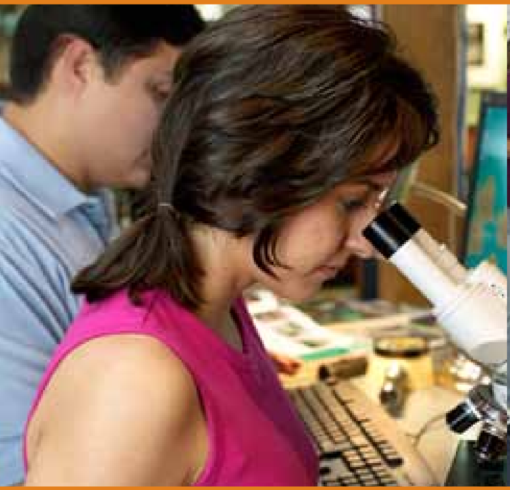
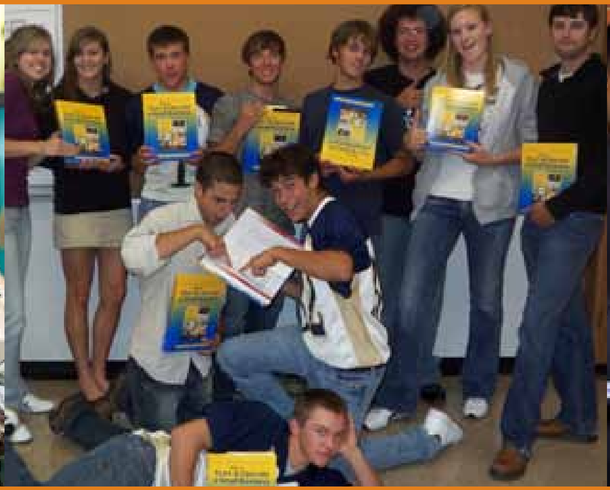
Public Sector Business Loan Funds

Views and Recommendations from Practitioners





A Joint Report of the
National Association of Development Organizations (NADO) Research Foundation
and the Development District Association of Appalachia
with support from the Appalachian Regional Commission, Bank of America
and the U.S. Small Business Administration

Public Sector Business Loan Fund Programs: An Introduction to the Report

The current economic downturn has created significant economic pressures for companies and entrepreneurs of all types, but America's small businesses have been especially hard hit.

While many parts of the various federal economic stimulus programs appear to have borne fruit, policymakers continue to struggle with the challenge of helping America's small businesses gain access to new sources of capital.

According to a May 2010 report from the Congressional Oversight Panel, the Troubled Asset Relief Program (TARP) has had little impact on easing the small business credit crunch. Despite the creation of TARP, the American Recovery and Reinvestment Act (ARRA), and several new U.S. Small Business Administration programs, the actual volume of bank lending to small businesses continues to decline.[1]

Although these trends have a variety of causes, no single solution will ensure a reverse in course. It is clear that the United States will need all hands on deck as it seeks to address the small business credit crunch challenge. As federal policymakers consider new solutions, they should tap into a long-standing and reliable resource: the national network of federally designated and capitalized revolving loan fund (RLF) programs.

These RLFs—which may be more appropriately referred to as public business loan funds—have been in operation for decades and are an important but poorly understood source of small business finance, especially in small metropolitan and rural America.

In an effort to improve the understanding of the public business loan fund industry, the National Association of Development Organizations (NADO) Research Foundation and the Development District Association of Appalachia (DDAA) sponsored a convening of the nation's leading loan fund professionals in May 2010. The group met in Cooperstown, New York to address a number of critical issues, including:

- How can public business loan funds, including those managed by regional planning and development organizations, become a more important part of the small business finance landscape, especially in distressed and underserved regions of the country?

- What is the market niche for these funds? How do they align with other private and publicly-backed business and entrepreneurial investment tools?

- What policy and regulatory changes are needed to help strengthen the industry, including expanding and modernizing federal programs to allow investments in knowledge-based firms and regional asset-based development strategies?

This report summarizes the discussions generated by these questions. It provides a brief introduction to the public business loan fund industry and its evolution over the past several decades. It examines how the field should be reformed to help expand its impact in terms of financing small businesses and entrepreneurs.

Finally, it reviews critical federal policy changes that are needed to ensure public loan fund managers can provide investment products that more effectively serve the needs of new and growing businesses. •

Real World Impact on America's Small Businesses and Entrepreneurs

Four employees from a shuttered steel company in Appalachian Ohio created a new firm, Control Design Integration, Inc., with assistance from Buckeye Hills-Hocking Valley Regional Development and a public-private consortium of regional and local partners. Recognizing the expertise of the displaced steel company workers in instrumentation, fabrication, communications and safety, the informal partnership helped package a $248,000 deal that ultimately allowed the four original owners to start and grow their firm into a worldwide business with 35 employees.[2]

Leasa Industries Company, Inc. was established in 1977 in one of Miami-Dade County's poorest neighborhoods in South Florida. It has grown to become the largest grower of bean and alfalfa sprouts and one of the largest manufacturers of tofu in the State of Florida. The company's products are available throughout Alabama, Florida, Georgia, South Carolina, Tennessee, the Caribbean, and even Alaska.

Leasa employs more than 90 employees and hires from within an empowerment zone in Miami-Dade County known as Liberty City. Many of their employees are mothers on welfare and ex-convicts from the area who the company assists in their efforts to create a better quality of life.

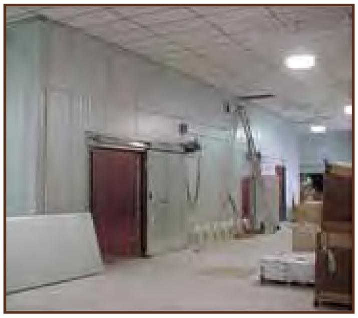
This company has been recognized nationally for their accomplishments and involvement in the community. The South Florida Regional Planning Council's Revolving Loan Fund assisted Leasa with working capital after the development of their new 30,000- square-foot facility. Today, the company has gross revenues of more than $7 million.

In 2003, North Wind, a six-year old, Idaho-based firm, wanted to finance a new building for its growing environmental and hazardous materials reporting-based consulting and research activities. However, the local firm was struggling to secure a traditional bank loan by itself.

The East Central Idaho Planning and Development Agency (ECIPDA) and its SBA 504 CDC affiliate, The Development Company, assisted the group with financing for its building expansion plans. With an improved and modern facility, North Wind tripled its workforce and increased its annual sales to over $23 million.

Basics of an RDO

The nation's 520 regional planning and development organizations (RDOs) work to strengthen local governments, economies and communities through regional collaboration, strategies and partnerships. As public-based entities governed by policy boards of local elected officials, along with private sector and community representatives, these entities often focus on developing and implementing comprehensive economic development strategies. For many RDOs, this includes the administration and management of various federally funded business development finance programs and loan funds.



Above: Original site of Holley Sweets baking company in Alabama. Center and Below: New baking facility with modern equipment such as German baking ovens and state-of-the-art walk-in freezer.

The key to public business loan funds capitalized with federal funds is that they are designed to complement private sector lenders and investors.

Holley Sweets, a small bakery in rural Alabama, first received business planning and finance assistance from the Southeast Alabama Regional Planning and Development Commission (RPDC) in 1996. This small business began baking flavored cakes in a small house using two stoves and selling them on a limited route of small grocery and convenience stores.

In 1997, the RPDC provided a microloan to the business, which had grown to nine employees, for working capital. Steady growth continued, and in 1998, the RPDC lent the company $10,000 from its EDA Revolving Loan Fund (RLF), allowing the bakery to nearly double its workforce. The company needed more space, a larger freezer and loading dock, so in 2001, a new 15,000 sq. ft. bakery facility was constructed with financing from a variety of sources. The packaged deal included $125,000 from the RPDC's EDA RLF, $170,000 in a traditional bank loan and $450,000 from USDA's REDLEG loan (a lending program associated with rural electric cooperatives).

The company's sales soon jumped to over $1 million and its workforce expanded to 65 employees. In 2007, the South Alabama RPDC advanced another EDA RLF loan of $36,000 for new equipment. Today, the company's annual sales are in excess of $1.5 million.

Real world stories like these are made possible every day across America with gap financing, seed capital and technical assistance from public business development finance intermediaries. However, many of the programs need to be updated for the modern economy. •

The Public Business Loan Fund Landscape

A host of federal agencies invest in business loan funds that are managed by state, regional and local intermediaries, including many of the nation's 520 regional planning and development organizations.

The vast majority of these public business development lending and technical assistance programs originated with funds from the U.S. Department of Agriculture (USDA) Rural Development, U.S. Economic Development Administration (EDA), U.S. Housing and Urban Development's (HUD) Community Development Block Grant (CDBG) program, and the U.S. Small Business Administration (SBA).

Most of these important gap financing and seed capital lending programs have been operating since the 1970s. Both HUD's CDBG Program and EDA's Revolving Loan Fund (RLF) program started in 1975. While most of USDA's business finance programs were also launched in the 1970s, its Intermediary Relending Program (IRP) was first opened for business in 1985. Programs focused on microloans began in the 1990s at SBA, and a new rural microloan program is currently being launched by USDA Rural Development.

Each of these federal business finance programs are typically targeted at a specific type of lending, population demographic, and/or mission and purpose such as job creation and retention in distressed areas, minority business development, community development (e.g. housing), rural development, post-disaster economic recovery, or in response to a sudden and severe event such as plant closure or industry downsizing from global trade.

In addition, the U.S. Environmental Protection Agency (EPA) has an RLF program focused on brownfields redevelopment, the Appalachian Regional Commission (ARC) has made investments in RLFs and other finance ventures across its 13-state region for decades, and the U.S. Treasury Department hosts a vibrant lending, technical assistance and tax credit program for Community Development Financial Institutions (CDFIs) and other related community development entities.

Because few of these programs have been expanded or updated in recent years, comprehensive data on the extent of federal investments is very difficult to access and analyze. In addition, much of the federal investment,

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Risk-Rewards of Entrepreneurship

In the Redding region of northern California, a manufacturer of high-end surveying equipment has been a long-standing partner and client of the Superior California Economic Development District (EDD). In the early 1980s, the firm was launched as an offshoot of a long-time surveying equipment sales company based in Sacramento. In 1989, the Superior California EDD provided a matching loan of $60,000 to the 10-employee firm after it emerged from Chapter 11 bankruptcy to purchase state-of-the-art equipment and machines.

By the early 1990s, the firm was expanding rapidly, yet it continued to struggle financially. In 1995, the EDD used its SBA 504 Development Company to partner with a local bank to help the company purchase a new building and expand to 40,000-square-feet. Two years later, the EDD provided an EDA RLF loan of $100,000 for the manufacturing firm, now at 60 employees, to purchase tooling and materials for a new product line.

By 2000, the firm had established sales offices in Mexico City, Brussels and Bejing, China, and had grown to 130 employees at its Redding plant. In 2008, the business was sold to Trimble Navigation. While the Redding plant was downsized in 2010 due to the global economic downturn, this example demonstrates the long-term relationships, commitment to mission and risk management that public loan fund operators must balance with their lending portfolios.

especially via HUD's CDBG program, flows through state or local agencies, limiting our ability to evaluate and capture the full scope of federal investments in public business loan funds.

The latest in-depth studies of these programs date to the early 2000s, and clearly need to be updated. Yet, even these older figures suggest that public business loan funds often manage sizable portfolios. For example, a 2002 study of HUD-backed third party loans found that funding reached $2.2 billion over the course of the 1990s.[3]

As of March 2009, 578 separate EDA-backed RLFs (operated by 450 different grantees) were operating in the U.S. These funds managed a combined capital base exceeding $852 million.[4]

According to a 2009 national survey by the National Association of Development Companies (NACO), 137 of the nation's 260 SBA 504 Certified Development Companies (CDCs) reported that they have invested more than $30 billion in SBA 504 CDC financing to more than 66,000 small businesses. When combined with their other lending tools, these CDCs have provided over $42 billion of financing to more than 128,000 small businesses.

Finally, USDA's Intermediary Relending Program (IRP) is one of the few sources of fixed rate, term financing available to small rural businesses for working capital, lines of credit and equipment.

As noted by Lee Beaulac of the Pathstone Corporation at a July 20, 2010 hearing of the U.S. House Agriculture Committee, "USDA has some 400 intermediary lenders participating in the program, and these lenders have made over $700 million in IRP loans to rural businesses across the country."

He also noted, "A typical intermediary revolves IRP funds three times over the life of the 30 year loan to an IRP lender, which means that every dollar in federal funds lent to an IRP intermediary translates to $3 lending to rural business."[6]

The key to public business loan funds capitalized with federal funds is that they are designed to complement private sector lenders and investors. Most importantly, they provide the gap financing and seed capital to make these deals a reality in underserved and distressed areas.

Without the portfolio of federal loan funds, most local businesses and entrepreneurs would lack the necessary access to affordable, dependable and flexible capital in impoverished regions. •

How Do Public Business Loan Funds Work?

Most public business loan funds are operated by regional planning and development organizations, community-based nonprofits or government entities including state agencies, local governments and local development corporations.

The funds are initially capitalized via federal grants or loans (in the case of the USDA IRP program), along with local matching funds. Federal funds are used by intermediaries to provide loans to borrowers, and in some cases, also allow loan fund operators to offer hands-on technical and business planning assistance.

Most funds have been established in areas of severe or sustained economic distress, whether regionally, locally or even targeted at the neighborhood level. A number of revolving loan funds have been created in recent years to assist businesses as they recover from major natural disasters such as the 2008 floods in the Midwest and the series of hurricanes along the Gulf Coast in the past decade.

While each federal program has varying operating requirements, programs such as EDA's RLF program only allow intermediary operators to use interest earned on loan investments for operating costs, thereby prohibiting them from using the original federal investment for RLF administration and staffing.

These funds are referred to as revolving loan funds because the initial investments "revolve." RLF operators lend money to businesses. When the borrower repays the principal and interest to the RLF, these dollars are reinvested in new deals, and the cycle continues. In many cases, the initial federal and local funds used to capitalize an RLF have revolved multiple times.

Business loan funds assume a variety of forms. A number of public loan fund intermediaries across the U.S. have built sizable capital pools by establishing and maintaining a diverse set of loan fund programs from multiple public (federal, state and local) and private (philanthropic, industry and corporate) sources.

At the same time, loan funds may be quite small, with an RLF operator managing one grant from a single federal agency. Studies from the late 1990s suggest that the median RLF size at that time was $500,000. While many of these smaller loan funds

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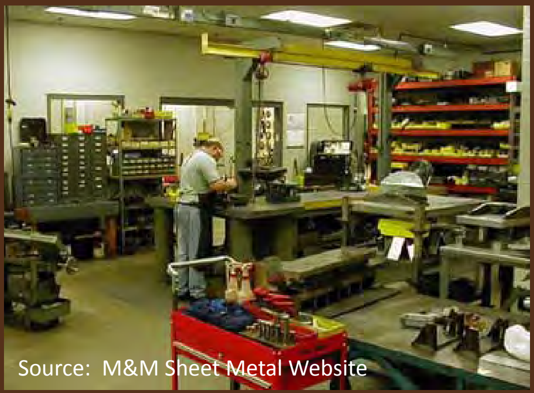
have enjoyed great success, their small size and targeted use of funds can limit their local impact if not properly managed, marketed and coordinated with other lending and economic development resources.

Some of the more successful public loan fund intermediaries manage and offer their local businesses and entrepreneurs a menu of lending sources and tools. These include investments from federal agencies, state sources, and even local investors such as local governments, community foundations and private sector industries (e.g. energy and utility companies, hospitals). These organizations gain many benefits from this increased scale. They have sufficient resources to recruit and maintain professional staff, to market programs, and to build efficient back office operations. They also command a wider range of financing tools which they can combine in ways that assist borrowers and achieve important local development outcomes. •

Packaging Deals, Matching Needs with Funding

M&M Sheet Metal, founded in 1979 in Williamsport, Pennsylvania, provides sheet metal fabrication to industrial, contracting, machine shop and manufacturing businesses. The company has received three loans from SEDA-COG, an RDO designaged as an EDA Economic Development District and an ARC Local Development District.



Source: M&M Sheet Metal Website

In 1991, the company received a $60,000 Small Business First loan for an expansion of their manufacturing facility. In 1992, they received a $33,000 ARC RLF loan for the purchase of equipment. Both loans were paid off with all conditions being met. Most recently, the company received a $200,000 Small Business First loan for the purchase of more extensive equipment in September 2009. The latest project involved the purchase of a laser cutting machine, which brought this aspect of their business in-house. They are also working with the SEDA-COG Procurement Technical Assistance Center to research and explore available government contracts that deal with laser cutting of parts.

M&M Sheet Metal currently has 14 full-time and two part-time employees, a significant amount in this rural region. By managing the laser cutting of parts internally, the company is now positioned better to retain its existing employees. With the new equipment, the company also expects to add new business and is planning to hire additional employees in near future. The small business loans from SEDA-COG have greatly improved the company's manufacturing capabilities, and since 2006 they were able to increase their revenue by 29 percent.

Long-Standing Partnerships

Wadal Plastics, Inc. was founded in 1988 by Dale Bauman as Bauman Machine and Tool. Wade Cullen joined Dale in 1989 and formed a partnership known as Wadal Plastics, Inc. The initial operation began with one molding machine and one customer. Sales for 1989 totaled $96,400. Robert Lang joined the ownership in 1992. Sales had grown and a 7,900-square-foot manufacturing facility was purchased by BWD (Bob, Wade & Dale) as part of the expansion.

The Northwest Wisconsin Regional Planning Commission (NWRPC), through its lending arm Northwest Wisconsin Business Development Corporation (NWBDC), provided a $54,000 EDA RLF loan to the business to purchase two additional plastic injection presses. The total cost of the expansion project was $220,000, with the remaining funds coming from owner equity and the Mid Wisconsin Bank.

In 1992, sales reached $400,000 and the business had seven full-time employees. The company continued to grow, and in early 1994, it expanded by purchasing additional presses and auxiliary equipment, along with a new credit line for working capital. This $293,000 expansion was financed by the Mid Wisconsin Bank, owner equity and NWBDC's EDA RLF. By 1994, sales for the company had grown to $1.5 million and its workforce had doubled.

Sales for the business continued to grow, and by the spring of 1995, the company needed to expand for the third time. NWRPC, with the assistance of the Wisconsin Department of Development, structured a deal that nearly tripled the firm's manufacturing space, doubled the number of injection molding presses, added an additional $200,000 of working capital and doubled the firm's workforce to 36 full-time employees.

As part of the expansion, NWRPC assisted the City of Medford and the business in obtaining a $350,000 HUD small cities Community Development Block Grant (CDBG) from the state. These resources, which were essential for equipment upgrades and working capital, were matched by another $150,000 for equipment from NWBDC's USDA Intermediary Relending Program (IRP) and $1.1 million from the Mid Wisconsin Bank/SBA. In addition, BWD, Inc financed the 14,400-square-foot building expansion privately.

In 1996, NWRPC assisted the business and the City of Medford in amending the CDBG Contract to provide more favorable loan terms from the City to the business when the business lost a major customer. The amended CDBG loan terms and associated private financing restructuring allowed the business sufficient time to diversify and increase its customer base allowing the firm to not only meet its financial obligations but also to exceed its employment goals. The repayment of the CDBG loan allowed for the creation of an innovative community venture fund that has helped finance further economic development in the area.

The business consolidated its operations in the City of Medford in 2009, creating the need to find additional space. NWRPC provided additional warehouse space in its Medford Enterprise Center, funded in part by EDA. With the relocation into the Medford Enterprise Center, the firm was able to expand its main plant and create 30 additional full-time jobs, bringing the total to over 60 full-time employees in this rural part of the state. •

Business Finance Marketplace: Where Do Loan Funds Fit In?

When public business loan funds were first established, the small business financing landscape looked completely different than it does today. At that time, banks were often the first and last recourse for business owners. While many entrepreneurs and small business owners were fortunate to have strong partnerships with community banks, new entrepreneurs and business owners operating in new industries or those located in less competitive finance markets such as inner cities and rural areas often faced major challenges in accessing needed capital.

The business finance landscape has improved immeasurably since the 1970s and 1980s. At that time, the U.S. venture capital industry was tiny, there were few organized angel investors, and only a handful of community development financial institutions and public-based RLFs were in business. Today, a whole range of both equity and debt financing opportunities are in place, and new tools, such as new microloan resources or Web sites like Prosper.com, seem to be emerging every day.

The emergence of the Community Development Finance Institution (CDFI) industry has played an important role in changing the marketplace, especially for community development and housing.

In many ways, public business loan funds were the first CDFIs. Yet, as public funds dried up in the 1980s and 1990s, most CDFIs opted to obtain capital from other sources. Today, the CDFI industry, which has grown to include at least 365 funds with $4.6 billion in assets, largely consists of funds created with private investments (and by the Treasury Department's CDFI program).*

Public business development loan funds can fill a critical capital gap in these instances. In many cases, their funding is used to supplement capital accessed from private sources.

**Editor's Note: Under current federal law, the U.S. Treasury Department's CDFI program prohibits public nonprofit entities such as regional planning and development organizations (e.g. EDA Economic Development Districts, ARC Local Development Districts, regional councils of governments and regional planning commissions) from serving as federally funded and designated CDFIs, even though these entities are often experienced and vital players in business development finance in underserved and distressed areas of the nation.*

While the industry has changed greatly, public business loan funds still fill an important niche. They were designed to be, and continue to serve, as gap fillers. Wherever possible, small business owners and aspiring entrepreneurs should seek capital from existing private investment sources. But these funds may not be readily available if the entrepreneur has a limited track record, a poor credit history, insufficient collateral, or is pursuing an idea in an unproven market.

Business loan funds can fill a critical capital gap in these instances. In many cases, their funding is used to supplement capital accessed from private sources. The business loan fund dollars can help lower the overall risk for private investors, and thus permit business expansions or projects that would have been impossible but for the public investment, especially in underserved and distressed areas.

In addition to filling capital gaps, many business loan funds offer a better deal to the customer. Most loan funds charge lower fees and offer more competitive loan rates for riskier businesses. Most importantly, business loan funds are willing to be more creative and flexible when working with customers since they are public service oriented or mission driven rather than stock holder or shareholder investment driven.

This flexibility is a critical competitive advantage for public business loan funds. They can be more innovative in terms of packaging deals and can invest in cutting edge deals that are deemed too risky for banks and other investors. Most importantly, most public business loan funds are designed to partner with banks and other private sector lenders.

The final benefit of these programs is that they have a primary focus on supporting local economic development, whether local wealth creation or job creation and retention. Loan fund managers look for good deals, but their definition of "good" is often different from traditional investors. They need and want to be repaid, but they also want to back firms that stay anchored in the community, creating jobs and economic opportunities into the future.

Two decades of data confirm that loan funds are achieving their goal of promoting the double bottom line. These funds:

• **Create Jobs:** EDA-backed RLF loans have helped create more than 280,000 jobs over the program's lifetime.[7]

• **Build Businesses:** Despite being located in distressed communities and operating with limited capital, firms backed by HUD investments

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Source: Boyd Station Website

VALUE-ADDED AGRICULTURE PRODUCTION

Boyd Station, LLC has been an active client of the SEDA-COG in central Pennsylvania since 2004. The company was established as a grain transfer facility along the Canadian Pacific Rail line in 2003.

Bryan Cotner developed the business as an agricultural commodity distribution facility. The company receives commodities via rail and distributes by truck to area feed mills and local farms. The processing center provides three value-added products: soybean hulls, soybean oil, and extruded and expelled soybean meal. The value added products are sold to feed mills and soy food processors.

SEDA-COG has provided Boyd Station, LLC with a variety of services that have helped the business to be more productive and profitable since 2004. In 2008, for example, SEDA-COG assisted the company in purchasing additional soybean processing equipment and making building improvements at their current facility.

Boyd Station received a $200,000 Small Business First loan in 2004. In 2009, the company received a $100,000 Tri-District EDA RLF loan, along with a $100,000 EDA RLF loan and a $200,000 FIF-AG loan from SEDA-COG. All payments have been made as agreed and all covenants are being met.

Over the past five years, the company's net sales have increased by 135 percent. The company has doubled its job creation with the funding since 2004 and now employs 16 people, making the firm an important employer within this rural area of the state. •

have survival rates equal to national benchmarks.

- **Leverage Other Investments:** Each HUD CDBG-backed loan attracts an additional $2.69 in private investment.[8]

- **Serve Distressed Regions:** Federal business loan programs typically operate in communities where the unemployment and poverty rates are significantly higher than national averages, including RLF programs capitalized by the Appalachian Regional Commission and EDA.[9]

- **Serve Underserved Customers:** About 25 percent of HUD CDBG-backed loans support minority entrepreneurs.[10]

- **Serve Underserved Rural Regions:** Business loan funds are a capital lifeline in rural America. A 2007 study of Appalachia found that RLFs were the second most important local source of business finance behind bank lending within its 13-state region.[11] •

Moving Forward: Prevailing Issues Facing the Industry?

While public business loan funds represent a sizable pool of capital, they are a greatly underutilized asset by federal policymakers in the current economic downturn.

The total federally supported loan pool is quite large and has had a substantial impact. Yet, in many ways, the programs have been frozen in place for the past decade. For example, EDA's leadership opted to capitalize or recapitalize fewer than a dozen RLFs in the mid-2000s, and only recently started making new RLF investments as part of its 2008 disaster supplemental assistance programs. Funding for HUD and USDA programs faced cuts in the past decade, with only modest increases in the past few years.

In addition, many of the new federal lending tools are often targeted at specific industries or geographies, such as renewable energy, rural microenterprise development, brownfields revitalization or value-added agriculture production.

There is a pressing need for broader federal development investment tools that help regions and local communities leverage their local assets and strengths, whether it is cultural and heritage tourism, advanced service sector industries, software and technology development and other high growth sectors and industries.

In a March 2010 report on global economic competitiveness, the McKinsey Global Institute noted that the service sector has contributed 87 percent of GDP growth in developed countries since 1985. Within the United States, we need to provide more flexible entrepreneurship and business development tools that are geared toward the modern global economy, including leveraging the knowledge-based and asset-based advantages of our local firms and entrepreneurs.[12]

We must overcome the reality that budget cuts have been accompanied by overall neglect of federal program operations. Existing federal program and oversight staff too often have limited access to professional development opportunities, new staff hires have been limited, and loan fund rules and regulations have not been updated sufficiently to account for major changes in the financial marketplace, let alone the emergence of new knowledge-based industries as well as

Saving An Essential Regional Asset

Doug and Wendi Hatlewick, with the assistance of the Northeast Council of Governments (NECOG) Development Corporation and another revolving loan fund, were able to seize the opportunity to become small business owners when their local grocery store, Leola Grocery, in rural South Dakota suddenly came up for sale. Wendi now works full time at the grocery store and has the flexibility she needs with their children. Leola Grocery employs six part-time employees and also offers fresh cut meat, preventing local residents from needing to drive significant distances for this staple. As Doug and Wendi were able to purchase the grocery store while it was still operating, the community was able to retain one of their most important assets.

A & O Sports in Hood River

Antoniuis (Tony) Kardol of Hood River, Oregon recently purchased the Roberto Ricci Designs North American distributorship of windsurfing and stand up paddle products, with support from a business loan from the Mid-Columbia Economic Development District (MCEDD). Tony has extensive experience in the windsurfing industry as an instructor, center manager and general manager of Vela Resorts, Inc.

Roberto Ricci Designs manufactures a full line of top quality windsurfing, stand up paddle and surfing equipment. Tony obtained financing from CenterPointe Bank to purchase this distributorship and obtained a loan from MCEDD to purchase additional inventory due to his initial success of establishing additional dealers and selling inventory quicker than originally forecasted. Operating as a sole proprietorship, under the name A & O Sports, Tony works with his wife Natalie to operate the business. He also received business consulting from the Small Business Development Center at Columbia Gorge Community College.

reliance of many small towns and rural areas on tourism and service sector businesses. As a result, a large number of existing loan funds sit idle at a time when demand for credit and capital is extremely high.

While almost all loan fund intermediaries could benefit from improved marketing and management, the vast majority of regional loan funds appear to have sound leadership, operations and partnerships with traditional banks and other lending sources.

Public business loan funds regularly invest in local business and have become an important part of the local business landscape. Yet even these effective public intermediaries seem to be operating with one hand tied behind their backs.

Why? Because most of the current federal loan programs still operate via regulations and cultures that were designed in the 1970s and 1980s. The old program rules may have made sense in the old economy where manufacturing firms were dominant local players and the pace of business change was less rapid. At that time, few other sources of business finance were available in many smaller metropolitan and rural communities, so publicly backed loan funds were often the only game in town.

Today's market characteristics are different. The pace of change is more rapid, and a significant share of businesses are now focused on service, retail or knowledge-related sectors.

At the same time, a whole host of other financial tools are in place. While the rest of the business financing world is operating in the 21st century, public business loan funds are too often operating with antiquated federal rules, regulations and reporting requirements. These rules create unnecessary bureaucratic hassles for loan fund managers, but, even worse, they limit access to hundreds of millions of already-appropriated funds that could be used to support small businesses and entrepreneurs across the United States.

For example, USDA IRP lenders with a proven track record often operate multiple IRP funds. When IRP intermediaries establish a new loan pool, USDA officials must still approve the first round of loans made from the IRP even though the intermediary already has a sound record of high performance. This slows down the intermediaries' loan approval process for their clients and is an unnecessary burden.

NADO-DDAA retreat participants stressed the importance of putting available public business loan fund resources to work.

By making a modest number of policy and programmatic changes, we could make a significant difference in terms of generating greater interest and market demand for loan fund investments. In particular, focus group participants recommended:

1) Strengthen Local Control of High Performing Loan Funds

Many revolving loan funds, especially those funded by EDA, were first capitalized in the 1970s and 1980s. By definition, these RLFs provide loans that revolve, i.e., interest and loan payments are used to replenish the initial loan pool. For many of these older loan funds, the initial investment has revolved multiple times. In other words, a loan was repaid, funds were re-lent, repaid, re-lent again, and so on.

Because these loan funds revolve and can be used to fund multiple businesses, they provide a substantial benefit from the taxpayer's perspective. But, at some point, it makes sense to sever the federal link. Once the initial federal investment has been paid back and recycled multiple times, these dollars should be "de-federalized." In other words, federal oversight and reporting requirements should be ended to allow for more local autonomy and control.

We recommend that all federally backed revolving or business loan funds, including EDA and ARC, be de-federalized after a period of seven years, assuming the federal funds have fully revolved at least twice and were used appropriately.

This move has multiple benefits. It removes significant administrative and paperwork burdens from both local economic development officials and federal agency staff. At the same time, it will help ensure that these already obligated dollars are put to work in communities, including for more modern investments and more closely in line with regional and local economic development strategies and priorities.

2) Encourage Voluntary Loan Fund Consolidation and Streamlined Funds

Many regional and local loan fund intermediaries operate multiple RLF loan pools, both from various federal sources and from a single federal agency. Meanwhile, some RLF lenders may be focused on responding to a specific event and/or type of lending and community and therefore only operate a single-purpose loan fund.

Studies from the late 1990s suggest that the median RLF portfolio falls in the range of $500,000. In some smaller communities, these small loan funds can have a significant impact.[13]

Key Focus Group Findings:

- *Strengthen local flexibility and control of RLFs, especially for high performing loan funds*
- *Encourage voluntary loan fund consolidation and streamlined administration of funds, especially if intermediary manages multiple RLFs from the same funding agency*
- *Modify current rules and regulations to reflect today's modern economy and realities, particularly with respect to technology and knowledge-based firms*
- *Improve federal interagency collaboration and reporting requirements*
- *Dedicate federal resources to recapitalize public business loan funds with proven performance history and accountability*

Where possible, federal agency officials should be authorized, trained and encouraged to work with regional and local loan fund intermediaries to support the merging or consolidation of multiple RLFs managed by intermediaries within an individual federal program (i.e. EDA RLFs, HUD CDBG and USDA IRP).

However, in many cases, these funds are too small to have a substantial impact, lack proper management capacity and/or are too limited in their authorized use and purpose.

Where possible, federal agency officials should be authorized, trained and encouraged to work with regional and local loan fund intermediaries to support the merging/consolidation of multiple RLFs managed by intermediaries within an individual federal program (i.e. EDA RLFs, HUD CDBG and USDA IRP). We also support giving intermediaries the flexibility and authority to voluntary consolidate smaller loan funds into larger regional investment pools, while retaining local involvement and oversight.

These larger multi-county loan fund pools would allow for the efficiencies associated with economies of scale. They would also reduce federal paperwork requirements for grantees and allow loan fund operators to amass the organizational and professional resources needed to support more professional management and staffing of public-based business loan funds.

In Wisconsin, for example, the state CDBG office, two regional planning commissions and more than two dozen local funds worked together to consolidate smaller, local CDBG RLFs into more productive regional loan funds.

In Florida, the South Florida Regional Planning Council (RPC) worked with three local EDA RLF operators to transfer management of these struggling and underutilized loan funds to the regional economic development district. Today, the combined funding for the four RLFs is $8.2 million. The South Florida RPC is using these funds to create new jobs, as well as increase private and public sector investments in its distressed areas. In recent years, the group has helped retain and create more than 1,200 jobs while assisting more than 54 small businesses with seed capital and gap financing. They have loaned out more than $9.4 million and leveraged more than $17 million in additional public and private sector investments.

3) Modify Current Rules and Regulations to Reflect Today's Modern Economy and Realities

Public business loan fund operators support the need for federal standards, conditions and performance requirements, especially during the start-up phase of an individual fund. However, federal oversight agencies should work with RLF intermediaries to make better use of federal reporting data, update lending conditions and requirements to allow for more local flexibility and innovation, and evolve RLF strategies and investments for effectiveness in our nation's growing knowledge, service and technology sectors.

For example, federal lending programs such as EDA RLFs, USDA IRP and HUD CDBG need to be modified and updated to allow intermediaries to partner and participate in deals with non-traditional forms of collateral and assets, especially with new and emerging forms of knowledge-based, service sector and technology industries.

We recommend that the White House convene a federal working group, along with a small group of professional loan fund managers and practitioners, to lead an in-depth review of the major RLF programs, including regulations, program guidelines, reporting requirements and grant management systems. This working group, chaired by the EDA Assistant Secretary, would develop a strategic plan for updating and streamlining current program requirements, which can then be submitted for consideration by Congress, Office of Management and Budget, and key federal agencies. This would include identifying ideas for supporting common reporting forms and systems.

Rural Firm with Global Reach

Big Equipment Company, located in Havre, Montana, strives to offer its customers the most versatile tractor configuration that allows them to meet the demands of today and the future by rebuilding a custom-built piece of equipment with any horsepower and application requirement the customer may need. Since opening its doors in 1994, the company has grown from one employee and $200,000 in sales to 15 employees and over $4 million in sales.

This rural-based company has tapped into the lending resources and technical assistance programs of the Bear Paw Development Corporation to grow into a local company with a global reach. Today, the company supports over 500 tractors performing customization work for companies and individuals in Australia, England, Canada, New Zealand, Middle East, Africa, South America, Philippines and the United States. Ron Harmon, owner of Big Equipment Company, was named the 2008 Montana Exporter of the Year by the U.S. Small Business Administration. Harmon noted, "Without the support of Bear Paw Development, I would not be in the position that I am in today, and for that, I have a lot of gratitude."

Source: Big Equipment Company Website

Bear Paw Development Corp has used its various loan programs, including USDA Rural Development's Intermediary Relending Program (IRP), EDA RLF funds supplemented with CDBG funds, and Montana Department of Commerce Micro-business loan funds, to meet the financing needs of Big Equipment over the years. The loans have been repaid and then lent out again as Big Equipment continued to grow. Bear Paw's SBDC program has assisted the business with SBA applications, technical assistance and access to worker training programs over the years. •

Cash Flow for Business Growth

In 2009, the Southern Georgia Area Resource Development Agency (an affiliate of the Southern Georgia Regional Commission) participated with the First State Bank of Valdosta on a loan to a custom chemical formulating, processing and packaging company. The company, in operation since 1997, had run out of room in their original plant and needed to grow. The request involved the purchase of a 10-acre site with a 100,000-square-foot industrial building, renovation of the building and the purchase of long life equipment.

The total project cost was $1.625 million and at least 10 to 15 new jobs were created. The equipment and building are being utilized to aid in this chemical company's expansion into three areas: Herbicides, Green Technologies and Bio-technologies. According to the owner, entering into these three areas would generate around $1 - 2 million in additional gross revenues in 2010, with around $600 million in new expenses with the addition of approximately 10 to 15 new employees. The expansion into the herbicide market will allow for future expansion of lines and workspace for additional employees. •

4) Improve Federal Interagency Collaboration, Capacity Building and Research

Most loan fund managers operate programs that use funds from multiple federal sources. The National Association of Development Companies (NADCO) reported in 2009, for example, that 137 SBA 504 CDCs have provided over $30 billion in SBA financing to more than 66,000 small businesses. These same entities provided another $12 billion in financing to more than 128,000 small businesses by leveraging their other public and private lending tools.[14]

These multiple funding streams help regional and local intermediaries address the specific needs of local businesses and entrepreneurs. While we support improved federal coordination across these various programs, we also discovered that many intermediaries have developed more innovative and effective lending and technical assistance programs by tapping into the broad portfolio of federal business lending programs.

We recommend that the key federal agencies—ARC, EDA, HUD, SBA, Treasury and USDA—convene an interagency working group to research and explore noteworthy practices and innovations in the public loan fund industry, especially related to the professional development needs and program performance measurements of these programs.

5) Recapitalize Public Business Loan Funds with Proven Performance History

Federal agencies should reserve and dedicate resources to capitalize new funds and recapitalize existing funds managed by regional intermediaries with a strong history of performance and accountability. These intermediaries with a record of putting federal dollars to work and helping to fuel business growth and new employment opportunities should be rewarded and given stronger preference for new funding. •

Intermediaries with a proven track record of putting federal dollars to work and helping to fuel business growth and new employment opportunities should be rewarded and given strong preference for new funding.

Modernizing the Industry: The Other Side of the Equation

Public business loan fund managers operate in a complex and difficult environment. Their efforts are worsened by arcane rules and regulations that create paperwork burdens without contributing to sufficient corresponding performance improvements. Updating regulations and improving program management from the federal level will make a big difference, but industry leaders must also be committed to improving the self-governance, peer accountability, performance measurements and professional standards of the industry.

As federal policymakers and program managers modernize the industry's core rules and regulations, the public business loan fund industry must also work to modernize and update its internal operations. In effect, federal policymakers and loan fund managers should commit to a grand bargain that combines regulatory streamlining and new federal investments with a local commitment to more advanced operations, management standards, and lending and technical assistance practices.

From the perspective of RLF industry leaders, this effort should involve the following activities:

1) Develop Professional Standards for Public-Based Loan Fund Operations

Leaders in the industry should convene a working group to develop standards for effective loan fund management and operations. These standards should be used to assess performance, benchmark funds against one another, and professionalize the field. Where possible, these standards and procedures should be based on best practices used in the mainstream financial industry, as well as based on established training certification programs offered by organizations such as the National Development Council, International Economic Development Council and NADO's Economic Development Finance Service (EDFS).

2) Expand Resources for Peer Review and Technical Assistance Programs

New standards and procedures are insufficient if they are not communicated and delivered to regional and local economic development practitioners.

RLF operators must be committed to improving the self-governance, peer accountability, performance measurements and professional standards of the industry.

Leading industry associations at the national (i.e. NADO's EDFS, National Development Council, International Economic Development Council, Council of State Development Finance Agencies, National Association of Development Companies and Association for Enterprise Opportunity) and state levels must commit to an expanded and more intensive series of training workshops that engages all current business loan fund programs in this newly designed content and new practices.

For example, federal programs such as EDA RLF, ARC RLF and USDA IRP should be modified to allow intermediary organizations/grantees to use a limited portion of the federal capitalization investment for professional certification and training opportunities each year.

In addition, programs such as EDA's RLF program should establish a peer review training and monitoring program to assist with mentoring of RLF program staff, sharing of noteworthy practices and programs, and establishment of industry standards and practices.

3) Create New Performance Measurement Systems

Along with new operating procedures and practices, the industry must create new ways to measure and benchmark performance. These benchmarks will allow federal agencies and local partners to better assess how public business loan funds perform. Underperformers can be targeted for reform, or if necessary, dissolution or transfer of management. Top performers should be encouraged to expand their operations or to assist underperforming loan funds with back office operational support, marketing assistance and/or strategic alliances.

Associations serving the CDFI and the Microenterprise industries have already developed effective model benchmarking programs. The Opportunity Finance Network's CARS (CDFI Assessment and Ratings System) program and the Microenterprise FIELD (Fund for Innovation, Effectiveness, Learning and Dissemination) Microtest program offer models to emulate for programs such as EDA RLF and USDA IRP. A similar system for public business loan funds should be developed.

4) Promote Stronger Management of Underperforming RLFs

When individual loan fund operators consistently underperform or are no longer achieving their missions, they should be encouraged to modify their RLF investment strategies, transfer management to a more experienced loan fund operator, or establish a strategic alliance with another proven loan fund operator for tasks such as back office support and marketing assistance. They should implement a corrective action plan to improve their deal flow, portfolio performance and/or management oversight.

5) Develop Partnerships with Other Development Finance Leaders

A number of leading industry associations, such as OFN, NADCO and CDFA, already serve other parts of the community development finance industry. Where feasible, the efforts noted in this report should be developed in coordination with these partner organizations.

The industry leaders who convened at the NADO-DDAA Cooperstown workshop have committed to advancing these initiatives to strengthen the public business loan fund sector.

The suggestions highlighted above would have an immediate impact on the small business finance landscape. Even better, these steps require no new federal dollars since they focus on existing resources. These reforms simply help ensure past federal investments are used more effectively in helping fuel business and employment growth today. •

Recommendations and Advice from Public Business Loan Fund Practitioners

1. Create a **clearly stated mission and purpose** for the loan fund program, including methods for linking investments with regional and local economic development strategies and priorities.

2. Establish **professional relationships and partnerships** with regional and local banks and other lending institutions.

3. Set up and maintain a **knowledgeable and active business loan fund committee** to assist in marketing, business development, application review and due diligence, and program oversight and accountability. This includes tapping into network of retired and active bankers, economic developers and other business experts from the region.

4. Avoid relying on the organization's policy board of local elected officials as the **business loan fund committee.**

5. Maintain a **professional loan fund staff** with the experience, background and skills required to operate a successful business loan fund; If necessary, establish partnerships with another organization to assist with back office, accounting, credit analysis, deal packaging, marketing or other operational support.

6. Require a **single purpose, independent audit** of loan funds by an outside auditor on an annual basis.

7. **Engage in peer reviews** with other public business loan fund operators and intermediaries across the nation or within multi-state region to explore trends, noteworthy practices and program innovations.

8. Pursue opportunities to **diversify your portfolio** of business lending and technical assistance tools and services, including potential partnerships and opportunities with nontraditional lending and investment resources.

Establish professional relationships and partnerships with regional and local banks and other lending institutions.

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Public Sector Business Loan Funds

Views and Recommendations from Practitioners

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Endnotes

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[2] Buckeye Hill-Hocking Valley Regional Development invested $26,500 from its EDA RLF as vital gap financing that was combined with $180,000 of bank financing and $15,000 in owner equity, along with $26,500 from the local Monroe County Community Improvement Corporation. Today, Control Design provides many services, including security (entry monitor, cameras, and CCTV), electrical maintenance and contracting, and computer-based control systems. Whether a business has the need for a building automation control system, custom computer-based data collection and reporting, PLC or PAC based control systems, or electrical panel design, their experienced engineering staff can provide anything from a design consult to a full design and turnkey solution.
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[14] NADCo 2009 industry profile

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through the regional strategies, partnerships and solutions of the
nation's network of 520 regional development organizations.

The **NADO Research Foundation's Economic Development Finance Service (EDFS)**
serves as a national peer network and resource for the nation's
public business loan fund intermediaries and professionals.

The **Development District Association of Appalachia (DDAA)**
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