



# ***CITY COUNCIL AGENDA REPORT***

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MEETING DATE: MAY 19, 2020

ITEM NUMBER: NB-1

**SUBJECT: APPROVE THE LAUNCH OF AN EMERGENCY SMALL BUSINESS LOAN PROGRAM IN PARTNERSHIP WITH SMALL BUSINESS DEVELOPMENT CENTER (SBDC) AND MAIN STREET LAUNCH, A COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION (CDFI)**

**DATE: MAY 11, 2020**

**FROM: DEVELOPMENT SERVICES DEPARTMENT/ ECONOMIC DEVELOPMENT**

**PRESENTATION BY: DANIEL INLOES, ECONOMIC DEVELOPMENT ADMINISTRATOR**

**FOR FURTHER INFORMATION CONTACT: DANIEL INLOES, AICP 714-754-5088**

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## **RECOMMENDATION:**

Staff recommends that the City Council:

1. Authorize the creation of an Emergency Small Business Loan Program in partnership with Small Business Development Center (SBDC) and Main Street Launch CDFI, a Community Development Financial Institution (CDFI).
2. Authorize the City Manager to execute an agreement, in a form approved by the City Attorney, with Main Street Launch with a total cost cap of 15 percent of deployed capital as an administrative fee for the complete management of the initial deployment of the funds in response to COVID-19 and negotiate an appropriate interest rate increase for an ongoing City of Costa Mesa's Emergency Small Business Loan Program for the administration cost of future loans.
3. Authorize the City Manager to work with HUD and EDA representatives to apply for funding options from the CARES ACT for the City of Costa Mesa's Emergency Small Business Loan Program.
4. Approve the allocation of \$250,000 for the creation of an Emergency Small Business Loan Program fund from either CDBG CV funds or the General Fund.
5. Approve the establishment of a donation platform managed by Main Street Launch CDFI to receive funds to boost the total fund amount.

## **BACKGROUND:**

### *State of Business Due to COVID-19*

The Government-instituted measures to limit the spread of COVID-19 have placed an incredible burden on the Costa Mesa business community. This impact is especially profound on small businesses. As businesses continue to suffer through forced closures and, eventually, uncertain transitional phases, many will need capital to pay for rent, insurance and other fixed expenses. The Small Business Administration (SBA) states that the average business has 15 days of cash flow in reserve; closures in California exceeded 50 days before some non-essential businesses were allowed to operate in a limited form. Many companies that have business interruption insurance are also being informed that their policies do not cover a pandemic and therefore their losses are not covered. The loan programs issued through the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") do not address the needs of many small business within the City either due to their turnaround times, the requirements of the loan, or the allocations that lenders are willing to provide is insufficient. While the City continues to see Paycheck Protection Program (PPP) and Emergency Injury Disaster Loan (EIDL) Advance loans as critical assistance to address the cashflow necessities of businesses at this time, their funds are all allocated. This means that a loan program with quick turnarounds could mean the difference between a small business surviving or not. Multiple failed businesses can result in delays in filling tenant spaces, affect morale within the community and negatively impact adjacent businesses. To address these concerns, many cities have instituted a loan program, with many others considering such. Examples include Sacramento's Small Business Emergency Economic Relief Loan Program; Garden Grove's Small Business Assistance Loan Program; Garden Grove's Jobs1st Loan/Grant Program; and, Santa Ana's Small Business Incentive Program.

### *Public-Private Partnership*

The SBDC is working with several cities to establish city loan programs for small businesses. As the City has historically been and continues to be a natural incubator for new and small businesses, providing a more diverse lending spectrum will assist business in the immediate crisis and over the long term. However, the City of Costa Mesa does not have the staff resources to promote, manage, issue, or audit loans. For this reason, partnerships with the Small Business Development Center and Main Street Launch CDFI would be necessary to implement such a program.

The SBDC is the most comprehensive small business assistance network in the United States. It is funded in part by the United States Congress through a partnership with the U.S. Small Business Administration. There are nearly 1,000 local centers available to provide no-cost business consulting and low-cost training to new and existing businesses. The Orange County SBDC office is located close to Costa Mesa, at 1300 S. Bristol Street in Santa Ana, and partners with California State University, Fullerton. The SBDC is working with Costa Mesa, at no charge, to design a loan program that addresses the

needs of the business community and it will continue to be a partner through the development and execution of the loan program. If the program is approved, the SBDC will continue to assist staff in development of materials for the loan program, marketing the program and assisting small businesses through the loan process, which includes packaging the loan applications, seeking City verifications of fulfillment of specific eligibility requirements, reviewing and presenting the loan to the fund selection committee, if there is one, and guiding the committee through issuance and repayment. While SBDC is willing to provide considerable assistance, this program still requires a financial institution like Main Street Launch CDFI to administer the loans.

Since 1979, Main Street Launch CDFI has empowered entrepreneurs through small business loans and technical assistance across the State of California. In the last 10 years it has invested \$72.6 million in loans to 884 businesses, creating and sustaining 6,000 jobs and helping add economic vitality to local communities. Main Street Launch CDFI addresses small businesses' need for affordable capital and business support services. Many of the entrepreneurs who Main Street Launch CDFI works with need intensive assistance in order to become loan ready and prepare a strong loan application and have little to no other resources for this service. Main Street Launch CDFI's lending and free technical assistance services are provided 1-on-1 by highly qualified and senior-level staff, who build close relationships with their borrowers, taking the time to understand their goals, challenges, and business management issues. Main Street Launch CDFI also connects the clients to community resources and business support opportunities. Main Street Launch CDFI also partners with city economic development agencies to provide lending and technical assistance to businesses. Combined, these services help to grow new and existing businesses throughout the state and to form critical opportunities for business ownership and job creation.

Staff is proposing that Costa Mesa move forward with Main Street Launch CDFI because of its strong working relationship with the regional SBDC office. Additionally, it provides a reasonable charge to conduct the work and is ready to immediately support a program as proposed. Main Street Launch CDFI would hold the funds provided by the City to issue the small business loans based on the program specifications. The CDFI would be paid 15 percent of the total fund amount to operate the loan program for the initial deployment of the funds. As loans are repaid in the future and become available for re-lending, CDFI would work with the City to identify a mutually agreed upon interest rate for future redeployment of loans to cover the administrative costs of future loans. Main Street Launch CDFI would manage the entire loan program, which includes but is not limited to: issuance; repayment; management; and auditing of the funds. There is insufficient City staff and expertise available to oversee such a program. The CDFI would also provide a platform for businesses, banks and residents to provide philanthropic grant funding to the program.

With the two partners identified above, the City would establish the submittal and eligibility requirements, providing the initial funding, and general program oversight. This partnership is possible due to urgent actions necessary for the City to respond to the effects of the COVID-19 Pandemic. After the immediate and direct impacts of the COVID-19 pandemic

have subsided and the initial loans paid back, staff would return to the City Council for appropriate revisions to the program.

## **ANALYSIS:**

### **Initial Focus for City Loan Program**

The COVID closures have placed an undue burden on all businesses in the City of Costa Mesa. The City cannot provide liquidity assistance to all 7,936 businesses which have an active business license. To help address COVID-19 related short falls, Costa Mesa can assist some of those businesses that did not receive funding through CARES ACT loans and help those who are proactively seeking to stay in business. For this reason, City staff is not recommending a grant or a zero-interest loan for this loan program to all businesses in Costa Mesa. Instead, staff is recommending the City seek out businesses who have not received funding from PPP and the EIDL loan programs but are still seriously committed to invest in their future through a loan program.

The effects of the mandated business closures are not uniform across all business sectors. Non-essential retail businesses with a brick and mortar locations are one of the most impacted sectors of the economy. Such businesses are paying rent or a mortgage on a commercial location yet have little to no revenue during the business closure and face the potential of the longest lag in restoring sales volumes.

The impact of losing one small business over another is similarly not uniform. Specifically, some businesses are more successful, provide more jobs, are more visible, more unique, occupy more building area, or are more critical to the success of the surrounding tenants than others. Therefore, to ensure that the limited resources of the Emergency Small Business Loan Program have the greatest benefit to the overall economy of Costa Mesa, staff recommends that loans be initially given to brick and mortar businesses located along one of the City's commercial corridors, provided that such businesses have secured a business license and all appropriate entitlements.

Half of all businesses in Costa Mesa fall along one of the several commercial corridors in the City. Selecting businesses from this dense collection of retail ensures that the City can have the greatest impact with the one percent of retail businesses the City may be able to assist through this program.

Most cities define a small business through the number of its employees. However, using employees as the primary limiting factor may incentivize some businesses to let additional staff go to qualify for the loan. Instead staff proposes using sales for the previous year to qualify to apply for the Emergency Small Business Loan Program. Staff believes this indicator is more appropriate to determine whether the proposed loan program would provide meaningful assistance. A business with a sales volume less than \$360,000 per year could find \$30,000 -- one month's revenue -- relevant and helpful to surviving this economic shutdown. Furthermore, restaurants within the City have a median of 11 employees; so using a citywide metric of five employees, which is the typical metric used by cities, would exclude restaurants and other uses which rely

on more employees to provide their service. The median monthly sales for smaller businesses whether by sales or by number of employees is between \$15,583 to \$30,583. Therefore, providing loans up to \$30,000 would address the needs of many small businesses in Costa Mesa. The following table reflects average monthly sales figures and employees for small businesses in Costa Mesa.

<b>Business Groups</b>	<b>Median Monthly Sales</b>	<b>Median Number of Employees</b>
All Businesses	\$47,000	5
Small Business in Typical Commercially Zoned Properties (C1, C2, CL)	\$55,000	5
Small Business General (6 Employees or Fewer)	\$30,583	5
Small Businesses (<\$330,000 Sales Volume)	\$15,583	2
Small Restaurants	\$33,000	6

\*Surveyed data from ESRI's Business Analyst pulled April 27, 2020.

## Funding

Funding is the primary task of the City in this effort. While these times are difficult, funding towards this effort can assist in a quicker recovery and have long term benefits as well, especially in the City's commercial corridors. The City will continue to work with regional agencies and partners to identify additional CARES ACT funding that may be applied to this loan program. For example, the City is currently putting an application together for the EDA Cares Act Recovery Assistance grant program. This is a program targeted at local jurisdictions and has a total allocation of \$1.5 billion. This fund has an 80-20 percent fund match; meaning the City's initial \$250,000 commitment could allow the City to seek an additional \$1 million in competitive federal funding.

Potential sources for local funding to initially launch the loan program are CDBG-CV funding from HUD or the General Fund. This includes both the funding to provide loans to local businesses and the funding to compensate Main Street Launch to administer the loan program. Main Street Launch would be paid 15 percent of the total amount of the fund to operate and manage the program for the duration of all loans issued from the initial deployment of the funds. After the initial loans are paid back, staff would return to the City Council for appropriate revisions to the program. Staff recommends the use of CDBG-CV funds to create the fund and pay the administrative costs to Main Street Launch.

HUD has notified the City it will receive \$668,000 through the CDBG-CV allocation. The proposed loan program is expected to be a qualifying use of these funds, as it would qualify for use of regular CDBG funds. Utilizing these funds for this program would be the most viable option. CDBG-CV funds are specifically allowed to be used for economic development purposes related to COVID-19. Other Cities are using CDBG-CV funds to establish small business loan programs. However, if the City Council determines that CDBG-CV funds would be more appropriately used elsewhere, one

option would be to use General Fund dollars. This flexibility is critical because the final HUD waivers and guidance on the use of CDBG-CV funds have yet to be published. This future guidance should clarify whether the funds may be used to fund the entire program or whether they might exclude the administrative costs.

Another critical funding source to ensure the longevity of this program is philanthropic grants and donations. Staff confirmed that Main Street Launch CDFI can institute a donation platform so financial institutions, other more fortunate businesses, and residents within the community can contribute toward the program.

While staff is requesting that the City Council initiate a small loan program with a funding amount of \$250,000, staff also recommends the Council allow the City Manager flexibility to determine which funding source to use based on comments and feedback from the City Council and expected information from HUD regarding the CDBG-CV program and associated waivers.

#### Small Business Disaster Relief Loan Guarantee Program

If the City is able to launch the loan program now, a recent action by California Infrastructure and Economic Development Bank (IBANK) appears likely to further bolster the program's success. Specifically, IBANK is providing the Small Business Disaster Relief Loan Guarantee Program. This program allows nonprofits and small businesses located in California with 1-750 employees that have been negatively impacted by COVID-19 to access a loan guarantee of up to 95 percent of the loan amount. This would mean any loan issued from the fund under this guarantee, would be covered by IBANK up to 95%.

#### Eligibility

To ensure that the loans are issued to small businesses in the City in a manner that meets the intent of the City, while at the same time addressing the requirements of CDBG-CV, IBANK, and small business loan best practices, the following requirements are proposed by staff:

##### **Program Eligibility List**

1. Independently-owned business within the City of Costa Mesa
2. Business has not received PPP or EIDL Funding.
3. Business must have a brick and mortar storefront on a commercially-zoned property
4. Business must have an active business license and be in good standing with the City.
5. Preference given to non-essential businesses such as: traditional retail, entertainment and recreational business and restaurants. Reference state policies.
6. Business must have fewer than 12 employees.
7. Business must have an annual revenue of \$400,000 or less.

8. Preference is given to businesses that have the greatest visibility or can directly impact the success or failure of other businesses.

Providing clear and detailed guidance will allow the City to ensure three important outcomes: 1) to ensure that the fiscal support of these loans can have the greatest effect on the community of businesses surrounding the loan recipient; 2) the eligibility requirements would ensure that businesses hit hardest by the pandemic are able to get needed support; and 3) the City's lender, Main Street Launch CDFI, can effectively implement the proposed loan program and focus program funds on critical small local businesses.

### Approval Process

Loan applicants would receive application preparation assistance from SBDC. Once complete, applications would be submitted to Main Street Launch CDFI to be reviewed and to determine: 1) whether the loan can be approved based on the eligibility requirements; and 2) the viability of the applicant to repay the loan. Each loan would be reviewed in the order submitted until all funds are disbursed.

Main Street Launch CDFI has been successful in implementing the mission statements of cities throughout California for decades. Allowing them to review and approve business applications would:

- Provide the most efficient review process.
- Provide an objective third party to make the selections limiting any concern of bias in the part of staff or the City.
- Leverage the professional experience of Main Street Launch CDFI in selecting appropriate loan matches.

Accordingly, staff recommends the use of Main Street Launch CDFI to determine loan awards.

### Use of the Loan

The proposed Emergency Small Business Loan Program would provide considerable flexibility to local small businesses. Loan funds could be used to pay rent, accounts payable, payroll, and/or insurance. Loans are not intended to be used for working capital or lost salary/draws for the small business owner. The goal of the program is to support the reopening and potential growth of the businesses as the community and the economy restarts.

### Loan Terms

Staff recommends a maximum loan amount of \$30,000. The loan term could vary depending on the loan amount but would not exceed five years as shown in the following table. The interest rate is proposed to be two to three percent. All loans issued

would have a four-month deferment on payments on the loan and then repayment would begin. Personal guarantees will only be required once the IBANK program has been exhausted and only for loans over \$10,000. With these loan terms and a fund of \$250,000 the City could assist a minimum of nine local businesses, and potentially significantly more, depending on the composition of loans granted, repayment time and other potential funds such as donations and federal matching grants.

Amount	City Interest Rate	Term	Personal Guarantee
\$1,000 to \$5,000	2%	12 months	No
\$5,000 to \$10,000	2%	20 months	No
\$10,001 to \$20,000	3%	40 months	Yes
\$20,001 to \$30,000	3%	60 months	Yes

#### Required Application Submittals

The intent of the program would be to include a simple submittal process to allow for a quick review process to expedite funding to local small businesses. The City would work closely with its partners to determine the minimally appropriate documentation such as completion of a simple application, proof of eligibility, and provision of at least one indicator of their financial security such as a credit score.

#### **ALTERNATIVES CONSIDERED:**

The proposed Emergency Small Business Loan Program would require a public-private partnership to: 1) ensure that City funds would contribute toward the assistance of a reasonable number of businesses, while providing an overall positive benefit to the community; 2) strengthen businesses surrounding the borrower; and 3) help ensure the health of the City's commercial corridors which are key to a quick local recovery. Staff believes the proposed program would provide for the highest likelihood of success; however, the following is the alternative for consideration.

The City could choose not to create an Emergency Small Business Loan Program. Without a City based Emergency Small Business Loan Program there would not be an opportunity to assist the greatest current need for local businesses; specifically, liquidity and cashflow to survive the business closures mandated in response to COVID-19. The City would have to rely on federal loans and other programs to assist small businesses within the City. With the PPP and EIDL loans exhausted this would be attempting to direct businesses to temporary programs, with limited funds, and large cohort of competitors. This would leave the City without recourse if businesses of the type the City wishes to support were in distress and unsupported by outside loan programs. Furthermore, without a program, there would not be a means to funnel additional philanthropic dollars or donations toward local small businesses or apply for grant programs like the one currently being offered by the EDA.



### **FISCAL REVIEW:**

If the City leverages CDBG-CV funds for this program and processes the loans through the proposed public-private partnership between the City, SBDC, and the Main Street Launch CDFI there would be minimal to no direct impact to the General Fund for the first year.

Should this program continue as a revolving loan fund for small businesses within the City, additional funds would be needed to maintain the program, as the program would not be self-replenishing due to the low interest rate and future revenue from interest rates being used to pay to administer the loan, along with the relatively high risk of the loans themselves. These additional funds can be secured through outside investment and/or grants but could also come from a future General Fund budget. There is no commitment to allocate additional funds into the program at this time.

### **LEGAL REVIEW:**

The City Attorney's Office has approved this report and the attached resolution as to form.

### **CITY COUNCIL GOALS & PRIORITIES:**

The proposed loan program is consistent with City Council Goal No. 3 (Keep the City Fiscally Sustainable)

### **CONCLUSION:**

Staff recommends that the City Council authorize an Emergency Small Business Loan Program in partnership with Small Business Development Center (SBDC) and Main Street Launch CDFI, and authorize the City Manager to execute an agreement, in a form approved by the City Attorney, for Main Street Launch CDFI to administer the initial loan funds with compensation of 15% of the deployed funds. Further, authorize the City Manager to work with HUD and EDA representatives to apply for funding options from the CARES ACT for the City of Costa Mesa's Emergency Small Business Loan Program. Approve the allocation of \$250,000 for the creation of an Emergency Small Business Loan Program fund from either CDBG CV funds or the General Fund. Approve the establishment of a donation platform managed by Main Street Launch CDFI to receive funds to boost the total fund amount.

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Attachment 1 - [Resolution](#)

