CASE STUDIES

REVOLVING LOAN FUNDS for DISASTER RECOVERY

INTERNATIONAL ECONOMIC DEVELOPMENT COUNCIL

The Power of Knowledge and Leadership

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INTERNATIONAL ECONOMIC DEVELOPMENT COUNCIL (IEDC)

IEDC is a non-profit membership organization serving economic developers. With more than 5, 000 members, IEDC is the largest organization of its kind. Economic developers promote economic well-being and quality of life for their communities, by creating, retaining and expanding jobs that facilitate growth, enhance wealth and provide a stable tax base. From public to private, rural to urban, and local to international, IEDC's members are engaged in the full range of economic development experience. Given the breadth of economic development work, our members are employed in a wide variety of settings including local, state, provincial and federal governments, public private partnerships, chambers of commerce, universities and a variety of other institutions. When we succeed, our members create high-quality jobs, develop vibrant communities, and improve the quality of life in their regions. www.iedconline.org.

PRIMARY AUTHORS

Mishka Parkins
Delaney Luna

EDITORS

Eli Dile
Lynn Knight, CEcD

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CONTRIBUTORS:

Vincent Dicara
Michelle Thompson
Sarah Garcia, AICP

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Introduction

Small businesses are the backbone of any local economy. Yet, they often lack the financial resources to weather the impacts of man-made and natural disasters. In fact, the Federal Emergency Management Agency (FEMA) estimates that 40 percent of small businesses do not reopen after experiencing a disaster.[1] To buffer against these problems, an increasing number of economic development organizations are offering financial and technical assistance to help small business survive a disaster event.

Financial programs that provide critical recovery funds are on the rise, partly due to the increasing frequency and intensity of natural disasters. The capital provided through these loans helps counteract economic dislocation caused by the disruption of business activities, which when prolonged can force businesses to close their doors permanently. Revolving loan funds (RLFs) are reliable funding mechanisms for disaster mitigation purposes. As such, the economic development organizations (EDOs) featured in this brief provide examples of how RLFs have been used pre- and post-disaster to revive distressed areas.

Disaster recovery RLFs typically fill the gap between the amount of capital needed to resume operations and the amount of capital available through conventional lending sources like local financial institutions. When properly structured, RLFs can continuously provide economic development benefits beyond the disaster recovery phase.[2] An early example of this can be found in Grand Forks, North Dakota. In 1997, more than 80 percent of Grand Forks flooded when several dikes failed and the Red River crested at 54 feet. While the town contended with several feet of floodwater, a fire broke out in the downtown area and rapidly spread across three blocks. Damage from both events was estimated to be nearly $2 billion. In order to provide economic assistance to small businesses, the city established two RLF programs: one with Community Development Block Grant Disaster Recovery (CDBG-DR) funds and the other with funds from the U.S. Economic Development Administration (EDA). These RLFs complemented each other and had the common objective to provide post- disaster financial assistance to businesses in order to retain and create local jobs.[3]

How RLFs Work

Revolving loan funds (RLFs) are self-replenishing lending tools. Built upon an initial capitalization, RLF funding is recycled as loan recipients make payments. As loans are repaid, the returns to the loan pool can be lent out again to another recipient. Most RLFs provide small to mid-sized loans.

Public funds from the federal, state, and local levels are typically used to establish RLFs. Often, funding acquired for RLF capitalization does not need to be paid back, functioning similarly to grants.[4] The U.S. Economic Development Administration's Revolving Loan Fund Program has been a long-standing source of RLF funding to local and state governments and other development organizations. The funding is obtained through a competitive grant process. Other agencies that provide funding to capitalize RLFs include the U.S. Department of Housing and Urban Development, the Environmental Protection Agency, and the U.S. Department of Agriculture, with different agencies offering RLF funding for purposes aligned with their particular mission. These public funds tend to have match requirements which can be met with support from local or private sources and philanthropic organizations. In some cases, a portion of the RLF funding can be used as grant, rather than loan funding, which is sometimes necessary to get businesses the help they need if they are not in a position to afford a loan.

Best Practices for Starting an RLF

It is best to set up an RLF before a disaster hits so that small businesses can quickly access recovery funds. Prior to setting up an RLF, however, EDOs should conduct a thorough assessment of the local capital market and the and the financing needs of small businesses.

This assessment helps the EDO identify financing gaps that the RLF can fill.

Additionally, assessing local demand for financing options helps the EDO determine the specific needs of small business owners. These needs may vary from fixed-asset financing, long-term financing at reasonable rates, or loans too small to be considered by private financial institutions.[5] If an organization's staff lacks the technical expertise for such assessments, the EDO can invest in staff training or contract an external professional

Once the EDO identifies the funding gaps, it establishes goals to guide the RLF and provide direction for screening criteria. These goals will also help determine the permitted and prohibited uses of funds, the target business population, and operating policies. The goals for each RLF depend on the economic priorities of the jurisdiction it covers and can vary accordingly. Some RLFs target small businesses within specific industries or in specific locations, such as a downtown area targeted for revitalization. Others target small businesses within a disaster- impact area, regardless of the industry. In the case of Economic Development Administration loans, the funds are often reserved for industries targeted in a region's EDA-approved Comprehensive Economic Development Strategy (CEDS).

Take, for example, the City of Flagstaff, Arizona. The city shaped its RLF lending priorities based on its current CEDS, which resulted in a set of business development objectives informed by an analysis of the local capital market and the demonstrated financing needs of targeted businesses. These goals are articulated in the city's Revolving Loan Fund Administrative Plan and include:

- Focus on business creation in areas challenged by high unemployment and a large number of displaced workers;
- Prioritize projects that create the greatest number of jobs per RLF dollar and impact in targeted sectors of high technology and tourism businesses;
- Emphasize those firms that use the area's natural resources and process them to final stages within the area; and
- Close the financing gap faced by existing firms that are too new or too undercapitalized to qualify for existing loans.[6]

After setting a vision for the RLF, establish operating procedures based on organizational capacity. Clear operational procedures should provide details regarding the structure, implementation, marketing, and management of the fund. For example, the established organizational structure should explicitly state the entity responsible for the implementation and administration of the RLF, as well as the role and responsibility of all entities involved. EDO staff should manage the fund and oversee the activities that service the RLF loans.

Generally, EDOs designate an advisory board or committee to review, approve, and modify terms of the loan. The committee can be comprised of EDO staff, staff of lending institutions, elected officials, and staff of membership associations. A loan monitoring process should also be specified, and should include detailed procedures on how to collect late payments and handle defaulted loans. By establishing solid portfolio monitoring practices, EDOs are better able to manage risk and maintain, or even increase, the funds available to small businesses. For a more detailed example, see the City of Flagstaff's Economic Development Administration Revolving Loan Fund Administrative Plan at http://flagstaff.az.gov/documentcenter/view/48295

The following case studies show how EDOs have used RLFs to drive economic recovery. For more information on the detailed steps of setting up an RLF, see the Appendix. Additionally, the Council of Development Finance Agency's EDA Revolving Loan Fund Best Practices Program is a valuable source of information.

Steps for Setting Up an RLF

1. Explore RLF options before a disaster hits
2. Conduct assessment of local capital market
3. Establish goals for RLF
4. Establish operating procedures
5. Create an advisory board
6. Set up loan monitoring process
7. Obtain capitalization funding
8. Launch the RLF

EAST CENTRAL IOWA COUNCIL OF GOVERNMENTS (ECICOG)

In June 2008, the Cedar River crested to record levels, flooding 10-square miles in the city of Cedar Rapids, Iowa.[7] Approximately 1,200 businesses were directly or indirectly affected by the flood, with 131 businesses and 1,865 jobs permanently lost.[8] However, by 2017, the city had 25 percent more businesses, greater residential growth (62 percent), and higher property values (18 percent) compared to 2007 levels.[9] In reviewing the city's early disaster response activities, Cedar Rapids' quick deployment of an RLF demonstrates how speedy business assistance can pave the way to economic recovery. Moreover, by leveraging federal, state, and local funds, the city was able to build back better.

By October 2008, EDA had awarded ECICOG a $1.5 million grant to establish and administer an RLF for the six-county region surrounding the city. With match contributions of $85,000 from the Washington County Riverboat Foundation and $15,000 from ECICOG, the fund totaled $1.6 million. Loans were made to businesses impacted by flooding, and each loan application was reviewed by an RLF Loan Committee that considers applications based on the importance of the business to the regional economy. Not only did the RLF serve as a gap financing measure, but it was a means to help the city diversify its businesses and create a more resilient economy.

Within five years of establishing the fund, nearly 30 loans valued over $3 million were disbursed, 325 private-sector jobs were created, and 327 private- sector jobs were saved. The fund was so successful that EDA provided an additional $2.9 million grant to recapitalize the fund in 2011. This example shows how federal investments can serve as a springboard to address immediate short-term needs and launch a long-term source of community financial capital.

UPPER MINNESOTA VALLEY REGIONAL DEVELOPMENT COMMISSION (UMVRDC)

The five-county region along the Upper Minnesota Valley was hit by flooding and storms between March and May 2011. Primarily a rural region dependent on agriculture, many families earn their livings through farming. When the area flooded, farm families found it difficult to find employment in other industries. In response, the Upper Minnesota Valley Regional Development Commission (UMVRDC) sought new ways to create job opportunities for all individuals displaced by the floods, and to establish economic stability through industry diversification. Establishing an RLF was identified as a method to enhance economic stability and address the more immediate needs of farming families.

UMVRDC articulated the following goal for its RLF:

To provide access to affordable capital through gap financing for business start- up or expansion in the region to create a more disaster-resilient region by supporting businesses that make the region less dependent on agriculture, create jobs that demand the skill-sets of those that were displaced or affected by disasters, retain existing jobs, improve income levels, diversify the economy, and provide more economic stability.[10]

The RLF was seen as a tool to build on the region's existing manufacturing base, bolster the renewable energy and value-added agriculture industries, and provide further diversification of essential service industries in the local economy.

UMVRDC administers the RLF, which is guided by an RLF Advisory Board comprised of local elected officials, appointed individuals, and CEDS and UMVRDC members. The RLF Advisory Board makes a point of incorporating diversity and inclusivity into its economic development goals. Of the 13 members on the board, each county is represented by its county commissioner and an at-large member from an economic development background. There is also a push to have equal representation by women in its membership. In terms of decision-making authority, the board recommends the approval or denial of all requests, major loan modifications or waivers, loan foreclosure actions, changes to the loan policy, and any other administrative items.

NORTH CAROLINA SMALL BUSINESS RECOVERY FUND

In 2017, a coalition of stakeholders in North Carolina partnered to establish the North Carolina Small Business Recovery Fund. This collaborative effort provides much-needed funds to help the state's small business community recover from the multiple natural disasters that occurred in 2016: Hurricane Matthew, the western wildfires, Tropical Storm Julia, and Tropical Storm Hermine. Partners in the fund include the NC Rural Economic Development Center, NC Small Business and Technology Development Center, and the NC Community Colleges Small Business Center Network. The fund was initially capitalized with $2 million in support from the Golden LEAF Foundation, and additional support was provided by BB&T, Wells Fargo, Bank of America, First Tennessee Bank, and the Economic Development Administration.[11]

The fund uniquely targets businesses that need capital for disaster mitigation and disaster recovery. The fund supports disaster mitigation because planning ahead "could mean the difference between a short interruption in business and a total shutdown."[12] As such, the rural center's Business Services Team offers business owners resilience planning assistance for prevention and recovery strategies, future loss mitigation, and business continuity planning. The fund also can be used to cover working capital and operational expenses, including expenses incurred from repairing damaged property or acquiring new property, as well as recouping lost revenues or reduced profitability.

Within weeks of establishing the fund, the rural center approved eight loans valued at over $825,000 to small businesses in seven North Carolina counties. To complement the fund, the rural center also implemented a Small Business Recovery Program to provide long-term planning and technical assistance to communities affected by Hurricane Matthew. This technical assistance component allows the rural center to take a customized approach, considering the unique needs and capacity of each community. Furthermore, the program encourages economic resiliency through industry diversification and entrepreneurial development. The communities that take part in the program focus on creating entrepreneur-friendly infrastructure by identifying, bolstering, or investing directly in the assets needed to strengthen their small business economies.

SNAPSHOT OF THE NORTH CAROLINA SMALL BUSINESS RECOVERY FUND

REQUIREMENTS: BUSINESS MUST DOCUMENT PHYSICAL DAMAGE OR ECONOMIC INJURY RESULTING FROM HURRICANE MATTHEW, THE WESTERN WILDFIRES, TROPICAL STORM JULIA, OR TROPICAL STORM HERMINE. ANY INDIVIDUAL WITH GREATER THAN 20 PERCENT OWNERSHIP IN THE AFFECTED BUSINESS MUST CO-SIGN THE LOAN

USES: PROPERTY REPAIR, DISASTER MITIGATION, PURCHASE OR CONSTRUCT NEW PROPERTY, OR WORKING CAPITAL AND OPERATIONAL EXPENSES.

MAXIMUM LOAN AMOUNT: $250,000

LOAN TERMS: UP TO 10 YEARS

INTEREST RATES: UP TO 24 MONTHS NO INTEREST, RATES FROM 3-9 PERCENT; FIXED. DEFERRED PAYMENT OPTIONS AVAILABLE.

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For more examples of funding strategies to support small businesses following a disaster, please see the IEDC publication Case Studies in Small Business Finance Following a Disaster on RestoreYourEconomy. org. The briefing highlights six communities that provided disaster recovery funding to help local small businesses quickly reopen and thrive post-disaster.plans focused on cloud-based information storage, and communication plans that will minimize disruption to business operations.

ENDNOTES

1. https://www.cnbc.com/2017/09/16/hurricane-watch-40-percent-of-small-businesses-dont-reopen-after-a-disaster.html
2. http://restoreyoureconomy.org/wp-content/uploads/2014/01/IEDC- Issue-Brief_JAN141.pdf
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4. https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=rlffactsheet.html
5. UPMRV doc
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7. http://www.cedar-rapids.org/discover_cedar_rapids/flood_of_2008/2008_flood_facts.php
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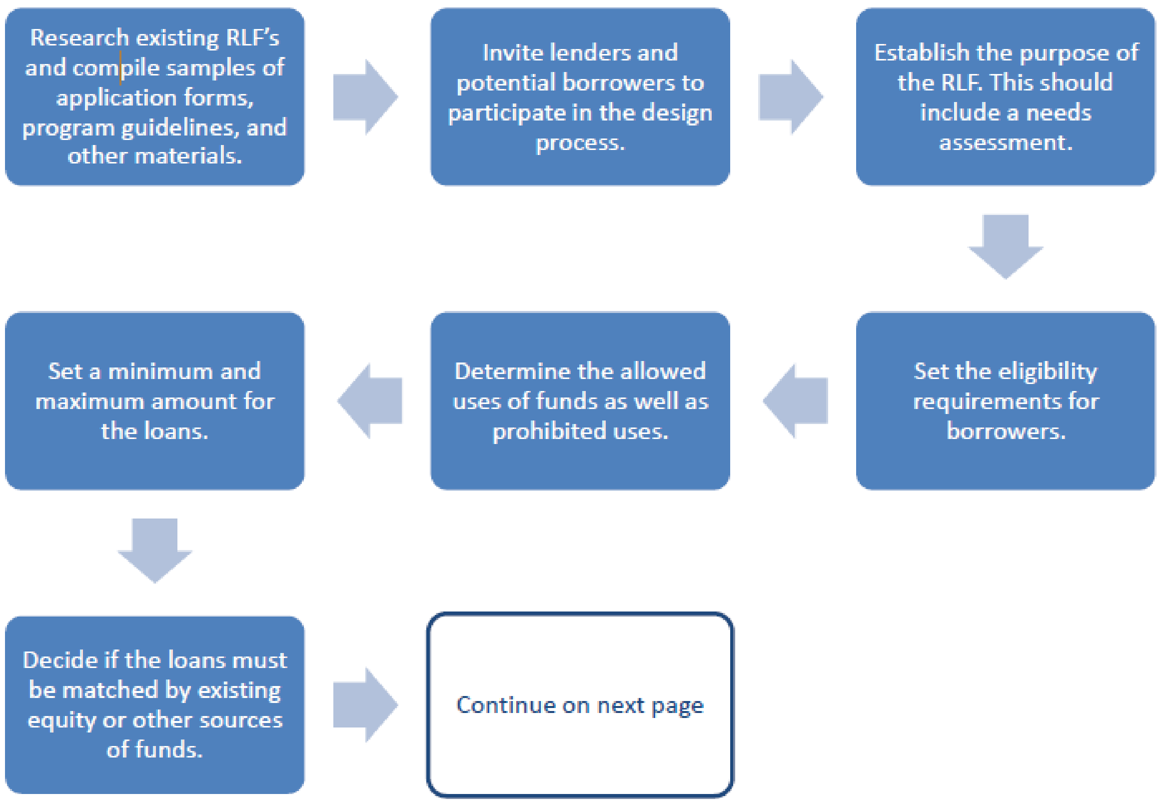
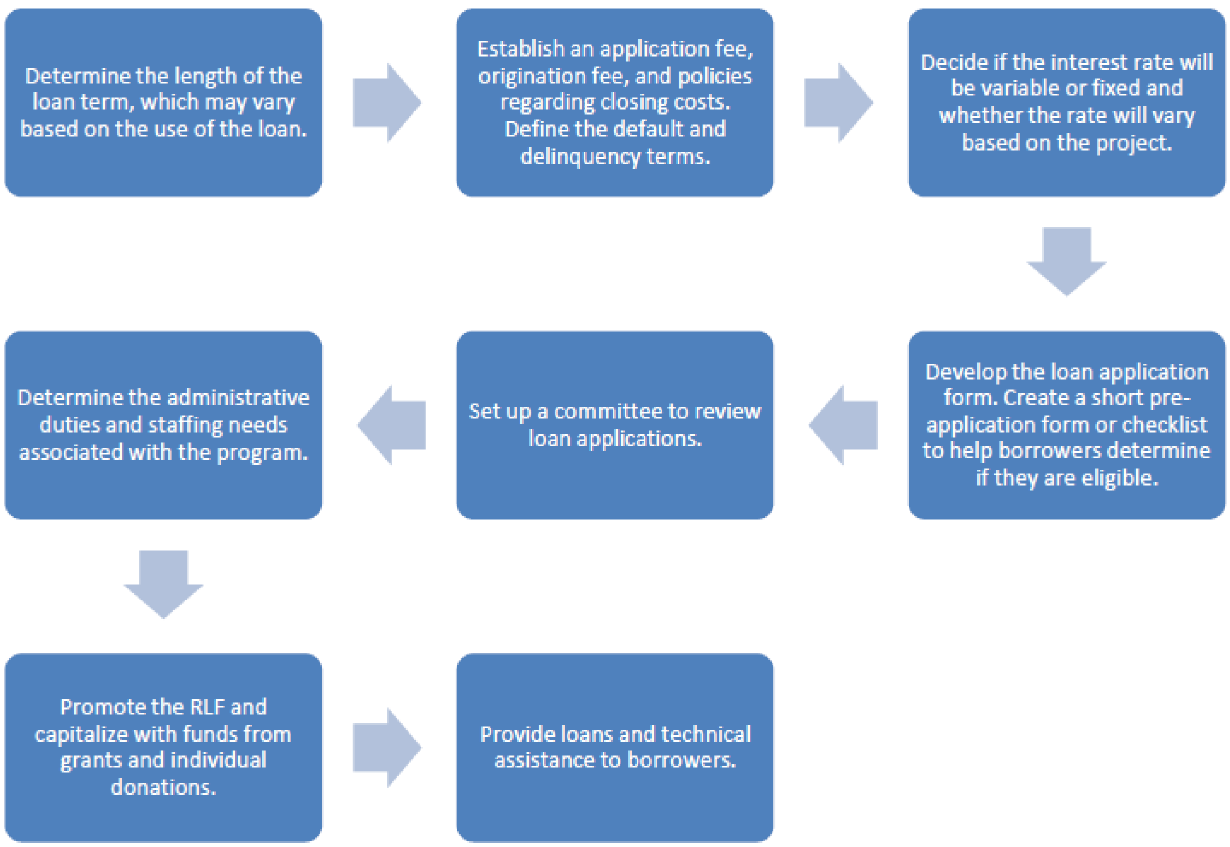
9. https://www.wsj.com/articles/how-a-midwestern-city-bounced-back- from-its-own-harvey-1505736000
10. http://umvrdc.org/wp-content/uploads/2011-Disaster-Recovery-RLF-Plan.pdf
11. http://fontanalib.org/new-fund-to-support-nc-small-business
12. http://fontanalib.org/new-fund-to-supp

Appendix: Council of Development Finance Agencies (CDFA) Basic Steps for Starting an RLF



Council of Development Finance Agencies (CDFA) Basic Steps for Starting an RLF (continued)



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