Access *to* Capital

Spurring Job Growth Through Greater Investment

By Jason Rittenberg, CDFA Research & Resources Coordinator
jrittenberg@cdfa.net

Access to capital may be the development finance tool that is most relevant to people's daily lives. Businesses and people share a common necessity: access to affordable, reliable cash. A business or household can function successfully while in debt, but operating without the "working capital" to pay for supplies/food or a lease/mortgage is another matter altogether. Furthermore, whether in the form of a home mortgage, a car lease, or a credit card, the typical American is familiar with the general benefits and downsides of loans.

The consumer debt programs with which we are all familiar, however, quickly become lost in the world of economic development finance. As we move beyond direct loans, the structural complexity of access to capital programs increases rapidly. Forgivable loans, capital access programs, loan guarantees, angel, seed, or venture investments, and funds of funds all involve capital access, but each has unique elements. In short, familiarity with direct loan structures does not always translate to a ready understanding of access to capital programs for economic development.

Defining Access to Capital Programs

The concept behind access to capital programs is straightforward. As it is used by CDFA, an "access to capital" program is any financing tool that helps a business acquire the cash—or "working capital"—it needs in order to launch, operate, or grow. As long as the program helps businesses access capital, the term applies.

> Many financing programs are not cost-effective for those with borrowing needs under $35,000, which is a significant problem for microenterprises.

Of course, many diverse programs are covered by this one label. An access to capital program can be tailored to address anything from small financing needs (as low as a few thousand dollars) to large scale projects (as high as tens of millions). A program can be further targeted based on owner characteristics (e.g., disadvantaged groups), business stage (e.g., start-ups), or industry type (e.g., technology). Alternatively, an access to capital program can simply be available to any business for any purpose. The options are virtually limitless.

It is largely because of this diversity that access to capital programs are a key facet of the development finance toolbox. Tax credits and bond financing are invaluable tools, but they cannot address the entire development finance spectrum by themselves. For example, there are 24 million U.S. businesses with five or fewer employees, and these microenterprises have capital needs smaller than $35,000. Many financing programs are not cost-effective at this level, which is a significant problem when you consider that the majority of job growth in the last decade came from small businesses. Access to capital programs can not only easily be designed to service microenterprises and small businesses, but they can also be tailored to fit almost any financial service gap that a development finance agency needs to fill.

Types of Access to Capital Programs

The flexibility of access to capital programs makes strict categorization difficult, but we can generally identify four types of programs:

Grant Programs
Grants are typically created either on a competitive basis (e.g., a business model competition) or to serve a niche type of business and purpose (e.g., minority technology businesses). The competitive model also provides a good opportunity for a development finance agency to bring together a variety of businesses and stakeholders who might not otherwise meet. Funds that are expressly designed to offer forgivable loans may share many characteristics of grant programs.

> Loans that can convert to grants provide a versatile tool for agencies looking to both incentivize development and reward excellence. New Jersey's Edison Innovation Green Growth Fund, for example, provides low interest loans to companies developing clean or energy efficiency technologies. If those companies meet pre-determined revenue or employment goals, then up to half of the loan converts to a grant.

Loan & Loan Participation Programs
Loans provide capital to a business, with the full expectation that the business will pay that money back. A common type of loan program is a revolving loan fund (RLF), in which the development authority issues smaller loans (although the actual size can reach $250,000) out of a larger loan fund; as loans are paid back to the authority, the fund is replenished and new loans can be issued. Another tool that largely fits in this category is loan participation, where an agency lends part of a larger amount in conjunction with a financial institution. Some loan participation programs are structured so that the finance agency is actually purchasing a portion of a loan from the lending institution, which then overlaps with the next category.

> Loan Participation Programs enable a development finance agency to directly address the access to capital needs of a business without assuming the entire risk for those needs. An example program is the Grow Missouri Loan Fund, which can provide a loan of up to 10% of the total loan amount. Qualified businesses benefit not only because they increase their capital access, but also because the program allows deferred payments on interest for up to three years and on principals for up to six years.

Credit Support Programs
Credit support is necessary when a business cannot qualify for a traditional loan without assistance. Some of the more common programs in this category are capital access programs (CAPs), loan guarantees, and collateral support programs.

> Capital Access Programs (CAPs) support loans by making matching contributions to a reserve fund belonging to the lender. More specifically, the bank and borrower pay an up-front insurance premium of 3-7%, and this is the amount matched by the state. The reserve fund is held as insurance across the institution's entire CAP portfolio, which means that later loans are additionally supported by the unclaimed premiums of earlier loans. California runs one of the largest CAPs in the U.S., supporting over 800 loans at a leverage ratio of 26:1 in 2010.

The common thread to these programs is that the development finance agency provides a financial incentive that makes the business a more attractive candidate to the lending institution. Whether the incentive goes into a reserve fund (such as a CAP) or towards a guarantee depends on the program.

Investment Programs
Investment occurs when a development finance agency or private sector investor infuses capital into a project for an interest in the business. Such programs are often covered under the category, "Innovation Finance," and include angel, seed, or venture funds, as well as fund of funds models. [See the Education & Programs column in this issue of *Perspectives* for more information on innovation finance.]

> Collateral Support Programs are a currently-popular model of credit support programs. In this model, the development agency sets aside funds to supplement the borrower's existing collateral, making the loan more attractive to the lending institution. For example, Michigan's program contributes to a collateral account for diversifying companies that cannot otherwise receive loans. The state will contribute up to 49.9% of the credit facility. The state enrolls an average of 30 loans each year with an average support level of 20%.

Advancing Access to Capital

While the underlying principle of access to capital is familiar to everyone, the diversity and complexity of specific programs make them difficult to monitor effectively. Adding to this difficulty is the fact that the federal government offers access to capital programs through multiple agencies (e.g., the Small Business Administration, the Department of Agriculture, and the Export-Import Bank), state development agencies often house multiple programs, and local agencies may even provide their own set of loans or related tools. An economic development practitioner looking for guidance on program resources or best practices can be quickly overwhelmed by this environment.

In order to better support the efforts of economic development professionals to provide access to capital programs, CDFA is reestablishing the Access to Capital Coalition (ACC). The ACC will lead the charge in advocating for the importance of developing a strong access to capital program in a community's development finance toolbox. Much like the CDFA Tax Increment Finance Coalition serves TIF, the ACC will provide a national forum for those in search of access to capital information by providing education, research, resources, and best practices for this set of tools. If you are interested in learning more about the ACC, contact CDFA. ■