

ECONOMIC DEVELOPMENT REVOLVING LOAN FUND STUDY
STUDY REQUIRED BY SALT LAKE COUNTY, UTAH – CODE OF ORDINANCES,
CHAPTER 3.71, “COUNTY PARTICIPATION IN AND APPROPRIATION TO A PRIVATE
ENTERPRISE PROJECT”

Salt Lake County is considering the Mayor’s request to implement a Private Enterprise Project to spur job creation and address a gap in the market regarding financing for small and medium enterprises (SMEs). Salt Lake County has prepared this study pursuant to Utah Code Annotated § 17-50-303 and Salt Lake County Code of Ordinances § 3.71. These provisions require that the County prepare and make available to the public a study to determine: (a) the value the County will receive in return for funds appropriated in aid of a private enterprise project, (b) the purpose for the appropriation, and (c) whether the appropriation is necessary and appropriate to accomplish the County’s policy objectives.

Copies of this study are available for public review and comment in the Salt Lake County offices of the Council, the Mayor, or the Clerk; an electronic version is available at www.slco.org/economic-development/revolving-loan-fund/report. In order that the Salt Lake County Council may receive public comment on the information contained herein, a public hearing will occur on December 5, 2017, at 4:00 pm.

Overview

This study relates to the Economic Development Revolving Loan Fund Program, a program that has been administered by Salt Lake County (the “*County*”) for the past 25 years (hereinafter the “*EDRLF Program*”). The mission and purpose of the EDRLF Program is to provide enhanced economic opportunities to low-income citizens, encourage businesses to expand employment, and promote economic development within Salt Lake County. The EDRLF is a unique financial resource which supports economic development and job creation by providing capital to promising, job-creating startups and businesses that are unable to qualify for loans from traditional financial institutions. The EDRLF Program also provides a mechanism for banks and financial institutions to support economic growth and community development while enabling them to meet their obligations under the Community Reinvestment Act (CRA).¹

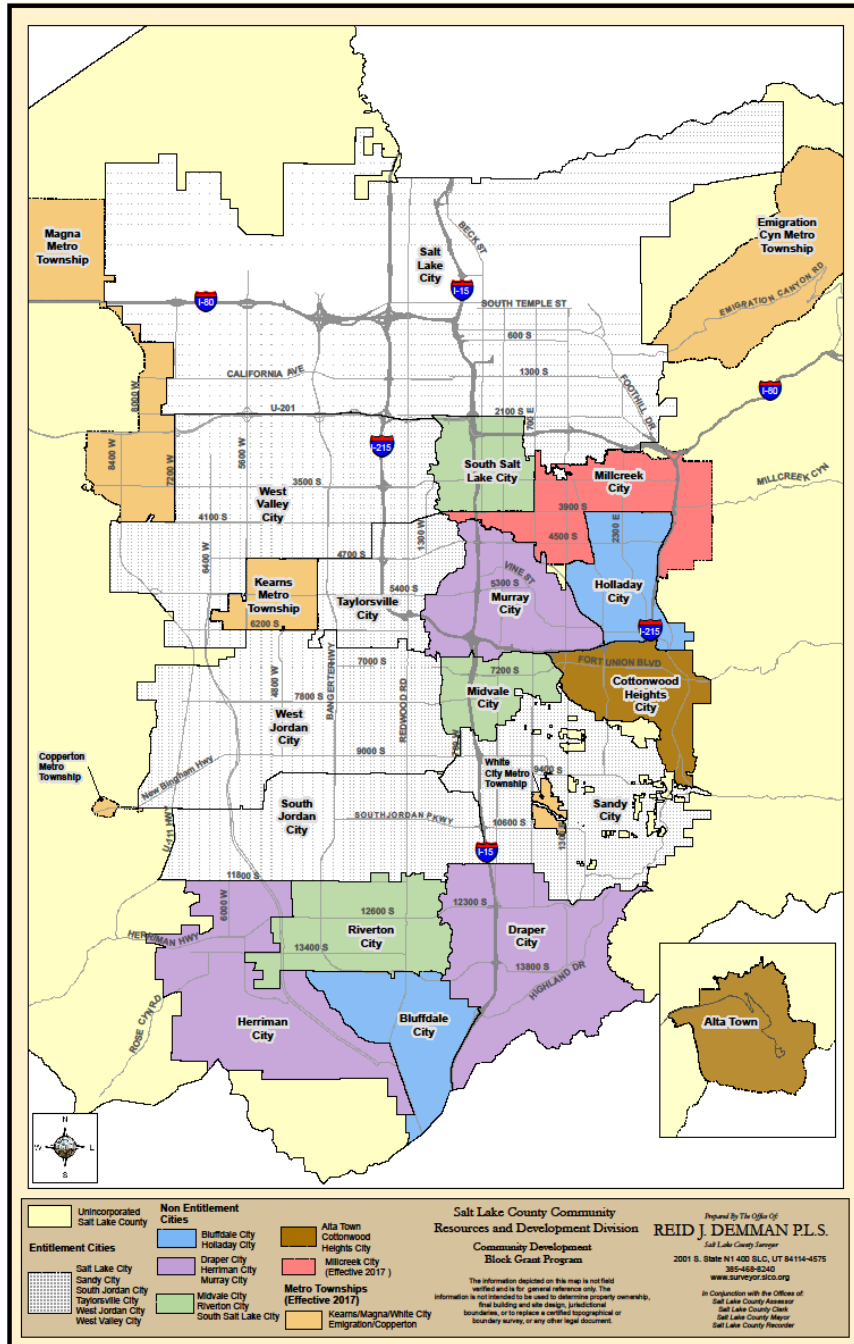
Over the course of its history, the EDRLF Program has been a useful tool for creating jobs and providing bridge financing to companies that are unable to secure loans through traditional financing means. Since 2005 alone, the fund has helped to create approximately 500 new jobs within Salt Lake County, and businesses that have received loans through the EDRLF Program are estimated to generate over \$17 million in revenue annually.

Despite these successes, however, the EDRLF Program is limited in its current form. The largest limitation stems from its association with Community Development Block Grant (CDBG) funding. Initially, the Fund seeded its loan loss reserve with \$400,000 of CDBG funding (hereinafter the “*CDBG LLR*”). The CDBG LLR enabled the Program to attract banks and financial institutions to participate in making loans to qualified SMEs, as it offered a level of

¹ The Community Reinvestment Act is a federal law that requires banks to help meet the needs of borrowers in all segments of their communities, including low- and moderate-income neighborhoods.

protection against loan defaults. However, the County's use of CDBG funds to seed the CDBG LLR limited the geographic application of the program. According to CDBG requirements, only businesses residing in certain areas of Salt Lake County, known as Urban County Eligible Areas, are eligible to receive a loan from the EDRLF Program. The map shown in Figure 1, below, identifies substantial geographic areas of the county (in white) where EDRLF Program loans are not able to be made due to CDBG restrictions (hereinafter the "Remaining Areas"). It is estimated that more than half of Salt Lake County's population and businesses reside in these areas and are therefore ineligible for financing through the EDRLF.

Figure 1. Community Development Block Grant Eligibility Areas



The County now desires to establish a new loan loss reserve with general county funds (a “*Non-CDBG LLR*”) to expand the EDRLF Program and complement the current CDBG LLR. This will allow the EDRLF Program to make loans to businesses residing in the Remaining Areas, which the County anticipates will increase the Program’s impact on job creation and the local economy. By using non-CDBG dollars to fund a separate, Non-CDBG LLR, the EDRLF will be able to offer loans to businesses throughout Salt Lake County (whether located inside or outside Urban County Eligible Areas), furthering the Program’s mission to stimulate job growth and support economic development within Salt Lake County.

Access to finance is vitally important to small business growth and, in turn, leads to job creation and retention. Small business funds like the EDRLF not only provide resources to finance current operations, but also afford business owners the capital necessary to expand their businesses. An analysis by the National Small Business Association (NSBA), which examined data from 1993 through 2016, found a correlation between small business owners’ ability to hire and their ability to access credit.² This same study found that, while not the only cause, the inability to secure financing may have led 16 percent of small businesses to reduce the number of employees and approximately 10 percent of small businesses to reduce employee benefits. Inability to secure financing was also a case of an additional 10 percent of small businesses’ inability to increase store inventory to meet existing demand.³ Finally, the NSBA found that businesses with fewer than 10 employees were three times more likely to create jobs if they were able to receive a loan. Combined, this data suggests that the ability to access financing plays a critical role in allowing small businesses to grow and contribute to the growth of the economy.⁴

A. Measuring the Net Value Received by the County for Money or Resources Appropriated to the Private Enterprise Project

County Ordinance 3.71 requires that the County determine the value it will receive in return for funds appropriated in aid of a private enterprise project. The ordinance also identifies criteria by which the County will determine the value received, including tangible and intangible benefits; expenditures saved; expenses forgone; and other “comforts or conveniences.”

Tangible Benefits: Job Creation

Tangible benefits to the County include the creation of approximately 37 new jobs. Studies suggest that SMEs create more jobs than larger businesses.⁵ Offering bridge financing to SME’s, then, is a powerful means of spurring job growth within Salt Lake County. Furthermore, SMEs

² Nat’l Small Bus. Association, 2016 Year-End Economic Report, available at <http://www.nsba.biz/wp-content/uploads/2017/02/Year-End-Economic-Report-2016.pdf>

³ Nat’l Small Bus. Association, 2016 Year-End Economic Report, available at <http://www.nsba.biz/wp-content/uploads/2017/02/Year-End-Economic-Report-2016.pdf>

⁴ Luz Gomez & Elaine L. Edgcomb, FIELD at the Aspen Institute, A Newly Crowded Marketplace: How For Profit Lenders are Serving Microentrepreneurs (2011), available at <http://fieldus.org/publications/ForProfitLenders.pdf>.

⁵ Neumark, David, Brandon Wall, and Junfu Zhang. “Do Small Businesses Create More Jobs? New Evidence from the National Establishment Time Series”. *National Bureau of Economic Research*. 2008. <http://www.nber.org/papers/w13818.pdf>; “Is Small Still Beautiful? Literature Review of Recent Empirical Evidence on the Contribution of SMEs to Employment Creation”. *International Labour Organisation*. 2013. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_216909.pdf

that receive loans through the EDRLF are required to create one new job for every \$35,000 loaned, 51% of which must be filled by persons having low- or moderate- income. This metric helps ensure that jobs are created using money from these loans. The goal of the EDRLF program is to have an 8.75 to 1 loan to LLR ratio. This means that for every dollar in the LLR, the fund can lend \$8.75. Using this ratio, the \$150,000 appropriated for this private enterprise project (i.e. to seed the Non-CDBG LLR) could result in over \$1.3 million in loans to businesses that are otherwise unable to qualify for traditional loans during the first funding cycle. At \$35,000 per job, \$1.3 million in loans would incentivize the creation of approximately 37 new jobs at local SMEs during the initial funding cycle. This equates to roughly one new job for every \$4,000 that the County invests during the first cycle. As the initial set of loans revolve, the EDRLF Program will be able to generate more loans and create more new jobs, bringing an even greater return on investment to the County.

Intangible Benefits: Job Retention and Economic Growth

Beyond the creation of new jobs, the appropriation of \$150,000 toward the EDRLF Program will also create intangible benefits for the County, such as job retention and general economic growth and development as a result of the multiplier effect.

Job Retention

In addition to creating new jobs, the EDRLF Program will also help preserve existing jobs at SMEs that would be more likely to fail without access to the bridge financing provided by the EDRLF Program. The Kauffman Foundation recently ranked Utah #1 in high-growth company density (the number of fast growing companies with at least \$2M in annual revenue), #2 in startup growth (the number of new employer businesses normalized by total business population), and #3 in the rate of startup growth over the last five years.⁷ However, the same study also ranked Utah 47th in the five-year survival rate of firms and 49th in established small business density, indicating a high rate of turnover or businesses relocating to more favorable locations (Figure 2).

In other words, the Kauffman Foundation report ranks Utah at the top of the nation in new startups, but near the bottom in terms of startups that are still around in five years. This suggests that while Utah leads the nation in business development, more needs to be done to strengthen the entrepreneurial ecosystem. And while this data is statewide in scope, Salt Lake County houses 37% of the resident population of the state and nearly 50% of non-farm jobs. With such an outsized economic impact, it is safe to say that Salt Lake County accounts for a good portion of those startups cited. Given Salt Lake County's impact on Utah's economy, and given the need to better support SMEs within Utah, it is important that market gaps are filled. The EDRLF fills a major market gap, and it is a useful, but geographically limited, tool for SMEs. The \$150,000 requested for this program would be a powerful step in better supporting the SMEs that drive the local economy.

⁷ The Kauffman Entrepreneurial Index for Small States, 2016

Figure 2. Challenges in Firm Longevity across Salt Lake County and Utah



Additionally, newly created jobs and locally retained jobs have a local multiplier effect. Whenever a new job is created, there is a chance that additional jobs may also be created via increased demand for local goods and services. Several scholars have found strong evidence for the presence of the local multiplier effect. Within tradable industries, UC-Berkeley-based economist Enrico Moretti discovered that, for each additional skilled job created, 2.5 jobs were also generated in the local non-tradable goods and services sectors, and an additional unskilled job created 1 job in the local non-tradable sector.⁸ Revenues from small businesses also have a large impact on local economies, with 48% of sales on average being recirculated into the local economy compared to 14% of purchases at chain and non-local stores.⁹

B. Why is the County appropriating funding to a private enterprise?

This appropriation will not go immediately or definitively to any one private enterprise. The EDRLF LLR is a reserve that works as insurance to banks in the event of loan default. The LLR is critical for bank involvement in the program. Currently there are six banks that participate in the EDRLF Program, and the hope is to enable more banks to participate in the EDRLF Program. Because the Non-CDBG LLR, to which these funds will be appropriated, will only be accessible to banks in the case of a loan default, the money does not immediately or definitively funnel to a private enterprise under the EDRLF Program.

As stated above, the current LLR was seeded with CDBG funds, which have geographical constraints. The creation of this new Non-CDBG LLR will allow the EDRLF to offer loans to businesses countywide, which will help increase the scope and the impact of the EDRLF. The EDRLF fills a gap in the market by lending to high-tech and manufacturing businesses that would not otherwise be eligible for traditional bank loans yet have a strong potential for growth

⁸ Moretti, Enrico, *Local Multipliers American Economic Review*, May 2010

⁹ American Independent Business Alliance, *The Multiplier Effect of Local Independent Business*, 2017

and job creation. Appropriating these funds for this program is critical to ensuring that this Program can have a greater impact throughout the valley.

Salt Lake County is growing. In order to meet the needs of current and future residents, as well as to ensure economic health, new jobs must continue to be created. As the economy thrives, local residents have increased access to opportunity as well as better health, security, and quality of life. Furthermore, as local SMEs prosper, local residents prosper, both directly and indirectly. Residents prosper directly through wages and the opportunities that full participation in the economy provide. Residents prosper indirectly through property and income taxes that are generated through SMEs, which fund schools, roads, public safety, and other amenities that further enhance quality of life.

C. The Goals of These Programs

Goal 1: Offer SMEs the capital they need to create more jobs

- The EDRLF currently has a requirement that for every \$35,000 loaned, one new job should be created. This ensures that the funding offered through the program goes toward job creation. The fund has the potential to lend at a ratio of 8.75 to the LLR. This means that the \$150,000 county investment could result in over \$1.3 million in loans. Based on the metrics and requirements, the \$150,000 investment by the county has the potential to create approximately 37 new jobs at local SMEs in its initial funding cycle. This equates to roughly one new job for every \$4,000 that the county invests during the first cycle. As the initial set of loans revolve, the EDRLF Program will be able to generate more loans and create more new jobs, bringing an even greater return on investment to the County.

Goal 2: Address lending gaps for SMEs countywide in order to further economic development

- A comprehensive SME development and funding tool or program does not currently exist. Furthermore, the nature of the EDRLF is to help fund businesses that cannot receive traditional loans but have strong growth potential. These businesses represent a higher risk than banks are willing to take on in isolation. However, by partnering with other lenders and through the LLR, the risk to each bank is mitigated.
- The EDRLF program currently exists in a geographically limited state. Because the CDBG LLR was seeded with CDBG funds, the EDRLF Program, in its current state, is limited to deploying capital to certain areas. By using county funds, this geographical limitation can be overcome, and loans can be made available to SMEs countywide.

D. Rigor and Risk Reduction: Our Due Diligence Process.

The requested appropriation and investment in this Program—\$150,000—is relatively small. Thus, the county is not at a sizeable risk. Furthermore, the county is currently undergoing a revision of the Master Participation Agreement (MPA) for the EDRLF. Once the MPA is completed, the county will submit an RFP that will seek funding partners in the EDRLF program. This process will ensure that the county is complying with all governing laws and policies during the procurement process. Furthermore, this will ensure that all private entities involved are qualified and have sufficient experience to consider and offer loans to applicants.

While there is risk that loans will default and the LLR will be used, by opening up loans to the entire county, loan applications will likely become more competitive and help ensure the quality of loan recipients. Furthermore, the EDRLF has a strong track record, and has rarely had to employ the LLR over its 25-year existence.¹⁰

Conclusion

The EDRLF is an existing program with a strong track record of success. During the past twelve years of its 25-year existence, the fund has contributed to the generation of over 500 new jobs in Salt Lake County. This success is in spite of geographic constraints that limit the fund's application throughout the county. These limitations are due to the use of CDBG funds used to seed the fund's LLR.

To increase the fund's scope and impact, \$150,000 of county funding will be used to seed a second LLR—a Non-CDBG LLR. This second LLR seeded with County, rather than CDBG, funds will overcome the geographical limitations and open the EDRLF Program to businesses throughout the entire valley. Furthermore, the \$150,000 appropriation will allow the program to lend an additional \$1.3 million to local SMEs and generate approximately 37 new jobs.

Aside from the new jobs that will be created, the \$150,000 appropriation will help ensure that local SMEs make it through the first five years by offering critical bridge loans to businesses that cannot receive loans through traditional financing means. Better filling this gap in the market will continue to foster a strong SME community, which will help ensure the prosperity of residents now and in the future.

Finally, it is anticipated that the new jobs created by the \$150,000 appropriation will have a multiplier effect. Each newly created job will likely increase demand for additional goods and services, thereby creating and supporting other jobs throughout the local economy.

Attribution and Contact Information

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¹⁰ The CDBG LLR has been employed twice over its 25-year history totaling \$106,058.62. This amount, when viewed in relation to the total amount of approved loans, is hardly significant. Since 2010 alone, \$3,395,000 have been loaned to fourteen companies.