Explanation of Financing Programs

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Industrial Revenue Bond Financing

Under the Cater Act, Industrial Development Boards of local municipalities can issue tax-exempt or taxable industrial revenue bonds to finance the building and equipping of a new plant or the major expansion of an existing plant.

These bonds are typically purchased by institutional investors, arranged through commercial banks or investment banking firms. By state law, the bonds are not government obligations and cannot be guaranteed by state or local government. Bond purchasers look to the company on whose behalf the bonds are issued for repayment; if the company is unrated, the bond purchasers look for a credit enhancement provided by the company, such as an irrevocable standby bank letter of credit, to guarantee repayment.

Purchasers of tax-exempt bonds do not have to pay federal income taxes on the interest income, resulting in a lower interest rate for the company. However, a number of restrictions are imposed on tax-exempt bonds under current provisions of the Internal Revenue Code. For example, at least 95% of the net proceeds must be used to finance a manufacturing facility, there is a $20 million project capital expenditure limitation, no company can have more than $40 million in tax-free bonds outstanding anywhere in the U.S. at the time of closing, and a volume cap restricts the amount of tax-free bonds that can be issued in any state during a calendar year to a percentage of population.

Therefore, it is imperative that companies seek the advice of qualified bond counsel. Due to expenses incurred as a result of these and other federal requirements, it generally takes a bond issue of $2 million and higher before the benefits derived from this financing method will exceed the costs.

Whether the bonds are tax-exempt or taxable, this financing method places the title to the property being financed in the hands of the IDB. The company's "lease payments" are in an amount sufficient to amortize the principal and interest on the bonds, and at the end of the lease, the company makes a nominal payment to the IDB and gains title to the property. Therefore, this is a capital lease, not an operating lease, and companies can still take depreciation.

USDA Rural Development Business Financing

The U.S. Department of Agriculture has a business and industry loan guarantee program that is intended to improve the economies of rural communities; it is not intended to guarantee loans that are substandard. For complete details, go to http://www.rurdev.usda.gov/rbs/busp/b&i_gar.htm.

Eligible locations: All municipalities and unincorporated areas of Etowah County are eligible.

Eligible lenders: federal or state chartered banks, farm credit banks with direct lending authority, savings and loan associations, credit unions, insurance companies, and mortgage companies that are part of a bank holding company.

Eligible borrowers: a cooperative organization, corporation, partnership, or other legal entity organized and operated on a profit or nonprofit basis; an Indian tribe on a federal or state reservation; a public body; or an individual. Individual borrowers must be citizens or permanent residents of the U.S. Corporations or other organizations must be at least 51 percent owned by U.S. citizens or permanent residents. Also, a borrower must be engaged in a business that will provide employment; improve the economic or environmental climate; promote the conservation, development, and use of water for aquaculture; or reduce reliance on nonrenewable energy resources by encouraging the development and construction of solar energy systems and other renewable energy systems.

Eligible purposes: business and industrial acquisitions; purchase of land, machinery, equipment and inventory; building construction, enlargement or modernization; educational or training facilities; tourist facilities; hotels and motels; pollution control or abatement; recreation facilities; working capital; refinancing when it is determined that it is necessary to create new or save existing jobs; commercially available energy projects that produce biomass fuel or biogas.

Equity requirements: Applicants must have audited financial statements that show tangible balance sheet equity as follows:
- 10% for existing businesses
- 20% for startup businesses
- 25-40% for energy projects

Collateral requirements: The discounted collateral value should be at least equal to the loan amount:
- 80% of the appraised value of real estate
- 70% of the appraised value of machinery and equipment
- 60% of the book value of receivables and inventory

Maximum loan guarantee amounts:
- 80% on loans up to and including $5 million
- 70% on loans greater than $5 million up to and including $10 million
- 60% on loans greater than $10 million

Loan maturities:
- 30 years for real estate
- 15 years or useful life of equipment
- 7 years for working capital

SBA 7(a) Loan Guarantees

This is a U.S. Small Business Administration program that guarantees repayment of a portion of bank loans to approved borrowers for eligible projects. It can be used for both fixed asset and working capital financing in an amount up to $2 million, with up to $1.5 million guaranteed by the federal government.

Borrowers must provide cash equity in an amount determined by the SBA and the lender; the balance is provided by the lender, up to 75% of which is guaranteed by the government. Borrowers also must provide a personal guarantee.

Eligible borrowers: legal, for-profit enterprises which conform to the following size standards:

- retail/service - sales not exceeding $3.5 million
- wholesalers - sales not exceeding $13.5 million
- contractors and manufacturers - no more than 500 employees

Eligible purposes:

- to purchase land, construct new buildings and expand or convert existing facilities
- to purchase machinery, equipment, furnishing, fixtures, supplies and materials
- long-term working capital, including the purchase of inventory
- short-term working capital needs, including seasonal financing
- refinancing of existing business debt that is not structured with reasonable terms and conditions
- to purchase an existing business

Loan maturities:

- 10-25 years for real estate
- 8-10 years for machinery and equipment
- 5-7 years for working capital

More details are at http://www.sba.gov/content/sba-loan-application-checklist.

SBA 504 Loans

This U.S. Small Business Administration loan program provides long-term financing for the purchase, construction, and/or renovation of land, buildings and long-lived equipment at fixed, below-market rates (plus federally required fees and loan packaging costs.) Unlike the SBA 7(a) program, it cannot be used for working capital or inventory.

504 loans are structured with a participating lender providing up to 50% of the total project costs, who gets a 1st lien on the assets. The SBA provides 40% through a "Certified Development Company," and takes a 2nd lien. The borrower contributes the remaining 10% (up to 20% in some circumstances.)

SBA Certified Development Companies serving Etowah County are:

- Alabama Community Development Corporation, www.alacom.com
- Southern Development Council, www.sdcinc.org

Eligible borrowers: a business must be operated for profit and fall within the size standards set by the SBA. Under the 504 program, a business qualifies if it has a tangible net worth not more than $15 million, and an average net income of $5 million or less after federal income taxes for the preceding two years prior to application.

Job creation requirements: Generally, a business must create or retain one job for every $65,000 guaranteed by the SBA. Small manufacturers must create or retain a ratio of one job for every $100,000.

Collateral requirements: Loans under the SBA 504 program must be secured to ensure repayment. Collateral can include a mortgage on the land and building being financed; liens on machinery, equipment and fixtures; lease assignments; and personal guarantees from individuals with 20 percent or more ownership in the company.

Loan amounts: There is no maximum project size, but the maximum amount of SBA's loan portion is $5 million, or $5.5 million for manufacturing and "green" projects.

Eligible purposes:

- the purchase of existing buildings
- the purchase of land and improvements, including grading, utilities, parking lots and landscaping
- the construction of new facilities or modernizing, renovating or converting existing facilities
- the purchase of long-term machinery

Loan maturities:

- 20 years for land and building
- 10 years for heavy machinery and equipment

Regional Revolving Loan Fund

The East Alabama Regional Planning and Development Commission administers a revolving loan fund to assist small local businesses and industries in their start-up and expansion activities. The goal of the program is to help create new jobs for area citizens by providing a portion of a project's financing needs in participation with a private-sector lender.

Eligible purposes: An RLF is not intended to provide venture capital or to support high-risk enterprises. This program can be used for the following purposes.

- purchase land or buildings
- construct or renovate buildings
- purchase machinery and equipment
- provide working capital

Loan amounts: RLFs support commercial bank loans with gap financing by providing up to $250,000 or 1/3 of the total project cost, whichever is less. They also can be used in conjunction with USDA and SBA loan programs.

Loan terms: The terms of the RLF loans are matched to the uses of funds, with financing structured to the productive life of fixed assets. The maturity and repayment terms will vary, but the following will be generally considered appropriate:

- 10-20 years for land and buildings
- 5-10 years for machinery and equipment
- 1-5 years (certain limits apply) for working capital

Evaluation criteria: A private-sector loan review committee is responsible for approving or disapproving loan applications. Among its evaluation criteria are:

- a commercial lender must participate in financing the project in cooperation with the RLF program
- it must leverage private-sector investment
- job creation requirements must be met
- there must be evidence of sufficient cash flow to service the debt
- equity injection will be required in most cases
- adequate collateral has to be offered
- business and personal financial statements must be provided
- personal guarantees of owners, partners, principals, and spouses will be required

More details are at http://www.earpdc.org/pages/?pageID=36.

State Small Business Credit Initiative

The federal Small Business Jobs Act of 2010 was enacted to help increase credit availability for small businesses. It created the State Small Business Credit Initiative, and Alabama was approved for $31,301,498 in funding. The Community and Economic Development Division of the Alabama Department of Economic and Community Affairs is responsible for managing this program, and the State Banking Department assists the ADECA staff in program implementation.

To summarize, there are two program categories: Capital Access Programs (CAPs) and Other Credit Support Programs (OCSPs).

1) CAPs provide insurance for business loans by establishing a separate loan loss reserve fund for each participating financial institution. Unlike programs such as the SBA 7(a) which guarantee a percentage of a loan on a case-by-case basis, the reserve fund is used to provide portfolio insurance for all loans enrolled in the CAP by financial institutions.

2) The OCSPs are comprised of loan guarantee and loan participation programs. Partial loan guarantees provide a lender with additional security to approve a loan or line of credit. Under the loan participation program, the State will purchase a portion of a loan at terms advantageous to the borrower. This also reduces exposure for the lender.

These programs cannot be used to refinance existing debt, or to support the unguaranteed portions of SBA 7(a) loans.

Eligible purposes: Loan proceeds must be used for a qualifying business purpose such as:
- startup costs
- working capital
- business procurement
- franchise fees
- equipment
- inventory
- the purchase, construction, or renovation of an eligible place of business

Eligible applicants: Corporations, partnerships and sole proprietorships, as well as non-profits and cooperatives, are eligible to participate in the SSBCI programs. The maximum borrower size is limited to 500 employees, but in practice a typical applicant will be much smaller.

Loan amounts: The principal value of the loan cannot exceed $5 million by law, but the average loan size is expected to be in the range of $100,000 to $250,000.

More information is at http://www.adeca.alabama.gov/Divisions/ced/cdp/Pages/SSBCI.aspx#Purpose.

Microloans

The U.S. Small Business Administration's Microloan Program provides small, short-term loans for small business concerns.

The SBA makes funds available to specially designated intermediary companies with experience in lending as well as in providing management and technical assistance. These intermediaries make the actual loans to qualified borrowers for eligible purposes.

The maximum loan amount is $50,000, but the average microloan is about $13,000.

Eligible purposes:

- working capital
- the purchase of inventory and supplies
- the purchase of furniture and fixtures
- the purchase of machinery and equipment

Proceeds from a microloan cannot be used to pay existing debts or to purchase real estate.

Loan maturity: The maximum term allowed for a microloan is 6 years.

Collateral requirements: Each intermediary lender has its own lending and credit requirements. Generally, intermediaries require some type of collateral as well as the personal guarantee of the business owner. Invariably, a 1st lien will be required on fixed assets purchased with loan proceeds.

Lenders: The SBA microloan intermediary serving Etowah County is TruFund Financial Services in Birmingham. Details are at http://www.trufund.org/microlending.

Crowdfunding

A new tool for entrepreneurs in Alabama to raise startup and growth funds was created when an intrastate crowdfunding law (SB44) was passed in the 2014 regular session of the state legislature and signed into law by the governor.

Stated simply, this is a mechanism whereby relatively small amounts of money are solicited from a large number of individuals over the Internet, primarily via social media, in order to finance a particular project or venture. In reward-based crowdfunding, entrepreneurs pre-sell a product or service to launch a business. In equity-based crowdfunding, the contributors receive unlisted shares of a new company.

The 2012 federal JOBS Act allows an exemption from Securities and Exchange Commission filings for equity-based crowdfunding actions, but the SEC has yet to issue formal regulations. Once the SEC finalizes their crowdfunding rules, entrepreneurs will have the option of deciding if it is in their best interest to use the state legislation or the federal one.

Under the Alabama law:

- All contributors must be residents of the state (intrastate investment offerings are exempt from SEC regulation.)

- Residents can give up to $5,000 annually, regardless of how much money they make (proposed SEC regulations would limit investors to a percentage of their income.) Amounts in excess of $5,000 may be accepted from Alabama investors who qualify as accredited investors as defined by federal law.

- The total amount that anyone can raise is capped at $1 million per year.

- These crowdsourced funds are under the regulatory authority of the Alabama Securities Commission, but it requires less much paperwork and expense compared to registering a conventional securities offering. Issuers must provide advance notice to the commission on Form CF1, containing the names and addresses of the owners, officers and directors; any persons who will be involved in the offer or sale of these securities; and the bank or other depository institution in which investor funds will be deposited. There is a nonrefundable filing fee of $150.

- Issuers may raise such capital with or without a broker. If a business uses a securities broker, the broker must be registered with the Alabama Securities Commission.

- All funds received from investors must be deposited into a bank or depository institution authorized to do business in Alabama, and all the funds have to be used in accordance with representations made to investors.

New Markets Tax Credit Financing

The New Markets Development Tax Credit Program is an alternative financing complement to conventional capital sources. Typically, it consists of a 7-year, below-market, interest-only loan in an amount of 15% to 20% of the total financing package, which can be in the range of $5 million to $100 million.

The objective of the program is to attract private sector investment to spur job creation and economic growth in low-income communities that traditionally have had inadequate access to capital due to the perceived greater risk.

It provides a tax credit against state income, financial institution excise, and insurance premium taxes for investors in approved “Community Development Entities.” These CDEs then provide funding to businesses that locate in qualified impoverished communities, especially central business districts, in Alabama. The maximum amount allowed for any particular project is $10 million.

Here’s how it works:

1) A CDE submits an application to be considered for an allocation of NMTCs.

2) After a competitive review of applications, an allocation of NMTCs is awarded to a CDE.

3) Once a project has been qualified, an investor will make an equity investment in the CDE.

4) The CDE provides the investor with tax credits in the amount of 50% of the investment.

5) The CDE provides a loan to the qualified business.

A list of Community Development Entities approved by the Alabama Department of Commerce is at http://www.madeinalabama.com/assets/2013/02/4-2012-NMTC-CDEs-Allocations.pdf.

A project must be located in a qualified census tract that meets the determination of a Low Income Community as per American Community Survey data, and there must be a reasonable expectation that the company will continue to be located in the LIC for the term of the loan.

Ineligible projects include golf courses, race tracks, gambling facilities, massage parlors, suntan facilities, stores where the principal business is the sale of alcoholic beverages, the development or holding of intangibles for sale or license, residential property, and certain farming activities.

More details are at http://www.madeinalabama.com/assets/2013/02/1-Alabama-Summary-New-Market-Tax-Credits.pdf.

Small Business Investment Companies

Small Business Investment Companies are private equity firms that are licensed and regulated by the SBA. They are privately owned and managed, and use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses.

Only companies defined by SBA as "small" are eligible for SBIC financing. Generally, the SBIC program defines a company as small when its net worth is $18 million or less and its average after-tax net income for the prior two years does not exceed $6 million.

SBICs may not invest other SBICs, finance and investment companies or finance-type leasing companies, unimproved real estate, companies with less than 51% of their assets and employees in the United States, passive or casual businesses (those not engaged in a regular and continuous business operation), or companies which will use the proceeds to acquire farm land. Also, SBICs may not provide funds for a small concern whose primary business activity is deemed contrary to the public interest.

SBICs pursue investments in a broad range of industries, geographies and stages of investment. Some invest in a particular field or industry in which their management has expertise. Most concentrate on a particular stage of investment (start-up, expansion or turnaround) and identify a geographic area in which to focus. The form of SBA funding that a particular SBIC uses can vary and will have an impact on the type of investments they make.

Debenture SBICs focus primarily on providing debt or debt with equity features. They typically focus on companies that are mature enough to make current interest payments on the investment so that, in turn, the SBIC can meet its interest obligations to SBA.

Participating Securities SBICs typically focus on making pure equity investments but can make debt investments as well. They are able to invest equity capital in earlier stage opportunities because interest is accrued on their obligation to SBA.

Specialized Small Business Investment Companies are a type of SBIC that provide assistance solely to small businesses owned by socially or economically disadvantaged persons.

More than 300 licensed SBICs are in operation today. A directory is at:
http://archive.sba.gov/aboutsba/sbaprograms/inv/INV_DIRECTORY_SBIC.html

Certified Capital Companies

The Alabama Certified Capital Company program, commonly referred to as CAPCO, makes investments in companies to provide needed growth capital, as contrasted to making loans. They operate in much the same way as Small Business Investment Companies, but CAPCOs get tax credits for making these investments while SBICs get SBA guarantees on the money they borrow to invest in small businesses.

Businesses that request CAPCO investment funding must meet the criteria and requirements set by the Alabama Department of Commerce, which administers the program.

Companies being considered for CAPCO financing must meet the following eligibility requirements:

- headquartered in Alabama or will be relocated to the state
- principal business operations in Alabama or will be relocated to the state
- have no more than 100 full-time employees, with 80% of the employees residing in Alabama or 80% of the payroll paid to employees in the state

Industries that qualify for the CAPCO program may include:

- manufacturing, processing, or assembling products
- conducting research and development
- providing services

In addition, each Certified Capital Company has its own investment criteria. A list is at:
http://www.madeinalabama.com/assets/2013/02/CAPCO-Contacts-01-08-13.pdf

For example, the Southeastern Technology Fund invests primarily in early and growth stage companies in the financial technology, healthcare IT, enterprise software, and information security sectors. It prefers to be the lead investor, its initial investment typically ranges from $1 million to $3 million, and it requires at least one seat on the company's board of directors. It looks for companies in large, vibrant markets, seasoned managers, products or services that are sustainably differentiated, a critical mass of customers, moderate capital needs and a compelling path to liquidity.

More information can be found at:
http://www.madeinalabama.com/assets/2013/02/4-CAPCO-Frequently-Asked-Questions.pdf