



Office of the City Manager

INFORMATION CALENDAR

February 5, 2013

To: Honorable Mayor and Members of the City Council

From:  Christine Daniel, City Manager

Submitted by: Michael Caplan, Economic Development Manager

Subject: City Loan Performance and Securitization Policy

INTRODUCTION

On September 11, 2012, Economic Development Staff brought a Resolution to Council authorizing the City Manager to amend the City of Berkeley's existing loan agreement with Urban Ore by creating a new promissory note and security agreement. The former agreement had fallen into delinquent status and needed to be restructured to become compliant. Council approved this Resolution and in their discussion expressed concern that loans given by the City be adequately secured. Council asked the City Manager to report back on policy regarding the security of City loans to business entities.

This report reviews current policies for loan securitization that Council put in place on May 31, 2011 when the new Revolving Loan Fund (RLF) Administrative Plan was approved. Staff believes these are good policies that should minimize the City's risk in making future loans.

This report also provides Council with a summary of loans made over the history of the City's RLF as well as the Citywide Loan Fund. The Citywide Loan Fund (CLF) is essentially City General Fund money that has been periodically used to fund projects deemed to be in the economic development and arts/culture interests of the City.

CURRENT SITUATION AND ITS EFFECTS

The Administrative Plan for the RLF, adopted by Council on May 31, 2011, established the current policies for securing loans and protecting the City's interests. Although RLF loans are inherently risky (to qualify the applicant must have been rejected by a commercial lender) these policies are designed to minimize risk.

As a practical matter, the Loan Board now requires that RLF Loans be fully secured through:

1. Cash or Cash equivalent
2. A position against real estate holdings with a conservative loan to value ratio.
3. Personal Loan guarantee.

The personal guarantee is perhaps the most important provision. The revised Administrative Plan specifies that *all principals with a 20% or greater interest* in the applicant business provide a personal guarantee in addition to any needed collateral requirements. The Plan also reduced the maximum size of the loans from \$100,000 to \$35,000 to minimize the risk of any given loan.

Taken together, these requirements have enhanced the City's security on all future loans through the RLF Program. See Attachments 1 and 2 for excerpts from the Administrative Plan outlining the complete RLF Financing Policies and Collateral Requirements.

Since the Administrative Plan was adopted, the City's loan activity has used personal guarantees to secure the City's interest. The most recent loan approved by the Loan Administration Board was to Kitchen on Fire, approved by the LAB on December 11, 2011, and required personal guarantees by the two principals. The restructuring of the Urban Ore loan, approved by Council on September 11, 2012, also required personal loan guarantees by the two principals.

#### BACKGROUND

In 1980, the City of Berkeley received a \$500,000 grant from the Economic Development Administration (EDA) to administer a commercial Revolving Loan Fund (RLF) to eligible small businesses in the Target Area. As loan recipients make payments, these funds are used to provide additional loans to new loan recipients. The principal goals of the RLF are job creation and assistance to small women-and-minority-owned businesses. Both businesses and nonprofit organizations are eligible for loans. Loans are targeted to businesses where the borrower provides documentation that private financing is unavailable. Interest rates are typically below market and terms can be more flexible than traditional bank financing.

The original RLF Target Area included a very small portion of South Berkeley in the commercial areas along Adeline and Sacramento streets, generally between Russell Street on the north and the Oakland border on the south. A subsequent expansion approved by EDA in 2005 moved the northern-most boundary to Dwight Street and west to San Pablo Avenue, leaving the southern and eastern boundaries the same. On May 31, 2011, Council adopted a revised Administrative Plan for the RLF that further expanded the boundaries to include the entire City of Berkeley. The Plan also made various changes to the loan program to protect the City's interest by better securitization of RLF loans.

To date, 34 RLF loans totaling \$1,883,417 have been originated. Approximately 190 jobs have been created or retained in connection with loans. As of December 31, 2012, approximately \$528,500 is available for new loans to Berkeley businesses. Two new loan applications are currently being processed.

Over the years the City has also provided CLF loans directly from its General Fund to businesses that provided economic and cultural benefits to the City. The CLF has not been as active in recent years but still holds a portfolio of five loans, four to large arts organizations. These loans originally totaled \$846,853 and, as of October 2012, had an outstanding balance of \$576,292.

Please see Attachment 3 for a complete listing of RLF loans and CLF loans made through October, 2012.

POSSIBLE FUTURE ACTION

Staff does not think further action is required at this time. If at a future time it becomes necessary to revise lending policies staff will return to Council with recommendations for revisions to the RLF Administrative Plan.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

None

CONTACT PERSON

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Attachments:

- 1: Financing Policies from the Revolving Loan Fund Administrative Plan
- 2: Standard Collateral Requirements from the Revolving Loan Fund Administrative Plan
- 3: Summary of RLF and CLF Loan Activity through October 2012.

**FINANCING POLICIES FROM THE CITY OF BERKELEY REVOLVING LOAN FUND  
ADMINISTRATIVE PLAN  
ADOPTED MAY 31, 2011**

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RLF loans may be made to qualifying businesses for tenant improvements, fixed assets such as equipment and machinery and real estate transactions on an exception basis.

1. Loan Size – The standard maximum loan size of \$35,000. The LAB may approve loan amounts larger than the standard maximum on an exception basis.

2. Interest Rates - Interest rates on loans will be fixed. The standard RLF interest rate on RLF loans will be equivalent to the prime interest rate quoted in the *Wall Street Journal* plus 2% at the time of loan approval by the LAB. The minimum or floor interest rate for RLF loans is five percent (5 %) or seventy five (75%) of the prime interest rate listed in the *Wall Street Journal*.

According to 13 CFR 307.15, the only exception for the above policy is if the prime interest rate listed in the *Wall Street Journal* exceed fourteen (14%) percent, the minimum RLF interest rate is not required to be raised above ten (10%) if doing so compromises the ability of the RLF program to implement the financing policy.

3. Application Fee - There will be a \$200 fee for each application. Fee will be credited towards loan fee and will be refunded if not approved.

4. Loan Fees – Loan fees will be 1% of the amount loaned.

5. Payment Terms - Payments will generally be made monthly; however, customized payment structures may be extended to borrowers depending upon their individual cash flow needs. In the case of multiple disbursement loans for equipment or tenant improvements, there may be an interest-only period until the loan is fully disbursed, generally not more than 180 days. Temporarily reduced or deferred payments may be considered as options in structuring a workout plan

6. Loan Terms - The standard loan terms will be 3-7years fully amortized, depending on loan amount. In general, loan terms will not exceed the average useful life of the assets being financed. The loan term will be the lesser of the average useful life of the asset being financed or the term based upon the borrower's ability to pay. Smaller loans will generally have shorter terms. Loans will be available for expansion, fixed assets, equipment and real estate loans.

7. Private Leveraging/Participation - The RLF is highly encouraged to participate in other financing institutions' loans and/or lines of credit. There is an EDA portfolio requirement in which the RLF will leverage a minimum of two private dollars for each RLF dollar loaned. This leveraging requirement applies to the portfolio as a whole rather than to the individual loan. Private investment is capital invested by the borrower or others or financing from private entities such as banks.

#### 8. Equity/Borrower Injection General Requirement -

The RLF will require all borrowers to inject owner equity as a percentage of the requested loan amount; this may be in form of owner equity and/or private financing. The owner equity injection should be as follows: at least 10% of requested loan amount for existing businesses and at least 20% of requested loan amount for startup businesses.

Additionally, start up business will be required to demonstrate significant industry experience or the equivalent. They will also be required to provide a secondary source of repayment and a complete business plan.

Exceptions may be made on a case-by-case basis depending upon the particular project. In general, existing equity or existing cash injection into the business indicates a reasonable level of commitment to the business; therefore consideration will be given to existing equity in determining new equity required as a result of the project being financed.

9. Collateral: Collateral pledged for each loan will depend upon the loan amount, the overall risk of the credit, and the availability of personal and business assets to be pledged as collateral. In general, the market value of pledged collateral will equal or exceed the loan. The value of pledged collateral will be verified through a market analysis, appraisal, or other means that are deemed appropriate for the particular project, costs for the valuation to be borne by the borrower. Lender must engage the appraiser. Collateralized security may include, but not be limited to, interest in machinery and equipment, furniture and fixtures, building, property, inventory and receivables.

Security in Personal Assets and Personal Guarantees:

Personal guarantees will be required of all principals with 20% or more interest in the borrower's business. Security in the personal assets of principals who owns 10% or more interest in the borrower's firm may be required as additional collateral. Such security can include property outside the business, including, but not limited to real estate of principals.

The City will secure loans by recording UCC-1 filings to secure equipment, fixtures, furniture, receivables, and inventory. Loans will be secured by collateral to the maximum extent possible to ensure an adequate secondary source of repayment. Generally, collateral pledged through UCC-1 filings for RLF loans shall not be pledged to other lenders or for other obligations of a business.

10. Credit Memorandums - Each application will be reviewed for standard underwriting criteria. A credit memorandum will be signed by the OED project manager and OED Manager and presented to the LAB. Generally the credit memo will address the following: location in the Target Area, management ability, and market feasibility, primary source of repayment, secondary source of repayment, leverage, environmental issues, job creation, credit history and the project's economic impact. All credit memos will include an analysis on the non-substitution documentation to verify that funds are not replacing private or commercial financing. Credit memorandums will also address other program requirements, such as the ratio of funds loaned to jobs created.

11. Financing Restrictions – RLF Capital may not be used to:

- a) Acquire an equity position in a private business;
- b) Subsidize interest payments on an existing loan;
- c) Provide the equity contribution required of borrowers under other Federal loan programs;
- d) Enable a borrower to acquire an interest in a business, either through the purchase of stock or through the acquisition of assets, unless the need for RLF financing is sufficiently justified and documented in the loan write-up. Acceptable justification could include acquiring a business to substantially save it from imminent foreclosure, or acquiring it to facilitate a significant expansion or increased investment;
- e) Provide loans to a borrower for the purpose of investing in interest bearing accounts, certificates of deposit or other investment not related to the objectives of the RLF;
- f) Refinance debt unless:
  1. Has moved or will move into the Target Area for reasons unrelated to RLF assistance;
  2. Has relocated to the Target Area prior to the date of the applicant's request for RLF assistance;
  3. Will expand employment in the Target Area substantially beyond employment in the area where the business was originally located;
  4. Is relocating from technologically obsolete facilities to remain competitive
  5. Is expanding into the new area by adding a branch affiliate of subsidiary while maintaining employment levels in the old area(s);
  6. Is determined "exempt" by EDA.
- g) Finance any activity that serves to relocate jobs from one commuting area to another. (A commuting area is that area defined by the distance people travel to work to and from the Berkeley area) This non-relocation requirement shall not apply to a business which:
  1. There is a sound economic justification and the City sufficiently documents in the loan write-up that the RLF is not replacing private capital solely for the purpose of reducing the risk of loss to an existing lender(s) or to lowering the cost of financing, or
  2. An RLF loan uses RLF income and/or recycled RLF funds to purchase the rights of a prior lien holder during an in-process foreclosure action in order to preclude a significant loss on an RLF loan. This action may be undertaken only if there is a high probability of receiving compensation within 18 months from the sale of assets sufficient to cover the RLF's expenses plus a reasonable portion of the outstanding loan obligation;

Additionally, all businesses that receive a RLF loan will sign First Source Agreements with the City. The businesses then utilize the City of Berkeley's First Source Program for the recruitment and referral of Berkeley applicants for new and replacement employment.

**STANDARD COLLATERAL REQUIREMENTS FROM THE CITY OF BERKELEY  
REVOLVING LOAN FUND ADMINISTRATIVE PLAN  
ADOPTED MAY 31, 2011**

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Loans will be secured to the fullest extent possible to protect the interests of the RLF as a secondary source of repayment. The RLF will obtain a perfected interest in a borrower's assets, including outside assets of related parties, as appropriate. Loans may be secured with the following types of assets:

- Real property
- Machinery & equipment
- Inventory
- Accounts Receivable
- Stock pledges
- Patents and other intellectual properties
- Securities
- Intangibles
- Personal and/or corporate guarantees

A personal guarantee will be required of any principal having a 20% or more ownership in the company being considered; it shall also be required of the principal(s) trust(s) deemed to be controlled by him or her. Personal guarantees may be collateralized with liens or property. Appropriate hazard and liability insurance shall be required, and key man life insurance shall be considered depending on the size and nature of the transaction and the health and ages of the principals. The City of Berkeley shall be named as a Loss Payee on the appropriate insurance policies. Trust deeds will be obtained and supported by lenders title policies in those cases where real property is pledged as collateral. Liens on all personal property will be perfected by UCC-1 filings. UCC searches will be conducted to determine encumbrances and to ensure the RLF obtains desired lien position.

## REVOLVING LOAN FUND STATUS REPORT (As of October, 2012)

As of October 31, 2012				Principal		Origination	Repayment	
<b>ACTIVE LOANS</b>	RLF \$	Term	Interest	Repaid	Interest Paid	Date	Date	Notes
The Vault Café	\$56,569.94	144	1.00%	\$5437.60	\$632.00	Aug-2011	Aug-2023	In compliance, restructured in Sept 2011
Biofuel Oasis	\$100,000.00	120	5.25%	\$26,670.48	\$20,670.92	May-2008	Nov-2023	In compliance
Kitchen on Fire	\$35,000.00	60	5.25%	\$3,627.81	\$1,023.76	Jan-2012	Feb-2017	In compliance
<b>Subtotal- Active Loans</b>	<b>\$191,569.94</b>			<b>\$35,735.89</b>	<b>\$22,326.68</b>			

				Principal		Origination	Repayment	
<b>REPAID LOANS</b>	RLF \$	Term	Interest	Repaid	Interest Paid	Date	Date	
Earl Long	\$15,950.00	60	4.00%	\$15,950.00	\$2,535.00	May-1982	Oct-1987	
Claude Stoller	\$46,722.00	120	9.25%	\$46,722.00	\$29,993.00	Aug-1983	Apr-1990	
Cooper/Guewel	\$15,000.00	36	9.00%	\$15,000.00	\$589.00	Apr-1989	May-1990	
Loni Simpson	\$23,600.00	36	9.00%	\$23,600.00	\$3,660.00	Feb-1988	Feb-1991	
David Duong	\$75,000.00	120	8.00%	\$75,000.00	\$9,661.00	May-1990	Dec-1991	
Michele McGeoy	\$25,000.00	84	9.00%	\$25,000.00	\$5,369.00	Jul-1990	Jun-1993	
Vicki Riggan	\$13,700.00	36	9.00%	\$13,700.00	\$4,664.00	Jan-1989	Jul-1993	
F Elhashash	\$26,900.00	60	5.00%	\$26,900.00	\$3,548.00	Oct-1988	Oct-1993	
KittamsWinokur	\$16,000.00	60	8.50%	\$16,000.00	\$3,689.00	Jan-1989	Nov-1993	
Gloria Johnson	\$13,500.00	60	9.00%	\$13,500.00	\$2,871.00	Apr-1989	May-1994	
Teegarden	\$50,000.00	60	8.00%	\$50,000.00	\$14,246.00	Mar-1990	Sep-1995	
Assefa Taye	\$36,000.00	48	9.00%	\$36,000.00	\$11,490.00	Dec-1989	Jan-1996	
S Sabucuonglu	\$90,000.00	60	8.50%	\$90,000.00	\$41,344.00	Aug-1989	Apr-1997	
Gillian Hall	\$10,000.00	36	7.00%	\$10,000.00	\$1,678.00	Aug-1991	Aug-1998	
InnerCityServices	\$27,000.00	60	5.00%	\$27,000.00	\$3,570.00	Oct-1993	Oct-1998	
Hooshmand/Lonay	\$81,655.00	120	6.00%	\$81,655.00	\$23,349.00	Aug-1993	Jan-1999	
Anselmo, Phillip	\$70,000.00	84	5.00%	\$70,000.00	\$12,101.00	Oct-1995	Oct-2002	
Herrera, Freddie	\$105,000.00	120	7.00%	\$105,000.00	\$42,488.00	Sep-1991	Sep-2001	
Taeed, Mansour	\$90,000.00	84	7.50%	\$90,000.00	\$47,411.00	Feb-1996	Mar-2003	
Cassanova, Ticia	\$90,000.00	120	4.00%	\$90,000.00	\$21,359.75	Jun-1993	Jun-2003	
A Better Way I	\$90,000.00	120	5.50%	\$90,000.00	\$19,210.00	Sep-1998	Jun-2004	
H Ghaderi I	\$50,000.00	84	6.25%	\$50,000.00	\$10,416.00	Oct-1997	Nov-2004	
Le Belle's	\$39,500.00	84	6.00%	\$39,500.00	\$21,313.80	Mar-1996	Jan-2000	
A Better Way II	\$90,000.00	84	5.00%	\$90,000.00	\$16,662.92	Jun-2012	Feb-2011	
<b>Subtotal- Repaid</b>	<b>\$1,190,527.00</b>			<b>\$1,190,527.00</b>	<b>\$353,218.47</b>			

				Principal		Amount	Date Written	
<b>WRITTEN OFF LOANS</b>	RLF \$	Term	Interest	Repaid	Interest Paid	Written Off	Off	
SB Pharmacy	\$56,000.00	12	6.00%	\$0.00	\$0.00	\$56,000.00	Jun-1990	
William Giles	\$56,500.00	60	5.00%	\$0.00	\$0.00	\$56,500.00	Jun-1990	
Eats 'N Sweets	\$22,890.00	84	7.00%	\$2,731.00	\$1,637.30	\$20,159.00	Jun-1990	
SB LDC	\$136,150.00	300	6.00%	\$107,216.00	\$23,283.00	\$28,934.00	Jun-1990	
Touch of Class	\$41,000.00	84	6.00%	\$450.00	\$0.00	\$40,550.00	Jun-1990	
Abe Kelly	\$25,000.00	60	5.00%	\$1,218.00	\$1,581.00	\$23,782.00	Mar-2005	
William & Martha Twymon	\$40,350.00	84	4.00%	\$1,010.00	\$1,374.00	\$39,340.00	Mar-2005	
Spud's Pizza	\$90,000.00	120	4.20%	\$4,801.87	\$12,161.12	\$85,198.03	Nov-2009	
The Vault*	\$90,000.00	84	4.00%	\$20,557.90	\$17,084.48	\$12,872.00	Sept-2012	
<b>Subtotal- Written Off</b>	<b>\$480,762.20</b>			<b>\$137,984.77</b>	<b>\$57,120.90</b>	<b>\$363,335.03</b>		

	Total RLF \$ Lent			Principal	Total	Amount		
	RLF \$			Repaid	Interest Paid	Written Off		
	<b>\$1,862,859.14</b>			<b>\$1,364,247.66</b>	<b>\$432,666.05</b>	<b>\$363,335.03</b>		

\*\$56,569.94 restructured into a new loan.

**CITYWIDE LOAN FUND STATUS REPORT  
(As of October, 2012)**

		<b>Principal</b>	<b>Interest</b>		
<b>ACTIVE LOANS</b>	<b>CLF \$</b>	<b>Repaid</b>	<b>Paid</b>	<b>Maturity Date</b>	<b>Status</b>
Urban Ore *	\$75,553.43	\$0.00	\$0.00	Apr- 2015	In Compliance combined two existing loans Dec 2012
Aurora Theater Company	\$417,000.00	\$109,200.00	\$0.00	Aug- 2021	In Compliance
Elmwood Theater Foundation	\$170,000.00	\$36,301.92	\$51,646.96	Apr- 2017	In Compliance
The Jazzschool Foundation	\$84,300.00	\$7,306.08	\$6,106.52	May-2017	Default
Berkeley Symphony Orchestra	\$100,000.00	\$60,000.00	\$0.00	Sept -2015	In Compliance
<b>Subtotal- Active Loans</b>	<b>\$846,853.43</b>	<b>\$212,808.00</b>	<b>\$57,753.48</b>		

		<b>Principal</b>	<b>Interest</b>		
<b>REPAID LOANS</b>	<b>CLF \$</b>	<b>Repaid</b>	<b>Paid</b>	<b>Maturity Date</b>	<b>Status</b>
Urban Ore - WBBAF	\$100,000.00	\$34,285.81	\$27,531.69	n/a	Combined above
Urban Ore	\$100,000.00	\$90,895.75	\$40,523.54	n/a	Combined above
The Jazzschool Foundation	\$30,000.00	\$30,000.00	\$2,969.80		Paid Off
Powis Parker Inc.	\$100,000.00	\$100,000.00	\$32,588.56		Paid Off
Café Caracas	\$52,500.00	\$52,500.00	\$12,079.13		Paid Off
Odyssia Café	\$100,000.00	\$100,000.00	\$32,991.47		Paid Off
Brady & Associates	\$30,000.00	\$30,000.00	\$10,332.56		Paid Off
Direct Network Access	\$100,000.00	\$100,000.00	\$9,258.83		Paid Off
Kennedy, Patrick	\$25,000.00	\$25,000.00	\$2,078.51		Paid Off
United Capoeria Associates	\$100,000.00	\$100,000.00	\$21,995.26		Paid Off
A Better Way	\$15,000.00	\$15,000.00	\$1,427.89		Paid Off

<b>LOANS TO BE WRITTEN OFF</b>		<b>Principal</b>	<b>Interest</b>		
<b>Borrower</b>	<b>CLF \$</b>	<b>Repaid</b>	<b>Paid</b>	<b>Maturity Date</b>	<b>Status</b>
The Phoenix Pastificio **	\$68,000.00	\$49,358.17	\$19,010.48	Mar-2004	Bankruptcy 2006, City never filed

	<b>Total</b>	<b>Principal</b>	<b>Total</b>		
	<b>CLF \$ Lent</b>	<b>Repaid</b>	<b>Interest Paid</b>		
	<b>***</b>				
	<b>\$1,591,800.00</b>	<b>\$939,847.73</b>	<b>\$202,485.97</b>		

\*Urban Ore: Original loan amount was for two loans of \$100,000 each. This loan was recently combined into one promissory note. The amount repaid and interest paid for the previous loans is reflected in 'paid loans'

\*\* Phoenix Pastificio: The loan was placed under the 2006 bankruptcy of Phoenix Pastificio. The City as notified of the bankruptcy and never filed to be paid.

There are no records of such communication. Staff is following up with borrower to obtain these records.

\*\*\* Does not double count the Urban Ore Loans

