Managing Risk for Businesses

11.438 Economic Development Planning
Jeff Levine, AICP
Starting a Small Business

- Concept
- Labor
- Plan
- Capital
- Location
What Makes a Business?

<table>
<thead>
<tr>
<th>Physical Needs</th>
<th>Items That Last and are Expensive (debt-financed)</th>
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</thead>
<tbody>
<tr>
<td>• Land</td>
<td></td>
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<tr>
<td>• Buildings</td>
<td></td>
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<tr>
<td>• Durable Goods</td>
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<table>
<thead>
<tr>
<th>Operational Needs</th>
<th>Items You Sell or Use to Make Money</th>
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<tbody>
<tr>
<td>• Inventory</td>
<td></td>
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<td>• Rent</td>
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<td>• Fuel</td>
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<table>
<thead>
<tr>
<th>Staff</th>
<th>The Folks Who Get it Done</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Permanent Full Time</td>
<td></td>
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<tr>
<td>• Permanent Part Time</td>
<td></td>
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<tr>
<td>• Contract</td>
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# How Can Government Help (if it wants to)?

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<th>Physical Needs</th>
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<tbody>
<tr>
<td></td>
<td>• Site Preparation</td>
</tr>
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<td>• Long Term Financing</td>
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<td>• Job Creation Programs</td>
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<td></td>
<td>• Job Training Programs</td>
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</table>
Obtaining Capital as a Small Business

- Personal Investment
- Investors
- Loans
The Business of Lending

- **Amount Needed**: What portion of overall investment is this?
- **Collateral**: What are you willing to risk?
- **Underwriting**: Does this make sense for a lender as a business?
- **Rate**: How much to charge?
Smarting a Small Business: Finances

- Gap
- Your Own Money
- Investors
- Bank Loan
Type of Programs and Some Federal Funding Sources

- Revolving Loan Funds
- Brownfields Cleanup and Assessment
- CDBG Development Activity & Section 108
Revolving Loan Funds

• Lending to accomplish a public policy purpose
• Providing gap financing to applicants that meet that purpose
• Market-driven planning tool
• Federal sources in addition to the EDA include the Small Business Administration, the Department of Agriculture and HUD
Running a Revolving Loan Fund

• Balancing act of running like a business but also with a mission
• Need to act with transparency
• Separate politics from lending as much as possible

Source: “Public Sector Business Loan Funds: Views and Recommendations from Practitioners” National Association of Development Organizations Research Foundation and the Development District Association of Appalachia. © National Association of Development Organizations. All rights reserved. This content is excluded from our Creative Commons license. For more information, see https://ocw.mit.edu/help/faq-fair-use/.

Recommendations and Advice from Public Business Loan Fund Practitioners

1. Create a clearly stated mission and purpose for the loan fund program, including methods for linking investments with regional and local economic development strategies and priorities.

2. Establish professional relationships and partnerships with regional and local banks and other lending institutions.

3. Set up and maintain a knowledgeable and active business loan fund committee to assist in marketing, business development, application review and due diligence, and program oversight and accountability. This includes tapping into network of retired and active bankers, economic developers and other business experts from the region.

4. Avoid relying on the organization’s policy board of local elected officials as the business loan fund committee.

5. Maintain a professional loan fund staff with the experience, background and skills required to operate a successful business loan fund. If necessary, establish partnerships with another organization to assist with back office, accounting, credit analysis, deal packaging, marketing or other operational support.

6. Require a single purpose, independent audit of loan funds by an outside auditor on an annual basis.

7. Engage in peer reviews with other public business loan fund operators and intermediaries across the nation or within multi state region to explore trends, noteworthy practices and program innovations.

8. Pursue opportunities to diversify your portfolio of business lending and technical assistance tools and services, including potential partnerships and opportunities with nontraditional lending and investment resources.

Establish professional relationships and partnerships with regional and local banks and other lending institutions.
# Revolving Loan Funds: Typical Missions & Evaluation Criteria

<table>
<thead>
<tr>
<th>Mission</th>
<th>Criteria</th>
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<tbody>
<tr>
<td>Job Creation</td>
<td>Investment per job</td>
</tr>
<tr>
<td>Business Development</td>
<td>Investment per business</td>
</tr>
<tr>
<td>Place Based</td>
<td>Impact on target place (vacancy rate, sales)</td>
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</table>
ELIGIBLE RECIPIENTS
• Start-up or existing business, including restaurants, retail shops, service businesses, manufacturers, home-based businesses, and many more
• For profit corporation, LLC, partnership or proprietorship
• Located in Worcester County, or parts of Franklin County or Middlesex County
• Tangible net worth may not exceed $6 million
• Less than $2 million average net profit after taxes during the previous two years

Create at least one new job for every $20,000
Requires cash investment by owners of 10%

ELIGIBLE ACTIVITIES
• Purchase of new or used equipment
• Inventory
• Working capital
• Leasehold improvements
• Acquisition of land and buildings
• Refinancing of business debt
• Gap financing in partnership with a bank

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BROWNFIELDS CLEANUP AND ASSESSMENT

• Brownfield (according to the U.S. EPA): “A brownfield is a property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant. It is estimated that there are more than 450,000 brownfields in the U.S. Cleaning up and reinvesting in these properties increases local tax bases, facilitates job growth, utilizes existing infrastructure, takes development pressures off of undeveloped, open land, and both improves and protects the environment.”

• Note “potential presence”
Brownfields Funding

- Assessment Grants
- Revolving Loan Fund Grants
- Cleanup Grants
- Area-wide Planning Grants
- Other grant programs

*Based on historical data provided by the ACRES database.
Community Development Block Grant

• Can contribute to local businesses as “development activity”

• May pay for physical improvements on a case-by-case basis or fund ongoing grant or loan programs

• Typical activities include:
  • Loans for Businesses and Commercial Real Estate Development Projects
  • Business Incubators
  • Façade Improvement Programs
  • Microenterprise Assistance Activities (<5 employees including owner)
  • Economic Development Infrastructure Projects
  • Job readiness, skills training, and job replacement programs
Façade Improvement Programs

• Usually matching funds
• Need to meet program requirements
• Usually targeted areas
• Needs to sync with other city rules (more on this next class)
Section 108 Loan Guarantees

- Business needs loan but doesn’t have collateral
- City pledges some of its future CDBG funding as collateral
- Business gets loan
- If business stops making payments, City has agreed to use CDBG funds to pay

✓ Usually used for large projects
✓ Still generally has to be ultimately underwritten by city
✓ May be paid off via other methods – such as future TIF revenue
✓ Should treat as a RLF investment
Paycheck Protection Program

• $349 billion in first tranche/$310 billion in second
• 2.5 times payroll costs, up to $10 million
• Up to 500 employees, more under some situations
• Fully forgiven if the funds are used for payroll costs (75%), interest on mortgages, rent, and utilities.
• Loan payments deferred for six months.
• No collateral or personal guarantees are required.
• Forgiveness is based on the employer maintaining or quickly rehiring employees and maintaining salary levels. Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease.
• Maturity of 2 years and interest rate of 1%