

COMMUNITY DEVELOPMENT LOAN FUND

LENDING PROCEDURES

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CDLF LENDING PROCEDURES

The State bears the responsibility to oversee all phases of the Community Development Loan Fund ("CDLF") for the State of North Dakota, using prudent judgment and sound management principles.

The following are the underwriting criteria and collection procedures for all CDLF loans.

DEFINITIONS AND RESPONSIBILITIES

Grant administration – the set of activities required to assure compliance with federal regulations in the implementation of a CDBG grant. The set of activities includes, but is not necessarily limited to, conducting an environmental review and maintaining the environmental review record, preparing draft loan documents, obtaining an attorney’s opinion on the documents, preparing final documents, conducting the loan closing, developing and maintaining the accounting system, documenting eligible expenses and issuing checks for those expenses, assuring compliance with federal labor standards, as applicable, conducting on-site visits, preparing and submitting requests for funds, preparing and submitting semi-annual reports and a final report which contain a detailed budget identifying all expenditures by source of funds, including grant funds, the local share and other sources.

Loan administration – the set of activities required to close and service a CDLF loan, which includes, but is not limited to, establishing the system for receiving loan payments and disbursing them to the state, loan servicing, establishing and implementing a procedure for restructuring or collecting delinquent loans.

CONFLICT OF INTEREST POLICY

The conflict of interest regulation applicable to the CDBG program is found at 24 C.F.R. § 570.489(h). The conflict of interest regulation applies to procurement (except as provided in 24 C.F.R. § 570.489(g)), acquiring and disposing real property, and assistance provided with CDBG funds to individuals, businesses and other private entities.

All personnel involved with CDBG funds must be aware of this regulation. The CDBG conflict of interest regulation applies to people working for, or elected to office in, a unit of general local government, a designated public agency, or subrecipients which are receiving CDBG funds. 24 C.F.R. § 570.489(h)(3). No such person may have any financial interest or benefit, or other interest in a contract, subcontract, or agreement concerning CDBG activities or the proceeds from these activities “either for themselves or those with whom they have family or business ties, during their tenure or for one year thereafter.” 24 C.F.R. § 570.489(h)(2) (emphasis is supplied).

Any individual or entity seeking CDBG funds for any activity in which they or related individuals or organizations have an interest must disclose that interest when applying for CDBG funding. Once the conflict of interest has been disclosed, the Division of Community Services is authorized to determine whether an exception may be granted.

The Division of Community Services has also determined that the federal conflict of interest regulation applies to those situations where a unit of general local government, a designated public agency or a subrecipient uses CDBG funds to replace other funds for which they are responsible, or otherwise reduce their risk while increasing risk to the CDBG funds. These situations must be disclosed as soon as possible so that the Division of Community Services may decide whether to grant an exemption from the conflict.

LOAN CLOSING PROCEDURES

The first step in collecting on any loan is to ensure that the documents, which comprise the contract, are thorough, properly prepared, and carefully completed by all parties to the contract. The preparation of documents is the responsibility of the grantee and any other entities involved in the project. All documents pertaining to the loan must be approved by the Department of Commerce Division of Community Services ("DCS") prior to loan closing. This is to ensure that the content of the documents is consistent with DCS's requirements.

A preliminary amortization schedule must be prepared by the servicing agent and submitted to DCS prior to funds being drawn. For multiple draws, following the initial 15-day interest deferral period interest shall accrue on the principal balance based on the date of the ACH wire. (The initial 15-day interest deferral does not supercede the requirement to clear funds from the account within 3 business days). Upon drawdown of all funds a revised amortization schedule detailing all draws must be submitted to DCS.

Actual associated filing fees (i.e. cost of filing, UCCs, mortgage filing, warranty deed filing) may be assessed to the borrower.

The following discussion for the grantee and other participants in the project are guides to be followed to ensure a timely completion and request for funds. Other requirements are included in the Required Collateral Documents. All of the requirements, which pertain to the specific project in question, must be received and approved by DCS before the borrower receives the funds. In addition, since each project has its own unique features, additional requirements may be necessary. It is advised that the standard DCS documents be used whenever possible to avoid omission of required clauses and covenants, which protect all of the parties to the contract. Omission of required clauses and covenants without prior written approval by DCS will result in the rejection of the documents and will delay a request for funds.

LOAN FUNDING PROCEDURES

Interest will begin to accrue to DCS on the outstanding principal within 15 days of the first ACH transfer. Loan closing shall occur within the 15-day period; interest to the borrower shall accrue from the date of closing. For multiple draws, following the initial 15-day interest deferral period interest shall accrue on the principal balance based on the date of the ACH wire. (The initial 15-day interest deferral does not supercede the requirement to clear funds from the account within 3 business days).

REQUIRED COLLATERAL DOCUMENTS

Loan collateral documentation requirements will vary depending upon the type of collateral taken as security for the loan. The following sections address the requirements for various types of collateral. All of the requirements shown are mandatory, and may not be waived nor omitted without prior written approval from DCS. Funds may be committed to a project prior to securing all of the listed requirements, however, no funds may be released to any borrower until all documentation is completed.

From time to time, special conditions will arise which require additional documentation, special wording, or other considerations. In those cases, DCS will define the special handling needs in advance, or may be required to request special requirements before issuance of the financial award.

Real Estate

All real estate loans require the same basic documentation. In addition, different types of real estate require additional documentation. For example, construction loans for new buildings require supplemental documentation not required for a mortgage on existing building. Or, land to be purchased by the borrower requires supplemental information not required for a mortgage on land already owned by the debtor.

Basic Documentation for all Real Estate Loans:

1. An Appraisal conducted by an independent, licensed appraiser, to be not more than six months old, must be provided for each parcel of real estate if the sales price or construction cost will be in excess of \$250,000. The appraiser must have physically inspected the property, and photographs of the property, adjacent properties, and street view must be included. All real estate valued under \$250,000 shall include documentation of value by an agreed upon independent third party.
2. A Mortgage, which must contain a "due-on-sale" clause. All parties having an interest in the real estate must sign the mortgage, even if not required to sign the Promissory Note. A copy of the recorded mortgage, bearing the recording stamp, is required.
3. There must be evidence of clear title, documentation may include; title insurance, title opinion, etc.
4. A Notice to Provide Required Insurance, signed by the owner of the property being offered as collateral, which acknowledges the requirement to provide the specified minimum insurance for the term of the loan, and to ensure the Contractor or the loan payee(s) is named as Loss Payee. The Loss Payee endorsement must appear on the policy specifically naming the Loss Payee.
5. Comprehensive Insurance Policy as required above, on all improvements to the real estate must be provided by the Debtor. The grant administrator must follow up to ensure that any

insurance binder presented at closing is followed up within 30 days by the actual insurance policy, and that the policy contains the required Loss Payee endorsement.

Construction Loans

1. Lien Waivers, or verification of such waivers by the primary lender, are to be obtained from all parties receiving payments for completed construction work and materials. These waivers are receipts for payment acknowledging completed work and disavowing any claims to materials or mechanics liens. Contractors, subcontractors, consultants, etc. are each required to submit lien waivers. If payment is made to the Contractor for the purpose of paying his subcontractors, the Contractor must provide lien waivers for the previous payment to subcontractors before any subsequent payments may be made to the Contractor. If the grant administrator has received verification of the lien waivers from the primary lender, a written statement of the conversation, date, time and name should be placed in the file.

These lien waivers protect the company, Contractor, lender, and borrower from having to make duplicate payments for work completed, for which payment was made but not received by the subcontractors, independents, consultants, or material suppliers, any of whom may file liens against the property if not paid. Any Contractor, subcontractor, etc. who resists this requirement should receive scrutiny and possible reconsideration for the job.

2. In the event the appraisal is an as-is appraisal on existing real estate, without including the value to be added by the construction, two copies of the Plans and Specifications for the proposed construction should be submitted, and should include an Itemization of Costs for the construction.

Purchase of Real Estate

1. Dated copies of the Purchase Agreement or acceptable documentation confirming asset purchases and Closing Documents signed by the Buyer and Seller.
2. A copy of the recorded Warranty Deed conveying title to the debtor, bearing the recording information must be forwarded to DCS.

MACHINERY AND EQUIPMENT, FURNITURE AND FIXTURES, ACCOUNTS RECEIVABLE, INVENTORY, WORK-IN-PROGRESS, CONTRACTS AND CONTRACT RIGHTS, AND GENERAL INTANGIBLES

Required on all of the above collateral:

The following sections include the requirements for the various collateral types. Unless specifically stated to be excluded under the separate section headings to follow, the following will be required on all of the above collateral.

1. Security Agreement identifying the collateral. The security agreement should specify whether the collateral is presently owned, or being acquired with the proceeds. An example could include the following language:

"All machinery and equipment, furniture and fixtures, titled vehicles, accounts receivable, inventory, work in progress, contracts and contract rights, and general intangibles, now owned and hereafter acquired, and all adhesions, appurtenances, substitutions, products and proceeds thereof, [including but not limited to those shown on attached Exhibit X.] (When applicable)."

All exhibits attached to the security agreement must be labeled as Exhibit, and be signed and dated by the borrower.

2. UCC-1 lien documents. These liens must be recorded in the State in which the business is operating and in the state of origin. Copies of the recorded UCC-1's bearing the recording stamp must be submitted to DCS.
3. A written UCC-11 Lien Search from the Secretary of States Office. This search should be conducted for all known names of the business. A post search will be required to include the filing of the CDLF lien. This report must verify that the CDLF lien was filed in the proper lien priority position. Any variance, or prior liens not previously consented to by DCS in the approval process, or other lien 'clouds' (judgment liens, mechanics liens, etc.) shall be resolved.

Machinery and Equipment

In addition to the above requirements, the following documentation is required when machinery and equipment is taken as collateral.

1. A Complete Listing of All Machinery and Equipment owned by the company and taken as collateral, identifying the equipment by Make, Model and Serial Number. Where equipment is to be purchased from the project budget, the equipment to be purchased should also be identified to the extent possible. Makes, models, and serial numbers are available through the purchase order in most cases. This list should be signed and dated by the debtor and physically inspected and signed by the grantee.
2. A Notice to Provide Required Insurance, signed by the Company, which acknowledges the requirement to provide the specified minimum insurance for the term of the loan, and to ensure the Contractor or lender is named as Loss Payee. The Loss Payable endorsement must appear on the policy specifically naming the local authority as Loss Payee.
3. A Comprehensive Insurance Policy as required above, on all machinery and equipment taken as collateral must be provided by the Debtor. The grantee must follow up to ensure that any insurance binder presented at closing is followed up within 30 days by the actual insurance policy, and that the policy contains the required Loss Payee endorsement.

Accounts Receivable, Inventory, Furniture and Fixtures, Contracts, Intangibles

The security agreement, UCC-11 lien search, and insurance discussed in the introductory section will normally suffice. In the event that furniture and fixtures are of uncommon value, the procedures outlined above for machinery and equipment should be followed.

Guaranty Agreements

Guaranty Agreements may be required of all principals of the borrower who own stock, or have stock option agreements, or other side agreements giving any principal de facto control of 20% or more of the stock. In some cases, guaranty agreements from other corporate entities may be required if they exercise significant control over the borrower.

In each case, the language required in the guaranty form can be crucial to the collectability of the loan. In some cases, the grantee and lender may wish to have the guaranty agreement drawn up by legal counsel. Those cases will usually arise when special conditions exist which require additional control or attention. In such cases, legal counsel should be informed that the language of the Exhibit guaranties must be included in the agreements they draft as a minimum requirement, and the drafted agreement shall require prior DCS approval.

Personal Guaranties

1. The Guaranty Agreement. A separate guaranty agreement should be prepared for each individual guarantor.
2. All Guarantors shall be notified individually of any changes to the loan terms.

Corporate Guaranties

The corporate guaranty requires essentially the same corporate documents as would be required for a loan made directly to the corporate guarantor.

1. The Guaranty Agreement. Corporate guaranties may be required and shall be structured based upon the credit. *The guaranties may be limited to no less than the ownership percentage of the individual, if the combined total of guarantees and the personal assets of those individuals is sufficient to cover the entire loan, including accrued interest and fees.*
2. Certificate of Incorporation from the State for the corporate guarantor.
3. Certificate of Good Standing for the corporate guarantor, from the State showing payment of franchise taxes and the ability to operate legally in the state.
4. Corporate Resolution that identifies all corporate officers and designates which officers are empowered to borrow/commit and guarantee debt on behalf of the company.

Assignment of Life Insurance

If life insurance is deemed necessary, life insurance taken as collateral is usually taken in two forms: (1) Key Man Life Insurance taken out specifically for the purpose of securing the loan, or (2) Assignment of an existing policy. The documentation requirements are essentially the same. Evidence of current policy and acknowledgement must be kept on file.

Motor Vehicles, Boats, Trailers

Motor Vehicles

1. Title to the vehicle must be obtained, and no other liens should be evident. Where a lien is indicated, the title must be accompanied by a lien release from the indicated lien holder. The named owner of the vehicle must be the same as the borrower. If not, DCS should be consulted.
2. A Lien Entry Form must be completed for each vehicle. The named debtor of the lien entry form must be identical to the named owner as it appears on the title.
3. Insurance Verification must be obtained for all vehicles. Usually, a commercial policy includes a fleet coverage clause, or will list the vehicles separately. In either case, the insurance policy must list the local unit of government/authority as Loss Payee on the declaration page of the policy. The Loss Payable endorsement must appear on the policy specifically naming the local authority as Loss Payee.

All Other Assets

All other assets should be secured through generally accepted procedures. Contact DCS for assistance in securing all other assets.

Waiver of Required Documents

The grantee shall not rely on verbal assertions from any DCS representative regarding the waiving of any documentation listed herein as being required. Such waivers require written confirmation by an authorized DCS staff.

LOAN SERVICING PROCEDURES

The successful and conscientious control of a loan program requires that the responsibility for loan administration be assigned to specific individuals who are accountable for the efficient and thorough execution of the duties involved. These assigned individuals should be trained, and preferably support personnel should be cross-trained so that, in the event of employee turnover, the expertise required is not lost. These individuals should receive the support and assistance of upper management to ensure the proper emphasis is given to their responsibilities. The importance of fixing responsibility, and making it a part of a performance evaluation, cannot be over emphasized.

Security of Loan Documents

The loan documents represent an asset, and all protective safeguards should be taken to preserve and protect the asset. The grantee shall take the necessary steps to ensure the integrity of the loan documents.

All original loan documents should be stored, preferably in fireproof file cabinets (locked) or vaults, under limited access/dual control conditions. Photocopies shall be made to create a working file for the personnel requiring daily access to the file, and the originals shall be secured in the manner described.

Certain documents will be required to be maintained under limited access/dual control conditions. The original Promissory Note, Guaranty Agreements, Security Agreements, and Insurance Policies shall be kept under lock, and preferably under dual locks eliminating the potential for unauthorized entry to the file and removal of documents. The grantee, or authorized agent, should establish written policies and procedures on how access to the documents will be controlled.

Documentation Tracking Requirements

In addition to the initial follow-up on documentation items such as title policies and insurance policies previously mentioned, certain other matters must be tracked throughout the life of the loan. A system must be in place to ensure the timely monitoring and completion of the following requirements.

Financial Statements and Tax Returns

Unless otherwise specifically defined in writing, the company will be required to provide annual financial statements (including a balance sheet, profit and loss statement, and statement of cash flow or year end tax returns with all supporting schedules). At year-end, the company shall provide the tax returns complete with all supporting schedules. (These will be due not later than 90 days after the end of their fiscal year). The company should be contacted immediately if the statements and tax returns are not received or are not complete when received.

Insurance Coverage

Collateral Insurance, Key Man and Other Life Insurance

Where insurance on the collateral has been a requirement of closing as outlined above, follow-up must be conducted to ensure that the policies are renewed upon expiration, and that the renewal preserves a satisfactory deductible and the Loss Payee endorsement. A copy of the renewed policy will be required, and the company and/or insurance carrier shall be contacted immediately if the renewal policy has not been received by the expiration date.

Real Estate Construction

Inspection Reports should be completed frequently, randomly, and without notice, by an agreed upon inspector.

The report should indicate the stages of completion of the construction, and an opinion as to the quality of construction. The completion percentage should be compared to the amount of funds advanced. These two amounts should match, and, if not, an explanation should be obtained as to why they do not. Pictures of various completion stages should accompany the inspections. A statement regarding the constructions' adherence to the Plans and Specifications should be included. (If a bank is involved a copy of their report will suffice).

LOAN COLLECTION PROCEDURES

The CDLF grantee has the option to collect loan payments from the loan recipient or it may contract with a loan servicing agent. It is the responsibility of the CDLF grantee or servicing agent to prepare an amortization schedule based on the terms of the loan and the loan disbursements. A copy of the amortization schedule must be provided to the DCS for verification of adherence to the terms and conditions of the approved loan.

Payments received by the grantee/servicing agency between the 1st and 15th day of each month will be due to DCS by the last day of that month. Those payments received between the 16th and the last day of the month will be due to DCS by the 15th day of the following month. All payments that are due but are not received must be documented and submitted to DCS at the time when payment was due based upon the previously stated schedule.

When submitting loan payments to DCS, the grantee/servicing agency will provide a copy of the check from the business, along with the breakdown of the payment (principal, interest and/or fees) and a calculation of interest retained by the grantee/servicing agency. The grantee/servicing agency may request a waiver for submitting a copy of the check from the business if they instead will provide a receipt from their loan software and can show that their loan records are audited on a regular basis.

The DCS, either for a desktop monitoring or an onsite records review, may request documentation of loan payments to verify that the correct amounts were submitted.

Guidelines for Collection Activity for CDLF Loans

The Unit of Local Government (ULG), unless otherwise contracted, (“Contractor”) has a responsibility to monitor and, in the event of a default, to initiate a workout dialogue and conduct negotiations to restructure the loan. In the event the default cannot be cured or the Borrower fails to cooperate, the local unit of government or Contractor is responsible for initiating reasonable collection action against the Borrower and all guarantors.

1. As soon as practical after payments are ten (10) days late, ULG/Contractor will send a reminder notice to the Borrower. **On the 10th day beyond the due date, a late fee of 10% of the payment amount or \$25.00 whichever is greater may be assessed to the borrower. Late fees may be charged or waived at the discretion of the ULG/Contractor.**

Until the project final report has been approved by DCS, all of the repayment collected must be forwarded to the DCS. This includes any late fees or penalties. Once the final report has been approved, late fees or penalties may be retained by the servicing agency.

2. As soon as is practical after payments are twenty-one (21) days late, ULG/Contractor will attempt to contact the Borrower by telephone or other means to determine the cause of late payment and if any assistance is needed.
3. The DCS will be informed by ULG/Contractor in writing if the Borrower is more than thirty (30) days late.
4. If not already done, and as soon as is practical after payments are sixty (60) days late, the Contractor will attempt to visit with the Borrower in-person.
5. If situations arise that may require any changes or amendments to the loan agreements, the Contractor will confer with the Borrower and present to the ULG its recommendations, including terms for work-out agreements and other, as may be advisable. If approved by the ULG, the Contractor will assist in preparing or presenting such proposed changes to DCS for its approval. If the ULG does not have a Contractor, the ULG will be responsible for the work-out process. If such changes or amendments are approved by DCS, Contractor will prepare all necessary documents.
6. The ULG shall determine when, or if, legal action shall be initiated on any loan for default or breach of contract be based on the Contractors recommendations. All costs and expenses related to or incurred in such legal proceedings shall be recovered from the proceeds of the liquidation, as defined in the loan agreement. If legal action is initiated, the Contractor will make available to the ULG or to any legal representative retained by the ULG for purposes of collection on any loans all documents and other information it may have related to the loan.

Loan Restructuring

The strategies and problems involved in a workout are too numerous for the process to be discussed fully here. It requires an experienced lender, and the Division of Community Services shall work closely with the Borrower, and the ULG/Contractor throughout the process.

There are some very simple yet effective solutions to some workouts. One solution is the Contract Modification, which may take several forms. The most common form is the Deferral.

A deferral involves forbearance of payments for a specified month or number of months with the payments usually added to the end of the contract in either a lump sum payment (also known as a balloon), or by extending the contract by the number of months equal to the forbearance period.

Certain conditions must be present prior to a deferral being granted.

1. The Company must have been responsive in the collection process leading up to the deferral.
2. The deferral must be an appropriate response to a verifiable need. In other words, the deferral must represent a solution to the problems, which created (or would have created depending upon the timing of the request) the delinquency.

The grantee may request a deferral only if the following procedures are followed:

1. The Borrower should request a deferral in writing from the ULG. The request shall be accompanied by:
 - a. Current balance sheets, income statements, statement of cash flow, accounts receivable aging reports, and accounts payable aging reports dated not more than 60 days from the date of the meeting.
 - b. A written explanation as to the difficulties the company is experiencing which create the need for the deferral.
 - c. A written Operations Plan outlining in detail how the company proposes to overcome the difficulties and return to profitable operation and resume payments on the debt.
 - d. All Job Tracking Reports outstanding and due at the time of the request.

If these items were received previously, as in the meeting outlined in the previous section, they need not be duplicated here.

2. The ULG/Contractor should forward these documents to the Division of Community Services, along with a summary of the site visit and interview, collection activity to date, and their conclusion on why they are recommending a deferral.

DCS will have 45 calendar days from the receipt of request and all appropriate documentation to evaluate the deferral decision. DCS will notify the ULG/Contractor of its decision in writing. If DCS rejects the deferral, it must do so in writing stating the cause for rejection.

3. Upon approval and collection of signatures a copy of all deferral documentation must be submitted to DCS.
4. The deferral will take effect on the effective date indicated in the Deferral document.

If the Borrower's difficulties are severe enough that a deferral does not represent an acceptable response, the local unit of government will work with the Borrower to decide upon a loan structure, which will provide a long-term solution to the Borrower's problems, and not merely complete deferral after deferral. If the latter situation exists and the Borrower has no plans for resolving its problems, it may be necessary to initiate legal action to collect the loan.

Default

Upon declaring the loan to be in default, the Borrower and all guarantors shall be notified in writing that the loan has been declared in default, the reason why, and that the balance has been accelerated and is immediately due and payable in full. Demand for payment in full should be made, with a deadline imposed for a response. Once the deadline is expired, a lawsuit may be filed to seek judgment against the company and the guarantors.

Copies of all correspondence (sent and received) and court filing pertaining to collection of the loan shall be forwarded promptly to the Division of Community Services.

Voluntary Surrender of Collateral

In some cases, the borrower may seek to voluntarily surrender the collateral and assets of the business. Extreme caution is advised in these cases, as certain actions must be taken to preserve the legal right to pursue additional collection action against the debtor. The advice of legal counsel shall be obtained before acceptance of any such offers from the debtor. Rarely will DCS encourage acceptance of the voluntary surrender of collateral without the preservation of all legal rights to collect any unpaid balances. Preservation of these rights requires an active agreement between the Lender and Borrower, since case law now interprets the acceptance of collateral as acceptance of payment in lieu of foreclosure (i.e. payment in full) without such an acknowledgment and agreement from the Debtor to the contrary.

In all such cases where collateral is voluntarily surrendered, the ULG/Contractor shall obtain prior DCS approval, which shall be conditional upon the ULG/Contractor obtaining from the debtor a Voluntary Surrender Agreement.

Bankruptcy

During the collection and liquidation process, the company or guarantors, or both, may petition the court for protection under the bankruptcy laws. DCS expects the local unit of government and the Contractor to initiate an aggressive pursuit of the company and guarantors within the bankruptcy statutes. A thorough investigation into the use of CDLF funds and changes in financial condition of the company and guarantors shall be conducted. The possibility of non-allowed and reversible transfers of assets, concealment of assets, etc., shall be thoroughly reviewed and investigated. In most cases, a Hearing on Assets (HOA), with all financial records being subpoenaed from the company and all guarantors will be a minimum requirement.

Writing Off the Loans

Once the collection process has been completed and the assets of the company have been liquidated, and further enforcement against the company and guarantors is not justified by the potential for recovery versus the cost of continued legal action, the local unit of government may request permission from DCS to write off the loan. This request shall be in writing and shall be accompanied by a summary of the collection efforts expended thus far, in chronological order (if the procedures outlined in this manual have been followed, most of the documentation and chronology will already be in DCS's possession). The request shall contain an explanation as to why further efforts to collect the balance are not warranted. Upon review, DCS will affirm the request in writing and write off the balance of the loan, or deny the request in writing and indicate the actions necessary to pursue collection.

DISCLAIMER

The ULG/Contractor should be conversant with the guidelines and requirements set forth in these procedures. These procedures cannot encompass all contingencies and relying on the strict adherence to these procedures will not absolve a ULG/Contractor from all responsibility. The Division of Community Services should be contacted immediately if assistance is required. Where further guidance is needed, the appropriate agency or outside service should be contacted for the ULG/Contractor to become informed as to the required actions.