

CDC CERTIFICATION GUIDE

I. INTRODUCTION

The Certified Development Company 504 Loan Program is economic development financing specifically designed to stimulate private sector investment in long-term fixed asset financing and to foster economic development, create or preserve jobs, and stimulate the growth, expansion, and modernization of small businesses.

Certified Development Companies (CDCs) are non-profit corporations certified and regulated by the Small Business Administration to package, process, close, and service “504” loans.

The 504 Loan Program was authorized by Congress under the Small Business Investment Act. The regulations governing the 504 program can be found in 13 Code of Federal Regulations Part 103 and Part 120, (Sections 120.800 – 120.991 refer exclusively to the Development Company Loan Program). We strongly encourage you to read thoroughly the requirements for program participation before submitting an application.

Additional Loan Program Requirements are detailed in the SBA Standard Operating Procedures and Notices.

II. HOW TO BECOME A CERTIFIED DEVELOPMENT COMPANY (CDC)

A. Non-Profit Status - 13 CFR§120.820

A CDC must be a non-profit corporation and must be:

1. In good standing in the State in which the CDC is incorporated and must provide a Certificate of Good Standing, or its equivalent;
2. In compliance with all laws, including taxation requirements, in the State in which the CDC is incorporated and any other State in which the CDC conducts business; and
3. CDC applicants must provide a copy of their IRS tax exempt status letter.

B. Area of Operations - 13 CFR §120.821

A CDC must operate only within its designated Area of Operations approved by SBA except as provided in 13 CFR §120.839. The Area of Operations is the state of the CDC’s incorporation.

C. CDC Membership – 13 CFR§120.822

The Membership as a requirement, 13 CFR§120.822, became optional in regulations published on March 21, 2014. CDCs may, at their discretion, continue to have a Membership. If the Membership option is chosen representation is no longer limited to financial, business, government, and community groups, but these groups may continue to be represented.

D. CDC Board of Directors - 13 CFR§120.823

The CDC must have a Board of Directors. The initial board may be created by any method permitted by applicable state law. In addition board members or renewal of board terms must be approved by the board.

1. There must be at least nine (9) voting members of the Board of Directors; however, we recommend no more than twenty-five (25) voting members. A CDC may request an exception for good cause from the D/FA or designee to have a Board with fewer than nine (9) directors.
2. The Board shall be comprised of persons, currently employed or retired, with a background/expertise in internal controls, financial risk management, commercial lending, legal issues relating to commercial lending, and corporate governance. A person may meet more than one of the background/expertise requirements.
3. At least one voting director must represent the economic, community or workforce development field.
4. At least two voting directors, other than the CDC manager, must represent the commercial lending field.
5. No person who is a member of a CDC's staff may be a voting member of the Board except for the CDC manager.
6. The Board must meet at least quarterly and shall be responsible for CDC staff decisions and actions.
7. The quorum shall be set by the CDC, but shall be no less than 50% of the voting members of the Board of Directors. The Board meetings require a quorum to transact business. A quorum must be present for the duration of the meeting.
8. Attendance at meetings may be through any format permitted by state law (i.e. in-person, teleconference, e-mail, fax, web conference and video conference).
9. Directors from the commercial lending fields must comprise less than 50% of the representation on the Board.
10. If the CDC is an approved affiliate with another entity under 120.820, there is no limitation on board overlap.
11. With the exception of approved affiliates, a CDC may not permit more than one of its directors to be employed by or serve on the Board of Directors of any single entity (including that entity's affiliates), unless that entity is a civic, charitable, or comparable organization that is not involved in financial services. No CDC Board member may serve on the Board of another CDC.
12. The Board shall have and exercise all corporate powers and authority and be responsible for all corporate actions. There must be no actual or appearance of a conflict of interest. The Board responsibilities include, but are not limited, to the following:
 - a.) Approving the mission and policies for the CDC;
 - b.) Hiring, firing, supervising and annually evaluating the CDC manager;

- c.) Setting the salary for the CDC manager and reviewing all salaries; and
 - d.) Establishing committees, at its discretion, including an Executive Committee and a Loan Committee. See Sections E and F.
13. The CDC business plan should include that all Board Directors must annually certify in writing that they have read and understand this section, and copies of the certification must be included in the Annual Report to SBA.
 14. The Board of Directors shall maintain Directors' and Officers' Liability and Errors and Omissions insurance in amounts established by SBA.
 15. It is the policy of the SBA to allow interim vacancies on the Board of Directors to be filled by a majority of the remaining Board members. However, any person filling an interim vacancy must stand for election at the next Annual or Special meeting of the Board of Directors whichever comes first.
 16. When the Board votes on SBA loan approval or servicing actions, at least two voting Board members, with commercial loan experience satisfactory to SBA, other than the CDC manager, must be present and vote.

E. Executive Committee - 13 CFR§120.823(a)

To the extent authorized in the Bylaws, the Board of Directors may establish an Executive Committee. The Executive Committee may exercise the authority of the Board; however, the delegation of its authority does not relieve the Board of its responsibility imposed by law or Loan Program Requirements. No further delegation or redelegation of this authority is permitted. If the Board establishes an Executive Committee and delegates any of its authority to the Executive Committee as set forth in the Bylaws of the CDC, the Executive Committee must:

- (A) Be chosen by and from the Board of Directors; and
- (B) Meet the same organizational and representational requirements as the Board of Directors, except that the Executive Committee must have a minimum of five voting members who must be present to conduct business.

F. Loan Committees - 13 CFR§120.823(a)

The Board may establish a Loan Committee with the authority of the Board. The Loan Committee's action must be ratified by the Board or Executive Committee prior to Debenture closing. The delegation of authority does not relieve the Board of its responsibilities imposed by law or Loan Program Requirements.

The Loan committee:

1. must be chosen by the Board from the Membership (if any), shareholders, or the Board,
2. have a quorum of at least five (5) committee members authorized to vote; have at least two members with commercial lending experience satisfactory to SBA;
3. have no actual or appearance of a conflict of interest;
4. consist of members who live or work in the Area of Operations of the state where the 504 project they are voting on is located unless the project falls under one of the exceptions listed in 13 CFR§120.839.

5. may be delegated the authority to provide credit approval for loans up to \$2,000,000 but, for loans of \$1,000,000 to \$2,000,000, the Loan Committee's actions must be ratified by the Board or Executive Committee prior to Debenture closing.

Only the Board or Executive Committee, if authorized, may provide credit approval for loans greater than \$2,000,000.

G. CDC Staff - 13 CFR§120.824

A CDC must have:

1. A full-time professional management, including an Executive Director (or the equivalent) managing daily operations.
2. A full-time professional staff qualified by training and experience to market the 504 program, package and process loan applications, close and service the loans.
3. All officers and paid employees of the CDC (including all contracted staff and contractors performing loan packaging, processing, closing and servicing for the must submit a completed SBA Form 1081, signed and dated within 90 days of submission to SBA, for each officer and paid employee and fingerprint cards for paid employees and contractors.
4. Professional services contracts must comply with the requirements in the most current version of SOP 50 10.
5. Board Members must also submit SBA Form 1081 and if they answer yes to question numbers 10 a, 10b, 10c, or 11 on SBA Form 1081 they must submit using either fingerprint cards or Electronic Fingerprint Submission.
6. CDCs may obtain, under written contract, professional services. However, the CDC must have:
 - (a) At least one salaried professional employee that is employed directly (not a contractor or an associate of a contractor) full-time to manage the CDC. A CDC may petition SBA to waive the requirement of the manager being employed directly if:
 - (1) Another non-profit entity that has the economic development of the CDC's Area of Operations as one of its principal activities will contribute the management of the CDC.
 - (2) The CDC petitioning SBA for such waiver is rural and has insufficient loan volume to justify having management employed directly by the CDC.
 - (b) SBA must pre-approve professional service contracts with the exception of accounting, legal, and IT services.
 - (c) Contracts must clearly identify terms and conditions satisfactory to SBA
 - (d) The CDC must provide copies of these contracts to SBA for review annually.
 - (e) If a CDC's Board believes that it is in the best interest of the CDC to contract for professional services, the CDC's Board must explain its reasoning to SBA. The CDC's Board must demonstrate to SBA that:
 - (1) The compensation under the contract is only from the CDC and is reasonable and customary for similar services in the Area of Operations.

- (2) The compensation must be stated as an hourly rate for each person performing on the contract.
 - (3) The compensation is only for actual services performed.
 - (4) The full term of the contract (including options) is reasonable.
 - (5) The contract does not evidence any actual or apparent conflict of interest or self-dealing on the part of any of the CDC's officers, management, and staff including members of the Board and any Loan Committee.
- (f) No contractor (under this section) or Associate of a contractor may be a voting or non-voting member of the CDC's Board.

H. Financial Ability to Operate - 13 CFR§120.825

A CDC must be able to sustain its operations continuously, with reliable sources of funds (such as income from services rendered and contributions from government or other sponsors). Any funds generated from 504 loan activity by a CDC remaining after payment of staff and overhead expenses must be retained by the CDC as a reserve for future operations or for investment in other local economic development activity in its Area of Operations.

I. SBA Form 1246 APPLICATION TO BECOME A CDC

SBA Form 1246 can be obtained from SBA's website at <http://www.sba.gov> or from any SBA Office. Review the application document carefully. Below are some of the documents which must accompany the application.

1. Membership – Membership no longer required.
2. Board of Directors - A listing of the Board of Directors which identifies each Director organized by their area of expertise as required in 13 CFR§120.824. All Board of Directors must submit a SBA Form 1081 Statement of Personal History (any Board member responding “yes” to questions numbers 10 a.,10 b., or 10 c. on the Statement of Personal History must also submit using either fingerprint cards or Electronic Fingerprint Submission.
3. Plan of Operation - a narrative describing the applicant's ability to package, process, and service the loans. In addition, the plan should identify the applicant's financial and legal capacity and identify how it plans to market the 504 program and the geographic area it plans to serve.
4. Organizational Chart - Listing of all officers and paid staff of the CDC (including all contracted staff and contractors performing loan packaging, processing, and servicing for the CDC) accompanied by SBA Form 1081 Statement of Personal History and fingerprint cards.
5. Certificate of Good Standing or its equivalent.
6. Articles of Incorporation - When working with counsel, we encourage the use of regulatory language be kept to a minimum. This will reduce the number of changes that will need to be made when regulations are revised.
7. By-Laws –certified copy of the By-laws signed by an officer of the Board of Directors. When working with counsel, we strongly encourage the incorporation of regulatory language to be included from Board of Directors sections.

8. Board Resolution authorizing the CDC's application.
9. Financial Statements and Projections demonstrating the CDC's financial ability to operate. Start-up CDCs must provide documentation of the sources of their start-up capital (i.e. Notes, grants, Contributions, etc.)

The completed application must be submitted to the local SBA District Office for review and eligibility. SBA prefers the application be submitted by e-mail. Upon completion, the District Office will forward its recommendation to the Associate Administrator for Financial Assistance at the SBA Headquarters for a final decision.

III. SUMMARY

As a regulated agent acting under the auspices of the U. S. Small Business Administration, it is important to understand that Certified Development Companies are autonomous and must not be controlled by any other entity or group as SBA can only regulate the CDC. 13 CFR §120.820, effective March 21, 2014, permits CDCs to be affiliated under specific circumstances detailed below:

- (a) A CDC must be independent and must not be affiliated (as determined in accordance with 13 CFR §121.103) with any Person (as defined in 13 CFR §120.10) except as permitted below.
- (b) A CDC may be affiliated with an entity (other than a 7(a) Lender or another CDC) whose function is economic development in the same Area of Operations and that is either a non-profit entity or a State or local government or political subdivision (e.g., council of governments).
- (c) CDCs may apply to participate in the **SBA Community Advantage pilot loan program**.
- (d) A CDC must not be affiliated (as determined in accordance with 13 CFR §121.103) with or invest, directly or indirectly, in a 7(a) Lender. A CDC that was affiliated with a 7(a) Lender as of November 6, 2003 may continue such affiliation.
- (e) A CDC must not be affiliated (as determined in accordance with §121.103 of this chapter) with another CDC. In addition, a CDC must not directly or indirectly invest in or finance another CDC, except with the prior written approval of D/FA or designee and D/OCRM or designee if they determine in their discretion that such approval is in the best interests of the 504 Loan Program.
- (f) A CDC may remain affiliated with a for-profit entity (other than a 7(a) Lender) if such affiliation existed prior to March 21, 2014. A CDC may also be affiliated with a for-profit entity (other than a 7(a) Lender) whose function is economic development in the same Area of Operations with the prior written approval of the D/FA or designee if he or she determines in his or her discretion that such approval is in the best interests of the 504 Loan Program.

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- (g) A CDC must not directly or indirectly invest in a Licensee (as defined in §107.50 of this chapter) licensed by SBA under the SBIC program authorized in Part A of Title III of the Small Business Investment Act, 15 U.S.C. 681 et seq. A CDC that has an SBA-approved investment in a Licensee as of November 6, 2003 may retain such investment.

SBA defines affiliation in 13 CFR§121.103 which states, in part:

(a) General Principles of Affiliation.

- (1) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists.
- (2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.
- (3) Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.
- (4) Affiliation may be found where an individual, concern, or entity exercises control indirectly through a third party.
- (5) In determining whether affiliation exists, SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.

This document is to serve only as a guide to the CDC certification process. Some of the source documents have been provided in the “Tools and Links” section below. If there is a conflict between this guide and SBA’s regulations and policies, then SBA’s regulations and policies shall prevail.

IV. TOOLS & LINKS

1. The web page for the 504 Application for certification:
<http://www.sba.gov/sbaforms/sba1246.pdf>
2. The web for the Small Business Investment Act:
<http://www.sba.gov/regulations/sbaact/small-business-investment-act-text-only.html>The pertinent material starts at:
TITLE V LOANS TO STATE AND LOCAL DEVELOPMENT COMPANIES.....Sec. 501. STATE DEVELOPMENT COMPANIES.
3. The Web page for the current Code of Federal Regulations:
http://www.access.gpo.gov/nara/cfr/waisidx_07/13cfr120_07.html
13 CFR Part 103 and Part 120, (Sections 120.800 – 120.991 refer exclusively to the Development Company Loan Program).