Financial and Payment Assistance Options for Small Businesses Including MBE/WBEs

Report in response to Resolution No. 20131024-055

City of Austin

January 2014

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Acknowledgments

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I. Executive Summary

Access to capital is a significant and well-documented barrier that small businesses, including minority- and women-owned business enterprises (MBE/WBEs), face. Small business owners in the construction contracting and subcontracting industry often lack the up-front funds necessary to undertake large, or even medium-scale, projects. City of Austin stakeholders from this industry have pointed out that the City's new wage requirements on companies receiving economic development incentives from the City (Chapter 380 economic development agreement projects) could pose even more challenges for small businesses that do not have the capital needed to compete and perform on these companies' potentially lucrative construction projects.

Accordingly, Resolution 20131024-055 calls on City staff to explore and report to Council on options for creating a program, such as a loan guarantee and/or collateral pool, that makes bidding and contracting on City projects and Chapter 380 projects a more viable option for small businesses, including MBE/WBEs.

In response to the resolution, City staff from multiple departments researched best practices and hosted a series of stakeholder meetings to receive input on potential financial and payment assistance options for small businesses. This report describes options for the City to consider and includes a staff recommendation based on this collaborative effort. The chart below is a summary of the model options detailed in the report.

Potential program models	Description	Applicable to City contracts	Applicable to Ch. 380 contracts
1) City approaches 3rd party financial institutions to offer independent loan program	Independent nonprofit lenders and banks would volunteer to offer loans with more flexible criteria than traditional commercial loans. No City funding would be necessary.	x	x
2) City contracts with a 3rd party financial institution to administer a loan program	The City would use a competitive procurement process to solicit and select a financial institution to offer loans with flexible underwriting terms. The City's contract with the lender would only cover the cost of administering the loan program.	x	x
3) City contracts with a 3rd party administrator and funds a loan pool	Same as Option 2 above but, in addition to contracting a 3rd party to administer the program, the City would provide the seed money for a revolving loan fund, subject to any statutory requirements on the City's deposits.	x	x

4) City establishes Quick Pay Program (QPP)	Like the program used in the construction of the new City Hall, the City would pay the prime contractor a "Quick Pay" amount at the beginning of a project. If its application is accepted for the program, a subcontractor could invoice the prime as work is completed and be paid from the "Quick Pay" fund within 10 days of the work being accepted and approved. QPP would apply to alternative delivery method projects only.	**x**	
5) City establishes Mobilization Prompt Pay Program (MPPP)	A slight revision to the current Super Prompt Pay Program, MPPP would allow prime contractors to submit pay applications twice a month, rather than monthly, at critical mobilization points during the project. This would allow eligible subcontractors to invoice twice a month and receive payments from the prime more quickly during the mobilization phase(s). MPPP would apply to construction projects valued at over $2M.	**x**	
6) City establishes Cash Flow Enhancement Program (CFEP)	Like the City's prior CFEP, this allows a prime contractor to invoice and be paid the "Cash Flow Enhancement" amount to be described in the General Conditions at the beginning of a project. Subcontractors whose application to the CFEP is approved could get a limited cash advance that would help with the expense of mobilization. The advance loan would be repaid through deductions from future progress payments.	**x**	
7) City establishes a loan guarantee and/or collateral pool fund	The City would allocate and deposit into an earmarked bank account a pre-determined amount of funding that would serve as a loan guarantee and/or collateral pool fund. The fund would cover a percentage of the borrower's debt obligation to the bank if the borrower defaulted on the loan.	**x**	**x**
8) Chapter 380 recipients pay for a loan guarantee and/or collateral pool fund	This model would be the same as option 7 above except that companies receiving Chapter 380 incentives would be responsible for paying a fee (likely a percentage of their economic incentive package) to create the loan guarantee and/or collateral pool fund; and only small businesses, including MBE/WBEs, hired on Chapter 380 projects would be eligible for the loan guarantee and collateral support.		**x**

As described in more detail in Section VIII, City staff recommends a multi-pronged approach. At a minimum, for both City contracts and Chapter 380 projects, staff recommends *Option 1: City approaches 3rd party financial institutions to offer independent loan programs with flexible* *underwriting terms*. This would not require City expenditure. As an additional option that could be made available for both City contracts and Chapter 380 projects, staff recommends *Option 3: City contracts with a 3rd party administrator and funds a loan pool*. For City contracts, staff further recommends *Option 4: City establishes Quick Pay Program (QPP)* plus *Option 5: City establishes Mobilization Prompt Pay Program (MPPP)*. The advantages, disadvantages, and resources needed for all options are further described in Section VIII. The specific requirements of each of these options would need to be determined once staff is given direction on which way to proceed.

II. Background

On October 24, 2013, Austin City Council passed Resolution 20131024-055, which directs staff to explore options for providing a guaranteed loan program, including a collateral pool, as a resource for small businesses that either: contract with the City directly or as subcontractors for companies that contract with the City; or contract with companies that receive Chapter 380 economic incentives with the City.[1] The resolution was adopted in response to and after extensive work over two years by the City and stakeholders to make revisions to the City's economic development policy.

Prior to passage of the resolution, in May 2012, the City Council created the Council Special Committee on Economic Incentives to compile findings and reports on issues including wage floors, demonstration of need for an incentive, employee health care benefits, small business incentives, and fee waivers.[2] The Special Committee met from June 29, 2012, through November 27, 2012. At the end of that period, the Special Committee approved five motions to propose amendments to the City's Economic Development Policy to the City Council for consideration. The Special Committee also directed the Economic Development Department (EDD)[3] to create an exception process for two of the Special Committee's proposed minimum core requirements.[4]

Among the motions passed by the Special Committee were proposals to add the following new minimum core requirements to the City's Firm Based Incentive Matrix:[5]

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[1] Resolution 20131024-055 is available online at: http://www.austintexas.gov/edims/document.cfm?id=199805.

[2] The Special Committee was created by Resolution No. 20120524-092, available online at: http://www.austintexas.gov/edims/document.cfm?id=170793.

[3] EDD was formerly the Economic Growth and Redevelopment Services Office (EGRSO) and was renamed in October 2013.

[4] A more complete recounting of the work of the Special Committee and EDD can be found in the August 2013 report, "2013 Report and Recommendations on the City of Austin Economic Policy," available online at: http://austintexas.gov/sites/default/files/files/EGRSO/EGRSO_Report_on_ED_Policy_Final.pdf.

[5] The Firm Based Incentive Matrix, used to determine firm eligibility for economic development incentives as authorized by Chapter 380 of the Texas Local Government Code, was originally adopted by the City Council in June 2003 via Resolution No. 20030612-015 and later amended by Resolution No. 20041028-003, available online at: http://www.austintexas.gov/edims/document.cfm?id=85636.

- pay prevailing wages to construction workers, or no less than the Living Wage as specified below;
- pay at least the City's $11.00 per hour Living Wage to full-time employees, contract employees, and contract construction employees (subject to an exception process whereby this requirement could be waived); and
- provide health insurance benefits for all new full-time employees, including domestic partners (subject to an exception process whereby this requirement could be waived).

Regarding the proposed Living Wage requirement, the Special Committee recommended that the City establish a stakeholder process to consider strategies for mitigating the potential impacts such a requirement may have on subcontractors.

In response, EDD hosted stakeholder meetings in April and May of 2013 and received comments, including the following, about the potential impacts of the Living Wage requirement applying to construction employees:

- Small companies are less able to absorb the up-front costs of higher wages and will have to seek higher-risk, more expensive financing. Smaller companies will have to submit higher bids to cover the increased costs, resulting in less competitive bids for economic incentive construction jobs.
- Small companies that cannot qualify for interim financing to cover the higher project costs until completion will not be able to compete for construction jobs on economic incentive driven projects.
- A wage increase for lower-skilled workers will cause the more highly skilled workers to demand a proportionate increase in pay for their services. This will result in significantly higher wage costs at all skill levels, not just workers currently making less than $11.00 per hour, creating a compression of pay issues across the board.

After discussing various alternatives, the stakeholders arrived at the following consensus recommendations, in order of preference:

1. Do not implement the $11.00 per hour wage floor policy.
2. If a wage floor policy is to be implemented, apply the Davis-Bacon prevailing wage scale maintained by the U.S. Department of Labor, and used on City projects, which establishes a prevailing wage for each construction employee category.
3. If the $11.00 per hour wage floor is implemented:
    a. Establish a City-funded loan guarantee program to enable local contractors to secure private financing. Under this program, the City would identify funding for a

collateral pool that would guarantee repayment of contractors' loans to private lenders.

b. Offer additional incentives to encourage Chapter 380 recipients to contract with companies that pay construction workers a minimum $11 per hour. This arrangement would be voluntary and would encourage Chapter 380 recipients to accept higher construction bids in exchange for lower tax costs.

These recommendations were presented to the MBE/WBE Small Business Procurement Program Advisory Committee, which then approved a resolution at its June 4, 2013 meeting recommending for City Council consideration that:

a. The City not implement the proposed $11.00 per hour minimum wage requirement for Chapter 380 agreements; and

b. The City instead implement the Davis-Bacon prevailing wage scale established by the Department of Labor as the wage requirement for Chapter 380 agreements.[6]

In its August 30, 2013 report, based on above-described discussions with stakeholders and research on best practices, EDD issued the following recommendation: Companies receiving incentives under Chapter 380 should be required to pay *either* prevailing wages conforming to the Davis-Bacon wage scale *or* the $11 per hour minimum Living Wage, *but not both*.

EDD further recommended against a collateral pool or loan guarantee program administered by the City.[7] The report cited several challenges to implementing such a program in-house:

- Lack of a readily available significant funding source or assets that can be used for either type of program;
- No available resources to engage in the credit analyses required for reviewing loan applications of this volume; and
- Lack of an expedient process to engage in transactions at a fast pace for small construction businesses to bid on projects.

[6] The resolution is available online at http://www.austintexas.gov/edims/document.cfm?id=194575.

[7] EDD's report also addressed comments by two stakeholders suggesting that a collateral pool be funded by savings generated from the City's rolling owner-controlled insurance program (ROCIP). The report explained why this is not feasible: "ROCIP is funded by the proceeds of voter-approved bonds issued for City Capital Improvement Program (CIP) projects. A recent legal opinion from the City's bond counsel states that bond proceeds can only be issued for the purpose for which it was issued, and this opinion is in agreement with prior Legal Department and Budget Office opinions received in 1994 and 2009. Therefore, a collateral pool for private projects using ROCIP funding is not viable." See page 17 of the report, available online at: http://austintexas.gov/sites/default/files/files/EGRSO/EGRSO_Report_on_ED_Policy_Final.pdf.

At its October 24, 2013 meeting, the City Council took two relevant actions. First, they adopted Resolution 20131024-056,[8] which revised the Firm Based Incentive Matrix to add the following minimum requirements for companies seeking economic incentives from the City:

- The Firm will ensure that all construction workers hired for construction funded by the Firm will be provided Workers Compensation Insurance and OSHA 10 Training;
- The Firm will comply with the City's MBE/WBE Ordinance (already a requirement because of Resolution No. 20120112-058,[9] the "Third Party Resolution");
- The Firm will ensure that all construction work funded by the Firm complies with the City's established prevailing wage requirements used on City of Austin public works projects. Unless living wage is exempted through the exception process, the City of Austin's living wage will apply to any prevailing wage classification that falls below the living wage. (The Firm may qualify for an exception from this requirement.)
- The Firm will ensure that all workers are paid at least the City of Austin's living wage, including full-time employees, contract employees, and construction workers hired for construction work funded by the Firm. (The Firm may qualify for an exception from this requirement.)
- The Firm will extend benefits to domestic partners of employees and their dependents. The Firm's policy should reflect the definition of a domestic partner as an individual who lives in the same household and shares the common resources of life in a close, personal, intimate relationship with an employee if under Texas law the individual would not be prevented from marrying the employee on account of age, consanguinity or prior undissolved marriage to another. A domestic partner may be of the same, or opposite, gender as the employee. (The Firm may qualify for an exception from this requirement.)
- The Firm will provide health insurance benefits for all new full-time employees. (The Firm may qualify for an exception from this requirement.)

The City Council also adopted a process by which firms could qualify for exceptions to certain specified core requirements.[10]

III. Resolution No. 20131024-055 Calling for This Report

[8] Resolution 20131024-056 is available online at: http://www.austintexas.gov/edims/document.cfm?id=200017.

[9] Resolution No. 20120112-058 is available online at: http://www.austintexas.gov/edims/document.cfm?id=163011.

[10] For more information, see Resolution 20131024-056, available online at http://www.austintexas.gov/edims/document.cfm?id=200017.

At the October 24, 2013 meeting, the City Council also adopted Resolution No. 20131024-055,[11] which is the basis for this report. The resolution noted that stakeholders had identified several impacts of the City's revised economic development policy, including a concern that small companies are "less able to absorb the up-front costs of higher wages and will have to seek higher-risk, more expensive financing." The resolution also pointed to the stakeholder group's recommendation that, if the City implements a Living Wage floor, the City should establish a loan guarantee and/or collateral pool program to enable local contractors to secure private financing. Noting that EDD staff had recommended against establishing a City-run loan guarantee or collateral pool program because of the lack of resources needed to run such a program, and noting that the City has partnered with third-party lenders in other programs, the resolution directed City staff to:

> *Explore options for working with third party financial institutions to provide a guaranteed loan program including a collateral pool as a resource for small businesses including City certified minority- and women-owned business enterprises that contract with the City directly, or through companies that contract with the City or contract with companies that receive chapter 380 economic incentives with the City.*

It further directed staff to:

> *Bring back multiple options regarding a possible guaranteed loan program including a collateral pool, and provide information on any related fiscal notes, program structure and administration information, and detailed outlines of potential benefits and services available for small businesses for Council consideration no later than December 12, 2013[[12]] to allow time for discussion prior to the mid-year budget adjustment in January 2014.*

With respect to the terminology used in the resolution, staff has interpreted a loan guarantee to mean a promise to repay the debt obligation (or some percentage of it) of a borrower if the borrower defaults. A collateral pool is typically a pool of funds that are held at a financial institution and are used as pledged collateral by borrowers that may need additional assets to qualify for a loan or a line of credit.

IV. Process Undertaken

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[11] Resolution No. 20131024-055 is available online at: http://www.austintexas.gov/edims/document.cfm?id=199805.

[12] In order to allow time to involve stakeholders, properly consider the large volume of information before the Committee, and account for the holidays, SMBR Director, Veronica Briseño Lara raised the issue of a deadline extension at the November 12, 2013 meeting of the MBE/WBE and Small Business Council Committee and heard concurrence on the extension from the members. Director Lara also sent a memorandum dated November 27, 2013 to the Mayor and City Council requesting a deadline extension to January 30, 2014. No objection or comment to this memorandum was received.

To execute City Council's direction, staff from the Small and Minority Business Resources Department (SMBR), Contract Management Department (CMD), Economic Development Department (EDD), Finance Department (Treasury Office, Purchasing Office, Controller's Office), City Manager's Office (CMO), and the Law Department began meeting on a weekly basis in November 2013. Staff conducted research on existing resources that the City provides to small businesses and gathered information on loan guarantee and collateral pool programs offered in other states and cities.

As part of the information gathering process, staff reached out to private organizations and public entities offering comparable programs in other cities, including San Antonio, Houston, and Dallas, and at the University of Texas at Austin.

Staff discussed the issue and collected stakeholder feedback on program options at the November 5th and December 3rd, 2013, as well as the January 7th, 2014 meetings of the MBE/WBE and Small Business Enterprise Procurement Program Advisory Committee. Staff also did so at the meetings of the Minority-Owned and Women-Owned Business Enterprises (MBE/WBE) and Small Business Council Committee on November 12th and December 10th, 2013 as well as on January 14th, 2014.[13] Staff hosted stakeholder input sessions on December 11th, 17th, and 19th, 2013, and January 9th, 2014, at various locations and times of day in order to receive the most feedback. Invitations to the December meetings were sent to the stakeholders that participated in the prior EDD meetings on the City's Economic Development Policy plus a random sampling of 42 MBE/WBE certified firms. Invitations to the January stakeholder meeting were sent to all 904 certified MBE/WBE firms as well as area nonprofit lending institutions.

Although City Council's resolution did not specify the type of industry or service that staff should consider as a primary focus for a potential program, it became apparent from the impetus of this discussion (i.e. construction wage rates) and stakeholder feedback (see below) that the greatest need for assistance is within the context of construction procurement. Therefore, staff focused efforts and recommendations on those serving the construction industry.

V. Stakeholder Feedback Received

The City has received extensive feedback on the needs of small construction businesses and the kind of program stakeholders want the City to enact. Key points include the following:

- Capital access is a significant barrier to the establishment, expansion, and growth of minority- and women-owned businesses. Small businesses, including City certified MBE/WBEs often lack the up-front funds necessary to undertake large, or even medium-scale, projects. As a result, it is difficult to bid for jobs and/or complete them.

[13] At the time of this report's release, a special called meeting of the Council Committee was scheduled for January 28, 2014.

- These conditions are exacerbated because MBE/WBEs have historically faced challenges borrowing from banks for many reasons, including lower incomes, lending processes that are difficult to navigate, difficulty demonstrating creditworthiness, lack of access to assets needed for collateral, and discrimination.

- Cash flow is a major challenge for small businesses. This can make meeting payroll very difficult. This is particularly true on a City contract if a company has to wait a long time to receive payment from the prime contractor and/or for relevant inspections to be completed.

- Now that the City has enacted new wage requirements on companies receiving economic incentives (Chapter 380 economic development agreement projects), it could become even more difficult for small businesses to have sufficient capital to compete for and perform construction jobs on these companies' projects.

- Creating a program, such as a guaranteed loan or collateral pool program, could make contracting on City projects and Chapter 380 projects a more viable option for small businesses, including MBE/WBEs.

- Any program that the City enacts should be flexible, fast, and not too burdensome for small business borrowers. Time is of the essence for construction subcontractors that are competing for project contracts. Representatives of minority contractor associations expressed concerns that many of the existing loans available through federal government programs such as the Small Business Administration (SBA) and the Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG) do not meet their needs because they require too much paperwork, have inflexible requirements, and take too long to process. They also wanted to see requirements that rank character and historical capacity, for example, higher than rigid measures like the traditional credit score.

- Stakeholders recommended that the City talk with alternative nonprofit lenders to understand if they offer resources that would meet the needs of MBE/WBE construction subcontractors.

- Stakeholders encouraged the City to consider setting up a program that is comparable to the "Pilot Cash Flow Enhancement Program" used on the Austin Convention Center Expansion Project and/or the "Super-Prompt Pay Program" used by the prime contractor on the construction of Austin's City Hall. They also suggested incentivizing the prime contractor for offering any cash flow enhancement or prompt payment programs. *(See Section VI for additional information on these programs.)*

- A payment assistance program through the prime contractor would be preferable to a loan program run by a financial institution because such institutions, even non-profits, apply high interest rates to cover their costs. It also can protect the City from taking on too much direct risk.

- Stakeholders that have served as prime contractors expressed concerns about setting up a program that requires paying subcontractors before the subcontractor has fully performed its job. Such a program can place too much risk on the prime contractor.

- Compared to labor costs, material is easier to lend or impose a lien on. This is because the risk to the borrower can increase when labor is paid prior to inspection or completion of work.

- Other stakeholders recommended the City work with third party financial institutions to provide loans to the small businesses and use City funds to create a loan loss reserve fund (this could also be referred to as a "loan guarantee fund"). If a borrower defaults, this fund could provide money that helps a financial institution recoup its losses. Because the financial institution knows that there is a fund that will offer such protection, it will be more likely to lend to the small businesses that need help.

- Because prompt payment is such a frequently discussed issue in commercial construction, the general contractor community stated support for concepts like a loan guarantee or collateral pool that would mitigate financial stress on subcontractors and general contractors. They expressed concerns that while such programs could remove burden from subcontractors, they may shift burden onto general contractors or higher-tiered subcontractors. Accordingly, they asked the City not to place an additional burden – either financial or administrative – on the general contractor, owner or higher-tiered subcontractors. They acknowledged that while there may be some projects where parties involved may come to agreements that ease burdens on a party, such arrangements should be addressed on a project-by-project basis rather than mandated across the board.

- Stakeholders from the Greater Austin Chamber of Commerce recommended that the program adopted be the same program for both Chapter 380 agreements and City of Austin construction projects. They also expressed concern with the concept of requiring Chapter 380 participants to contribute financially to a collateral pool because it could deter businesses from locating here.

VI. Key Features of Relevant Past and Current Programs

The City of Austin has implemented various programs to address the need for capital and capacity building in the small, minority- and women-owned business contracting community. These programs have been attempted in various forms on a variety of projects. In developing this report, staff examined past programs in an effort to identify best practices to consider for future implementation. This section describes these programs for reference.

a. History of Cash Flow Enhancement & Super-Prompt Pay Programs Used on the Convention Center and City Hall Projects

The ideas of quicker payment and access to capital were heavily explored and piloted during the 2000's as several large capital improvement projects (CIP) projects were underway.

On the Convention Center Expansion project, the Cash Flow Enhancement Program (CFEP) was utilized. The basic premise of this program was to provide subcontractors access to cash early in the project to cover contract mobilization expenses such as payroll, supplies and materials, and leasing or purchasing equipment needed on the project.[14] Any subcontractor performing work on the project that was a small business and demonstrated financial need was a candidate for the program. Each subcontractor completed a City application that was reviewed by a committee with the final recommendation being made by the SMBR Director. The subcontractor could request an advance of up to 5% of the value of their contract. Credit references for the applicant were required from banks and suppliers and a formal contract was signed. The program was funded as a General Conditions line item in the prime contractor's contract in the amount of $300,000. The prime contractor paid the subcontractor via a lump sum for identified mobilization costs and through the standard prompt pay process for ongoing expenses. Repayment was made through deductions from progress payments and the prime contractor kept a 5% retainage of the invoiced amount.

On the construction of the City Hall (2003-2004), a program referred to at the time as "Super-Prompt Payment Program" (SPPP)[15] was utilized. Similar to CFEP, any subcontractor performing work on the project that was a small business and demonstrated a financial need could apply. A formal review committee vetted the applications and made a recommendation for approval or denial to the SMBR Director or the Director's designee. Credit references for the applicant were required from banks and suppliers and a formal contract was signed, though a letter of intent to contract with the prime was acceptable as well. The program was funded as a General Conditions line item in the prime contractor's contract in the amount of $300,000. This amount was invoiced by the prime and paid early in the work to serve as the funding pool for future Super-Prompt Payments. The primary differences between this program and the CFEP were the expenses covered and the method of repayment. In SPPP, eligible expenses were invoiced payroll, materials and supplies, and lease payments for equipment for work performed on the project, rather than CFEP's mobilization expenses. In CFEP, payment was a lump sum and repayment was deducted from future progress payments. In SPPP, approved subcontractors submitted invoices to the prime contractor and payment was made quickly out of the general conditions funding, often prior to the prime contractor submitting its invoice for that work for payment by the City.

In later years (mid-late 2000's), the City attempted to expand these programs by piloting them on a number of specified projects. Contractors were invited to participate in the programs

[14] For future programs under consideration, the City interprets mobilization costs to typically include the costs of assembling the staff, purchasing supplies and materials, and bringing equipment to the project site in order to begin work. Specific mobilization costs depend on a project's scope of work.

[15] This is not to be confused with the "Super-Prompt Payment" programs of later years that were structured differently.

offered. This occurred for several years but, to City staff's knowledge, no contractors opted to participate in the CFEP or the SPPP. In January of 2006, the MBE/WBE Advisory Committee voted to separate the two programs and move forward with SPPP. CFEP was to be pursued at a later date. With time, the SPPP evolved.

The program that was ultimately memorialized in the City's construction documents and procedures in 2008 was different than what was used on the construction of the City Hall. Like the City Hall program, this SPPP paid prime contractors more quickly and, while an application process was still required for subcontractors wishing to opt into the SPPP process, approval allowed the primes to invoice the City *twice* a month rather than only once a month. This would then allow the prime contractors to disburse funds to the subcontractors more quickly. This new version of SPPP has been included in many contracts since its inception. However, no subcontractors have applied for the program.

Concerns still exist for the long-term viability of the SPPP as currently modeled because the review and approval of twice a month pay applications has the potential to seriously impact existing staff resources. While it has not been tested because there have been no participants, staff is also concerned that this may not meet the needs of quicker payment to subcontractors. This is because the prime contractors may choose not to go through an invoice correction process when necessary and may instead opt for just hitting the "next regular invoice" cycle, resulting in unintentional payment delays. Reasons cited for lack of participation include concerns about submitting multiple invoices (administrative burden for both prime and subcontractors) and the amount of time necessary for the application and approval process. On one project, the prime contractor implemented its own prompt pay program, and as a result the subcontractors did not have a need for a City program.

b. Other City programs

In addition to prompt payment programs, the City has previously offered and continues to offer loan programs. For example, the City's Neighborhood Housing and Community Development Department (NHCD) used to offer the Neighborhood Commercial Management Program (NCMP), which was resourced by federal CDBG and HUD Section 108 funds. NCMP provided loans to existing business to expand operations; acquire land and improvements; construct a new building; make leasehold improvements; and to purchase machinery and equipment.

While NCMP no longer exists, the City now offers the Family Business Loan Program (FBLP).[16] FBLP, managed by EDD, consists of an $11 million loan pool funded by HUD Section 108 allocations. The $11 million HUD allocation provides borrowers access to an additional $30

[16] More information on FBLP available at http://www.austintexas.gov/sites/default/files/files/EGRSO/FBLP_Flyer.pdf and http://austintexas.gov/news/new-measures-get-low-interest-loans-hands-small-business.

million in private financing. This loan program leverages public and private investment to foster business expansion, stimulate job creation and increase Austin's tax base.

FBLP is a public-private loan participation program that that makes fixed-asset and working capital loans available to qualified small business owners that are ready for business expansion. The three partners are: commercial banks designated as SBA lenders; SBA Certified Development Company (CDC)[17] designated as an SBA 504 or a Community Advantage lender; and the City of Austin managing the HUD Section 108 grant. FBLP makes low-interest loans to finance renovation and new construction of buildings, acquisition of buildings, refinancing of existing debt to an independent institutional lender and working capital. The program requires borrowers to create one job for every $35,000 borrowed, and 51% of individuals hired must be deemed low to moderate income by federal measurements.

The City's NHCD also offers a Community Development Bank Program. Funding for the program comes from HUD's CDBG program and is granted to PeopleFund, a nonprofit organization (registered 501(c)(3) and Community Development Financial Institution) that administers loan programs offering flexible capital and technical assistance to small and minority- and women-owned businesses that are expanding or relocating to low-income areas. NHCD grants PeopleFund $150,000 to administer these loan programs in exchange for the qualifying businesses creating or retaining six jobs for low to moderate income individuals.

NHCD also offers the Microenterprise Technical Assistance program. Funding comes from HUD's CDBG program and is granted to BiG (Businesses Invest in Growth) Austin,[18] a nonprofit 501(c)(3) organization. BiGAUSTIN provides annual training and technical assistance to eligible microenterprise firms. A micro-enterprise firm is a firm that employs five or fewer individuals, including the owner. The technical assistance services provided to businesses include certifying eligible microenterprise businesses, education and training and direct assistance in developing business and marketing plans. NHCD grants BiGAUSTIN $200,000 in exchange for: 256 hours of technical training to eligible businesses; assisting 33 unduplicated clients; providing a minimum of three curriculum-based training courses resulting in the certification of 33 unduplicated eligible microenterprise businesses; and, conducting reviews of no less than 16 existing business plans to ensure that each plan meets expected professional standards.

Information on other relevant City programs are included in Appendix 2 to this report.

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[17] In economic and community development there are two types of entities that use the acronym CDC: Community Development Corporation, CDC, (typically associated with affordable housing) and the SBA Certified Development Company, CDC (associated with SBA 504 loans assisting small businesses). For more information, see: http://www.sba.gov/community/blogs/community-blogs/small-business-cents/cdcs-and-cdcs-community-development-corporation.

[18] BiGAUSTIN began as a City of Austin micro-lending program in 1993. It became an independent, Board-governed entity in 1995.

VII. Options Considered

Staff considered a myriad of options based on stakeholder feedback and research on best practices. The following models, culled from a wider array of options, are the ones that warranted further analysis. For each model, staff has provided information about existing programs that fit the model, advantages, disadvantages, relevant stakeholder feedback, and City resources needed to implement a program.[19]

1) City approaches 3rd party financial institutions to offer independent loan program

a. Overview: In this model, one or more financial institutions (including banks and nonprofit lenders) volunteer to offer loans to small businesses, including City-certified MBE/WBEs. Once a financial institution agrees to participate, the City would include its name in a list of lenders participating in the City-endorsed loan program. This model would not require expenditure of significant staff time. The financial institutions would agree to make their lending criteria more flexible than traditional loan requirements so that more small businesses, including MBE/WBEs, could qualify. Two types of financial institutions would provide these lending services:

1. Non-profit lenders: These institutions have a mission to provide loans and other assistance resources to small businesses who may not otherwise be able to access commercial loans. Because these non-bank lenders are not held to the same regulatory requirements as banks or have been delegated authority by SBA, they have more flexibility to lend to borrowers considered higher risk by traditional banks. They typically offer supplementary training and mentorship resources that have resulted in a low rate of delinquencies and defaults. Example non-profit lenders: PeopleFund, Acción Texas Inc., and BiGAUSTIN.

2. Banks: While banks may not be able to make their lending requirements as flexible as non-profit lenders can, some banks can choose to take affirmative steps to make loans more flexible than they would otherwise be for MBE/WBEs that have been awarded a contract to perform work for the City or a Chapter 380 recipient.

b. Existing example(s): The City of San Antonio recently launched this type of program. Non-profit lender Acción Texas Inc. and nine banks, including Frost Bank, are offering a pilot loan program for minority- and women-owned contractors that have been awarded a contract by the City of San Antonio. The program was launched after concerns surfaced about the low participation of African-American business enterprises in the execution of contracts under the City's 2012 Bond Package.

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[19] The Law Department will provide Council and staff a legal analysis in a separate memorandum.

Community groups and businesses were involved and the Mayor called on staff to bring forward a multi-year Diversity Action Plan. Staff did so and included this financial institution pilot loan program as one of several strategies in the Action Plan. The pilot loan program is still in its infancy but staff from the City of San Antonio has stated that interest in City contracts by MBE/WBE contractors has increased since launching the Action Plan.

c. Advantages of this model: This model would not require formal action by the City nor would it require a substantial injection of City funds. The City could dedicate staff to assisting with the outreach for this loan program, as the City of San Antonio did, but no City funds would be at risk in the lending itself. Moreover, this process would rely on the expertise of financial institutions, which have experience in making lending decisions like these. Because their funds are at stake, they will be likely to make smart decisions and offer resources that increase the borrowers' likelihood of success.

d. Disadvantages of this model: This model relies on voluntary participation by financial institutions. Lenders may not make loan criteria flexible enough to allow the most disadvantaged small businesses to access capital. Stakeholders are also concerned that the interest rates for such loans will be too high.

e. Stakeholder feedback: Stakeholders expressed concerns about banks using high credit scores and interest rates that would make the loans inaccessible to the small businesses that are most in need of assistance. There were also concerns expressed about the infancy of the San Antonio model and its lack of documented success.

f. City resources needed: If financial institutions voluntarily choose to offer and participate in this program, there would be no City resources needed to manage it. The City could choose to dedicate staff time (1 FTE) to perform outreach and education about this resource for small businesses.

2) City funds a 3rd party financial institution to administer a loan program

a. Overview: In this model, the City would utilize a competitive procurement process to solicit and select a financial institution[20] to administer a loan program to serve small businesses, including MBE/WBE construction contractors and subcontractors, working on a City contract or a Chapter 380 project. The City's contract with the financial institution would only cover the cost of administering the loan program. The financial institution would provide the loan pool and could utilize grants, loan fees, and/or

[20] These could potentially be banks or nonprofit financial institutions. Austin has several nonprofit organizations that are also classified as Community Development Financial Institutions (CDFIs), whose primary goal is to provide access to credit for underserved small businesses and entrepreneurs that have trouble getting loans from traditional banks.

interest to fund the loan pool.[21] No City funds would be loaned out. The City contract would fund activities including the review and denial of applications as well as the processing, servicing, and closing approved loans. Contract performance measures would be established for each of these services.

b. Existing example(s): The City's current contract with PeopleFund to offer the Community Development Bank Program, which is funded by $150,000 from CDBG, and the City's current contract with BiGAUSTIN to offer the Microenterprise Technical Assistance program, which is funded by $200,000 from CDBG, are both relevant examples illustrating City contracts with a nonprofit financial institution to provide resources to small businesses.[22]

   Also, in 1993, when BiGAUSTIN was started as a City micro-lending program, the City funded the administrative expenses of establishing the program while grants and other funding sources were utilized for the loan pool. BiGAUSTIN has since become an entity independent of the City and currently contracts with the City to offer the Microenterprise Technical Assistance program.

c. Advantages of this model: Under this model, no City funding would be at risk from loan defaults. Moreover, financial institutions have expertise in making lending decisions. Some of them, particularly some nonprofit lenders, have experience building the capacity of underserved small businesses. Because banking regulations do not apply to the nonprofit organizations, they have the flexibility to extend credit to businesses that banks cannot. For example, nonprofits may have flexible underwriting grids and may avoid establishing minimum credit score requirements that are too high for small and MBE/WBE businesses to meet. Instead, they can evaluate every loan application on an individual case-by-case basis. Because of the training, education, and support they provide to clients, some have exceptionally strong track records of success (very low loan delinquency and default rates). Those nonprofit lenders that are considered "preferred lenders" by the SBA have been delegated authority by the SBA to make independent credit decisions. This allows for streamlined treatment of SBA 7(a) Community Advantage Loans and prompt decision making and funding (e.g., 2-4 business days after loan documents are received). Such prompt decision-making shows that they are more likely to have the capacity to make loan decisions in the

[21] Nonprofits such as CDFIs get funds from a variety of sources. For example, traditional banks may invest their own capital in CDFIs and receive Community Reinvestment Act (CRA) credit in return.

[22] City staff reached out to several nonprofit lenders, including PeopleFund, BiGAUSTIN, Acción Texas, Business and Community Lenders (BCL) of Texas, and Capital CDC, to obtain information about the kinds of services they offer and clients they serve. Staff received feedback and/or information from PeopleFund, BiGAUSTIN, and BCL of Texas.

tight timeframe that is required in the construction industry.[23] Moreover, nonprofit lenders could invite MBE/WBEs to participate in capacity-building programs (e.g., a boot camp) in which small businesses complete training and provide financial documentation in advance, which then positions the business to quickly qualify for loans as soon as a project opportunity arises. With this model, because it will utilize a competitive procurement process, the City may have some power to dictate the manner in which the program is administered.

d. Disadvantages of this model: Some stakeholders have expressed concerns that banks cannot process a loan quickly enough and that nonprofit lenders do not have the unique technical experience required to serve the construction industry. Also, whether or not a nonprofit lender would have the funds readily accessible to fund a loan pool is uncertain. Moreover, any lender will have to charge some level of fees and interest rates to recoup administrative costs. These fees and interest rates may impose a strain on small businesses that are already struggling with access to capital.

e. Stakeholder feedback: Some stakeholders have expressed concerns that banks cannot process a loan quickly enough and that nonprofit lenders do not have the unique technical experience required to serve the construction industry. They also stated concerns that financial institutions will require too much documentation and will charge high fees and interest rates.

f. City resources needed: The resources needed would depend on the scope of the program the City desires to implement (e.g., approximately how many loans should be processed, at what amounts, etc.). The City's costs would likely include 1) the funds paid to the financial institution for administering the program, and 2) possibly one or more City FTE(s) to serve as the contract administrator that would oversee and monitor the activities of this contract with a financial institution. More definitive decisions on needed resources will be made after the scope and breadth of these potential contracts are defined, and a determination is made as to the department responsible for these potential contracts.

3) City contracts with a 3rd party administrator and funds a loan pool

a. Overview: In this model, the City would utilize a competitive procurement process to solicit and select a financial institution[24] to administer a loan program (as described above in option 2). In addition, the City would contribute a pre-determined amount of

[23] This information is based on conversations and comments received from some nonprofit lenders in Austin. At least one of the lenders with whom staff spoke disclosed that, although it was not its predominant type of client, it has experience in providing loans to construction subcontractors.

[24] See footnote 13.

funding, as a grant, to establish a dedicated revolving loan fund for small and MBE/WBE businesses. The selected financial institution could be required to match the City's contribution to the revolving loan pool. Therefore the City would fund: a) administration of the loan program as described in option 2 and b) the seed money for a revolving loan fund. The revolving loan fund could grow as loans are repaid, the financial institution identifies other funding sources, and/or the financial institution's contribution increases. The City would continue making the grant for a pre-determined period, perhaps two or three years subject to annual appropriation, but the amount would decrease incrementally each year as the loan pool grows.

b. Existing example(s): The City's current contract with PeopleFund to offer the Community Development Bank Program, which is funded by $150,000 from CDBG, and the City's current contract with BiGAUSTIN to offer the Microenterprise Technical Assistance program, which is funded by $200,000 from CDBG, are both relevant examples illustrating City contracts with a nonprofit financial institution to provide resources to small businesses.[25]

Also, in 1993, when BiGAUSTIN was started as a City micro-lending program, the City funded the administrative expenses of establishing the program while grants and other funding sources were utilized for the loan pool. BiGAUSTIN has since become an entity independent of the City and currently contracts with the City to offer the Microenterprise Technical Assistance program.

c. Advantages of this model: As noted in option 2, financial institutions have expertise in making lending decisions. Some of them, particularly some nonprofit lenders, have experience building the capacity of underserved small businesses. Because banking regulations do not apply to the nonprofit organizations, they have the flexibility to extend credit to businesses that banks cannot. For example, nonprofits may have flexible underwriting grids and may avoid establishing minimum credit score requirements that are too high for small and MBE/WBE businesses to meet.

Instead, nonprofit lenders can evaluate every loan application on an individual case-by-case basis and consider a more comprehensive picture of the borrower's creditworthiness. Because of the training, education, and support they provide to clients, some have exceptionally strong track records of success (very low loan

[25] City staff reached out to several nonprofit lenders, including PeopleFund, BiGAUSTIN, Acción Texas, Business and Community Lenders (BCL) of Texas, and Capital CDC, to obtain information about the kinds of services they offer and clients they serve. Staff received feedback and/or information from PeopleFund, BiGAUSTIN, and BCL of Texas.

delinquency and default rates). They may also utilize streamlined procedures that enable the prompt decision-making that is required in the construction industry.[26]

Moreover, because it will utilize a competitive procurement process and will be providing seed money for the revolving loan fund, the City can dictate the manner in which the program is administered. For instance, the solicitation could clearly identify the parameters of the contract and the types of loans to be administered – for example, a quick turn-around time, the use of additional criteria beyond credit scores for eligibility, and specify that the loans will be for construction contractors.

Finally, this model would allow the City to provide seed money to establish a self-sustaining loan pool without creating a long-term funding obligation. This model would also allow the City's obligation to be paid in increments from multiple fiscal year budgets, subject to annual appropriation and applicable accounting requirements.

d. Disadvantages of this model: Although the amount is within its discretion, the City would have to dedicate a substantial amount of money to create a meaningful revolving loan fund (see section 3(f) below regarding "City Resources Needed"). If there are defaults on loans, especially at the outset of the program, the fund would be depleted before it is able to serve multiple small businesses. Also, as stated regarding the other models above, some stakeholders have expressed concerns that nonprofit lenders do not have the unique technical experience required to serve the construction industry. Finally, although the level of fees and interest rates that would be imposed is uncertain, they could impose a strain on small businesses that are already struggling with access to capital.

e. Stakeholder feedback: As stated above, some stakeholders have expressed concerns that banks cannot process a loan quickly enough and that nonprofit lenders do not have the unique technical experience required to serve the construction industry. They also stated concerns that financial institutions will require too much documentation and will charge high fees and interest rates.

f. City resources needed: The resources needed would depend on the scope of the program the City desires to implement (e.g., approximately how many loans should be processed, at what amounts, etc.). The City's costs would include: 1) the funds paid to the financial institution for administering the program; 2) seed money to establish the

[26] This information is based on conversations and comments received from some nonprofit lenders in Austin. At least one of the lenders with whom staff spoke disclosed that, although it was not its predominant type of client, it has experience in providing loans to construction subcontractors.

revolving loan fund, likely between $250,000 to $1,000,000;[27] and 3) possibly one or more City FTE(s) to serve as the contract administrator. The contract administrator will be necessary to oversee and monitor the activities of this contract with a financial institution. More definitive decisions on needed resources will be made after the scope and breadth of these potential contracts are defined, and a determination is made as to the department responsible for these potential contracts.

4) City establishes Quick Pay Program (QPP)

a. Overview: The model developed and used in the construction of the City Hall (then called Super Prompt Pay) has merit and should be considered a viable option for helping to ensure small businesses, including MBE/WBEs, have quicker access to payments.[28] To recap, the very simplified process of operation for QPP would be as follows:[29]

- Identify a project as "Quick Pay Program" eligible and the amount that would be made available to the prime contractor as a General Conditions line item in the pre-solicitation phase so this could be included in the procurement documents and communicated accordingly.
- The prime contractor would invoice and be paid the "Quick Pay" amount at the beginning of the project.
- Subcontractors interested in participating in this process would complete the application process. Any subcontractor who is certified as an MBE/WBE or an SBE would be eligible to participate.[30]
- Once approved, that subcontractor would invoice the prime as work is completed and inspected.

[27] Staff estimates that the revolving loan fund would need a balance of approximately $500,000 to $1M. The City may require the third party financial institution to match any seed money that the City contributes. If the City decides to proceeds in this fashion, the City could contribute between $250,000 to $500,000 in seed money and require the financial institution to contribute a matching amount. Otherwise, the City would need to contribute $500,000 to $1M on its own.

[28] For more information on the program used on the construction of City Hall, see Section VI.

[29] Formal procedures and documents would need to be developed. This overview is merely intended to convey the general flow of the process.

[30] These certification processes are already established and administered through SMBR.

- If the work is determined to be acceptable, the prime would 1) pay the subcontractor within 10 days and 2) include that work in the next pay application to the City of Austin.

b. Advantages of this model: Quick Pay is simple in design and would be easy to implement. Program parameters would need to be developed and formalized. Because this is payment for work that has been properly completed and installed (outside of the advance of the initial Quick Pay funds to the prime contractor – which would be limited to 5% of the value of the contract with a to-be-established cap), the risks associated with advancing funds prior to performance of work are reduced.

c. Disadvantages of this model: This program may cost the City more contractually because of the increased general conditions overhead costs to the prime contractor in processing more frequent payments, which are then passed on to the City. These impacts would be difficult to accurately determine as they would be factored into the overall bid price and would not be delineated. Defining the parameters of the eligible project may help to mitigate this impact.

d. Stakeholder feedback: Feedback from the stakeholders on this concept was largely positive as it does not involve a commercial lender and would not be overly burdensome to the subcontractor. This is especially true if the City uses MBE/WBE/SBE/DBE certification as the primary requirement. The general contracting community (through a spokesman from the Associated General Contractors of America (AGC)) stated support for programs that were less administratively burdensome to the general contractor. As this puts more of a burden on them, general contractors may not see it as favorably as other options. However, they did state support for programs like these if they are not implemented across the board.

e. City resources needed: Staff does not anticipate that additional resources will be necessary for this program.

5) City establishes Mobilization Prompt Pay Program (MPPP)

a. Overview: Because it does meet some of the needs raised by stakeholders, the current model of SPPP can be retained but slightly updated to become a Mobilization Prompt Payment Program (MPPP). As stated in Section VI, the basis for the existing SPPP model is to allow prime contractors the ability to submit pay applications twice a month, rather than monthly. This allows the eligible subcontractors to invoice twice a month and receive payments more quickly. We have heard from stakeholders that this is especially important when work is initiating and the contractors and subcontractors are mobilizing.

With slight changes to SPPP, such as limiting the timeframe for the twice-monthly billing to the initial stages of the contract or key mobilization phases, and eliminating the application process for the subcontractors, MPPP could be feasible. With a focus on the front-end of the process, MPPP would allow for expedited payment during the critical mobilization period. Additional discussions on the parameters for MPPP project eligibility are necessary but the program could include the following:

1. Project is identified as a MPPP project prior to issuing the solicitation. This is included in the procurement documents and communicated accordingly.

2. Inclusion in the program allows the prime to invoice twice monthly for the first X%[31] of project time. Upon completion of that time period, billing resumes at the monthly rate specified in the contract.

3. Flexibility in additional "twice-billing" periods would be added by contract to cover peaks of additional mobilization that may occur as subcontractors are coming on board at later points in the project.

b. Advantages of this model: MPPP structured in this way facilitates cash flow as work is starting on the contract and can help with the concerns about mobilization expenses, but mitigates the concerns of long-term broad-reaching staff impacts associated with reviewing and processing multiple pay applications a month.

c. Disadvantages of this model: This program may cost the City more contractually because of the increased general conditions overhead costs to the prime contractor in processing more frequent payments, which are then passed on to the City. These impacts would be difficult to define as they would be factored into the overall bid price and would not be delineated. Defining the parameters of the eligible project may help to mitigate this impact. Additionally, the increase in pay applications would result in increased project expenses for staff charges to the project. This would primarily be for inspection staff and project management staff review of the additional pay applications. While we do not anticipate this to be a major impact to the projects' budgets, input from the departments sponsoring capital projects should be gathered and considered as staff finalizes the program framework.

d. Stakeholder feedback: Feedback from the stakeholders on this concept was largely positive as it does not involve a commercial lender and would not be overly burdensome to the subcontractor. With the elimination of the application process, this becomes even more attractive. The subcontracting stakeholder community may not agree with the time-cap on the processing of twice-monthly invoices and desire it to continue for the duration of the contract. The general contracting community

[31] Still to be determined and may be variable based on project type/need. Staff is preliminarily thinking the first two months of project time is appropriate.

(through their AGC spokesman) stated support for programs that were less administratively burdensome to the general contractor. However, because this benefits the prime as well as the subcontractors, the general contractor community may view it more favorably.

e. City resources needed: This program will result in increased expense to the capital projects through internal billing of staff working on the project. At this time, a need for additional FTEs has not been identified.

6) City establishes Cash Flow Enhancement Program (CFEP)

a. Overview: The previous model of the Cash Flow Enhancement Program, which was used on the Convention Center expansion and is described in Section VI, could be resurrected. The needs identified in the early 2000's when this model was piloted still exist. To keep this program in line with current City structure, some slight modifications might be necessary, however, the framework still holds firm. A simplified program process would include the following:

1. Identify a project as "Cash Flow Enhancement Program" eligible and the amount that would be made available to the prime contractor for disbursement in the pre-solicitation phase so this could be included in the procurement documents and communicated accordingly.

2. The prime contractor would invoice and be paid the "Cash Flow Enhancement" amount at the beginning of the project.

3. Subcontractors interested in participating in this process would complete the application process. Any subcontractor who is certified as an MBE/WBE or an SBE and meets the other program criteria would be eligible to apply[32]. The approval process would include review of the application materials, including credit references from banks and suppliers.

4. The advance would be limited to 5% of the subcontractor's contract with the prime and would be paid by the prime to the subcontractor.

5. The loan would be repaid through deductions from future progress payments.

b. Advantages of this model: CFEP helps with one of the primary impediments to contracting for small firms – initial access to capital and the expense of startup and mobilization. The administration of this program as an internal City of Austin

[32] These certification processes are already established and administered through SMBR.

program helps ensure the process remains simple and timely, a concern heard repeatedly from stakeholders.

c. Disadvantages of this model: Of all the options evaluated, this model may present the highest risk to the City. The funds are loaned out of the project coffers, and while the recipient of the loan must execute a contract stipulating terms of repayment, the borrower's failure to perform remains a risk for the City. This program will also likely incur higher staff cost. If this were to be implemented across the board, there would need to be a contract administrator and/or lending specialist hired specifically for the purposes of monitoring these contracts and working on the loan approval processes. This program may also cost the City more contractually because of the increased general conditions overhead costs to the prime contractor in processing the initial loan disbursements and in deducting loan payments from progress payments. These impacts would be difficult to define as they would be factored into the overall bid price and would not be delineated. Defining the parameters of the eligible project may help to mitigate this impact.

d. Stakeholder feedback: Feedback from the stakeholders on this concept was largely positive as it does not involve a commercial lender and would not be overly burdensome to the subcontractor. The general contracting community (through their AGC spokesman) stated support for programs that are less administratively burdensome to the general contractor. Due to the complexity of deducting loan payments from future progress payments, CFEP might prove to be very burdensome to the general contractors and be viewed unfavorably by them.

e. City resources needed: Because of the complexity of administering this program, a lending specialist will be necessary to facilitate the review and approval process for the CFEP loans. Additionally, due to the risks associated with these loans, a contract administrator will be required to oversee and monitor the activities and payments on contracts under this program. Until the scope and breadth of these potential contracts are defined, and a determination is made as to the department responsible for these potential contracts, it is unclear if this activity can be absorbed by existing staff or if an additional FTE will be required for contract administration activities.

7) City establishes a loan guarantee and/or collateral pool fund

a. Overview: In this model, the City would allocate and deposit into an earmarked bank account a pre-determined amount of funding that would serve as a loan guarantee and/or collateral pool fund for small and MBE/WBE businesses working on a City contract or Chapter 380 project. The fund could serve two purposes:

1. Provide a loan guarantee: A loan guarantee by the City would be a promise by the City to repay the debt obligation (or some percentage of the debt obligation) of a

borrower if the borrower defaults, subject to applicable legal requirements. In this option, we recommend a model in which the City would guarantee up to 50% of a qualifying loan and the borrower is responsible for the remaining 50%.[33] The City would designate a maximum length of time (e.g., two years) for the guarantee to be valid. Upon successful loan maturity, assets would be returned to the City fund to serve other qualified borrowers and lenders. Although there are several ways to design a program that provides a loan guarantee, one example would operate as follows:

A small business owner approaches a bank to borrow $50,000 but the lender is not willing to make the loan without additional security. The business owner notifies the lender about the City's loan guarantee program. The lender applies to the City's loan guarantee program and provides details about the borrower and the conditions of the loan that it proposes to make.[34] The City evaluates it and, if acceptable, agrees to pay up to 50% of the borrower's debt ($25,000) if the borrower defaults. With the added security, the lender agrees to make the loan. The City, the borrower, and the lender then enter into a tri-party agreement outlining the terms and conditions sufficient to protect the City's interests and comply with applicable law.

2. Provide a collateral pool:[35] A City-funded collateral pool would be used to pledge assets to provide collateral on a loan when a borrower needs additional collateral to qualify for a loan or line of credit. The money in the collateral pool account would be pledged as collateral on behalf of the borrower. If the borrower defaults and the lender seeks to collect, the lender will have rights to the City's pledged cash collateral to cover the deficiency, as allowed by applicable legal requirements. Like the loan guarantee, in this option, we recommend a model in which the City would pledge up to 50% of the collateral amount needed on a qualifying loan. The City would designate a maximum length of time (e.g., two years) for the pledge to valid. Upon successful loan maturity, funds would be returned to the City fund to serve other qualified borrowers and lenders. Although there are several ways to design a program that provides collateral support, one example would operate as follows:

[33] City Council could consider a range of percentages and amounts for this model.

[34] An alternative permutation of this model would establish a loan guarantee program in which the City would work with one pre-designated financial institution.

[35] Some collateral pool programs are called "collateral support programs" or "collateral enhancement programs." It should also be noted that different states may have different legal and state constitutional allowances than the state of Texas.

A small business owner approaches a bank to borrow $50,000 but lacks $25,000 needed in collateral to meet the bank's requirements for the loan. The lender applies to the City's collateral pool program and provides details about the borrower and the conditions of the loan that it proposes to make. The City evaluates it and, if acceptable, would agree to provide the lender with up to 50% of the collateral security needed on the loan. The City, the borrower, and the lender then enter into a tri-party agreement outlining the terms and conditions sufficient to protect the City's interests and comply with applicable law.

b. Existing example(s): Many cities and states offer loan guarantee and collateral support programs, set at varying levels of debt coverage. The City of Phoenix, for example, offers a collateral support program called "Expansion Assistance and Development" (EXPAND). However, most programs, including Phoenix's, were established with federal funds such as CDBG funds, or the Treasury Department's State Small Business Credit Initiative funds, rather than earmarking a City's general funds,[36] and may have different applicable state constitutional provisions from the state of Texas.

c. Advantages of this model: Loan guarantees and collateral support encourage lenders to make loans that they otherwise may not have approved to underserved businesses. The terms of the loan are also more likely to be better for the borrower.

d. Disadvantages of this model: Although the amount is within its discretion, the City would have to dedicate a substantial amount of money to create a robust fund (see section 7(f) below regarding "City Resources Needed") and is subject to legal requirements imposed by state and federal law. If there are defaults on loans, especially at the outset of the program, the fund will be depleted before it is able to serve many small businesses.

e. Stakeholder feedback: Stakeholders spoke to the significant need that lenders have for collateral and the frequent inability of MBE/WBEs to provide adequate collateral, especially in light of the bonding requirements with which businesses also have to comply.

f. City resources needed: The resources needed would depend on the scope of the program the City desires to implement (e.g., approximately how many loans should be secured, at what levels, etc.). The City's costs would include 1) new staff (1 FTE) with lending expertise that could administer this program, 2) money set aside for a loan guarantee and collateral pool fund, and 3) initiation of possible collection from default

[36] The City of Austin currently uses it CDBG funds for other programs, some of which are detailed in VI(b) of this report. For more information on the process the City uses for allocation of its CDBG funds, see http://austintexas.gov/sites/default/files/files/Citizen_Participation_Plan.pdf and http://austintexas.gov/news/concise-data-driven-action-plan-submitted-hud.

loans. Staff estimates that, to establish a loan guarantee and collateral pool fund that would secure 50% of two to three $50,000 loans a month for one year, the City would need to dedicate approximately $750,000 to the fund.

8) Chapter 380 recipients pay for a loan guarantee and/or collateral pool fund

a. Overview: This model would be the same as option 7 above except that companies receiving Chapter 380 incentives would be responsible for paying a fee (likely a percentage of their economic incentive package) to create the loan guarantee and/or collateral pool fund; and only small and MBE/WBE businesses retained to work for contractors or companies receiving Chapter 380 economic development incentives from the City would be eligible for the loan guarantee and/or collateral support.

b. Existing example(s): Staff is not aware of existing examples in which companies receiving economic incentives are expected to pay a fee to create a loan guarantee fund for construction contractors.

c. Advantages of this model: Rather than expending the City's general funds and putting those funds at risk, the burden would be shifted to private companies that are receiving tax abatements from the City (and typically other incentives from the county and state). Loan guarantees and collateral support encourage lenders to make loans that they otherwise may not have approved to underserved businesses. The terms of the loan are also more likely to be better for the borrower.

d. Disadvantages of this model: Collecting a fee from companies that are seeking economic incentives from the City to locate their business here, on top of the other wage and benefits requirements they must now meet, will mitigate the benefits of the incentive package. Especially for those companies whose incentive packages are small (under $30,000 a year from just the City), the levied fee will make the incentive less valuable. As a result the incentive system may fail to encourage businesses to locate in Austin.

Moreover, using this method, it will take a substantial amount of time to build a revolving loan fund that would be beneficial to participants. For example, staff estimates that, in order to provide an initial round of loans to businesses contracting with Chapter 380 recipients, a fund of approximately $225,000 would be necessary. This estimate is for a program that would guarantee 50% of approximately nine $50,000 loans annually. Based on the limited number of existing Chapter 380 agreements and the dollar value of the City's incentives to each of these companies, a large fee would have to be collected from the Chapter 380 recipients in order to gather the baseline $225,000 for the fund.

e. Stakeholder feedback: The Chamber of Commerce has expressed concern that this option will discourage businesses from locating in Austin.

f. City resources needed: As stated in option 7, the resources needed would depend on the scope of the program the City desires to implement (e.g., approximately how many loans should be secured, at what levels, etc.). Because the Chapter 380 companies would be responsible for the funding of the loan guarantee and collateral pool fund, the City's primary direct cost would be a new staff (1 FTE). The staff member would need to have lending expertise and would be responsible for overseeing the collection of fees from Chapter 380 companies as well as the administration of the loan guarantee program itself.

VIII. Recommendations

Staff has given careful consideration to the above options and recommends the following multi-pronged approach to best meet the construction community's and City of Austin's needs.

- **At a minimum, for both City contracts and Chapter 380 projects, staff recommends *Option 1: City approaches 3rd party financial institutions to offer independent loan program*.** As described in Section VII above, in this model the City encourages independent nonprofit lenders and banks to voluntarily offer loans with more flexible criteria than traditional commercial loans. No City funding would be necessary unless the City wanted to dedicate 1 FTE to education and outreach related to the program. It should be noted, however, that the success of such a program would be contingent on the voluntary participation and cooperation of third party financial institutions. While such a program could increase access to capital for small businesses, if the third party institutions choose not to participate, this program may not have a significant impact.

- **For both City contracts and Chapter 380 projects, staff recommends *Option 3: City funds a 3rd party administrator and loan pool***. Unlike the payment assistance models described in the report, this model could apply to both City contracts and Chapter 380 projects. This is because the City is not the owner of the Chapter 380 projects and would therefore have difficulty implementing payment assistance programs through the prime contractor. In the Option 3 model, the City would: a) utilize a competitive procurement process to solicit and select a nonprofit financial institution to administer a loan program; and b) contribute seed money to start a revolving loan fund.

  - The solicitation would have to clearly identify the parameters of the contract and the types of loans to be administered – for example, it could call for a program that will be implemented in a manner that serves the unique needs of construction subcontractors, a quick turn-around time on each loan decision, and the use of additional criteria beyond minimum credit scores for eligibility..

  - For the revolving loan fund, the selected financial institution could be required to match the City's seed money contribution. If each party contributes $250,000 to $500,000 in seed money, the revolving fund can begin with a balance of

$500,000 to $1M. Otherwise, the City would fund the full $500,000 to $1M balance on its own. The fund could grow as loans are repaid and as the financial institution identifies other funding sources and/or increases its contribution. The City would continue making the grant for a pre-determined period, perhaps two or three years subject to annual appropriation, but the amount would decrease incrementally each year as the loan pool grows.

- **For City contracts, staff recommends Option 4: City establishes Quick Pay Program (QPP).** This model resembles the program used in the construction of City Hall. The City would provide the prime contractor a "Quick Pay" amount at the beginning of a project. Subcontractors who have applied and been approved for the Quick Pay program can invoice the prime contractor as work is completed and once the work has been accepted. They can then be paid from the "Quick Pay" fund within 10 days.

  As a start, the program could apply to projects on all alternative delivery model projects. This is because of the more involved relationship the City has with the prime contractor on these types of procurement and flexibility allowed by state law in the award of these types of contracts. This program would require limited resources from an FTE perspective (possibly one certification FTE) and the funding for the program would already be included in the project budget. This program would ensure that funds would be quickly available to small businesses for work properly completed and installed.

- **For City contracts, staff further recommends Option 5: City establishes Mobilization Prompt Pay Program (MPPP).** This model is a slight revision to the current Super Prompt Pay Program and would allow prime contractors to submit pay applications twice a month, rather than monthly, at the beginning of the project. The program would allow eligible subcontractors to invoice twice a month and receive payments from the prime contractor more quickly during peak mobilization periods. Staff recommends that MPPP be available for projects estimated to be $2M or greater. This program would not require additional FTE resources. It should be noted, however, that overall project budgets would be impacted by additional billing of staff related to review of the pay applications. Funding for mobilization payments would be included in the project funding. It would also address the critical need that the small business contracting community has for mobilization resources. It would also benefit the City because it would assist in projects moving forward in a timely manner.

These recommendations are based on the feedback received from stakeholders as well as research into best practices around the country. Because the options provided are described in broad strokes, many details would need to be settled once City Council decides on the program(s) it wants to pursue. Additionally, at the conclusion of the disparity study, there may be additional recommendations to any adopted program in order to incorporate race and gender neutral aspects to further enhance the City's MBE/WBE Program. Staff will work at the direction of the City Manager and the City Council as appropriate to execute next steps and implement the option(s) that best serve the City's diverse interests.

IX. APPENDIX

A. Chart of options considered

B. Descriptions of relevant existing City of Austin programs

C. List of meetings at which staff made presentations and collected stakeholder feedback

APPENDIX A: Chart of Options Considered

Potential program models	Description	Applicable to City contracts	Applicable to Ch. 380 contracts
1) City approaches 3rd party financial institutions to offer independent loan program	Independent nonprofit lenders and banks would volunteer to offer loans with more flexible criteria than traditional commercial loans. No City funding would be necessary.	x	x
2) City contracts with a 3rd party financial institution to administer a loan program	The City would use a competitive procurement process to solicit and select a financial institution to offer loans with flexible underwriting terms. The City's contract with the lender would only cover the cost of administering the loan program.	x	x
3) City contracts with a 3rd party administrator and funds a loan pool	Same as Option 2 above but, in addition to contracting a 3rd party to administer the program, the City would provide the seed money for a revolving loan fund, subject to any statutory requirements on the City's deposits.	x	x
4) City establishes Quick Pay Program (QPP)	Like the program used in the construction of the new City Hall, the City would pay the prime contractor a "Quick Pay" amount at the beginning of a project. If its application is accepted for the program, a subcontractor could invoice the prime as work is completed and be paid from the "Quick Pay" fund within 10 days of the work being accepted and approved. QPP would apply to alternative delivery method projects only.	x	
5) City establishes Mobilization Prompt Pay Program (MPPP)	A slight revision to the current Super Prompt Pay Program, MPPP would allow prime contractors to submit pay applications twice a month, rather than monthly, at critical mobilization points during the project. This would allow eligible subcontractors to invoice twice a month and receive payments from the prime more quickly during the mobilization phase(s). MPPP would apply to construction projects valued at over $2M.	x	
6) City establishes Cash Flow Enhancement Program (CFEP)	Like the City's prior CFEP, this allows a prime contractor to invoice and be paid the "Cash Flow Enhancement" amount to be described in the General Conditions at the beginning of a project. Subcontractors whose application to the CFEP is approved could get a limited cash advance that would help with the expense of mobilization. The advance loan would be repaid through deductions from future progress payments.	x	
7) City establishes a loan guarantee and/or collateral pool fund	The City would allocate and deposit into an earmarked bank account a pre-determined amount of funding that would serve as a loan guarantee and/or collateral pool fund. The fund would cover a percentage of the borrower's debt obligation to the bank if the borrower defaulted on the loan.	x	x
8) Chapter 380 recipients pay for a loan guarantee and/or collateral pool fund	This model would be the same as option 7 above except that companies receiving Chapter 380 incentives would be responsible for paying a fee (likely a percentage of their economic incentive package) to create the loan guarantee and/or collateral pool fund; and only small businesses, including MBE/WBEs, hired on Chapter 380 projects would be eligible for the loan guarantee and collateral support.		x

APPENDIX B: Descriptions of relevant existing City of Austin programs

Music Venue Assistance Micro Loan Program (MVA) – Music Division of EDD, EDD

This program provides low-interest loans for Eligible Sound Mitigation Costs, available only for the following types of commercial uses:

Cocktail Lounge	Indoor Entertainment
Outdoor Entertainment	Restaurant General (General)
Restaurant General (Limited)	Theater

The Applicant must have a minimum of two (2) years of experience operating at Venue, or six (6) years of experience operating at a business in the type of commercial use for which loan is requested. Venues must be locating to/ located in the Eligible Area. "Eligible Area" means any area within the City limits of Austin, TX. MVA Program loans are limited to the amount of available funds, as approved by City Council for the program.

Family Business Loan Program (FBLP) – SBDP, EDD

The Family Business Loan Program (FBLP) is a public-private partnership loan program that provides low-interest, fixed asset and working capital financing for small business expansions that will create jobs. The FBLP finances a portion of the small business owner's expansion project with funds provided by a U.S. Department of Housing and Urban Development (HUD) Section 108 loan guarantee. The City partners with local U.S. Small Business Administration Section 504 certified community lenders and local private banks to fund each project, thus providing borrowers with access to additional funds from other private and public sources. Borrowers are required to create at least one full-time job for Austin citizens deemed low to moderate income for every $35,000 in loan funds borrowed.

FBLP has partnered with private lending institutions to leverage a private-public partnership that allows for greater flexibility on the type of eligible business-expansion projects. Small businesses must meet the following criteria to be considered for the program:

1. In operation for at least two years.
2. Financial documentation must show successive profits for the previous two years.
3. Tangible net worth of less than $15 million.
4. Profits after taxes of less than $5 million (on average for the last two years).
5. Must be willing to locate project in the Austin metropolitan area.
6. Must be willing to meet job creation requirements and report jobs created.

7. The maximum loan amount for any given project is forty percent (40%) of the total project cost or up to $1,000,000; whichever is lower. The maximum job-cost ratio for the project is $35,000 per full-time equivalent job to be created.
8. Projects require LRC and HUD approval.
9. The maximum loan amount and term for working capital will be evaluated on an individual basis. Factors to be considered may include but not limited to the project size, nature of the project, and public benefits.
10. The applicant must commit a minimum of ten percent (10%) of the total project cost. The applicant will be required to provide proof of equity availability.
11. Applicants will be encouraged and required whenever possible to leverage 108 funds with the SBA 504 Program, and programs of the Federal Home Loan Bank through its member banks.

Additional Housing and Urban Development (HUD) and Small Business Administration (SBA) guidelines for eligibility and underwriting criteria apply.

Eligibility requirements:

- Working capital financing (only considered in conjunction with the total project and will not be financed independently).
- Renovation and new construction of commercial and industrial buildings.
- Acquisition of commercial and industrial land and buildings.
- Refinancing of existing debt to an independent institutional lender (as part of a new project creating new job opportunities).

**Loan funds cannot be used to reimburse costs incurred prior to completion of the HUD Environmental Review with the exception of project planning costs

<u>Business Retention and Enhancement– SBDP, EDD</u>

The Business Retention and Enhancement (BRE) loan program provides low-interest, fixed asset loans up to $250,000 to retail businesses in danger of being displaced from, or wanting to move to, the eligible areas of downtown. The eligible areas consist of Congress Avenue from 11th Street to Lake Ladybird and East 6th Street from Congress Avenue to the IH-35 access road, and BRE is funded by City development fees collected within these areas. Borrowers must own or have a 5-year or longer lease on property located within the eligible areas, and must commit to creating or retaining jobs as a condition of receiving a BRE loan.

The BRE Program is intended to provide low-interest loans for Eligible Costs to:

- Existing businesses located within the Eligible Area that are being displaced because of development, and
- Businesses locating to the Eligible Area

The BRE Program is available only for these types of commercial uses:

Art Gallery	Indoor Entertainment
Food Sales	Restaurant (General)
General Retail Sales (Convenience)	Restaurant (Limited)
General Retail Sales (General)	Theater

Applicants must have a minimum of two (2) years of business operating experience in the type of commercial use for which you are requesting a loan. "Eligible Area" means the area of Congress Avenue bounded by 11th Street on the north, Town Lake on the south, and the alleys directly east and west of Congress Avenue, and the area of East 6th Street bounded by Congress Avenue on the west, the southbound frontage road of IH-35 on the east, and the alleys directly north and south of East 6th Street, as indicated on the BRE Program map.

Brownfields Cleanup Revolving Loan Fund –Austin Brownfields Revitalization Office, Austin Resource Recovery

This program offers low-interest loans, contingent on available funding, to eligible parties for brownfield revitalization.
Funds available to anyone redeveloping a brownfield; funds to be utilized are for cleanup/ decontamination only (hazardous waste, petroleum, lead-based paint and asbestos removal).

City can be awarded up to $1 million dollars; at least 50% of the funds must be used to implement a revolving loan fund (RLF) to provide no-interest or low-interest loans for brownfields cleanups, and a 20% cost share which may be in the form of a contribution of money, labor, materials, or services and must be for eligible and allowable costs. The loans repaid are called earned income.

Rental Housing Development Assistance (RHDA) Program – AHFC, NHCD

Program is expected to provide financing for the acquisition, rehabilitation, new construction, debt relief, or rent "buy-downs" for affordable rental housing projects. Financing is provided to both for-profit and non-profit developers, including CHDOs. The RHDA Program is administered on behalf of the
City of Austin by AHFC using a variety of funding sources, including federal funds (HOME, CDBG, NSP, HOME or CDBG Program Income), and non-federal/ local funds (general fund, housing trust fund, other local funding that may be available from time to time).

Organizations or applicants must be in Good Standing. Minimum requirements for projects are as follows:

1. Located within the corporate City-limits of Austin.
2. Projects must consist of one (1) or more residential units.
3. Units must be used for residential purposes only.
4. New construction projects must be certified for and meet the City of Austin's S.M.A.R.T. Housing™ requirements.
5. Rehabilitation projects must have a minimum of one (1) condition that violates either the City's Housing Code or federal Housing Quality Standards (HQS).
6. The project must be owned, developed or sponsored by a for-profit or non-profit organization in good standing with the City of Austin/AHFC.
7. If applicable, projects must meet HUD Environmental Review requirements.

Better Buildings Program – Austin Energy

(Unlike the other programs in this list, this program serves residential end-users rather than commercial ones. However, because Resolution No. 20141024-055 referenced it, staff has included it here.)

This is a financing program for residential customers only; maximum loan amount is $11,000. Applicants must qualify for the loan. This is an interest buy down program, not a credit enhancement program. (Partnered through Velocity Credit Union.)

APPENDIX C: List of meetings at which staff made presentations and collected stakeholder feedback

MBE/WBE and Small Business Procurement Program Advisory Committee

Tuesday, November 5, 2013 5:30 PM, City Hall, Boards and Commissions Room 1101

Tuesday, December 3, 2013 5:30 PM, City Hall, Boards and Commissions Room 1101

Tuesday, January 7, 2014 5:30 PM, City Hall, Boards and Commissions Room 1101

Minority-Owned and Women-Owned Business Enterprise and Small Business Council Committee

November 12, 2013 AT 3:00 P.M., City Hall, Boards and Commissions Room 1101

December 10, 2013 AT 3:00 P.M., City Hall, Boards and Commissions Room 1101

January 14, 2014 AT 3:00 P.M., City Hall, Boards and Commissions Room 1101

A Special Called Meeting is set for January 28, 2014 AT 3:00PM, City Hall, Boards and Commissions Room 1101

Stakeholder Meetings

Wednesday, December 11, 2013 from 6:00 p.m. – 7:30 p.m.
Austin Energy, Town Lake Center, First Floor Assembly Room, 721 Barton Springs Road, Austin, TX 78704

Tuesday, December 17, 2013 from 9:00 a.m. – 10:30 a.m.
Austin City Hall, Boards & Commissions, Room 1101, 301 W. 2nd Street, Austin, TX 78701

Thursday, December 19, 2013 from 2:00-3:30p.m.
Austin City Hall, Bullpen, Room 1029, 301 W. 2nd Street, Austin, TX 78701

Thursday, January 9, 2014 from 2:00-3:30p.m.
Austin City Hall, Bullpen, Room 1029, 301 W. 2nd Street, Austin, TX 78701