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PROJECT OVERVIEW AND SURVEY RESULTS

INTRODUCTION TO THE RDLF/IRP EVALUATION

The primary intent of this report is to evaluate the Intermediary Relending Program (IRP), a business development program operated by the Farmers Home Administration (FmHA). The IRP, formerly called the Rural Development Loan Fund (RDLF), provides loans to rural intermediaries which in turn make loans to rural businesses that are unable to secure credit in the private market. The IRP has grown to be the largest federally funded rural development loan program with a current loan portfolio of over $100 million.

This evaluation will look at how the RDLF/IRP has developed over time and how it currently operates in rural communities nationwide. Although the RDLF/IRP was first authorized in the Economic Opportunity Act of 1964, there has never been a comprehensive evaluation to examine the effectiveness, efficiency or impact of the program.

In addition to evaluating the RDLF/IRP, this report will critique another economic development program administered by FmHA, the National Non-Profit Corporation Program (NNCP). The NNCP is similar to the IRP in that FmHA development funds are extended to rural businesses through intermediaries; however the two programs offer different types of development assistance and assign different responsibilities to the local intermediary organizations.

Previous research conducted as part of the Rural Development Policy Project evaluated the efficiency and effectiveness of rural development programs and critiqued a broad array of federally administered programs. The research developed an evaluative framework by which rural development programs were evaluated as service delivery systems. These evaluation criteria have been adapted for the purposes of this report and applied to the performance evaluations of the RDLF/IRP and the NNCP.

Evaluation Criteria:

A. Intermediary Organization and Capacity -- What types of organizations administer the loan funds? What is the development capacity of these organizations? What was their business development experience before administering the RDLF/IRP?

B. Capital Gaps -- What private market inefficiencies are the intermediaries trying to address in their lending? What types of deals do intermediaries finance? In which industries are loans concentrated?

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C. Targeting -- Are the targeted beneficiaries of the program clearly defined by FmHA? Are intermediaries uniformly targeting these populations? Are some intermediaries targetting more or less than others?

D. Loan Fund Administration and Performance -- How are intermediaries administering the loan fund(s)? How do they evaluate risk associated with their lending decisions? What if any risk rating systems do they use? Do they establish loan loss reserves and if so how are they determined?

E. Technical Assistance (TA) -- Do the businesses receiving loans require technical assistance? How many intermediaries provide TA in tandem with their financial assistance? What types of TA are provided and how is it paid for?

F. Efficiency -- Is the program cost effective? What are the technical assistance and administrative costs associated with the program? What is the average cost per job?

G. Federal Oversight and Accountability- Can administrators, intermediaries, and policy makers track how funds are being used? Are reporting requirements being enforced uniformly?

REPORT METHODOLOGY

Two research instruments have been employed by the research team to collect information and data for this evaluation: a national survey of intermediaries participating in the RDLF/IRP programs and four site visits to evaluate the administration of RDLF/IRP programs as well as the local impact of RDLF/IRP and NNCP funds.

Intermediary Survey

A survey was the primary tool used in gathering a wide range of data on the intermediary organizations and the operations of the RDLF/IRP loan funds. Six types of information were gathered from RDLF/IRP intermediaries: organizational information on the intermediary and its capacity as a business development lender, perceived capital gaps within the target area, loan fund administration, loan fund performance,loan fund efficiency and FmHA administrative practices.

The survey was mailed to 70 intermediaries who had received RDLF and/or IRP funding during the time period September 1980 through July 1991. Due to the extensive nature of the survey, research staff conducted follow up phone interviews with all survey respondents to ensure the validity of answers and ask additional questions.

A 61% response rate provided the research team with a representative sample of intermediaries. The sample includes a range of organizational types: community development corporations, economic development districts, regional planning commissions, national nonprofit intermediaries, and quasi-public and public institutions. In addition, the sample includes intermediaries with a long history in loan fund administration as well as organizations that have only recently secured loan funds.

The research team encountered several barriers in collecting the data requested from intermediaries. Program costs and loan fund performance were not recorded uniformly by each intermediary. FmHA does not request some of the information the research team sought from intermediaries and therefore many intermediaries did not maintain records of such information. These problems arose in collecting annual technical assistance and administrative costs, job creation numbers, number of low income jobs created, and funds leveraged. Several intermediaries only recently began recording job creation figures and very few recorded to whom these jobs were targeted.

Site Visits

The site visits have been developed into case studies and included in this report to illustrate how programs have been implemented in various regions. Several of the survey findings were reinforced through the site visits: namely, how local economic, industrial and banking trends impact the programs' performance, and how various types of intermediaries implement the program differently.

The research team made site visits to RDLF/IRP intermediaries in Maine, California and Mississippi, and made a fourth trip to Minnesota to visit one of the NNCP intermediaries. These sites were selected for geographic diversity as well as the diversity of intermediaries and development programs being administered within each state. During these site visits, the research team visited not only with intermediaries administering the loan funds, but also with bankers involved with the program, businesses that have benefitted from the funds, and state FmHA officials administering the programs locally.

SURVEY SAMPLE

30 intermediaries received RDLF loans from either the Community Services Administration (CSA) or the Office of Community Services (OCS) between the years 1980-1984. Several of the original RDLF loans were made as pass-through loans to intermediaries for specific project funding and did not result in the establishment of a revolving loan fund. As of July 1991, only 25 organizations had active RDLF revolving funds and 13 of these RDLF intermediaries returned completed surveys.

47 intermediaries had received IRP loans from FmHA as of July 1991. 32 of these intermediaries responded to our survey, although eight of them had not yet advanced funds to ultimate recipients by the close of FY91. The intermediaries which had not yet made any loans responded solely to survey questions dealing with organizational capacity, anticipated management of funds and the nature of the capital gap confronting rural businesses.

A total of seven respondents administer more than one RDLF and/or IRP portfolios. Three intermediaries operate two separate RDLF portfolios and five intermediaries operate RDLF as well as IRP funds. These intermediaries provided the research team with insights comparing the various administrative agencies and the regulatory climates in which the funds have been administered.

DESCRIPTIONS OF SURVEY RESPONDENTS

70

Survey Respondents:40
30 Private Non-Profit (17 CDCs) [1]
9 Quasi- Public Organizations
1 Public Agency

12 RDLF-I INTERMEDIARIES RESPONDED TO THE SURVEY	5 RDLF-II INTERMEDIARIES RESPONDED TO THE SURVEY	32 IRP INTERMEDIARIES RESPONDED TO SURVEY[2]
12 Non-Profits (9 CDCs)	4 Non-Profit (4 CDCs) 1 Quasi-Public	22 Non-Profits (10 CDC) 9 Quasi-Public 1 Public

[1] Seven of the intermediaries which identified themselves as non-profits are non-profit subsidiaries of quasi-public organizations.

[2] Only 23 of these respondents, including 7 CDCs, had actually lent out funds by the end of FY 1991.

RDLF/IRP SURVEY RESPONDENTS

COMMUNITY DEVELOPMENT CORPORATION

4. Midwest Minnesota Community Development Corporation
* 6. Arkansas Enterprise Group
8. Self Help Ventures Fund
9. Lokahi Pacific
10. Albia Industrial Development Corporation
11. Mountain Association for Community Economic Development
12. Tri-Island Economic Development Council Inc.
    Development Commission
15. Kentucky Highlands Investment Corp.
16. Community Enterprise Development Corp. of Alaska
* 18. Community Resource Group Inc.
22. Coastal Enterprises Inc.
23. Del Norte Economic Development Corp.
24. The North Carolina Rural Fund for Development
30. Northern Community Investment Corp.
31. Delta Foundation
* 34. Rural Community Assistance Council
35. Chicanos Por La Causa

NONPROFIT GROUPS

1. California Statewide Certified Development Corp.
2. National Rural Development Finance Corp.
3. Miami Area Economic Development Service
* 5. Coastal Area District Development Corp.
7. Nebraska Economic Development Corporation
* 14. Eastern Maine Development District
* 17. Trico Economic Development District
19. South Georgia Area Resource Development Agency Inc.
20. Rural Missouri Inc.
32. Three Rivers Planning and Development District
36. Georgia Mountains Regional Economic Development Corp.
42. Community Transportation Association
43. Housing Assistance Council

QUASI-PUBLIC GROUPS

13. North Central Pennsylvania Regional Planning and Development Commission
21. Colorado Housing and Finance Authority
* 26. Lake Champlain & Lake George Regional Development Corp.
28. Northwest Pennsylvania Regional Planning and Development Commission
29. Southern Alleghenies Planning and Development Commission
33. Northeast Planning and Development District
38. Franklyn County Industrial Development
* 40. Androscoggin Valley Council of Governments

* Groups which have not lent out funds in FY 1991

SURVEY RESULTS

INTERMEDIARY ORGANIZATION AND CAPACITY

Types of RDLF/IRP Intermediaries

Non-profit community development corporations (CDCs) received 99% of the RDLF funding available in 1980-1984, through either CSA or HHS. Though the other 1% of the intermediaries funded during this time were national intermediaries, their loan funds were funnelled through locally based CDC affiliates. Since FmHA began administering the program in 1985, CDCs have received a significantly smaller share of the total funding.

In analyzing survey results, the research team separated respondents into different categories in order to identify differences in administration and performance among different types of intermediaries.

Survey respondents have been broken down into three categories for the purposes of this data analysis: CDC Intermediaries, Nonprofit Intermediaries, and Quasi-Public or Public Intermediaries. These are defined as:

> CDC Intermediary -- Locally based, non-profit organizations, controlled by a community based board of directors, organized to address the economic development issues of low income people.
>
> Nonprofit Intermediary -- Locally or nationally based private non-profit organizations, including non-profit subsidiaries of public or quasi-public bodies.
>
> Quasi-Public or Public Intermediary -- This category included Regional Planning and Development Commissions, Housing Finance Agencies and others.

In some cases, information will be broken down into CDC and non-CDC categories, RDLF-I, RDLF-II and IRP categories, or CDC, non-profit and quasi-public/public organizations.

Loan Fund Experience

The average intermediary surveyed is 17 years old, employs 15 individuals and has been running a business development loan fund for more than 9 years. Of the 40 survey respondents, 36% serve multi-county areas, 28% are statewide organizations, 10% are multi-state and the remainder are county, regional or national in scope.

Out of all survey respondents, 72% had administered business development loan funds before securing RDLF/IRP funding. Intermediaries had secured loan fund capital from a variety of public and private sources: CSA, EDA, SBA, private foundations, banks.

Only 50% of the RDLF-I respondents had previous loan funds experience before securing the RDLF-I loan. These intermediaries, many of which currently administer multiple loan funds, began cultivating their economic development lending strategies through their experience with the RDLF program.

The survey revealed that CDCs had longer track records in operating revolving loan funds than other intermediaries surveyed. On average, CDCs have been operating funds for 11 years while non-CDCs reported an average 6 years experience in administering loan funds.

Funding Sources

After securing either RDLF or IRP loans, many respondents ranked FmHA as their primary funding source. This indicates that previous funding sources (CSA or HHS) provided smaller capital loans or grants as compared to the current RDLF/IRP funding. In addition, the RDLF/IRP funds significantly increased the intermediaries' capital lending base.

Survey respondents were asked to list their three major funding sources of the last five years. The following table illustrates where the various intermediaries secure their major funding.[3]

FUNDING SOURCE	CDC	Nonprofit	Quasi-Public & Public
Private Foundations	35%	8%	0%
State Governments	18%	23%	50%
Local Governments	6%	31%	10%
Program Income	53%	38%	10%
U.S. Department Health and Human Services	65%	8%	0%
Farmers Home Administration	59%	77%	40%
Financial Institutions	24%	23%	10%

[3]Percentages exceed 100 percent because intermediaries listed multiple sources of funding.

CDCs rely more on foundations, HUD, HHS and their own program income than do non-CDCs while other non-profits and quasi-publics are largely financed by their state governments and by FmHA.

<u>Programs and Services Provided</u>
Surveyed intermediaries were asked to identify the services and programs that they provide. There was a heavy concentration in small business lending and commercial development among all the intermediaries.

INTERMEDIARY PROGRAM AREAS

Program Area	CDC	Nonprofit	Quasi-Public
Housing Development	29%	15%	10%
Commercial Development	35%	54%	30%
Industrial Development	24%	62%	70%
Regional Planning	0%	23%	40%
Small Business Lending	76%	85%	90%
Micro-Enterprise Development	24%	0%	20%
Community Facility Development	18%	23%	50%
Business Management and Technical Assistance	53%	23%	10%

CDCs demonstrated more activity as technical assistance providers and housing developers than did other intermediaries surveyed. Non-profits and quasi-publics are more involved with commercial and industrial development, and small business lending. Finally, non-CDCs demonstrated a greater involvement in regional planning activities and community facility development.

B. CAPITAL GAPS

Defining Existing the Capital Gaps Addressed by the RDLF/IRP

All 40 survey respondents were asked to characterize the nature of the capital gaps facing rural businesses. Most respondents focused on lending barriers within the banking industry, a general lack of investment capital in rural areas and the specific problems facing small, under-collaterized businesses.

Very few groups identified the recession as a contributing factor to the lack of available capital. Groups were more focused on changes within the banking industry which have shifting capital away from rural business development. Recent regulatory changes have encouraged banks to restructure their risk rating systems resulting in less credit availablity for small businesses.

As the following chart illustrates, a significant portion of the RDLF I funds were channelled to start-up businesses while RDLF II and IRP loans have been targeted more to expanding businesses.

STAGE OF BUSINESSES RECEIVING RDLF/IRP FUNDS

STAGE OF BUSINESS	RDLF-I	RDLF-II	IRP
START-UP	93 (45%)	21 (33%)	58 (30%)
REORGANIZATION	3 (2%)	0 (0%)	6 (3%)
EXPANSION	112 (53%)	44 (68%)	133 (67%)
TOTAL	208 (100%)	65 (100%)	197 (100%)

Several factors have contributed to this shift. Loan decisions on the RDLF-I funds were left largely to the discretion of the intermediary with very few restrictions imposed by CSA as the federal oversight agency. Intermediaries were encouraged to invest in ventures that were unable to secure financing from conventional sources (under-collaterized, start-up businesses etc.) and would generate employment and/or low income ownership.

Current IRP regulations promote more conservative lending on the part of the intermediary. FmHA security requirements ensure that all loans are sufficiently collateralized and FmHA has the power to intervene if they are not satisfied with security decisions. Though FmHA does not often exercise this power, the regulations encourage intermediaries to minimize the risk on all investments. IRP funds are not administered as high risk loan funds and are therefore targeted to more stable business ventures.

Capital Gaps Addressed with RDLF/IRP Funds

The following charts illustrate the types of financing being provided through RDLF/IRP loans as well as the industries in which the funds are being channelled.

This table shows that the majority of all deals are either long-term working capital, construction, or equipment, and that the majority of borrowers are in manufacturing, retail and wholesale (to a lesser extent), and services.

It is difficult for small businesses to secure fixed rate, long term financing. This is one of the most critical capital gaps being addressed by RDLF/IRP funds. Survey respondents attempts to address this demmand for fixed rate term credit. More than 75% of the respondents offer all their loans at fixed rates and the average interest rate on IRP loans is 8 years.

USES OF RDLF/IRP FINANCING[4]

Uses	RDLF I		RDLF II		IRP	
Long-term	38	28.79%	25	28.41%	43	17.99%
Short-term	6	4.55%	3	3.41%	0	0.00%
Construction	26	19.70%	12	13.64%	65	27.20%
Equipment	36	27.27%	42	47.73%	98	41.00%
Building/R.E./hsg.	13	9.85%	0	0.00%	18	7.53%
Inventory	6	4.55%	6	6.82%	3	1.25%
Renovation	1	0.76%	0	0.00%	2	0.84%
Boat/airplane	6	4.55%	0	0.00%	0	0.00%
Debt consolidation	0	0.00%	0	0.00%	4	1.67%
Buy-out	0	0.00%	0	0.00%	6	2.51%
Total	132	100.00%	88	100.00%	239	100.00%

INDUSTRIES RECEIVING RDLF/IRP FUNDS

Sectors	RDLF I		RDLF II		IRP	
Public utilities	0	0.00%	0	0.00%	2	0.96%
Manufacturing	28	28.57%	46	71.88%	80	38.28%
Retail	20	20.41%	6	9.38%	44	21.05%
Services	37	37.76%	6	9.38%	38	18.18%
Transportation	0	0.00%	0	0.00%	4	1.91%
Wholesale	0	0.00%	1	1.56%	19	9.09%
Construction	8	8.16%	3	4.69%	19	9.09%
Agriculture	1	1.02%	0	0.00%	2	0.96%
Communications	0	0.00%	0	0.00%	1	0.48%
Processing	0	0.00%	2	3.13%	0	0.00%
Real estate	1	1.02%	0	0.00%	0	0.00%
Natural resources	2	2.04%	0	0.00%	0	0.00%
Tourism	1	1.02%	0	0.00%	0	0.00%
Housing	0	0.00%	0	0.00%	0	0.00%
Total	98	100.00%	64	100.00%	209	100.00%

[4] Two intermediaries target their RDLF/IRP lending stricIty to housing construction. Their numbers were not included in this chart.

C. TARGETING

RDLF and IRP regulations encourage intermediary lenders to create job opportunities for low income people and displaced farm workers but there are no requirements or targetting goals established. It is left up to the intermediary to determine how they will implement the lending program, how they will target the loans, and what types of hiring restrictions they will impose on ultimate loan recipient.

Only 9 out of the 40 respondents target their lending to low income entrepreneurs. These 9 groups represent both CDCs, non-profits, and quasi public organizations. This indicates that the decision to target loans to low income entrepreneurs is not tied to program regulations but rather an independent administrative decision made by intermediaries.

For groups that target low-income entrepreneurs, the leveraging ratio is 2.90 for the RDLF I, 1.85 for the RDLF II, and 4.59 for the IRP. For groups that do not target low-income entrepreneurs, the leveraging ratio is 5.73 for the RDLF I, 3.83 for the RDLF II, and 3.03 for the IRP. Across the board figures indicate that targeting to low income borrowers makes it more difficult to leverage additional lending dollars.

Out of the 40 survey respondents, 11 require borrowers to create jobs for low income people as part of their RDLF/IRP lending agreement. These groups monitor the borrowers progress in meeting these goals though only a portion of the intermediaries actually record the number of low income jobs created. Another 9 intermediaries encourage their borrowers to create jobs for low income people but do not require it as part of a loan agreement.

For the 11 intermediaries that require borrowing businesses to create jobs for low-income workers, the leveraging ratio is 1.14 for the RDLF I, 3.83 for the RDLF II, and 2.89 for the IRP. These leveraging ratios are slightly below average for the portfolios as a whole.

D. RDLF and IRP LOAN FUND ADMINISTRATION and PERFORMANCE
Survey respondents reported on their RDLF/IRP lending for the last five years and they were asked questions regarding how loan decisions are made, how the loan funds are administered and how the portfolios perform.

Risk Rating Loans
Intermediaries rely primarily on the same business indicators as would a private banking institution in making loan decisions: credit reports, cash flows, and quick ratios. Fourteen percent of the intermediaries stressed the importance of solid collateral in their lending.

The survey asked intermediaries to define the risk rating system used in reviewing loan applications. Risk rating systems, often used by banks, establish loan catagories according to risk. Lenders attempt to maintain a certain level of lending within each category thereby ensuring a balance portfolio with regard to risk. The survey revealed that very few intermediaries had developed or were in the process of developing such systems.

Most intermediaries review loans on an individual basis and if they meet the established lending criteria they are funded. Intermediaries relied heavily on loan review committees to determine the credit worthiness of a loan.

No pattern emerged showing a correlation between the size and experience of the intermediary and the method used in measuring risk.

Though intermediaries stressed the importance of RDLF/IRP funds as subordinated capital, many intermediaries were reluctant to take a second position to a bank investor on security. They felt that IRP funds should not be treated as the high risk capital and the intermediaries security position should be solid. For instance, if an intermediary's 30% investment in a project is making it possible for the bank to invest 70% of the total project cost, the intermediary would be reluctant to take second position on all security. At minimum they would want to share first position with the bank on a portion of the collateral.

Loan Loss Reserves
Though in some cases, FmHA officials will suggest a loan loss reserve level, neither the RDLF or IRP regulations mandate the establishment of a loan loss reserve. The reserves on RDLF funds range from 0-20%, 0-16% for RDLF-II, and 0-20% for IRP. Groups establish these levels according to the performance of their loan portfolio and 55% of the respondents said that these levels have varied over time.
The average loan loss reserves for these portfolios are 8.7%, 7.2% and 3.6% respectively. Ten of 12 RDLF I intermediaries maintain a reserve, and three of five RDLF II intermediaries and

23 of 32 IRP intermediaries maintain a reserve. The average loan loss reserve for IRP portfolios is lower than the other because the IRP funds are significantly younger and have not generated as many loans. It is expected that this average will rise as the loan funds mature.

Out of all survey respondents, 13 do not maintain a loan loss reserve -- seven CDCs, four nonprofits, and two quasi-publics. In general, these groups compensate by maintaining very high security standards to guard against loss.

<u>Leveraging</u>

Leveraging outside funds to be used in conjunction with RDLF/IRP has become increasingly important. RDLF/IRP funds are limited to funding only 75% of any one project and intermediaries and/or borrowers have always had to leverage the additional funds from another source. In addition, intermediaries are now required to document their leveraging ability in order to apply for FmHA funding.

Different types of intermediaries have different leveraging sources and levels. The majority of nonprofits, both CDCs and non-CDCs, leverage funds most frequently from banks.

CDCs must turn to a wider range of non-bank leveraging sources than do non-CDCs. A variety of reasons account for the difficulty CDCs have in leveraging bank funds. Some CDC economic development programs emerged as a response to a lack of capital resources in rural areas. For example, Community Enterprise Development Corporation of Alaska, works in Alaska where banks are reluctant to invest in rural commercial development. CDCs that address credit gaps left by private lenders are more reliant on public funds or foundation support by necessity.

LEVERAGING SOURCES FOR ALL RDLF/IRP LENDING

Leveraging Sources	CDCs	Nonprofit	Quasi-Public/ Public
Banks	47.06%	84.62%	60%
Local Funds	17.65%	0	20%
State Funds	5.88%	0	0
Federal Funds	5.88%	15.38%	0
Community Credit Union	5.88%	0	0
Owner Equity	5.88%	0	0
Internal Funds	5.88%	0	10%
No Response	0	0	10%

LEVERAGING RATIOS FOR RDLF-I, RDLF-II, IRP by INTERMEDIARY TYPE

	CDC	Nonprofit	Quasi-Public/Public
RDLF-I Leverage Ratio	3.25	3.26	n/a
RDLF-II Leverage Ratio	1.62	n/a	4.84
IRP Leverage Ratio	2.69	3.11	3.76
Overall Leverage Ratio	2.80	4.52	3.91

CDC respondents have been less successful in their leveraging attempts than have the other non-profits and quasi-publics. The intermediaries that worked with banks demonstrated a greater ability to leverage funds.

REPORTED RDLF I, RDLF II, and IRP LENDING 1987-1991

	RDLF-I	RDLF-II	IRP
Number of Intermediaries Surveyed	11	4	24
Total Number of Loans	109	62	178
Total Loan Amounts	$8,021,039	$2,795,089	$17,680,878
Average Loan Size	$73,587	$45,082	$99,330
Number of Jobs Created	1,699	1,230	4,133
Cost Per Job	$4,721	$2,272	$4,278

CDC's make larger RDLF/IRP loans when compared to non-profit and quasi-public intermediaries and their average cost per job is higher when compared to other groups.

CDCs have created 777 jobs at a cost of $6,305 per job. Non-profits have created 2,383 jobs at a cost of $3,949 per job and quasi-publics and publics have created 973 jobs at a cost of $3,465 per job.

Since we are focusing on the job creation of loan funds, the following charts only represent the lending of RDLF/IRP intermediaries which focused their lending to businesses development.

REPORTED RDLF I LOAN ACTIVITY FY1987 - FY1991

	CDC	Nonprofit	Quasi-public/ public
Number of Intermediaries Surveyed	9	1	0
Total Number of Loans made	94	7	0
Total Amount of Loans Made	$7,109,977	290,000	0
Average Loan Size	$75,638	$41,429	0
Number of jobs Impacted	1,656	43	0
Cost per job	$4,293	$21,187	0
Amount Leveraged	$23,128,569	$988,000	0
Leveraging Ratio	3.25	3.26	0

REPORTED RDLF II LOAN ACTIVITY FY1987 - FY1991

	CDC	Nonprofit	Quasi-public/ public
Number of Intermediaries Surveyed	3	0	1
Total Number of Loans made	33	0	29
Total Amount of Loans Made	$2,235,259	0	$559,730
Average Loan Size	$67,735	0	$19,301
Number of jobs Impacted	993	0	237
Cost per job	$2,251	0	$2,361
Amount Leveraged	$3,624,500	0	$2,709,150
Leveraging Ratio	1.62	0	4.84

REPORTED IRP LOAN ACTIVITY FY1989 - FY1991

	CDC	Nonprofit	Quasi-public/ public
Number of Intermediaries Surveyed	7	9	8
Total Number of Loans made	42	90	110
Total Amount of Loans Made	$4,899,166	$9,409,722	$3,371,990
Average Loan Size	$116,647	$104,552	$30,654
Number of jobs Impacted	777	2,383	973
Cost per job	$6,305	$4,018	$3,466
Amount Leveraged	$13,221,217	$29,305,059	$12,671,711
Leveraging Ratio	2.69	3.11	3.76

More able to speak about them - mix of grp's, structure admin grps at 2 levels

Delinquency and Default Rates

It is not surprising that the RDLF-I demonstrated the highest level of delinquency and default rates since it is the oldest of the portfolios and for some intermediaries represents their first exposure to administering a loan fund.

In the last five years survey respondents made 109 RDLF-I loans and during this time period, intermediaries experienced an 11% default rate. At the close of FY 1991, 7 loans were delinquent amongst all RDLF-I respondents.

The RDLF-II respondents made 62 loans over this 5 year time period maintaining on average a 3% default rate and reported 8 delinquent loans at the end of FY 1991.

The IRP respondents reported on three years of lending. 178 loans were made and only 1 default was reported during that period. At the close of FY 1991, 2 IRP loans were reported to be delinquent. The IRP portfolios are too young to analyze with regard to their delinquency or default rates.

Loan Terms

TERMS OF LOANS TO ULTIMATE RECIPIENTS

	Program Average	CDCs	Non-profits	Quasi-Public & Public
RDLF-I	9.5%, 6.5 years	9.5%, 6.5 years	7.7%, 8.4 years	n/a
RDLF-II	9.9%, 7.3 years	11.5%, 9.2 years	n/a	8.0%, 5.0 years
IRP	7.4%, 8.8 years	8.4%, 11.1 years	7.6%, 8.6 years	6.6%, 8.7 years

CDCs charge a higher interst rate on their loans and the terms of their loans are longer when compared to other non-profits and quasi-publics.

E. TECHNICAL ASSISTANCE (TA)

FmHA does not provide funding to RDLF/IRP intermediaries for the provision of TA in conjunction with financial assistance. It is up to the intermediary to decide what types of assistance can be offered and how the costs will be covered.

50% of the respondents reported that they "always" or "often" provide TA to their RDLF/IRP borrowers. Another 25% reported that TA is "sometimes" provided with their RDLF/IRP lending. There did not seem to be a correlation between the size of the loans and the provision of tecnical assistance.

The intermediaries that do provide TA are often unable to cover the costs of their TA with the interest rate spread that they charge on their RDLF/IRP loans. These intermediaries supplement the TA costs of their RDLF/IRP portfolio with income generated from one of their other loan funds or programs.

CDCs provide technical assistance more often than do non-CDC groups. However, they are more dependent on non-loan fund sources to pay for it.

		CDCs		Nonprofits		Quasi-publics	
Number		17	%	13	%	10	%
Extent:	Always	3	17.65	1	7.69	1	10.00
	Often	7	41.18	4	30.77	3	30.00
	Sometimes	4	23.53	4	30.77	3	30.00
	Never	3	17.65	3	23.08	3	30.00
	Blank	0	0.00	1	7.69	0	0.00
Costs)	Loan fund	3	17.65	4	30.77	1	10.00
Covered)	Other loan fund	2	11.76	3	23.08	1	10.00
By:)	Other income	6	35.29	2	15.38	2	20.00
	Foundation support	1	5.88	0	0.00	0	0.00
	Government grants	4	23.53	0	0.00	2	20.00
	SBDC	0	0.00	0	0.00	0	0.00
	N/A or blank	1	5.88	4	30.77	4	40.00
Areas:	Management	14	82.35	3	23.08	1	10.00
	Production	5	29.41	1	7.69	1	10.00
	Planning	11	64.71	6	46.15	4	40.00
	Accounting	12	70.59	1	7.69	2	20.00

	CDCs		Nonprofits		Quasi-publics	
Areas: Marketing	9	52.94	4	30.77	4	40.00
(cont'd) Training	0	0.00	5	38.46	3	30.00
IRP financing	1	5.88	3	23.08	4	40.00
Import substitution	0	0.00	0	0.00	1	10.00
Gov't procurement	0	0.00	0	0.00	0	0.00
Permanent financing	0	0.00	1	7.69	0	0.00

CDCs provide more more often than do non-CDC groups. However, they must use non-loan fund sources more often with which to do it.

F. COST EFFICIENCY

Costs of Technical Assistance and Administration

The data presented significant difficulties for the calculation of T.A. and administration costs. Many groups did not provide cost figures. In addition, cost figures reflected not only a current year's loans but also the outstanding loans of the previous years, but the data did not indicate how many loans of previous years continued to be outstanding. Consequently, calculations of T.A. and administration costs per outstanding loan would be vague at best.

However, the IRP program has only been in operation for three years. We assumed that the number of open loans would accumulate over that time, and that none would close in those three years. The following figures, therefore, reflect only the average T.A. and administration cost for IRP intermediaries who reported their costs. Even as new intermediaries joined the program over the three years, the costs remained stable as a percentage of outstanding loan amounts (taken at initial loan size).

Each chart is calculated on different numbers of loans to reflect the loans made by intermediaries who provided cost information (and in the case of the T.A. chart, who provide T.A.). Consequently, they do not mirror each other.

ADMINISTRATIVE and TECHNICAL ASSISTANCE COSTS of SELECT IRP PORTFOLIOS

Year	1989	1990	1991
Loans Made	20	13	48
Original Outstanding	$ 1,907,250	889,350	3,705,721
Average Loan	$ 95,363	68,412	77,203
Cumulative Loans Open	20	33	81
Cumulative Outstanding	$ 1,907,250	2,796,600	6,502,321
Cumulative Average Loan	$ 95,353	84,745	80,276
Tech. Assistance Cost	$ 23,539	26,264	37,931
Current Avg. T.A. Cost	$ 1,177	796	468
T.A. Cost/Outstanding	1.23 percent	0.94 percent	0.58 percent
Loans Made	27	39	94
Original Outstanding	$ 2,738,500	3,964,946	9,207,682
Average Loan	$ 101,426	101,665	97,954
Cumulative Loans Open	27	66	160
Cumulative Outstanding	$ 2,738,500	6,703,446	15,911,128
Cumulative Average Loan	$ 101,426	101,567	99,445
Administration Cost	$ 82,305	211,516	483,486
Current Ave. Adm. Cost	$ 3,048	3,205	3,022
Adm. Cost/Outstanding	3.01 percent	3.16 percent	3.04 percent

Technical Assistance for CDCs, Nonprofits, and Quasi-Publics:

G. FEDERAL OVERSIGHT and ACCOUNTABILITY

RDLF Administration under FmHA vs HHS

Many of the RDLF/IRP intermediaries surveyed have administered their loan program under more than one of the federal agencies since 1980: the Community Services Administration (CSA), the Office of Community Service (OCS) and Farmers Home Administration (FmHA). Survey respondents were asked to comment on the varying regulatory climates of the various agencies and whether transfer of the program affected the manner in which the program was administered.

Of the 14 RDLF intermediaries that responded, the vast majority of RDLF respondents said they did not observe a change in the administration of the program since it was transfered from OCS to FmHA. Two of the intermediaries felt that FmHA has a more business oriented administration than HHS and is more involved in regulating lending.

FmHA's Administration of the RDLF/IRP

The RDLF and IRP portfolios are currently administered by the Business and Industry Division of FmHA. State FmHA offices are responsible for monitoring RDLF/IRP programs within their state and intermediaries submit quarterly progress reports directly to the state. There is little contact between the intermediaries and the national office on RDLF/IRP matters.

For the purposes of this report, the research team requested the release of all intermediary reporting documents from the national office. To fulfill this request, the national office had to call in all documents from the various state offices. In other words, the national FmHA office does not maintain records on the performance of the programs nationally. Beyond granting final funding approval to the intermediaries, the national office has very little involvement with the operations of these programs.

This decentralized nature of FmHA's IRP program was evident in speaking to intermediaries as well as to state FmHA officials. The administrative problems that intermediaries raised in their phone interviews were largely related to problems they were having with the state FmHA office.

All but two intermediaries reported that they had a good working relationship with FmHA. The two intermediaries that reported having problems with FmHA, had encountered difficulties working with their respective state offices and both problems revolved around the closing of the IRP loan with FmHA.

Follw-up phone interviews with intermediaries enabled the research team to clarify administrative and regulatory problems that intermediaries were experienceing with FmHA.

Administrative Problems with FmHA

The following issues were identified by intermediaries in the survey and through follow-up phone interviews.

TIMELINESS OF IRP LOANS CLOSING WITH INTERMEDIARIES

In follow up interviews with survey respondents, intermediaries described the problems they encountered closing their original IRP loan with FmHA. According to the survey the average time lapse between obligation of funds and closing of the IRP loan was 180 days. In contrast, the majority of the RDLF loans were closed immediately after obligation.

FmHA REVIEW OF LOANS TO ULTIMATE RECIPIENTS

In the survey, two intermediaries felt that FmHA was overly intrusive when it came to reviewing loans to ultimate recipients. In one case, a FmHA state office refused to approve an intermediary loan because they felt the interest rate being charges to the ultimate borrower was too high. Though regulations specify that terms of loans are determined by the intermediary, the state FmHA office in this case became involved and the interest rate was eventually reduced.

ENVIRONMENTAL REVIEW

Environmental reviews must be conducted on all projects applying for IRP funding. Regulations require that FmHA staff conduct these assessments and due to limited staff and the logistics involved, intermediaries have complained that this process holds up their ability to make loans in a timely manner.

FEDERAL NATURE OF IRP DOLLARS

Confusion existed amongst intermediaries as to the nature of IRP dollars after they are loaned out and revolved back into the fund. Ar ethese funds still federal in nature and therefore subject to FmHA regulations? Of the 28 IRP intermediaries which addressed this question, 12 understood that their IRP funds were not subject to a loan by loan review once they had been loaned out once, 11 were unsure, and 5 felt that FmHA would maintain oversight and the review process would remain the same minus the environmental review.

LOANS TO INTERMEDIARIES CAPPED AT $2 MILLION

Many of the intermediaries have already borrowed the maximum $2 million in IRP funds from FmHA. A number of these intermediaries lent out their $2 million within the first year and would like to access additional IRP funds. In addition, the research team spoke with several state FmHA officials who would like to see the cap raised to $4 million.

EROSION OF PRINCIPAL

Of the 14 RDLF intermediaries that responded to the survey, 9 commented that the erosion of principal, through inflation and repayment to FmHA, limited their ability to administer the program effectively. These RDLF funds continue to make loans though they can not generate the same volume and they are forced to make smaller loans.

This problem will soon be encountered by IRP intermediaries as their loan funds are drawn down.

The Process of Drawing Down IRP funds from FmHA

There are several bottlenecks that hamper the efficient flow of IRP dollars from FmHA to the intermediaries and ultimately to the business borrowers.

Once an intermediary's application for IRP loan funds has been approved by FmHA's national office, funds are obligated to the state office where the loan agreement between the intermediary and FmHA is finalized. The average time lag between the obligation of IRP funds to the intermediary and the closing of the actual IRP loan is 180 days according to survey respondents. However, some intermediaries have waited for up to one years for their final loan agreement to be approved by FmHA. During this waiting period, an intermediary stands poised with potential borrowers yet they are unable to commit to any loans until their IRP agreement is finalized.

IRP funds, once obligated to the intermediary, can only be drawn down on a deal by deal basis. After a potential borrower files a loan application with the intermediary it must be submitted to the state FmHA office for approval. Again, the timeliness of this process varies dependant on the efficiency of the state FmHA office. The survey revealed that 44% of the intermediaries had their loans approved by FmHA within two weeks of submitting loan requests, 31% responded that their average turnaround time was one month, 16% waited between one and two months and the remaining 9% experienced two to four month turn around time.

As the chart below illustrates, IRP funds are not being advanced efficiently to the ultimate borrowers. As of July 1992, only 60% of the IRP funds obligated to intermediaries in 1988 and 1989 had actually been advanced to businesses.

YEAR	FEDERAL APPROPRIATION LEVEL	FUNDS OBLIGATED	FUNDS ADVANCED	PERCENTAGEOF OBLIGATED FUNDS ADVANCED AS OF 7/6/92
1988	$14 MILLION	$13,990,000	$8,366,292	60%
1989	$14 MILLION	$12,500,000	$7,400,239	60%
1990	$19.5 MILLION	$19,050,000	$7,771,740	41%
1991	$32.5 MILLION	$31,999,540	$10,799,830	34%
1992	$32.5 MILLION	$14,050,000	$0	0
TOTAL	$112.5 MILLION	$91,589,540	$34,338,101	37%

INTERMEDIARY RELENDING PROGRAM LOANS

STATE	TOTAL STATE IRP FUNDS	INTERMEDIARY	IRP LOAN AMOUNT	DATE OBLIGATED	DATE CLOSED	AMOUNT DRAWN DOWN AS OF 9/6/92
ARKANSAS	$2,000,000	Community Resources	$1,000,000	5/23/90	2/21/91	0
		Arkansas Enterprise	$1,000,000	5/14/91	8/9/91	$250,000
CALIFORNIA	$6,300,000	California Coastal	$2,000,000	6/25/90	12/17/92	$732,250
		California Statewide	$1,500,000	5/15/90	11/9/90	$922,000
		Del Norte Economic	$300,000	7/6/90	1/8/91	$150,000
		Rural Community	$2,000,000	9/27/90	8/29/91	$300,000
		Arcata Economic	$500,000	9/23/91	12/18/91	0
COLORADO	$1,200,000	Colorado Housing	$1,200,000	7/20/90	9/4/90	$683,490
GEORGIA	$6,500,000	South GA ARDA	$750,000	9/30/88	2/16/89	$750,000
		GA Mountains REDC	$1,500,000	1/16/90	3/29/90	$1,500,000
		Coastal Area District	$1,000,000	4/5/91	N/A	$150,000
		CSRA Rural Lend Auth.	$1,000,000	6/26/91	10/30/91	$521,000
		South GA ARDA	$1,250,000	4/10/91	9/24/92	$250,000
		Middle Flint ADC	$1,000,000	5/21/92	N/A	0
ILLINOIS	$1,500,000	IL Development	$1,500,000	5/16/90	12/14/90	$1,496,500

STATE	TOTAL STATE IRP FUNDS	INTERMEDIARY	IRP LOAN AMOUNT	DATE OBLIGATED	DATE CLOSED	AMOUNT DRAWN DOWN AS OF 9/6/92
IOWA	$1,900,000	Albia Industrial	$900,000	12/1/88	2/21/90	$625,000
		Dubuque County	$1,000,000	9/10/91	N/A	0
KANSAS	$3,350,000	So. Central KS Economic Dev.	$750,000	9/29/88	10/27/89	$736,500
		Mid. America, Inc.	$750,000	12/6/88	3/12/90	0
		Pioneer Country Dev.	$300,000	4/13/90	N/A	0
		Great Plains Development	$300,000	9/16/92	N/A	0
		So. Central KS Economic Dev.	$1,250,000	6/5/92	N/A	0
KENTUCKY	$2,626,000	Kentucky Highlands	$1,876,000	6/18/91	10/28/91	$219,760
		Purchase Area	$750,000	3/31/92	N/A	0
LOUISIANA	$2,000,000	North Delta	$2,000,000	9/17/91	1/28/92	0
MAINE	$5,060,000	Coastal Enterprises	$1,560,000	9/21/88	9/11/89	$1,560,000
		Eastern Maine Dev.	$1,500,000	8/2/90	10/25/90	$651,500
		Androscoggin Valley	$2,000,000	4/4/92	8/13/91	$1,295,000
MARYLAND	$4,120,000	Community Trans	$2,120,000	9/28/88	6/30/89	$561,000
		Housing Assistance	$2,000,000	4/9/92	N/A	0

STATE	TOTAL STATE IRP FUNDS	INTERMEDIARY	IRP LOAN AMOUNT	DATE OBLIGATED	DATE CLOSED	AMOUNT DRAWN DOWN AS OF 9/6/92
MINNESOTA	$2,990,400	City of Fosston	$640,400	8/7/91	2/18/92	0
		Midwest MN	$1,350,000	4/15/91	7/9/91	$708,720
		Development Corporation	$250,000	4/21/92	N/A	0
		Northeastern MN	$750,000	1/6/92	4/6/92	0
MISSISSIPPI	$5,250,000	Northeast MS PDD	$2,000,000	4/29/91	6/17/91	$1,560,000
		South Delta PDD	$1,250,000	6/18/91	9/24/91	0
		Three Rivers PDD	$2,000,000	2/28/91	4/16/91	$2,000,000
MISSOURI	$2,000,000	Rural Missouri	$1,000,000	2/5/91	3/21/91	$785,000
		Green Hills Rural	$1,000,000	9/27/91	N/A	0
NEBRASKA	$2,000,000	Nebraska Economic	$2,000,000	5/5/89	2/8/90	$1,629,769
NEW JERSEY	$1,000,000	South Jersey Economic	$1,000,000	7/18/90	N/A	$265,500
NEW YORK	$3,500,000	Lake Champlain	$500,000	9/26/89	7/6/90	$40,000
		New York Job Development	$650,000	1/17/89	7/6/90	$378,820
		New York Job Development	$1,350,000	9/27/91	N/A	0
		North Country	$1,000,000	8/2/91	3/4/92	$287,500

STATE	TOTAL STATE IRP FUNDS	INTERMEDIARY	IRP LOAN AMOUNT	DATE OBLIGATED	DATE CLOSED	AMOUNT DRAWN DOWN AS OF 9/6/92
NORTH CAROLINA	$5,952,140	NC Rural Fund for Dev.	$900,000	11/25/88	7/13/89	$900,000
		Self Help Venture	$1,500,000	9/20/90	7/15/91	$278,000
		Advancement	$352,140	8/29/91	1/23/92	$150,000
		Advancement	$647,860	4/22/92	N/A	0
		Dunn Area Committee	$850,000	4/24/92	N/A	0
		Neuse River Development	$1,702,140	4/29/92	N/A	0
OKLAHOMA	$3,500,000	Miami Area Economic	$1,000,000	11/18/88	4/7/89	$1,000,000
		Rural Enterprises	$1,500,000	11/22/88	10/5/89	$780,000
		Miami Area Economic	$1,000,000	7/30/91	8/29/91	0
PENNSYLVANIA	$4,485,000	Northwest PA Reg.	$510,000	9/29/88	8/21/89	$510,000
		North Central PA	$500,000	12/14/88	6/15/89	$500,000
		Northern Tier	$500,000	12/14/88	8/7/89	$396,150
		Southern Alleghenie	$500,000	4/3/90	10/24/90	$492,500
		Northwest PA Reg.	$975,000	6/25/91	N/A	0
		North Central PA	$1,500,000	9/20/91	12/19/91	$272,850
SOUTH CAROLINA	$850,000	Lake City Development	$850,000	4/17/92	N/A	0
SOUTH DAKOTA	$3,500,000	SD Economic Development	$2,500,000	1/3/89	9/20/90	$350,000
		First District	$1,000,000	1/15/92	N/A	0

STATE	TOTAL STATE IRP FUNDS	INTERMEDIARY	IRP LOAN AMOUNT	DATE OBLIGATED	DATE CLOSED	AMOUNT DRAWN DOWN AS OF 9/6/92
TENNESSEE	$5,876,000	Cumberland Area	$2,000,000	1/14/91	3/15/91	$2,000,000
		So. Central TN Development	$1,876,000	7/29/91	1/27/92	$250,000
		Southeast Local	$2,000,000	2/5/92	5/14/92	0
UTAH	$800,000	Deseret Certified	$800,00	12/15/88	5/30/89	$800,000
VERMONT	$3,680,000	Northern Community	$1,300,000	9/21/88	7/17/89	$1,087,500
		Vermont 503	$1,000,000	9/27/88	9/8/89	$530,554
		Franklin County	$900,000	3/16/90	9/21/90	$300,000
		Rutland Industrial	$480,000	9/3/91	N/A	0
WASHINGTON	$300,000	Trico Economic	$300,000	1/28/91	4/19/91	$100,000
WEST VIRGINIA	$6,000,000	Mid-Ohio Valley	$3,000,000	9/15/88	5/19/89	$1,155,883
		WV Economic	$3,000,000	9/15/88	9/21/89	$1,474,855
WISCONSIN	$2,350,000	Impact Acceptance	$2,350,000	4/18/90	9/24/91	0
	$90,589,540		$90,589,540			$34,337,601

KANSAS STATE REVOLVING FUND

Introduction

The Kansas state revolving fund (SRF) targets small community wastewater projects by setting aside a share of funds for communities that meet specific population criteria. This targeting method may be appropriate in Kansas, given that rural facility needs make up less than a fifth of total state needs. The majority of facility needs costs in the state are concentrated in metropolitan areas; Kansas City does not yet provide secondary treatment as required by the federal Clean Water Act. Since the Kansas SRF offers loans only at a fixed interest-rate, data on the characteristics of small communities that obtained funds in the SRF set-aside will be instructive when assessing the effectiveness of this targeting method in addressing the needs of lower-income communities.

Wastewater Facility Needs (1988)

According to the 1988 EPA Needs Survey, $467.3 million is needed to address the backlog in statewide facility needs to meet federal Clean Water Act requirements. New interceptor sewers and secondary treatment projects account for more than half of statewide needs estimates. According to state SRF staff, the most critical current water quality projects entail addressing the outstanding need for secondary treatment in the state's major urban areas.

Facility needs in nonmetropolitan areas total $81.8 million, 17-percent of statewide estimates. Rural needs estimates show that inadequate treatment is the most pressing problem; secondary treatment projects account for 40-percent of the rural needs backlog. Existing rural facilities also need to be upgraded and improved as evidenced by the high share of cost estimates for system replacement/rehabilitation and correction of infiltration/inflow problems. These two facility need areas account for a third of rural needs estimates.

Rural needs account for more than a quarter of statewide secondary treatment cost estimates, and nearly a third of all replacement/rehabilitation estimates. The data show that while numerous small and rural communities are currently served by operating facilities, there is an outstanding need to upgrade and rehabilitate these existing facilities.

In contrast, statewide needs data show the greatest overall costs in new interceptor sewer and secondary treatment categories. Metropolitan areas have the greatest need to expand sewer service and to upgrade facilities to meet current federal treatment standards. According to Kansas SRF staff, the backlog in metropolitan treatment projects exists because several larger cities in the state did not pursue EPA Construction Grants funding to address their treatment needs. The need for new sewer service in metro areas has occurred as a result of growth and development in suburban areas.

Chart 1 illustrates the share of cost estimates by project component on a statewide basis and among rural facilities. The last tier of the chart indicates the relative share of costs among rural facilities compared to the state as a whole.

Chart 1.

Share of Facility Needs Cost Estimates in Kansas (from 1988 EPA Needs Survey)

	Share of Cost of Facility Needs Component						
	I	II	IIIa	IIIb	IVa	IVb	V
Statewide	25%	4%	16%	11%	9%	35%	3%
Nonmetropolitan	40%	0	10%	21%	10%	16%	2%
Nonmetro as share of statewide need	**28%**	3%	12%	**32%**	**20%**	8%	10%

(Needs category: I: Secondary treatment; II: Advanced treatment; IIIa: Infiltration/Inflow; IIIb: Replacement/Rehabilitation; IVa: New collector sewers; IVb: New interceptor sewers; V: Combined sewer overflows.)

Although rural cost estimates comprise a relatively small share of statewide estimates, compliance data indicate that rural facility noncompliance may pose a significant risk to public health and environmental quality. Eighty-percent of all operating wastewater facilities in Kansas, some 470 facilities, are located in nonmetropolitan counties. Seventy-two rural facilities are in violation of effluent discharge permit standards. An additional 32 rural facilities are not currently providing secondary treatment as mandated under the Clean Water Act. In total, one in every four rural facilities is not providing adequate treatment, due to the need for either operational or capital improvements.

Kansas State Revolving Fund: History

Kansas established its state revolving fund in FY89. Loan program priorities were structured primarily to address the treatment facility needs of larger, urban areas.

In order to ensure that some loan funds would be available for smaller communities, the Kansas SRF sets aside a minimum of 10-percent of all funds for small community projects, defined as those serving populations of 5,000 and fewer. Ninety-two-percent of cities in the state meet small community population criteria. The set-aside is the only targeting feature of the Kansas SRF.

Kansas SRF loans are offered at a fixed interest-rate based on the bond buyer index. In FY89 and FY90, interest ranged from 4.2 to 4.65-percent, with fluctuations only as a result of the market.

State Revolving Fund Characteristics

In FY89 and FY90, annual available Kansas SRF loan funding totalled $10 million, with $1 million available each year in the small community set-aside. The SRF allocation increased to $24 million in FY91 and $2.4 million was available in the set-aside in that year. During the three year period, available small community set-aside funds totalled $4.4 million.

Characteristics of borrowers:
Between FY89 and FY91, thirteen loans totalling $6.66 million, 15-percent of all SRF funds, were committed to small communities. Most were located in nonmetropolitan areas. Overall, set-aside borrowers obtained relatively small SRF loans of less than $1 million, and those serving lower-income populations also obtained supplemental grants to reduce debt service costs.

Use of Set-Aside: As noted, the total level of SRF loans obligated to small communities during the three-year period exceeded 10-percent, the share of funds set aside specifically for small communities. Discussions with Kansas SRF staff, summarized below, provide an explanation regarding why the share of funding issued for small community projects exceeded the set-aside level.

In FY89 and FY90 each, less than 4-percent of SRF monies were obligated to small communities. However, in FY91, more than twice the amount of funding set aside for small communities was obligated to projects that met set-aside criteria. State staff report that funds were not fully utilized by small communities in the early SRF years both because of the availability of EPA Construction Grants, HUD Small Cities Community Development Block Grants and other grant funding, and because applicants required additional start-up time to meet SRF loan criteria. SRF staff in a number of states have also reported that loan demand has lagged because of the continued availability of EPA grants during the start-up of the SRF program. In addition, SRF staff report that applicants consider loans to be a last resort and prefer to pursue more affordable funding from grant sources such as HUD Small Cities.

Kansas SRF staff believe that the increased level of small community loans obligated in FY91 was the result of two factors: 1) small communities had completed preliminary loan requirements; and 2) applicants that needed grants to reduce debt service needs were successful in obtaining grants and then pursued relatively small SRF loans to complete project financing.

Project type: Most small community projects received funding to address treatment needs, all using lagoon systems. Ten of twelve small community projects addressed treatment, and four of these projects included other facility components such as interceptors, collectors and facility rehabilitation. Of the remaining two projects, one addressed infiltration/inflow needs and the other financed new collector sewers. The predominance of treatment projects reflects the high need for treatment projects in metropolitan and nonmetropolitan areas as documented in EPA Needs Survey data.

Community income: Small community SRF borrowers represent a cross-section of low- and moderate-income communities, in metropolitan and nonmetropolitan areas. The average median household income (MHI) of set-aside recipients was $14,653.

Nonmetropolitan small community borrowers had the lowest average median household incomes, and most also would have qualified for federal funding subsidies, including HUD Small Cities Block Grants and FmHA water/sewer low-interest loans and supplemental grants. Four set-aside borrowers had incomes below the 1990 national poverty level.

Community size: Among small community borrowers, community size averaged 1,326 persons. Not one set-aside borrower exceeded 3,000 in population size, although the maximum population size that would qualify for set-aside funding was 5,000 persons.

Loan size: The amount of funding borrowed from the SRF by small communities is significantly low. Set-aside communities obtained relatively small SRF loans, averaging just over $500,000. Loan amounts ranged from $80,000 to $1,215,000. Only two loans were $1 million or greater. The small loan size among set-aside borrowers may reflect not only the relatively low financing needs of small communities but also may be an indication of the limited debt service capacity of small, rural lower-income communities.

As noted above, the average median household income of nonmetropolitan borrowers would make them eligible for other federal funding subsidies. In fact, two of the lowest income borrowers also received HUD Small Cities grant funding, thereby reducing their SRF borrowing needs. This suggests that debt service costs and debt repayment ability influence small, rural lower-income community borrowing in the SRF. Borrowers with relatively small financing needs may be able to develop affordable projects by combining HUD grants and SRF loans, while others with higher financing needs may require FmHA assistance to develop affordable projects. The relatively small loan size among set-aside borrowers may be an indication that some rural lower-income small communities cannot borrow from the SRF if they cannot reduce debt service costs to an affordable level.

The distribution of small community loans by income illustrates the relatively limited borrowing power of lower-income communities. (When analyzing this data, it is important to note that the Kansas SRF offers loans only at fixed interest-rates - slightly over 4-percent during this time period.

The largest loans -- exceeding $900,000 -- were obligated to small communities with the highest incomes and largest population sizes. Nineteen-percent of SRF small community loans totalling $1.28 million went to below-poverty-level communities, with loans averaging $320,000. Moderate-income (approximately equal to state nonmetropolitan median household income) small community borrowers received nearly three-quarters of all small community funding.

Summary

Data from the Kansas SRF indicate that some relatively small communities are able to take advantage of set-aside funding when loans are offered at fixed interest-rates slightly below market rate. Although there appeared to be a lag in the use of set-aside funds, the Kansas SRF ultimately obligated a higher level of funding to small community projects than was available in the set-aside. This outcome is noteworthy because it suggests that a set-aside does not necessarily function as a cap limiting the amount of funding that will be loaned to a particular population group. However, with 92-percent of Kansas municipalities meeting set-aside population criteria, it is not surprising that applications in the state for "small" community funding might exceed the set-aside funding level.

Community income and loan size data offer insight into the effectiveness of targeting small communities in a program that uses a set-aside with no interest-rate subsidy based on community economic need. The majority of small community loans were issued to borrowers of moderate-income. Small community loans were relatively small, averaging $500,000. With an SRF fixed interest- rate at 60-percent of the bond buyer index (ranging from 4.2 to 4.65-percent over the three years), small communities have been able to gain access to market financing at better rates than would be achieved on their own, due to the size of the issues, size of community, relative risk and issuance costs.

Due to the relatively small size of loans, the benefits of funding access and savings in borrowing also enabled some lower-income borrowers to obtain affordable financing. These same communities would have qualified for FmHA low-interest loans as well as supplemental grants. While FmHA funding terms might have offered a greater level of subsidy to these communities, it is uncertain whether FmHA funding would have provided significant savings to these borrowers, given the amount of financing needed. Moreover, in these cases, the SRF set-aside may have made SRF financing more accessible than FmHA funding, given potential competition for FmHA funds from other communities including those with drinking water needs.

SRF set-aside data indicate that debt service affordability may be a critical factor for some small, rural lower-income communities. The data suggest that supplemental grants may be necessary to reduce SRF debt-financing needs to an affordable level. Two of four poverty-level small communities obtained HUD Small Cities funding and borrowed only $500,000 total in SRF loans. The exact amount of HUD grant funding was not provided but is likely to exceed half of total project costs, making the SRF the smallest contributor to overall project funding. Kansas SRF staff anticipate that joint SRF-HUD grant funding may become a leveraging pattern for small, lower-income community projects to help applicants reduce borrowing needs, particularly because Kansas SRF loans will continue to be offered at a fixed rate, with no subsidy based on economic need.

The overall level of SRF funds loaned to small communities may be limited in the future, given the relatively small loan size. Small community borrowers are likely to continue to seek small SRF loans, since it appears that the level of small community borrowing is related to project affordability and debt service capacity. Low-income participation may also be limited, as such communities are likely to seek grant awards before pursuing SRF funding.

The apparent pattern of small community borrowing -- relatively small loans and limited lower-income community borrowing -- may leave several gaps in addressing small, rural wastewater facility needs. First, small communities with higher cost projects may not pursue SRF loans unless debt service is affordable or supplemental grants have been obtained to reduce debt service costs. It is unclear how many small communities would be unable to address facility needs because of burdensome costs. In fact, the relatively small overall cost of nonmetropolitan facility needs, which total 17-percent of statewide estimates, indicates that rural, small community projects are generally of lower cost.

Second, lower-income small communities in particular may be limited in their ability to borrow from the SRF unless they are successful in obtaining grants. A small customer base and limited financial capability may make 100-percent SRF financing unaffordable, causing such communities to seek subsidies from other programs that base funding priority and eligibility on economic need. For these communities, HUD grants and FmHA financing may be a more accessible and affordable option.

VIRGINIA STATE REVOLVING LOAN FUND

Introduction

Virginia's state revolving fund (SRF) targets small, rural lower-income communities by offering loans at sliding-scale interest-rates based on community economic need characteristics. Such a targeting approach appears appropriate, given that wastewater facility needs in nonmetropolitan areas account for nearly half of statewide needs estimates. SRF loan data show that the SRF interest-rate structure has enabled 37 small, rural lower-income communities to address their wastewater facility needs. These projects account for more than half of all SRF loans issued to-date.

Wastewater Facility Needs (1988)

According to the 1988 EPA Needs Survey, $755.6 million is needed in Virginia to address the backlog in wastewater facility needs in order to meet federal Clean Water Act standards. Facility needs in rural counties account for 36-percent -- $271.7 million -- of the total statewide cost estimates for compliance projects. Of 346 facilities in Virginia, 201 are located in nonmetropolitan counties.

Chart 1 shows a breakdown of wastewater facility cost estimates by needs category. The chart shows that secondary treatment projects account for the largest share of statewide facility cost estimates. Nearly half of treatment cost estimates would address projects located in nonmetropolitan counties.

Chart 1.

Share of Facility Needs Cost Estimates in Virginia (from 1988 EPA Needs Survey)

	Share of Cost of Facility Needs Component						
	I	II	IIIa	IIIb	IVa	IVb	V
Statewide	30%	6%	4%	1%	16%	16%	27%
Nonmetropolitan	36%	9%	4%	1%	29%	21%	.2%
Nonmetro as share of statewide need	**43%**	**53%**	38%	27%	**65%**	**49%**	0%

(Needs category: I: Secondary Treatment; II: Advanced Treatment; IIIa: Infiltration/Inflow; IIIb: Replacement/Rehabilitation; IVa: New Collector Sewers; IVb: New Interceptor Sewers;

V: Combined Sewer Overflows.)

Treatment level and compliance data indicate that both capital and operation and maintenance improvements are needed to meet federal discharge standards. Nonmetropolitan facilities account for 73-percent of all facilities that currently provide less than secondary treatment (38 facilities). Eighty-two-percent of the state's 78 facilities that are not in compliance with discharge permit standards are in rural areas.

New collector and new interceptor sewer needs estimates show that nonmetropolitan areas have a greater share of the overall need to provide new or expand sewer service than do metropolitan areas. Reliance on inadequate on-site waste disposal facilities is predominant in nonmetropolitan areas. A total of 57 of the 70 on-site systems that must be replaced with new sewer systems to provide adequate treatment are located in rural areas. Overall, 77-percent of proposed new construction projects (in contrast to enlargement, upgrade or rehabilitation projects) that are needed to meet federal standards are in nonmetropolitan counties.

Virginia wastewater facility data illustrate: 1) the outstanding need to upgrade existing rural and urban facilities to meet secondary and advanced treatment standards; and 2) the backlog of need in rural areas to provide new sewer service to replace failing on-site systems. When viewed in conjunction with noncompliance data, it appears that, even where treatment facilities exist in nonmetropolitan areas, many are not meeting permit standards and may require assistance with facility operation and maintenance.

Virginia State Revolving Fund: History

Virginia established its state revolving fund in 1987 and first issued loans in FY88. The funding structure was designed to: 1) benefit smaller communities that have difficulty gaining access to market financing; and 2) help small communities to meet current treatment standards. These goals reflect the critical need for treatment project financing in smaller, rural communities as documented in EPA Needs Survey data.

The Virginia SRF targets small and lower-income communities through its loan interest-rate structure and priority scoring system.

<u>Project affordability</u>: Loan interest-rates are based on affordability guidelines, including an evaluation of the ratio between annual sewer user charges and median household income. Interest-rates are determined on a case-by-case basis and may be as low as zero-percent.

Virginia uses the following guidelines to determine affordable loan interest-rates:

Median Household Income	Annual User Charge Ratio
0 to $15,000	.5-percent
$15,001 to $23,000	1-percent
$23,001 and over	1.5-percent

Funding accessibility: The Virginia SRF provides increased access to lower-income communities through its priority scoring system. The system awards points for "fiscal stress." In addition, projects that address treatment noncompliance receive the highest priority weighting in the SRF -- ensuring that facilities provide mandated secondary treatment as required under the Water Quality Act of 1987. Targeting treatment compliance projects addresses an outstanding rural facility need as indicated by Needs Survey data.

State Revolving Fund Characteristics

A review of SRF loan data from FY88 - FY91 shows that the Virginia SRF is providing funding to a diverse mix of higher and lower-income communities in both metropolitan and nonmetropolitan areas. Loan fund distribution reflects state demographic data. Virginia issued 63 SRF loans, totalling $198.4 million during the four-year period. The average loan size was $3.15 million, and loan interest averaged 2.24-percent.

Project type: Fifty-four projects, representing 86-percent of all projects financed, received financing to construct treatment facilities necessary to meet compliance standards. Rural treatment projects make up 80-percent of all compliance projects funded in the SRF.

The SRF also issued seven loans to rural communities to construct new public sewers to address failing on-site systems. All new sewer service loans were issued at zero-percent interest. The Virginia SRF issued loan financing for one new sewer service project serving a metropolitan area.

This funding distribution is consistent with Needs Survey data which show the predominant need for treatment compliance projects in both metropolitan and nonmetropolitan areas, as well as the lesser but outstanding rural need for new sewer service to replace failing on-site systems.

Community size and income characteristics: Overall, most Virginia SRF loans and loan funding have gone to small, lower-income communities in nonmetropolitan areas. Because 51 of 63 loans were issued to projects located in nonmetropolitan communities, the characteristics of these communities dominate the loan portfolio.

Community size: Although the average SRF borrower was just over 10,000 persons, the median borrower was a community of 2,400 persons. Nonmetropolitan borrowers were typically very small communities with populations under 5,000. In contrast, metropolitan borrowers had an average community size of 40,000.

Community income: The average median household income of SRF borrowers was $12,195. Nonmetropolitan borrowers had an average median household income of $11,334, while metropolitan borrowers had incomes averaging more than $14,000.

It is instructive to look at median household income data of rural SRF borrowers relative to eligibility criteria in the FmHA water/sewer funding program to gain a better understanding of financing affordability. In the FmHA program, rural borrowers with median household incomes equal to 100-percent of or greater than the state nonmetropolitan median household income would be considered of moderate-income and would be eligible only for market-rate interest loans at 40-year terms.

However, rural borrowers with incomes below the SNMHI would be considered lower-income and would be eligible for FmHA loans at below-market interest as well as supplemental grants. Borrowers with incomes at or below the national poverty rate or below 80-percent of the state nonmetropolitan median household income (SNMHI) would qualify for 5-percent FmHA loans and grant funding totalling up to 75-percent of project costs.

On the following page, Chart 2 shows the income levels of rural SRF borrowers using FmHA income guideline categories. Rural borrowers with incomes below $14,225 -- the SNMHI (1980 Census) -- would qualify for FmHA interest-rate subsidies and supplemental grants.

Chart 2. **Income Range of SRF Borrowers**

Income	# Loans		SRF Funds		Share of Funds
	Metro	Rural	Metro	Rural	Total SRF
< $11,380	0	14	0	$36m.	18%
to $ 14,225	6	23	$33m.	$61.7m.	48%
$14,225 +	6	14	$31m.	$36m.	34%

A total of 42 rural Virginia SRF borrowers would have qualified for lower-interest-rate loans and supplemental grants in the FmHA program. These 42 borrowers received 80-percent of all SRF funding, totalling $129 million.

Loan interest-rates: Overall, Virginia SRF borrowers obtained loans at 2.24-percent-interest. Nonmetropolitan borrowers received loans at 1.81-percent-interest on average. In contrast, the typical metropolitan borrower obtained 4.04-percent-interest.

Virginia issued nearly half of all SRF loans -- 33 -- at zero-percent interest, indicating that the fund was able to provide substantial subsidies to those with limited financial capability. Overall, the distribution of loans by interest-rates indicates that the sliding scale interest-rate formula provided the greatest level of subsidy to communities with the greatest economic need.

Loan interest-rate data indicate that the sliding-scale interest-rate structure provided subsidies that may be comparable to those offered by FmHA. A majority of Virginia SRF borrowers obtained loans at less than 2-percent interest. This rate is comparable to a 5-percent FmHA loan with a 40-year term. While the SRF was not able to provide supplemental grant financing, the SRF issued a substantial number of loans at zero-percent interest, thereby reducing the impact of SRF borrowing on user charges. Given the high level of borrowing by rural lower-income communities, it appears that the SRF interest-rate structure provides comparable if not better subsidies than the FmHA program.

Loan size: Loans averaged $3.1 million among all SRF borrowers. Nonmetropolitan projects obtained loans less than half the size of metropolitan areas, with nonmetropolitan areas receiving an average loan of $2.6 million compared to an average metropolitan loan of $5.4 million. According to Virginia staff, SRF loans provided 100-percent financing for all projects.

Summary

Data from the Virginia SRF indicate that the sliding-scale interest-rate structure is effectively targeting small, rural lower-income community wastewater facility financing needs. The Virginia SRF uses a three-tiered system of affordable user charges, with the lowest ratio for communities with the lowest median household incomes of $15,000 or less. This structure is ultimately results in greater subsidies to lower-income and smaller communities to ensure that affordable user charge ratios are met[1].

Virginia SRF recipient data show that basing loan interest-rates on economic criteria <u>for all borrowers</u> can result in effective targeting of rural, small and lower-income community projects without compromising the long-term viability of the fund. Small, rural lower-income community borrowers were able to borrow at relatively low interest-rates while facilities serving larger, higher-income areas obtained higher-rate loans.

During the 4-year period, more than half of all loans -- 33 -- were obligated at zero-percent interest and totalled $75 million, 38-percent of Virginia loan funds. Zero-percent loans were issued for both single- and multi-community projects, with an average loan size of $2.28 million. Among single community projects, community size averaged just over 2,000 persons, receiving an average loan of $1.85 million.

The Virginia SRF obligated a similar level of funding -- $80 million -- at interest-rates of between 5 and 7-percent. With an average loan size of $5.3 million, higher rate borrowers obtained loans more than four times the size of small community borrowers and nearly a third higher than the average SRF borrower. Borrowers receiving a lower overall subsidy represented larger communities averaging more than 25,000 persons with median household incomes averaging $15,951.

The Virginia loan portfolio shows a funding distribution pattern that maintains the integrity of the fund while providing financing to borrowers based on ability to pay. The lowest-income borrowers received the greatest level of subsidy, while the highest-income group borrowed at twice the average interest-rate. The total amount of loan funding issued at the

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[1] It is not possible to determine the impact of the loan interest-rate structure since the Virginia SRF does not maintain uniform data on sewer user charges.

highest interest-rates is approximately the same as that issued at zero-percent -- $80 million.

Regarding SRF loan distribution, the data show that Virginia was able to enhance the loan repayment stream by issuing deeply subsidized loans in an amount equal to that of loans issued at the highest interest-rates. The data also show that subsidies were provided to applicants with the greatest economic need. Communities with greater repayment ability did not receive significant subsidies.

Examining the characteristics of small, rural community borrowers provides an indication of how this population can be effectively targeted while maintaining the health of the fund. Small community projects obtained relatively small loans, compared to other Virginia SRF borrowers. Small community loans averaged $1.07 million, just a third of the average loan size of <u>all</u> SRF borrowers. As a result, Virginia was able to issue more than a third of all loans to small communities, but the share of funds obligated to such communities totalled only 14-percent of all SRF dollars. At the same time, the Virginia Fund was able to obligate the majority of funds as larger loans to communities of varying sizes and incomes.

From a policy analysis perspective, the contrast in terms of number of loans and share of funding is important. It provides data on the cost of small community projects compared to those of large communities, and it demonstrates that a substantial number of small community projects may be funded without depleting the entire fund.

However, it is important to recognize that Virginia was able to balance funding distribution among smaller and larger municipalities, and between communities of varying incomes, because the state's wastewater facility funding needs span communities with distinctly different characteristics. For example, Virginia is home to some of the highest income and lowest-income communities in the country. Therefore, the state is able to spread loans among projects with significantly different repayment abilities. This same loan distribution may not be possible in other states, such as West Virginia, with few larger or higher income municipalities.

The effectiveness of the sliding-scale interest-rate formula may be tied to several factors. First, as noted above, demographic characteristics of Virginia communities allow the state to obligate funds at a range of interest-rates while also meeting the objective of addressing water quality needs. Second, state SRF staff have been aggressive in working with small and lower-income communities to develop viable wastewater projects. The impact of such outreach and technical assistance is reflected in the number of small, rural, lower-income community projects in the SRF portfolio. Third, the SRF priority system gives greater ranking to projects that are located in areas of fiscal stress. Finally, the loan interest-rate structure appears to provide the flexibility for communities to develop affordable projects by

Moreover, the loan program has been successful in addressing the outstanding need for treatment plant compliance projects in rural areas. Forty-three rural treatment projects have been financed by the SRF. The funding structure has also enabled seven rural communities to develop new sewer service by providing funding at the deepest subsidy level of zero-percent interest. As such, the data indicate that the SRF interest-rate structure made it possible for rural communities to develop new service by increasing project affordability.

RURAL DEVELOPMENT LOAN FUND / INTERMEDIARY RELENDING PROGRAM

MAINE CASE STUDY

The economy of Maine has experienced radical shifts in the last ten years - the growth and economic expansion of the 1980's has been overshadowed by the economic downturn of the 1990s. Over the last five years, the state's economy has been severely impacted by the recession and the banking crisis' devastating impact on New England. Current unemployment figures for the state stand at 7.8% with some counties reporting rates as high as 12%.

The following case study focuses on the RDLF and IRP funds operating in Maine and how these programs are administered and targeted within the state. In conducting the case study, the research team met with three private bankers, a community development corporation, two economic development districts, five small businesses, as well as Maine Farmers Home Administration (ME FmHA) staff. The research team came away from the visit with an overwhelming impression of cooperation amongst all parties involved in economic development activities, from the bankers to the Farmers Home officials.

The demand for IRP funds was recognized by bankers as well as the intermediaries administering the funds. Both acknowledged the increased need for business development funds as credit gaps widen within traditional financial markets. Though three intermediaries are currently operating IRP funds in Maine, the manner in which the various funds are administered differs.

INTRODUCTION TO MAINE'S ECONOMY

New England experienced an economic boom in the 1980's spurred on by high technology which fueled the expansion of new manufacturing industries in Maine. These developments hurt some traditional manufacturing industries. Between 1979 and 1988, the metals, machinery and electronics industries added 8,500 jobs to the state's employment base while at the same time natural resources and clothing industries lost an estimated 16,700 jobs.[1] Low skilled manufacturing jobs were being lost and replaced with high skilled, higher paying jobs. The presence of slow growing markets, unfavorable exchange rates and the increasing presence of foreign producers made it more difficult for indigenous industries to maintain a competitive position in the marketplace.

Industries were forced to shift away from simple manufacturing processing towards more sophisticated production and value added production. Many firms, unable to make this shift within their industry were forced out of business. The footwear, fishing and

[1] Adams, Stephen J., The Productivity Imperative and the New Maine Economy, Maine State Planning Office, Economic Division, April 1990, Pg. 7.

food processing industries were hit especially hard by this market shift.

During the 1983 recession Maine's unemployment rate peaked at 9% and later dropped to a low of 4% in 1989. In the last year these unemployment figures have jumped again with non-metro unemployment rising from an average of 5.2% to 8.2% and metro unemployment experiencing a similar increase from 4.4% to 7.4%.

In their December 1991 economic forecast, the New England Economic Project, projected that though the national economy as a whole is expected to creep sluggishly out of the recession, a delayed recovery is seen for New England.[2] Manufacturing employment losses are expected to continue through 1992 while some employment growth in non-manufacturing sectors is expected by mid-1992. This could mean a very slow recovery for Maine's economy and a demand for economic development efforts targeted to industries having difficulty securing growth capital.

CREDIT GAPS

There are several inter-related trends within the banking industry impacting Maine: structural deregulation of the banking industry, increases in the number of bank mergers and a significant number of bank and thrift failures in New England. These changes have impacted the availability of commercial credit to small rural businesses and increased the demand for gap financing programs such as RDLF/IRP.

A recent report focusing on the availability of commercial credit in rural New England found that most rural bankers would increase their lending to small businesses if they could.[3] However these bankers are restrained by deposit bases unable to support higher lending levels, high loan to deposit ratios, poor business climates and sluggish economies, as well as poorly prepared loan applications. In addition, recent bank regulations have increased assets requirements and tightened credit rating systems forcing banks to cut back on their commercial lending even further. Eighty-two percent of the bankers interviewed for the rural credit study said they regularly refer businesses to other credit sources, such as local development organizations or public

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[2] Summary of Commentary on Current Economic Conditions by Federal Reserve District, Federal Reserve Bank of Atlanta, January 1992.

[3] Markley, Deborah. The Impact of Deregulation on Rural Commercial Credit Availability in Four New England States: Empirical Evidence and Policy Implications, Report to the Ford Foundation and the Rural Economic Policy Program of the Aspen Institute, May 1990, Pg 27.

lending programs, if they are unable to provide credit in house.[4]

Small local banks in Maine are experiencing an increase in commercial credit requests as the larger banks retreat from small business lending. Local banks have traditionally been perceived as making credit decisions on a smaller more personal scale as opposed to the larger banks in which credit decisions depend on inflexible lending formulas rating cash flow and collateral. However, cash flow and collateral are the growing concerns of smaller banks as a tightening culture of risk assessment dominates the banking industry as a whole. In other words, these smaller banking institutions cannot absorb the increased demand for small business lending.

All three intermediaries administering RDLF/IRP funds reported an increase in the number of calls coming from established small businesses in need of short term capital. These are businesses that were considered good risk investments by banks before federal regulators imposed new risk rating systems. Many of these businesses report their banks calling in long standing, performing lines of credit. New bank regulations and the accompanying conservative lending practices have resulted in less capital available to small businesses even those with a proven track record.

With banks retreating from this commercial market, both businesses and bankers are increasingly looking to intermediaries to fill the credit gap. Funds such as the IRP, provide a cushion to the bank and provide flexible financing to the consumer that a bank is unable to provide.

Intermediaries have reported an increase in the high quality, limited risk deals being submitted to their lending committees. In the past, the intermediary would be seen as the lender of last resort for start-ups and high risk ventures that a traditional bank would not even consider. With banks tightening their lending criteria, intermediaries have the opportunity to finance these ventures. The challenge facing the intermediary in this economic environment, is how to implement a program such as the IRP with both economic and social objectives.

<u>INTRODUCTION TO MAINE BASED IRP PROGRAMS</u>

There are currently three intermediaries administering RDLF and/or IRP funds in Maine. Coastal Enterprises Inc. (CEI), a community development corporation serving the state of Maine, administers a $500,000 RDLF which they secured in 1980 and a $1,000,000 RDLF originally capitalized in 1983 as well as a

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[4] Idib, pg 27.

$1,560,000 IRP financed in 1989. Eastern Maine Development Corporation (EMDC), a regional private non-profit devoted to planning, business assistance and economic development, began administering a $1,500,000 IRP in October 1990. The most recent recipient of IRP funds in Maine is the Androscoggin Valley Council of Governments (AVCOG), a quasi-public planning and development council serving Androscoggin, Franklyn and Oxford counties of Maine. They have been operating a $2,000,000 IRP since August 1991.

Though all three IRP funds have had significant impacts in financing small businesses that would otherwise be unable to secure credit, the manner in which the programs are targeted differs. CEI, as an organization involved in a wide array of economic development and social service activities, targets their programs specifically to low income people and actively works to encourage the creation of jobs for low income people through their business lending. Both AVCOG and EMDC support a broader economic development agenda which promotes small business creation and expansion in low income communities. Their goal is economic development of a geographic area through both public and private investment in business development.

FARMERS HOME ADMINISTRATION

The Maine FmHA (ME FmHA) office administers the IRP program as a business development program not a job creation program. When assessing IRP loan requests from intermediaries, ME FmHA loan officers review a check list of criteria. Though job creation and retention figures are considered in reviewing each loan application these criteria do not appear on their list of items to scrutinize. The ME FmHA evaluation criteria relate strictly to security and soundness issues and are pulled directly from the IRP regulations (environmental review, security etc.).

ME FmHA is eager to see additional IRP monies administered throughout the state and have identified several intermediaries which they feel will at some point have the capacity to administer the program. They feel it is critical that an organization has the proven capacity to operate a business development loan fund before administering an IRP. In addition, they believe that CEI, AVCOG and EMDC all have the capacity to administer more than the currently allowable $2 million in IRP funds and they would support efforts to amend the regulations and see the cap raised.

FmHA staff scrutinize the business soundness of all IRP loans and they do not see themselves or the IRP intermediaries in a position to take on significant risk. The IRP loans made from FmHA to the intermediaries are secured as full recourse loans, meaning FmHA has access to the assets of the intermediary as a whole in the case of a default.

Though the state office is cautious with regards to security issues, they feel that the national FmHA office is overly conservative on these matters. ME FmHA was not aware of any trouble with collateral requirements on outstanding IRP portfolios and therefore did not see the justification for recent regulations requiring the filing of security on loans ultimate recipients with FmHA. In their view, security issues should be settled upon FmHA loaning funds to the intermediary.

The following sections of this case study describe the RDLF and/or IRP loan funds being administered in Maine. All three groups administering the programs are responding to credit gaps left by private lending institutions in the state. While the lending styles of the various intermediaries may differ, they share similar objectives.

COASTAL ENTERPRISES INCORPORATED

CEI was founded in 1977 as a private, non-profit community development corporation. Their business development program has matured over time and as of 1991, CEI managed a capital base of some $21 million. These funds have leveraged an additional $65 million in investment targeted towards Maine enterprises.

When CEI began their operations in 1977 their goal was to raise capital for loans to start-up and expanding businesses and to create jobs and employment opportunities for low income people. CEI secured their initial loan capital in the form of a grant from the Community Services Administration (CSA) in 1979, to develop a fisheries project. In 1980, they secured $500,000 in an RDLF-I loan from CSA, which enabled them to expand their development efforts in the fishing industry.

The majority of the RDLF I funds were devoted to one deal, the Vinalhaven fish processing plant. The lessons learned from this first RDLF-I development project, where 55% of the loan was devoted to one project, has helped shape CEI's current economic development and lending philosophy.

In 1980, CEI loaned $275,000 of their RDLF-I loan to Vinalhaven, a cooperative fishing pier complex off the coast of Rockland Maine. In addition to providing this RDLF loan for working capital and equipment, CEI became involved in technical assistance as well as packaging together other financing sources for the Vinalhaven's development. The decline of the fishing industry in the Northeast combined with internal problem that the company encountered, forced CEI to refinance their loan to Vinalhaven several times in order to keep the company afloat. CEI saw the value of their investment in that the company was providing employment to an estimated 60 people and positively impacting the population of the island. However, continued problems forced CEI to write off the loan against losses in 1990.

The experience of Vinalhaven provided CEI with some important lessons with regard to building the organization's development capacity and managing a stable diversified loan portfolio. After securing their RDLF II in 1983 from OCS, CEI began making smaller investments in a variety of businesses and business sectors. From 1984-1988, they worked at building an asset base and developing their capacity as technical assistance providers.

CEI's RDLF/IRP FUND PERFORMANCE

CEI has administered RDLF/IRP since funds were first made available through CSA and has therefore operated the program within several regulatory climates. The RDLF funds significantly increased CEI's capacity as an economic developer.

CEI has administered the RDLF/IRP program under CSA, OCS, and FmHA. Staff described CSA's management style as "socially oriented" in comparison to the current "risk management" methods practiced by FmHA. Though CSA's administration was not versed in business development they focused on the job creation and targeting goals of the program. A high risk investment such as Vinalhaven was encouraged by CSA because of the job creation potential of the project and less attention was given to the soundness of the business plan. Some CEI staff felt that the RDLF lost its job creation focus when it was transferred from CSA to OCS.

The RDLF, as administered by CSA, was driven primarily by job creation goals. The current administrative style of FmHA stresses the business orientation of the program. CEI's current lending program strives to meet both business and social objectives simultaneously. Interviews with bankers in Maine revealed CEI's strong reputation within the business community for their thorough critique of a businesses' credibility and at the same time focusing on the job creation and retention potential for low income persons.

Some formal technical assistance is provided by CEI as part of their IRP financing. The technical assistance that does take place is primarily upfront work done when a business has submitted an application to CEI for financing. CEI has a strong technical assistance component in their organization but these services are primarily devoted to smaller loans. In addition, paying for technical assistance out of the interest rate spread on the IRP funds would mean increasing the cost of the loans to the ultimate recipient.

As part of their lending program, CEI staff work closely with businesses in developing workplans which incorporate low income employees into job creation plans. CEI staff assist businesses in defining strategies to target low income or unemployed persons in recruitment efforts. In addition, CEI educates employers as to tax advantages and programs available for hiring employees formerly on public assistance or part of a job training program. Included in every IRP loan agreement are job targeting goals and a reporting system to monitor progress in meeting these goals. This policy has resulted in approximately 22% of all jobs created or reattained through IRP assistance going to low income people.

The majority of the loans from both CEI's RDLF and IRP funds (84%) have gone towards business expansion activities with the remaining 16% being devoted to business start-ups. Approximately 72% of their loans went to manufacturing businesses and another 25% to service industries. Their loans ranged from $50,000 to $150,000 with an average loan request of $125,000. Approximately 60% of all loans made are to meet a companies long term, one year or longer, working capital needs. The other 40% were devoted to equipment costs.

With the IRP program alone, CEI has lent out $1.56 million and leveraged an additional $6.6 million. The average interest rate on the IRP loans made by CEI was 11.9%, providing them with a 10.9 point spread to cover the administration of the program and the loan loss reserve. Approximately 346 jobs have been created at an average cost of $4,416 per job. CEI has been approved for an additional $440,000 in IRP funds which brings their IRP portfolio to $2 million - the maximum allowable under current regulations.

Loan loss reserves for all loan fund pools are established independently depending on the performance of individual loans within a portfolio, available security and economic security of businesses. The RDLF I fund maintains a 7% reserve, RDLF II a 16% reserve and the IRP fund maintains a 10% reserve. A five percent reserve is automatically set aside at the closing of each loan and on a semi-annual basis, each loan is reviewed and reserves reassessed. This system enables CEI to monitor the bottom line performance of a loan portfolio enabling each portfolio to contain a variety of risk levels.

CEI worked with the following two businesses providing IRP financing and bringing together banks, federal funds and other monies to complete the financial packaging of the business plan. One of the deals involved a business expansion and one involved a start-up.

OAK ISLAND FISHERIES

Many jobs in the fishing industry were lost in Maine in the 1980's. Layoffs at several major fishing and fish processing plants in Rockland contributed to unemployment hitting 9% in 1989. Oak Island Fisheries, a fish processing company in Rockland Maine, was founded in 1989. Oak Island was started by one individual on an entrepreneurial and undercapitalized basis in an unequipped warehouse on Rockland's waterfront. He identified a market niche created by the massive shut downs and put together a business plan based on the processing of fish products including scallops, whole fish, frozen block fillets and shrimp.

In the first year of operation the company generated $2.6 million in sales which increased to $4.0 million in 1990. With an eye to expansion, the sole owner of Oak Island brought in a business partner in 1991 to contribute additional financial resources and industry expertise.

The business partners first approached Key Bank for expansion financing. It was apparent to the bank after reviewing Oak Island's first business plan, that the company was going to outgrow their capital base within six months. The bank was not able to extend themselves any further in the business and they suggested that Oak Island seek additional financing from CEI.

After the IRP funds had been committed by CEI, Key bank agreed to extend their loan. The presence of IRP monies provided an incentive to the bank, allowing them to share a first position on security and assuring them that the business would have the necessary capital to support a successful expansion effort.

At the time, Oak Island employed 36 people (30 of which were previously unemployed due to lay-offs) and anticipated increasing their employment to 60 within 3 years. Of the twenty to thirty new jobs projected, 13 were to be targeted to low income people including 6 AFDC recipients. Oak Island management worked with the CEI staff in securing jobs for low income persons.

Financing Package: CEI - $100,000 IRP loan, 11.5%, 7 yrs.
Key Bank - $400,000 Line of Credit
Key Bank - $235,000, 75% SBA Guarantee
Owner Equity - $65,000
CEI's IRP cost per job $3,333 - $5,000

MOULDED FIBRE TECHNOLOGY INC.
Moulded Fibre is a new company which designs, develops, produces, and distributes environmentally responsible moulded fibre packaging out of 100% recycled newspaper products. The company, which started production in May of 1991 focuses on low volume custom designed packaging market in the Northeast.

The Sandy River Group, a health care and environmental business development company in Portland, was the lead investor in the business start up. They were joined by two other joint venture partners who together contributed $250,000 in equity. CEI and the Sandy River Group approached Fleet Bank, a regional bank based out of Providence, Rhode Island to provide an additional $386,000 in financing. As a general practice, Fleet does not get involved in business start-ups because they do not like to rely on projected cash flows and estimates.They were however, drawn to this deal because of the significant investment of owners equity and the involvement of two known business partners, Sandy River Group and CEI. Fleet expressed confidence in CEI's business sense as well as their commitment to creating jobs.

Moulded Fibre's principal investors were initially interested in the job creation potential of the new venture and were very open to creating jobs for economically disadvantaged workers. On the advice of CEI, they began working with two job training and placement agencies focusing on unemployed and low income individuals. Moulded Fibre has successfully targeted a significant number of their jobs to low income individuals. The company's business plan projected employing 18 people over the first year and targeting 11 of these positions to low income individuals. They currently employ 20 people in marketing/sales, drafting and engineering, production, and molding shaping **and 11 of these employees are low income.**

Financing Package:	CEI	- $98,200 IRP loan, 12%, 7 yrs.
	SBA 504	- $324,000
	Fleet Bank	- $386,000
	Town of Westbrook	- $25,000
	Owner Equity	- $250,000

CEI's IRP cost per job $4,910

ECONOMIC DEVELOPMENT DISTRICTS ADMINISTERING IRP FUNDS
The two most recent recipients of IRP funds are Eastern Maine Development Corporation (EMDC) and Androscoggin Valley Council of Governments (AVCOG). Both are Economic Development Districts (EDDs) serving multi-county areas and had previous experience administering business development loan funds capitalized by a combination of state and federal dollars.

As is true with many EDDs around the country, both organizations had historically administered both planning and an economic development programs. Recently Many EDDs have been expanding their community economic development activities due to both the demand for and the income generating potential of these activities.

Both EMDC and AVCOG, were encouraged to apply for funds by ME FmHA office. ME FmHA identified the need for development funds in the counties served by these two EDDs and felt the organizations had demonstrated the capacity to operate business development programs. Consistent with their role as advocates, ME FmHA intervened and assisted both EMDC and AVCOG in developing IRP applications that would be competitive when ranked by the national FmHA office against other applications.

Both EDD's were able advance the IRP funds to ultimate recipient quite rapidly which speaks to the demand for such funds in the field. They are comparable organizations in terms their funding sources, the array of services they provide, their style of development and the manner in which they administer their IRP program. The following section describes the IRP programs as they have been administered thus far by these two EDDs.

ANROSCOGGIN VALLEY COUNCIL OF GOVERNMENTS (AVCOG) and EASTERN MAINE DEVELOPMENT CORPORATION (EMDC)

EMDC has served the six counties of eastern Maine since 1967. Their service area includes Maine's two poorest counties, Waldo and Washington. One third of EMDC's budget is devoted to regional planning, one third to community development and one third to business assistance. In their capacity as community developers they operate as an SBA 504 Certified Development Corporation , administer an EDA revolving loan fund as well as an investment fund capitalized through a grant from the Office of Community Services. EMDC began administering their $1.5 million IRP in 1990 and as of the close of FY1991 had lent out over $670,000 to 5 businesses. These IRP funds leveraged an additional $2.3 million in funds for these businesses and created/maintained 89 jobs at a cost of $7,528 per job.

AVCOG has served the areas of Franklyn, Androscoggin and Oxford, counties in southwestern Maine, for over thirty years by providing a wide range of planning and economic development activities. The emphasis of their program's has shifted in the 1990's away from planning towards economic development activities. In addition to operating their EDA revolving fund, AVCOG is an approved SBA Certified Development Corporation and houses a Small Business Development Center. They began administering their $2 million IRP in October 1991 and in their first five months of operation lent out $525,000 to 5 businesses. Thus far these IRP funds have leveraged an additional $1,312,000 in local funds, both owner equity as well as bank funds. 93 jobs have been created at an average cost of $5,645 per job.

Both AVCOG and EMDC were able to advance most of their IRP funds within the first six months of operation. An abundance of "good" business ventures are in need of capital and many of these businesses are referred to them by banks that are retreating from the commercial lending arena. EDD's have always enjoyed good relationships with the banking community and at times found themselves in competition with banks for business deals. Now, businesses that would have been considered bankable five years ago are approaching EDD's for fixed rate term loans which banks can not offer. Both Avcog and EMDC on average charge 9% interest rates on their IRP loans and these rates are fixed for the terms of the loan which average 10 years. These are terms that private banks will not extend to a businesses, especially a start-up venture.

EMDC reported that they receive daily calls from businesses that are having their performing lines of credit called in by their banks. These are for the most part established manufacturing ventures with between 10 to 50 employees. Banks, under pressure from regulators, are cutting back on this type of credit, leaving businesses in desperate need of fixed rate term credit. Though financing lines of credit is not eligible under the IRP program, in limited cases EMDC has structured fixed rate one year loans to meet the needs of these businesses until they are able to secure credit from another bank.

Though traditionally EMDC has been primarily a lender to start up businesses, as of late they have been responding to the increased demand for expansion capital. AVCOG as well, has devoted most of their IRP capital to business expansion efforts aimed at increasing business competitiveness, efficiency and job retention.

Very little technical assistance is provided in tandem with these IRP loans. Though both organizations provide business counselling services, it was reported that most deals funded through IRP are coming from established businesses in need of little outside assistance. These are businesses in need of capital not development assistance.

When asked about the job creation potential of this program both AVCOG and EMDC responded that circulating money to sound businesses in an economy with unemployment hovering at 9% is considered targeted lending. Capital is being circulated in the economy, enabling businesses to expand and stabilizing the employment base. Both AVCOG and EMDC support the flexibility of the IRP program in terms of the job creation and targeting requirements. In their opinion targeting requirements can disqualify a solid business from receiving loan funds and in effect defeat the overall goal of business creation.

In reviewing loan portfolios, both organizations focus primarily on the financial viability of a business plan. Job creation numbers are not viewed as a key factor in reviewing a deals eligibility for IRP funding. The job creation stipulations attached to the EDA loan funds, which both AVCOG and EMDC administer, are far more restrictive in comparison than IRP regulations. EDA requires that one job be created/retained for every $10,000 in loan funds extended to a business. Though the bottom line cost per job in a loan portfolio might average $10,000 or below, the groups feel restricted by this requirement on a loan by loan basis. EMDC sees the IRP needs of businesses seeking loans of $75,000 to $150,000 which are too small for the SBA 504 program.

This does not imply that AVCOG and EMDC do not make every attempt to create jobs for economically disadvantaged workers and to maintain a low cost per job. They do, however, prefer to operate without the restraints of targeting regulations which can prioritized job creation at the expense of sound business lending practices.

Both AVCOG and EMDC reported an efficient working relationship with the ME FmHA office however the environmental review process was raised by both groups as a time consuming and inefficient process. ME FmHA staff are required to perform the review of each potential IRP project and will not accept a review conducted by and independent consultant. Due to limited staff and the geographic distribution of projects, this process is often the last element in a project application to be completed. It was estimated that the current one month turn-around on loan approvals would be cut to two weeks if the environmental review process could be streamlined.

AVCOG received their IRP loan after new FmHA security regulations had been enacted. Current regulations require that all security on loans to ultimate recipients be filed with the ME FmHA office. Though this does not present a major obstacle in loan processing, it is an additional administrative step to which AVCOG would rather not be subject.

The following two business deals were financed in part with IRP funds from either AVCOG or EMDC. In both cases, the EDD's involvement made the bank investment possible.

Maine Bottling Company
The Maine Bottling Company was founded in 1990 to produce and distribute natural spring water from an aquifer located near the company's operating facility near Poland Maine. The company's principals approached AVCOG for expansion funding in December 1991. They had plans to acquire and install additional equipment to enable them to produce a new size and style of bottle.

At the time the company employed 18 people and the expansion project had the potential to create an additional 8 jobs.

Partial funding for the project had been committed by Mid-Maine Savings Bank, however, due to internal capital constraints, the bank was unable to allocate additional monies. Maine Bottling Co.'s primary lender, Peoples Bank was unable to advance additional credit at the fixed rate terms requested due to restrictions imposed on them by their regulators.

AVCOG was the only source of fixed rate financing available and the IRP funds enabled the company to secure the $91,000 in bank funds.

Financing Package:	AVCOG	$125,000 IRP loan, 8%, 5 years
	Mid-Maine Savings Bank	$ 91,000

AVCOG's IRP Cost per job $15,625

Ducktrap River Fish Farms Inc.
The Ducktrap River Fish Farms Inc. was started in 1978 as a trout farm, producing 10,000 pounds of trout per year for sale to local restaurants and food stores. The company's line expanded to include smoked seafood, trout, and mussels until the owner decided to phase out the trout farm itself and focus on the expanded product line. Though the company had expanded significantly since 1978 they were still operating from a 5,000 square foot building and five trailers in Lincolnville, Maine.

In 1990, the company approached EMDC for expansion financing in order to relocate to the Belfast Industrial Park in Belfast Maine. The company had a commitment for partial financing from Camden National Bank. Though the bank was confident with the company's soundness and proposed expansion plans, they had reached their credit limit with Ducktrap.

Through the expansion, the company planned to add an additional 15 jobs bringing total employment up to 55. These 15 jobs would be created in Waldo county, one of the poorest counties in the state.

EMDC was interested in investing in the company for several reasons: they expanding markets both in and out of state as well as creating employment in a poor community. EMDC committed IRP funds as well as SBA 504 guarantee funds.

Financing Package:	EMDC IRP	$150,000
	SBA 504	$470,000
	Owner Equity	$114,000
	Camden National Bank	$570,000

EMDC's IRP Cost per job $10,000

CONCLUSION

The most significant difference between the lending programs as administered by the various intermediaries in Maine is the way in which funds are targeted. FmHA appears to share the perspective held by AVCOG and EMDC, that the IRP is a business creation program and not a low income job creation program. EDD's can provide credit in low income areas where private lending institutions alone cannot meet the needs. Through the IRP funds, EDDs are able to provide affordable debt capital to rural businesses trying to maintain or expand their enterprise.

ME FmHA does not encourage intermediaries to establish low income hiring goals for the businesses they lend to nor do they monitor how jobs generated by a project are targeted. FmHA achieves their targeting through the selection of IRP intermediaries. These intermediaries are expected to target their loan dollars in defined service areas and are required to the maximum extent possible, create job opportunities to low income people and farm families. According to ME FmHA officials, stabilizing businesses in poor rural communities will naturally benefit low income people.

CEI on the other hand, as an intermediary which began administering the RDLF under the lending culture of CSA, maintains a lending program which mandates job creation for low income individuals while at the same time managing investment risk. As a community development corporation, their mission differs from that of the EDD's in that all of their programs are targeted to low income individuals. Consistent with this mission, CEI requires that their RDLF/IRP borrowers create opportunities for low income people.

All IRP intermediaries in Maine are responding to the widening credit gap. All three groups reported an increase in the number of credit requests coming from healthy businesses that have previously not had problems accessing debt financing. These are not the businesses that have traditionally been unbankable due to weak collateral or poor cash flow projections.

This widening credit gap gives intermediaries such as AVCOG, EMDC and CEI the opportunity to finance businesses that would have otherwise been lost to their banking competitors. The bad news is, this increased competition for gap financing sources, such as the IRP, will work to the disadvantage of the businesses that have traditionally been closed out of the private banking market. In other words an IRP intermediary will choose between lending to a well collateralized business that recently had their credit line pulled or an under-collateralized, start-up business in need of working capital. The IRP intermediary may be the lender of last resort for both businesses.

Because of the varying volumes of IRP loan activity it is impossible to compare the IRP portfolios of CEI, AVCOG and EMDC on a level playing field. The average loan size for all groups was comparable as were the types of industries targeted. CEI leverage $4.40 dollars to every $1 in IRP funds as compared to $2.25 for AVCOG and $3.22 for EMDC. However, CEI has also processes more than twice the number of IRP loans as either EMDC or AVCOG.

The average interest rate on CEI's IRP loans is higher than those of the EDD's since they began operating their fund when market rates were higher. On average CEI charges 11.5% on their IRP loans while the EDD's have been charging approximately 9%.

Two administrative constraints with regard to FmHA were mentioned by each group. First, it was agreed that the current regulations restricting any one groups from securing more than $2 loan funds was too confining. It is expected that CEI, EMDC and AVCOG will have no trouble advancing $2 million in IRP funds and ME FmHA agrees that these intermediaries have the capacity to handle additional loan dollars. Secondly, the environmental review process needs to be streamlined in order to increase the efficiency of loan processing.

THE NATIONAL NON-PROFIT CORPORATION PROGRAM

MINNESOTA CASE STUDY

BACKGROUND ON THE NATIONAL NON-PROFIT PROGRAM

The Food Security Act of 1985, known as the 1985 Farm Bill, not only transferred the RDLF back to FmHA and re-named it the Intermediary Re-Lending Program, but also authorized the Non-Profit National Rural Development and Finance Corporation program. The National Non-Profit Corporation Program (NNCP), as it is now referred to, was intended to provide loans, guarantees, and other financial assistance to profit or non-profit local businesses to improve business, industry and employment opportunities in rural areas. From a public policy standpoint, the NNCP was intended to increase state involvement in rural economic development activities.

Funding for the program was made available from $20,000,000 from the Rural Development Insurance Fund and $14 million in grant funds made available from the remaining balance in the RDLF fund. The NNCP has not received any additional appropriations since this original set aside of funds though it remains authorized as a program under law.

The original legislation intended for a national Washington D.C. based intermediary, the National Rural Development Finance Corporation (NRDFC), to administer the National Nonprofit Program. However in the end, FmHA was designated to administer the program under their Business and Industry Division and FmHA in turn, selected three intermediaries as National Non-Profit Corporations (NNCs) to locally execute the program. The National Rural Development Finance Corporation was selected as one of the NNCs along with the Midwest Minnesota Community Development Corporation (MMCDC) in Detroit Lakes, Minnesota and the Southern Development Foundation (SDF) in Lafayette, Louisiana.

The following case study describes the overall legislative and regulatory framework of the NNCP and how one NNC, The Midwest Minnesota Community Development Corporation, administers the program.

HOW THE NATIONAL NON-PROFIT PROGRAM WORKS

The National Nonprofit Program as authorized under the Food Security Act of 1985 (Public Law 99-198) was enacted in December 1985. The original program regulations were released in September 1986 (CFR part 1980, Subpart G) and revised in February 1990. The program is currently administered by the Community Facilities

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Director at the National Office of FmHA [1] and administered locally through the selected NNCs.

To be eligible as a National Non-Profit Corporation (NNC), an organization had to demonstrate that they were a non-profit eligible to do business in at least three states, that they had the financial resources to provide not less than 10% of the financial assistance provided to ultimate borrowers, and that they had written approval to administer revolving loan funds by the Governor of each state in which they intended to do business. All three intermediaries that applied for NNC status were ultimately funded.

There are two major funding components to the NNCP: FmHA grants to selected NNCs and the extension of FmHA loan guarantees to approved public or private lending organizations. NNCP funds are to be used by NNCs, and their state affiliates to provide both technical and financial assistance to businesses operating in rural areas.

NNCP Guarantees

In order to receive FmHA guarantee funds through the NNCP, a public or private lending institution must be approved by FmHA to process and service loans as an NNC, which will in turn process loans to ultimate business recipients. The lender along with the NNC applicant request guarantee funds from FmHA, and if approved, FmHA guarantees are made to the lender. FmHA guarantees will be for between 80% - 90% of the loan amount dependant on the agreement negotiated between FmHA and the lender. The approved lender then makes funds available to the NNC, through a loan or line of credit, which will ultimately be draw down as qualified businesses borrow funds from the NNC. An NNC can work through one lender as is the case with SDF or develop a network of approved lenders throughout their service area as is the case with MMCDC.

It is left to the NNC and the approved lender to negotiate the terms of the guaranteed loan agreements. Though FmHA limits the terms of the loan guarantee to no more than ten years, the structure and repayment schedules of all loans to NNCs are left to the discretion of the lending institution. For instance, MMCDC has a ten year line of credit with a ten year draw down period negotiated with all of their approved lenders. SDF and NRDFC, in contrast, negotiated a three year draw down period on their line of credit with the National Cooperative Bank.

It is also the responsibility of the lending institution to ensure that all loans to the NNCs are sufficiently secured.

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[1] Administrative oversight of the program was transferred from Business and Industries Division of FmHA to Community Facilities Division.

Though loans are made to the ultimate recipients by the NNC, they must also be approved by the participating lender. The lender can make requests on how loans are secured and what collateral position they want to hold.

NNCP Grant Money
The second component of the NNCP, the grant funds, are allocated directly by FmHA to the NNC and may be used to compliment a loan guarantee or on their own to provide technical assistance to businesses. Grant funds are drawn down from their FmHA account by the NNC as needed to provide either financial or technical assistance.

Technical assistance, as defined by the regulations, covers a wide range of problem solving activities. Grant funds can be used to pay for the actual cost of these services and can be advanced to the business recipient in the form of a loan or grant. Technical assistance can be provided by the NNC, a state affiliate or an outside consultant. In addition, the actual provision of technical assistance is not dependant the recipient's receiving financial assistance. The decision as to how grant funds are dispersed and how they are matched with loan guarantees is left up to the individual NNC.

In order for an NNC to draw down their grant funds from FmHA, descriptions of all proposed projects must be submitted to FmHA to ensure the project's compliance with regulations. If the NNC wishes to use grant funds as part of a loan package, they must submit documents to FmHA accounting for the all financiers involved in the project and describe the investment of any NNCP guaranteed loan funds.

FmHA grant and guarantee funds can never exceed seventy-five percent of the total cost of a project and cannot exceed $500,000.

IMPLEMENTING THE NNCP
In applying as an NNC, each intermediary submitted a proposed workplan to FmHA which delineated how grant and guaranteed loan funds were to be expended. NNC applicants were asked to demonstrate to FmHA their ability to maintain a network of state affiliates and lenders throughout their multi-state target area and work with these institutions in providing technical and financial assistance to eligible businesses.

In 1987, grant agreements were finalized between FmHA and the three selected NNCs. The obligation of the grant funds to the NNC's did not necessarily mean that guarantee agreements had been finalized between FmHA and lenders in all of the targeted NNCP service areas. In fact, in the case of Midwest Minnesota

Community Development Corporation, the first guarantee agreement with a bank was not closed until August 1988 and the final guarantee agreements were not closed until 1989.

The following are the original grant fund and loan guarantee amounts authorized by FmHA for each of the NNCs.

Midwest Minnesota Community Development Corporation (MMCDC)
States covered: Kansas, Minnesota, Nebraska, South Dakota

Guaranteed Loan Authorization:	$9,000,000
Grant Fund Authorization:	$5,010,000
Total Authorization:	$14,010,000

National Rural Development Finance Corporation (NRDFC)
States Covered: Alabama, California, Iowa, Mississippi, New York, Oklahoma, Pennsylvania, South Carolina, Texas, Virginia, and Washington.

Guaranteed Loan Authorization:	$6,140,000
Grant Fund Authorization:	$4,853,668
Total Authorization:	$10,993,668

Southern Development Foundation (SDF)
States Covered: Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, South Carolina, Tennessee

Guaranteed Loan Authorization:	$4,000,000
Grant Fund Authorization:	$4,000,000
Total Authorization:	$8,000,000

For the purposes of this study, a site visit was made to the Midwest Minnesota Community Development Corporation to observe how the NNCP is administered and what their experience has been with the program. MMCDC received the largest allocation on guarantees as well as grant funds and were the only NNC that had not previously operated outside of their home state.

MIDWEST MINNESOTA COMMUNITY DEVELOPMENT CORPORATION

The President of the Midwest Minnesota Community Development Corporation (MMCDC) described the National Non-Profit Program (NNCP) as having all the necessary elements of an effective rural economic development program; loan guarantees to entice the participation of private lenders, technical assistance funds, generous loan limits of up to $500,000 and administrative flexibility in the provision of technical assistance. The only limitation to the NNCP as identified by MMCDC, is that deals are limited to relatively low risk investments due to limited risk that banks are willing to take even with an 80% guarantee.

Midwest Minnesota Community Development Corporation is a private non-profit corporation which began operation in 1971. MMCDC is one of the oldest and largest CDCs in Minnesota, serving primarily the northwestern part of the state and providing loans and technical assistance to start up and expanding rural businesses. The NNCP program was MMCDC's first attempt to expand services outside of Minnesota and they have experienced limited success in promoting the program in South Dakota, Nebraska, or Kansas.

MMCDC's organizational mission is to provide capital to rural businesses, promote job creation and retention and stimulate economic development utilizing both public and private capital. As is true with any investor, MMCDC's objective is to match the risk of the investment with the expected return. Through their various sources of financing, they are able to offer financial and technical assistance to a wide variety of business types and industries at various stages of development and risk exposure. MMCDC currently administers several business development loan funds in addition to the NNCP: an RDLF fund that was capitalized in 1980, a recently secured IRP fund, and a fund capitalized by the Economic Development Administration. MMCDC has also secured several Community Economic Development grants from the Office of Community Services enabling them to invest in specific development projects.

With access to these various business development funds, MMCDC can match the needs of each business with the repayment and security requirements of a particular funding source. For instance, the risk involved with their NNCP lending portfolio is significantly lower than the risk of the RDLF portfolio. This is a function of the histories of both loan funds as well as their current lending activity. The RDLF was one of MMCDC's first business development funds and as was true with many of the early RDLFs intermediaries, MCDC was forced to write off a number of their original loans: in this case $300,000 out of their original $500,000 loan. The portfolio has now stabilized and they maintain an 8% loan loss reserve on the outstanding loans. MMCDC maintains a 4% reserve on their relatively new IRP fund and a 2% reserve on the NNCP fund. These loan loss reserve levels are all determined by MMCDC staff and auditors after consideration of the risk assumed within each portfolio.

Though MMCDC will not normally invest more than $500,000 in any one business, they have acted as the loan packager in bringing together sources of investment capital for expanding business ventures. For example, a candy manufacturing venture, which had previously secured funds from MMCDC, was in need of expansion capital exceeding MMCDC's lending capacity. MMCDC identified the FmHA Business and Industry loan guarantee program as a potential source of funding and worked with a local bank and the business in seeing that the B&I loan was finalized. MMCDC's intervention was instrumental in convincing the bank, which had never worked with FmHA before, to proceed with the loan.

MMCDC's level of involvement in any one business varies depending on the business client's financial and technical assistance needs. For instance, MMCDC can provide financial assistance to an established business in need of capital because they have reached their credit limit with the local bank. In other situations, MMCDC has provided technical assistance to a business which would not as yet be considered a good risk for financial assistance but required funds for a feasibility study to determine when and if financial investment in a venture is prudent.

The NNCP is the only loan program administered by MMCDC that has both a technical assistance and a financial assistance component working in tandem. Though they have successfully administered the program in their home state of Minnesota, they have not been able to effectively serve the other states within their target area.

MMCDC's NNCP PROGRAM

In their original workplan submitted to FmHA, MMCDC proposed to operate the NNCP program in Minnesota, South Dakota, North Dakota, Nebraska, Kansas and Illinois. MMCDC worked to establish state affiliates and secure the participation of lenders in each of these states by working through the state economic development officials. Developing these state affiliate relationships proved to be a difficult task. State governments were not embracing the idea of the program or working with an out of state non-profit entity.

MMCDC staff were able to secure the cooperation of state economic development agencies in South Dakota, Nebraska and Kansas. These states expressed an interest in the program, acknowledged the need for additional rural development dollars and recommended lending institutions within the state for MMCDC to consider as participants. MMCDC was not able to get officials in North

Dakota or Illinois to cooperate and they eventually dropped these states from the NNCP service area.

Originally, MMCDC envisioned the state affiliates playing an active role in marketing the program and acting as the broker between the businesses and the guaranteed lenders. However, beyond granting MMCDC the ability to operate the NNCP within their borders, participating states have not played an active role in promoting the NNCP or marketing the program to small rural businesses in their state.

In part, MMCDC attributes this inactivity to changes amongst key personnel responsible for the NNCP within each state. Personnel changes in Kansas and Nebraska represented the loss of individuals with knowledge of and commitment to the program. These individuals were not replaced with persons willing to market and promote the NNCP and as a result there is little networking between the state affiliates and participating lenders. This lack of continuity has created significant problems for MMCDC as the NNC.

Though it was the program's intent, that state affiliates market the program and act as the technical assistance provider or contractor, it has been the lending institutions within each state that have been more pro-active participants in the program. Despite their alleged commitment to the program, these banks have not generated any volume of NNCP loan activity.

GUARANTEED LENDERS

Though the grant agreement from FmHA to MMCDC was finalized in November 1987, no guaranteed NNCP lenders had been approved by FmHA. FmHA encouraged NNCs to begin operating the program despite the fact that these lending agreements were outstanding and MMCDC was encouraged to lend out their grant funds. Though MMCDC intended, according to their proposed workplan, to combine all grant funds with guaranteed funds in a 1 to 3 ratio, their first loans were derived 100% from grant funds. Though FmHA endorsed this decision at the time, they are asking that MMCDC correct this imbalance in grant and guarantee expenditures.

It was not until August 1988, that lines of credit with the five Minnesota banks were closed and approved by FmHA. MMCDC was then positioned to implement their proposed NNCP workplan in Minnesota. One year later, loan agreements with three out of state lenders were closed. In total MMCDC secured nine million dollars in loan commitments from eight lending institutions throughout the four state target area. These agreements represented commitments from each institution to provide MMCDC with access to a credit line to make business loans to ultimate recipients. Each line of credit was made available to MMCDC at a cost of Prime plus two, except in the case of the South Dakota

Economic Development Finance Authority where the cost of funds is fixed at 3%.

All five Minnesota lenders are small independent rural banks. First National Bank, Citizens Bank, Minnwest Bank, Northwoods Bank each committed $500,000 in funds to the program. CommunityFirst, the only bank that MMCDC had previously worked with, committed $1 million in funds for the program. The Minnesota lenders were quick to move their NNCP guarantee funds and by the end of fiscal year 1991 all funds authorized for use in Minnesota had been lent out.

In South Dakota, the South Dakota Economic Development Finance Authority is both the NNCP state affiliate and the designated NNCP lender for the state. Though they committed $3 million to the NNCP, they have not advanced any of the funds to the NNC. FirstTier Bank in Lincoln Nebraska and Bank IV in Wichita Kansas each committed $1.5 million to the program. FirstTier is the only lender outside of Minnesota that has yet advanced any of the funds they committed to the NNC. In the summer of 1992, they advanced $150,000 to NNC for the financing of ScottsBluff Sash and Shade Co.

Due to the ten year limit on all FmHA loan guarantees, all credit lines were extended to MMCDC for up to ten years. The guarantee funds in Minnesota have been exhausted while the funds reserved for Nebraska, South Dakota and Kansas have barely been tapped. These untapped funds are becoming increasingly restrictive as time goes on and the terms on the guarantee expire. Any loans made through SDEDFA, Bank IV, or FirstTier will have to be for seven years or less in order to remain within the parameters of the FmHA guarantee.

MMCDC staff attribute the lack of lending outside of Minnesota to several possible factors. First the inability for the CDC to actively work with the lending institutions in each state due to limited staff time and travel involved. In December 1990, MMCDC staff visited lenders in Kansas and Nebraska and launched a mailing to businesses in those states to generate interest in the NNCP funds. Though the marketing attempt did not result in the financing of any businesses, it did generate some funding requests. MMCDC reported that the deals were either classified as bad risks or in several cases, the affiliate lenders decided to fund the project themselves without utilizing the NNC or the NNCP guarantee funds.

The banks that have been most responsive to the program have been the Minnesota banks, all small institutions involved in rural lending. In contrast, the lenders in South Dakota, Nebraska, and Kansas are all large, metropolitan based institutions. The lending climate in these banks is not condusive to rural, commercial lending. Though these banks agreed to participate in the program, they are not inclined to actively market the NNCP funds or work with the NNC intermediary in Minnesota.

In addition, the inflexibility of the guarantee agreements between FmHA and the lending institutions have created some problems. For instance, a business in ScottsBluff Nebraska approached the FistTier branch office in ScottsBluff for a business loan. The loan application was submitted to FirstTier's central office in Lincoln where it was considered for an NNCP guaranteed loan. The Lincoln office was reluctant to extend a business loan in Scottsbluff due to its distance from the bank office and FmHA would not transfer the NNCP guarantee to the Scottsbluff branch. Therefore, that particular business was not funded through FirstTier.

MMCDC has approached FmHA regarding the untapped guarantee and grant monies. MMCDC suggested that guarantees which have not been utilized in South Dakota, Kansas or Nebraska be transferred to Minnesota either through existing or new lenders. In addition they would like to see FmHA allow them to use additional grant funds in Minnesota. Though the NNCP program has not yet made a significant impact in Nebraska, South Dakota or Kansas, FmHA is reluctant to give up on utilizing funds within those target states.

INTENDED USE OF FUNDS

The complexity of the NNCP program not only lies in the various affiliated lenders and state entities but also in the different types of financing packaged in the various deals. Grant funds, guaranteed loans and additional private funds are all a part of the NNC program. MMCDC can provide an eligible business with financial assistance and/or technical assistance as an NNC.

Financial assistance is provided through loans made by the NNC to business recipients. MMCDC structures these loans using both NNCP guaranteed funds (through one of their lenders) as well as grant funds maintaining a three to one ratio of guaranteed dollars to grant dollars in every loan package. This allows them to maximize the use of their funds.

Loan are made directly from the NNC to the business at a cost of Prime plus two and in many cases the cost of the loan is fixed at closing. MMCDC charges interest on the entire loan to the business, both the guaranteed loan and grant portion. Payments on these loans are used to cover payments on MMCDC's credit line as well as any other administrative costs associated with the lending. All principal and interest payments to MMCDC are revolved back into a fund for re-lending that is considered non-federal in nature and therefore free from program restrictions.

One of the key elements of the NNCP program which distinguishes it from other business development programs is the availability of grant funds for technical assistance. MMCDC's disbursed the TA grant funds as they saw fit depending on the needs of the particular business. In some cases they are loaned to business for the purpose of hiring an outside consultant to provide a service while in other cases MMCDC provides the technical assistance directly to the business. The technical assistance delivered to businesses outside of Minnesota have been provided by MMCDC and private consultants. None of the state affiliates have provided technical assistance.

The following chart illustrates the annual distribution of MMCDC's NNCP funds. It is evident that the majority of funds have been committed to financial assistance and that the technical assistance is frequently provided without accompanying financial assistance. The total number of deals completed annually declines from 1988 through 1990 as authorized funds are exhausted. The decline does not indicate a decline in demand or capacity.

MMCDC's NNCP EXPENDITURES 1988 - 1990

	FY 1988	FY 1989	FY1990	FY 1991
TA Funds	$340,000	$196,300	$220,990	$50,130
FA Funds	$1,776,875	$300,250	$227250	0
# of Deals with only TA $	70	39	31	11
# of Deals with only FA $	0	0	0	0
# of deals with both TA & FA $	12	8	4	0
Total # of deals	82	47	35	11

The chart below reveals the distribution of NNC deals throughout the targeted states. One Hundred and seventy five NNCP transactions took place in Minnesota. Though the majority of the assisted businesses received strictly technical assistance, several businesses received both technical and financial assistance. The chart also illustrates the limited impact of the NNCP in Nebraska, Kansas and South Dakota. The declining number of deals closed in Minnesota from 1988 - 1990 represents the drawdown of both guaranteed funds as well as grant funds and not a declining demand for such funds.

STATE DISTRIBUTION OF MMCDC's NNCP DEALS

1988	1989	1990	1991
MINNESOTA-81 SOUTH DAKOTA-1 KANSAS-0 NEBRASKA-0	MINNESOTA-43 SOUTH DAKOTA-2 KANSAS-1 NEBRASKA-1	MINNESOTA-32 SOUTH DAKOTA-3 KANSAS-0 NEBRASKA-0	MINNESOTA-8 SOUTH DAKOTA-0 KANSAS-3 NEBRASKA-3

As of June 1992 one business had received financial assistance in Nebraska and none had secured such assistance in either Nebraska or Kansas. There was a higher level of technical assistance in these states as compared to Minnesota however. This is due to MMCDCs ability to generate business without the assistance of the affiliate organizations or lenders in those states.

MMCDC's NNCP LOAN ACTIVITY

MMCDC's average NNCP loan is for $250,000, with loans ranging from $50,000 to $480,000. On average every NNCP dollar loaned thus far has leveraged approximately $1.2 in additional financing. The funds thus far have impacted 987 jobs at a cost of $4,704 per job.

These NNCP loans are significantly larger than the IRP or RDLF loans made by MMCDC which average $63,000 and $33,770 respectively. The regulations for the NNCP program allow for loans of up to $500,000 in comparison to the RDLF or IRP's limits of $150,000. The NNCP enables MMCDC to target larger capital needs of businesses.

The RDLF program has out performed NNCP in terms of leveraging but this may be a function of the lower ceiling imposed on their maximum loan. Over the last five years of the RDLF has demonstrated the ability to leverage $3.75 for every RDLF dollar while at the same time averaging a cost of $2,159 per job. After ten months of operation, the IRP has only leveraged $.43 for every IRP dollar while their cost per job has averaged $14,000.

MMCDC's NNCP BUSINESS DEALS
The following businesses received NNCP funding from MMCDC. Both companies had previously received either financial assistance or technical assistance from MMCDC

StoneL
Fergus Falls, Minnesota
StoneL was started by two engineers who had previously worked with a larger valve manufacturing company where they felt frustrated with their inability to influence product design and innovation. With their knowledge of the technology involved in valves and valve monitoring systems they started their own company, StoneL in 1989. The valves produced by StoneL are often used in chemical plants and public utility facilities to both manually and automatically open and shut valves.

StoneL's two principal owners approached MMCDC because they were unable to secure a bank loan with the limited equity investment and collateral they could offer. Banks were also reluctant to invest in a start up business with high research and development costs associated with the product. The principals approached MMCDC after having secured $310,000 in equity and debt and approached MMCDC for an additional $220,000 in start-up capital. Because of the size of the loan and the potential for needed technical assistance, MMCDC loan staff considered the NNC program.

CommunityFirst Bank was the lender involved in the deal advancing $165,000 to MMCDC with the FmHA NNCP guarantee. MMCDC in turn lent $220,000 to StoneL ($165,000 guarantee and $55,000 in NNCP grant funds) at P+2 for five years.

In conjunction with the financial assistance provided to the company, MMCDC provided Stonel with technical assistance in the development of a marketing brochure. MMCDC used NNCP grant funds to contact with a company to design the brochure and StoneL paid for the production.

StoneL, currently employs between 15 -17 people with some seasonal variation, has plan for gradual expansion. They are working to expand their international markets and as their product line develops they may need to expand their production space. Though the venture is healthy for a start-up company, they are heavily debt burdened and will find it difficult to leverage any more financing at this time. MMCDC is working with them to stabilize their development.

The closing of the NNC loan with Stonel was a lengthy process due to issues related to security. The principals in StoneL continue to feel that MMCDC overly-collateralized the loan by demanding to take real estate collateral, equipment as well personal guarantees. Though they realized they could not get the financing that they needed, and that MMCDC was a lender of last resort, they were unhappy with the conditions tied to the NNCP loan.

<u>Kenny's Candy</u>
<u>Perham,, Minnesota</u>

Kenny's has received both financial and technical assistance from the NNCP. Kenny's Candy opened in 1987 in a small store front in Perham where they produced, package, and marketed their licorice and fruit candy products.

Sales grew from their first year of $600,000 to over $1.5 in their third year and doubled again in their fourth year of operation to over $3 million. Employment grew from 10-15 full time employees to 45-50 during the same time period.

Kenny's has received two separate technical assistance grants from MMCDC. They first approached MMCDC for assistance in 1988. They were exploring expansion possibilities and needed to do some up-front research on the feasibility. Through the NNCP MMCDC advanced $1,500 in grant funds for a financial feasibility study, $1,500 for accounting assistance, and $,2500 for a technical feasibility study.

In 1988, Kenny's candy approached MMCDC for a working capital loan. At the time they were employing 30 people and were in need of equipment and working capital which would allow them to hire another 10 employees. MMCDC worked through CommunityFirst Bank, drawing down $161,250 on their NNCP credit line. MMCDC then loaned Kenny's $250,000 ($161,2500 guarantee funds and $53,750 grant funds) at P+2 for seven years.

In May of 1989, Kenny's Candy approached MMCDC for an additional $175,000 to finance the purchase and installation of equipment and climate control system. These funds were added to the existing guarantee which existed with CommunityFirst Bank. The term of the loan was negotiated at seven years at prime plus two.

CONCLUSION

The NNCP guarantee funds fulfill several important credit needs that are not met by the private sector. In Minnesota where the much of the commercial lending done in rural areas is conducted through small rural independent banks, it is not unusual for a business to borrow the maximum allowable for any one individual/business. Some banks won't lend out more than $250,000 to any one borrower, taking into account both personal and business debt. In these cases a business needs a back-up source of capital or an incentive to encourage the bank to extend additional credit. The NNCP was able to fill this gap.

[illegible] Bank limit

The $500,000 loan limit allowable under the NNCP is significantly higher than the $200,000 or $150,000 limit of the IRP program. The average NNCP loan in 1991 was $250,000 with loans ranging in size from $50,000 to $480,000. The NNCP is one of the few lending programs with this generous a lending limit.

Though no bank turn-downs are required in order for a business to qualify for NNCP funds, both bankers and MMCDC staff agreed that the NNCP program encouraged banks to invest in deals that they would otherwise not consider. Banks regarded the guarantee and in some cases the guarantee in combination with the TA funds as a significant safeguard against risk.

Bankers and MMCDC staff agreed that the NNCP is not a high risk program. All NNCP loans are highly collateralized loans and MMCDC as well as the banks scrutinize the deals as would any private lending institution.

The ability to offer technical assistance to businesses, either with or without financial assistance is an element of the program valued highly by the MMCDC staff as well as bankers associated with the program. In several cases, these funds enabled MMCDC to provide the technical assistance needed to reduce or manage the risk associated with providing financial assistance. In marketing a loan proposal to a private lender, MMCDC will stress their ability to service the businesses needs throughout the term of the loan.

The success of MMCDC's NNCP within the state of Minnesota speaks to the demand for the technical and financial assistance offered by the program and the capacity of MMCDC as an economic developer in Minnesota. The banks in Minnesota worked well with MMCDC in processing loans and marketing the program to businesses. MMCDC, in working closely with businesses and lenders, was able to meet the technical assistance as well as financial needs of businesses.

MMCDC's failure to meet program objectives in Kansas, Nebraska and South Dakota was a function of the programs organization and not a lack demand for development capital. In planning the program, MMCDC envisioned a network developing amongst state affiliates and out of state lenders who would work as extensions of MMCDC. When the networking system failed, MMCDC was unable to step in and fill the void with their own staff.

The financial and technical assistance elements of the NNCP program are in great demand and yet if there is no effective delivery system in place to implement the program, the funds will go unused. In order for MMCDC to move the rest of their allocated

NNCP funds, they will need to either renegotiate their agreement with FmHA or work to invigorate their lenders and affiliates in South Dakota, Kansas, and Nebraska.

RURAL DEVELOPMENT LOAN FUND / INTERMEDIARY RELENDING PROGRAM

MISSISSIPPI CASE STUDY

The site visit to Mississippi included visits with two intermediaries administering IRP funds and one intermediary administering an RDLF. These funds are concentrated in two distinct areas of the state: Northeastern Mississippi and the Southern Delta region. In addition to meeting with RDLF/IRP intermediaries, the research team visited seven businesses that have benefitted from RDLF/IRP financing, spoke with two bankers in the state and met with state FmHA officials in Jackson. The following case study illustrates the issues encountered by the intermediaries administering the RDLF or IRP in Mississippi.

One community activist interviewed in Greenville Mississippi described the economy of the Mississippi Delta as one of "neo-colonial poverty". Land and capital resources are controlled by the white population with the majority black population unable to access ownership or control. This dynamic stymies the black entrepreneurial sector of the economy cutting off opportunities for expansion and development. In contrast, a banker in Pontotoc Mississippi describes Northeastern Mississippi as a land of opportunity and expansion. The region boasts of an expanding business base, a skilled labor market, and a healthy banking industry.

With this economic dichotomy at work, it is not surprising to see that federal economic development programs, such as the RDLF/IRP, operate differently in the Delta region as compared to Northeastern Mississippi. While long terms poverty, years of low capital investment and the presence of racial inequalities negatively impact economic development programs in the Delta, a sense of economic expansion and opportunity are positively impacting rural development in the Northeast region of the state. These dynamics were evident in visiting RDLF and IRP intermediaries and talking to those administering the programs in these two distinct areas of the state.

INTRODUCTION TO MISSISSIPPI'S ECONOMY

Unemployment in the state averaged 8.3% in 1991, its lowest level in ten years, and is expected to drop to 7.8% in 1992.[1] Though employment for the state looks relatively healthy, one needs to look beneath the surface at how regional economies within the state are growing or contracting. For instance, the Delta region, with a majority black population in most counties, maintained on average a 26% unemployment rate in 1991 as opposed

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[1] Mississippi Institutions of Higher Learning Center for Research and Planning, Mississippi Economic Review and Outlook, November 1991, pg. 7

to Northeastern Mississippi, where blacks make up less than 30% of the population, and unemployment averaged 9.8%.[2] These demographics play a significant role in Mississippi's economy and how different regions of the state develop.

Manufacturing is the major employment sector in Mississippi accounting for 22% of the states employment with a concentration in the Northeastern part of the state. This sectoral growth in Mississippi counters a national trend which shows manufacturing levels dropping due to the recession. [3] Low labor costs in the state, especially when compared to markets in North Carolina, are a contributing factor. This has lured new manufacturers into the area and encouraged the expansion of existing industries such as furniture manufacturing in the Northeastern part of the state.

Agriculture, though still important to Mississippi's economy, does not play the major role it did thirty years ago when it was the major economic force in the state. Agriculture related employment remains the major source of employment in nine of Mississippi's eighty-two counties. The majority of these agriculturally based economies are located in the Delta region.[4] The high unemployment numbers in the Delta point to the seasonal nature of agricultural employment and the fact that new industries have not moved into the area to fill the employment gap left by the demise of agricultural industries.

The Southern Delta region lost several major manufacturing industries in the last five years taking several hundred permanent jobs out of the region. Corporate takeovers during this time period lead to the consolidation of industries and closing of local plants in search of cheaper international labor markets. There are currently some prospects of businesses moving into the area and creating new employment opportunities.

The decline of the agricultural sector throughout the 1980s and the lack of manufacturing growth in the Delta and other rural areas in the state, has contributed to the migration of populations from rural areas into less rural regions of the state in search of new employment opportunities. Many displaced farm

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[2] Mississippi Employment Security Commission, Labor Market Information Department, 1991 figures.

[3] Mississippi Institution of Higher Learning, pg.5.

[4] The Myth of Rural Life, Page 17

workers sought employment in manufacturing industries which for the most part located in and around cities.[5]

This case study will look at how the RDLF/IRP funds have been used to encourage business and job creation opportunities in rural areas.

CREDIT GAPS

A 1989 study conducted by Mount Auburn Associates for the Mississippi Task Force for Economic Development Planning included an in depth look at the condition of business finance in the state. [6] The report found that Mississippi as a whole is a capital poor state with few banking resources and low levels of bank deposits per capita. However, in terms of institutional soundness, banks in Mississippi are healthy with very few falling into receivership or failing. Only two forced mergers of failing banks occurred in Mississippi between 1983 and 1988.[7] These relatively stable commercial banks are the major source of financing for businesses in Mississippi.

While the levels of per capita deposits in urban and rural areas are comparable in Mississippi, regional disparities exist in per capita deposit levels. For instance, deposit levels amongst commercial banks in Central, North Central and Northeast Mississippi are high while deposit levels in the Delta Region and Southern Mississippi are low. Trends in deposit growth between 1982 and 1987 indicate that these disparities are growing.[8] The existence of a high deposit levels in an area do not indicate that more business lending takes place, but it does indicate that high deposit areas have more lending resources at their disposal.

Bankers, RDLF/IRP intermediaries and FmHA officials interviewed for this report all characterized the banking environment in the state as cautious and conservative. One banker attributed the stability of banks in Mississippi to the cautious conservative nature of bankers in the state. Indicators show that Mississippi banks are conservative in investing the limited resources they

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[5] Ibid. pg 17

[6] Mount Auburn Associates, Financing for a Globally Competitive Economy: Final Report to the Finance Committee, November 1989.

[7] ibid., pg.12.

[8] Ibid., pg. 12.

have. For instance, in 1987 the state's commercial banks ranked 39th out of all fifty states in loan to deposit ratios indicating that banks do not aggressively lend out their deposit base but rather are more likely to invest in less risky securities.[9]

The Mount Auburn report also revealed that businesses, banks, and economic development officials were largely unaware of sources of debt financing outside of commercial banks.[10] The exception to this being the furniture industry, concentrated in Northeastern Mississippi, which has been forced to seek out additional sources of capital to meet their expansion needs. Commercial banks in the area are limited by their size and their inability to concentrate their investments in any one industry.

According the Governors's Economic Development Task Force, one third of Mississippi's employers surveyed cited the cost and availability of financing as a serious threat to their competitiveness, and almost one half said that the inability to obtain financing had caused them to cancel, scale down or postpone expansion plans.[11] These trends speak to the need for programs such as the RDLF/IRP to address unmet capital needs and supplement the private capital market.

The RDLF and IRP programs are working within the constraints of this conservative banking environment to increase rural businesses's access to capital and supplement the lending of commercial banks.

INTRODUCTION TO MISSISSIPPI BASED RDLF/IRP PROGRAMS AND FmHA

The State Director of Community and Business Programs for Mississippi Farmers Home Administration (now the Deputy Director of Strategy- RDA), oversees the RDLF/IRP programs within the state. MS FmHA closed their first IRP loan for $2 million to Three Rivers Planning and Development District (TRPDD) in April 1991 and two months later a $2 million dollar IRP was closed with Northeastern Mississippi Planning and Development District (NEMPDD). Though both intermediaries had extensive business lending experience and had operated federally capitalized revolving funds, neither organization had worked previously with FmHA. Since both organizations serve the growing northeastern part of the state, they were able to lend out all their IRP funds within the first year of operation.

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[9] ibid., pg. 12

[10] ibid. pg.5.

[11] Mount Auburn Associates, Financing for a Globally Competitive Economy:Final Report to the Finance Committee, November 1989.

MS FmHA believes that Planning and Development Districts (PDDs) are the appropriate vehicles through which to channel IRP monies in Mississippi. These organizations have developed strong business lending track records through their EDA and SBA lending programs. Planning and Development Districts, according to FmHA, have a reputation for working well with banks as well as local governments and municipalities in the state. Both TRPDD and NEMPDD have been instrumental in meeting the growing capital demands in their area.

A third IRP loan was made in September 1991 to the South Delta Planning and Development District (SDPDD) for $1.25 million. Unlike the first two IRPs, SDPDD has had trouble lending out their funds and as of August 1992 had not made any loans to businesses. FmHA and SDPDD attribute this to the poor economic climate in the Delta region. SDPDD has had few viable businesses approach them for funding. In addition, they have had difficulty leveraging funds from banks to finance the businesses that are viable.

Though the national office of FmHA makes the final decision in selecting an IRP intermediary, the state offices wield significant decision making power through the scoring of each application. According to FmHA regulations certain criteria must be considered in selecting IRP intermediaries and through the application process, intermediaries are scored and ranked according to their ability to meet these criteria. The criteria include the poverty and unemployment rates within the intermediaries service area, an intermediaries ability to leverage outside funds for lending, and the economic development experience of the intermediary. MS FmHA believes that an intermediary's lending track record should be the strongest consideration in this selection process and it is the track record of the PDDs within the state that have earned FmHA endorsement.

The emphasis of the IRP program as described by the MS FmHA, is business creation. IRP dollars are targeted to economically viable businesses that cannot, for one reason or another, secure bank funds. MS FmHA does not see a need to focus the program specifically on the job creation potential of each business receiving IRP funds. Instead FmHA encourages the development of healthy businesses which contribute to the economic base of an area, encouraging additional investment and job creation.

For the purpose of this case study, the research team visited, the Delta Foundation which administers an RDLF Fund as well as two IRP intermediaries Three Rivers Planning and Development District and Northeast Mississippi Planning and Development District. These RDLF/IRP development funds are concentrated in two distinct parts of the state: the economically distressed Delta region and the economically vibrant Northeast.

DELTA FOUNDATION

The Delta Foundation's mission is the promotion of economic, human and social development of minority and economically underprivileged residents of the Delta region. It order to advance this mission, the programs of the Delta Foundation strive to create and assist in the development of self-sustaining for-profit enterprises that increase minority and economically underprivileged control and ownership of resources.

The Delta Foundation was started in 1969 by 14 civil rights and community organizations. It was created as a vehicle through which real assets, income and human capital would be anchored in minority communities throughout the Delta region and build the foundation for permanent economic growth. They began their business development activities in 1981 with a $250,000 loan fund which was capitalized by the Community Services Administration (CSA). Currently they have a staff of 10 and one quarter of their time is devoted to loan fund activities.

In addition to operating the RDLF, Delta oversees three subsidiary corporations which have all together created in excess of 3,000 jobs; Delta Enterprises, Sun Delta Capital Access Center, and Delta Capital Corporation. These corporations own some ventures, while lending and providing venture capital to others.

Delta was one of the first organizations to receive an RDLF loan from the Community Services Administration (CSA). In 1980 they received a $3 million RDLF loan from CSA to be followed by another $1 million in 1983 after CSA had been dismantled and the program moved to OCS. The regulations for both the CSA and the OCS administered RDLF, stated one of the purposes of the program to be creating employment and/or ownership opportunities for low-income residents in local economic enterprises. The programs mission as stated encompassed the mission of Delta.

As one of the first intermediaries to receive an RDLF loan, Delta has seen the transition from the RDLF as administered by CSA to the RDLF as administered by FmHA. Immediately after the original IRP funds were obligated to Delta, CSA began putting pressure on the organization to get the money into the field. According to some staff, Delta felt that there was less concern for the quality of these original loans, in terms of their financial feasibility, and more emphasis placed on the number of loans processed. This resulted in the development of a loan portfolio with some very high risk deals.

When The Office of Community Service (OCS) took over administration of the program more attention was given to the administrative practices of the intermediaries and according to some, a climate of distrust developed between OCS and the RDLF intermediaries. Delta and some other intermediaries, felt that OCS was working towards dismantling the program all together. Similar to CSA, OCS as an organization did not have a business development focus. They did not share CSA's commitment to the social objectives of the program. Bowie described the current oversight of the RDLF by FmHA as having a strong business orientation and a consistent interest in the overall health of the loan portfolio.

Delta's business development mission is to increase ownership and employment opportunities for the community while at the same time developing the long term stability of their loan portfolio. This requires balancing the risk involved in making loans to emerging and start up businesses against the social objectives of targeting business loans to low income entrepreneurs.

From 1985 through 1989, Delta focused their energy internally on building the health of their loan fund and building the stability of their subsidiary corporations. A number of defaults, especially in their first RDLF portfolio, forced Delta to tighten their lending practices while not compromising their social objectives. They feel they have attained that balance in their current RDLF operation and are now actively looking for additional loan capital. Delta recently secured additional loan capital totalling approximately $3 million from the Tennesee Valley Authority, The Episcopal Mission, and the Small Business Administration.

Delta's current loan portfolio includes over 100 loans made to low and moderate income business owners. Delta's lending is targeted to businesses that cannot access capital in the private market due to a variety of reasons: race and/or income level, lack of collateral, lack of experience, risk assessment of the business.

Delta historically has not worked closely with private banks in their business development activities. They have secured both state and federal funding, private foundation support and funding from religious institutions. As a black community based organization which has assisting primarily black businesses, Delta has faced racial lending barriers in leveraging private financing for their borrowers. They have however been successful in leveraging private financing for their subsidiary businesses. In general, black business owners and operators often do not benefit from a long term business relationship with the local bank as do many white business owners and therefore they are more reliant on alternative lending institutions like Delta.

In the last five years, Delta has closed 24 RDLF loans totalling $1.69 million. These funds have leveraged close to $6 million in additional financing and impacted 970 jobs at a cost of $1,742 per job. Interest rates on RDLF funds are slightly above market rate and have ranged from 10% to 15% depending on the market rate at the time. Though some consider these rates high, Delta contends that the businesses they serve are not confined by the price of capital but rather access to it.

Delta currently has approximately $500,000 in their RDLF account for re-lending though their entire RDLF portfolio totals $4 million. Delta continues to see a steady demand for business development funds. Therefore, they are preparing an application to FmHa for IRP funds to expand their lending capacity and meet this demand. In preparing their IRP application, Delta is seeking letters of commitment from banks interested in working with Delta on business development. FmHA has informed Delta that in order for their IRP application to be competitive with other intermediaries, they must demonstrate their ability to leverage outside funds.

The following are examples of businesses that have been received financing from Delta's RDLF. They illustrate the types of businesses that without Delta's assistance would be unable to secure traditional debt financing from a bank.

Tradeway
Mound Bayou, Mississippi
Tradeway is a combination convenient store, liquor store, produce market, gas station and game arcade that has most recently added on a thrift store. The business is owned and operated by a black family in Mound Bayou which had previously managed and operated a 600 acre family farm on the property. The family farm, like many in the area, was unable to compete in the marketplace with larger farms and in 1984 they were forced to close.

Seeing the need for a multi-purpose store and utilizing a portion of the farm property that they owned, the family decided to build the Tradeway on a plot of land on RT 61, a well travelled thoroughfare. The family started the construction of the physical building themselves, using their own materials and labor, and completed 70% of the job before they ran out of funds.

They were not strong candidates for bank financing : low income entrepreneurs with a start-up business and no collateral. Delta worked with the business on their business plan and provided them with the fixed rate financing that they needed. Their loan was secured with the value of the building complex and nine plots of farming land.

The project created six jobs for low income individuals and assisted a low income entrepreneur start a now successful and growing business.

$49,995 RDLF Loan for 12 yrs. at 11%

Griffin Lamp Co.
Shelby, Mississippi
Griffin Lamp Company manufactures automotive safety lighting products, safety mirrors, and truck equipment which they market to equipment manufacturers, wholesalers and military contractors. After the death of the original owner, the business was put into trust. The current owner was the general manager of the company for two years before he secured a business partner and acquired the company in 1987.

When the new owners took over, the company employed 20 people and grew to employ 27. There was some fluctuation in the employment due to sales and production demands.

The company was experiencing a cash flow problem creating a bottleneck in responding to product orders. In terms of profitability, the company was healthy. They needed an infusion of cash to enable them to stay afloat during production.

They were denied credit by three different local banks. Delta's loan officers and the principal owner of Griffin lamp attribute the credit denial to several factors. First, the company demonstrated poor cash flow and had insufficient collateral to satisfy a bank. In addition, the principal owner of Griffin Lamp is black racial discrimination needs to be considered as a factor.

Unable to secure a line of credit from a bank, the business approached Delta for assistance. They were in need of working capital for the acquisition of materials ,direct labor costs and overhead to keep the production line in operation. Delta was able to offer them short term fixed rate financing and it was secured by $100,000 of their accounts receivable.

$50,000 for 90 days

Delta continues to be involved with the company which is still struggling with long term cash flow problems.

REGIONAL PLANNING and DEVELOPMENT DISTRICTS ADMINISTERING IRPs
Ten Planning and Development Districts (PDDs) were established in Mississippi in 1970 by the Executive Order of the Governor. These Planning and Development Districts serve as liaisons between local officials and the state and federal governments in developing and implementing plans to address local and regional planning and economic development needs.

Over the last five years PDDs have diversified by adding direct economic development activities to their traditional planning and technical assistance functions. Most of the PDDs operate business development funds capitalized by grant funds from the Economic Development Administration (EDA) and many also operate as Small Business Administration (SBA) 504 lenders.

The two Regional Planning and Development Districts currently administering IRP funds, the Three Rivers Planning and Development District (TRPDD) and the Northeast Mississippi Planning and Development District(NEMPDD), are located in the northeastern part of the Mississippi. This region of the state is enjoying business expansion while much of the rest of the state is experiencing businesses shut downs or relocations. Both TRPDD and NEMPDD received $2 million in IRP funds in 1991 and both groups will have obligated the full amount within the first year of operation. The South Delta Planning and Development District received a $1.25 million IRP loan from FmHA but as of it's first ten months of operation has not made any business loans.

Since FmHA expressed its faith in the Planning and Development Districts as the appropriate vehicle through which IRP monies should be administered and it can be expected that future IRP loans will be administered by Planning and Development Districts.

The PDDs share FmHA's development philosophy which stresses the economic development of areas rather than conditioning business loans on the creation of low income jobs. The PDDs interviewed for this report described program flexibility with regard to job creation and targeting as one of the strengths of the IRP program. The IRP allows intermediaries to respond to the credit needs of a business without the extensive job creation requirements attached to EDA loans.

<u>Three Rivers Planning and Development District</u>
Three Rivers Planning and Development District (TRPDD) is a private non-profit providing economic development and regional planning services to an eight county service area in Northeastern Mississippi : Lafayette, Union, Pontotoc, Lee, Itawamba, Monroe, Chickasaw, Calhoun.

After securing their IRP funds, FmHA became TRPDD's largest funding source followed by the EDA, and state and local governments. Their staff of 17 devote 100 percent of their time to business development activities. They began operating their first business development loan fund in 1985 with a $750,000 EDA grant and have made 31 loans totalling $4,551,500. These funds leveraged an additional $15,059,525 in both public and private monies and impacted 2216 jobs.

TRPDD maintains strong relations with the banking community in the area and their IRP loan application included financial commitments totalling $5,400,000 from seven banks. This is how they have managed to maintain a three to one leveraging ratio on all IRP projects that they have financed. Though EDA funds as well as SBA 504 loan guarantee authority are often part of a TRPDD financing package, bank funds are a part of almost all projects.

TRPDD identifies several business credit gaps that they strive to address in their business development ventures. Credit gaps exist, especially now in the growing furniture industry, because banks cannot concentrate their capital resources too much in any one industry but instead are required to maintain diversified portfolios. With the economy of the northeast growing at such a steady pace, demand for capital is greater than the lending capacity of area banks. For this reason, TRPDD has had loan applications referred to them from banks who were unable to extend credit themselves. In addition, most banks have limits on the amount of credit they can extend to any single borrower and if an individual has exceeded that limit they need to seek out another source of financing.

The loan terms that TRPDD can offer with their funds are more favorable that those being offered by area banks. Traditional financial institutions are not willing to make fixed interest loans due to fluctuations in the cost of money. They are especially reluctant to make fixed rate loans for longer than one year. This is the type of financing being sought by start up businesses or businesses looking to expand. Without access to this type of credit, small businesses and industries, which play an important role in the local economy would stagnate.

In accordance with IRP regulations, businesses are required to verify their inability to secure bank financing. In many cases, bank turndowns are not based n the credit worthiness of a business but rather that the bank cannot offer the business credit at the terms they desire. Most of the TRPDD's IRP loans are fixed at 7% for an average term of ten years. Banks have referred businesses to TRPDD for this reason.

TRPDD provides important financing to businesses facing these credit gaps. IRP funds have been used to supplement bank loans to businesses in cases where the bank credit alone could not meet the capital needs. This gap financing is important to banks, enabling them to invest in businesses while maintaining limited exposure in any one deal. However, TRPDD does not like to take a subordinated debt position when investing with a bank partner and in most cases will share the collateral position with a bank in these situations.

TRPDD does not maintain a loan loss reserve on their IRP or any of their loan funds, but instead maintains that they back up their loans with "rock solid collateral and personal guarantees by the business owners." Each of the loans is reviewed by a loan committee made up of eight bankers, one from each county within the planning district. Therefore, TRPDD does not finance companies which were turned down by banks for lack of sufficient collateral since they themselves admit that their security standards are similar to many banks.

From April 1991 through February 1992, TRPDD has committed their entire $2 million dollar IRP portfolio. Due to regulations which limit any one intermediary from receiving more than $2 million in IRP funds, TRPDD is unable to apply for additional funds though they claim there is a need for additional development capital and they feel they have the capacity to manage a larger loan pool. In fiscal year 1991, they made 17 IRP loans; 11 start-ups and 14 expansions, totalling $648,175. These funds leveraged over $3 million in outside financing and impacted 879 jobs at a cost of approximately $700 per job.

Without development capital such as the IRP, TRPDD believes businesses in need of expansion capital will have no where else to turn. Banks alone cannot provide these businesses with the capital that they need and often TRPDD must intervene and provide a portion of the required development capital. Such was the case with American Trousers Inc., a denim manufacturer which employed 600 people between two plants, located in Houston and Columbus Mississippi. TRPDD's IRP funds were an essential part of a consortium deal to save the company and retain the 600 jobs in the area.

American Trousers
Columbus, Mississippi
American Trousers had long been owned by a family living on the West Coast and managed locally. The local management team was running the company into the ground and after two years of significant losses, the family owners decided to sell. The workers, in an effort to save their company and their jobs, formed a cooperative management team, the Small Business Concern, and began to explore buy-out options. The Small Business Concern approached the Mississippi State Economic Development Department for assistance in raising the necessary capital and from there they went to TRPDD who took on the role of developer in bringing together the various financing pieces. TRPDD describes the strength in this deal as being the collective that united behind this effort to save jobs in the area.

The total purchase price of the business was $5,750,000 and the initial financing package included the participation of five banks, TRPDD as a SBA 504 lender, $180,000 in equity, and the participation of loan funds from two other Regional Planning and development Districts. At the last minute one of the bankers dropped out and TRPDD invested $120,000 in IRP funds at Prime plus 1.5 for 15 years.

Northeast Mississippi Planning and Development District
Northeast Mississippi Planning and Development District (NEMPDD), founded in 1972, is a non-profit, quasi-public agency providing economic development and regional planning services to the most Northeast part of the state covering the counties of Marshall, Benton, Tippah, Alcorn, Prentiss, Tishomingo.

They operate in a region of the state adjacent to TRPDD's area thereby facing many of the same opportunities as well as barriers in their development. Unlike TRPDD, NEMPDD does not leverage a great deal of bank financing. They tend to partner IRP funds with other funds that they administer: EDA, ARC and State Minority Business Enterprise Funds.

This lack of interaction with private banking institutions seemed to be more of a function of an organizational choice on the part of NEMPDD rather than a reluctance of banks in the area to work with them. NEMPDD matches IRP funds with the other loan funds they administer and these sources are packaged effectively to meet the lending needs of their borrowers. Future plans for NEMPDD included expanding their working relationships with area banks as they see a need to leverage additional dollars.

In 1981 NEMPDD's first business development loan fund was capitalized by EDA at $500,000 and in 1987 the Appalachia Regional Commission capitalized an additional business development fund at $500,000. The IRP funds added significantly to their ability to expand lending activities and these funds had fewer restrictions with regard to job creation or targeting than did other funds.

NEMPDD's IRP loan with FmHA was closed in May 1991 and within their first year of operation all $2 million in funds were obligated. They financed primarily in business expansions not start-ups. with all their loans going out at 7% fixed rate for an average term of ten years.

Though they require bank turn down letters from all businesses coming to them for funding, NEMPDD uses the same collateral requirements as would a bank in reviewing loan applications. The Director admits that they scrutinize a loan as tightly as a bank and often businesses come to them not because a bank has turned them down for lack of collateral or a good business plan, but simply that NEMPDD can offer loan terms better suited to business needs. The credit gap NEMPDD feels is primarily long term, fixed rate financing, which is rarely available to small or expanding businesses.

The lending experience of NEMPDD has taught them that well secured loans do far better than loans made with weak collateral. Therefore, even if FmHA loosened the security requirements, NEMPDD would operate the program as they do currently. Chances are, if a bank turned away a loan due to weak security, NEMPDD would reject the loan as well. However, on the advice of the state FmHA office, NEMPDD holds a 4% loan loss reserve in escrow.

The following is an example of an IRP business financed by NEMPDD:

Booneville Machine and Metal
Booneville, Mississippi
Booneville Machine and Metal approached NEMPDD for an expansion loan in 1991 after the company had been in business for two years. The machine shop, employing 7 metal workers, produces machine parts in addition to designing metal products to meet specified needs.

They were looking to develop a new facility in order to increase efficiency and accommodate a growing workforce. The overhead they were paying on the original facility was too high and they wanted to expand into a larger space allowing them to increase production efficiency and cut down on labor costs.

The bank would not provide fixed rate financing for more than one year to such a young business even though they could show three profitable years and had a significant amount of their own capital to invest in the deal. NEMPDD intervened and loaned the company $100,000 at 7% fixed for ten years.

The company projected that they would increase employment in two years by 13. One year after the loan was closed, they are still employing 7 machinist though efforts are being made to hire additional skilled labor.

Owners Funds:	
Line of Credit	$30,000
Cash	$50,000
Owner Financed Equipment	$84,000
Real Estate	$36,000
Total Owners Funds	$200,000
IRP Funds	$100,000
Total Project Cost	$300,000

CONCLUSION
The Delta Foundation uses RDLF funds to finance businesses that cannot access private capital due to financing barriers in the banking industry. TRPDD and NEMPDD's IRP funds target businesses that are unable to secure sufficient affordable capital due to current regulatory restrictions in the banking industry and the limitations of small independent banks operating in the expanding economy of Northeastern Mississippi.

The RDLF/IRP lending of Delta, TRPDD and NEMPDD all address credit needs that are not being met by the private banking industry. As the credit gap facing rural small businesses expands, affecting a wider range of business types, a variety of economic development responses may be required.

Delta's targets their lending to groups that have traditionally been closed out of the private lending market: low income and/or minority entrepreneurs, under-collateralized businesses, start up ventures. The PDD's interviewed for this report target their funds to businesses that have traditionally been served by private lenders but for a variety of market reasons are unable to secure the fixed rate, term credit they need. In both cases, businesses view the RDLF/IRP lender as the lender of last resort whether it is an issue of accessibility of affordability.

IRP funds are providing important financing to businesses in Mississippi. Funds are proving to be most successful regions of the state where the economy is strong, businesses are looking towards expansion and banks are healthy. Both PDDs in the Northeastern part of the state were able to loan out their $2 million in lending capital within their first year of operation and expressed interest in securing additional IRP lending dollars if possible.

In contrast, SDPDD has not advanced any of their IRP funds. With the high unemployment and low median income levels in the Delta region there is undoubtedly a need for economic development dollars. However, SDPDD and Delta have both encountered problems in leveraging private dollars to support RDLF/IRP lending efforts.

In order to submit a competitive IRP application, Delta was told by FmHA that they needed to demonstrate an ability to leverage private dollars. The Delta Foundation, though they have been in existence for over twenty years, has only recently focused on building investment relationships with banks. As mentioned earlier, they have not historically enjoyed strong institutional support from the banking community but instead have relied on state, federal and foundation funding. It remains to be seen whether Delta can leverage bank financing for projects and at the same time target their investment funds to low income entrepreneurs.

However, it appears after talking with FmHA officials, that Delta will be handicapped in their IRP application due to the mixed performance of their RDLF portfolio. Though Delta is currently operating their RDLF funds in the black, the portfolios have suffered losses in the past, and FmHA seemed more inclined to continue working with Regional Planning and Development Districts as IRP intermediaries.

Examining how the RDLF and the IRP programs are being administered in Mississippi clearly illustrates the development of the program from its origins at CSA in 1980 to its current home at FmHA. The original RDLF program placed a heavy emphasis on job creation and targeting opportunities to low income individuals with less emphasis on business evaluation. The current FmHA program operates within a more conservative business climate with less emphasis placed on the social impacts of job targeting and low income ownership opportunities.

In making this choice, FmHA endorses a model of economic development which generates investment capital in an area but does not necessarily target the funds to low income employers or employees. This model generates employment, job creation and business expansion and proves successful in an expanding economic climate but has more difficulty in a capital poor area such as the Delta.

OHIO STATE REVOLVING LOAN FUND

Introduction

Ohio's state revolving fund (SRF) provides an example of targeting small, lower-income community needs by offering loans at a fixed hardship interest-rate based on community size and economic need criteria. Such a targeting method appears appropriate, given that nearly a quarter of Ohio's facility needs are located in nonmetropolitan areas. SRF loan recipient data show that the hardship interest-rate structure benefits small, rural moderate-income communities.

Wastewater Facility Needs (1988)

According to the 1988 EPA Needs Survey, $2.56 billion is needed in Ohio to address the statewide backlog in wastewater facility needs in order to meet federal standards. Facility needs in rural counties account for 23-percent of statewide cost estimates and total $586 million. As Chart 1 illustrates, the need to upgrade treatment facilities to meet secondary standards accounts for the greatest share of cost estimates, both in metropolitan and nonmetropolitan areas.

Chart 1.

Share of Facility Needs Cost Estimates in Ohio (from 1988 EPA Needs Survey)

	Share of Cost of Facility Needs Component						
	I	II	IIIa	IIIb	IVa	IVb	V
Statewide	20%	12%	10.5%	2.4%	20%	19%	15%
Nonmetropolitan	36%	14.5%	2.4%	2%	25%	12%	8.5%
Nonmetro as share of statewide need	**41%**	27%	5%	19%	**28%**	14%	13%

(Needs category: I: Secondary treatment; II: Advanced treatment; IIIa: Infiltration/Inflow; IIIb: Replacement/ Rehabilitation; IVa: New collector sewers; and IVb: New interceptor sewers.)

Nearly half -- $212.6 million -- of total rural facility needs estimates are solely for secondary treatment projects. In addition, there is an outstanding need to extend or provide new sewer service in both metro and nonmetro areas, as indicated by the share of need for new collector and new interceptor sewers.

Of the 892 operating facilities in Ohio, 30-percent are located in rural counties. More than a third of all facilities not currently meeting discharge permit standards are located in rural counties, and 31-percent of rural treatment facilities are not currently providing secondary treatment. Facilities located in rural areas do not have a disproportionately high rate of noncompliance; however, targeting rural facility needs is necessary to upgrade water quality and to ensure that treatment facility problems do not pose threats to public health.

Ohio State Revolving Loan Fund: History

Ohio established its SRF program FY90. The program targets rural, small low-income community needs primarily through its interest-rate structure. In addition, ranking criteria used in the SRF priority system may increase the accessibility of SRF loans for small, rural communities.

SRF loans are offered at two fixed loan interest-rates, a 2-percent hardship rate and 5-percent standard rate. Interest-rate determination is based on community size, median household income and percentage of population below poverty level.

- The SRF sets a population limit of 3,000 or fewer as the basic criterion for hardship-interest-rate eligibility. This cut-off is intended to address projects in which economies of scale cannot be achieved. For communities of fewer than 3,000 persons, median household income and percentage of population below poverty level relative to other communities in this population group are evaluated. If either falls into the lowest quarter in a population group, the community is considered eligible for 2-percent financing.

- For communities with populations between 3,000 and 10,000 persons, a 2-percent loan may be issued when both median household income and percentage below poverty level fall in the bottom quarter of their population group. Communities with populations greater than 10,000 are not eligible for 2-percent loans.

- An additional provision is offered for lower-interest-rate eligibility: communities that were originally assigned the 5-percent rate, but whose facilities plans show user charges in excess of thresholds established by Ohio EPA, are eligible for a 2-percent loan.

In addition, the SRF priority system gives priority weighting to projects that address treatment facility noncompliance. This priority structure may benefit rural areas, given the rate of noncompliance and need for secondary treatment facilities located in nonmetropolitan areas as documented in EPA Needs Survey data.

State Revolving Fund Characteristics

In FY90 and FY91, the Ohio SRF issued 28 loans totalling $101 million. Three-quarters of total Ohio SRF loan funding, $77 million, was issued at 5-percent interest, with the remainder obligated at the 2-percent hardship interest-rate. Most loans were issued to smaller communities, with only two projects serving populations of more than 10,000. Nearly half of all loan funding, $48.6 million, was issued to borrowers located in nonmetropolitan areas. All but one SRF-funded project addressed treatment plant noncompliance, reflecting state funding priorities. Loans averaged $3.6 million in the Ohio SRF, with a median loan of $2.6 million.

Characteristics of Hardship Interest-Rate Borrowers: Overall, nearly a quarter of all Ohio SRF funds, $23.33 million, was issued at 2-percent interest. Two-percent borrowers accounted for 40-percent of all loan actions.

Project type: All 2-percent loans financed treatment compliance projects, reflecting state priorities as well as the predominant rural facility need for treatment projects.

Community size: The 2-percent borrowers were small communities, averaging 2,469 persons in size - consistent with the eligibility criteria noted above. The relatively small community size also reflects the rural character of 2-percent borrowers, all of which were located in nonmetropolitan areas.

Community income: SRF staff provided data on median household income and poverty rate, since both are evaluated to determine hardship interest-rate eligibility.

Median household income: Borrowers that received 2-percent loans had an average median household income slightly above $16,043, the state nonmetropolitan median household income (SNMHI, 1980 Census). Because all 2-percent borrowers were located in rural areas, this relative income data is useful in comparing eligibility for FmHA funding subsidies.

Rural communities with incomes that exceed the SNMHI are eligible only for market-interest-rate loans (at 40-year terms) in the FmHA water and sewer funding program. Therefore, the average Ohio SRF hardship borrower is receiving a greater subsidy with a 2-percent 20-year SRF loan than would be obtained in the FmHA program.

Poverty rate: The percentage of population below poverty level averaged nearly 12-percent among hardship-interest-rate borrowers. All hardship borrowers had poverty rates that exceeded the 1990 national average, with the rate of poverty in this group ranging from 11.3 to 21.2-percent.

When viewed in conjunction with relative median household income data, poverty rate appears to be the determining factor in 2-percent hardship-interest-rate loan awards. Hardship-interest-rate borrower income data indicates that the interest-rate structure is targeting areas with pockets of poverty, rather than areas with more widespread community economic need as measured by criteria such as median household income.

The absence of borrowers with relatively low median household incomes in the hardship group may indicate that such communities are seeking funding from FmHA, given that funding terms which include the availability of supplemental grants may be more affordable than SRF loans. The data may also indicate that rural communities with lower-incomes are not able to gain access to SRF loan financing.

Loan size: Two-percent borrowers obtained loans averaging $2.1 million, two-thirds the average size of the loans obtained by the average Ohio SRF borrower. Nearly half of all 2-percent borrowers also obtained supplemental grants from other funding sources, with an average of $500,000 in grant monies. This suggests that some small, rural lower- and moderate-income communities may not be able to borrow from the SRF even at subsidized rates unless they are able to obtain supplemental grants to reduce debt service costs to affordable levels.

Data on loan size also indicate that small, rural communities may have lower relative financing needs than those of larger municipalities. The relatively low cost of small, rural community wastewater projects continues to be documented in SRF loan recipient data and FmHA funding reports. At the same time, loan size is clearly affected by debt service affordability. As a whole, this group cannot afford 100-percent debt financing, as evidenced by the share of borrowers that also obtained grants.

The low overall level of funding issued at 2-percent in the Ohio SRF is due in part to the typical cost level of small community wastewater treatment projects as well as the limited debt service capacity of small, rural moderate-income communities.

User charges: User charge data on 2-percent borrowers shows that the subsidy provided in hardship interest-rates may ultimately result in more uniform rates among all SRF borrowers. The data show that although rural borrowers are paying a higher share of their income in user charges than are metropolitan borrowers, the average annual rates are similar. For example, with SRF loans, rural 2-percent borrowers paid an average of 2-percent MHI in sewer user charges ($304/household/year) while metropolitan 5-

percent borrowers paid an average 1.4-percent of MHI ($322/household/year).

The intent of the hardship-interest-rate subsidy structure was, in part, to enable small communities that would not be able to achieve economies of scale to gain access to affordable financing. Since the hardship-interest-rate structure has enabled small, rural communities to develop projects at household user charges that are comparable to larger municipalities, it would appear that the subsidy is helping smaller populations to keep sewer user charges in check. The data indicates that Ohio SRF hardship-interest-rate subsidy is helping to offset the higher per-capita costs associated with projects serving a small customer base.

However, since nearly half of all hardship-interest-rate borrowers also received supplemental grants, it would appear that the interest-rate structure alone may not ensure that small, rural communities can develop projects at comparable user charge levels. Clearly, small, rural communities have a limited ability to spread costs. Supplemental grants may therefore play a critical role in helping these communities to reduce debt service costs to an affordable level.

Summary

The Ohio SRF hardship interest-rate is enabling some small, rural communities with moderate-incomes to address treatment facility needs, the predominant rural facility need as documented in the 1988 EPA Needs Survey. The hardship-interest-rate structure is providing a significant subsidy to smaller, rural communities with a relatively high rate of poverty. The typical hardship borrower would not be eligible for FmHA grants and would not be able to achieve the same savings on the bond market. The hardship rate clearly meets its stated intent by providing a subsidy to communities that lack the ability to achieve economies of scale.

Because loan eligibility criteria include an evaluation of relative poverty rate, the hardship-rate structure may fill a gap by providing access to subsidized-loan funds in cases where applicants would not be eligible for other federal funding subsidies. This distinction is important because it indicates that the Ohio SRF may be able to direct subsidies to those with economic need that would not be able to obtain comparable or greater subsidies from FmHA, the major source of water/sewer funds for rural communities.

However, rural Ohio hardship-interest-rate borrowers are not utilizing the SRF as the only source of project financing; in nearly half of all cases, they are also obtaining grants averaging 27-percent of project costs. This suggests that small, rural moderate-income communities may not be able to develop affordable projects with 100-percent debt financing, even with interest-rate subsidies.

Hardship borrower data show that rural lower-income communities that would qualify for FmHA loans and supplemental grants are not borrowing from the SRF. This may suggest that lower-income rural areas cannot develop affordable projects with loans at hardship interest unless they obtain supplemental grants. Therefore these communities must seek FmHA funding or secure supplemental grants before they can take advantage of SRF loans.

Overall, the Ohio SRF interest-rate structure appears to be playing an important role in providing access to below-market-rate financing for rural, small communities, even when supplemental grants are not obtained. Communities of fewer than 2,500 persons have been identified by EPA as having the least access to bond financing and as paying the highest relative cost to borrow capital. For communities of fewer than 2,500 persons, prospects for borrowing on the municipal bond market are even worse. With the average community size of 2,649 persons among 2-percent borrowers, it is clear that the Ohio SRF is filling a critical role in helping smaller communities to gain access to financing and in helping small, rural communities to gain access to interest-rate subsidies, both of which would be unlikely on the municipal bond market.

Further, the data indicate that the Ohio SRF is directing subsidies to nonmetropolitan borrowers in cases where subsidized loans and supplemental grants would not be made available in the FmHA water and sewer funding program since borrowers' average MHI levels exceed 100-percent of SNMHI. The use of poverty rate data in subsidy determination enables rural areas with pockets of poverty to obtain subsidies in the Ohio SRF, while the use solely of MHI data in FmHA typically precludes the award of additional subsidies. Thus, the Ohio SRF may be filling a need for affordable financial assistance among poorer communities that would not be met by other federal subsidy programs such as FmHA.

WISCONSIN STATE REVOLVING FUND

Introduction

Wisconsin's state revolving fund (SRF) targets new sewer service projects serving lower-income households by providing hardship loans and grants based on community economic need factors. Wastewater facility needs data indicate that this targeting method is appropriate, given that nonmetropolitan areas have the greatest outstanding need for new sewer service. Moreover, cost estimates show that new sewer service projects in rural areas are likely to carry high per-capita costs. Data on the characteristics of unsewered projects that received hardship-assistance illustrate the critical need for subsidies to develop affordable new sewer service projects.

Wastewater Facility Needs (1988)

According to the 1988 EPA Needs Survey, $1.2 billion is needed in Wisconsin to address the backlog in wastewater facility needs to meet federal Clean Water Act standards. Facility needs estimates in nonmetropolitan counties account for 11-percent of statewide cost estimates and total $130 million. Chart 1 shows the relative share of wastewater facility cost estimates by project component. Secondary treatment projects account for the largest share of the cost estimate backlog for all facilities both statewide and in nonmetropolitan areas.

Chart 1.

Share of Facility Needs Cost Estimates in Wisconsin (from 1988 EPA Needs Survey)

	Share of Cost of Facility Needs Component						
	I	II	IIIa	IIIb	IVa	IVb	V
Statewide	**43%**	12%	5%	2%	11%	12%	18%
Nonmetropolitan	**47%**	2%	1%	2%	**36%**	10%	3%
Nonmetro as share of statewide need	12%	1.5%	2%	100%	**36%**	9%	0

(Needs category: I: Secondary treatment; II: Advanced treatment; IIIa: Infiltration/Inflow; IIIb: Replacement/Rehabilitation; IVa: New collector sewers; IVb: New interceptor sewers; and V: Combined sewer overflow.)

Wisconsin wastewater facility needs data are consistent with national data; treatment projects account for the greatest share of total state needs and rural facility needs. Wisconsin is addressing treatment facility needs in its "compliance maintenance" program, an innovative program that combines technical, planning and financial assistance.

Wisconsin data show that nonmetropolitan areas have a greater level of need for new or expanded sewer service than is true of metropolitan areas. New collector sewers, a project component integral to new service, account for more than a third of total rural cost estimates. Collectors represent a higher share of total rural facility needs (36-percent) than for such facilities on a statewide basis (11-percent). The relatively high level of funding needed for rural collectors -- $46.6 million -- also suggests that high per-capita costs are associated with this project component, given sparse population settlement patterns and small population size.

More than half of all Wisconsin's operating sewer facilities are located in nonmetropolitan areas. The Needs Survey shows that there are currently 434 operating facilities in nonmetropolitan areas, and that an additional 55 nonmetropolitan facilities are projected to be in operation when the backlog is addressed.

Wisconsin State Revolving Fund: History

Wisconsin established its Clean Water Fund (Fund) in 1988 to help municipalities construct wastewater facilities. The Fund provides SRF loan financing obtained as a result of federal capitalization grants in addition to offering loans and grants derived from state bond issues and state appropriations. The Fund offers: 1) direct loans using federal capitalization grants; 2) leveraged loans from the proceeds of revenue and general obligation bonds sold by the state; and 3) hardship loans and grants.

The Wisconsin Fund targets unsewered areas -- a significant need totalling nearly half of all rural facility cost estimates -- in its funding subsidy structure. The following is a brief description of hardship-assistance criteria as well as the standard Fund interest-rate structure.

Hardship-Assistance: Up to 12-percent of the total financing authorized by the Fund may be issued as hardship-assistance. Applicants that meet hardship criteria, based on community economic need, may receive loans at interest-rates as low as zero-percent and grants of up to 90-percent of project costs. Hardship-assistance may be used for planning and design as well as construction, thereby helping some applicants to gain access to project funding by providing seed money to meet preliminary requirements.

Projects must meet two conditions in order to qualify for hardship-assistance:

a) total residential wastewater user charges as a percentage of the total adjusted gross income must exceed 1.5-percent; and

b) total charges imposed by the municipality that relate to wastewater treatment as a percentage of the total equalized value of property in the municipality must place the municipality in the 25-percent of municipalities with the highest percentage.

Standard Assistance. The Fund offered a relatively low interest-rate of 2.5-percent in the first two years (1989 -91) of the program. This "transition" interest-rate was offered to projects that were ready to proceed in FY90 but were unable to successfully compete for remaining EPA Construction Grant financing. Since applicants were aware that this relatively low interest-rate would provide a higher level of subsidy than would be offered once the SRF mechanism became the primary source of wastewater funding, the transition rate served to stimulate demand for loans.

The post-transition interest-rate structure of the Clean Water Fund provides a subsidy to unsewered projects. The interest-rate schedule reflects program priorities: facilities that maintain compliance schedules are eligible for the highest level of subsidies, followed by unsewered areas. Facilities that are in violation of state and federal standards may obtain loans only at market rates. This structure is intended to reward facilities that are taking measures to meet compliance requirements. Subsidy rates are based on technical status rather than economic need or noncompliance.

Post-transition interest-rates are based on market rates as follows:

a. 55-percent of market rate for compliance maintenance and new/changed limits categories
b. 70-percent of market rate for unsewered areas
c. market rate for violators, industrial capacity and future growth projects

• Compliance maintenance refers to existing wastewater treatment facilities that are implementing projects necessary to prevent a municipality from significantly exceeding its effluent limitation permit.

• New/changed limits refers to projects necessary to meet new permit guidelines or new effluent limits established after May, 1988.

State Revolving Fund Characteristics

Between 1989-91, the Wisconsin Fund provided $421.7 million to 70 projects. This total includes $398.8 million in assistance at standard interest-rates (transition and post-transition) and $21.9 million in hardship-assistance. Most loans and loan funding went to compliance maintenance projects. Projects that addressed unsewered area needs received $28.6 million in standard and hardship-assistance, representing 7-percent of total funding.

Chart 2 shows the distribution of funds at standard interest-rates by project type. Ninety-five-percent of Wisconsin wastewater funds were issued at standard interest-rates. Unsewered projects received 4-percent of Fund monies, totalling $17.7 million, at standard interest-rates. Three-quarters of all standard-rate assistance was issued for compliance maintenance projects.

Chart 2. **Distribution of Funds with Standard Assistance**

	Compliance Maintenance	New/Changed Limits	Unsewered Projects
Transition Rate	$200.4 m	$78.2 m	$14.9 m
Post-transition Rate	101.8 m	1.7 m	2.8 m
Total	$302.2 m	79.9 m	17.7 m

Hardship-assistance: Five-percent of the Fund, $21.9 million, was issued as hardship-assistance for seven projects. Hardship loans totalled $13.4 million, grants accounted for $5.9 million and $2.6 million was awarded for planning and design (no breakdown of loan and grants was provided for this category).

Chart 3 shows the distribution of hardship-assistance by project type. Unsewered projects received the majority of hardship grant assistance as well as planning and design funding.

Chart 3. **Distribution of Funds with Hardship-Assistance**

	Compliance Maintenance	New/Changed Limits	Unsewered Projects
Grants	$ .6 m	$ .2 m	$5.1 m
Loans	$9.4 m	---	4.0 m
Planning/ Design	.7 m	.1 m	1.8 m
Total	$10.7 m	.3 m	10.9 m

Characteristics of Unsewered Projects: A fifth of all Wisconsin wastewater assistance was issued for unsewered projects. These 14 projects received $28.6 million, 7-percent of total funds obligated. The average interest-rate of all unsewered projects was 2.4-percent, with an average loan of $1.55 million.

Unsewered projects received 4-percent of funding issued at standard interest-rates totalling $17.7 million; they received 50-percent of all hardship loan and grant assistance, totalling $10.9 million.

Community characteristics:[1] Unsewered projects that received standard funding and those that received hardship-assistance were very small communities, averaging fewer than 1,000 persons. According to SRF staff, most unsewered community projects were located in nonmetropolitan areas. Because most were special service districts, the location could not be determined from Census data.

Project cost: Unsewered projects were relatively small, averaging $1.55 million. Projects that were financed at standard loan assistance rates averaged $1.7 million, while unsewered projects that received hardship-assistance were 25-percent larger on average, at $2.28 million.

[1] Data on community income could not be provided for this case study, given that most unsewered borrowers were unincorporated areas and special sanitary districts which are not included in U.S. Census data. The SRF does not maintain data on community median household income.

However, hardship-assistance unsewered projects obtained less project funding in loans than did projects financed at standard rates. Hardship-assistance unsewered projects borrowed an average of $1 million and received an average grant of $1.28 million. Hardship-assistance unsewered projects obtained loans just two-thirds the size of standard-assistance unsewered projects.

Loan interest-rate: While the majority of unsewered project loans were issued at 2.5-percent interest, hardship unsewered projects were heavily subsidized, with loan interest-rates averaging .45-percent.

Household costs: Annual household user charges among all unsewered projects averaged just over $400. It is interesting to note that despite the deep subsidies provided to hardship unsewered projects, resulting annual household user charges were only slightly lower than those of households that borrowed at standard rates. Chart 4 provides a breakdown of the characteristics of unsewered projects in both hardship and standard assistance categories.

Chart 4. **Comparison of unsewered projects in the Clean Water Fund**

	Hardship Rates	Standard Rates
Average project cost	$2.28 m	$1.72 m
Average loan size	$1.01 m	$1.72 m
Average grant size	$1.27 m	--
Average household costs	$401/year	$441/year
Average population size	752	710
Average interest-rate	.45-percent	3.2-percent

The data indicate that, even with deep subsidies, user charges associated with new sewer service projects serving rural, small populations may be high. Clearly, small community size and inability to spread costs contribute to user charge level. In addition, affordability criteria used in Wisconsin's hardship-assistance eligibility determination influences user charge levels. With average annual household costs of $400, the data indicate that the deep subsidy does not result in markedly lower user charges among unsewered projects financed in the Fund.

Access to wastewater construction funding: Unlike most other state wastewater financing programs, Wisconsin offered hardship-assistance to cover planning and design costs. Unsewered projects obtained 69-percent of hardship-assistance to cover planning and design costs. The predominance of unsewered projects in this hardship category indicates their relative need for affordable up-front monies to gain access to construction financing.

Summary

The Wisconsin Fund is targeting the needs of unsewered areas by providing funding subsidies for planning and design costs as well as for construction funding. Loan recipient data indicates that the state has been effective in helping unsewered projects to gain access to construction funding. In addition, the data shows that deep subsidies play a critical role in addressing the financing needs of unsewered areas serving rural lower-income residents.

Wisconsin has taken several steps to ensure that some unsewered projects will be able to take advantage of funding subsidies. This is an important component of evaluating the impact of the availability of hardship-assistance in the Fund, since unsewered projects have not historically been a Clean Water Act funding priority. With the transition to SRFs, Wisconsin revised its priority system, reducing the weight given to population size and giving equal weight to new service and treatment projects. Changes in the priority system have enabled unsewered community projects to qualify for SRF funding. As a result, unsewered projects represent a fifth of all funded projects. In contrast, many states have obligated all wastewater loans for treatment projects and have not provided any funding for new sewer service projects.

Data on unsewered area use of hardship-assistance for planning and design costs may also provide information on the reasons for a low overall level of funding for unsewered projects. Unsewered areas used the majority of funds available for planning and design costs, representing only a fraction of total wastewater funding. The predominant use of such funds by unsewered areas provides evidence that these areas have not yet completed preliminary loan requirements and indicates that unsewered areas require funding subsidies to cover up-front costs.

Given the outstanding need to complete preliminary requirements, these projects may currently have limited capital financing needs. In the future, unsewered area construction projects may account for a larger share of total funds obligated, given access to affordable up-front financing and completion of planning and design studies.

Wisconsin Fund data indicate that unsewered projects serving lower-income residents clearly require deep subsidies to develop affordable projects. Data on hardship-assistance projects shows that even with low-interest loans and grants, new sewer service projects carry high user charges. Although user charges were comparable among all Wisconsin unsewered projects, it is questionable whether such household user charges would be affordable to poverty-level households.

Unfortunately, it is unlikely that other funding programs would be able to provide the deep subsidies that were offered in hardship-assistance in the Wisconsin Fund. For example, in the FmHA program, poverty level applicants would qualify for 5-percent interest loans at 40-year terms and supplemental grants totalling 75-percent of project costs. But, limited grant funding has made it difficult for FmHA to obligate such a high grant share. At the same time, Wisconsin hardship-assistance funding terms may be comparable to if not better than those of FmHA, with potential loan interest-rates as low as zero-percent and grant share as high as 90-percent of project costs. Data in the case study shows deep subsidy levels, with loan interest-rates of .45-percent and 59-percent of project funding in grants.

User charge data may contribute to the assertion, made by some SRF staff, that user charges for new sewer systems may be unaffordable, particularly for lower-income households, even with 100-percent grant funding. Further, user charge data may confirm that some unsewered areas will not pursue financing for new sewer service projects because household user charges are too high.

Finally, it is important to recognize that hardship-assistance funding awarded to lower-income unsewered projects in Wisconsin derive from supplemental state appropriations. Wisconsin was able to offer grants and deep subsidies thanks to state revenues and authorizations. Since the state subsidy is a component of Wisconsin wastewater funding, communities have been able to benefit from a simplified and expeditious process to obtain loans and supplemental grants. Without hardship-assistance as part of one wastewater financing program, such communities would have had to compete for supplemental grants and would have had to meet the requirements of other funding programs to reduce SRF debt service costs to an affordable level.