

## Revolving Loan Funds as Local Economic Development Tools in Indiana

### Revolving Loans Funds

- Revolving loan funds are pools of capital set aside for lending to businesses, through which the repayment of capital and interest provides funds for additional loans to be made
- RLFs are enjoying a renaissance as increasingly popular tools for LEDOs to use to promote local economic development
- RLFs in Indiana are tied to promotion of local entrepreneurship, which increasingly is promoted along with attraction and retention/expansion as fundamental goals of local economic development organizations

## Revolving Loans Funds - survey

- The Indiana Economic Development Association and the Indiana Rural Development Council set out to jointly survey LEDOs regarding RLFs
- An initial e-mail query was sent out through the IEDA e-mail list in early summer
- USDA was also asked for a list of grant recipients for revolving loan funds

## Revolving Loans Funds - study

- A number of LEDOs with RLFs were then surveyed through sit-down interviews
  - Five RLFs had sufficient information and records for quantitative analysis
- Results were tabulated, and compared with information on revolving loan funds provided by the Council of Development Finance Agencies

## Revolving Loans Funds – rural flavor

- RLFs appear to have high usage in rural counties and communities
- Two potential reasons:
  - Rural communities perceive fewer opportunities to succeed with new business attraction, and turn to local entrepreneurship as a high priority alternative strategy
  - USDA makes funds relatively easily accessible for such communities

## Revolving Loans Funds – size matters

- RLFs operate as a tool of LEDO organizations
- They do not generate sufficient revenue to be self-sustaining in terms of covering overhead, personnel, marketing, etc.
  - Estimated size needed to be self-sustaining is approximately \$1.5 million
- Most Indiana RLFs that were surveyed are in the <\$100,000 to \$300,000 range
- Most RLFs surveyed are less than 10 years old
- According to CDFA, larger RLFs can be economic development tools that are useful for business attraction

## Revolving Loans Funds - funding

- There are a variety of sources of funding theoretically available for revolving loan funds in Indiana
  - U.S. Economic Development Agency
  - USDA – three types
  - Local governments
  - Local community foundations
  - State government
  - LEDO self-investment

## Revolving Loans Funds - funding

- Most revolving funds that were studied in Indiana use funds from the United States Department of Agriculture, Office of Rural Development
- Far and away, the most common USDA program source is the Rural Business Enterprise Grant (RBEG)
- Other potential USDA fund sources are the Intermediary Relending Program and the REDLG program

## Revolving Loans Funds - funding

- RBEG grants typically are around \$75,000 to \$100,000
- RBEG grant cycle is approximately annual
  - One annual cycle of funds allotted to Indiana, and a potential second cycle during some years from un-used funds that come from other states
- Several counties have received funding with RBEG funds in more than one cycle

## Revolving Loans Funds - funding

- One Indiana county received funding from EDA
  - Grant dollars were greater than RBEG funds
  - Reporting requirement and lending controls are more stringent than USDA
- Many counties provided local match funds for RBEG from either local government, local foundation or self-financed from the LEDO's own funds
- One county mentioned that it has a micro-loan fund through OCRA

## Revolving Loans Funds - funding

- One community received substantially all of its RLF funding from local government
- When the loan fund suffered a loss, there was political flack from the perception of mistreatment of taxpayer resources
  - That RLF has been dormant recently as a result

## Revolving Loans Funds - funding

- RLFs that receive funding from non-local sources, such as state or federal agencies, seem insulated from public concern over losses
  - May be:
    - 1) a case of less public scrutiny (via Open Door Laws) and less public awareness; or,
    - 2) greater public acceptance of losses from non local “grants”
- RLFs are generally expected to make “risky” investments in borrowers who may not meet commercial lender creditworthy standards, and RLFs typically do expect to suffer higher rates of losses as a result

## Revolving Loans Funds - funding

- In terms of risk, CDFA counsels to expect losses of up to 20% or more when making “small” loans typical of those made in the Indiana RLFs that were studied

## Revolving Loans Funds – what businesses are eligible to receive loans?

- Various lending sources will potentially impose restrictions on what types of businesses may receive loans
  - EDA has focus on manufacturing
  - USDA RBEG is more flexible, fewer restrictions
  - Local funds can be the most flexible
- The LEDO will need to adhere to funding source requirements, as well as self-imposed standards
  - i.e., no tattoo parlors

## Revolving Loan Funds - customers

- Some examples of loans that have been made by Indiana RLFs
  - Buyout of a local tool-and-die shop
  - Bait shop
  - Trophy and plaque company
  - High end, custom furniture manufacturer
  - Quiznos sub franchise

## Revolving Loan Funds – lending practices

- Sources of funds can have an impact on what the RLF will make loans funds for
  - For example, federal funds can come with environmental strings attached that make land acquisition more complicated
  - USDA funds have areas in some counties not defined as “rural” and not eligible for use of RLF funds
- Most RLFs seem to broadly fund equipment acquisition, working capital, etc.

## Revolving Loan Funds – their product

- RLFs set range of size for loans they will make
- Most set lower threshold at \$5,000
  - One RLF set minimum at \$1,000
  - Most RLF loans are actually \$10,000 or above
- Most set upper threshold at ~\$50,000
  - One has \$60,000 upper limit
  - One RLF made a \$79,000 loan as a five year loan with a large balloon payment to facilitate cash flow
- Most loans fall into a \$10,000 to \$25,000 range

## Revolving Loan Funds – their product

- Loans are made at a wide variety of interest rates
- Most set a “prime minus X”
- Some vary the interest rate according to the perceived needs or ability of the business to repay
- Loans are typically made for three to five years

## Revolving Loan Funds – their process

- LEDOs are administrators for the RLFs
- Loan applicants in most counties have to have a business plan, may be required to take courses from SBDC before being approved for a loan
- Most LEDOs have committees that make loan approval decisions
- Most committees have heavy-to-exclusive membership dominance by local bankers

## Revolving Loan Funds – banker involvement

- Local bankers are heavily involved in most RLFs
- RLFs often are partners with banks in loans to businesses
  - Bank may bring an applicant that is marginally non-creditworthy; if RLF takes a second security position, the bank can reduce its risk, and lend to the local entrepreneur
  - RLF interest rate that is lower than the bank's rate can lead to a "blended" interest rate that is lower, better terms for the borrower

## Revolving Loan Funds – banker involvement

- Bankers can bring tools to the RLF loan evaluation
- Bankers have tools for assessing creditworthiness, may have access to benchmark financial information for business sectors
- Bankers can provide a significant marketing strength for the RLF

## Revolving Loan Funds – banker involvement

- On the negative side, bankers can bring a lack of loss tolerance
- Bankers may bring vested interests, conflict-of-interest

## Revolving Loan Funds – loan security

- This is the nightmare part for LEDOs
- RLFs do require collateral, but are more flexible than banks
- If a loan goes bad, in a joint funding with a bank, the RLF may get nothing
- If the RLF is the sole lender, collections are not fun
  - RLFs have to go to court to take possession of pledged collateral – cars, boats, equipment

## Revolving Loan Funds – job creation

- Documentation of job creation has been uneven among RLFs
- Across five funds with good records, apparent ratio of job creation is approximately \$5,000 lent for each job created
- No good numbers on total outside investment that has been leveraged; one RLF indicates ~10-to-1 in private investment

## Revolving Loan Funds –perceptions

- The RLF can be provide the LEDO with a positive image in the home community
- Most LEDOs felt that the fund was a public relations asset for their organization
  - Allows the LEDO to demonstrate that it doesn't just chase out-of-state businesses
- Can strengthen relationships with local bankers
- In counties with divergent growth patterns, can be a tool to help businesses in the slower growing portion of the county

## Revolving Loan Fund study

- Questions?