North Dakota Development Fund

Century Center · 1600 East Century Avenue, Suite 2 · PO Box 2057 ·
Bismarck, ND 58503
Phone: 701-328-5310 · Fax: 701-328-5395

Loan and Investment Policy

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Your Partner in Growing North Dakota

Executive Summary

The North Dakota Development Fund, a division of the Department of Economic Development and Finance of the North Dakota Department of Commerce, is a statewide nonprofit development corporation. It has the authority to take equity positions in, to provide loans to, or to use other innovative financing mechanisms to provide capital for new or expanding businesses in this state, or relocating businesses to this state. The corporation's principal mission is the development and expansion of primary sector businesses in this state.

The Fund is responsible for the administration and management of two "fund pools," the Development Fund and the Regional Rural Development Revolving Loan Fund (Rural Fund). Both Funds are revolving funds, as defined by legislation, and are administered by the North Dakota Development Fund's Board of Directors. The North Dakota Development Fund also manages the following investment programs:

a. Rural Incentive Growth Program
b. Small Business Technology Investment Program
c. Child Care Loan Program
d. New Venture Capital Program (The Development Fund manages this program on behalf of the Bank of North Dakota.)

Mission Statement

Creating flexible public/private gap financing partnerships through loans and equity investments to spur the development and expansion of primary sector business in the state of North Dakota.

Philosophy

- The Fund is a flexible gap financier.
- The Fund takes a disciplined approach to making informed credit decisions.
- The entrepreneur must have a realistic financial commitment at stake.
- The Fund is a team player in community economic development projects.
- Economic development starts at the local level. The community must be involved and supportive and the local investor(s) must be committed.
- The Fund acts as a resource for technical assistance to the entrepreneur, community and investor(s).

Program Overview

Development Fund

The Development Fund ("Fund") is authorized by law to make investments in primary sector North Dakota businesses. Development Fund investments include equity positions, loans, and other innovative financing mechanisms. The Fund may form corporations, limited partnerships, or other forms of business associations in order to further its mission of primary sector economic development.

Rural Fund

The Regional Rural Development Revolving Loan Fund (the "Rural Fund") was created in 1993 as part of the bill that repealed North Dakota's Sunday closing laws. The result was a fund available for economic development in rural North Dakota. The funds must go to a new or expanding primary sector business. To access the Rural Fund, the business must be in a community with a population of 8,000 or less or the business is located more than five miles outside the city limits with a population of 8,000 of more. Based on the last 10 year U.S. Census, businesses within five miles of the city limits of Williston, Minot, Dickinson, Jamestown, Fargo, West Fargo, Bismarck, Mandan, and Grand Forks do not qualify for Rural Fund investments.

"North Dakota business" means a business owned by a North Dakota resident, partnership, association, corporation, or limited liability company domiciled in this state or a corporation or limited liability company, including a wholly owned subsidiary of a foreign corporation or limited liability company that does business primarily in this state or does substantially all of its production in this state.

"Primary sector business" means an individual, corporation, limited liability company, partnership, or association which through the employment of knowledge or labor adds value to a product, process, or service that results in the creation of new wealth. The term includes tourism but does not include production agriculture. The Fund follows the North Dakota Department of Commerce's process for certifying primary sector businesses.

"Production agriculture" means the production of crops and livestock on or near a farm as part of the regular farm enterprise directed by a farm operator and the farm operator's partners. The term does not include an investor-owned livestock feeding or milking operation located apart from a farm headquarters which is managed by employees.

Investment Principles

All investments are made on a sound business basis.
The Fund's investment activities will be prudently managed.
The Fund serves the reasonable investment needs of the people of the State of North Dakota.
The Fund will make investments that promote legislative goals.

Objectives

To approve investments that have an economically productive or socially desirable purpose within the state and meet the Fund's credit standards.
To maintain a diversified portfolio of investments that will limit the overall risk in the portfolio.
To position the Fund to adapt to varying economic, technological and competitive conditions.
To manage the Fund within legislative goals and objectives, appropriate risk limitations, and applicable laws and regulations.
To leverage Fund investments with ownership equity and financial institution credit.

Trade Area

The exclusive focus of the North Dakota Development Fund is business development in this state; however, it is not excluded from participation with other states or organizations in projects that have a clear economic benefit to state residents in the creation of jobs or secondary business. While the Fund is not prohibited from making investments in businesses whose place of business is outside the state, as a matter of policy the Fund will not, in the absence of special circumstances, make an investment in such businesses. The business must demonstrate a substantial benefit to the state in order to be considered for funding.

Investment Parameters

Owner Equity: Generally, the borrower is required to have a minimum of 15% equity in the project.

Guarantees: In loan transactions, personal guarantees are required from individuals who own 20% or more of the company. May also be required from other entities and individuals key to the continuation of the business.

Lead Lender: The borrower will generally have a relationship with a financial institution.

Commitments: While the Fund may be the first entity to commit funds to a project, the funds will not be released until there are firm commitments for the entire funding package.

Closing: The borrower is responsible for all costs associated with the investment closing. These estimated fees must be paid upon acceptance of the Fund's commitment letter.

Authorized Investments

The Development Fund investment funds may be used to provide working capital or to finance the purchase of fixed assets, but not to refinance existing debt. The business must demonstrate that the request is necessary to complete the financial package. In addition, funds cannot be used to relocate an existing North Dakota business within North Dakota, unless there are substantial economic reasons for relocation. Funds may be used to purchase real property and equipment, expand existing facilities, provide working capital, and purchase inventory.

Loan Criteria

A loan will be made only when a specific source of repayment can be identified and agreed upon and the source reasonably assures repayment.

The Fund may structure a loan as a direct loan, a participation loan with a financial institution, or as subordinated debt.

The collateral must reasonably assure repayment of the loans. Examples of acceptable collateral may include: accounts receivable, inventory, machinery, equipment, federal government securities, mortgage on real estate, letters of credit from acceptable financial institutions, and contracts.

In most cases, personal guarantees will be required from the principals. Other forms of guarantees may also be required. The Fund will also try to obtain life insurance on all guarantors and/or other key individuals in the business.

The interest rate on loans will be set to provide the proper risk/return considerations and in keeping with the legislative intent. The rate of return consideration may be met through a combination of loan pricing and/or other revenue considerations.

The Fund will place primary emphasis on the borrower's ability to repay a loan rather than on the collateral pledged as security. The repayment terms assigned to loans will vary depending on the use of the proceeds as well as the overall nature of the business.

The following maturities are general guidelines for loan terms:

- Real Estate: 10 to 15 years
- Equipment: 5 to 7 years
- Working Capital: 3 to 5 years

Equity Criteria

All equity investments will be evaluated to provide a rate of return associated with the proper risk/return considerations and in keeping with the legislative intent.

The Fund equity investments can be convertible preferred stock, common stock or an ownership in real property with the local community. The Fund prefers to make its investments by way of convertible subordinate debt.

The NDDF investments are made in funding stages based on the funding the needs of the company. This allows the Fund to leverage its risk by not investing the full funding upfront. The staging of funds is based on the company meeting milestones agreed to by each party at time of investment closing.

The Fund considers in its funding requests the creation of jobs and new wealth. The Fund takes into consideration the economic impact the company has to the community it is or going to be located at and the surrounding area.

The Fund, in most cases, looks to exit the company by payout within 5 years of the investment.

Tourism Criteria

The business must have a direct impact on the local or regional tourism industry. An emphasis will be placed on community support for the project.

To be approved for funding under a tourism project, the business must submit the same application and information and meet the same qualification standards that the Fund requires for primary sector businesses as described earlier in this loan policy. The only difference is that in the business plan, more emphasis is placed on the marketing plan and how the business will attract tourists – particularly out-of-state visitors.

The business and marketing plan is reviewed by a committee, which is made up of one Department of Commerce Tourism Division employee and one employee of the Fund. After the business/marketing plan and other information are reviewed, the committee rates the business based on the following 100 point scale:

- Uniqueness – 10 points
- Attractability – 10 points
- Length of stay – 10 points
- Location –15 points
- Marketing –15 points
- Hospitality –15 points
- 30% of revenues from outside of the state – 15 points
- Overall impression – 10 points

Of the 100 possible points, the business must score a minimum of 85 points. If the business scores the minimum, then the project is presented by the Fund's staff to its Board of Directors, who will have the ultimate decision on the business being approved as a tourism project.

Investment Approval

The Board of Directors is responsible for the general supervision of all affairs of the Fund, including establishing the investment policies of the Fund and approving all projects. The Board may assign lending authority to the NDDF staff as deemed appropriate. The responsibility for the day-to-day management of the investment practices of the Fund, in conformity with the investment policies approved by the Board of Directors, rests with the Fund's CEO.

An investment request shall not be processed nor an investment made in which a staff member or a Board member has an ownership interest or in which an immediate family member has a relationship, unless specifically authorized to do so by the Board of Directors. Specific authorization requires a unanimous vote by the Board of Directors.

Credit Quality

In addition to the specific statutory or policy requirements which must be met by the business, all investments must be reviewed using the "Five C's of Credit" -- Character, Capacity, Capital, Conditions, and Collateral. Ideally, a business will possess or meet all of these qualifications. The determination of whether the applicant satisfactorily meets or possesses these qualifications will rest with the Staff and the Board of Directors.

Investment Review: Each investment shall be monitored by the Fund staff. A financial analysis of the Fund's investments $100,000 or greater shall be completed annually. All investments greater than $100,000 with downgrades moved to substandard will be reviewed by the board quarterly.

Non-performing Investment Identification and Administration: Each investment identified as a non-performing investment shall be reported to the Board of Directors. General criteria for non-performing investments include:

- Have a strong potential for loss or non-accrual of interest.
- Have no repayment plan or an inadequate repayment plan.
- Have seriously deviated from the original repayment or earnings plan.
- Have material reversals in financial positions or earnings.

The Staff must prepare and periodically update a plan of action to return the investment to a satisfactory status. The CEO will approve all workout plans for investments of $100,000 or greater.

Sanctions for failure to comply with a loan or investment agreement: The CEO will notify the business of noncompliance and pursue appropriate action.

Investment Files

A file must be maintained for each investment approved by the Fund as per the retention policy. Each file must contain sufficient information to provide a single reference source for all relevant matters concerning the investment. This information must include documentation on all action taken or proposed to be taken and all approvals and signatures required by this policy and established investment procedures. The CEO will be responsible for developing an annual report to the board which states the performance of the Fund.

Confidentiality of Information

N.D.C.C. Chapter 10-30.5-07 provides for confidentiality of corporation records. The following records of the corporation are confidential:

- Commercial or financial information, whether obtained by the corporation directly or indirectly, of any entity in which an equity interest is purchased or considered for purchase, to which a loan has been made, or capital otherwise provided, under this chapter.
- Internal or interagency memorandums or letters which would not be available by law to a party other than in litigation with the corporation.

Nondiscrimination

All requests for investment must be handled without discrimination.

Annual Review of Investment Policy

Changes or additions to this policy should be made as needed to keep it current and workable. The Board of Directors must approve or disapprove changes or additions after considering the recommendations of the CEO. This policy must be reviewed in its entirety at least annually by the Board of Directors.

Exceptions

Exceptions to this policy should be approved only under limited circumstances. Any exception must be approved by the Board of Directors.

Investment Modifications

The North Dakota Development Board of Director's have given authority to the CEO and the Vice-President of the North Dakota Development Fund to negotiate or waive any terms and conditions of a loan and equity investment approved by the Board of Directors including the term of servicing the investment. The Board of Directors also gives authority to the CEO and the Vice-President to increase the funding amount of loan and equity investments up to 10% of the originally approved amount. Any amount greater than 10% would require Board of Director approval.

All terms and conditions that were either negotiated or waived including investments where the funding amount was increased would be required to be brought to the North Dakota Development Fund Board of Directors meeting held after the negotiations or waivers were made for review.

Application Process

1. The applicant contacts a local financial institution, an economic development office, or the Fund to determine whether the business project is eligible. An early joint meeting between investors, entrepreneurs, community developers and other appropriate players is recommended.

2. Through the local contact, the applicant submits sufficient information for the Fund to properly evaluate the merits of the request.

3. The Fund conducts due diligence in concert with the other players. Outside resources may be used to analyze projects. Generally, a 15-20 day lead time is needed to process debt and equity requests; however, this varies based on the due diligence process.

4. All qualified projects go to the Board of Directors for consideration or review. Applicants with requests greater than $150,000 will make a presentation at the regular Board meeting, which are held the fourth Thursday of the month or other times determined by the Fund's Staff and the Board of Directors. Requests less than $150,000 are presented to the Board of Directors on a monthly basis for review and ratification. Requests of $150,000 or more or requests that are time sensitive may also be presented by teleconference for approval. (Dollar limits are cumulative and include existing advances in determining the approval process.)

5. Applicants receive written notice of approval or denial. After the applicant accepts the commitment letter and provides the necessary documents, closing usually takes 15-30 days.

Appeal Process

Denial is based on the business not meeting the definition of a primary sector business or on review of the business plan/credit quality. The appeal process will consist of the following steps:

1. Client will provide written documentation to the CEO detailing reasons the review was in error.
2. The CEO or Senior Investment Officer will respond to the client's points.
3. The CEO will forward both responses to the Chairman of the Board of the Fund.
4. The Fund's Board of Directors will determine the appropriate course of action based on the Chairman's recommendation.
5. A written decision will be provided to the appropriate individuals.

Please note: Projects that were denied funding and then have a significant change in circumstances or information are permitted to reapply.

Sample Business Plan Format

A well-thought-out business plan is important when requesting financial assistance from the North Dakota Development Fund. This outline represents a general approach: business plans should be tailored to the specific business project.

Executive Summary - should concisely describe the key elements of the business plan.

- Business location and plan description.
- Discussion of the product, market, and competition.
- Expertise of the management team (attach resumes).
- Summary of historical and financial projections.
- Amount of financial assistance requested.
- Form of and purpose for the financial assistance.
- Complete uses and sources of funds.
- Business goals and objectives.

The Company

A general description of the business, including the product or service.

- Tax identification number.
- Historic development of the business, including such items as:
    - Name, date and place (state) of formation, and legal structure (e.g., proprietorship, partnership, corporation).
    - Significant changes (include dates) in ownership, structure, new products or lines, acquisitions.
    - Subsidiaries and percentage of ownership, including minority interests.
    - Principals and the roles they played in the formation of the company.

The Product/Service/Jobs-describe the present product or service lines, including:

- Relative impact of each product or service to the sales projections.
- Product evaluation (use, quality, performance).
- Compare to competitors' product lines, and competitive advantages over other producers.
- Demand for the product(s).
- General description of the project, the purpose for which it is undertaken, projected job creation, and salary/wage rates for all employees.

Management

- Organizational chart.
  - Key individuals (include supervisory personnel having special value to the organization): -Responsibilities
- Personnel resumes (describing skills and experience as they relate to activities of the business).
- Present salaries (include other compensation such as stock options and bonuses).
- Other employees:
  - Number of employees at year end, total payroll expenses for each of previous three years (breakdown by wages, benefits).
  - Method of compensation
  - Departmental/divisional breakdown of work force.
  - Planned staff additions.

Ownership

- Names, addresses and business affiliations of principal holders of subject's common stock and other types of equity securities (include details on holdings).
- Degree to which principal holders are involved in management.
- Principal non-management holders.
- Names of board directors, areas of expertise, and the role of the board when business is operational.
- Amount of stock currently authorized and issued.

Marketing Plan

- Describe the industry and the industry outlook. Identify the principal markets (commercial / industrial, consumer, government, international). Include current industry size as well as its anticipated size in the next two years. Explain the sources of the projections.
- Describe major characteristics of the industry.
- Describe the effects of major social, economic, technological or regulatory trends on the industry.
- Describe major customers, including: names, products or services sold to each; percentage of annual sales volume for each customer over previous three years; duration and condition of contracts in place.
- Describe the market and its major segments. Describe principal market participants and their performance. Identify the firm's target market. For each customer, include the requirements of each and the current ways of filling these requirements. Also include information on the buying habits of the customers and the impact on the customer of using the product or service.
- Describe the companies with which the business competes and how the business compares with these competitive companies. This is a more detailed narrative than that contained in the description of the product or service, above.
- Describe prospective customers and their reaction to the firm and any of the firm's products or services they have seen or tested.

- **Marketing strategies**. Describe the firm's marketing strategy, including overall strategy; pricing policy; method of selling, distributing and servicing the product; geographic penetration; field/product support; advertising, public relations and promotion and prioritization.
- **Selling activities**. Describe how the firm will identify prospective customers and how and in what order the firm will contact the relevant decision-makers. Also describe the sales effort the firm will have (e.g., sales channels and terms, number of salespersons, number of sales contacts, anticipated time, initial order size) and estimated sales and market share.

Technology

- Describe the technical status of the product (idea stage, development stage, prototype stage) and the relevant activities, milestones, and other steps necessary to bring the product into production.
- Describe the present patent or copyright position. Include how much is patented and how much can be patented (e.g. how comprehensive and effective the patents or copyrights will be). Include a list of patents, copyrights, licenses or statements of proprietary interest in the product or product line.
- Describe new technologies that may become practical in the next two years which may affect the product.
- Describe new products (derived from first generation products) the firm plans to develop to meet changing market needs.
- Describe regulatory or approval requirements and status, and discuss any other technical and legal considerations that may be relevant to the technological development of the product.
- Describe current and future plans for research and development efforts.

Production/Operating Plan

Explain how the firm will perform production or delivery of service. Describe capacity and status in terms of: -Physical facilities. Owned or leased, size and location, existing facilities (sales volume and unit capacity), expansion capabilities and capital equipment (types and quantities). Include a facilities plan and description of planned capital improvements and a timetable for those improvements.

- Suppliers. Name/location of principal suppliers, length of lead time required, usual terms of purchase, contracts (amounts, duration and conditions) and subcontractors.
- Labor supply (current and planned). Number of employees, unionization, stability (seasonal or cyclical), and fringe benefits (insurance, profit sharing, pension). -Key patents (provide profile).
- Technologies / skills required to develop and manufacture the products (provide listing/ description).
- Cost breakdown for material, labor and manufacturing overhead for each product, plus cost vs. volume curves for each product.
- Manufacturing processes - block and work flow diagram if helpful.
- Describe production or operating advantages. Discuss whether they are expected to continue.
- Specify standard product costs at different volume levels.
- Present a schedule of work for the next one to two years.

Financial

- Accountant - name, address
- Legal counsel - name, address
- Banker - name, location, telephone number, and contact officer.
- A funding request detailing the desired financing, including uses and sources of funds. If phased financing, describe phases, projected timing and detailed uses and sources of funds.
- Amount to be raised from debt and amount from equity.
- Plans to "go public." (Relate this to future value and liquidity of investments.)
- Company historical financial statements and tax returns for the previous three years.

- Three years projected financial statements (years one and two should be monthly; year three quarterly). Projections should include profit and loss, balance sheet and cashflow statements. Include key assumptions made in the proformas and how these assumptions reflect industry performance. Three years projected capital expenditures including leases and acquisitions.
- An aging of accounts receivable and an aging of accounts payable.
- Personal financial statements and three years of tax returns of principal(s).