

Business Assessment Tool: Is HUD's Section 108 Loan Guarantee Program Right for My Needs?



The Department of Housing and Urban Development's (HUD's) [Section 108 Loan Guarantee Program](#) can be a valuable financing tool for businesses that need to borrow funds for acquisition of new facilities, expansion of current operations, working capital, or a variety of other business uses. Although only local or state governments may borrow Section 108 loan funds directly, borrower communities can provide Section 108 funds to businesses through loans or grants. HUD approval as well as local government approval is required for all Section 108 financing.

The terms and structure of loans depend on the needs of the business and the community's underwriting assessment, but in general, communities have made loans ranging from \$25,000 to several million dollars. The sizing of each Section 108 loan varies by loan and by community, based on the amount of Section 108 financing that the community can access,¹ its goals to diversify its loan portfolio, and both local and HUD program requirements. Communities can provide loans for terms of up to 20 years at lower interest rates than those that are typically available through commercial banks.

Since capacity may vary at the local and state level for technical assistance related to Section 108 resources for businesses, this document is intended to provide communities with a tool for business owners to conduct a high-level assessment to determine whether Section 108 financing could be an appropriate resource for their needs. This tool also aims to help business owners identify the additional information they would need in order to be able to apply for a loan through a local Section 108 loan program or approach the appropriate local or state officials regarding assistance if no local Section 108 business loan program currently exists. It is not intended to serve as formal, comprehensive guidance.

The use of Section 108 funds must meet one of three program objectives: (1) benefit low- and moderate-income (LMI) persons; (2) aid in the prevention or elimination of slums or blight; or (3) meet an urgent need (e.g., natural disaster recovery). The majority of business activities receiving Section 108 loan guarantees provide a benefit to LMI persons, which borrowers can accomplish through a variety of ways (see Step 4). "LMI person" generally means a member of a household that has an income equal to or less than 80% of area median income [Median Family Income Calculation Methodology](#).

If a business requests a loan from its community through this program, the interest rate the business will pay will be determined by the community. Generally, the community will seek to cover its cost of the Section 108 funds plus a spread (e.g., the Section 108 rate plus 50 basis points). HUD also charges a one-time, up-front fee which it sets annually (it is 2.0% in federal fiscal year 2020), which along with closing costs are typically passed along to the business borrower.

This tool includes questions divided into two categories: 1) Basic Program Questions and 2) Business & Financing Needs Questions. By working through these ten questions, you will know whether to further explore Section 108 guaranteed funds for your business' needs.

¹ *The amount of Section 108 borrowing capacity for each community is five times its latest approved Community Development Block Grant (CDBG) grant minus any outstanding Section 108 loan balances or existing outstanding commitment. To view the current borrowing capacity visit the [HUD website](#). Communities that do not receive grants directly can apply for Section 108 loans through the entitlement community they're located in or through their state's CDBG program.*

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Basic Program Questions:

STEP 1: Is your business a for-profit?

Yes. Please proceed to the **Next Step**.

No. See information below and based on this information determine whether to proceed to the next step or coordinate with your local community.

Along with other activities, non-profit organizations may carry out projects and/or activities on behalf of a community (the non-profit entity is then considered a 'subrecipient' of the community receiving the grant). In these instances, additional procedures will be required. If your business is a non-profit, contact your local community or state agency for more information.

STEP 2: Do you have a financing gap in a project necessary to expand your business or to remain in operation in your community?

You should be able to show that you have approached other lenders and still have a financing gap, such as an approved loan size that is less than your project requires or that contains unreasonable terms (e.g., short term and balloon repayments, high down payment requirements, or high interest rates).

Please note that lack of financing due to the poor financial condition and/or lack of profitability of the business would not constitute a financing gap (see section titled: "Is Your Project Viable?").

Yes, my business needs \$ **Debt and/or equity from conventional lenders/investors cannot meet my business needs. Please document the gap for future conversations with local officials. Please proceed to the **Next Step**.**

No, my business needs can be met with available resources. If business needs can reasonably be met without the benefit of a federally guaranteed loan, then Section 108 is not the right resource for your project. Section 108 guaranteed loan proceeds, to the extent practicable, should not be a substitute for non-federal financial support.

STEP 3: Will your proposed project or use of the assistance you receive benefit LMI persons through one or more of the following?

New Jobs. The creation of new full-time equivalent (FTE) permanent jobs as a result of the project. You will need to document that at least 51% of these jobs are initially held by people in LMI households and do not require extensive education or training or be willing to work with a local workforce organization to prioritize the hiring of LMI persons for the majority of the new positions). For example, if you have a forty-hour work week, five permanent part-time, 20-hour per week jobs equal 2.5 FTE and at least 1.5 of these jobs would need to be held by or made available to LMI individuals.

Note: Please keep in mind that new jobs can be created over a reasonable period of time (e.g., one to five years). Permanent jobs created cannot include short-term seasonal, construction jobs or jobs created indirectly.

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Basic Program Questions:

Retained Jobs. For activities that **retain jobs**, there must be sufficient information documenting that the jobs would have been lost without the Section assistance and that one or both of the following applies to at least 51% of the jobs:

- The job is held by an LMI person; or
- The job can reasonably be expected to turn over within the following two years and steps will be taken to ensure that the job will be filled by, or made available to, a LMI person

If your business meets either of the above and you are willing to work with your community to document job information, proceed to the **Next Step**.

Provision of Goods or Services to an Area with a Lower-Income Population or Directly to a Lower-Income Clientele. The provision of essential goods and services to a lower-income area (such as a grocery store or pharmacy in a high poverty neighborhood) or providing services that primarily serve a lower-income clientele (such as a health clinic serving a majority Medicaid-eligible population).

Note: Businesses that focus on high-end goods, such as a jewelry store, would not be considered to provide key services to the residents of an area. Additionally, if your business will be located in an area that is not primarily residential, such as an industrial area, or does not provide goods or services directly to residents of an area (e.g., a distribution company), it likely cannot qualify under this criterion.

If your business meets the goods or services or clientele criteria, proceed to **Step 5**.

If your business does not meet either of the above criteria, consider whether it meets one of the criteria below:

- Prevent or eliminate slums or blight – such as through the redevelopment of a building that is in severe disrepair, in a neighborhood with an official blight designation, or is on a site where hazardous materials may be present, such as a former gas station or manufacturing site – proceed to **Step 6**
- Meet an urgent need – like reopening a business in a designated national disaster area – proceed to **Step 6**

STEP 4: How many jobs do you estimate that your project will create or retain?

At least one FTE permanent job for every \$50,000 of Section 108 funds requested. If part-time jobs will be created, then you can count part-time jobs based on hours. For example, six full-time jobs and eight 20-hour/week jobs (ten FTEs) allows you to receive up to \$500,000 in assistance.

Less than one FTE permanent job for every \$50,000 of Section 108 funds requested but will provide additional community benefits. If a business is unable to meet the jobs requirement, it may still be possible for a business to qualify through a waiver if it can demonstrate other community benefits will occur from the project.

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Basic Program Questions:

If your project will meet either of the above outcomes, proceed to **Step 6**. If it will not, continue to **Step 5**.

STEP 5: How many LMI people will benefit from goods or services that will be offered?

Business will provide goods or services to at least one LMI person per \$1,000 of Section 108 assistance requested. As an example, if you receive \$1 million in assistance, you must be serving an area (census tracts or block groups) with a population that includes at least 1,000 LMI individuals.

Business will provide services to at least one LMI client per \$1,000 of Section 108 assistance requested. As an example, if you receive \$1 million in assistance, you must be serving at least 1,000 people over a period of time to be required by the local government.

Business will provide goods or services to fewer than one LMI persons or clients for each \$1,000 of Section 108 assistance but will provide additional community benefits. If a business is unable to meet the above requirements, it may still be possible for a business to qualify through a waiver if other community benefits will occur from the project.

If your project will meet any of the above outcomes, proceed to **Step 6**.

Basic Business & Financing Need Questions:

STEP 6: What type of financing gap do you need to fill?

Equity. Section 108 funds are always loaned to the local community and, as such, must be repaid to the lender. However, the community can grant the funds to create additional equity in conjunction with federal, state and local tax credit programs, such as the New Markets Tax Credit (NMTC) and Historic Rehabilitation Tax Credit programs. In general, though, communities typically only grant Section 108 funds if the project delivers important community benefits to targeted residents, employees or neighborhoods. Proceed to **Step 9**.

Debt. Section 108 funds can be a flexible source of debt financing for a project. Repayment terms for the loan are negotiated between the local community and the business owner (but cannot exceed 20 years). Proceed to the **Next Step**.

A combination of debt and equity. Proceed to the **Next Step**.

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Basic Business & Financing Need Questions:

STEP 7: Do you have collateral to secure the loan for the amount you are requesting?

Amount of financing gap (from Step 2) X 1.25= \$ **(Typical value of collateral needed)**

Yes: The value of the collateral you have available (e.g., the property your business is using to expand) should exceed the loan request. The typical loan-to-value ratio (loan amount and any senior financing divided by the fair market value of the assets pledged, such as real estate or other property) would not exceed 80%. If the loan-to-value ratio (i.e., the total debt divided by the value of the collateral you have available) is higher than 80%, you may be asked to pledge other assets, depending on the requirements of the community.

If you believe adequate collateral is available, you should proceed to the **Next Step**.

STEP 8: How quickly do you think you will be able to repay the loan? Review the typical terms below to determine acceptability.

20 years or fewer. Your loan term will be based on when and how much you can repay on an annual basis and on the collateral you have pledged, since some collateral only retains its value for a certain period of time (e.g., machinery might have a useful economic life of 10 years). The maximum term of Section 108 financing is 20 years. Shorter, flexible terms (e.g., interest-only periods.) can also be available depending on your community's program and when used in conjunction with other sources of financing that carry timing restrictions (e.g., NMTTC). Proceed to the **Next Step**.

Longer than 20 years. Please consult with your community about other options that may be able to meet your business's needs.

Note: You will need to repay the guaranteed loan; however, the guaranteed loan terms may provide the flexibility needed to proceed with a project that otherwise would not move forward (i.e., a period during construction where payments may be interest-only).

STEP 9: Can you demonstrate enough profitability from your current business operations or from your operations with the proposed project over time (i.e., term of the loan you are seeking) to repay the loan with interest?

Yes: Cash Flow > Future Debt Service. My business's existing cash flow will be adequate to pay the debt service (principal and interest) on the requested Section 108 assistance (and any other existing or proposed debts/obligations) over time, without the proposed project.

Yes: Projected Cash Flow > Future Debt Service. My business's projected cash flow after implementation of the proposed project will be adequate to pay the debt service on the requested Section 108 assistance (and any other existing or proposed debts/obligations) over time. I can provide documentation that my projections are reasonable and based on market information.

Note: Communities typically want to see a ratio of 1.2:1 (\$1.20 in available cash flow for every \$1.00 of debt service) or greater; however, sometimes communities will accept a lower ratio. To estimate the interest that

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Basic Business & Financing Need Questions:

would be due on a potential loan, you can use either the current 90-day London Interbank Offering Rate (LIBOR) rate or the 10-year Treasury Yield.

If existing cash flow or projections indicate a reasonable expectation that the project will have enough cash flow to repay the loan, you should proceed to the **Next Step**. If not, please consult the community to see if it or its partners can provide other types of assistance.

STEP 10: Is your business credit-worthy and well-managed?

The community providing the Section 108 assistance, or its partners, will underwrite all requests for assistance. This underwriting process will review the historical financial information and credit history of you and your business to assess credit worthiness and management capacity. If this review of both you and the business is satisfactory, the community/partners will undertake additional underwriting to appropriately size your requests based on your business's ability to repay.

Yes. My business, as well as any of its co-owners/partners, has a good history of paying its creditors and can demonstrate that it is well managed. Proceed to the **Next Section**.

No. My business is struggling in a competitive environment and will need additional guidance before I request Section 108 assistance. Please consider contacting a local community development financial institution (CDFI), your local government, or the Small Business Administration to find out about the availability of small business assistance resources.

Note: The Section 108 loan program may not function well as a financing tool for start-up businesses because the business may not have cash flow available to repay the loan and provide collateral to secure the loan for a significant number of years. However, some communities have provided financing to start-ups where the project will provide significant levels of community benefit (e.g., jobs and critical goods and services for LMI residents). Many communities provide technical assistance to new and emerging businesses. Check with your community to see what other types of assistance may be offered.

If I was able to answer "yes" to the questions through Step 10, what's next?

Contact your local elected officials and/or the staff assigned to the Section 108 Loan Guarantee Program at your local or state government offices (which often operate the community development office) to see if they have an existing Section 108 loan guarantee business assistance program. If not, provide them with information on this program and encourage them to contact HUD (Section108@hud.gov) for more information.

What will I need to give them to move the process forward?

Business & Project Information:

Description of business. Detailed description of the business, its products and services, key management.

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Use of Funds. Intended use of funds requested and how these funds will fill an existing project funding gap or business need. If applicable, include construction cost estimates, invoices, purchase orders, and vendor quotes.

*Note: If your project **involves construction or the installation of equipment**, Davis-Bacon (prevailing wage standards), environmental review, and other federal requirements typically apply. Make sure your contractor is familiar with this type of project financing, prevailing wage rates, and required documentation. It is helpful to provide cost estimates that take this into account. Also, do not move forward with construction activities before working with your community to take the appropriate steps.*

Other Sources of Funding. Provide information on other committed sources for your project (loans, equity, etc.). These sources should show that you as the business owner are also contributing equity or demonstrating personal investment in the project.

Market study or business plan related to the proposed project, if applicable.

Description of anticipated public benefit of your proposed project or of your business's continued operations (if at risk). Refer to your answers to Steps #3-5 above.

Financial Information:

Financial Statements. Last three years' financial statements of business/owner and guarantor.

Tax Returns. Tax returns of proposed borrower/owner and guarantor.

Interim Statements. Interim financial statement of proposed borrower (less than 90 days old).

Projections. Financial statement projections (Balance Sheet & Profit and Loss) for the business, along with supporting assumptions.

Personal financial statement (for all owners with 20% or more ownership).

Organizational Documents. Ownership structure/documentation (sole proprietorship, partnership, corporation, LLC).

History. Background, experience of owner (resumes, references).

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The list above is a typical list of required documents for a business applying for a guaranteed loan; however, all communities and projects are different. A state or local government, or the entity that is carrying out the program on their behalf (such as a local community development financial institution or quasi-public economic development agency), will likely require additional documents during the underwriting process.