Revolving Loan Funds

- One of the most common development finance models
  - Part of the basic economic development “tool kit”
- Fills capital gaps not addressed via guarantees or CRA regulations
  - Externalities, high-risk debt, high info & transaction costs
- Several thousand exist in the US, mostly run by public agencies or non-profit economic development organizations
- Primarily funded through with government grants, especially from CDBG, EDA and state governments
- RLFs make loans to small businesses, largely for job creation goals. Loan repayments are then recycled to make additional loans.
- Typical RLF supplies medium-term debt at below market interest rates
- Growth in technical assistance services by RLFS

RLF Capitalization and Impact

- Collectively, RLFs report large impacts but most RLFs have capital below $1 million and make 10 to 20 loans per year.
- A small set of RLFs have large capital bases, high lending volumes and generate more impact.
- Average RLF loan is small and higher risk than bank loans.
  - For federally funded RLFs, average loan was $52,000 and default rate was 9.2% in mid-1990s.
  - State surveys show RLFs supplying smaller loans and have lower default rates.

State RLF Survey: Key Summary Data

Measure	AR	CA	IL	MN	NC	OH	WA
Total Loans Made	1,088	2,827	1,743	2,634	2,060	2,081	1,071
Median # of Loans	21	34	8	12	33	NA	12
Median Capital ($000)	NA	500	400	500	1,300	1,300	<500
Share of grants/ equity	NA	70%	95%	75%	69%	76%	90%
Median loan size	42,500	48,000	37,433	37,500	51,500	NA	30,000
Median loan term	5 yr.	7 yr.	7 yr.	8 yr.	8 yr.	NA	3.5 yr,

Performance Data: State RLF Profiles

Performance Measure	CA	IL	MN	NC	OH	WA
Total Jobs Created and Retained	14,537	18,5702	25,135	11,091	20,483	9,877
Average Cost per Job	$14,308	$5,148	$6,485	$9,233	$21,188	$5,984
Default Rate	6.9%	7.3%	6.1%	3.5%	1.2%	<5%

RLF LEVERS AND POLICIES

- Targeting policy- most critical RLF policy:
  - Eligible type of business/projects. Sets potential impact & scale
  - Informed by local ED goals & strategies, capital gaps
- Financial products and terms:
  - Loan size, interest rates, repayment terms and security; critical value in supplying subordinate and market rate debt
  - Tradeoffs between development and financial goals
- Capital structure and funding sources:
  - Defines level and type of lending for RLFs
  - Should match targeting and financing strategy
- Underwriting criteria and risk standards:
  - Formal policies to support sound lending and risk managements
  - Standards for ED impact, business capacity, repayment risk
- Development services:
  - Build demand, increase impact and reduce financial risks.
  - Core loan packaging, one-on-one advice and referral services
- Relationship building:
  - Explicit efforts to build referral networks, secure co-investment, expand development services, gain funding and political support,

Financial-Development Trade Offs

Scenario: $ 2 million RLF	Assets and Cumulative Loans after 10 Years
Base Case: 7% rate, 5 year amortization 2% loss rate	Assets: $1.82 million Loans: $4.48 million
9% Interest rate	Assets: $2.16 million Loans: $5.2 million
3 Year Amortization	Assets: $1.84 million Loans: $6.4 million
4% Loss Rate	Assets: $1.54 million Loans: $4 million

RLF MANAGEMENT CHALLENGES

- Strategy Challenges
  - Defining a strategy to maximize impact with limited capital. Complement other economic development activities and avoid capital substitution.
  - Managing the trade-offs between economic development and financial objectives: taking risks and incurring losses, repayment terms and revolving loan capital,
- Operating Challenges
  - Managing professional origination, underwriting and approval process with limited staff and for high-risk borrowers.
  - Providing/securing sufficient technical assistance for client firms.
  - Building strong relationships with multiple partners: business community, lenders, political leaders, economic development agencies, and technical assistance providers.
- Capitalization Challenges
  - Securing sufficient and appropriate capital to achieve a sustainable scale

Industrial Site Revolving Loan Fund

- What is ISLF's targeting strategy? Financing strategy/policies?
- How well do they align with city ED goals?
- What are the strengths and weaknesses of these strategies?
- How well do ISLF lending operations appear to be managed?
- Do you see any best practices or lessons for other development finance entities from ISLF's experience?
- What changes or improvements would you recommend?