

## CDC Best Practices Guidance Executive Compensation

This guide discusses best practices for Certified Development Company (CDC) compliance with certain 504 Loan Program Requirements. “504 Loan Program Requirements” include those imposed on CDCs by statute, SBA regulations (including 13 CFR Part 120), any agreement the CDC has executed with SBA, SBA’s Standard Operating Procedures (SOPs) (including 50 10 (Lender and Development Company Loan Programs) and 50 55 (504 Loan Servicing and Liquidation)), official SBA notices and forms, and loan authorizations, as such requirements are issued and revised by SBA from time-to-time. In the event of any conflict between this guide and the 504 Loan Program Requirements, the 504 Loan Program Requirements take precedence. SBA regulations (13 CFR 120.180) require all CDCs to comply and maintain familiarity with all 504 Loan Program Requirements as such requirements are revised from time-to-time.

### A. Overview

As outlined in 13 CFR §120.823(d)(3), the Board of Directors (Board) of a Certified Development Company (CDC) is responsible for “[s]etting the salary for the CDC manager and reviewing all salaries.” The Board has a duty to carry out this responsibility with “...no actual or appearance of a conflict of interest.” Additionally, under 13 CFR § 120.823(d)(5), the Board must ensure that the CDC’s expenses (which includes all compensation expenses) are “reasonable and customary.” Further, under 13 CFR § 120.823(d)(9), the Board must ensure that the CDC “establishes and maintains adequate reserves for operations,” and under 13 CFR § 120.823(d)(10), the Board must ensure that the CDC “invests in economic development in each of the States in its Area of Operations.”

13 CFR § 120.830(a)(2) requires a CDC’s Annual Report to contain a report on compensation that includes detailed information on total compensation (including salary, bonuses, and expenses) paid within the CDC’s most recent tax year for current and former officers and directors. In addition, the report must include details on compensation of current and former employees and independent contractors with total compensation of more than \$100,000 during the CDC’s most recent tax year. SBA Form 1253 (CDC Annual Report Guide) requires the CDC’s Report on Compensation to include the following: (1) a copy of the CDC’s executive compensation policy; (2) documentation of the Board’s basis for determining executive compensation; (3) evidence of the Board’s review and approval of the current executive compensation package; (4) detailed information on all compensation (including salary, bonuses and expenses) paid within the CDC’s most recent tax year for current and former officers, directors, and key employees (even in cases where compensation is less than \$100,000), plus details of deferred compensation packages where applicable; and (5) detailed information on all compensation (including salary, bonuses and expenses) paid within the CDC’s most recent tax year for current and former employees and independent contractors with total compensation of \$100,000 or more during that period, plus details of deferred compensation packages where applicable. A copy of the CDC’s federal tax return for the most recent year, including all schedules, must also be submitted with the CDC’s Annual Report. Submission of the IRS Form 990 does not serve as a substitute for the required Report on Compensation.

CDC Best Practices are centered on adoption of an Executive Compensation Policy that addresses the following:

1. Assigns the responsibility for setting and reviewing executive compensation to the Board, without the actual or appearance of a conflict of interest, including prohibiting a CDC Manager who is a member of the Board from being involved in determining his/her own compensation.
2. Establishes the frequency and timing of executive compensation reviews, to be conducted prior to hiring, prior to making any adjustments to compensation, and annually thereafter.
3. Defines executive compensation to include salary/wages, bonuses/incentives, deferred compensation, non-taxable benefits, and any other applicable category of compensation. Requires the Board, in setting the amount of compensation, to review other CDC payments to the executive, to close relatives of the executive, and/or to entities in which the executive has an ownership interest.
4. Describes the process for establishing that all executive compensation meets the test of being reasonable and customary for the CDC’s Area of Operations, while ensuring that the CDC establishes and maintains adequate reserves for operations and complies with the requirement to invest in other economic development.
5. Requires documentation of the Board’s analysis and basis for setting all executive compensation, including retention of copies of any compensation consultant reports or other compensation data.

6. Requires documentation of Board review and approval for all executive compensation.
7. Requires documentation of all deliberations and decisions by way of Board meeting minutes or Board reports.

## **B. Board Responsibility**

The policy should assign the responsibility for setting and reviewing executive compensation to the Board. The Board must exercise this responsibility with no actual or appearance of a conflict of interest. For that reason, a CDC Manager who is a member of the Board cannot be involved in determining his/her own compensation.

## **C. Frequency and Timing of Executive Compensation Reviews**

The policy should address the timing and frequency of executive compensation reviews to be at minimum:

1. Prior to hiring a new executive team member;
2. Prior to any adjustments to executive compensation; and
3. At least annually to ensure the compensation is reasonable and customary for the CDC's Area of Operations, while ensuring that the CDC establishes and maintains adequate reserves for operations and complies with the requirement to invest in other economic development.

As a best practice, the CDC should consider aligning the executive compensation review with annual performance reviews of executives.

## **D. Defining Executive Compensation**

The policy should clearly define the forms of income that the CDC may include in compensation packages for its executive team members. At a minimum, executive compensation includes:

1. Reportable compensation from the CDC (W-2/1099-MISC);
2. Reportable compensation from related organizations (W-2/1099-MISC);
3. Deferred compensation;
4. Non-taxable benefits; and
5. Any other applicable category of compensation.

## **E. Determining "Reasonable and Customary" Compensation**

The policy should direct the Board to define a review process for setting and reviewing executive compensation to ensure compensation:

1. Is reasonable and customary for the CDC's Area of Operations;
2. Is consistent with the mission of the CDC, including ensuring that the CDC invests in economic development in its Area of Operations;
3. Does not impair the CDC's financial ability to operate and ensures that the CDC continues to establish and maintain adequate reserves for operations;
4. Takes into consideration other CDC payments to the executive, to close relatives of the executive, and/or to entities in which the executive has an ownership interest;
5. Is comparable to similarly situated organizations (i.e., other CDCs and non-profits in the CDC's Area of Operations); and
6. Is consistent with executive's management of the CDC in compliance with 504 Loan Program Requirements.

The review process should, at a minimum, identify the factors that will be used to determine if compensation is reasonable and customary, and provide guidelines for acceptable sources of data (such as IRS Form 990s) to be used for the purpose of comparing executive compensation with similarly situated organizations.

## **F. Documenting Compensation Analysis and Reviews**

The policy should outline the standards for the Board to document its analysis and basis for setting and reviewing all executive compensation, including names of all participating Board members, dates of meetings, details from the sources

used to determine reasonable and customary compensation, retention of copies of any compensation consultant reports or other compensation data, and other key decision factors.

#### **G. Obtaining and Documenting Board Approval**

The policy must clearly state the requirement for Board review and approval of all executive compensation, including the requirement of a Board resolution of approval and Board meeting minutes or reports reflecting all deliberations and decisions.

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Frequently Asked Questions**

**1. What is reasonable and customary compensation for a CDC's Area of Operations?**

Factors to be considered in determining whether executive compensation is reasonable and customary for a CDC's Area of Operations include the following:

- Nature of duties
- Background and experience
- Knowledge of the 504 Loan Program
- Size of the CDC and its 504 Loan Portfolio
- Time devoted to the 504 Loan Program
- CDC's financial ability to operate, including establishing and maintaining adequate reserves for operations
- CDC's investments in other economic development activity in its Area of Operations
- Other CDC payments to the executive, to close relatives of the executive, and/or to entities in which the executive has an ownership interest
- Performance of the 504 Loan Portfolio
- Executive's management of CDC in compliance with 504 Loan Program Requirements
- Economic conditions in general and locally
- Amounts paid by similarly situated organizations in the CDC's Area of Operations, including other CDCs and non-profit entities

**2. Where can we find comparable compensation data?**

There are a number of sources that can provide credible data on compensation. These include websites that publish tax returns for non-profits (e.g., Guidestar.org and Foundationcenter.org). National and state non-profit organizations also conduct salary surveys and make them available free or at a nominal cost to members and at a cost to non-members. In addition, for-profit bank data surveys can also be used.