Utilizing Revolving Loan Funds (RLFs) to Improve Equitable Impacts from Economic Development Efforts

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Intro to Revolving Loan Funds

The Revolving Loan Fund (RLF) program was established in 1975. It is made available through an Economic Adjustment Assistance (EAA) grant authorized under section 209 of the Public Works and Economic Development Act of 1965 (42 U.S.C. § 3149). An EAA grant is funded by the Department of Commerce (DOC) through the Economic Development Administration (EDA). A state, county, city, town, or other political subdivision of a state is eligible to apply. An example of a political subdivision of a state would be a territory of a state, designated by EDA as an Economic Development District (EDD).

RLFs are evergreen pools of capital recycled or reloaned into a community in perpetuity. They are managed by local governments or other eligible non-profit organizations engaged in economic development activities. RLFs exist to provide underserved small businesses and enterprises access to capital for start-up, operating needs, expansion, or growth.

Today, a typical award for one of these grants to establish an RLF ranges between $500,000 and $2,000,000. There are more than 500 active RLFs nationwide with a combined capital base of approximately $935,000,000. Since inception, EDA reports that more than 45,000 loans have been made from its RLF Program, impacting over 733,000 jobs in its 48-year run.

Why RLFs are Effective Economic Development Finance Tools

There are over two hundred federal programs spread over eighteen different agencies that may be used to provide economic development financing according to Toby Rittner, President and CEO of the Council of Development Finance Agencies (CDFA) (Rittner, 2023). The vast majority of economic development financing comes from grants. Federal grants dollars are passed down through state governments, then into local governments. Local governments will then utilize or apply those funds to meet an economic or community development need or project. Although individuals are the beneficiaries of such work, gaining access to the services, utilities, and infrastructure developed, they are seldom benefitted directly.

There are few tools in economic development finance that provide funding directly to individuals. The RLF is very impactful because it bridges that gap. Like most economic development finance tools, it is capitalized through a grant to a local government entity to administrate, but it is then made available to individuals that engage in business activities in that community. RLFs can have a wide variety of eligible uses of funds and applicants.

RLFs are particularly suited to be accessed by underserved populations providing more equitable access to capital across a region. RLFs are typically used to leverage smaller investments and projects that may not create enough jobs to be eligible for economic development incentives at the state level, but these projects play a vital role in the economy.

According to Mr. Rittner, Small Businesses make up 99.7% of all firms and have been responsible for 60-80% of all new job growth in the past decade. Most small businesses have financing needs that can be served by RLFs and that makes for a relatively large audience. Without programs like the RLF, small business projects can be overlooked while economic development efforts concentrate on landing larger companies or projects that attract other types of economic development finance incentives, leaving small businesses underserved, particularly in rural markets where limited resources are available for those efforts.

Expanding the Meaning of Equity

Equity, in Economic Development, is defined as "the consistent and systematic fair, just, and impartial treatment of all individuals, including individuals who belong to underserved communities that have been denied such treatment, such as Black, Latino, and Indigenous and Native American persons, Asian Americans and Pacific Islanders and other persons of color; members of religious minorities; lesbian, gay, bisexual, transgender, and queer (LGBTQ+) persons; persons with disabilities; persons who live in rural areas; and persons otherwise adversely affected by persistent poverty or inequality." (JR., 2021) The term "Underserved" refers to populations sharing a particular characteristic, as well as geographic communities, that have been systematically denied a full opportunity to participate in aspects of economic, social, and civic life, as exemplified by the list in the preceding definition of "equity." Social inequity leads to economic disadvantages. The U.S. Treasury defines Socially disadvantaged individuals as those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities. Economically disadvantaged individuals are those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business area who are not socially disadvantaged.

Small Projects, Big Impacts

Projects needing as little as $5,000 in capital are well served with the RLF Program. RLFs provide access to capital for eligible applicants that would typically struggle to obtain reasonable financing from an alternate source. For example, a locally managed RLF in South Central Tennessee assisted an African American gentleman with a loan to start his pressure washing business, and his project had several attributes that made it difficult for him to obtain credit on reasonable terms in the conventional market. First, his project was a start-up. He had a good plan and had been doing the work for a few months part time while working at a local factory, but did not have a strong resume. He did not possess a degree or certificate and his credit had suffered due to a prior incarceration for a non-violent offense. The recipient was a model borrower after accessing capital through the RLF. Not only did the project prevent recidivism, it provides an opportunity for an individual to have ownership in his community and fosters an environment that creates an opportunity for wealth creation for future generations.

In another example, an RLF provided long term financing to a gentleman over 65 years of age. Surely, no creditor would decline an application for financing because of someone's age, but the applicant could not obtain conventional financing on reasonable terms without the RLF. The project was a start-up, in a new industry to the area, and was not large enough to qualify for state level incentives or tax abatements at the time of application. Today, that applicant is 84 and his loan has almost matured, and he has over 25 employees earning or exceeding the prevailing wage for workers in that industry.

RLFs have also assisted a day care operator in a rural area that struggled to get conventional credit. Unable to obtain conventional bank financing, initially, the business owner accepted seller financing for the business, then learned about the RLF and applied for long term financing for her business. Once stabilized, thanks to financing on reasonable and reliable terms, she soon expanded with a second RLF application. Once she reached capacity a second time, she sold the original daycare to one of her employees and built a larger facility on a new site. Now at capacity again, she reached out recently looking to acquire a second location.

Projects like these examples enable marginalized populations the same access to capital that a large corporation would have. Wealth creation comes from ownership and opportunity and making capital available to small businesses can do more than just create jobs. For the individuals that utilize it, RLFs can enhance their quality of life and build a stronger community.

Eventually, many small businesses that get their start with a small RLF loan will qualify for conventional financing down the road.

Tracking the Results

Traditional measures are generational norms. They are ingrained in the culture of economic development practitioners because those expectations are embedded in statute. They are a fundamental part of the legislative intent behind the programs used to finance economic development activities. As the management styles and concepts of economic development finance progresses from one paradigm to another, leaving behind assumptions that proved inefficient or ineffective, those traditional measures remain the primary way to gauge results even when those results are poor measures of the intended outcome.

Paradigm shifts in approaches to economic development over the years has seen priorities evolve from the Keynesian school of thought where full employment was the main goal (Jahan, Mahmud, & Papageorgiou, 2014), to the Free-Market approach that embraced perfect competition as a way to dispel shortcomings of its predecessor (The Investopedia Team, Kelly, & Velasquez, 2024). Today there is momentum, particularly in rural economies, to shift away from traditional methodology to a "Well-Being" approach. This shift is a transition from scorecards with new jobs, dollars invested, and new tax revenues created to addressing questions about the impact on the Well-Being framework. Instead of just reporting the number of jobs created or retained, overall remuneration may also be measured against the local prevailing wage for an industry or occupation in the region. Emphasis may also be placed on other basic benefits (e.g., paid leave, health insurance, retirement/savings plan). The employer having a mentorship program that helps the employee develop the skills and experiences necessary to advance along a career path, for example, enhances economic mobility and may help alleviate worker displacement as technologies advance.

<u>Traditional Measures</u>

Economic developers cannot abandon traditional measures as they are required by statute to be reported on for most federal programs. Tracking additional metrics that are not required by the program means that practitioners would have a greater reporting burden internally and people in these roles often times wear several hats and have multiple responsibilities already.

RLFs are regulated by federal statute and policy, but they are also guided by an operating plan written by the organization that manages the RLF. While RLF operators will continue to track jobs and investments as traditional measures of success as required, they can adopt program goals that encourages other criteria as well. Policy actually requires the plan to be updated every five years allowing the organization to be adaptive and set out revised targets based on periodic reviews. Revising and updating the criteria used for measurement improves the likelihood that efforts in economic development activities will lead to outcomes that will strengthen and enhance “Well-Being” in their locality.

A Well-Being approach to economic development causes resources to be directed toward projects that enhance or build upon existing assets, encourage entrepreneurship over recruitment, demonstrate stewardship of environmental resources, and foster regionalism. These priorities shift the focus from traditional measures like the number of jobs and dollars invested to include the preservation, creation, and improvement of social services and enhance quality of life in an equitable way.

<u>Alternative Measures</u>

Under this emerging philosophy on economic development, practitioners have an opportunity to evaluate non-traditional criteria and apply a formula for success that is locally driven. Measures selected will be different for every practitioner based on the needs in their community. Practitioners can design their own rubric, but value must be assessed to attributes such as how well a project improves economic mobility, wealth creation, and retention, locally. Other priorities may include job quality over quantity, measured by how wages from jobs created compare to the prevailing wage for jobs in that industry. A project can also be scored on other attributes such as benefits offered or provided. Quality of life attributes may include a methodology for determining the degree to which a project enhances local assets, complements existing industries, or improves environmental sustainability. Efforts that celebrate improved social, environmental, and economic outcomes should take precedent and be evaluated under the context that the definition of success cannot be standardized. Successful economic development must be embedded and integrated into broader strategies and systems that include many other facets that affect the quality of life like education attainment, health systems, transportation, housing, workforce, community development, and environmental sustainability.

<u>Well-Being Approach</u>

Practitioners should focus on a project's impact and demonstrate how the investment advances equity in the region. The perspective is what needs to change. Success is no longer defined by the dollar amount of the investment, how many dollars it leveraged, or how many jobs it was projected to create alone. Practitioners should be tracking how well the project is aligned with the three dimensions of the Well-Being framework: (Dabson, 2021)

1. Economic well-being

2. Social well-being; and
3. Environmental well-being

Further, projects or investments can be graded on how well they are aligned with these six themes:

1. Advancing entrepreneurship or other economic generators, retention of existing businesses or creating favorable conditions for viable and appropriate business attraction
2. Builds upon existing community or regional assets
3. Embraces or builds upon regional collaboration
4. Advances equity or inclusion; or
5. Improves sustainability and reduces negative environmental impacts
6. Serves multiple objectives and helps integrate broader strategies and systems

RLF projects are either repaid, prepaid, or they result in a loss, but evaluating implementation of the Well-Being approach will require a deeper level of assessment. Assigning a numerical value to an intangible idea based on how well, or how poorly a project supports one of the themes above converts the intangible to a quantitative variable that can be scored. A rubric could be developed utilizing a Likert scale that assigns a quantitative value to a subjective dimension or criteria, with level of agreement/disagreement. The local practitioner can then assign weights to those dimensions to fine tune the measurement based on the priorities of the region.

In order to prepare such a rubric, the practitioner would need to compile a selection of public policy goals to assess for each project considered. The Likert scale would require the practitioner to rate a project on a scale, of one to five for example, where one means that the project does little or nothing to support the public policy goal and five strongly impacts the public policy goal in a positive way. A number in between the two extremes would be a subjective selection indicating that the project does support the public policy goal, but to some lesser degree. The practitioner could organize the public policy goals under the three dimensions of the Well-Being framework above and summarize the values for a total score.

To fine tune the rubric, the practitioner could assign weights to each of the framework dimensions and multiply the score totals by those weights, and take the sum of the result. That would allow a locality to place a higher degree of importance on one of the framework dimensions. Assigning weights is more effective when they are percentages where the total of all assigned weights adds up to one.

Over time, the values can be further defined, so that the subjectivity is more inherent in the public policy goal itself rather than the rubric, increasing consistency of application of the methodology. A matrix can be prepared to specifically describe a condition or a range where the practitioner should select a certain degree along the Likert scale. For example, if a public policy goal is to improve energy efficiency, the matrix might define a score of “One” to mean that no efficiency improvements are planned. A “Two” could be defined to result in a reduction in energy consumption greater than 3%, a “Three” might be defined as a reduction in energy consumption greater than 5%, a “Four” might be defined as a reduction in energy consumption greater than 8%, and a score of “Five” might apply when the project results in a reduction in energy consumption greater than 10%, for example. Similarly, parameters can be defined in the matrix to corroborate with the degrees along the Likert scale to reduce ambiguity and make the assessments more consistent.

Utilizing a tool like this to assess how well a project impacts the public policy goals that a region has selected is not intended to be a finite restraint. A practitioner could add on bonus content and award extra points for meeting objectives not included in the rubric. For example, giving a project an extra five points for being located in an opportunity zone, HUB Zone, or LMI tract. Many facets can be integrated into an evaluation rubric. What's more, having such a tool can help ensure that resources are invested and prioritized toward projects that have the highest and best impact.

The key to effective assessment will be to conduct the same assessment at a later date and compare the two observations to determine the validity of the initial assessment. Those results would then be used to evaluate, amend, and improve the framework for the weights assigned to the criteria. This provides an opportunity to demonstrate the long-term ancillary impacts of the investment and demonstrate the breadth of the impact more fully. In this context, results are not measured against other projects or compared with arbitrary statistics of other communities because there are too many variables that are not comparable. This framework allows a project to be assessed based on its own merit, compared to itself.

Challenges to Implementation

The Well-Being approach targets improvements that are often overlooked in society. It targets the disadvantaged as beneficiaries. Equity and inclusion entails bringing people to the table that may have never been there before. They may bring inexperience or ignorance, but they may also bring new perspectives and ideas that challenge norms. New perspectives and ideas lead to change, and change is uncomfortable.

Another challenge is the way information is consumed today. People expect immediate, visible and obvious results and it is easier to assemble charts of data. Traditional measures are often interpreted as “winners and losers” with the winner inching out a victory because of the number of jobs it predicted it would create. Effective measurement is instead experimental, resulting in insights from cause and effect that evolve and improve the process to achieve better results. The idea that everyone can have a trophy is difficult to sell, but self-improvement is really the only fair judgement that can be made.

It may take many investments to substantively move the needle to demonstrate an impact on the Well-Being of a community. Revitalization of a downtown or main street will often require several different types of investments from several different resources over an extended period of time before the ecosystem becomes sustainable, for example. Stopping or reducing a negative impact on the environment may go unnoticed because there is no visible or observable change, but the impact is still good for the community in the long term.

Taking Inventory

A good first step is to define what “Equity” is in the region. Even if one of the goals in the RLF plan is lending to underserved groups, the term itself must be defined. Underserved can be many things. Being a member of a certain group categorized by race, color, age, religion, or gender, is not the only way to define an underserved group. An underserved group may be as simple as a pocket of residents cut off or separated by geographical barrier in a city or town. A neighborhood across the tracks, on the other side of the river, or simply in an older part of town can all be identified as an underserved group, depending upon what is being encouraged (Administration, 2023).

Identifying measures of improvement that enhance well-being criteria is not easy. Simply directing marketing efforts to people or businesses in a specific industry or marketing only to people of a specific race, gender, or ethnicity is a shallow attempt at an equitable lending strategy. In practice, particularly in rural areas, it is not often realistic to mirror lending to a defined underserved group in correlation to the demographic distribution of the region. Disbursement will never appear to be fair or equitable using numbers alone. A strategic multi-faceted rubric that addresses and corresponds to the three dimensions of the Well Being framework and the themes that support it is much more realistic See an example assessment (Fitzgerald, 2024).

Gaining Support

A strategic component to the Well-Being approach is about creating an ecosystem that supports entrepreneurship and reinforces retention of human capital. Mo Collins, Speaker, Advisor, Consultant, and Educator specializing in building ecosystems that support entrepreneurship talks about "The Stack" because small businesses come in all shapes and sizes (Collins, 2023). Some are Microenterprises and are more driven by purpose than by profits. People in the community recognize something that is missing and fill that void. These businesses are not all long lived, but they provide a vibrance and cultural experience that fosters more favorable conditions to attract additional investments.

Another theme or attribute of the Well-Being approach is working projects that make sense and complement resources and assets of the region. Landing a project that is not a good fit for the community is not productive, regardless of the amount being invested or the number of jobs created. A business that is not a good fit for a region is not going to experience the level of success that it should, or could, in an environment that it complements.

Targeting investments that are well aligned with a separate regional or state initiative with the same goal is not duplicative, it is fostering collaboration. When efforts are collaborative, they take advantage of momentum already established and share a greater advantage with the group. Advantages like these can lead to the development of clusters, local concentrations of similar or complementary industries. Clusters are the key organizational unit for understanding and improving the performance of regional economies. Competitive advantages in a global economy lie increasingly in local things like aligned efforts across multiple regional strategies all working together to improve business' ability to aggregate production and exchange goods, services, talent, and tech, and attracting complementary inbound investments (Porter, 1998).

The Well-Being approach is a broader initiative. It empowers individuals to participate in the process and awards good stewardship and sustainable practices that lead to a better economic, social, and environmental climate for future generations. A broader initiative addresses more than one of the six themes and can place different emphases on intended outcomes.

Conclusion

Utilizing a rubric, based on unique local attributes, at the time of application to gauge and assess how well a project addresses Well-Being criteria provides a measure for the success of that project moving forward and provides a basis for determining process improvements to guide future investments of time and capital. The only way to develop practices and approaches to improve equitable lending outcomes is to isolate the public policy goal anticipated at the time of application in writing and compare the anticipated result to the outcome as the project matures. Assigning specific criteria, even if the measure is subjective, provides a par or a basis for comparison to determine whether or not the policy goal fell short, was met, or exceeded expectations, and to what degree.

Ultimately, making equitable lending decisions, and improving upon the processes to improve the potential for more equitable outcomes, requires practitioners to continually revaluate projects on an ongoing basis using the lens of the Well-Being Framework to identify impacts to equity or mobility and use those findings to help drive future investments.

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