

Community Revolving Loan Fund

Description

In a sense, virtually all loan funds are revolving loan funds. That is, as the amounts loaned out come back to the fund, they will be used to lend out again. But for communities seeking a steady supply of financing for local businesses, a stress on the revolving aspect is important, ruling out the idea of drawing off any earnings for the operation of the fund. Moreover, whatever the original source of capital for the fund, the revolving feature also suggests that the capital is never returned but continues to be used in the community. This may imply that the capital has been a grant or gift rather than a loan.

Not planning on returning the capital to its funders is a feature that distinguishes the revolving loan fund from the **Community Development Loan Fund**, whose capital is generally re-payable, even if on very concessionary terms.

The central aim of CRLFs is to fill a gap in the business financing needs of the community, where there are credit demands that are not filled by conventional finance institutions like banks. Community-based revolving loan funds can be set up to be independent, or they can be administered as an integral part of a CEDO's business development/job creation program. The latter format is usual for Community Futures groups. In either instance, a precise definition of the target area provides the initial criterion for eligibility to access the fund. Other screening criteria may be established that limit clients to those in a particular industry, to microentrepreneurs, to youth, etc. Then, within the category of those eligible, clients are chosen under the risk/return policies of the CRLF. A CRLF may begin with just a general intent to finance local businesses or with a single special focus (say, forestry-related businesses). It may later on expand to create one or more other specialized funds (say, a youth entrepreneurship fund). Also, the CRLF may contract to administer specialized funds for government or private agencies.

Probably the oldest CRLF in Canada, the Colville Investment Corporation of Nanaimo, BC, was a separately incorporated subsidiary of a CEDO organized in 1975 with a grant from HRDC's predecessor federal agency. Now organized as the Community Futures Development Corporation of Central Island, it also administers two other funds, one in partnership with the Nanaimo Credit Union. A very specialized rural CRLF was established by a CEDO in Maine: Coastal Enterprises, Inc., capitalized a \$1.4 million fund to finance daycare centres, drawing grants from the Ford Foundation as well as state and federal government agencies. Coastal Enterprises, Inc., also operates other more general funds, including an equity capital company. The Community Futures Development Corporation of Strathcona (B.C.)

administers two of its own funds and four others on contract, one for the labour-sponsored Working Opportunities Fund and three for government agencies, both provincial and federal.

The scale of operations and lending of CRLFs can vary considerably, and unless it has a portfolio of perhaps \$3,000,000, it will require subsidies for its operating expenses. For example, the small-town or rural Business Development Corporations, as initially funded by the federal government, received up to \$1.5 million, but also received operating grants.

Any initial capitalization of the CRLF may or may not be added to at any time by fresh infusions from the same or other sources. Earnings are ordinarily expected to cover any losses so that the fund can continue operations, but if earnings are not expected to cover (or do not in fact cover) administrative costs, then those costs are usually expected to be underwritten by the loan fund's sponsor. In short, the intended (as well as actual) financial return from operations can vary from fund to fund.

The Strathcona CFDC mentioned earlier attacked the problem of declining federal funds for its small business lending by recruiting capital from B.C.'s Working Opportunities Fund (a labour-sponsored investment fund). Thereby Strathcona's scale of operations has increased with a resulting increase in earnings. WOF had excess capital to put to work and offered up to \$1 million to Strathcona for its small business lending (which is typically at prime plus three percent). The federal Western Economic Diversification agency pitched in with a \$200,000 loan loss reserve account at Strathcona, where the interest earned on that account could offset most losses (a fair assumption since the CFDC has achieved a historical loan loss rate of three to five percent). Strathcona will earn 40 percent of all the interest it charges on the \$1 million, with the other 60 percent going to WOF.

Benefits

The community maintains a source of financing directly targeted to the needs of its local businesses. Terms and eligibility criteria can be adjusted to local needs, rather than set by traditional requirements for profits or low-risk management or unrestricted public eligibility. Also, such funds do not have to conform to all sorts of legal regulation that banks, credit unions, and the like must abide by. In short, given the necessary prudence for sustainability, the CRLF can do just about anything that seems appropriate to it to provide credit to local businesses.

Major challenges

The significant challenge for all CRLFs is the same as for any development finance institution, namely, to balance its own institutional sustainability with its mission to fill a community financing gap. The record in the US of CRLFs is very mixed, with some funds clearly not able

to manage themselves without losses that threaten continued operations. Yet other funds manage to achieve the same loan/loss ratios as ordinary banks. The question is, again, does the CLRF that operates with a bank-level loan/loss ratio actually fill needed finance gaps, or is it merely making loans that would be made by any bank?

The Community Futures Development Corporations (CFDCs) administer a specialized Canadian version of the CRLF which is subject to the same potential mistake. However, an evaluation study of their performance indicates that, at least from the opinion of their loan clients, they have mainly made loans that banks would not have. This and other research suggests that the best performing CRLFs are going to be those associated with a comprehensive program of community economic development, in short, associated with an effective CEDO. Thus free-standing CRLFs will have a greater challenge to survive and continue good work.

Some practical steps

1. CEDOs and other sponsors of a CRLF must first determine carefully exactly what the development mission is for their projected fund. Merely to assume that it will fill a business lending gap is not enough. Sponsors must have a very clear idea of which gaps under what circumstances appear in the local lending scene, and then decide which of these identified gaps will be the priority targets for the CRLF. Such clarity is key to CRLF performance. Moreover, the choice of targets may be related to accessibility of capital for the CRLF. That is, some sources may have conditions on providing the capital - for example, that the CRLF serve microentrepreneurs solely. Other capital sources may have even more stringent requirements, ultimately tending to supervise all loan decisions.
2. Having matched likely capital to the general CRLF policy framework, the CEDO should approach the over-all design and organization of the CRLF in much the same way as a CEDO might approach any business that it sought to launch. (See [Community-Owned Venture Development](#).) That is, it must recruit the lead officer or officers, carry out close feasibility studies, and ultimately prepare a detailed business plan for the CRLF.

Resource organizations & contacts

The CFDCs and their Business Development Centres have their own provincial associations, which are likely sources of information and orientation to the tasks of the CRLF. In B.C.: Community Futures Development Association of B.C., #1607 – 1166 Alberni Street, Vancouver, BC V6E 3Z3 (tel. 604-681-7130, Ron Trepanier, Managing Director).

Publications

- ***Case Study:** “Capital, Community, and Jobs.” An overview of the range of actors and approaches (including CRLFs) being taken to increase capital for community economic development in Canada. For a more detailed description, consult the source of this article, *Capital, Community and Jobs: Local Solutions for Financing Investments in a New Economy* (Canadian Labour Market and Productivity Centre, 55 Metcalfe St., Ottawa, ON K1P 6L5, telephone: 613-234-0505).
- The Corporation for Enterprise Development has a detailed report on all revolving loan funds in Ohio, which is probably illustrative of those elsewhere in the U.S. It is available on its website (www.cfed.org).
- An abstract of the CfED study is available as an email issue of the newsletter published by the Community Extension Service, at the University of Wisconsin: CENewsletter, No. 270, April 1999. It is just one of a great many other useful items available on the website: www1.uwex.edu/pubs/ni/ni.cfm