Real Deals
SSBCI 2.0 Product Playbook
Revenue Based Loans

Drexel’s Nowak Metro Finance Lab & Kauffman Foundation
Executive Summary

Background
The State Small Business Credit Initiative (SSBCI 2.0) is a federal program authorized by the 2021 American Rescue Plan that gives $10 billion to states to create programs that invest in — and help grow — small businesses. Each state is tasked with designing the programs and products that reach a broad range of diverse entrepreneurs from this unprecedentedly large program.

Challenge
How do states structure capital, administer programs, and build the partnerships necessary to successfully leverage this federal investment to create jobs, reach and support businesses, and permanently strengthen their state economies?

Opportunity
Revenue Based Loans (RBL) is an innovative and underutilized financial product that states should consider in their SSBCI 2.0 portfolio. RBL offers more flexible repayment, aligns incentives between founders and funders, and allows a broader range of ventures to grow early in their lifecycle — maximizing chances of success and repayment.
About the Nowak Metro Finance Lab

The Nowak Metro Finance Lab is a research lab based at Drexel University to help local governments identify and implement public finance strategies to support strong and inclusive cities and states. The Lab’s current and founding director is Bruce Katz, co-author of The New Localism and The Metropolitan Revolution: How Cities and Metros are Fixing Our Broken Politics and Fragile Economy.

The Lab has partnered with the Ewing Marion Kauffman Foundation to provide free research and support to states as they implement the $10 billion State Small Business Credit Initiative, with the goals of:

1) Strengthening and building local small-business capital ecosystems;
2) Reaching underserved entrepreneurs without access to capital; and
3) Driving catalytic innovation in metropolitan regions and states
Definitions

**Capital Product:** An agreement wherein one entity or firm invests money into another; examples included loans, equity investments, and other means of extending credit and capital to businesses.

**Term Loan:** A capital product where a lender provides a one-time lump sum of money that is generally repaid in fixed dollar amounts over the life of the loan. The fixed amounts do not change based on the borrower’s monthly revenues (examples: traditional home loans; SBA 7(a) and 504 loans).

**Revenue-Based Loans:** A loan product where a lender provides a one-time lump sum of money that is repaid from a fixed percentage of the borrower’s revenue* until an agreed-upon multiple of the initial investment is met, usually between 1.5 and 3x. While this is type of financing can be more costly overall, it allows flexibility, mission-alignment, and other benefits in reaching more diverse firms and entrepreneurs.

* "revenue" can mean: EBITDA (earnings before interest, taxes, depreciation, and amortization), Free Cash Flow ("FCF"; i.e., EBITDA + CapEx), and other variations
Example Deal
Sonoran Precision Agriculture (Hypothetical)

**Business Background:** Founded by a first-generation college student and a business partner, the company serves independent farmers with mapping, automated fertilizer spreading, and data analytics to help maximize farms’ harvest yields.

**Revenue Profile:** As a new business supporting small farms, revenues are modest and seasonal based on the growing season, with several large recurring customers and few assets except some equipment.
Example Deal – Loan Profile
Sonoran Precision Agriculture (Hypothetical)

Business/Loan Profile

<table>
<thead>
<tr>
<th>Avg. monthly revenue:</th>
<th>$70,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collateral:</td>
<td>None</td>
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<tr>
<td>Use of Proceeds:</td>
<td>Hiring, software</td>
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Revenue ($k) vs. Month

Loan Application

Month
Example Deal – Term Loan
Sonoran Precision Agriculture (Hypothetical)

Traditional Term Loan
Principal: $200,000
Term: 5-year term
Interest Rate: 12%
Monthly Payment: ~$4,450

Revenue and Payment % ($k)
Month

Loan Application
Burdensome Initial Payments

Payment Revenue
Example Deal – Revenue-Based Loan
Sonoran Precision Agriculture (Hypothetical)

**Revenue-Based Loan**
- Principal: $200,000
- Term: 5-year term
- % Monthly revenue: 6%
- Repayment Cap: 1.5x principal

**Gross Revenue By Month**
(% share = loan repayment)

**Example Deal – Revenue-Based Loan**
Sonoran Precision Agriculture (Hypothetical)

<table>
<thead>
<tr>
<th>Month</th>
<th>Revenue</th>
<th>Payment</th>
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<tr>
<td>J</td>
<td>6%</td>
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**Loan Application**
- Lower Initial Payments
- % share = loan repayment

**Payments grow with Revenue**
Side-by-Side: Term vs. Revenue-Based Loan
Sonoran Precision Agriculture

<table>
<thead>
<tr>
<th>Term Loan</th>
<th>Revenue-Based Loan</th>
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<tbody>
<tr>
<td>Principal: $200,000</td>
<td>Principal: $200,000</td>
</tr>
<tr>
<td>Total payment: $266,933</td>
<td>Total payment: $300,000</td>
</tr>
<tr>
<td>First 12 months: $53,386</td>
<td>First 12 months: $51,300</td>
</tr>
<tr>
<td>Costs/Benefits:</td>
<td>Costs/Benefits:</td>
</tr>
<tr>
<td>➢ Less expensive capital overall</td>
<td>➢ Higher total interest paid</td>
</tr>
<tr>
<td>➢ Burdensome early on for borrowers</td>
<td>➢ More affordable in early stages</td>
</tr>
<tr>
<td>➢ Less flexibility for seasonality</td>
<td>➢ Flexibility if/when revenue decreases</td>
</tr>
<tr>
<td>➢ Collateral or personal guarantees</td>
<td>➢ No collateral or personal guarantees</td>
</tr>
<tr>
<td>➢ Simple monthly payment calculation</td>
<td>➢ More revenue analysis for borrower</td>
</tr>
</tbody>
</table>
# Summary of Benefits of RBL

<table>
<thead>
<tr>
<th>RBL Features</th>
<th>Pros</th>
<th>Cons</th>
<th>Example</th>
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</table>
| **No Collateral/Guarantee** | ➢ Collateral requirements are a key hurdle underrepresented founders  
➢ Protects founders against personalized, catastrophic downside risks | ➢ Requires more up-front lender diligence  
➢ More industry-wide training needed | Latino food entrepreneur using ghost kitchen with few assets or savings can move from simple delivery to brick-and-mortar space |
| **High-touch**       | ➢ Lender gets deep insight into business, can flag issues well before late payment  
➢ Entrepreneurs gain significant knowledge w/ cashflow analysis | ➢ Requires more staff resources from lender  
➢ Servicing payment requires access to financials and relatively sophisticated software | Entrepreneur now documents free cashflow and has more precise understanding of how much capital they can reinvest into their business and anticipate trends in future revenue |
| **Flexible payment** | ➢ Great for seasonality, accommodates decrease revenue with lower APR  
➢ Quicker pay-off with business success and growth | ➢ IRR increases with revenue growth, must create protection for borrower, usury regulations  
➢ With flexibility comes (typically) higher cost of capital overall | After the busy holiday season, repayment for entrepreneur will decrease as demand and orders recede; value of RBL payments decrease proportionally, then rise w/ summer season growth |
| **Mission-Alignment** | ➢ Creates incentive for lender to support business success  
➢ Can recycle funds more quickly into more lending | ➢ Requires sophisticated staff and continuing resources  
➢ Requires mission-driven lender to uphold non-usurious standards | Business accelerates and repayment total to quickly reach 1.5x multiple two years into five-year term, with help from capital provider |
RBL-SSBCI Program Integration
Program Options with Revenue Based Loans

Four options for SSBCI-supported loans, per Treasury’s SSBCI capital guidelines:

1. Capital Access Programs (CAPs)
   • Loan loss reserves, w/ borrower and/or lender contributing up to 7 percent of loan amount to reserve fund, matched by state with SSBCI funds, totaling 14 percent

2. Loan Guarantee Programs (LGPs)
   • State SSBCI funds guarantee between 20 and 80 percent of an enrolled loan

3. Collateral Support Programs (CSPs)
   • States SSBCI funds provide cash to increase the value of borrowers’ available collateral

4. Loan Participation Programs (LPPs)
   • State SSBCI funds purchase a portion of loan or make direct companion loan alongside private lender
## SSBCI Program Integration
### Overview of Revenue-Based Products Possible with SSBCI

<table>
<thead>
<tr>
<th>Product</th>
<th>Pros</th>
<th>Cons</th>
<th>Reach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Loss Reserve (CAP)</td>
<td>➢ Most familiar to CDFIs ➢ Most effective for reaching LMI businesses in SSBCI 1.0; extending credit to new borrowers</td>
<td>➢ Limited risk mitigation (14%) ➢ Borrower/Lender must pay in ➢ Low SSBCI match (1:1 max) ➢ Requires full portfolio of loans</td>
<td>Moderate</td>
</tr>
<tr>
<td>Loan Guarantee (LGPs)</td>
<td>➢ First-loss guarantee capital ➢ Covers up to 80% of loan ➢ Creates room for experimentation in building RBL best practices</td>
<td>➢ Less familiar to CDFIs ➢ CDFIs still need capital, does not expand existing balance sheet</td>
<td>High Potential</td>
</tr>
<tr>
<td>Collateral Support (CSPs)</td>
<td>➢ N/A – Not Collateralized</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Participation (LPPs)</td>
<td>➢ Gets capital directly to lenders (up to 80% of fund) ➢ Expands CDFI balance sheets/lending capacity</td>
<td>➢ Possibly more underwriting ➢ Purchase standards may be too rigid, esp. for RBL ➢ Typically require personal guarantees (a la SSBCI 1.0)</td>
<td>Lower</td>
</tr>
</tbody>
</table>
**RBL Fund-Level Outcomes**

For modest estimates of an overall fund portfolio revenue growth of 1.5%

<table>
<thead>
<tr>
<th>Business Performance</th>
<th>Proportion of Fund ($)</th>
<th>Revenue Growth</th>
<th>Avg. Repayment Year</th>
<th>Effective APR</th>
<th>Year 8 Loans Outstanding*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>15%</td>
<td>+20%</td>
<td>4</td>
<td>19.2%</td>
<td>0%</td>
</tr>
<tr>
<td>Moderate</td>
<td>30%</td>
<td>+10%</td>
<td>4.8</td>
<td>17.3%</td>
<td>0%</td>
</tr>
<tr>
<td>Weak</td>
<td>30%</td>
<td>+0%</td>
<td>5.8</td>
<td>15.2%</td>
<td>25%</td>
</tr>
<tr>
<td>Troubled</td>
<td>20%</td>
<td>-10%</td>
<td>8</td>
<td>12.5%</td>
<td>100%</td>
</tr>
<tr>
<td>Failed</td>
<td>5%</td>
<td>-50%</td>
<td>--</td>
<td>NA</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Fund Average</strong></td>
<td><strong>--</strong></td>
<td><strong>1.5%</strong></td>
<td><strong>5.6</strong></td>
<td><strong>15.9%</strong></td>
<td><strong>28%</strong></td>
</tr>
</tbody>
</table>

* 28% of loans still have balance after Year 8; this represents only 3% of overall loan payments/principal
RBL Fund Returns
Mapping Repayments, Returns, and Profits over an 8-Year Timeline

Loan Balance  Principle Paid  Fund Returns  Fund Profits

Fund Profile:
- $10 million fund
- $200,000 avg. loan
- Assumes 3% of funds outstanding, per previous slide

Insights:
- Breakeven in Year 3
- Achieves close to 1.5x portfolio return
- Does not show reinvested funds (i.e., conservative returns estimate)
Opportunities for Patient Capital w/ RBL & SSBCI

**Supportive Direct Investment:**

- Cover lender/borrower portion of required SSBCI 1:1 match in CAP Loan Loss Reserves
- Expand 1:1 match on SSBCI Loan Loss Reserve (e.g., Colorado bonus in Enterprise Zones)
- Invest capital into SSBCI Guarantee Programs, growing CDFI/local lending capacity (*high potential*)
- Provide first-loss capital in an SSBCI Loan Participation, incentivizing private participation

**Capacity-Building and Ecosystem Support:**

- Fund training for RBL underwriting, loan servicing, and implementation; including supplier capital, underwriting against contracting revenue/opportunities (see our SCF deck)
- Fund development of RBL software, subscriptions, and access for local lenders
Recommendations for States

1. **Review your Treasury application** for possible RBL integration within your approved programs

2. **Contact your local lenders and business service providers** to assess current practice and capacity for RBL lending

3. **Check out the Innovative Finance Project**, a Nowak Metro Finance Lab collaboration with Catalyze to identify and scale innovative financial products; resources include:
   - Sample term sheets for RBL
   - Lending guidelines and best practices
   - Trainings and webinars

4. **Reach out to the Nowak Lab** for more information: bryan.jeffrey.fike@drexel.edu
Contact

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