Financial and Payment Assistance Options for Small Businesses including Minority- and Women-Owned Businesses

Report in response to Resolution No. 20131024-055

City of Austin

January 2014

Overview

- Background
- Process undertaken
- Stakeholder feedback
- Options
- Recommendations

Background

- **May 2012:** Creation of Council Special Committee on Economic Incentives and stakeholder process
- **August 2013:** EDD report on COA Economic Development Policy
- **Oct. 2013:** Council revised the Firm Based Incentive Matrix to include:
  - Prevailing wage requirement
  - City living wage floor
  - Health insurance benefits
  - Extension of benefits to domestic partners
- **Oct. 2013:** Council resolution calling for this report
  - Greatest need in construction industry

City Council Resolution 20131024-055

- Explore financial and payment assistance options for Small and Minority-Owned and Women-Owned Businesses – such as a guaranteed loan program including a collateral pool

- The intended participants are small businesses, including MBEs and WBEs, that either:
  - Contract with the City as a prime or a subcontractor; or
  - Contract with companies that receive Chapter 380 economic incentives with the City

Terminology

- Loan Guarantee
  - A promise to repay the debt obligation (or some percentage of it) of a borrower if the borrower defaults
- Collateral Pool
  - A pool of funds used as pledged collateral by borrowers who may need additional assets in order to qualify for a loan or a line of credit
- Mobilization
  - Depending on project scope, typically includes assembling staff, purchasing supplies and materials, and bringing equipment to the project site in order to begin work

Process Undertaken

- Multi-departmental staff committee
- Research and outreach to other cities and lenders
- Public Meetings
  - 3 meetings of MBE/WBE Advisory Committee
  - 4 meetings of MBE/WBE Council Committee
  - 4 stakeholder sessions

Stakeholder Feedback

- Access to capital is significant barrier for small construction businesses
- Small construction business owners often lack mobilization funds
- Chapter 380 wage requirements could pose additional financial challenges for small businesses to compete for work
- Turn around time for loans needs to be quick for construction
- Loan process should be flexible and not too burdensome
- Funds should be easier to access than conventional loans
- Consider programs City previously used on Convention Center and City Hall

Options

Potential program models	Applicable to City contracts	Applicable to Ch. 380 contracts
1) City approaches 3rd party financial institutions to offer independent loan program	x	x
2) City contracts with a 3rd party financial institution to administer a loan program	x	x
3) City contracts with a 3rd party administrator and funds a loan pool	x	x
4) City establishes Quick Pay Program (QPP)	x	
5) City establishes Mobilization Prompt Pay Program (MPPP)	x	
6) City establishes Cash Flow Enhancement Program (CFEP)	x	
7) City establishes a loan guarantee and/or collateral pool fund	x	x
8) Chapter 380 recipients pay for a loan guarantee and/or collateral pool fund		x

Option 1: Independent Loan Program

- City approaches independent nonprofit lenders and banks
- Lenders voluntarily offer loans with more flexible criteria than traditional commercial loans
- No City funding would be necessary
- Example - City of San Antonio
- Lenders have expertise in making credit decisions
- Concerns that interest rate will be too high; the funds will still be inaccessible; the traditional lending process moves too slow
- City costs: None
  - Optional: City could choose to dedicate 1 FTE for education and outreach

Option 2: City Contracts w/3rd Party Administrator

- City uses a competitive procurement process to select financial institution(s) to offer loans with flexible underwriting terms
- City pays only administrative costs of loan program
- City funds are not loaned out and are not at risk from loan defaults
- During the procurement process, the City can establish the parameters of the loan program
- Concerns that interest rate will be too high; the funds will still be inaccessible; the traditional lending process moves too slow
- City costs: Dependent on City's preferred program scope & size
  - Funds paid to financial institution for program administration
  - 1 or more City FTEs to serve as contract administrator

Option 3: City Contracts w/Administrator and Funds Loan Pool

- City contracts with a 3rd party for administration plus City funds the loan pool
- City could require financial institution to match City's funds
- City would continue to fund for a period (likely 2-3 years, subject to annual appropriation). Annual funding could decrease as the loan pool grows
- During the procurement process, the City can establish the parameters of the loan program and the eligibility requirements
- City funds potentially at risk of default, which could deplete the pool
- City costs: Dependent on City's preferred program scope & size
  - Funds paid to financial institution for program administration
  - Grant/seed money for revolving loan pool ($250K-$1M)
  - 1 or more City FTEs to serve as contract administrator

Option 4: Quick Pay Program

- City establishes Quick Pay Program (QPP)
  - Prime contractor invoices City for "Quick Pay" funds. Subcontractors would apply for QPP program and perform the work. Subcontractor then invoices the prime as work is completed and is paid by the prime from the "Quick Pay" funds within 10 days of the work being accepted and approved. The prime would then invoice the City on the next regular pay application.
- Similar to program used on new City Hall construction
- Payment occurs once work is performed which reduces risk for the City; easy to implement for COA projects
- May cost the COA more contractually due to increased general conditions cost for primes
- City Costs: No additional staffing resource needs have been identified. May result in higher overall bid/contract price.

Option 5: Mobilization Prompt Pay Program

- City establishes Mobilization Prompt Pay Program (MPPP)
  - Prime contractors can submit pay applications twice a month, rather than monthly, at critical mobilization points during the project (typically the first few months of work)
- Subcontractors can receive payments more quickly during critical mobilization phase
- May cost the COA more contractually due to increased general conditions cost for primes
- May also increase staff charges to capital projects due to review and processing of extra pay applications
- City Costs: No additional staffing resource needs have been identified. May result in higher overall bid/contract price.

Option 6: Cash Flow Enhancement Program (CFEP)

- City establishes Cash Flow Enhancement Program (CFEP)
  - Prime contractor invoices City for "Cash Enhancement" funds. Subcontractors would apply for CFEP. If approved, prime would advance funds (up to 5% of the subcontractor's contract amount) to fund mobilization expenses. The loan would be paid through deductions from progress payments.
- Similar to program used on Convention Center expansion
- Subcontractors can receive access to funding during critical mobilization phase. Administration as an internal City of Austin program helps ensure funding is accessed in a timely fashion
- Higher risk option as project funds are loaned out in advance of performance of work
- City Costs: A lending specialist would be necessary to facilitate the review and approval process of CFEP loans. Additionally a contract administrator will be required to monitor the activities and payments for the potential contracts. May result in higher overall bid/contract price.

Option 7: City Funds a Loan Guarantee/ Collateral Pool

- City establishes a loan guarantee and/or collateral pool fund
  - City would deposit funds into a specific bank account to serve as a loan guarantee and/or collateral pool fund
  - The fund would cover up to 50% of the borrower's debt obligation to the bank if borrower defaults
  - Program administered by the City
- Encourages lenders to make loans that they may not have approved due to lack of security and/or offer better loan terms
- City funds potentially at risk of default, which could deplete the pool
- City costs: Dependent on City's preferred program scope & size
  - 1 City FTE with lending expertise to administer program
  - Money earmarked for loan guarantee and collateral pool fund (approx. $750K)
  - Potential initiation of collection from default loans

Option 8: Chapter 380 Recipients Fund Loan Program

- Loan guarantee and/or collateral pool fund created through fees paid by Chapter 380 recipient
  - Fee could be a percentage of Ch. 380 incentive package
- Risk of defaults shifted from City to Chapter 380 companies
- Collecting a fee from Chapter 380 companies will mitigate the incentive package, defeating the purpose of the incentive
- Using this method, it would take a long time to build a significant fund
  - Number and value of Ch. 380 agreements each year are small. It would take large fees to generate a robust fund (e.g., $225K)
- City costs: 1 City FTE with lending expertise to administer program and oversee collection of fees

Recommendations

- City approaches 3rd party financial institutions to offer independent loan program – *Option 1*
  - No City funding necessary. Relies on voluntary participation by financial institutions
- City funds a 3rd party administrator and loan pool – *Option 3*
  - Competitive procurement process to select a lender. City contributes seed money for revolving loan fund
- City establishes Quick Pay Program (QPP) – *Option 4*
  - Allows for subcontractor to be paid when work is completed and accepted, but prior to prime contractor receiving payment
  - Applies to projects that use alternative delivery methods
- City establishes Mobilization Prompt Pay Program (MPPP) – *Option 5*
  - Allows for bi-monthly payments at beginning of project for mobilization expenses
  - Applies to construction projects valued at over $2 million

Questions