# A Tale of Two Loan Funds

By Susannah Cameron & Susan Weekes

*This is a tale of two models of microlending. Both the ACCE$$ Riverdale Community Loan Fund and the Metro Credit Union's Community Micro Loan Program provide small business loans to people in Toronto, but each uses a distinctive approach.*

Microcredit or microlending is recognized as an effective way to assist low-income entrepreneurs in generating income and creating employment through the start-up or expansion of a small business. Microloans may range from $1,000-$25,000 depending on the lender. The borrower's small business, home-based or retail, creates employment for the owner and up to five employees.

For one of a number of reasons – a lack of assets or collateral, a poor credit history or, for recent immigrants, no credit history in Canada at all – many small business owners do not qualify for credit from conventional financial institutions. If 2-3 years of financial information about a business is not available, most financial institutions will reject a credit application on the grounds that the business is still in its start-up phase.

In light of this, the success of microlending in Latin America, Asia, and Africa came as an inspiration to Canadians. The first experiments in Canada, Calmeadow's First People's Funds (1987) and Calmeadow Nova Scotia (1991), were modeled after microlending programs in the developing world. Many economic and social agencies, church groups, business centres, credit unions, and other groups have since followed suit.

Practitioners soon discovered they could not simply transplant the strategy to North America. Lending methodologies, due diligence processes, and the size and scope of the projects all needed adjustment to the Canadian context. As there has never been any single association or instruction manual to guide the development of microloan funds in Canada, they have taken many different forms.

Some funds have experimented with peer lending. Others offer only individual loans. Some guarantee loans through a financial institution, while others lend directly. Notably, some funds do not lend strictly to small businesses but to nonprofits, co-operatives, or housing organizations as well.

This article examines examples of two of approaches to microlending in Canada: a community loan fund and a credit union.

## ACCE$$ Riverdale Community Loan Fund

The Riverdale Community Development Corporation (RCDC) is located in Toronto's east end. An urban initiative at the neighbourhood level, the RCDC provides microbusiness support services, a retail revitalization strategy, community enterprise development, and a local business network connected with the film and TV production sector. RCDC is also home to the ACCE$$ Riverdale Community Loan Fund.

The Community Loan Fund started in March 1999. With the assistance of a hired researcher, an advisory committee comprising members of the local community determined the fund's mission, purpose, design, and structure. The researcher wrote business and marketing plans for the fund, explored regulatory issues, and created disclosure documents and loan agreements.

The ACCE$$ Riverdale program has three objectives. It aims to make credit available to viable, under-financed microenterprises, to create employment and income opportunities for people in Riverdale, and to provide residents, business, and other local organizations with a means to put their savings to work in their own neighbourhoods.

Investors receive 2% interest on their capital. ACCE$$ Riverdale does not lend directly. It guarantees loans that are in turn administered through the Metro Credit Union's commercial loan branch. The money in the guarantee fund is invested. A reserve fund ensures that investors will be repaid. The reserve fund is capitalized from interest on loans, donations, and the interest generated from investing the guarantee fund. The reserve fund is kept at 20% of all outstanding loans to cover any loan losses.

Sharing space, administration, and small business expertise with the RCDC lowers program overheads. Borrowers can go to workshops, business start-up courses, and receive free business consulting from the RCDC. They can also take advantage of the staff's contacts in the neighbourhood, participate in trade shows, community events, and business awards shows that the RCDC supports.

Companies, agencies and individuals are asked to invest in the loan fund for a 1-, 2- or 3-year term. Personal solicitation has proven the most effective route to finding new investors. The concept of community investing is not that well understood by the general public. Prospective investors need to be informed about the benefits of the program to borrowers and about the due diligence to ensure low loan losses.

Queen Street East, in the Riverdale neighbourhood of Toronto. Photo: ACCE$$ Riverdale.

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Investors have expressed gratitude for the opportunity to support the local Riverdale economy. They in turn help build support for the program. Investing locally creates links between established businesses and residents who invest in start-up businesses. Investors receive a newsletter and invitations to periodic events, like tours of borrowers' businesses and investor forums.

## The Metro Credit Union's Community Micro Loan Program

The Community Micro Loan Program originates in Calmeadow's MetroFund launched in 1994. The Metro Credit Union acquired the microloan portfolio in June 2000 and houses it in one of its downtown branches.

The Metro Credit Union's Community Micro Loan Program focusses on low-income, self-employed people with small businesses that have been in operation for 1-5 years. Through business loans and access to a full range of financial services the program endeavours to help these entrepreneurs reach financial solvency within a competitive business environment.

In addition to the program's capital, Metro Credit Union makes available its tracking systems and legal, lending, and collections expertise.

## Comparing the Two Funds

**Loan Review Process**

ACCE$$ Riverdale has one paid co-ordinator whose job it is to find and maintain relations with investors, to promote the loan program, and to meet with all potential applicants. This may include referring clients to credit counselling or to a business consultant. If the entrepreneur seems ready, the co-ordinator helps them complete their loan application. She writes a summary of the application, requests a credit check, and conducts due diligence as necessary.

The co-ordinator works with a loan review committee of eight volunteers who meet monthly to decide whether to approve or decline each loan. They read all applications. The co-ordinator arranges for two

## Community Loan Funds vs Credit Unions

A *community loan fund* pools capital from social investors and re-lends it to local entrepreneurs, co-operative, or community-oriented enterprises (e.g., worker or consumer co-ops, regional development bonds, not-for-profit enterprises, or community loan funds). Social investors (individuals, companies, agencies, etc.) want their money to help create local jobs, develop local enterprise, provide essential services, or empower workers or consumers. Key to community loan funds is their use of volunteer and public resources to establish the fund, identify borrowers, manage risk, and raise capital. Examples include ACCE$$ Riverdale Community Loan Fund, the Montreal Community Loan Association (ACEM), the Edmonton Community Loan Fund, and the St. John Community Loan Fund.

Some *credit unions*, in addition to conventional services, offer microlending programs. Typically, the goal of the program is to provide credit and retail financial services to low-income people poorly served by traditional financial institutions and to help them become profitable within a competitive business environment. Members who have used the microlending program may "graduate" to become clients of its commercial lending program. Credit unions with microlending programs are Toronto's Metro Credit Union, VanCity Credit Union in Vancouver, and Assiniboine Credit Union in Winnipeg.

committee members to interview each applicant, usually at his/her place of business.

The benefits of using a volunteer loan review committee are many. ACCE$$ Riverdale's committee is made up of small business owners, community activists, former financial lenders, an accountant, and a real estate agent, so they bring many different perspectives to the loan review meetings. They enjoy the work, too. They learn from one another and find the process of meeting with small business owners rewarding.

Although there has been some turnover, a core group has been volunteering to serve on the committee since ACCE$$ Riverdale started in 1999. So the lessons learned through the process of assessing loans have stayed with the group. The loan review committee also helps develop policy for the loan fund.

The Metro Credit Union's Community Micro Loan Program has one staff member who administers the program. She conducts outreach for the program, responds to requests for information, and meets with potential applicants. She does the due diligence, interviews the applicant, and makes the loan decision herself. She has support from the commercial lending and marketing branches of the Metro Credit Union. The approval process takes about seven days compared to 2-4 weeks through the ACCE$$ Riverdale Community Loan Program.

A single credit officer is able to make decisions more quickly and efficiently than a committee that meets on a monthly basis. S/he is therefore is able to provide more timely service to the applicant. On the other hand, deciding whether to decline or approve a microloan is very difficult. The decision to make the loans often rides on an assessment of the applicant's character, so additional perspectives can help.

**Client Eligibility**

To be eligible for ACCE$$ Riverdale, applicants must be over 18 years of age and reside or have a business in the Riverdale area. ACCE$$ Riverdale will consider applicants with refugee status.

To be eligible to apply for the Community Micro Loan Program, one must be a graduate of a recognized business training program, have legal residency in Canada, and be at least 19 years of age. The loan program is promoted to participants of the many business training programs run by Toronto agencies with which Metro Credit Union has relationships.

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By limiting applications in this way the Community Micro Loan Program ensures that applicants have the technical skills to run their business. It also ensures that the program manager spends her time assessing loans – not helping applicants to develop marketing plans or cash flow projections. On the other hand, restricting the program to graduates of business training excludes viable businesses where the owner has gained business skills through experience.

Both microloan programs require that borrowers have a legally registered business. Both require that candidates fill out an application form and provide a cash flow projection, references, business records, business registration, tax return, and other supporting documents, depending on the business (e.g., business plan, leases, licenses, certificates, marketing materials, or sample products.) Neither fund will loan to people with a large debt load, who have been irresponsible about repaying credit in the past, or who have a court judgment against them.

The geographical restriction on applicants to the ACCE$$ Riverdale Community Loan Fund has positive and negative consequences.

Focussing on a particular community in a city as large as Toronto improves the loan review committee's ability to assess the loans. The loan review committee members live and work in the Riverdale area so they are familiar with rental rates, business competition, and markets. The co-ordinator has an easier job monitoring borrowers. She can notify borrowers when a business opportunity in the area arises and make linkages between businesses. The down side is that some applicants who live outside Riverdale must be referred elsewhere.

The Metro Credit Union's Community Micro Loan Program takes applicants from the Greater Toronto Area. So the credit officer has to travel greater distances for site visits – but she also has a much greater number of potential borrowers.

**Loan Product & Portfolios**

ACCE$$ Riverdale offers first time borrowers up to $5000 to be repaid over 1-2 years. Upon repayment of the first loan, the borrower may choose to apply for a second of up to $10,000. If it is repaid, the borrower may apply for a third to a maximum of $15,000.

The Metro Credit Union's microloans range from $1,000-$5,000 for start-ups. Businesses in operation more than one year have access to a variety of amounts to a maximum of $15,000. Loans have terms of up to five years with monthly installments.

Both programs have an interest rate that is intended to recover some of their operating costs. ACCE$$ Riverdale's rate is based on a rate of variable prime plus 5.25% (of which prime plus 1.25% goes to the Metro Credit Union). ACCE$$ Riverdale also requires borrowers to put a deposit in its reserve fund for the duration of the loan term. The Metro Credit Union's Community Micro Loan Program has an administration fee of 6%. The interest rate charged on each loan is prime plus 6%.

From its inception to December 2002, ACCE$$ Riverdale made over 50 loans totaling over $260,000. From June 2000 to December 2002, the Community Micro Loan Program disbursed over 100 loans worth approximately $500,000.

No evaluation has been conducted to compare the results or impacts of the two programs, but the Metro Credit Union's program is probably disbursing more loans for a few reasons. The Metro Credit Union is building on an existing portfolio of clients. The manager at the Metro Credit Union is assessing loans on an on-going basis rather than once a month. It is also likely that it is easier to approve loans going through one staff member rather than seeking a unanimous positive decision from a committee.

Thus far, the two loan funds have similar loan loss rates hovering between five and seven percent of the portfolio. This is not unexpected as the ACCE$$ Riverdale loans are administered through the Metro Credit Union and so the collections procedures for the two funds are very similar.

One might expect a microlending program using a committee to conduct a more thorough due diligence process than one using a single staff member. This might be the case in other circumstances, but the manager of the Metro Credit Union's program is very experienced. She worked at Calmeadow for three years and moved with the portfolio to the Metro Credit Union. Prior to this, she worked for the Royal Bank for six years. Even with her extensive experience making loan decisions, she is recommending changes be made to her program so loans over $10,000 are taken to a credit committee.

Another important reality about these loan funds is that they do not operate in isolation from one another. If staff from either program encounter business owners who need services from the other, they are referred.

People starting up very small business need more than financing. Typically, microcredit programs are offered in conjunction with either a financial service or a business support service organization, both of which are critical to the success of most businesses in North America. In this city we are lucky to have both.

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# Innovation & CED

*What can they learn from each other?*

By Eric Leviten-Reid & Sherri Torjman

*Innovation*. To some it means everything. To others, not much at all.

Such is the life of a buzzword: of such consequence to everything it ceases to mean anything in particular.

Over the past two years, innovation has emerged as a focal point of Canada's public policy. Industry Canada and Human Resources Development Canada have jointly undertaken a consultation process on Canada's Innovation Strategy and are now moving to develop the innovation agenda.

This is the terrain on which the Caledon Institute of Social Policy and the Community Economic Development Technical Assistance Program have launched their own research initiative on innovation and CED.

The strategy? Avoid the "everything or nothing" syndrome. Instead, focus on the specific body of concepts and practices commonly identified with "innovation" and ask three questions:

- How does this version of innovation compare with the kind of innovative work that goes on in CED?
- What can CED contribute to innovation?
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We held focus groups with approximately 100 CED practitioners from across the country. We conducted an extensive review of the research literature relating to innovation. A scan of CED initiatives identified ways in which communities are addressing various aspects of the innovation challenge. A workshop last fall at the Winnipeg conference on Community-led Innovation capped off the process. Caledon and CEDTAP shared their preliminary findings and got feedback on their draft recommendations for strengthening the innovation capacity of the CED sector.

Ultimately, we intended that research build a dialogue between practitioners of CED and proponents of innovation, challenging both to broaden their horizons and see what they could learn from one another. The following article summarizes the research findings.