt may be granted to a Community Development Block Grant (CDBG) Loan Program grantee community for a CDBG Revolving Loan Fund (RLF) loan that meets the eligibility criteria. The community must receive approval from the State of Michigan (State) CDBG Loan Program in advance of discharging any existing debt.

**Eligibility.** In order to be eligible for a discharge of debt, a CDBG loan must:

1. have been fully funded prior to the grantee community executing either a Subrecipient Agreement, or a First Restated Grant Agreement;
2. have been in default for a minimum of 6 consecutive months prior to requesting the discharge of debt; and
3. have sufficient proof/documentation to establish that the grantee community exhausted all reasonable collection methods. The Community should document all communication to/from the borrower, all collection activities, and any information used to make its decision.

**Documentation.** Submit the following required documentation to the Program Specialist:

1. A discharge of debt request on UGLG letterhead with the loan specific information, the request, and signed by an authorized CDBG Loan Fund representative; and
2. Documentation of the collection activities that were completed by the community.

Upon receipt and review, the Program Specialist will provide the community written approval via email or, in the alternative, required next steps and/or action items.
Chapter 3 Form(s)

1-A  Progress Report
2-C  Job Creation Summary Report and Income Certification Calculator
3-A  HELP Overview
3-B  HELP Loan Exhibit and Program Guidelines
8-A  Grant Payment Request
12-B  Grant Amendment Request