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**FINANCING ECONOMIC
DEVELOPMENT PROJECTS**

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Economic Development Programs

- To attract private investment into communities:
 - create jobs
 - increase tax base
 - change perceptions
 - prove a market
 - create affordable housing





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**What Is Economic
Development Financing?**



- Financing that Encourages Investment in Short and Long-Term Assets
- Financing that Stimulates Investment by Providing Incentives to Lenders and Borrowers
- Financing that Exists as Part of an Economic Development Financing System



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**Economic Development Projects
May Seem Riskier**



- Pioneering Project
 - Business with short track record
 - Unproven real estate market
 - Questions about rent and vacancy
 - Questions about collateral
 - Uncertain property market
 - Unfamiliar locations – rural, deteriorated big city neighborhoods



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**Public Sector
Incentive Financing**



- Incentives to Lender and Borrower
 - Lender incentives
 - subordinate mortgage
 - loan guarantees
 - Borrower incentives
 - manageable debt service
 - less equity
 - grants reduce debt and/or equity
 - tax incentives reduce operating costs or attract equity



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Grants

- Funds from Public and Non-profit Sources that Require no repayment
- Reduce the Amount of Debt and/or Equity that Must Be Attracted
- Reduces Risk Taken by Lender and Owner



Tax Incentives

- Tax Increment Financing
 - Varies from state to state
- Tax Abatement
 - Varies by state
 - Reduction in property tax and/or state income tax
- Federal Tax Credits
 - Reduction in federal income tax

ED Financing Programs

- Need
 - Banks are constrained from making long term loans
 - Borrowers lack the 25-30% equity required
 - Cash Flow is tight
- Public Loans Must Be Underwritten like Private Loans


Underwriting the Business


- Economic Developer's Tool for Understanding a Company's Financial Picture
- Answers an Important Question: If I Lend a Company Money, Can it Pay Me Back?

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What Credit Analysis Is Not

- Does not Provide Answers
- A Substitute for Talking with Owners
- Cannot Be Done in a Vacuum


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Form of Analysis

- Step One** – Is the Company a Dog?
 - Analyze the balance sheet
 - management of company's resources
 - hidden equity
 - nature of liabilities
 - Analyze the profit and loss statement
 - how well the company buys and sells inventory or services to make a profit
 - determine how much cash flow is available to repay debt service


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Form of Analysis (cont.)

- Step Two** – Is Cash Flow Greater than Debt Service?
 - Businesses have three demands on cash flow
 - debt service
 - permanent working capital
 - capital expenditures
 - Existing cash flow pays for debt service
 - Future profits pay for permanent working capital needs and capital expenditures

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Loans

- A Self-Amortizing Loan Is Normally Repaid with a Monthly Level Debt Service Payment that Consists of Principal and Interest
- Principal is the repayment of the loan while interest is the payment to the lender for the loan



Calculating Debt Service

$$\text{Debt Service (D/S)} = \frac{\text{Loan Amount} \times \text{Constant}}{\text{D/S}}$$

Calculating Debt Service (cont.)



- Example
 - \$200,000 loan
 - 10% for 10 years

$$\begin{array}{rcl} \text{Loan Amount} & & \$200,000 \\ \times & \frac{c}{D/S} & \times \frac{c}{D/S} \\ \hline & & = \$31,720 \end{array}$$

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Project Sources and Uses

- Structuring the Project
 - Sources of funds must be equal to uses of fund
- Identify all project costs (uses)
 - Acquisition
 - Construction
 - Soft Costs
 - Working Capital
- Identify all project sources
 - Debt
 - Equity
 - Grants
- If uses are greater than sources, find additional sources





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Project Sources and Uses Form

Uses of Funds		Project Sources & Uses of Funds					
Use	Amount	Letter	Year	Amount/Date	Category	Amount	Amount after Reserve
Land							
Building Construction/Repairs							
Machinery and Equipment							
Furniture and Fixtures							
Landmark Improvements							
Construction							
Working Capital							
Total Uses of Funds	1					2	3

Total Uses = Total Sources



Comments:



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Loan Structuring


- Quick Analysis:
 - Is $CF > D/S$?
 - $CF = PAT + \text{depreciation}$
- What if CF is Not Greater than D/S?
 - Identify savings from cash flow
 - Restructure deal




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Small Business Administration 7(a)

- Loans
 - SBA 7(a) is a lender-based program that provides guaranties of up to 85 percent
 - Eligible uses
 - Long-term loans
 - Rates up to prime plus 2½ percent
 - Reasonable response time (upon receipt of complete application)
- Borrowers
 - Most small businesses are eligible for SBA loans


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SBA 7(a) (cont.)


- Terms
 - Maximum maturity is based on the useful life of the asset financed
 - working capital will not exceed 10 years
 - fixed assets will be limited to the economic life of the asset
 - real estate typically is 20 years


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Abolins Tacoma, WA



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SBA 504
Loan Program

- SBA 504
 - Fixed asset financing
 - Fixed rate financing
 - Long-term (10/20 years)
 - Reasonably priced
 - Low down payment
 - Subordinated financing

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SBA 504 (cont.)

- Typical SBA 504 deal

Private Lender	50%	(1st item)
SBA 504 (CDC)	40%	(2nd item)
Local Injection	10%	(equity)
Total Project Cost	100%	
- Eligible borrowers
 - User businesses
 - For-profit
 - Existing companies
 - Must have sound business purpose

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SBA 504 (cont.)

- Jobs Requirement
 - Individual loans
 - one job per \$50,000 of SBA 504 loan
 - special geographic areas: one job per \$75,000 of SBA 504 loan
 - small manufacturers: one job per \$100,000 of SBA 504 loan
- Structure
 - Bank first mortgage equal to or greater than SBA 504 loan
 - Federal sources such as CDBG less than 50 percent of project



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**Rural Development
Business Programs**



- Funded by U.S. Department of Agriculture (USDA)
- Rural Business Cooperative Service (RBS) provides credit opportunities and services to businesses in under-served rural areas
- Communities with fewer than 50,000 people in non-urban areas



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Rural Development Business Programs (cont.)



- Commercial Lending
 - Business and Industry Guarantee Loans
 - purpose is create and maintain employment and to diversify and improve economy of rural communities
 - provides guarantee of 70-90 percent of a loan made by a commercial lender
 - maximum loan amount is \$25 million
 - community facility program



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**U.S. Department
Of HUD Programs**



- CDBG
- Section 108



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**Community Development
Block Grant Program**



- Provides Annual Grants on a Formula Basis to Public Entities
 - Metropolitan cities
 - Urban counties
- States for purposes of providing funds to non-entitlement areas
- Indian Tribes or Nations



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CDBG (cont.)



- Eligible Projects Must Meet One of Three National Objectives
 - Benefit low and moderate income people
 - Prevent or eliminate slums and blight
 - Meet urgent community development needs
- Low and Moderate Income Benefit
 - Primary objective of CDBG program
 - Not less than 70 percent of the overall allocation of CDBG funds must be spent on activities that benefit low and moderate income persons
- CDBG Recipients
 - Each recipient of CDBG funds develops its own programs and funding priority
 - Recipients must submit to HUD community objectives, projected uses of funds and certifications on an annual basis



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**HUD Section 108
Loan Guarantee**


- Loan Guarantee Provision of the CDBG Program
- Eligible Applicants
 - Entitlement communities
 - Small cities through state CDBG program
- Amount
 - Up to five times the public entity's latest (approved) CDBG entitlement amount less outstanding commitments or principal balances
- Collateral
 - Pledge of current and future CDBG funds
 - The assets financed by the loan
- Term
 - Up to 20 years




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Brownfields Programs

- EPA
 - Brownfields Assessment, Revolving Loan Fund and Clean Up Grants
 - Resource Conservation and Recovery Pilot Grants


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EDA Title IX

- Public Works Grants
 - Grants to **local governments** to assist in infrastructure improvements
- Must show job creation
- For economically distressed areas or have employment linked to low-income populations
- Non-relocation restrictions
- Davis Bacon applies
- Improvements must remain in ownership of local government so use is restricted to off-site public improvements
- Requires a 50% local funding match

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EB-5 Immigrant Investor

- Investment by Foreign Nationals in job creating entity
- Investment of \$1 million (\$500,000 in special circumstances)
- Either Direct or Through Regional Centers
- Investment in large projects, generally over \$20 million
- Investor and family receive a green card, permanent if jobs are created


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The RLF as a Component of an Economic Development Strategy

- What Is a Revolving Loan Fund (RLF)?
 - Financing tool
 - fills gaps in the local capital markets
 - recycles dollars so that they stay in the community
 - leverages private sector financing through financial incentives
 - finances riskier, smaller, unconventional deals

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Sources of RLF Capital

- Community Development Financial Institution
- USDA – Intermediary Relending Program
- CDBG
- SBA Micro Lending Program
- Direct Allocation from Local Governments
- Private Foundation Grants and Program Related Investments (PRIs)
- Bank Community Development Corporations


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Tax-Exempt Financing

- Funding through State and Local Bond Issues
- Interest Exempt from Federal Income Taxes = Lower Borrowing Rates
- Different Types of Tax-exempt Financing
 - Industrial Revenue Bonds (IRBs)
 - 501 c-3 bonds
 - 63-20 bonds
 - Tax increment financing



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Self Financing Bonds (Tax Increment Financing (TIF))



- Bonds Issued, Repaid with Increases in Real Estate or Sales Taxes
- Tax Base for a District Is Estimated and "Frozen"
- Tax Revenues Beyond this Amount or Tax Increment Is Used for Payment to Bondholders
- May Only Be Used for Eligible Public Purposes
- Provides Public Funding for
 - Off-site or eligible public uses (reduces project budget) or
 - Allocates project tax payments to fund improvements (expands sources of funds)



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Tax Credits



- A Direct, Dollar-for-Dollar Reduction of Tax Liability
- Types
 - Rehabilitation Tax Credits (RTC)
 - New Markets Tax Credits (NMTC)



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Rehabilitation Tax Credits



- Historic Rehabilitation
 - 20 percent, one-time credit on rehab costs
- Must qualify:
 - certified historic structure or contributing building in National Register historic district
 - commercial, industrial or rental housing
 - substantial rehabilitation – spend greater of \$5,000 or property's adjusted depreciable basis
 - follow Secretary of Interior standards – National Park Service (NPS)



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**Model T Building
Omaha, NE**







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State Historic Credits



- Some States Have Their Own Tax Credits for Historic Preservation
 - Offset state income tax liability
 - State credits have lower value to investors



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New Markets Tax Credit Program



- What Is It?
 - Designed to generate new, private sector investment in targeted distressed areas
 - Tax credits passed through to investors
- Who Administers?
 - CDFI Fund, division of U.S. Treasury
 - CDFI allocates tax credit authority over seven years to Community Development Entities (CDEs)



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New Markets Tax Credit Program (cont.)

- Eligible Projects
 - Projects with high community impact
 - Job creation
 - Services for low income residents
 - Located in deeper distress census tracts



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Omaha Standard
Council Bluffs, IA







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Opportunity Zone

- Investment vehicle for investors with capital gains
- Avoid capital gains tax by investing in approved Opportunity Zones
- OZ designated by states



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Economic Development
Financing Programs

- Provide financing to complete marginal projects
- EDF fills the gaps in the capital markets – it does not duplicate existing resources
- EDF goal is to leverage private sector dollars in order to expand the amount of capital available
- EDF resources are scarce compared to private sector capital

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