



# Revolving Loan Funds

## PRIMER

### INTRODUCTION TO REVOLVING LOAN FUNDS

A revolving loan fund (RLF) is a pool of capital from which loans are made to provide gap financing, primarily to small and mid-sized businesses. The fund revolves in the sense that it is self-replenishing, utilizing interest and principal payments on old loans to issue financing for new projects. RLFs provide critical financing when credit access may be limited, and are used to fill the breach between the amount a borrower can obtain in the private market and the amount needed to start or sustain a business.

RLF's are frequently created to serve a specific purpose or intended market. Though most RLFs aim to assist businesses, many exist to support specific sectors where private investment may be lacking or nonexistent (e.g. underserved markets, healthcare, environmental sustainability, etc.). Because they are often goal-oriented, RLFs are a financing instrument that can solve a particular need, catering to both the borrower and the objective. If an RLF can demonstrate that lending to such markets can be profitable, it might encourage private lending and thereby create a market no longer requiring support.

State and local governments, economic development authorities, non-profits utilities and universities generally operate RLFs. Programs may be individually managed by one agency or alternatively, administered in collaboration with an independent third party.

With competitive rates and flexible terms, RLFs are attractive to borrowers and lenders alike, as financial institutions enjoy a lower overall risk in helping to support small businesses. Nonetheless, RLFs must strike a balance between charging attractive rates and earning a return, as interest is used to cover administrative costs and replenish the fund for future lending.

### USE OF REVOLVING LOAN FUNDS

Initial capitalization of an RLF typically comes from a combination of sources, such as varying levels of government (local, state, federal), or private entities like financial institutions or philanthropic organizations. State and local governments often use a number of revenue sources to seed RLFs; these may include: set-asides, bond proceeds, direct appropriations, ratepayer funds, dues or lottery proceeds. Additionally, private financing can allow governments to leverage their limited funds to reach potential goals that would otherwise be unattainable using only public resources.

Eligible uses for loan proceeds typically include operating capital, land or building acquisition, new construction, property rehabilitation or improvements, and the purchase of equipment. Loan duration varies according to use of the funds, with loan amounts usually totaling less than \$100,000. Larger amounts (up to \$250,000 and beyond) can be made available as resources may allow, and when a borrower has secured a substantial share of financing from private lenders.

While RLFs are typically employed to support projects with additional risk, borrowers are held to strict standards regarding loan securitization. Before a loan is issued, an applicant or prospective business owner is required to furnish substantial documentation, which generally includes: a business plan, business or management qualifications/experience, credit histories and financial statements, sufficient collateral to repay



the loan, other personal or corporate guarantees, and cash flow projections. A board of directors or loan committee then takes responsibility for reviewing documents, and contracting with a financial institution for the loan fund's portfolio management responsibilities.

As a public investment tool, RLFs are designed to achieve positive outcomes on the public's behalf, such as community revitalization or economic growth. Consequently, borrowers are often required to meet performance benchmarks established by the loan administrator or board of directors. Typically, such measures include: the number/type of jobs created or retained, increases in tax revenue, private investment relative to public funding, and benefits accruing to low or moderate-income citizens, etc.

### QUESTIONS FINANCE DIRECTORS SHOULD ASK ABOUT REVOLVING LOAN FUNDS

While revolving loan funds provide plenty of benefits, there are drawbacks. The Finance Officer should be able to answer the following if presented with an opportunity to consider financing from an RLF:

- » Are sound policies and procedures in place to protect the RLF from the risk of borrower default, as well as to ensure that funds are replenished in a manner to ensure continued credit availability?
- » Is the RLF's loan portfolio structured in a way to ensure a consistent stream of capital replenishment, so as not to preclude the ability to make new loans as applications are received?
- » Are adequate protections in place to protect the fund's capital base from erosion due to operating costs and inflation? If not, will additional investment be necessary to remain functional?
- » Are the standards to obtain a loan cost prohibitive relative to the level of financing that is sought?
- » To what extent is a proposed project or business venture's viability predicated on securing a loan from the RLF? (i.e., if unable to proceed, the degree of risk may be too high).
- » Are loans being granted to applicants with true and demonstrated need, or are they being made to entities that do not require this special form of subsidization?
- » Is the program meeting its stated objectives? Is it being utilized? Are adjustments necessary?

### OUTSIDE RESOURCES FOR REVOLVING LOAN FUNDS

- » American Council for an Energy-Efficient Economy (ACEEE): <https://aceee.org/sector/state-policy/toolkit/revolving-loan-funds>
- » Community Development Finance Agencies (CDFA): <https://www.cdfa.net/cdfa/cdfaweb.nsf/resourcecenters/rlf.html>  
[www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=rlffactsheet.html](http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=rlffactsheet.html)
- » U.S. Economic Development Administration (USEDA): <https://www.eda.gov/rlf/>
- » Wikipedia: [https://en.wikipedia.org/wiki/Revolving\\_Loan\\_Fund](https://en.wikipedia.org/wiki/Revolving_Loan_Fund)

### About GFOA

The Government Finance Officers Association (GFOA) represents approximately 20,000 public finance officers throughout the United States and Canada. GFOA's mission is to promote excellence in state and local government financial management. GFOA views its role as a resource, educator, facilitator, and advocate for both its members and the governments they serve and provides best practice guidance, leadership, professional development, resources and tools, networking opportunities, award programs, and advisory services.