ATTACHMENT 3

REVOLVING LOAN FUND RESPONSE
AEDC

AEDC Small Business Lending Center

AEDC provides loans and support to entrepreneurial, innovative business and community endeavors.
100 Ericson Court, Suite 100A, Arcata, CA 95521 707.822.4616 707.822.8982 fax www.aedc1.org

January 30, 2014

Dawn Elsbree
Headwaters Fund Executive Director
County of Humboldt
520 E Street, Eureka, CA 95501

Dear Ms. Elsbree:

Arcata Economic Development Corporation (AEDC) has taken great pride in having provided loan origination, processing, underwriting and servicing of Headwaters loans since the inception of the Headwaters Fund. In addition, all loans have been matched with AEDC funds at a minimum 1:1 ratio and more recently, in the last two years, we have been able to bring in additional partners on larger projects that had leveraged Headwaters Funds 2:1 and up to 3:1.

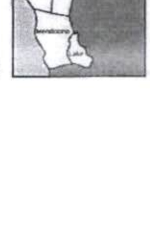
The strength of AEDC is our ability to underwrite and service the smaller micro-loans while still having the expertise and experience to broker a larger $2,000,000 project like the recently completed Open Door Clinic in Eureka. In addition, our federal CDFI status (Certified Development Finance Institution) enables us to obtain matching federal fund grants for Humboldt County loans, if the Headwaters Fund would like to pursue this option.

We hope that you see the value in utilizing our services to lend Headwaters money to local businesses. We have had a number of recent applications totaling over $1.1M, which means if we again had access to the RLF we would have an immediate need for over $500,000.

We look forward to continuing the successful long-term relationship between the Headwaters Fund and AEDC Small Business Lending Center. Please feel free to contact me with any questions you might have regarding our proposal. Thank you.

Sincerely,
Ross Welch

Ross Welch
Executive Director



County of Humboldt's Headwaters Fund
Proposal for Lender Services
Arcata Economic Development Corporation

Institutional Experience and References:

Arcata Economic Development Corporation has been a catalyst for regional economic development growth since 1978, fostering small business growth and job creation by providing financing for businesses that often don't have access to funds through traditional lenders. Funds are available from $5,000 to $5 million and can be used for start-up or expansion, inventory, equipment, working capital, leasehold improvements or commercial property. AEDC also works with the City of Arcata, the City of Eureka along with other communities to administer low-interest Community Development Block Grant loans.

AEDC is a collaborator, and by bringing together other agencies like the Humboldt Area Foundation, the Headwaters Fund, Redwood Region Economic Development Commission and the City of Eureka, they were able to leverage funds responsible for the façade improvements and earthquake retrofit of the Carson Block Building in Old Town Eureka.

Staff Experience:

The local AEDC staff consists of seven employees with years of experience in funding, servicing, collecting and marketing all types of business loans. Four of our team has local banking experience with institutions such as, Redwood Capital Bank, Humboldt Bank, Bank of Loleta, Six Rivers Bank, Wells Fargo and Bank of America. Please see Exhibit "A" with the complete resumes of our employees.

Cost/Revenue:

Budget showing total estimated RLF amount your institution could loan out in the community over the next three years, cost to the County for Headwaters Funds to participate in your program, number of clients to serve, and projected revenue to the County. Detail about how you will ensure at least a 5-6% return to the County on the overall loan portfolio.

See attached Exhibit B to review AEDC's historic usage of Headwaters Funds, total yearly income and loan losses. We are proposing the following changes to the current reimbursement program we have with the Headwaters Fund.

- For loans $150,000 and less (Headwaters portion), Headwaters would receive 65% of all interest collected and AEDC would receive 35%. This is an increase for Headwaters over the current 60/40 split.
- For loans over $150,000, AEDC would receive a flat 1% of the note rate charged. For example, if a loan was written at 9%, Headwaters would receive 8% and AEDC would receive 1%.

This new rate schedule would give Headwaters a larger return than in the past, but still make it worthwhile for AEDC to search out and assemble larger profile projects with other partners.

fees subordinate to interest / [illegible]

See attached Exhibit "B" for a detailed cost analysis breakout.

Design Description:

Provide a description (up to two pages) of how you would design, organize, execute and monitor the program.

Please see Component One below to see how AEDC currently underwrites and services our existing loans with the Headwaters Fund.

Insurance Requirements:

AEDC currently has on file with the County all insurance requirements listed in section IX of the RFP.

Violations:

AEDC has had three years continuous audits with no findings and an unmodified opinion from our auditor. Arcata Economic Development Corporation is now considered to be a low-risk auditee. We have included a copy of our most recent audit, and previous audits have been supplied each year to Headwaters staff. We have no violations or corrective action orders outstanding.

Component One – Headwaters Participation Loans

A. Specific gap loans that fit the criteria in the Headwaters Fund RLF Manual include loans for business start-ups. Banks and Credit Unions will not normally fund business start-ups and AEDC can often fund these types of loans. AEDC will also fund loans for existing business expansion based on projections, which is an area that other financial institutions often will not do. Another gap funding opportunity is lack of collateral. We can make up for this gap by cross-collateralizing with other assets outside of the business and accepting loan guarantors as well.

B. Non-Headwaters RLF sources of funding used to match Headwaters Funds: AEDC has numerous sources of outside funding that we are able to use as Headwaters matching funds. Our most recent partner is Humboldt Area Foundation. They have indicated a willingness to use up to $1,000,000 of their assets to help fund local projects. We have leveraged their funds with Headwaters funds for two separate projects during the past two years, and a new loan will be funded within the next 30-days using money from HAF, Headwaters and AEDC.

   Other sources of funding that we can use for Headwaters match is our USDA loan fund. These funds are borrowed by AEDC and can be used everywhere in Humboldt County except for Eureka, which is not considered a qualifying rural area. We also have SBA microloan funds that can be used as a match in amounts of $50,000 or less in Humboldt County. AEDC also has the

$1.4M Old Growth Fund that can be used as match and we have our own AEDC revolving loan fund that has unrestricted funds that we can access as well.

C. Percentage of Headwaters Funds to participate in loans; AEDC plans to continue matching Headwaters funds at a minimum of 1/1.

D. Underwrite loans; AEDC will utilize the Headwaters Revolving Loan Fund Lender Manual as a guide for underwriting loans. Items that are left to lenders discretion, we will then use the AEDC Loan Policy Manual as a guide, a copy is included with this proposal.

E. Secure loans; AEDC will secure loans as per the AEDC Loan Policy Manual.

F. Execute Participation Agreement with Headwaters Fund for each new loan (this document to be created based on the terms negotiated through this RFP process). We expect the Participation to be the same as what is currently in place, but we can modify the form based on the negotiated contract.

G. Track and collect loan payments, interest, and late fees; AEDC utilizes the PIDC Portfol software system to track and collect loan payments. We will continue to use this system to prepare our monthly invoices as well as track interest, principal and late payments.

H. Collect the debt and re-pay Headwaters portion monthly; We plan to continue the procedures we have in place that include keeping all headwaters money collected in a separate account and supplying Headwaters with one combined monthly check for proceeds collected.

I. Provide monthly, quarterly, and annual reports as specified in the Revolving Loan Fund Manual; AEDC has perfected a system with Headwaters staff that gives them a detailed monthly breakdown of each Headwaters participation loan, total interest and principal credited and breakout for each loan.

J. Anticipated return to the Headwaters Fund RLF: The ROI will vary depending on loan losses which should be anticipated with higher risk loans. See attached Exhibit "B" for historic ROI figures. .

Component Two – New Loan Mechanisms for Headwaters RLF Funds

Proposers will describe a program and costs that include, but are not limited to, the following:

A. *Describe an identified gap in the local capital market;*

At times AEDC struggles to find enough money to lend out to our clients. However, the past two years we have had money on the sidelines looking for borrowers, which has been mainly caused by the poor economy. As recently as two months ago we met with the Headwaters Finance Committee and explained we still had $2,000,000 of our money on deposit looking for borrowers. Since then, we have seen an uptick in demand to the point that if our Headwaters contract is not renewed, we will be out of funds by April. When we run out of money, our gap funding programs cease to exist until we get more.

B. *Describe a program in which Headwaters RLF funds are used to fill this gap;*

If we (AEDC) were able to borrow money from Headwaters (at a reasonable rate) we can get a grant from the Federal Government that matches what we receive from Headwaters. As a CDFI (Certified Development Financial Institution), we are allowed to receive a grant that would match what we would receive from Headwaters. If we borrowed $500,000 from Headwaters at 2% for ten years, we could get the same terms via a CDFI grant. Thus, we would have a new $1,000,000 loan fund available to lend out.

This is similar with what we do with our USDA and SBA loan funds. With USDA & SBA we borrow directly from the government in $300,000 to $750,000 amounts at a current rate of 1%. There is a long lead time with USDA so it can take months before we can obtain these funds after applying.

C. through G. Answers for items C through G are identical to those listed under Component One listed previously. Match funding sources, underwriting tracking and securing the loans are the same procedure as previously listed.

Anticipated return to the Headwaters Fund RLF is 2%, since this would be the note rate on an AEDC loan.

Exhibit "A"

AEDC Staff (Jan. 2014)

Ross Welch
Executive Director, since May 2008

Mr. Welch comes to AEDC with thirty years of lending experience in Humboldt, Del Norte and Mendocino Counties. Prior to working at AEDC, Ross worked in commercial lending and as branch manager at Redwood Capital Bank. Besides lending experience, Ross has also served on various community organizations such as the Crescent City JayCees and Rotary Clubs in Eureka, Arcata, Fortuna and Fort Bragg. He is currently a member of the Arcata Rotary Club and the Arcata Chamber of Commerce Board of Directors.

Kelli Denney
Loan Manager, since September 1999

Ms. Denny is responsible for the review of all AEDC loan requests. She manages revolving loan funds that include SBA Microloans, USDA IRPs and three local revolving loan funds. Ms. Denney works within the requirements of various loan funds, including Community Development Block Grant, USDA, Community Development Financial Institution Grant Funds, Rabobank EQ-2 Funds, SBA Microloans, SBA 504 loans, Old Growth funds, AEDC revolving loan funds and Headwaters. Kelli has over 20 years of commercial banking experience.

Jayne Lovig
Associate Loan Officer, since January 2008

Ms. Lovig has over twenty years' experience in lending and auditing for banks, lenders and mortgage insurance companies. At AEDC, Jayne prepares SBA microloans, as well as those from USDA, the Headwaters Fund and the AEDC revolving loan funds. Her position allows more loans to be processed in a shorter time -- a real benefit for entrepreneurs seeking funding for their business.

Susan Seaman
Program Director, since March 2007

Ms. Seaman, a graduate of Humboldt State University, has been working in marketing, outreach and program management since 1991. Besides general marketing, at AEDC she runs and creates community programs such as the Prosperity IDA Scholarship, Spotlight on Success, an annual celebration of small business; Lemonade Day and the Trailing Spouses program.

Teri Paterson
Controller, since October 2010

Teri comes to AEDC with almost thirty years experience in the retail environment, most recently as the Controller/Finance Manager at Redwood Harley-Davidson. Teri worked with AEDC through her clients, and was acquainted with the team and lending requirements from the borrower's side. Since joining AEDC, Teri has helped AEDC achieve a "low-risk" auditee status with three years of no findings in our annual audit.

Exhibit "A" (Continued)

Tony Rodrigues
Loan Servicing, since June 2004

Mr. Rodrigues is responsible for AEDC's loan servicing, collections and annual site visits. After a loan is made, Tony continues the relationship with the borrowers. Prior to working at AEDC, Mr. Rodrigues worked for Humboldt Bank (now Umpqua Bank) in the Collections Department, the Records Management Department, and as their Construction Disbursement Specialist.

Keif Chavera
Office Manager, since August 2006

Ms. Chavera, the voice of AEDC for all incoming calls, is the office manager and the accounts payable/receivable bookkeeper. She has worked in the administrative field since her service in the United States Air Force as an Office Assistant. She also worked for the Paralyzed Veterans of America and the Department of Justice, Attorney General's Office Registry of Charitable Trust Section. During her time in the military, she assisted the liaison between the Government of Japan and the Controller for Kadena Air Base in Okinawa, Japan.

Exhibit "B"

AEDC - Headwaters Fund Loan Portfolio Performance

Period	Period End Loan Balance	Average Loan Balance	Interest Paid HWF	Loan Losses	Cash Basis ROI
FY 2013	$ 1,490,811.13	$ 1,777,818.78	$ 86,516.32		4.87%
FY 2012	$ 2,004,187.70	$ 2,210,949.78	$ 98,895.67	$ (194,922.44)	-4.34%
FY 2011	$ 2,265,128.52	$ 1,542,186.77	$ 78,925.72	$ (20,873.03)	3.76%
FY 2010	$ 1,338,030.29	$ 1,344,221.96	$ 73,938.79	$ -	5.50%
FY 2009	$ 1,233,673.19	$ 921,701.35	$ 37,640.30	$ -	4.08%
FY 2008	$ 351,996.91	$ 433,329.30	$ 24,535.83	$ -	5.66%
FY 2007	$ 343,961.34	$ 268,911.20	$ 15,193.36	$ -	5.65%
FY 2006	$ 192,813.60	$ 205,045.30	$ 12,828.64	$ -	6.26%
FY 2005	$ 250,802.30	$ 304,658.77	$ 19,397.66	$ -	6.37%
FY 2004	$ 209,041.13	N/A	$ 9,612.27	$ -	N/A

Current Balance (1-30-14)		$1,642,410
$1.1M in pending loans eligible for Headwaters match		550,000
Open Door Draw, expected within 60 days		310,000
Projected balance by 6-2014	$	2,502,410
* Projected balance by 12-2014	$	3,000,000
* Projected balance by 12-2015	$	3,500,000
* Projected balance by 12-2016	$	4,000,000

* June 2014 projected balance is based on actual pending loans eligible for Headwaters matching funds. The remaining balances are calculated by using a figure of $500,000 per year increase in loans.

It should be noted that AEDC 's limit for it's Headwaters RLF was not increased to $3,000,000 until June of 2010. Previous to June 2010 we had a $1.5M limit, shich we reached in 2009/2010.

Arcata Economic Development Corporation

LOAN POLICY MANUAL

Adopted September 27, 2005
Changes Adopted November 28, 2006
Changes Adopted January 23, 2007
Changes Adopted July 24, 2007
Changes Adopted October 23, 2007
Changes Adopted May 26, 2009
Changes Adopted March 23, 2010

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I. Introduction

A. **Loan Management.** AEDC has established written Loan Policies to ensure that loan requests are handled in a consistent manner and to provide guidance when making underwriting decisions.

AEDC will maintain two separate documents to help manage its lending activity: a Loan Policy Manual and a Loan Procedure Manual. The Loan Policy Manual will contain general program guidelines and policy direction, and will be subject to review and approval by the Board of Directors. The Loan Procedure Manual will contain specific underwriting, structuring, documenting and servicing procedures and forms. The Procedures Manual will be subject to review and approval by the Loan Committee.

B. **Mission Statement.** The mission of Arcata Economic Development Corp (AEDC) is to foster economic and community development in cooperation and coordination with regional partners, in order to build and maintain healthy communities.

C. **Vision.** AEDC's operations—programs, loans, and staff and community involvement—are well managed and financially sound.

AEDC is recognized as an integral element in the Prosperity! Network and in the economic development community as a whole. We foster collaborative communication, and ensure that community economic development efforts are not duplicated. We always seek to broaden existing relationships while developing new regional partners.

AEDC's emphasis will be on:

- Contributing to a creative and innovative economic development system based on regional values for a healthy economy;
- Supporting the development and expansion of new and existing businesses;
- Creation, enhancement and retention of jobs;
- Improving the standard of living;
- Ongoing exploration and implementation of innovative programs.

D. **Approval Authority**

Board of Directors. The Board of Directors will review and approve all loan requests over $200,000 and authorize disbursement; approve all loans funded by the AEDC RLF and authorize disbursement; and, adopt SBA 504Resolutions authorizing the sale of debentures. The Board of Directors may take action at a regularly scheduled meeting or at a special meeting. A quorum to take action on loan requests is five (5) members including one Board member with commercial lending experience. The Board of Directors will review recommendations from the Loan Committee and staff.

The Board of Directors may delegate this authority to the Executive Committee. A quorum of the Executive Committee must participate in the decision. A quorum to approve loan requests and authorize disbursements is four (4) members; a quorum to approve SBA 504 loans and adopt SBA 504 Resolutions is five (5) members including one Board member with commercial lending experience. Executive Committee minutes will be submitted to the Board of Directors for review and comment.

Loan Committee. The Loan Committee will review and approve all loan requests of $100,001 to $200,000 and authorize disbursement. The Loan Committee may take action at a regularly scheduled meeting, a special meeting, or by conference call on a limited basis. The Loan Committee will review recommendations from the Loan Manager. A quorum must participate in the approval. A quorum is five (5) members; at least three (3) Board members are required for a quorum.

The Loan Committee will review and submit recommendations to the Board of Directors on loans over $200,000, and on SBA 504 loans. A quorum to recommend SBA 504 loans must include one member with commercial lending experience. Loan Committee minutes will be submitted to the Board of Directors for review and comment.

Staff. The Staff will review and approve all loan requests of $100,000 and under and authorize disbursement. The Executive Director, or a designee, will review recommendations for approval from the Loan Manager of loans up to $10,000. The Executive Director, or a designee, and one Loan Committee member that has commercial lending experience, will review recommendations for approval from the Loan Manager of loans from $10,001 to $100,000. The Staff may take action (document, close and fund) when a loan is ready for review.

Staff approvals will be submitted to the Loan Committee at the next regularly scheduled meeting for review and comment.

Written Notification. Within three (3) working days of any loan decision, the applicant will be notified in writing of the decision.

Appeals. An applicant who is denied a loan by the Loan Committee or by the staff may request that the Board of Directors review and take action on their application. Said appeal shall be placed on the agenda of the next regularly scheduled Board of Directors meeting.

Conflict of Interest. Any member of the Board of Directors, the Executive Committee, or the Loan Committee who may have a current or future financial interest in a loan application must abstain from voting on said application.

E. **Investment Area.** AEDC may provide loans and other services to small businesses and public interest enterprises located in the counties of Del Norte, Humboldt, Lake, Mendocino, Siskiyou, and Trinity. AEDC is also authorized to provide SBA 504 loan services throughout the State of California.

F. **Eligible Borrowers.** AEDC will lend to private, for-profit enterprises and public interest, non-profit enterprises, with priority given to those projects that support the mission of AEDC, and have a reasonable probability of success. Borrowers may be companies or projects in need of additional financing or they may be start-up companies or projects. An existing company should have an historic track record that includes at least one year of profitability out of the last three years. An existing public interest enterprise should have unrestricted assets that can be pledged to the project.

Eligible Borrowers may include, but are not limited to, the following classes of Borrower:

1. Business owners who do not meet conventional financial requirements.
2. New or unproven business owners.
3. Start-up businesses.
4. Businesses that create or retain jobs that pay higher than the region's median wage.
5. Businesses that create or retain one job for each $35,000 lent.
6. Child care/education providers.
7. Public interest projects that can demonstrate repayment from unrestricted cash flow.

8. Affordable housing projects or mixed use projects within the service area.

Borrowers who have a previous bankruptcy may be eligible for loans if they can demonstrate that performance subsequent to the bankruptcy filing has been according to the terms of credit agreements for at least a two-year period after filing.

G. **Incentives to Encourage Directed Investment.** From time to time AEDC may wish to provide direct encouragement to a targeted industry or business activity. At the sole discretion of AEDC, pricing incentives may be deducted from standard interest rates or fees for loans that meet targeted characteristics. The AEDC Program Committee will periodically review and recommend incentive policies to the Board of Directors for adoption. Some examples of targeted characteristics may include:

- If the enterprise is an exporting industry;
- If the new jobs created pay higher than the region's median wage;
- If the business is relocating operations into a distressed community in the service area;
- If the business makes childcare available to an underserved community.

II. Underwriting Guidelines

A. **Application.** Loan Applicants will be treated with dignity and fairness, but no application will be advanced by AEDC until it contains sufficient detailed information to determine eligibility for the loan, and make reasonable predictions about the potential success of the project.

1. **Loans $5,000 and under.** AEDC staff will assist Applicants in completing the application package, which will contain at a minimum:

a) A business plan with at least one year of projections for a new business. A business plan may be required for an established business, if deemed necessary by AEDC, or it may show historical cash flow and repayment ability.
b) A minimum of one year of tax returns on the business, individual applicant, and/or guarantor.
c) Personal financial statements on all individual applicants, which are less than 90 days old.
d) Personal financial statements on all guarantors, which are less than 90 days old.
e) Personal financial statements on each individual who owns 20% or more of a business or project, which are less than 90 days old.
f) If determined to be primary collateral, then Borrower must provide a list of assets (equipment, machinery, etc) that includes a description of the item and approximate value. A list of assets will not be necessary if determined or proposed as secondary collateral, but may still be required if deemed necessary by AEDC staff.
g) Any required Resolutions from the governing body of the business authorizing a loan.
h) Copies of all relevant organizational documents, i.e. Articles of Incorporation, Bylaws, Partnership Agreements.

Additional documents may be required from time to time. A detailed list of documents required for each loan will be found in the Procedure manual. All loan applications must conform to document requirements in effect at the time the application is filed.

2. **Loans $5,001 to $10,000.** AEDC staff will assist Applicants in completing the application package, which will contain at a minimum:

a) A business plan with at least one year of projections for a new business. A business plan may be required for an established business, if deemed necessary by AEDC, or it may show historical cash flow and repayment ability.
b) A minimum of two years of tax returns on the business, individual applicant, and/or guarantor.
c) Personal financial statements on all individual applicants, which are less than 90 days old.
d) Personal financial statements on all guarantors, which are less than 90 days old.
e) Personal financial statements on each individual who owns 20% or more of a business or project, which are less than 90 days old.
f) If determined to be primary collateral, then Borrower must provide a list of assets (equipment, machinery, etc) that includes a description of the item and approximate value. A list of assets will not be necessary if determined or proposed as secondary collateral, but may still be required if deemed necessary by AEDC staff.
g) Any required Resolutions from the governing body of the business authorizing a loan.
h) Copies of all relevant organizational documents, i.e. Articles of Incorporation, Bylaws, Partnership Agreements.

Additional documents may be required from time to time. A detailed list of documents required for each loan will be found in the Procedure manual. All loan applications must conform to document requirements in effect at the time the application is filed.

3. **Loans $10,001 and above.** AEDC staff will assist Applicants in completing the application package, which will contain at a minimum:

a) A business plan with at least two years of projections for a new business. A business plan may be required for an established business, if deemed necessary by AEDC, or it may show historical cash flow and repayment ability.
b) A minimum of three years of tax returns on the business, individual applicant, and/or guarantor.
c) Personal financial statements on all individual applicants, which are less than 90 days old.
d) Personal financial statements on all guarantors, which are less than 90 days old.
e) Personal financial statements on each individual who owns 20% or more of a business or project, which are less than 90 days old.
f) If determined to be primary collateral, then Borrower must provide a list of assets (equipment, machinery, etc) that includes a description of the item and approximate value. A list of assets will not be necessary if determined or proposed as secondary collateral, but may still be required if deemed necessary by AEDC staff.
g) Any required Resolutions from the governing body of the business authorizing a loan.

h) Copies of all relevant organizational documents, i.e. Articles of Incorporation, Bylaws, Partnership Agreements.

Additional Documents may be required from time to time. A detailed list of documents required for each loan will be found in the Loan Procedure manual. All loan applications must conform to document requirements in effect at the time the application is filed.

B. **Underwriting Loans.** In underwriting loans, AEDC will complete the AEDC Credit Approval/Risk Rating Matrix. (Exhibit A). No loan will be approved with a score of 14 or less. Scores between 15 and 20 may be approved but should be carefully structured and placed on a Watch List. Loans scoring 21 or higher are eligible to be approved.

Credit Bureau reports will be obtained on all individuals owning more than 20% of the business. A Dunn and Bradstreet Report will be obtained on existing businesses.

In addition to the Credit Approval/Risk Rating Matrix, a Credit Evaluation Summary (Exhibit B) will be prepared on all loan requests.

For loans $10,000 and under, the Fair Isaac Credit Score (or similar credit score) provided on the Credit Bureau report can be a determining factor in the approval of the loan in lieu of the AEDC Credit Approval/Risk Rating Matrix. The following is a guideline for using the Fair Isaac Credit Score in loan approvals:

1. **Loans $5,001 to $10,000:** a minimum Fair Isaac Credit Score of 680 must be achieved.
2. **Loans $5,000 and under:** a minimum Fair Isaac Credit Score of 650 must be achieved.

III. Structuring Guidelines

A. **Collateral.** AEDC will take collateral at a discounted collateral value. Independent third-party appraisals or evaluations may be obtained on pledged assets. Although AEDC prefers to be in a first lien position on all collateral, the lien position may be at the discretion of AEDC and may be enhanced by guarantors.

A discount formula will be applied to the appraisal or evaluation in each asset category according to the following list:

1. Cash, 100%
2. Accounts Receivable, 20% of all receivables that are less than 30 days delinquent.
3. Inventory, 20% of non-obsolete inventory.
4. New equipment, 80%, used equipment, 50%. Adjustments should be made if the equipment has a rapid obsolescence factor or if it is equipment that may not be used in more than one type of company
5. Titled Vehicles, 100% of the Blue Book Loan value.
6. Residential Real Estate, 90% based on a current appraisal, broker evaluation, assessed value, or acceptable internet based value comparison website as determined by AEDC staff.
7. Commercial Real Estate, 80% based on a current appraisal, broker evaluation, broker evaluation, assessed value, or acceptable internet based value comparison website as determined by AEDC staff.

8. Unimproved or undeveloped land, 50% based on a current appraisal, broker evaluation, broker evaluation, assessed value, or acceptable internet based value comparison website as determined by AEDC staff.
9. Collateral not located within our service area will be discounted at an additional 50% of our standard discount.

AEDC will require that all loans over $100,000 be secured with discounted residential or commercial real estate collateral. The equity of the discounted real estate must equal no less than 50% of the total loan amount. One or more properties may be pledged to meet this requirement.

For all loans under $100,000 or for those loans that are over $100,000, but do not meet the required 50% discounted real estate equity requirement, the level of additional collateral or the minimum level of total collateral allowed is at the discretion of the loan committee or appropriate approval authority as defined in section I.D – Approval Authority.

For any loan amount $250,000.00 or more, an appraisal completed by a certified general appraiser will be required on both commercial and residential property regardless of whether the real property is considered primary or secondary collateral.

B. **Term.** The term of the loan should match the asset life of the collateral and/or the purpose of the loan. A multi-purpose loan may use the longest term or have more than one term, subject to the following guidelines:

1. Line of Credit, annual resting and renewal required.
2. Inventory /Working Capital Loans, 1 to 7 year term, with some consideration given to the amount of the loan.
3. Equipment, 1 to 10 year term, generally not to exceed the useful life of the equipment.
4. Commercial Real Estate, up to 25-year amortization with appropriate balloon payment, not to exceed the term of the lease in the case of trust properties.

On a case by case basis, a longer amortization may be allowed to accommodate the cash flow of the Borrower. However, the term or maturity date must still match the asset life of the collateral and/or purpose of the loan.

C. **Loan Fees.** There will be a 2% transaction fee on all loans, except SBA Microloans which are limited to $100, plus all out of pocket expenses will be borne by borrower including, but not limited to, appraisal fees, environmental audits, filing fees, portfolio insurance, and attorney fees.

D. **Interest Rates.** The Board of Directors, upon the recommendation of the Loan Committee, will review and set interest rates based on program and market requirements each fiscal year.

E. **Environmental Considerations.** Commercial loan applicants may be required to provide information on environmental matters pertaining to the applicant's business and facilities. The applicant may provide the required information via an approved form provided by AEDC or through a Phase I Assessment provided by an environmental consulting firm approved by AEDC. AEDC may require an Environmental Data Resources report (EDR).

F. **Borrower Reporting Requirements.** As the analyst determines the strengths and weaknesses in a loan, thought should be given to conditions that might be placed on the loan in order to control the risks identified in the individual transaction.

At a minimum each Borrower will be required to provide periodic financial statements, which include an income statement and balance sheet. The frequency of the reporting will be dependent upon the risks inherent in the loan transaction. High risk Borrowers will be required to report more frequently than lower risk Borrowers. Other periodic reports that might be required in support of the transaction include, but are not limited to: Personal and Business Tax Returns, Accounts Receivable Aging, Inventory listings detailing the method of accounting used (LIFO, FIFO), Sales Reports, Borrower statement of compliance with all loan covenants, a Community Impact Report, or a Milestone Progress report.

IV. Servicing Guidelines

A. **Preparation of Loan Documents.** All loan documents will be prepared in accordance with a Collateral Documents Check list, and will use the standard loan documents developed by AEDC. Each loan file will contain a Disbursement Agreement, signed by the Borrower, detailing how the proceeds of the loan were disbursed.

B. **Loan Files.** Original executed loan documents will be secured in a fireproof cabinet, when not being used by staff. Copies of all loan documents will be maintained in a secure manner and information contained in these files will be held in the strictest confidence.

C. **Billings.** Customers will receive monthly billings on their accounts at least 20 days before a payment is due.

D. **Loan Modifications.** Terms and conditions of an existing loan may be modified from time to time. Revisions of a loan agreement are only allowed when it would result in a reasonable assurance of improved repayment ability and/or enhanced viability of the loan recipient.

The Loan Manager, with concurrence from the Executive Director, has the authority to approve the following loan modification requests:

- First-time deferment requests that do not exceed three months. The borrower must make interest-only payments during this period;
- Collateral modification requests that are specific to subordinations and substitutions provided that the discounted loan to value (LTV) is not adversely affected by more than a one (1) point change according to the AEDC Credit Approval/Risk Rating Matrix section 3;
- Any modification or restructuring (including substitutions, subordination, and release of collateral) of loans approved at the Staff level as described in section D. Approval Authority – Staff.

The Loan Committee has the authority to approve all other loan modification requests including:

- Deferred principal requests exceeding three months;
- Deferments of principal and interest;
- Second requests for the same borrower (excluding subordinations and substitutions);
- All other collateral modification requests (i.e. releases);

A fee commensurate with the volume of work associated with the request will be charged to the borrower.

E. **Collections.** A very pro-active schedule for Borrower contact will be maintained as follows:

Action	Number of Days Past Due
• Attempt to contact by telephone	15
• Mail first Notice of late payment	30
• Mail second Notice of late payment	60

•	Prepare action plan	75
•	Initiate Legal action	120

F. **Problem Loans.** When an account reaches 75 days delinquent on reporting or payment requirements, the AEDC staff will prepare an action plan for collecting the outstanding balance of the account, and present it to the Loan Committee for approval. A downgrade of the risk rating score must be considered once the account has reached 75 days delinquent.

V. Managing Risk

A. **Portfolio Standards.** AEDC will strive to maintain Portfolio Standards that reflect its ability to professionally make and manage its loan programs. These standards include:

- An annual Loan Loss Rate at or below 3%
- An annual Total Portfolio at Risk Rate (>30 days) at or below 12%
- An annual Portfolio Deployment Rate of 70%
- No single AEDC funded loan from any source of funds (i.e. SBA Microloan, USDA, Old Growth, AEDC RLF) or combination of source of funds may represent more than 8% of our combined Loan Portfolio
- No single borrower may receive AEDC funded loans from any source of funds (i.e. SBA Microloan, USDA, Old Growth, AEDC RLF) or combination of source of funds that total more than 8% of our combined Loan Portfolio.
- An AEDC Operating Reserve Account equal to 30 days operating cash

B. **Portfolio Insurance Program.** The Portfolio Insurance Program has been established to reduce the risk associated with under- collateralized small business loans. Any loan, or portion thereof, not fully collateralized by a Deed of Trust on real property will be required to participate in the Portfolio Insurance Program. Each loan recipient will pay a fee equal to two (2%) percent of the loan amount not collateralized by a Deed of Trust. This fee plus a matching two (2%) percent paid by either AEDC or the borrower will be placed in a Portfolio Loan Loss Reserve Account jointly established with the California Capital Access Program (CalCap).

C. **Loan Loss Reserve Accounts.** Loan Loss Reserve Accounts are designed to hold cash that AEDC may use to repay AEDC lenders or to replenish loan funds in the event of a loan loss. Loan loss reserves will be allocated to the appropriate reserve accounts when each loan is closed and at the annual review of risk ratings. The current Loan Loss Reserve Accounts are:

SBA Loan Loss Reserve Account. A separate Reserve Account shall be created and maintained with a cash balance not less than 15% of the outstanding principal balance of the combined SBA Microloan portfolios. This Reserve Account may only be used to repay AEDC's SBA loans. The Reserve Account balance shall be verified and adjusted on a quarterly basis. Cash shall be allocated from unrestricted revenue sources.

USDA Loan Loss Reserve Account. A separate Reserve Account shall be created and maintained with a cash balance not less than 6% of the outstanding principal balance of the combined USDA loan portfolios. This Reserve Account may only be used to repay AEDC's USDA loans. The Reserve Account balance shall be verified and adjusted on a quarterly basis. Cash shall be allocated from loan fees and loan payments from the USDA portfolios.

Portfolio Loan Loss Reserve Account. A separate Reserve Account shall be created and maintained with a balance not less than 8% of the outstanding principal balance of all AEDC funded loans enrolled in the Portfolio Insurance Program. This Reserve Account may only be used to replenish loan funds in the event of a loan loss. The Reserve Account balance shall be verified and adjusted on an annual basis. Cash shall be allocated from loan fees and unrestricted revenue sources.

Corporate Loan Loss Reserve Account. A separate Reserve Account may be created by the Board of Directors and maintained with a balance equal to the AEDC Allowance for Bad Debts less cash held in the Portfolio Loan Loss Reserve Account. This Reserve Account may be used to replenish loan funds in the event of a loan loss or to pay for expenses associated with collection and recovery. The Reserve Account balance may be verified and adjusted on a quarterly basis. Cash may be allocated from loan fees and unrestricted revenue sources.

D. **Allowance for Bad Debts.** The Allowance for Bad Debts Account is maintained to recognize the realizable value of AEDC's loan portfolio. Bad debt allowances will be charged on the basis of each loan's risk rating when the loan is closed. Adjustments to the Allowance for Bad Debts will also be made annually following the review of Risk Ratings.

E. **Annual Review of Risk Rating.** Every loan will be reviewed, using the Credit Approval/Risk Rating Matrix at the time of approval and at least annually on its anniversary date or upon receipt of annual financial statements. Loans scoring lower than 20 should be reviewed quarterly.

Risk Ratings:

- A score of 0 to 13 will be considered a doubtful loan.
- A score of 0 to 14 will be considered a substandard loan.
- A score of 15 to 20 will be considered a watch loan
- A score of 21 to 25 will be considered an acceptable loan
- A score of 26 to 30 will be considered an above average loan

Staff will review the Allowance for Bad Debts account and make adjustments in conjunction with the Annual Review of Risk Rating.

A percentage of the uncollateralized outstanding principal balance on each AEDC funded loan will be allocated to the Allowance for Bad Debts account. The following scale will be used on all loans:

- Doubtful: 100% or the estimated loss after liquidation of collateral
- Substandard: 100%
- Watch: 50%
- Acceptable: 25%
- Above Average: 10%

F. **Annual Site Visit.** Loan staff will conduct annual site visits with each borrower. The status of collateral is monitored through site visits. Site visits may also be used: to observe the physical operations and status of the borrower, to communicate any unmet servicing requirements, to verify borrower occupancy, to identify any possible environmental problems, and to make the borrower aware of the availability of management assistance programs.

G. **Non-Accrual Loans.** If a loan reaches 120 days delinquent, the loan must be placed on non-accrual. No income will be recognized by AEDC on accounts that reach this delinquency milestone, until the principal has been paid in full, or the account otherwise returns to health. Failure to recognize income on the books of AEDC does not relieve the Borrower of his/her responsibility to pay according to the terms of his Promissory Note, and the Borrower should never be told that his/her loan has been placed on non-accrual.

H. **Work out Plan.** Any Work out Plan agreed to by the Borrower must receive approval through the standard loan approval process before being documented and implemented by AEDC Staff. Once properly approved, the plan must be put in wiring, modifying loan documents, as necessary, and signed by the Borrower.

I. **Charge-Offs.** If a loan reaches 180 days delinquent, the loan should be charged-off the books of AEDC. A charge-off does not relieve the Borrower of his/her responsibility to pay according to the terms of his/her Promissory Note. Accordingly the Borrower should never be told that his/her loan has been charged-off, and every attempt should be made to continue to recover the full balance due.

The Executive Director shall refer all charge-offs to the Loan Committee for review and approval. Post charge-off collection activity will be included in the Delinquency Report.

VI. Reporting Requirements

The following reports should be presented at each regularly scheduled Board meeting or at the specified reporting period:

- Pipeline: A monthly report of all loans currently under consideration, together with their size and estimated timing of loan closing.
- Funds Available for Lending: A monthly report showing all committed and uncommitted funds available for lending by funding source.
- Delinquency: A monthly report of all loans delinquent more than 30 days.
- New Loans: A report of all loans made since the last Board meeting, including amounts, and community impacts.
- Restructured Loans: A report of all loans restructured since the last Board meeting, including the impact on the risk rating for that loan.
- Risk Rating Report: A quarterly summary of the relative risk in the portfolio, with a review of the Loan Loss Allowance Account and the Corporate Loan Loss Reserve Account.
- Community Impact Report: An annual report of the cumulative community impact of all loans made that year.

EXHIBIT A

Applicant Name: _______________
Dba: _________________________

AEDC Credit Approval/Risk Rating Matrix

1. **Capacity:** Capacity to repay is the most critical of the five factors. Assign 1 point for each of the following topics:

___ Current economic climate of business type is strong and the Business Plan demonstrates business strength.
___ Length of repayment time is feasible for business.
___ Contingency sources for repayment or additional source of income.
___ Payments are current on existing credit accounts.
___ Cash Flows demonstrate business strength and meet industry standard.
___ **Debt Service Coverage:** Assign a point value that reflects Debt Service Coverage.

$$\textbf{Debt Service Coverage} = \frac{\textbf{Net Income + Depreciation and/or Amortization Expense}}{\textbf{Current Portion of Long-Term Debt}}$$

(Calculated on year 2 of cash flow projections for start-up businesses)

5 points - Debt Service Coverage of 1.75:1.0+
4 points - Debt Service Coverage of 1.25:1.0 to 1.74:1
3 points - Debt Service Coverage of 1.0:1.0 to 1.24:1
2 points - Debt Service Coverage of 0.90:1.0 to 0.99:1
1 point - Projections are unrealistic, or no historical repayment ability

*Debt service coverage ratio measures the ability of a firm to service principle repayments and is an indicator of additional debt capacity. The ratio is a valid measure of the ability to service long-term debt.

Score for Capacity Section_______ (10 points maximum)

2. **Capital:** Money personally invested in the business. Assign a point value that most accurately reflects the capital investment.

$$\textbf{Debt to Equity} = \frac{\textbf{Total Liability}}{\textbf{Total Equity}}$$

4 points- debt-to-worth ratio is no more than 2.50:1
3 points- debt-to-worth ratio is between 2.51:1 and 3.50:1
2 point- debt to worth ratio is between 3.51:1 and 4.50:1
1 points- debt to worth ratio is between 4.51:1 and 5.50:1.

*The ratio shows what is owed in relationship to the owner's equity in the company. The higher the ratio, the more risk of failure for the business and for the ability of the creditor to collect the loan.

Score for Capital Section______ (4 points maximum)

3. **Collateral:** Assets that are pledged as a form of security on the loan. Assign a point value that most accurately reflects the collateral pledged, on a discounted basis.

3 points -	Loan to value equals 75% or better.
2 points -	Loan to value equals 75% to 90%.
1 point -	Loan to value equals 100%.
0 points -	Loan to value is greater than 100%

NOTE: Personal guarantee in all cases is assumed.

Score for Collateral Section_____ (3 points maximum)

4. **Conditions:** Is the loan to be used for working capital, additional equipment or inventory? Economic climate of industry is considered. Assign a point value that most accurately reflects the conditions.

3 points-Economic climate is strong and/or usage is equipment.
2 points-Economic climate is satisfactory and/or usage is inventory.
1 points-Economic climate is weak and/or usage is working capital.

Score for Conditions Section______ (3 points maximum)

5. **Character:** A subjective impression as to whether a client is sufficiently trustworthy to repay loan. Assign 1 point for each character measure met.

Responsibility measures:

___ Has significant related work experience/transferable skills. (Resume)
___ Located at current home or business address for more than 2 years.
___ Business start-up process completed.
___ Sets personal and business goals: meets objectives.

Integrity measures:

___ No public records (bankruptcy, lien, judgments, criminal activity, outstanding violations of any type filed with the City's Licensing Department)
___ Strong and positive business & personal references
___ When faced with questions about business plan, responds with information in a timely and thorough manner.

___ **Credit History:** Assign a point value that most reflects credit history.

3- Excellent:	no derogatory; explanation maybe required based on past history of account
2- Good:	most accounts paid within 30 days; some past dues; bank records show no overdrafts within the last 6months with valid explanation needed
1 - Fair:	past dues and/or has established payment agreement(s) with all creditors with valid explanation needed
0 -Poor:	unexplained bankruptcy dismissed; unexplained dismissed judgments/liens that have been satisfied; many charge offs.

* Beacon scores range from 200 – 900 points. An average person scores between 500 – 700 points, a score of 700 is considered an excellent credit score.

Score for Character Section______ (10 points maximum)

Total Loan package Score:

Capacity Score (10) ______
Capital Score (4) ______
Collateral Score (3) ______
Conditions Score (3) ______
Character Score (10) ______

Total Score ______

The maximum score a client could achieve is 30.
0-13 Doubtful – Unacceptable – Not Approved
0-14 Substandard – Unacceptable - Not approved
15–20 Possible approval with contingencies, Watch
21-25 Acceptable
26-30 Above Average

Prepared by:
Signature: ______________________ Date: __________

Comment:

EXHIBIT B
CREDIT EVALUATION SUMMARY

Key Information

- Loan Applicant and Business Name
- Business Location
- Loan Purpose
- Loan Terms Requested
- Nature of Business
- Prior Loan History
- Key Borrower Financial Information
- Key Business Financial Information

Credit Evaluation

- Credit Approval Matrix
- Major Strengths from the Matrix
- Major Weaknesses from the Matrix
- Mitigating Factors for Policy Exceptions
- Credit Recommendation

Credit Decision

- Approval Authority and Schedule
- Funding Source
- Loan Terms and Conditions as Approved or Reason for Denial
- Date Applicant Notified of Decision