CDC Best Practices Guidance
Investment in Other Economic Development Activities

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

SBA requires that any funds generated from 504 loan activity by a CDC remaining after payment of staff and overhead expenses must be retained by the CDC as a reserve for future operations or invested in other local economic development activity in its Area of Operations (13 CFR § 120.825). A CDC's Board of Directors is required to ensure that a CDC's staff and overhead expenses are reasonable and customary (13 CFR § 120.823(d)(5)), and that the CDC establishes and maintains adequate reserves for operations (13 CFR § 120.823(d)(9)). A CDC's Board is also required to ensure that the CDC invests in economic development in each of the States in its Area of Operations in which it has a portfolio, and the Board is required to approve each such investment. If the investment is included in the CDC's budget, the Board's approval of the budget may be deemed approval of the investment. If the investment is not included in the budget, the Board must separately approve the investment (13 CFR § 120.823(d)(10)).

A CDC is required to submit a written report on investments in economic development in each State in which the CDC has an outstanding 504 loan with the CDC's Annual Report (13 CFR § 120.830(a)(4)). Tab 1 of SBA Form 1253 (CDC Annual Report Guide) sets forth the requirements for the Economic Development Report, which is designed to provide local economic information as well as analytical data on the impact of the CDC's non-504 assistance to small business. Among other things, the report must include the following: (1) a summary of the CDC's current activity in non-504 SBA loan programs (including 7(a) packaging, Microloan, and Community Advantage); (2) a summary of the CDC's current activity in non-SBA lending programs (including UDAGs, HUD 108 CDBG, EDA, and USDA); (3) a summary of the CDC's activity in non-lending programs, including grants and other non-lending economic development efforts; and (4) a detailed description of the CDC's economic development strategy that outlines the efforts the CDC will undertake during the upcoming fiscal year to serve its Area of Operations, including projections for 504 loan activity and investments in other economic development and including evidence of the Board's approval of the investment plan for the upcoming fiscal year and the basis for determining the type/amount of investment.

Tab 1 of SBA Form 1253 also provides the following guidance on reporting on non-lending investments in economic development activities. CDCs are required to document non-lending investments in economic development activities by instituting a results-based reporting requirement from the recipient entity. For non-lending investments in economic development activities, the CDC should track and report on: (1) the initial investment amount for each program; (2) the amount of investment made during the fiscal year being reported; (3) the expected results of the investment in specific program(s) (at the time of the investment); and (4) the actual results of the investment in non-lending other economic development activities. A CDC must report on the previous year's investment and results, the current year's investment and expected results and the upcoming year's budget estimate. CDCs should use a results-based assessment when considering the investment and/or reinvestment year after year. The results-based reporting should be a requirement of the entity and/or program receiving the investment. All of this information together should be reviewed and approved by the CDC's Board of Directors.

Best Practices for meeting the requirement to invest in other economic development activities are centered on a Results-Based Reporting framework. This framework consists of the CDC Board of Directors, in conjunction with CDC Management, identifying programs/areas in need of support where the CDC can invest a portion of its 504 Revenue with the objective of supporting economic development and growth in its Area of Operations.

B. Best Practices for Results-Based Reporting and Project Evaluation consist of 6 Parts.

Part 1: Determining where and how much to invest:

When determining where and how much to invest, it is recommended that the CDC follow the four steps below.

A. The CDC should identify or create investment opportunities (programs, initiatives, grant or lending opportunities, etc.) that support local economic development activities, preferably in small business development. If the investment is in the form of a program run by the CDC (such as a local loan program), then CDC Management should prepare a plan for the Board's review and approval.

B. If the CDC is investing in an unrelated entity, it should receive a letter of request, application, or proposal with a project plan from each potential recipient. The type of request received would typically vary in detail depending on the size of the request, how the investment will be used, and the length of time over which the results will be achieved. The plan should identify the expected results, which should be specific and measurable, and include the timeframe in which these results are expected to be realized.

C. The CDC should decide which project, entity or program (ideally from multiple options) will provide the best overall benefit for economic development in the CDC's Area of Operations. The CDC should determine how the project, program, or entity receiving the investment will be evaluated at the end of the reporting period, and how this evaluation will be used by the CDC in considering increased funding or reinvestment in the project, program, or entity, or termination of the CDC's investment.

D. The CDC Board should then determine the amount of investment to be made, the recipient entity or program, and the expected results of the investment.

Part 2: Approving the investment and its expected results:

It is recommended that the decision to invest in a given project, program or entity be based on the expected results. The CDC's annual plan for investment in other economic development activities must be Board-approved (13 CFR § 120.823(d)(10)). If the investment is included in the CDC's budget, the Board's approval of the budget may be deemed approval of the investment. If the investment is not included in the budget, the Board must separately approve the investment. Documentation of the Board's approval (including a Board resolution) and the basis for determining the type/amount of investment must be included in the CDC's Annual Report (Tab 1, SBA Form 1253). The Board's approval of the investment should take into account the expected results of the investment and the time period during which these results are expected to be realized.

Part 3: Evaluating the expected versus the actual return on investment:

At the end of the project timeline, the recipient project, program or entity should be required to provide a report to the CDC on how the investment was used and the actual results yielded by the investment (i.e., Results-Based Reporting). This report should provide enough information for the CDC Board to assess and determine whether the projected results of the investment (at the time of the investment) met the actual results achieved.

Part 4: Deciding to reinvest in the same program or invest in something different:

It is recommended that the CDC Board then determine whether the investment generated the expected results. This assessment by the Board should be used in deciding whether or not to make additional investments to support the same project, program or entity. If the outcome of the investment does not generate the expected results, then the Board should consider returning to Part 1 (determining where and how much to invest) to choose a different program/entity to support.

Part 5: Using the results to determine the following fiscal year's budget:

Year after year, as part of the CDC budgeting process, the CDC should follow the same process of determining the amount to be invested along with the expected results, tracking the actual results of the investment, and evaluating the return on investment and determining whether to invest in the same program(s) or others.

Part 6: Report on Economic Development (CDC Annual Report):

The CDC's Annual Report must include a detailed report on the CDC's investment in other economic development activities in its Area of Operations. The Report requirements are summarized above in the Overview section of this guide. (See also, SBA Form 1253, CDC Annual Report Guide.)

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Frequently Asked Questions

1. **What are considered to be some examples of acceptable CDC investments in other economic development activities?**
   - Direct Loan Programs
   - SBA Microloan Program & 7(a) Community Advantage Loan Program
   - Small Business Incubators
   - Technical Assistance Provides such as Small Business Development Centers, Veteran's Business Outreach Centers, Women's Business Centers, and/or the Service Corps of Retired Executives
   - Contributions to other local nonprofits that provide grants and/or entrepreneurial training to small businesses or scholarships to students for participation in such entrepreneurial training programs
   - Workforce development and job training programs
   - Revolving Loan Funds as direct loans or matching funds for a federal, state or local program
   - Downtown revitalization projects
   - Financing economic impact studies to enable or document local economic development efforts

2. **What CDC expenses are not considered to be investments in other economic development activities?**
   - Activities or memberships that support the CDC's 504 loan program marketing and outreach such as:
     - Membership in a Chamber of Commerce
     - Support of events or conferences where the SBA 504 Program is the CDC's point of participation
   - Support for or investment in programs that are not associated with economic development or small business development in the CDC's Area of Operations (e.g., charitable donations to the local symphony or a contribution to the American Heart Association).

3. **What if the CDC is not financially able to invest in other economic development activities?**
   CDCs are required by regulation to use any funds generated from 504 loan activity remaining after payment of staff and overhead expenses as a reserve for future operations or for investment in other local economic development activity in its Area of Operations (13 CFR § 120.825). SBA expects CDCs with adequate reserves to invest in other local economic development activities, and for the CDC Board to ensure that such investments are made (13 CFR § 120.823(d)(10). In limited situations, SBA may recognize that a CDC with insufficient reserves (but with expenses that are otherwise reasonable and customary) is unable to make a financial investment in other economic development activities in its Area of Operations without impairing the CDC's financial ability to operate. In these cases, the CDC may consider donating in-kind employee man hours to a program(s) or initiative(s) that engages in other economic development activities. The approval, budgeting, and reporting processes should be identical to that of making a financial investment.

4. **What type of reporting is recommended to be required of the recipient entity?**
   - <u>Application Materials</u>: The CDC should receive a letter of request, an application or a proposal for use of funds from each recipient entity that is interested in receiving an investment/support. Larger or more long-term requests should involve an application or proposal with a timeline of accomplishment, plan of activities and outcome metrics. The request for support should clearly state how the funds will be used and the expected results of the investment within a specific time period.
   - <u>Results Materials</u>: The CDC should require a report on the actual use and results of the investment within the specific time period.
   - <u>Note</u>: SBA requires a CDC that is operating as a Multi-State CDC to maintain a separate accounting of each State of all 504 fee income and expenses and provide, upon SBA's request, evidence that the funds resulting from its Multi-State CDC operation are being invested in economic development activities in each State in which they were generated (13 CFR § 120.825).