Warren County Local Development Corporation

Revolving Loan Program

DECEMBER 2021

OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

Contents

Report Highlights

Warren County Local Development Corporation

Audit Objective

Determine whether the Warren County Local Development Corporation (Corporation) officials provided adequate oversight of the revolving loan program.

Key Findings

Corporation officials did not provide adequate oversight of the revolving loan program. For the 15 active loans, we found:

- Fourteen loan files did not have required and/or other supporting documentation.
- Eleven loan files did not contain any evidence that annual site visits occurred, annual financial statements were reviewed or whether jobs were created and/or retained.
- Twelve loan files lacked documentation to support the loan proceeds were used properly.
- Four active loan agreements were altered, and three loans were made without Board approval.
- Loan agreements did not have enforcement mechanisms to ensure funds were used for appropriate purposes and job creation and/or retention goals were met.

Key Recommendations

- Ensure loan files contain all required information and site visits are conducted and documented in the loan files.
- Forward all loan modification requests to the Board for approval.
- Develop written policies and procedures outlining actions to take when job creation and/or retention goals are not met.

Board officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Background

The Corporation was established in 1986 by the Warren County (County) Board of Supervisors.

The Corporation is governed by a seven-member Board of Directors (Board) who are appointed annually by the Chairperson of the County Board of Supervisors. The Board's Chairman (Chairman) is elected annually by the Board from among its ranks.

The Board contracts with the Warren County Economic Development Corporation (EDC) to provide the day-to-day management of the Corporation's revolving loan program. The EDC is a 501(c)(3) organization and is managed by a President who is an employee of the EDC. For the purpose of managing the Corporation's day-to-day operations, including the revolving loan program, the President functions as the Corporation's chief executive officer.

Quick Facts	
Outstanding Loans	19
Original Balance of Loans	$1,884,713
Balance of Outstanding Loans	$856,654
Loan Terms	Up to 15 years at 5 to 9 percent

Audit Period

January 1, 2019 – February 28, 2021

Revolving Loan Program

Local development corporations (LDCs) are private, not-for-profit corporations often created by, or for the benefit of, local governments for economic development or other public purposes. LDCs are used to finance local government operations and projects. LDCs may be created pursuant to New York State Not-For-Profit Corporation Law, Section 1411 for various reasons, including to promote and enhance employment opportunities.

The Corporation's mission statement is to stimulate economic development activities, retain and increase employment opportunities for County residents and businesses, encourage the expansion and growth of existing business in the County, and increase availability of affordable housing for County residents through the provision of low interest loans to businesses. The Corporation has two current revolving loan programs available to businesses in the County: an economic development loan fund and the rapid recovery loan program. Previously, the Corporation had a small business loan program and issued the last loan from this program in February 2012.

The economic revolving loan program is the primary loan program offered to businesses and can be used to establish or expand business activity within the County. The rapid recovery loan program was established due to the COVID-19 pandemic and provides loans to small businesses that did not receive funds through the United States (U.S.) Small Business Administration Paycheck Protection Plan. The revolving loan funds originally were funded by grants from New York State and by small cities grants from the U.S. Housing and Urban Development agency. To support the Corporation's mission, the County provides the Corporation with $50,000 annually, except for 2019, to cover administrative costs.

The economic revolving loan program is the primary loan program offered to businesses. …

Three EDC employees – the President, bookkeeper and coordinator – manage the Corporation's revolving loan program. The current bookkeeper began working for the EDC in December 2019, and the current President started in July 2020. The EDC's former President was employed by the EDC from September 2013 until his passing in July 2020.

How Should Officials Approve and Disburse Loan Funds?

An LDC board is responsible for ensuring loans are issued to eligible borrowers for allowable purposes and ensuring repayments are made in a timely manner according to loan agreements. LDC boards should develop and adopt policies and procedures for approving, collecting, monitoring and enforcing loan agreements. These policies and procedures should include eligibility requirements that applicants must meet to be able to participate in the program and criteria for approved applicants to follow describing how the loan funds may be used. LDC boards should only approve loans that meet the eligibility and criteria requirements.

The Board has adopted standard loan policy guidelines for the processing and approval of loan applications. According to the policy guidelines, to obtain a loan from the Corporation's revolving loan program, an interested business must complete an application and provide required documents outlined on the application checklist, including a description of the business's operations and proposed project, tax returns and credit report, among other items. Additionally, the business must provide a loan denial letter indicating it previously had been denied a business loan from a commercial lender. However, if a business applies for a loan from the Corporation's rapid recovery program, it is not required to provide a loan denial letter.

The EDC coordinator works with businesses to ensure they have all necessary documents outlined on the revolving loan program application checklist. Once the application is complete, the business pays a $300 application fee and $20 credit report fee, and the coordinator forwards the application to the President for review.

After the President reviews the loan application, he sends it to the Corporation's business review committee (committee) for review. The Chairman is responsible for appointing all members of the committee with the Board's approval. For each loan application, the committee must ensure all applications are complete and are accompanied by appropriate supplemental information.

According to the Corporation's loan policy guidelines, the committee also must prepare a written report for the Board summarizing its review process and providing recommendations for lending, as appropriate. At a minimum, the committee should document its loan application recommendations in its meeting minutes. Also, for public transparency, the committee should announce its meeting dates in advance.

At a minimum, the committee should document its loan application recommendations. …

The Board meets monthly to discuss the status of current loans and to review and approve loan applications as necessary. If the committee has recently recommended a loan for approval, the Board will discuss the loan application. During the meeting, the Board will specifically discuss what the loan proceeds will be used for and how it fits into the Corporation's mission. The loan applicant will attend the meeting so they are available to answer any questions the Board may have. If the Board intends on approving the loan, they will pass a resolution indicating the loan amount, terms and rate and the collateral used to secure the loan.

After the approval process is complete, the Corporation prepares a loan term sheet for the business to accept and sign. The agreement outlines conditions such as what the project loan funds will be used for, the total amount of the loan, the date the funds will be disbursed, how many jobs will be created or retained and the terms of the loan, interest rate and monthly payment.

After the loan closing, the Corporation distributes the loan funds and files any liens on business property used as loan collateral, if appropriate, with the Warren County Clerk (County Clerk) and New York State Department of State. The loan checks are prepared by the EDC bookkeeper and signed by two Corporation Board members.

No Documentation Available Indicating Committee Members Were Appointed and Loan Recommendations Were Not Documented

Although we found documentation indicating that the committee existed, Corporation officials were unable to provide us with any evidence showing that the Chairman had appointed the committee members or that the Board approved the committee appointments. Because the Chairman and Board did not appoint and approve committee members, this allowed the former President to select a group of individuals to review loan applications and make approval and denial recommendations, which he then presented to the Board. The current President told us the committee members included representatives from three local banks, a law firm and an accounting firm, all located in the County, who served on the committee as needed to review loan applications.

Also, the committee did not announce its meeting dates in advance, prepare meeting minutes or provide written loan recommendations to the Board. Corporation officials could not explain why committee members were not formally appointed, minutes were not prepared, and proposed loan recommendations were not formally reported to the Board in writing.

According to the Chairman, the former President[1] told the Board the results of the committee's review for each loan application. The Chairman additionally told us that the Corporation had always operated this way. Because the Corporation relied on the former President to communicate the committee's recommendations about potential loan approvals and denials, the Board could not ensure that the committee's recommendations were properly or fully communicated. As a result, the Board may not have received sufficient information to make an informed decision when voting to approve or deny loan applications.

Loan Files Were Incomplete

We reviewed the 15 active loan files for businesses[2] that had original loan amounts totaling approximately $1.3 million and found that the businesses had pledged sufficient collateral and the Corporation's disbursements of the loan

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1 The committee has not received any new loan applications to review since July 2020.

2 Refer to Appendix C for further information on our sample selection.

proceeds were accurate. However, 14 loan files did not contain completed loans applications, sufficient and complete supporting documentation or evidence that the Corporation collected all required loan fees, as follows:

- Eleven loan files did not have sufficient supporting documentation to show that the loan application and credit report fee were paid in full. Eight of the 11 loan files had copies of checks or other documentation showing that the businesses made partial payments for the loan application fee ranging from $150 to $250. However, the three remaining files did not have any documentation showing that the businesses paid either of the fees.
- Nine loan files did not have a required denial or commitment letter from a commercial lender.
- Three loan files did not have documentation to show that the loans were reviewed and approved.
- Two loan files had incomplete loan applications because they were missing supplemental items such as financial statements and credit reports.

The bookkeeper and coordinator could not explain why the loan files were missing required documentation or why the committee and the Board approved these loans without complete applications because many of these loans were handled by the former President. When the Board approves loans without required information, the Board cannot fully determine whether applicants are eligible to receive a loan and/or that the loans will be used for an eligible purpose. Further, these officials could not explain why application and credit report fees were not always collected in full. When fees are not charged appropriately on all loans, it could give the impression that the Corporation is favoring certain businesses over others. Additionally, the Corporation is not collecting all the application fees to which it is entitled.

...[T]he President should follow-up with businesses to ensure loan proceeds are used as intended.

How Should Corporation Officials Monitor Loans?

The Corporation's policy guidelines and operating plan requires Corporation officials to make annual business site visits and requires business owners to submit annual financial statements to the Corporation for review. Also, it states that "additional information may be procured as appropriate" and that "review reports will be presented to the BRC [committee] for further recommendations as appropriate."

Consequently, as part of managing the Corporation's revolving loan program, the President should follow-up with businesses to ensure loan proceeds are used as intended. Additionally, the President should review records (e.g., payroll registers and year-end tax filings) to ensure businesses are creating and/or retaining the number of jobs listed on their loan applications.

In addition, the Corporation should include enforcement mechanisms in all loan agreements to hold businesses accountable to the job creation and/or retention goals listed on their loan applications. Furthermore, the Corporation should require businesses to submit invoices for purchases such as machinery, equipment or other items purchased with loan funds. After receiving those invoices, the Corporation should file appropriate collateral statements with the County Clerk to ensure it has a claim to those assets in the event that a business defaults on its loan.

The President and Board Did Not Adequately Monitor Loans

We found that the former and current Presidents did not adequately follow up with businesses consistently after loan funds were disbursed to determine whether funds were used for approved purposes. We examined the disbursement records for 15 businesses[3] to determine how loan funds were used and found that 12 businesses with original loans totaling $988,000 did not have adequate documentation to show how they used $688,000 (70 percent) of their loan funds.

For example, one loan issued in July 2020 for $168,000 should have been used to purchase machinery and equipment. While there was a list of items in the loan file that the business indicated it would purchase with the loan funds, the Board did not require the business to provide invoices for those purchases. As a result, the Corporation did not have invoices for those purchases to verify the business actually purchased the items listed in the file or to file the appropriate collateral statement with the County Clerk.

The current President told us he visited this business's site and verified the items were purchased. However, without the invoices the Board must rely only on the President's observation. Additionally, without appropriate collateral statements filed with the County Clerk, the Corporation has no claim to the assets in the event the business defaults on the loan.

We also found that the Board did not include enforcement mechanisms in the Corporation's loan agreements to ensure businesses create and/or retain the number of jobs listed in their loan applications. In addition, the Corporation did not follow up with businesses to determine whether they were achieving their job creation and/or retention goals. Of the 15 businesses reviewed, 10 pledged in their loan applications to create and/or retain a combined total of 104 jobs. However, only two businesses had self-reported numbers in their loan files indicating they had created and/or retained 16 jobs.[4]

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3 Ibid.

4 Refer to Appendix A for further information on the projects that we reviewed.

Furthermore, 11 loans files did not have any documentation showing that the former and current Presidents had made required site visits. The Corporation did not require these businesses to submit their annual financial statements and had not requested job reporting figures since 2017. When the President does not make annual site visits and annual financial statements and job reporting figures are not required to be provided, it impairs the Board's ability to assess the businesses' financial health and determine whether the loans issued to the businesses are still collectable or whether jobs have actually been created and/or retained.

How Should Loan Agreements Be Enforced?

All monthly loan payments are collected electronically through an automatic clearing house (ACH) transfer. Borrowers may choose to make additional principal payments by check. The bookkeeper usually initiates the ACH on the 10th day of each month.

If a loan payment is returned for insufficient funds by the bank, the coordinator follows up with the borrower to determine the reason, whether the Corporation should update the borrower's banking information, or whether the bookkeeper needs to process another ACH. Delinquencies that continue for 90 days are referred to the Corporation's counsel for further action.

According to the Corporation's loan requirements, the committee reviews any requests by borrowers to adjust the terms and conditions of their loan then refers the requests to the Board to determine whether the adjustments are in the Corporation's best interests. The loan guidelines do not include any provisions to allow the President to approve modifications of loan agreements.

The Corporation did not require these businesses to submit their annual financial statements. ...

Loan Agreements Were Not Always Enforced

We reviewed all loan payments made by 15 businesses[5] during our audit period to determine whether payments were made in accordance with their loan agreements. We obtained each borrower's loan payment transaction history from the Corporation's bank and reviewed deposit slips for payments made in person to determine whether payments were made in a timely manner and according to loan agreements and whether they were recorded in the accounting records. We found that payments were not always made according to loan agreements, as follows:

- Two businesses had a total of 11 late or missed payments because the ACH payments were returned for insufficient funds. The Corporation did

5 See supra, note 3.

not assess late fees for the delayed payments, which resulted in a loss of $410 in late fee revenues. The bookkeeper told us that the former President said the Corporation did not enforce late payment penalties. This practice continued under the current President.

- Four loans had modifications that the Board did not approve. The current President allowed these businesses to make interest-only payments because he thought he had the authority to approve these loan modifications.

When the Corporation allows exceptions to be made to loan agreements without Board approval documented in the minutes of its proceedings, it could give the public the impression that officials and the Board are not being transparent and that certain businesses are being given more favorable arrangements than others. Also, if businesses are aware that the Corporation will not enforce late payment penalties, they may delay their monthly payments assuming they will not suffer any financial consequences.

What Do We Recommend?

The Chairman should:

1. Appoint members to the committee.

The Board should:

2. Approve members appointed by the Chairman.
3. Require the committee to:
    - Announce its meeting dates in advance.
    - Recommend approval only to those loans that have a complete loan application and all required supplemental documentation on file.
    - Prepare and retain meeting minutes that include all recommendations to approve or deny loan applications.
    - Formally submit proposed loan recommendations to the Board in writing.
4. Ensure that officials collect all loan application fees.
5. Approve only those loans that have a complete loan application that includes required supplemental documentation.
6. Develop enforcement mechanisms for loan agreements to ensure businesses fulfill their promised job creation and/or retention goals and use loan funds only for approved purposes.

The President should:

7. Perform and document all annual site visits. Also, ensure businesses submit documentation such as annual financial statements and invoices for equipment purchases.

8. Ensure that appropriate collateral statements are filed with the County Clerk.

9. Forward all loan modification requests to the Board for approval.

10. Enforce all late payment penalties, and obtain Board approval before waiving late fees.

Appendix A: Summary of Projects Tested

Business Type	Loan Amount	Pledged Job Creation (C) Retention (R)	Self-Reported Jobs Created (C) Retained (R)	Purpose
Construction	$40,000	C 3 R 5	Unknown[a]	Purchase Renovate Property
Leisure	46,250	Unknown[b]	Unknown[a]	Refinance/New Building Construction
Sports Complex	309,000	Unknown[b]	Unknown[a]	Equipment/Working Capital
Home Improvement	30,000	C 1 R 6	Unknown[a]	Refinance
Event Center	60,000	N/A[c]	N/A[c]	Equipment
Retail	9,400	C 1 R 2	Unknown[a]	Equipment
Manufacturer	167,513	C 13 R 3	C 5 R 3	Equipment Working Capital
Manufacturer/Retail	115,000	R 18	Unknown[a]	Refinance/Working Capital
Restaurant	52,650	C 6 R 11	Unknown[a]	Equipment/ Working Capital
Restaurant	80,650	C 3 R 14	Unknown[a]	Refinance/ Equipment
Restaurant	20,000	C 8 R 1	C 7 R 1	Working Capital
Home Improvement	50,000	R 3	Unknown[a]	Building Reconstruction
Restaurant	65,000	C 6 R Unknown[a]	Unknown[a]	Renovations/ Equipment/ Working Capital
Retail	12,500	N/A[d]	N/A[d]	Working Capital
Hospitality	200,000	Unknown[b]	Unknown[a]	Purchase Property
Totals	**$1,257,963**	**104**	**16**	

a) The loan records do not document any job creation or retention figures.

b) The loan records do not adequately document projected job creation or retention figures.

c) The Board passed a resolution to waive this business from job creation or retention requirements.

d) Due to the loan type (Rapid Recovery) there was no pledged employee job creation or retention in the application, nor was one required.

Appendix B: Response From Corporation Officials

Warren County
LDC

December 5, 2021

[redacted]
Principal Examiner
NYS Office of the State Controller
Division of Local Government and School Accountability
One Broad Street Plaza
Glen Falls, NY 12801

RE: NYS OSC Draft Report of Examination 2021M-102

Dear [redacted]

Please accept this letter as the formal response to the above referenced Report on behalf of the Warren County Local Development Corporation (the "LDC").

The LDC accepts the findings of the Office of the State Comptroller as set forth in its Draft Report. The Report concludes that oversight in several noted areas of the LDC had evolved into a less than formal process and a more robust loan review process should be adopted by the Board of Directors of the LDC. The Economic Development Corporation (the "EDC") agrees with that assessment.

While the current EDC administration and the LDC Board cannot retroactively change the handful of identified past processes, all involved are committed to and have already taken steps to ensure that takes place, as will be provided you in detail in the forthcoming Corrective Action Plan. As an example, the LDC is in the midst of a full review of its by-laws now and will include the recommendations from this Report in that process.

There are a couple of minor clarifications to note as we acknowledge the report and its recommendations. The first concerns the example of loan collateral for a recent loan not being on file with the County Clerk. That UCC in question was in process and subsequently filed by the County's Attorney after the audit concluded. Additionally, the report identifies four loans that had modifications made without formal board approval. Those loans were indeed modified by the previous LDC President to interest only and that fact was shared with the LDC board. They

Warren County LDC * 1340 State Route 9, Lake George, NY 12845 * 518-798-7542 * www.warrenldc.org have all subsequently been returned to their previous terms or the modifications recognized by formal resolution. In this example, we do ask that consideration be given of the unique circumstances facing the LDC and EDC during the period covered by the Draft Report with regard to these modifications. The LDC, like many community organizations during the audit period, were trying to address the many challenges to loan recipients presented by COVID-19 and the actions of the President, in communication with the LDC Board were done in this context. We do recognize and agree to address the process for any loan modification going forward as recommended by the report.

In conclusion, the Report of Examination of the LDC Revolving Loan Fund is a welcome outside review of what appears to have become a less than formal process over time. The constructive recommendations are all in line with the LDC's, along with the EDC as its administrator, desire to continue to improve and strengthen its operations and processes. The community we serve benefits from a robust revolving loan program which, as it recognizes and implements these recommendations, should continue to grow and deliver ever increasing return to Warren County.

Peter McDevitt
Warren County LDC Chairman

Jim Siplon
Warren County EDC and LDC president

Warren County LDC * 1340 State Route 9, Lake George, NY 12845 * 518-798-7542 * www.warrenldc.org

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We gained an understanding of the Corporation's revolving loan program and recording and reporting requirements by interviewing Corporation staff and Board members and by reviewing by-laws, policies and applicable source documentation.
- We used our professional judgment to select 15 loans from the 19 that were open during our audit period. The 15 loans included 11 current loans and four loans that were paid-in-full during our audit period. We excluded the remaining four loans from our sample because they were owned by business owners who had filed for bankruptcy before our audit began. We reviewed the 15 loans to determine whether the loan applications were complete, applicants submitted all required supporting documentation and pledged an appropriate amount of collateral, there was a quorum of Board members at the meetings when the loans were approved, and the loans were intended to support local economic development and were made for eligible projects and/or activities. We also determined whether post-loan follow-up activities included annual site visits and whether these visits were completed. Additionally, we reviewed the loan disbursements to confirm they were for the amount of the approved loan.
- We reviewed payment history for all 15 loans for which we expected regular payments during our audit period. To determine whether loan payments were made in full and accurately recorded, we traced the loan payments from the loan payment transaction history provided by the bank and deposit slips to the Corporation's accounting records. We also reviewed committee and Board minutes to determine whether loan modifications were made by the Board.
- Of the 15 loans, we reviewed five that had modifications to the original terms of the loan. We also reviewed Board minutes to determine whether the Board approved the modifications.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Corporation has the responsibility to initiate corrective action. We encourage the Corporation to prepare a written corrective action plan (CAP) that addresses the recommendations in this report and forward it to our office within 90 days. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Corporation to make the CAP available for public review in the Corporation's office.

Appendix D: Resources and Services

Regional Office Directory
www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas
www.osc.state.ny.us/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems
www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management
www.osc.state.ny.us/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans
www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders
www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller
www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers
www.osc.state.ny.us/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics
www.osc.state.ny.us/local-government/academy

Contact

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