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Minnesota Rural Health Care Policy

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This issue of the *Minnesota Agricultural Economist* centers on two topics of crucial importance in non-metro Minnesota: (1) the continuing issue of developing effective health care policy and (2) providing effective incentives for economic development. Neither topic can be described as an agricultural issue as such, but both are of vital importance to residents of Greater Minnesota, including those engaged in agriculture.

Interest in rural health care as a public policy issue has been gaining momentum nationally for the last five years, and for good reason. Consider:

- rural people are older, poorer, and experience more chronic illness than urban people;
- the primary source of income for rural doctors is Medicare, which pays rural doctors at a rate much lower than urban doctors for the same treatment;
- because of federal policies inhibiting use of inpatient services, rural hospitals are failing at an alarming rate;
- during the downturn of the agricultural economy in the early 1980s, many rural people dispensed with their health insurance altogether and have not been able to afford it since.

Minnesota has not been immune to these problems, nor to a surging interest in health care as a policy issue. At the national level both Sen. Dave Durenberger and Rep. Vin Weber have been very active in

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Revolving Loan Funds: Funding Economic Development in Non-Metro Cities

Thomas F. Stinson and Andrea Lubov

Locally administered revolving loan funds (RLFs) have become increasingly popular tools for providing economic development assistance. By mid-1989, 157 such funds had been established statewide in Minnesota, and those funds had lent more than $42 million to new or expanding businesses. While some of those loans undoubtedly substituted for funding available elsewhere, many added to the local supply of economic development capital. Revolving fund financing now has

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sponsoring and enacting legislation that affects rural health care. Most recently, Sen. Paul Wellstone has submitted legislation that would establish a national-level plan for universal health insurance.

On the state level, the Minnesota Legislature created the Minnesota Health Care Access Commission in 1989 to develop and recommend a plan to provide access to health care for all Minnesotans. Paul Ogren and Roger Cooper, both rural members of the State House of Representatives, were instrumental in the passage of the final bill that would have enacted a version of the Commission's plan. Governor Arne Carlson vetoed this bill last year. A new state plan for uninsured Minnesotans, agreed to by a bi-partisan negotiating committee of state legislators and backed by the Governor's Office, was recently signed into law. This plan, HealthRight, is the first state health insurance plan in the nation, and will be watched with great interest by other states that are grappling with similar concerns.

Locally, there have been several different initiatives to help communities do strategic planning for the future of their health care system, most notably the Northern Lakes Health Care Consortium program in northern Minnesota which has been funded by the Blandin Foundation.

Given all the obvious interest in this issue, it is more than a little strange that, until recently, Minnesota has had no formally established organization that concentrated its attention on rural health care. The Minnesota Department of Health would have been the logical place for such an organization to be housed, but that department has traditionally seen itself as a regulatory agency. It has always treated health care generically; needs, problems, and issues were not classified as urban or rural. A March, 1989 publication, *Access to Hospital Services in Rural Minnesota*, by the Health Economics Program in the Department of Health, admitted that the Department does not classify hospitals as rural or urban, but rather by size.[1] Failure to distinguish between rural and urban hospitals suited the needs and objectives of the Department of Health, but did not suit everyone. Advocates for rural health issues and professionals serving rural areas have felt that rural health issues should be given separate, if not special, attention.

The Center for Rural Health

It took an agent outside of government to nudge the Department of Health to consider rural health care as a distinct area of concern. In early 1989, representatives of nine major state health organizations met to discuss rural health issues and to explore possibilities for collaboration. This group became the Minnesota Rural Health Coalition, and had a broad base of support from consumers and health care providers. In late 1989 the Coalition sponsored a statewide forum at the University of Minnesota. After a day-long identification of problems and issues, the 75 participants concluded that "(1) there [was] an immediate threat to rural health care access in Minnesota and (2) there [was] a need to develop statewide, focused rural health intervention strategies."[2]

In June 1990, the Northern Lakes Health Care Consortium, one of the founding members of the Coalition, received a grant from the Northwest Area Foundation to begin planning the work of the Coalition. A second statewide forum was convened in late 1990, and it was decided to formally establish a State Center for Rural Health. Though the Center is a private organization, the Minnesota Department of Health had an active role in the Center's creation; the Director of the Department's Health Economics Program, who personally believed strongly in the need for such a Center, was represented on the Coalition's steering committee.

Today the Center for Rural Health, housed administratively with the Northern Lakes Health Care Consortium in Duluth, offers the following services:

- Health professional placement and retention
- Rural health information center
- Policy development
- Community-based health care transition program (planning and technical assistance for communities)
- Quality network development (assistance to hospitals and clinics who want to form networks)

The Center receives its funding from foundations, from annual dues it charges participating members, and from fees for service to communities.

The Office of Rural Health

Federal funds became available in the fall of 1991 for state departments of health to establish offices of rural health. Minnesota along with 14 other states without offices of rural health applied. (Funds were also available for states that already had offices of rural health. Texas received the most, $56,586, and thirteen other states each received $38,000, which was the smallest award.) In the fall of 1991 Minnesota was awarded $44,879.[3]

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[1] Access to Hospital Services in Rural Minnesota, *Minnesota Department of Health, Health Systems Development Division, Health Economics Program, March, 1989, p. 2.*

[2] *"Minnesota Center for Rural Health Concept Paper," January 30, 1991, p. 2.*

[3] *"Funding Distribution Model for State Offices of Rural Health," National Rural Health Association, August, 1991.*

Since receiving funding for an Office of Rural Health, the Minnesota Department of Health has been in the process of setting up this new office. The office will be part of the Office of the Commissioner and is currently interviewing candidates for the Director's position. The Commissioner's Office has said that a mission statement, policies, and goals will not be developed until the Director is hired.

In February, 1992 the $204 billion Labor Health and Human Services and Education spending bill was passed.[4] This bill assures that state offices of rural health will receive $2.5 million for another year. This legislation will maintain Minnesota's Office of Rural Health at approximately its current funding level for at least another year.

Thus, Minnesota has gone from having no rural health organizations in 1989 to now having two. Having two clearly sends a message that rural health is important, but is having two redundant? People who have been instrumental in the establishment of both the Center and the Office do not believe so; the Center (the private organization, based in Duluth) will be able to access foundation and private funding while the Office will be able to take advantage of federal funds.

But what are the policy implications of having two rural health organizations? How do the Center and the Office differ in terms of the activities and services they will provide? While the differences are not always apparent in this early stage, we do have the experience of other states to draw upon. Both types of organizations have been operating in several other states and their experience helps us assess the probable future of having two organizations in Minnesota.

Other States' Activities

Prior to the 1991 federal funding for new offices of rural health, there were 23 states that had such offices. The oldest, in North Carolina, was established in 1973. Institutional arrangements in the states vary considerably. For example, Idaho's office is actually a satellite of the University of Washington's Area Health Education Center (AHEC) and has no state mandate and receives no state funds. Several state offices are housed in a university: Oregon, Montana (AHEC), North Dakota, Nevada, Arizona. South Dakota is the only state to have both the University (USD) and the Department of Health as its home. Most, however, are a part of state government, usually the Department of Health.[5] Activities of rural health organizations in these other states fall roughly into four areas:[6]

Technical Assistance to Communities and Hospitals/Clinics

- Planning, needs assessments and surveys
- Market analyses
- Grant writing
- Research, policy analysis and data development
- Manpower shortage area designations
- Hospital classification

Financial Assistance

- Student loans
- Hospital transition grants
- Planning grants to communities
- Tax credit programs for health professionals

Public Education and Information

- Health Education (particularly on AIDS)
- Advocacy
- Information clearinghouse
- Interagency coordination
- Annual conference

Health Professionals

- Recruitment, placement and retention of physicians and nurses
- Recruitment of rural students to medical schools
- Direct public health nursing

Annual budgets for these activities range from $54,000 in Nebraska to $1.375 billion in California.* Staff size varies from one professional in Georgia to 42 in Arkansas and 213 in California, but most have 3 or 4 professional staff.[7]

Finding a Niche: A Lesson from Wisconsin

The state whose situation is most like Minnesota's is Wisconsin. It, too, has two rural health organizations. The University of Wisconsin Office of Rural Health was established in 1975 to help develop rural health training sites for the health professions schools in the Center for Health Sciences. The university office serves as a statewide resource for physician practice development, provides technical assistance to communities, and administers the Physician Loan Assistance Program.

[4] *Conversation with Jane Williams, Congressman Vin Weber's policy adviser on rural health care issues, February 21, 1992.*

[5] *"State Initiatives to Improve Rural Health Care," Health Policy Studies, Center for Policy Research, National Governors' Association, 1991.*

[6] *Ibid.*

[7] *Ibid.*

* *The budget for California's Rural and Community Health Program includes funding for primary care clinics and county health programs.*

Table 1. State Offices of Rural Health (prior to 1991 Federal Funding)

State	Date Est.	Staff Size	Location	Budget	Primary Activities
Alabama	1989	6	Department of Public Health	$350,000	Tech. asst., research, policy analysis, grant writing
Arizona	1982	40	University of Arizona Medical School	$3 million	AHEC, Recruitment/placement/retention, Research Center
Arkansas	1987	42	Department of Health	$2.8 million	Manpower shortage designation, tech. asst., resource coordination
California	1978	80	Department of Health	$1.35 billion	Financial & tech. asst. to clinics, direct public health nursing to counties, research
Georgia	1977-78	1	Department of Human Resources	In-kind	Education, tech. asst. to rural health departments in counties, recruitment/retention
Idaho	1987	6	University of Washington AHEC	$450,000	Education (AIDS), recruitment/retention, strategic planning
Illinois	1989	11	Department of Public Health	$5 million	Hospital closures, transition grants, planning, scholarships
Iowa	1989	4	Department of Public Health	$187,000	Interagency coord., graduate nursing program grants, introducing growth to medical professions
Kansas	1989	3	Department of Health & Environment	$65,000	Annual conferences, interagency coord., education, tech. asst.
Mississippi	1990	3	Department of Health	$234,000	Data, policy analysis and development, tech. asst., recruitment/retention, information clearinghouse
Montana	1987	3	Montana State University AHEC	not avail.	Community assessments, planning
Nebraska	1990	3	Department of Health	$54,000	Student loans, transition grants, planning, recruitment of students
Nevada	1977	4	University of Nevada Medical School	$415,000	Community assessments, recruitment/retention, tech. asst., integragency coord., education, clearinghouse
New Mexico	1981	4	Department of Health	$1.2 million	Manpower shortage designation, tech. and financial asst. to communities
North Carolina	1973	25	Department of Human Resources	$2 million+	Recruitment/retention, recruitment of students
North Dakota	1980	18	University of N.D. Medical School	$1.1 million	Planning, education, outreach via satellite
Oregon	1979	3	Health Sciences University	$284,500	Rural hospital classification, tax credits, recruitment/retention, clearinghouse
South Dakota	1989	5	University of S.D. and Department of Health	$150,000	Community assessments, manpower shortage designation, tech. asst., recruitment/retention
Texas	1990	4	Department of Health	$262,500	Clearinghouse, policy analysis and research, tech. asst.
Utah	1981	2	Department of Health	$90,000	Interagency coordination, advocacy, tech. asst., education, recruitment/retention, community health nursing
Eastern Washingtonn	1987	8	Washington State University	$200,000	Planning, financial analysis, market analysis
Wisconsin	1975	5	University of Wisconsin Medical School	$260,000	Tech. asst., recruitment of students, student loans
North Central Wisconsin	1989	2	Private Nonprofit	$100,000	Education, recruitment/retention, data development, clearinghouse, AHEC, transition grants

While the two Wisconsin rural health organizations collaborate, they each seem to have developed their own niches:

University of Wisconsin Office of Rural Health	North Central Wisconsin Office of Rural Health
Policy Analysis	Data Development
Recruitment and Retention—Statewide	Recruitment and Retention—Regionally
Technical Assistance to Communities	Information Clearinghouse
Physician Loan Program	Education
Drafting and Implementing Legislation	Grants for Community-Based Initiatives

(Continued from page 3)

The North Central Wisconsin Office of Rural Health was established in 1989 as a program of the Wausau Health Foundation, though it is now a private nonprofit organization. The north central office is an extension of earlier regionally oriented activities of the Foundation that included providing support for emergency medical technician training and scholarships for nursing education. The north central office collaborates with the university office. The mission of the north central office is to assist community-based initiatives, coordinate the development of regional positions and consensus on health policy, and provide seed-money for community health projects.

The university office is statewide in scope, while the north central office is focused more on the regional and community level. Neither office is associated with state government. The university office has remained true to its original focus on placement of rural physicians and now also administers the state physician loan program. Interestingly, it is the north central office and not the university office that provides health education to communities and an information clearinghouse. Nevertheless, the Wisconsin system seems to work to everyone's advantage.

An Opportunity for Minnesota

Minnesota has an opportunity to have an equally beneficial system. But the key will be the Department of Health's understanding of how to complement, and distinguish itself from, the Center for Rural Health.

Having the Office of Rural Health within a state agency has advantages and disadvantages. The first advantage is the statewide jurisdiction that it enjoys. Secondly, because the Department of Health is a major regulator within state government, the Office is in an ideal position to influence those who issue regulations affecting rural health care. Third, the Office will be able to coordinate major rural health funding programs. And the fourth benefit is the access it has to the rest of the Department of Health and the possibility of developing a solid partnership with Medicaid and other agencies.

In the face of these advantages, however, there are at least three major challenges. The first has to do with how the Office deals with politically sensitive issues. As an example, because state agency-based offices are ultimately responsible to the governor, "one state office was expected to oppose any bill in which there were requests for new appropriations not included in the governor's budget."[8] A second potential problem is the danger that in an understaffed agency, professional staff could be pressed into service on behalf of other health issues, especially urban issues. The third challenge is that state offices of rural health are often viewed with suspicion by communities and medical and hospital associations. This is because the state has traditionally been the rule maker and enforcer, the regulator, with no history of working **on behalf** of communities and other health groups.

The Center for Rural Health, as a private nonprofit entity, faces none of these disadvantages. The Center had its genesis as a coalition of the very groups that eye the state warily: rural hospital and medical organizations and rural health professionals. This allows for a natural division of labor: The Center has a mandate to provide community technical assistance and other services that communities and hospitals need and are willing to pay a fee to receive. The Office of Rural Health is then free to do what it does best and is best suited to do: health planning and research, policy development and analysis, and the drafting and implementing of legislation. The Office should also be the repository of all rural health data and should administer all state- and federally-funded programs such as physician loan programs.

As part of a state agency, relationships between the Office and the legislature, the upper levels of the executive branch and the media will be circumscribed.[9] It needs an advocacy organization with which to work, and the Center fits the bill. The Center can bring together hospitals,

[8] *"State Approaches to Solving Rural Health Problems: Workshop Summary," Office of Rural Health Policy, Health Resources and Service Administration, U.S. Department of Health and Human Services, June 1990, p. 14.*

[9] *"Rural Health Care," The Newsletter of the National Rural Health Association, Vol. 4, No. 1, January, 1992, p. 1.*

physicians and other health professionals, the public health community and other interested parties. It can also advocate for health care policy change and can lobby legislators.

This alliance of the Center for Rural Health and the Office of Rural Health can be a powerful proponent for change in rural health care. Together they can focus greater attention on the problems, develop approaches for solving them, and work toward long-range reform in rural health care policy and improved health systems in Minnesota communities.

Revolving Loan Funds: Funding Economic Development in Non-Metro Cities

(Continued from page 1)

gained popular acceptance as an important source of development financing, particularly in Minnesota's smaller, non-metro cities.

Most local revolving funds received their initial capital indirectly, through a pass-through of state or federally funded economic development loan or grant destined for a local firm. By channelling those loans through a local RLF rather than making them directly to firms, and by stipulating that all payments of principle and interest (debt service) be made to the local revolving fund to provide funding for future loans, state and federal agencies have created a strong incentive for cities to establish RLFs as part of their economic development program.

Growth in both the number and size of city-based economic development RLFs appears to be almost entirely attributable to changes in state and federal policy. But, despite the obvious public policy stake in their formation and existence, RLFs have received little scrutiny. Studies summarizing lending activity and financial practices of local revolving funds in Minnesota and elsewhere in the nation have been lacking.

This study attempts to fill some of that gap. It presents background data collected through a comprehensive survey of public, economic development revolving loan funds operating in Minnesota. Although information was sought and collected from all 157 public and non-profit revolving loan funds in existence when the survey was conducted during the summer of 1989, this report focuses on the 99 funds based in cities outside Minnesota's metropolitan statistical areas (MSAs). Data on the sources of the funds' original capital, loan activity, and loan experience follow. The paper concludes with suggestions about how revolving funds might be made more effective in the future.

This is not a study of the value of revolving loan funds in promoting local economic development. Such a study would require general agreement on the role RLFs should play in local economic development, something which does not presently exist. There are important differences in perceptions of the types of firms, entrepreneurs, and credit problems which should be targeted, differences which affect the number and size of loans made, the terms on which loans are granted, and delinquency and default rates. Without a well defined set of goals or targets for revolving loan funds, it is impossible to measure success or to evaluate fund activity fairly.

Distribution of RLFs

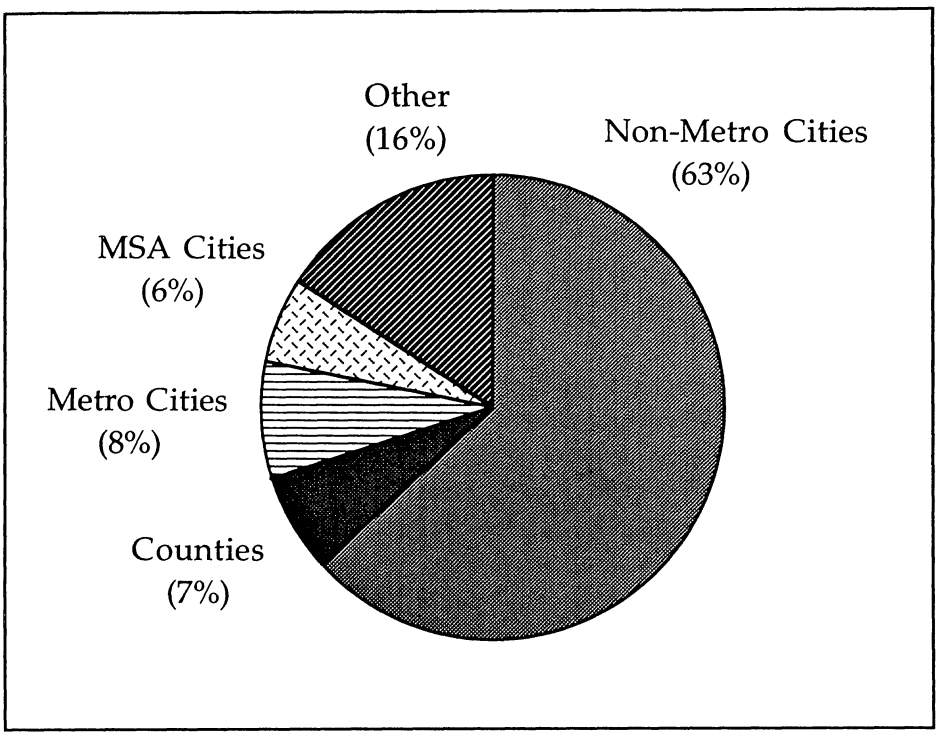
Nearly 70 percent of the 157 public and non-profit economic development revolving loan funds identified in Minnesota were organized by local governments outside the state's metropolitan areas (figure 1). The majority (99) were created by cities; 10 were administered by non-metro counties. Of the remaining funds, 26 were maintained by non-profit groups or quasi-public bodies, 12 were created by cities in the seven county twin cities metropolitan area, and 10 were created by cities in the Rochester, Duluth, St. Cloud, and Fargo MSAs.

Finding revolving loan funds in 99 non-metro cities was a surprise. While this is only 17 percent of Minnesota's non-metro cities, the majority of Minnesota's larger non-metro communities now have RLFs. It is only in the state's smaller communities that they are not widely available.[1] Nearly 80 percent of non-metro cities with populations greater than 5,000 and approximately one-third of non-metro cities with populations between 1,000 and 5,000 had such funds (table 1).

While revolving loan funds for economic development have become so widespread in Minnesota's larger non-metro cities that they can be considered to be part of the current economic development landscape, they do not yet appear to be fully utilized. Sixteen funds made no loans between 1985 and 1989, and an additional 26 made only one loan during that period. More important, over $6 million was available for lending in mid-1989 when data were collected. A lendable balance this large may reflect a substantial

[1] *Only Minnesota cities with home rule charters had explicit statutory authority to establish revolving loan funds for economic development. This may have prevented some of the state's smaller cities from establishing their own RLFs.*

Figure 1. Economic Development RLFs by Administrative Location



untapped resource available for economic development financing in the state. It may also indicate that some funds are finding few local lending opportunities that meet their credit guidelines.

It is also possible that needs in some communities are going unmet while adjoining communities have funds available to lend. But, without knowledge of program goals and capital needs in those localities with current lendable balances, it cannot be determined whether current lendable balances reflect a lack of lending opportunities, or lending standards that are too conservative or restrictive.

Table 1. Non-Metro Cities with Economic Development RLFs, by Size of City, 1989

Population	Number of Cities	Cities with RLFs
G.T. 10,000	17	8
5,000 - 10,000	14	14
2,500 - 4,999	34	11
1,000 - 2,499	89	31
L.T. 1000	440	35

Sources of Initial Funding

While localities must have proper legal authority to establish an economic development RLF, the availability of initial capital is the principle barrier to their formation. A revolving fund must have capital to make its first loan, and successful RLFs typically require a substantial amount of initial capital. Undercapitalized revolving funds often fail because the debt service available each year to be recycled into additional economic development loans is inadequate to maintain local interest in the program. Finding a substantial source of initial capital is a prerequisite for success.[2]

Only seven non-metro cities reported forming revolving loan funds before 1984. The rest were formed between 1984 and 1989, following changes in state and federal policy which redirected a portion of their local development assistance through city-based RLFs. Beginning in 1984, state approved assistance for a particular business expansion or start-up was often transferred from the appropriate state or federal agency to a newly established local revolving loan fund, typically providing initial capitalization for that fund. The RLF, in turn, made the actual loan to the firm. Debt service on the loan then went to the revolving fund, not the state or federal agency originally providing the financing. Nearly 80 percent of the RLFs based in non-metro cities received their initial funding from such state or federal program transfers (table 2).

The Minnesota Economic Recovery Fund was by far the largest source of capital for revolving loan

[2] *In 1989 the legislature authorized cities to appropriate up to $50,000 per year which could be paid to a private, non-profit organization for economic development activity. Some smaller cities have used this authority recently to establish RLFs under the direction of a local or regional non-profit development organization.*

Table 2. Sources of Initial Funding for RLFs Based in Non-Metro Cities

Source	Number of Funds	Total $(000)	Average
Minnesota Economic Recovery Fund	65	10,769	166
Federal EDA-UDAG	8	2,598	325
Other External	13	821	63
Internal	14	2,185	156
Source Unreported	7	1,422	203

funds in non-metro cities. That program, established in 1984 and administered by the state's Department of Trade and Economic Development (DTED), is expressly designed to fill capital gaps where existing public and private financing is found to be inadequate.[3]

The Economic Recovery Fund has two separate funding sources: the Small Cities Development Program, which receives federal funding through the Small Cities Community Development Block Grant program (CDBG), and the Economic Recovery Grant program, which receives an appropriation from the state general fund. Projects funded must meet certain conditions with respect to job creation, private capital contributions, and private sector financial participation. Those receiving federal contributions must also meet criteria targeting low and middle income residents, the elimination of slums and blight, and other urgent community needs.

The Minnesota Economic Recovery Fund provided just over 60 percent of the initial capitalization of non-metro RLFs. The combination of state funds and federal small cities community development grants provided nearly $10.8 million in original capital for economic development revolving funds in 65 non-metro cities. The average initial capitalization provided was nearly $166,000.

Federally administered Economic Development Administration (EDA) loans and Urban Development Action Grants (UDAG) provided initial capital for 8 non-metro cities. These grants were, on average, about 50 percent larger than the average grant offered by DTED, and they accounted for 15 percent of the initial capitalization of local RLFs.

Other external funding sources, including foundations and private contributions provided start-up capital in 13 communities, while internal funding from existing cash balances or excess tax increment financing district funds helped start programs in 14 communities, and averaged $156,000. Seven communities did not report the source of their initial funding, and several received start-up funding from more than one source.

City-based economic development RLFs in non-metro Minnesota owe their existence to DTED's Minnesota Economic Recovery Fund program. There were few such funds before the Minnesota Economic Recovery Fund was enacted, and that program provided initial capital for nearly two thirds of the funds now operating. Only 17 percent of the initial funding for the revolving funds was identified as coming from sources other than the state and federal government.

Additions to Capital

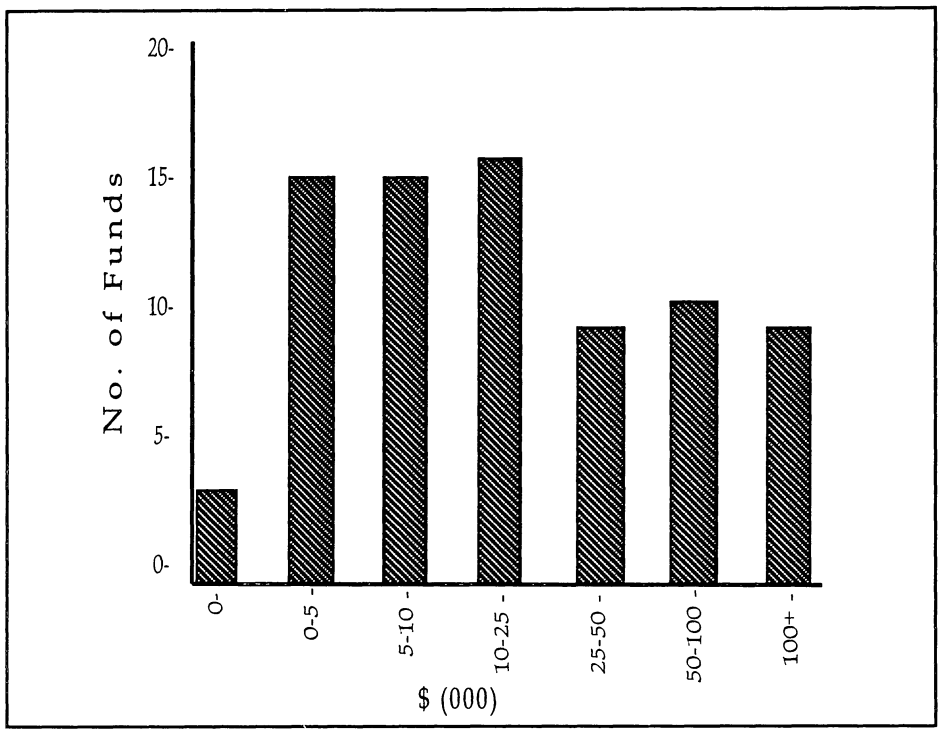
If revolving funds are to fulfill their potential as a self-renewing source of financing for local economic development they must generate new revenues. Either debt service payments must be sufficient to provide capital for future loans, or the fund must attract additional sources of financing. Most revolving funds in non-metro cities have been unable to do either.

Understandably, funds available from recycling debt service payments were not large. A $100,000 loan made at 8 percent interest for 10 years, for example, generates less than $15,000 per year in debt service, too little to fund a second major project until several years after the first loan is made. Of the 77 funds reporting earnings for 1988, nearly two thirds reported less than $25,000 in receipts from debt service on outstanding loans. Nine funds, however, reported more than $100,000 in receipts (figure 2).

City based RLFs also were not particularly successful in adding to their lending capacity by obtaining additional grants. Only 24 had supplemented their original capital. But, those who had obtained further funding benefited substantially, raising on average, slightly more than $220,000 each. Four revolving funds located in non-metro cities had found as many as three additional sources of funding. Four cities added to the lending capacity of their RLF by making a direct contribution of revenue. Those internal contributions were substantial, averaging more than $600,000.

[3] *For a more detailed discussion of the Minnesota Economic Recovery Fund see Julia Friedman, "Improving Capital Market Efficiency Through State Programs," The Report of the Governor's Commission on the Economic Future of Minnesota, 1987, pp. 147-150.*

Figure 2. 1988 Earnings by Non-Metro RLFs



Given the apparent difficulty of raising additional capital and the slow pace at which debt service on outstanding loans accumulates, it was a surprise to find funds in non-metro cities reporting substantial amounts of capital available for lending. In response to a question asking the amount of money currently available to lend, RLFs in non-metro cities reported free balances totalling $6.6 million, nearly 20 percent of their initial capitalization. While 50 funds reported current balances of less than $25,000, sixteen funds had more than $100,000 available. Funds capitalized in 1985 or later had the largest free balances, suggesting that they may be receiving rapid repayments, but for some reason have been unable to find suitable firms to receive additional loans.

Table 3. Number of Loans Made by RLFs Based in Non-Metro Cities, 1985-1989; by Size of Community

City	Size	Number of Loans Made		
	0	1	2-5	6 +
G.T. 10,000	1	0	2	5
5,000 - 10,000	1	4	5	4
2,500 - 4,999	2	0	5	4
1,000 - 2,499	3	11	10	7
500 - 999	3	6	10	1
L.T. 500	5	5	2	3

Loan Activity

Non-metro cities made 365 loans between 1985 and 1988, and an additional 93 loans in the portion of 1989 preceding the survey. Ninety six of the ninety nine funds identified reported making loans during that four and one half year period (table 3). While nearly all funds made loans for fixed assets, many also were made for working capital. Less than five percent of the loans were for inventory or equipment purchases.

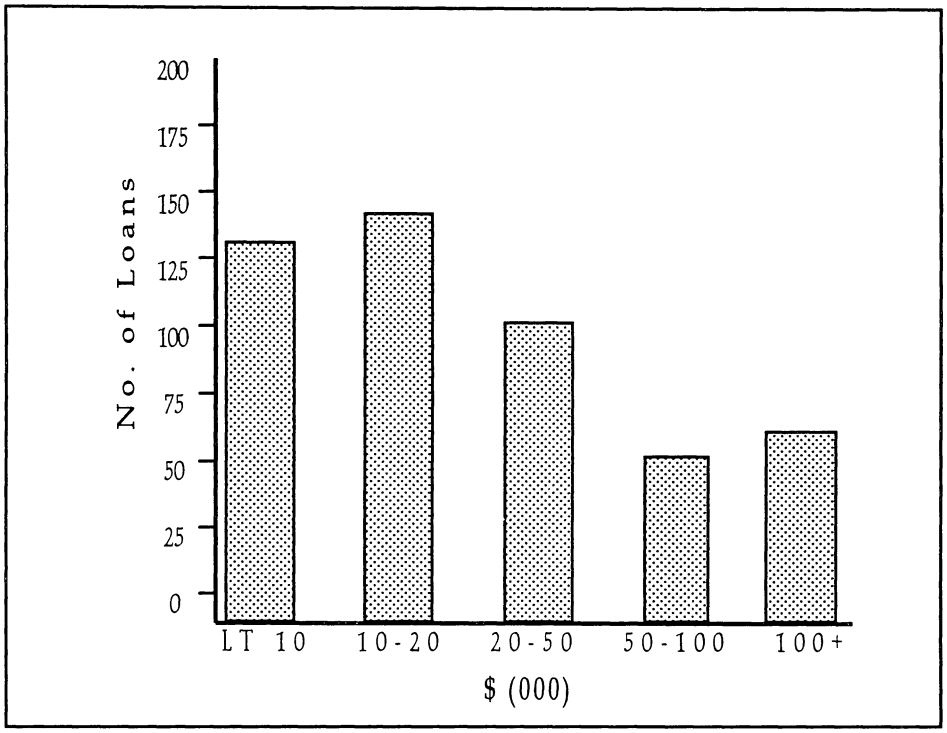
Many loans were small. Loans of less than $20,000 accounted for 55 percent of all loans, and loans of less than $10,000, 25 percent. But, nearly 25 percent were for over $50,000 and 14 percent were for more than $100,000. The typical fund made an average of 2.5 loans between 1985 and mid-1989 (figure 3).

Typically the terms for the revolving fund's first loan, the one passing through capital supplied by the state or the federal government, are set by the originating agency and are favorable to the borrower. Local funds are free to set their own terms for succeeding loans. Those terms also appeared to be more favorable to borrowers than those available in private capital markets.

RLFs usually charged below market interest rates. Most loans (72 percent) were made at interest rates between 5 and 8 percent, and 13 percent were made at interest rates less than 5 percent. During this time the prime rate ranged from 8.25 to 11 percent. Typically interest rates were negotiated on a loan-by-loan basis between the fund and the borrower, not set as a fixed percentage of current market rates. Nearly three fourths of RLF loans were for more than five years; 18 percent were for more than 10 years. Only 5 percent were for periods of 2 years or less.

Consistent with the long maturity of most local revolving fund loans, the percentage of loans outstanding was high. More than 85 percent of loans made were still outstanding at

Figure 3. Non-Metro RLF Loans, 1984-89, by Size of Loan



the time the data was collected. When compared to revolving funds based in cities in metropolitan areas, non-metro RLFs appeared to have a larger percentage of loans remaining outstanding, possibly because non-metro funds had a larger percentage of initial loans in their portfolios.

Credit Experience

Default and delinquency rates play a key role in determining whether local revolving loan funds will fulfill their promise of providing a renewable source of economic development assistance, for a single default can wipe out much of a local fund's capital. Revolving funds based in non-metro cities are particularly vulnerable, since their capital is often tied up in one or two loans.

Data was collected to allow the credit histories for initial loans to be separated from those for loans made with recycled funds. Since much of the credit analysis for the original loan is done by the state or federal agency providing the funds, while later loans were made using the fund's own credit guidelines, default experience could differ.

Choosing an appropriate standard to compare default rates for RLF loans against is difficult. RLFs are supposed to make loans to individuals unable to obtain credit from the private sector, so default rates higher than commercial banks should be expected. Low default rates might indicate that credit standards are too conservative. But, if there truly are barriers preventing otherwise viable firms from obtaining necessary capital, default rates might well be lower given the favorable terms afforded most borrowers by the RLFS.

The default and delinquency rate found for original loans was higher than that for recycling loans. Of the original loans made by the revolving fund 13 percent were either delinquent or in default by September, 1989, the time the survey was completed. For loans made with recycled funds, the default and delinquency rate was 8.5 percent, lower than the rate for original loans and suggesting that local lending practices may be more conservative than those of the granting agencies. Default rates for recycling loans made by RLFs based in non-metro cities were substantially greater than those found for other RLFs. Funds based in metro cities and those in non-metro MSA cities, for example, had default rates of less than 4 percent.

Default rates for the recycling loans varied considerably depending on the group responsible for the credit analysis. When elected officials, including board members of the fund and committees appointed by the board were involved in evaluating credit quality, default rates were nearly 14 percent. Loans evaluated by either the local bank, fund staff, or some combination of bank and fund staff had default rates of less than 8 percent. When a local bank actually participated in the loan the default rate fell to 4 percent.

Conclusion

Revolving loan funds for local economic development appear, at the time they are established, to offer the best of all worlds to non-metro communities searching for ways to add to available sources of funding for business development. The RLF will provide loans to deserving local businesses, loans that could not be obtained from the private market, and those loans will be made at interest rates allowing new enterprises to be successful.

Revolving funds also hold the promise of becoming a continuing, self-sustaining source of capital for local economic development, a source requiring neither additional taxes nor further contributions from the business community. City-based RLFs offer local officials the ability to respond quickly to entrepreneurs' requests for funding, eliminating

delays associated with submitting requests for aid to appropriate state or federal agencies, then waiting for approval and funding.

Revolving loan funds have been an effective conduit for directing capital into Minnesota's non-metro communities. Testimony to their power is the fact that 18 communities used their own funding, and 17 raised funds from sources other than the state and federal development agencies to provide the initial capital for their funds. This is impressive evidence that there is both a belief that additional sources of financing are needed in non-metro areas, and a local willingness to commit the time and effort needed to establish them.

Results from this survey of RLF activity in Minnesota's non-metro cities, however, raise some doubt about whether these funds in their present form are an effective solution to economic problems in small communities. The most important concern is that it does not appear that revolving funds have been particularly successful in recycling debt service on existing loans into other loans to the community. Nearly half the funds had made one loan or less between 1985 and 1989. And, a significant amount of lending capacity was available but going unused. Default and delinquency rates, particularly on loans made by funds where professional or bank staff were not involved in the credit analysis, appeared high.

It is important to recognize that these findings are not criticisms of the management of existing RLFs, for they are not inconsistent with responsible management practices. For example, if a fund's initial capitalization is in the form of a single large loan made on favorable terms to a local business, it will take some time before accumulated debt service payments are large enough to fund another loan. It is also likely that in smaller communities, especially those with fewer than 1,000 residents, the number of opportunities for funding may be limited. And, no matter what the size of the community, there may be periods when no applicants for funding meet lending guidelines. Even high default rates, although worrisome, are not necessarily indications of poor management, but rather of the high risk pool of loans being made.

What is troubling about these results is the questions they raise about city based revolving loan funds as an institution. By focusing on cities and encouraging establishment of many city based funds we appear to be creating barriers to the efficient use of state funds for non-metro economic development. Funds may be sitting idle in one community while good projects go unfunded in a neighboring community. Equally disturbing is the ultimate inequity of the funding. Localities whose first RLF project—funded by either state or federal funds—is successful automatically gain access to a pool of additional funds. Those whose initial projects fail are left with nothing.

Defaults are to be expected in any loan portfolio, but in a portfolio of sufficient size defaults will not bankrupt the program. When a city's portfolio contains only one loan, default is catastrophic since it destroys the program. Under the existing RLF program many small communities are faced with a one shot development effort and, unfortunately, a long wait before a second infusion of capital arrives should that effort fail. Although the winners in this system benefit handsomely, there is a question of whether this wheel-of-fortune approach is in the long-term best interests of all of Minnesota's non-metro residents.

These findings suggest that it may be time to re-examine the goals of the Economic Recovery Fund as well as whether its current structure offers the best possibility for meeting those goals. There is much to be said for a local revolving fund approach to economic development financing, but those advantages depend greatly on the existence of a large and diversified loan portfolio. Currently, many RLFs based in non-metro cities have far too few loans to provide the diversification needed to offer a reasonable likelihood of success.

New institutional arrangements encouraging the pooling of revolving funds across several cities within an area with shared economic interests should be investigated. Those pools and geographic areas need not be as large as those of the current regional initiative funds, but it appears that revolving loan funds must extend beyond municipal boundaries if they are to obtain the size and stability necessary to achieve their promise.

Creating larger, more diversified funds might also allow increased use of full time development specialists to monitor the existing loan portfolio and provide technical assistance when needed. That action might also increase the success rate for firms receiving RLF assistance.

Economic development planners face many challenges as they try to improve the economic outlook for non-metro cities. Identifying appropriate incentives for the creation of multi-city revolving funds and overcoming existing attitudinal and political barriers to their creation are important, but difficult tasks with an enormous potential impact on the future quality of life for those living in non-metro Minnesota.

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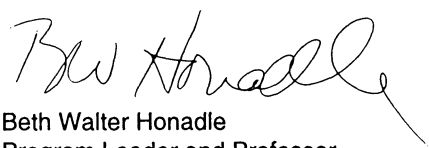

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