National Sponsors

# CDFA Spotlight:
# Revolving Loan Funds (RLFs)

## Overview

A revolving loan fund (RLF) is a gap financing measure primarily used for development and expansion of small businesses. It is a self-replenishing pool of money, utilizing interest and principal payments on old loans to issue new ones. While the majority of RLFs support local businesses, some target specific areas such as healthcare, minority business development, and environmental cleanup.

Establishing a revolving loan fund provides access to a flexible source of capital that can be used in combination with more conventional sources. Often the RLF is a bridge between the amount the borrower can obtain on the private market and the amount needed to start or sustain a business. For example, a borrower may obtain 60 to 80 percent of project financing from other sources.

Quality RLFs issue loans at market or otherwise competitive and attractive rates. Many RLF studies have shown that access to capital and flexibility in collateral and terms is more important to borrowers over lower then market interest rates. RLF programs should be build on sound interest rate practices and not perceived as free or easy sources of financing. RLFs must be able to generate enough of an interest rate return to replenish the fund for future loan allocations. With competitive rates and flexible terms, a RLF provides access to new financing sources for the borrower, while lowering overall risk for participating institutional lenders.

Eligible uses for RLF loans include:

- Operating capital
- Acquisition of land and buildings
- New construction
- Facade and building renovation
- Landscape and property improvements, and
- Machinery and equipment.

## Loan Characteristics

Durations vary according to the use of funds. A loan used for working capital, for instance, may range from 3 to 5 years, while loans for equipment are up to 10 years and real estate loans may last 15 to 20 years.

Loan amounts range from small ($1,000 to $10,000) to mid-sized ($25,000 to $75,000), with larger ($100,000 to $250,000 and up) amounts available when the borrower has secured a substantial sum from private lenders.

## Capitalizing a Revolving Loan Fund

Initial funding, or capitalization, of a revolving loan fund usually comes from a combination of public sources, such as the local, state, and federal governments, and private ones like financial institutions and philanthropic organizations. Funding acquired for capitalization is usually the equivalent of a grant – it does not need to be paid back.

Most revolving loan funds have at least one local public source for capitalization combined with other sources. If capitalization is *exclusively* local, the RLF may have greater flexibility in lending, as state and federal involvement tend to include restrictions that may not fit local business needs.

State and local governments often use one or a combination of the following to capitalize an RLF: tax set-asides, general obligation bonds, direct appropriations from the state legislature, annual dues from participating counties or municipalities, and funds directed from the state lottery.

The federal government is another common source of capitalization. Communities may apply for funding from the United States Department of Agriculture (via the Rural Economic and Community Development Administration), Housing and Urban Development (via Community Development Block Grants), and the Department of Commerce (via the Economic Development Administration).

**Standards and Results**

While RLFs take on projects with above average risk, borrowers are held to standard financial requirements in loan security. Before a loan is issued, a business or prospective business usually supplies the following documentation:

- Business plan
- Business experience and management information
- Credit history and financial statements
- Sufficient collateral to repay bank and RLF funding
- Other personal or corporate guarantees on the project, and
- Cash flow projections.

As a public investment instrument, revolving loan funds are expected to result in public goods – namely projects contributing to economic growth and community revitalization. Borrowers therefore, must address performance measures established by the loan administrator such as:

- Number and type of jobs created or retained
- Increase in tax revenue
- Private funding relative to public investment, and
- ·Benefits to low and moderate-income citizens, from business ownership to job opportunities.

**Administration**

A Loan Review Committee or board of directors takes responsibility for reviewing loan proposals, designating of an administrative body (can be public, nonprofit, or private), and contracting a local bank for the loan fund's portfolio management responsibilities. The committee or board is usually a combination of legal, private lending, business, community development, and local government professionals.

Staffing a revolving loan fund requires a team of financial specialists. In one approach – best for funds issuing a higher volume of loans – each team member is responsible for a different stage of the lending process. For instance, one staff specializes in loan packaging while another specializes in monitoring existing loans. An alternative approach assigns each loan to an individual who monitors it from beginning to end.

**Issues**

While revolving loan funds have plenty of benefits, there are some drawbacks. Since RLFs provide access to a flexible source of affordable financing, operating costs may come to exceed operating income, resulting in erosion of the fund's capital base. Annual inflation also contributes to capital base erosion. In either case, the fund may require additional public investment to remain functional.

Review committees must also carefully weigh which loans to make. For example, making too many long-term loans could result in fewer new loans, slowing down the revolving mechanism and straining the fund. In other cases, borrowers who could make it without special support may apply for funds, thus limiting opportunities for high-need businesses.

**Examples**

The EPA Brownfields Cleanup and Redevelopment initiative (http://www.epa.gov/brownfields) includes a revolving loan fund component. On January 11, 2002, the Small Business Liability Relief and Brownfields Revitalization Act was signed into law. The brownfields cleanup RLF program provides grants to support cleanup efforts. Grants of up to $1 million over five years provide funding for a grant recipient to capitalize an RLF and to provide sub-grants to carry out cleanup activities at brownfields sites. Grant recipients must use at least 60 percent of the awarded funds to capitalize and implement an RLF. Proposals may be submitted by "coalitions," or groups of eligible entities, to pool their revolving loan capitalization grant funds.

The Cascadia Loan Fund (http://www.cascadiafund.org/) provides loans to small businesses and nonprofit organizations in Washington and Oregon. The Cascadia RLF is capitalized primarily through individual donations and investments. Loan interest and fees cover the operating expenses. In addition, donations and grants are used to administer technical assistance and special programs. Loans are available for businesses owned by low-income people, women, minorities, and immigrants, child care businesses, businesses that create family-wage jobs in low-income communities, businesses in rural communities, nonprofit community building organizations, cooperatives, and businesses that work to preserve or restore the environment. From 1985 to 2003, the Cascadia Loan Funds provided 434 loans for a total of $29 million. The average loan size during this period was $28,000 and the maximum loan was $500,000. Cascadia loans are used to finance equipment and inventory, working capital, building improvements, debt refinancing, and other qualifying expenses. The default rate for Cascadia loans is extremely low (1%) in part because borrowers are given customized technical assistance and closely monitored to ensure success.

In rural Arkansas, Southern Financial Partners (http://www.southernfinancialpartners.org) is a non-profit organization that provides financial and technical assistance to small businesses. SFP administers the Arkansas Rural Healthcare Revolving Loan Fund to support the start up and expansion of healthcare businesses. As of October 2005, close to $9 million has been loaned to healthcare professionals, hospitals, and non-profit organizations in rural Arkansas. Loans have been used to establish primary care practices, health clinics and hospitals, purchase buildings, vehicles, and equipment, make capital improvements to clinics and hospitals, and update computer and software for billing systems. The Arkansas Rural Healthcare RLF is capitalized through support from federal agencies including the USDA, state authorities, and private foundations including the Robert Wood Johnson Foundation.

**Starting a Revolving Loan Fund**

If small businesses in a community have issues accessing conventional financing, public and/or private entities can set up a Revolving Loan Fund. Here are some basic steps for starting an RLF:

1. Research existing RLF’s and compile samples of application forms, program guidelines, and other materials.
2. Invite lenders and potential borrowers to participate in the design process.
3. Establish the purpose of the RLF. This should include a needs assessment.
4. Set the eligibility requirements for borrowers.
5. Determine the allowed uses of funds as well as prohibited uses.
6. Set a minimum and maximum amount for the loans.
7. Decide if the loans must be matched by existing equity or other sources of funds.
8. Determine the length of the loan term, which may vary based on the use of the loan. For example, the term for a loan to purchase equipment may be based on the life of the product while a loan for real estate may have a 15-year term.
9. Establish an application fee, origination fee, and policies regarding closing costs. Define the default and delinquency terms.
10. Decide if the interest rate will be variable or fixed and whether the rate will vary based on the project.
11. Develop the loan application form. Create a short pre-application form or checklist to help borrowers determine if they are eligible.
12. Set up a committee to review loan applications.
13. Determine the administrative duties and staffing needs associated with the program.
14. Promote the RLF and capitalize with funds from grants and individual donations.

15. Provide loans and technical assistance to borrowers.

### Summary

Revolving loan funds provide critical financing when credit access is limited, supporting the development and expansion of local businesses and other special initiatives. While a revolving loan fund cannot finance projects on its own, it is an integral part of the small business loan package. Borrowers benefit from flexible and favorable terms, and financial institutions enjoy lower overall risk in supporting small businesses. The results include new jobs, new businesses, and a healthier local economy.

### Revolving Loan Fund Links

### National Resources

EDA RLFs Make a Difference (report by NADO)
http://www.nado.org/pubs/rlf02.pdf

Establishing a Revolving Loan Fund (Ohio State University Extension)
http://ohioline.osu.edu/cd-fact/1229.html

Administering a Revolving Loan Fund (Ohio State University Extension)
http://ohioline.osu.edu/cd-fact/1230.html

### State and Local Resources

State of Georgia – Downtown Development Revolving Loan Fund
http://www.dca.state.ga.us/economic/financing/programs/ddrlf.asp

MassDevelopment – Seafood Revolving Loan Fund
http://www.massdevelopment.com/financing/lg_seafood.aspx

City of Minneapolis – Two Percent Revolving Loan Fund
http://www.ci.minneapolis.mn.us/cped/docs/resource_two_percent_revolving.pdf

Erie County Industrial Development Agency - Business Development Fund
http://www.ecidany.com/loan_bdf.asp

Mississippi Development Authority – Capital Improvements Revolving Loan Fund
http://www.mississippi.org/content.aspx?url=/page/3062&

Urban Redevelopment Authority of Pittsburgh – Business Development Center (BDC) Revolving Loan Funds
http://www.ura.org/bdcLoanPrograms.html

St Louis Development Corporation – Revolving Loan Fund
http://stlouis.missouri.org/sldc/busdev/rlf.html

Cascadia Revolving Fund – Olympic Microloan Fund (Washington)
http://www.cascadiafund.org/programs-omf.html

Salt Lake City – Small Business Revolving Loan Fund
http://www.slcgov.com/ced/hand/smllbusness.htm

**Council of Development Finance Agencies**
815 Superior Avenue
Suite 1301
Cleveland, Ohio 44114
Phone: (216) 920-3073
Fax: (216) 771-4938
E-mail: info@cdfa.net