Revolving Loan Funds in North Carolina

A Profile of the Industry

Matt Hull and Carl Rist

Just beyond the gleaming corporate headquarters that herald North Carolina as one of the nation's banking centers exists a $90 million lending industry that quietly serves local markets. Without the fanfare that accompanies the corporate banking world, these revolving loan funds (RLFs) make loans to build businesses and revitalize communities in areas underserved by private financial institutions. As in most states, little is known about this industry collectively, but as a result of the research described in this article, a clearer picture of North Carolina's RLF industry has begun to emerge. For example:

- RLFs represent at least $90 million in capital dedicated to small business lending in North Carolina.
- With a median loan fund size of $1.3 million, North Carolina's funds are, on average, significantly larger than the RLFs in any other state surveyed.
- North Carolina's RLF industry has a unique structure — larger funds, but fewer of them — that is, in large part, a product of state government policy and funding.
- While a handful of high-performing funds dominate the state's RLF industry, the rest of the state's RLFs do not have a very diversified capital base and, on average, are only revolving their capital, if at all.

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What is a Revolving Loan Fund?

Revolving loan funds (RLFs) are community-based financial institutions that provide access to capital for individuals and communities underserved by private financial institutions. RLFs exist in every state and are supported by funders at all levels of government, as well as by private and philanthropic institutions. They provide loans to local businesses that cannot attract private financing, and recycle the repayments by relending the capital to other businesses. RLFs are a flexible and effective tool for promoting business development, job creation, and economic self-sufficiency. RLFs have proven to be financially sustainable institutions that collectively manage up to several billion dollars in assets.

The Counting on Local Capital Project

The profile of North Carolina's RLFs in this article was developed by the Corporation for Enterprise Development (CFED) as part of a national research and policy project, *Counting on Local Capital. Counting on Local Capital*, funded by the Ford Foundation, seeks to build knowledge about the size, level of activity, and impact of RLFs. North Carolina is one of seven states profiled as part of the project, joining Arkansas, California, Illinois, Minnesota, Ohio, and Washington.

Methodology

North Carolina was selected as one of six state partners in the national Counting on Local Capital project in July 1997. The state's application was sponsored jointly by the North Carolina Department of Commerce and the North Carolina Rural Economic Development Center.

Since a single, comprehensive inventory of RLFs in North Carolina did not exist, one of the primary tasks was to develop such a list. With help from various state and non-profit sources, 88 organizations thought to be operating loan funds were identified and sent a detailed survey. From this list, 53 organizations (60%) responded. Over half of the responding organizations indicated that they did not operate a loan fund, while 24 organizations responded that they operated at least one RLF. Three of the organizations operated two separate loan funds, bringing the total number of RLFs in the study to 27.

Among the 27 RLFs in our sample, special note should be made about four of these funds. While the purpose of our survey was to identify and profile *economic development* RLFs, we received surveys from four of the larger cities in North Carolina that reported on relatively large RLFs funded primarily with Community Development Block Grant (CDBG) grants to Entitlement Cities. Each of these funds makes a combination of economic development and housing loans, but the fund managers were unable to provide data on just the economic development portion of the portfolio. Despite the fact that these differences make these four funds somewhat unlike the other funds in our profile, this report includes them in its analysis because:

- the Department of Housing and Urban Development (HUD), which funds both Small Cities CDBG grants and CDBG grants to Entitlement Cities, has been, by far, the largest source of federal dollars for RLFs, and
- data on RLFs funded with CDBG grants to Entitlement Cities, in particular, has been the most difficult to obtain during the research on RLFs for the Counting on Local Capital project.

Recognizing these differences, though, this article will at times exclude these four funds from the analysis. Thus, when reference is made to "Economic Development ONLY RLFs," this means the 23 RLFs (excluding these four distinct funds) that make economic development loans only. Otherwise, when this report refers to "All RLFs," this will indicate the entire sample of 27 RLFs from North Carolina in the database, including these four distinct funds.

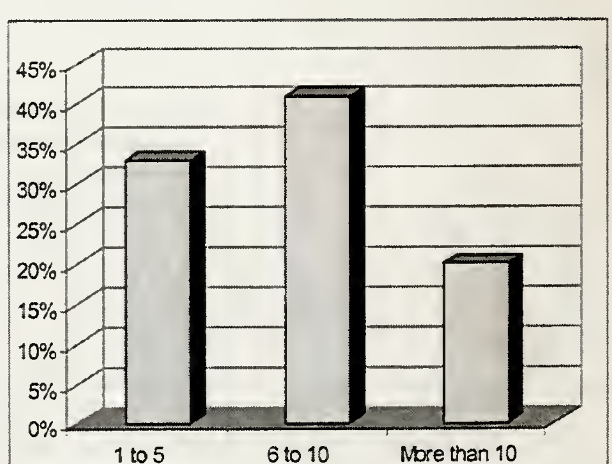
Findings from the North Carolina RLF Profile

The Basics

The organizations that operate RLFs in North Carolina are predominantly nonprofits (46 percent) and public sector organizations (42 percent). Moreover, the 27 RLFs that responded to our survey are relatively active lenders. Eighty-three percent had made a loan within the last six months.

In addition, compared to the other states studied for this project, North Carolina's RLFs are relatively more mature. The largest share of RLFs in North Carolina have been operating for 6 to 10

Chart 1. Years in operation: N.C. revolving loan funds



years. One-third of all funds began operating in the last five years; the oldest fund started lending in 1981.

Finally, the vast majority of organizations that operate RLFs in North Carolina operate a single fund (88 percent), while only 12 percent operate multiple funds. Compared to the other states studied for this project, North Carolina ranks among the states with the smallest percentage of RLFs with multiple funds.

Where the Money Comes From: Sources of RLF Capital

The 27 RLFs that responded to our survey report $90.5 million in total capital from public, private, and philanthropic sources. The total capital in the "economic development only" RLFs is almost $70 million. Based on total capital reported in its RLFs, North Carolina ranks fifth among the seven states surveyed as part of the Counting on Local Capital project.

As shown in the following chart, the federal government has been the largest source of capital for these RLFs. As indicated in the chart below, the federal government has invested more than $40 million in North Carolina RLFs, or almost 45 percent of total capital. The second largest source has been state government, with an investment of $26.937 million or almost 30 percent of total capital. The third largest source has been the private sector, which accounts for almost one quarter of total capital.

Table 1. Sources of RLF capital

Source	Amount	% of Total
Federal	$40,083,500	44.3
State	$26,937,300	29.8
Private	$20,175,000	22.3
Program Income	$2,002,300	2.2
Local	$1.281,000	1.4
Other	$80,000	0.1
Total	$99,559,100	

Federal funding

Among federal funders, the Department of Housing and Urban Development (HUD) has made the largest investment in RLFs in North Carolina. Largely through Community Development Block Grants (CDBG) made to Entitlement Cities, HUD has contributed roughly $22.5 million or 56 percent of all federal dollars in North Carolina RLFs. Other contributing federal agencies in decreasing order include the U.S. Department of Agriculture, the Economic Development Administration, the Small Business Administration, and the Appalachian Regional Commission.

It should be noted that the Small Cities CDBG program is also funded with federal dollars from HUD, but is administered at the state level. For this reason, Small Cities CDBG grants are included as part of state capital sources in the section that follows. However, if Small Cities CDBG dollars are included with federal sources, HUD's share of total capital increases to $33.9 million, or almost 38 percent of total capital in North Carolina RLFs.

State funding

The role of state government in supporting RLFs is one of the unique features of the RLF industry in North Carolina. As noted in the aforementioned chart, state government sources make up the second largest share of capital in North Carolina RLFs. With roughly equal shares coming from General Assembly appropriations and CDBG grants made through the Small Cities program, the state government has invested $26.9 million in North Carolina RLFs or almost 30 percent of total capital. Among the seven states studied in Counting on Local Capital, North Carolina ranks among the leading three states based on the share of total capital contributed from state sources.

Of particular note is the role of the General Assembly in appropriating funds to capitalize RLFs in North Carolina. Since the late 1980s, when the General Assembly appropriated funds to the North Carolina Rural Economic Development Center to establish a microenterprise demonstration, the state has directly appropriated funds to several of the state's leading RLFs as part of a comprehensive development finance strategy aimed at filling capital gaps in North Carolina.

Private sector funding

Overall, private sources of capital make up the third largest source of capital in North Carolina RLFs, accounting for approximately 22 percent of total capital. The largest source of private capital is foundations ($15.9 million or 79 percent of private sources), followed by banks ($2.6 million or 13 percent of private sources). Among the other states studied for this project, only Arkansas has such a major foundation investment in its RLFs.

However, the distribution of private capital is highly uneven across RLFs in North Carolina. The state's largest RLF, the Self-Help Ventures Fund, which is one of the nation's leading community development financial institutions, has a total of almost $16 million in private capital or more than three quarters of all capital in North Carolina contributed by private sources.

Capital sources for the average RLF in North Carolina

The majority of the capital in the typical North Carolina RLF comes from state sources, augmented by a significant portion of federal dollars, and a smaller portion of private dollars. This is portrayed in the graph below, which excludes from analysis both the Self-Help Ventures Fund and the four large public RLFs that fund both economic development and housing.

Capitalization Structure and Trends

Size of RLFs

The size of the median RLF in North Carolina is significantly larger than in any of the other states studied for this project. Overall, the median size of RLFs in North Carolina is $1.3 million, with a range in size from $27.9 million (the Self-Help Ventures Fund) to $90,000 (Metropolitan Low-Income Housing and CDC). In fact, in no other state was the median RLF size larger than $1 million. Moreover, this finding is not distorted by the presence of a handful of larger RLFs. Even excluding the Self-Help Ventures Fund and the four RLFs that fund both housing and economic development loans, the median RLF size in North Carolina is still $1.2 million. At the same time, based on the seven state surveys conducted as part of the Counting on Local Capital project, North Carolina has a smaller total number of funds than all but one other state.

There are several key implications that follow from the larger average size of North Carolina's RLFs. First, the state's RLFs may be closer to achieving sustainability than the funds in other states. Practitioners interviewed for this project estimate that it takes a capital base of $3 to $3.5 million and an active loan portfolio of at least $2 million to generate both the revenues necessary to support the staff needed to operate a RLF professionally, and the volume of loans necessary to achieve a reasonably diversified portfolio.

Second, larger average fund size may also lead to more efficient RLF administration. For example, 83 percent of North Carolina RLFs reported making at least one loan in the past six months, a figure that is the second highest among all other states surveyed for this project.

Debt vs. equity

Overall, debt capital totals $27.7 million or 31 percent of the total capital in North Carolina RLFs. The largest source of debt capital is foundation investments, followed by federal sources and banks. Typically, foundation investments and federal loans carry highly subsidized rates and terms, making much of this debt "near equity."

As with private capital, debt financing of RLFs in North Carolina is highly uneven. Excluding the Self-Help Ventures Fund, debt capital makes up only 18 percent of total capital in North Carolina RLFs, the majority of which comes from the USDA's Intermediary Relending Program (IRP). Based on this finding there would appear to be significant opportunities for RLFs in North Carolina to use their equity capital to leverage additional debt capital.

Capital needs vs. capital availability

Despite capital resources of roughly $90 million in North Carolina's RLF industry, respondents to our survey indicated a great need for additional capital. In fact, a total of 15 RLFs in North Carolina reported a combined need of $19.3 million in additional capital, or almost 25 percent of the total capital base of RLFs in the state.

Another 19 RLFs in the state reported $11.7 million in available capital for lending. While this might appear a likely source for funds that need additional capital, this level of available funds may also represent a prudent reserve of 10-15 percent.

Where the Money Goes:

Loan products

At the median, the average loan size reported by North Carolina's RLFs was $51,500, with the loans ranging in size from $17,500 to $100,000. This average loan size[1] was the largest among all states studied as part of Counting on Local Capital. Moreover, the median minimum loan size ($17,500) was higher than that reported in any other state. If outliers such as the Self-Help Ventures Fund and the four housing/economic development RLFs, are excluded, the average loan size and the median minimum loan size both increase to $63,250 and $20,000, respectively.[2] Interestingly, when examining average loan size based on the age of the fund, it appears that older RLFs tend to have lower average loan sizes than newer funds.

In terms of financing position, the largest share of RLFs in the state (45 percent) offer subordinated financing. Almost one-third of RLFs (30 percent) offer primary financing. Another 25 percent of funds reported "other" positions, including "gap financing" and "equal collateral." However, of the funds that offer primary financing, one-half are newer funds that have made their first loan since 1990.

RLF loan terms

The average RLF in North Carolina offers loans at an interest rate of 4.5 percent and a term of 8 years. In addition, the vast majority of RLFs (75 percent) charged fixed rates — only a small minority (7 percent) reported offering variable rates.

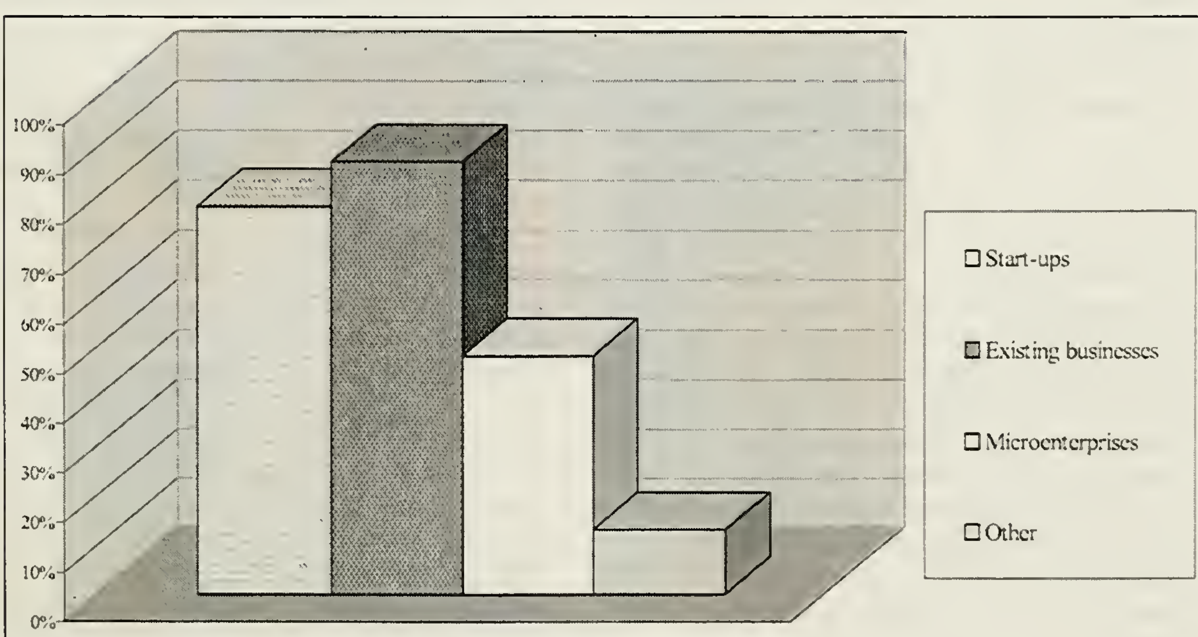
The method of establishing the interest rate varied across RLFs in North Carolina and provided some rather contradictory findings. Of the 23 RLFs that responded to a question about what kind of interest rate they charge, almost 40 percent indicated charging a subsidized rate. Twenty-five percent of respondents indicated charging a market rate. Another 37 percent of respondents reported charging a rate based on some "other" formula, typically one based on the prime rate plus a certain percentage point or some other unsubsidized rate.

If one combines these "other" responses with those charging market rates, it would appear that the majority of RLFs in North Carolina do not subsidize the interest rate charged for their loans. However, based on the responses from the eight RLFs that reported the interest rate that they charge, a median figure of 4.5 percent, it would appear that RLFs in North Carolina do charge a subsidized interest rate. Thus, the data on whether RLFs in North Carolina typically charge market or subsidized interest rates is inconclusive.

Businesses targeted

Existing businesses are the primary target of North Carolina RLFs. Of the 23 respondents (out

Chart 2. Types of businesses targeted by RLFs in North Carolina



of a total of 27 RLFs) who reported that they target particular groups of potential borrowers, the largest percentage (87 percent) indicated that they target existing businesses. At the same time, a large percentage of respondents (78 percent) also indicated that they target start-up businesses. In addition, almost half (48 percent) of the RLFs that target particular groups of borrowers report that they target microenterprises. Further, while both older and newer funds targeted start-ups and existing businesses fairly equally, newer funds tended to target microenterprises more frequently than older funds.

Additional product demand

Sixty-eight percent of the respondents indicated that the most commonly requested product not offered by North Carolina's RLFs was venture or equity capital. Despite this demand, though, there is very little activity around venture or equity capital among the state's RLFs. Only one fund that was identified, but which did not return CFED's survey, offers equity financing to borrowers. This fund, the Innovation Research Fund (IRF) of the North Carolina Technological Development Authority, is yet another example of a centrally-operating, state-initiated RLF. The second most frequently requested service not offered by North Carolina's RLFs was management training, followed by worker training.

Lending Activity and Fund Performance

Lending activity

RLFs in North Carolina manage a current portfolio of almost $46 million in loans and report cumulative lending activity of over 2000 loans worth more than $102 million. On a median capital base of $1.3 million, the average RLF has almost 20 loans outstanding worth $763,729. On a cumulative basis, the same average RLF has made 33 loans for slightly more than $1 million. From the perspective of the average fund, it appears that RLFs in North Carolina are only barely revolving their capital, if at all. However, excluding the four housing/economic development RLFs (for which there is almost no lending data), North Carolina's "economic development only" RLFs have made a total of $101,874,615 loans, cumulatively, on slightly less than $70 million in capital. This seems to indicate that some of the state's funds, particularly larger funds, are revolving their capital to a much larger extent than others.

Compared to the other states in the Counting on Local Capital project, RLFs in North Carolina appear to be relatively effective lenders. For example, among the six states that reported cumulative lending figures, RLFs in North Carolina made the third highest cumulative number of loans and the third highest cumulative dollar volume of loans. This was accomplished despite the fact that North Carolina contains a smaller total number of funds than all but one other state and that North Carolina ranks fifth among the seven states studied in terms of total capital. In addition, North Carolina RLFs reported the highest median percentage (73 percent) of current loan volume as a share of total capital.

Additional data on lending activity:

- Only 22 percent (6 out of 27) RLFs have loan loss reserves. The total accumulated in these loan loss reserves across all RLFs in North Carolina was only $1,619,841 — or slightly less than 2 percent of total capital reported.
- Credit tests on borrowers are very common. Eighty percent of respondents indicated performing some type of credit eligibility test on prospective borrowers.

Delinquencies and defaults

Because there is no standard definition of delinquencies in the RLF industry, survey respondents were first asked how they define delinquencies. Almost two-thirds of the survey respondents (63 percent) reported a definition for delinquent loans. The most common definitions of delinquency were equally split between "payments over 30 days late" (35 percent) and "payments over 60 days late" (35 percent).

In total, the 20 RLFs that reported on delinquencies reported a total of 135 delinquent loans valued at $2,523,030. Delinquency rates among individual funds ranged from 0 percent to 16.9 percent. The aggregate delinquency rate for the 15 RLFs that reported at least one delinquent loan was 4.8 percent; the aggregate delinquency rate for the 20 RLFs who reported zero or more delinquencies was 4.3 percent. These rates contrast favorably when compared with delinquency rates among small banks. For example, based on preliminary data for 1998, the percentage of past due and "non-accrual" commercial loans among banks with $300 million in assets or less was 5.22 percent.[3]

Compared with delinquencies, information about defaults was not reported as consistently among the RLFs that responded to our survey. In fact, only 40 percent of the survey respondents (11 out of 27) could provide a definition of defaults. The most common responses ranged from 60 days past due (25 percent) to 90 days past due (16 percent) to 120 days past due (25 percent).

In total, the 14 RLFs that reported on defaults reported a total of 173 loans in default valued at $1,614,062. Default rates among individual funds ranged from 0 percent to 11.2 percent. The aggregate default rate for the 9 RLFs that reported at least one loan in default was 4.1 percent; the aggregate default rate for the 14 RLFs that reported either 0 or more loans in default was 3.5 percent.

Performance measure: Portfolio at risk

The RLFs reporting defaulted and delinquent loans provide the raw data needed to calculate one of the most important performance measures: percentage of portfolio at risk. In assessing the viability and sustainability of the RLF industry, it is essential that practitioners and funders determine the total amount of the capital that is currently at risk, either because of delinquency or default. The chart above reveals that eight to nine percent of the capital base is currently at risk. While this does not mean that all this capital will be lost, it is an important indicator for evaluating the risk of RLF portfolios and the level of loan loss reserves that are necessary to ensure that the industry's capital base is not eroded. Currently, the loan loss reserves totaling slightly less than 2 percent of total capital are inadequate to replace the capital at risk.

Technical assistance

The commitment to providing quality technical assistance services to borrowers appears relatively strong among RLFs in North Carolina. The large majority of the state's RLFs (80 percent) provide some type of training or technical assistance to borrowers. The service most commonly provided is one-on-one technical assistance (80 percent). The second most frequently offered type of service was classroom training (40 percent).

Of the 16 respondents who reported providing one-on-one technical assistance, almost two-thirds also reported providing some other type of service. This would suggest that most funds provide technical assistance, not simply as a cursory service, but rather as an essential part of their products and services. However, this is more characteristic of the newer funds, as 75 percent of those funds offering no technical assistance services made their first loan in 1985 or earlier.

RLF management and administration

RLFs in North Carolina typically rely on rather limited staff and resources to accomplish their mission. Based on information reported by 11 of 27 survey respondents, the median RLF in North Carolina has one staff person and an operating budget of $60,000 per year. This falls in the middle of the few states in the project that could provide significant data on this question.

Despite these rather limited resources, RLFs in North Carolina typically provide the range of managerial and administrative tasks common to RLFs, and by and large, do so in-house. The most common tasks provided in-house by North Carolina RLFs were loan packaging (92 percent), followed by receipt of loan payments and portfolio management (83 percent each). North Carolina RLFs use outside contractors to a lesser extent, although a significant portion contracts out for loan closings (29 percent) and liquidations (25 percent). The task most commonly *not* provided by North Carolina RLFs was underwriting (25 percent). This may be a reflection of the fact that, since a large share of North Carolina RLFs (45 percent) typically take a subordinated position on deals, lenders with the primary position are likely perform the underwriting.

The Impact of RLF Lending

The most common measure for assessing the impact of RLF lending on individuals and communities underserved by private financial institutions is to measure job creation and retention. This measure is notoriously difficult to quantify, given the inherent complexity of the job creation process and the difficulty of isolating the importance of a single factor, even one as important as capital, in such a complex process. Nonetheless, job creation remains the best proxy available to RLFs for documenting the impact of their lending on the economic condition of distressed communities or individuals. Thus, this article presents this data for

North Carolina RLFs below, along with information about the extent to which RLFs in the state target different types of communities and individuals that may lack access to capital.

Job creation and retention

The most common impact measures used by North Carolina RLFs are job creation (70 percent of survey respondents) and job retention (63 percent). Together, the RLFs who responded to the survey and could provide data on job creation and retention helped to create 5,257 jobs and retain another 5,793. By far, the leader among the state's RLFs was the Self-Help Ventures Fund, which reported helping to create 1,580 jobs and to retain 3,605, almost two-thirds of all jobs retained by RLF lending in North Carolina. In comparison, the typical RLF was focused more on job creation than retention, reporting a median of 170 jobs created and 46 jobs retained. Only a handful of North Carolina RLFs reported data on self-employment.

This median figure of 170 jobs created per RLF in North Carolina was by far the highest median job creation figure among the six states in our study that provided significant data on job creation and retention. However, one must be cautious in interpreting these figures. In addition to the difficulties with reporting job creation and retention mentioned above, it must also be noted that only 56 percent of North Carolina survey respondents actually reported data on job creation and only 44 percent on job retention. In general, there is a great need to improve the definitions and reporting methods for impact measures within the RLF industry.

Targeting strategies for RLF borrowers

The practice of targeting capital to specific groups of borrowers is essential to a strategy for reaching underserved entrepreneurs. Not surprisingly, in North Carolina almost all RLFs target their lending to potential borrowers in particular underserved groups. In fact, only two respondents (7 percent) indicated that they did not practice some kind of targeting. The group most likely to be targeted was low to moderate income borrowers (83 percent). Women and minorities (58 percent each) were also common targets of RLF lending in North Carolina.

Table 2. Borrowers targeted: (% of RLFs)

Low/Moderate income:	83%
Women:	58%
Disabled:	17%
Minorities:	58%
Youth:	4%
Other:	29%

Conclusions

This profile of North Carolina's RLF industry leads to a number of broad conclusions:

In North Carolina, RLFs are a $90 million industry. Together, on a capital base of $90.5 million, RLFs in North Carolina have made over 2000 loans worth over $102 million. As a result of this lending, these RLFs have helped to retain almost 5,800 jobs and create another 5,200.

Unlike most other states, North Carolina's RLF industry has a unique structure that is, in large part, a product of state government policy and funding. While most states have a large number of relatively small RLFs, North Carolina has a fairly small number of funds that are larger in size. With a median loan fund size of $1.3 million, North Carolina's funds are, on average, significantly larger than the RLFs in any of the other states studied for this project.

Moreover, much of the resources in these RLFs are concentrated in a few funds that operate statewide and have received significant resources from the state government. This includes the Self-Help Ventures Fund, the state's largest RLF, whose rapid growth has been aided by state government resources, including a multi-million dollar appropriation in 1995. This also includes both the Microenterprise Loan Program of the North Carolina Rural Economic Development Center and the Capital Support Loan Fund of the North Carolina Minority Support Center, each of which was initially created with a General Assembly appropriation and operates statewide through a network of local organizations. Finally, this list contains the large Community Development Block Grant (CDBG) RLF at the Department of Commerce Finance Center, which has grown rapidly as the result of a key policy decision in the early 1990s. Since 1992, all units of local government have been required to return all repayments from loans made to private companies using CDBG funds to the Commerce Finance Center. Previously, these repayments had been used by some local governments to create their own RLFs.

There is some evidence that the unique structure of North Carolina's RLF industry has led to greater lending efficiency. First of all, on a very basic level, almost all of RLFs in North Carolina are active. Eighty-three percent reported making at least one loan in the past six months, a figure that is the second highest among all other states surveyed as a part of this project. Second, these funds are making good use of their capital. RLFs in the state reported the highest median percentage (73 percent) of current loan volume as a share of total capital. Third, among the six states that reported cumulative lending figures, RLFs in North Carolina made the third highest cumulative number of loans and the third highest cumulative dollar volume of loans. This was accomplished despite the fact that North Carolina contains a smaller total number of funds than all but one other state and that the state ranks fifth among the seven states studied in terms of total capital.

Finally, with a larger median loan fund size ($1.3 million) than in all the other states studied for this project, North Carolina's RLFs may be closer to achieving sustainability than the funds in those other states. Practitioners estimate that it takes a capital base of $3 to $3.5 million and an active loan portfolio of at least $2 million to generate both the revenues necessary to support the staff needed to operate a RLF professionally and the volume of loans necessary to achieve a reasonably diversified portfolio.

But, has greater efficiency led to less equity? The flip side of North Carolina's RLF industry, which is characterized by relatively larger, potentially more efficient funds, is the fact that there are fewer of them. While this survey could not determine whether access to RLF capital was relatively more uneven across North Carolina compared with states that have hundreds of funds, such a finding is not inconceivable. Moreover, North Carolina's typically larger funds carry the highest average loan size ($51,500) of all the states studied. While this loan size is still not within the range typically offered by commercial lenders, does this mean that some smaller borrowers in the target markets of these funds are not being served? These are questions that call for further inquiry.

In order to continue growing, the state's RLF industry must overcome some fundamental barriers related to its unique structure. The handful of larger funds that dominate the state's industry and have been the primary beneficiary of direct state funding and policy support tend to be high-performing, have a diversified capital base, and revolve their capital. On the other hand, the rest of the funds in North Carolina's RLF industry do not have a very diversified capital base and, on average, are only barely revolving their capital, if at all.

Building North Carolina's RLF industry will require a two-pronged strategy that will require both increasing the total amount of capital in the industry and, at the same time, building the management capacity and sophistication of the average fund. RLF practitioners and state policymakers should consider a formal intermediary or industry association to carry out this strategy.

Increasing the Amount of Capital in North Carolina RLFs. The North Carolina RLF profile revealed a significant demand for additional capital. While the state's RLFs appear to be, on average, more efficient that RLFs in other states, the state's industry is relatively small, even after adjusting for population differences. Among the seven states studied for the Counting on Local Capital project, North Carolina ranked fifth in RLF dollars per capita.

One possible strategy for increasing the amount of capital in North Carolina's RLFs would be to explore the creation of mechanism to pool existing funds so that they can be used more efficiently and effectively. In order to explore this possibility, the survey asked RLFs if they would support the creation of a regional or statewide intermediary or support organization to deliver this type of service.

While the responses in North Carolina were not quite as enthusiastic as in other states, there still appears to be significant interest in such a concept. Given this interest, the state's RLF practitioners should now consider the establishment of

Table 3. Ranking of needs in survey (% of respondents ranking)

	"most important"	"second most important"
Data Collection	35%	10%
Portfolio Management	16%	11%
Asset Management	6%	0%
Policy and Advocacy	10%	5%
Capacity Building	19%	33%
Evaluation	5%	25%
Secondary Market	16%	21%

a more formal institution — whether an intermediary or a trade association — to assist the industry. With the need for additional capital far outweighing available capital among the state's RLFs, though, such an institution should focus on much more than just re-allocating existing capital. Rather, this new institution should have a broad mission that would include both increasing total capital in the state's RLFs and building the management capacity of the state's funds.

Increasing the Management Capacity in North Carolina RLF. In considering strategies for increasing the capital in North Carolina's RLFs, whether by accessing new sources of capital, such as private bank capital or secondary markets, or by utilizing new types of capital, such as debt capital, one important consideration must not be overlooked. All of these strategies will require a new level of standardization in loan underwriting and documentation procedures across RLFs in North Carolina.

For the most part, the North Carolina RLF profile revealed that the performance of the state's average fund lags behind the small cluster of industry leaders. Nevertheless, in a state with relatively few funds, these funds are critical in ensuring equitable access to RLF capital across the state.

Of course, the state's average funds are by no means unsophisticated. For example, compared with the RLFs in the other states studied for this project, North Carolina's RLF reported some of the highest levels of computer technology usage in data collection. Yet, when asked about the importance of various support services needed to improve RLF performance and impact, our survey respondents indicated a number of needs.

The need most frequently mentioned as either "most important" or "second most important" by respondents (52 percent) was capacity building. Assistance with data collection (45 percent) and secondary markets (37 percent) were also mentioned frequently by respondents as the most important or second most important need.

These findings reinforce the need for a formal mechanism — whether instituted in a trade association or intermediary — to build the management capacity of the state's funds by capturing and sharing the expertise of industry leaders in North Carolina and nationwide. CP

Endnotes

[1] Throughout this report, when reference is made to the "average loan size" of North Carolina RLFs, this refers to — more precisely — the median of the average loan size of all 27 RLFs included in this study. We use this abbreviated terminology to make the text more readable.

[2] Part of the reason for this larger minimum size of loans is that most of the state's microenterprise programs count as one RLF under the Rural Center's Microenterprise Loan Program.

[3] *FRBSF Economic Letter,* "New View of Bank Consolidation," Federal Reserve Bank of San Francisco, Number 98-23, July 24, 1988.