

# Risk Analysis System, Update 2024

The Economic Development Administration (EDA) has monitored and evaluated the performance of Revolving Loan Fund (RLF) Program awards using the Risk Analysis System (RAS) since 2018. Since the implementation of risk rating, EDA has aimed to improve upon the tool in a manner that allows RLFs to better align their lending practices with the evolving needs of borrowers and the broader economic landscape. After extensive consideration and review, it has been determined that five of the current measures are either unnecessary or redundant. These changes are based on feedback from EDA grantees and EDA RLF program staff, as well as data analysis supported with technical assistance grants.

EDA plans to remove the following five measures from the existing RAS:

1. Capital Base Index
2. Tenure
3. Loan Write-Off Ratio
4. Default Rate Over Time
5. Cash Percentage Over Time

This change will leave the following ten measures in place, with a maximum of 30 points.

1. Default Rate
2. Dollars Written Off
3. Updated RLF Plan
4. Financial Control
5. Timely and Complete Reporting
6. Financial Reporting
7. Net RLF Income
8. Cash Percentage
9. Leverage Ratio
10. Cost Per Job

Scoring will be adjusted in proportion to previous RAS rating levels:

- A. 27-30 points
- B. 20-26 points
- C. 19 points or less

These changes will go into effect starting with the 9/30/2024 Financial Reports. The following sections detail reasons for removing the five measures. An updated scoresheet is provided at the end of the document. If you have any questions, please contact [RLF@EDA.Gov](mailto:RLF@EDA.Gov).

## BACKGROUND

The EDA RLF program has undergone a period of significant transition since the RAS was first introduced in 2018. In 2020, two important developments occurred that impacted the RLF program: the passage of the [Reinvigorating Lending for the Future Act \(RLF Act\)](#) and the [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#).

The RLF Act shortens an RLF recipient's reporting requirements from *perpetuity* to *7 years after final disbursement*. As of July 2024, EDA has released the federal interest in 385 RLF awards. During the same

time, EDA expanded the RLF program using funding provided under the CARES Act. The RLF program received about 50% of the agency's \$1.5 billion CARES Act appropriation, making 358 awards totaling over \$700 million to operators in all 50 states and 3 U.S. territories. These developments have yielded an RLF portfolio that is significantly less tenured than it was prior to 2020 with different economic conditions. EDA will continue to evaluate the on-going usefulness of each individual measure over time and will reassess these measures when EDA's regulations are revised.

EDA has also made a major investment in overhauling the program's data and reporting infrastructure. The Salesforce application for post-award monitoring shifts from manual financial reporting processes to an automated, centralized platform and yields improved data quality and efficiency and reduced public reporting burden.

## AMENDMENTS

### Measure #1 to Remove: Capital Base Index (CBI)

#### **Challenges of Current Measure**

- A. *Lack of Relevance Given Change in RLF Reporting Timeline:* The *CBI* was originally introduced to evaluate RLF asset growth from program income and loan losses relative to the original fund capitalization. The condensed timeline for EDA oversight of an award following passage of the RLF Act limits an RLF's ability to substantially grow the *CBI* with program income and offset written-off loans.
- B. *Failure to Accommodate Differences in Local Lending Strategies:* The flexibility in lending practices that the RLF Program encourages allows grantees to offer different strategies depending on their service area needs and industry concentrations. The *CBI* measure is often misunderstood to infer that an RLF should grow and operate like a traditional lending institution when the program is designed to fill the gap between traditional lending institutions and entities that cannot access traditional loan capital.

### Measure #2 to Remove: Tenure

#### **Challenges of Current Measure**

- A. *Poor Indicator of Ability:* When the RAS was implemented in 2018, EDA received public comment demonstrating concern for objectively assessing the importance of management roles despite the variety, size, and type of organizations and staff profiles in the economic development community. Years of employment in the job function was used for objective simplicity in scoring, while subjective resume review was deemed time intensive and inconsistent. It has become clear that depending upon the structure of the RLF, some roles have higher turnover based on design.
- B. *Inequitable:* When it comes to providing credit to historically underserved communities which have been left behind by private lenders, there is enormous value in hiring staff who share demographic, language, and cultural characteristics with the communities the RLF operator hopes to reach. This often translates to hiring younger staff who are more closely embedded in these communities.

### Measure #3 to Remove: Loan Write-Off Ratio

#### **Challenges of Current Measure**

- A. *Lack of Relevance:* The monetary size of loans written-off by the RLF is more likely to highlight a potential risk to the federal interest in the award than the number of loans written-off. If the RLF can minimize the dollar amount of the loss, it indicates that the operator is able to enforce collateral rights and recovery collection efforts. The raw number of fully or partially written off loans is not a meaningful indicator of risk.
- B. *Duplication:* This measure provides EDA with similar information to *Dollars Written-Off* but is less useful based on data analysis of the current RLF portfolio. In other words, the current RAS is

double counting the risk indicator and unintentionally weighing this measure more heavily than other measures.

#### Measure #4 to Remove: Default Rate Over Time

##### **Challenges of Current Measure**

- A. *Administrative Burden:* According to RLF program staff, the *Default Rate Over Time* measure is frequently reported incorrectly by grantees and can be calculated inconsistently given that the reference period for the ‘consecutive months’ component is inherently vague.
- B. *Duplication:* There is significant overlap in the scoring distribution of the *Default Rate* and *Default Rate Over Time* measures. 90% of RLFs score the same on the two measures, while 6% of RLFs score better on the *Default Rate Over Time* measure and 4% score worse on the *Default Rate Over Time* measure.
- C. *Outdated Measure:* There once was a better rationale for collecting 'over time' measures when reporting was done manually with PDF forms and Excel spreadsheets, and EDA did not have the sophisticated data analysis or business intelligence tools now available in the RLF Salesforce application. Customizable Salesforce reporting provides EDA Project Officers with information they can use in their outreach to RLF grantees prior to default rates rising to any specific target level.

#### Measure #5 to Remove: Cash Percentage Over Time

##### **Challenges of Current Measure**

- A. *Administrative Burden:* As with *Default Rate Over Time*, the *Cash Percentage Over Time* measure is frequently reported incorrectly by grantees and can be cumbersome to calculate correctly.
- B. *Duplication:* There is significant overlap in the scoring distribution of the *Cash Percentage* and *Cash Percentage Over Time* measures. 65% of RLFs score the same on the two *Cash Percentage* measures, while 32% of RLFs score better on the *Cash Percentage Over Time* measure and just 3% score worse on the *Cash Percentage Over Time* measure.
- C. *Outdated Measure:* The *Cash Percentage Over Time* measure was intended to track trends in cash balances over time, which previously relied on attestations from grantees due to the absence of a dedicated RLF reporting system. However, with the implementation of the Salesforce RLF Application, RLF program staff now have access to improved analytical tools that provide better time-series reporting.

## **SUMMARY**

Overall, the five measures EDA is removing do not have a statistically significant impact on predicting an RLFs performance or risk. By removing these measures, EDA is employing a data driven process to streamline its RAS and reduce the reporting burden on grantees. These changes, combined with the advanced data analysis and business intelligence insights that Salesforce provides, will enable EDA to make better quantitatively based decisions and facilitate more effective monitoring of the measures that significantly predict risk.

**UPDATED RISK ANALYSIS SYSTEM SCORING TABLE**

These measures are calculated using information from the revised RLF Financial Report, Form ED-209.	<b>SCORE</b>		
	3	2	1
<b><u>Performance Metric: Assets</u></b>			
<i>An RLF Recipient must adhere to prudent lending standards to safeguard the quality of the loan portfolio.</i>			
<b>Measure: Default Rate</b>			
<i>Determined by:</i> RLF Principal Outstanding for Loans in Default divided by RLF Principal Outstanding for Total Active Loans	Less than 10%	From 10% to 20%	Greater than 20%
<b>Measure: Dollars Written-Off</b>			
<i>Determined by:</i> Loan Losses divided by the difference between Total RLF Dollars Loaned and Total RLF Principal Outstanding	Less than 10%	From 10% to 20%	Greater than 20%

<b>Performance Metric: Management</b>			
<i>It is critical to the success of the RLF that Management is experienced with the EDA RLF Program, their RLF Plan, and reporting requirements. Critical positions include: Executive Director, Lending Director, Finance Director, and Reporting Official. Vacancies in any of these positions can lead to program neglect and result in late reporting, weak loan generation, and accounting errors.</i>			
<b>Measure: RLF Plan</b>			
<i>Determined by:</i> Updated RLF Plan	RLF Plan up to date	RLF Plan out of date, update submitted within 6 years	RLF Plan expired and not updated within the last 6 years
<b>Measure: Financial Control</b>			
<i>Determined by:</i> Number and Magnitude of audit findings	No findings	Minor findings	Material findings, for example Questioned Costs, Insolvency, Interrelated party transactions
<b>Measure: Timely and Complete Reporting</b>			
<i>Determined by:</i> Date audit and/or additional reports (such as SF-425 or Corrective Action Plan) submitted to EDA	On time	Up to 30 days late	Over 30 days late or no receipt
<b>Measure: Financial Reporting</b>			
<i>Determined by:</i> Date RLF Financial Report (Form ED-209) submitted to EDA	On time with no corrections needed	Up to 60 days late and/or returned to RLF Recipient for minor corrections. Minor corrections include errors on the Grantee Information or Management Summary sections on the Financial Report.	More than 60 days late; or sent back for major revision. Major revisions include errors on the Portfolio Financial Status, Loan Portfolio Summary, Risk Scoring Measures, and Portfolio Loan List sections on the Financial Report.

<b><u>Performance Metric: Earnings</u></b>			
<i>An RLF Recipient is expected to manage costs and generate income in order to increase the RLF's Capital Base.</i>			
<b>Measure: Net RLF Income</b>			
<i>Determined by:</i> Portion of RLF Income Used for Administrative Expenses divided by Total RLF Income	Less than 50%	From 50% to 100%	More than 100%
<b><u>Performance Metric: Liquidity</u></b>			
<i>RLF Recipients are expected to keep a robust lending pipeline and maintain cash within a range of the Region's average cash as a percentage of the Capital Base.</i>			
<b>Measure: Cash Percentage</b>			
<i>Determined by:</i> RLF Cash Available for Lending (Net of Committed RLF \$) divided by RLF Capital Base compared to regional ACP	Less than 90% of the ACP	From 90% to 110% of the ACP	More than 110% of the ACP
<b><u>Performance Metric: Strategic Results</u></b>			
<i>The purpose of the RLF Program is to provide regions with a flexible and continuing source of capital for creating and retaining jobs and inducing private investment that will contribute to long-term economic stability and growth.</i>			
<b>Measure: Leverage Ratio</b>			
<i>Determined by:</i> Total Dollars Leveraged divided by RLF Dollars Loaned	Meets or exceeds required leverage	N/A	Less than required leverage
<b>Measure: Cost Per Job</b>			
<i>Determined by:</i> RLF Dollars Loaned divided by Total Jobs compared to RLF Plan Target	Less than 90% of RLF Plan target	90% to 110% of RLF Plan target	Greater than 110% of RLF Plan Target