Loan Product Options
Integrating IDA and Microenterprise Development Programs

IDA programs and microenterprise development (MED) programs have a lot in common. Both seek to assist the poor to invest in assets that will produce lasting benefits. AFI IDA and microenterprise participants have similar requirements to increase success. Microenterprise participants need training and technical assistance to start or expand their businesses. They may also need capital but may not have the credit history to allow them to secure it through traditional means. IDA participants planning to use their IDA savings to start or expand a small business have similar training and credit issues, and their businesses may even require capital beyond what the IDA can provide.

Despite such commonalities, few programs have attempted to link IDA and microenterprise development strategies. The Corporation for Enterprise Development (CFED), a national nonprofit organization that works to expand economic opportunities, has recognized the potential benefits of such integration. In a 2004 bulletin, they noted, "While IDA programs promote responsible savings behavior, microenterprise development programs promote responsible credit management—two complementary sides of the asset-building coin."[1] From this recognition was born a new initiative, *Integrating Savings and Credit*.

With support from the Charles Stewart Mott and JP Morgan Chase Foundations, CFED funded research to explore whether and how AFI IDA and MED programs were currently integrated. In the second phase, they asked five community development financial institutions (CDFIs) to test the integration of IDA savings and small business credit using a product-development process. Their questions: By combining savings and credit strategies, could IDA and MED programs reduce duplication and increase efficiency and the appropriate use of loan capital? Could an integrated loan product increase access to capital?

Many low-income entrepreneurs do not have the equity capital that mainstream lenders require to decrease loan risk. An integrated savings and credit product could allow the IDA savings to be used as equity. In addition, the integrated product could weight IDA participants' saving patterns, thus strengthening their credit history. It could also help them be responsible IDA participants by including aspects of their IDA activities in the loan criteria, such as credit repair.
Two of the *Integrating Savings and Credit* demonstration sites were Lenders for Community Development in San Jose, California, and Alternatives Federal Credit Union in Ithaca, New York.

[1] "Savings and Credit for Microentrepreneurs," *Effective State Policy and Practice,* CFED, 2004.

Lenders for Community Development

Lenders for Community Development (LCD) [http://www.l4cd.com/], in San Jose, California, has supported small business owners through microloans, training, and technical assistance for over 10 years. LCD was also one of two co-managers[2] of the Assets for All Alliance, an IDA collaborative operating since 1999 with AFI funding in San Mateo and Santa Clara Counties.

LCD wanted to develop a loan product specifically tailored to IDA participants and to use new methods of underwriting and evaluating credit requests. It would allow participants who had demonstrated commitment to saving for their business an opportunity to access additional capital, even in the absence of an established credit history. This new loan product essentially used the IDA savings history as a proxy for a credit history.

The IDA Star Loan

With CFED's support, LCD went through a product- development process that included surveys and focus groups with IDA microenterprise participants and graduates and with microloan borrowers. The result was the IDA Star Loan. IDA participants automatically qualify for a loan if they meet the following six criteria: 1) have participated in the IDA program for at least nine months; 2) missed no more than two deposits per year; 3) have had a clean credit history since they enrolled in the IDA program; 4) have credit card debt of no more than $10,000; 5) plan to invest the IDA funds in a business; and 6) meet with LCD's business advisor to evaluate whether they can afford to repay the loan. The simplified IDA Star Loan process requires less underwriting time and makes it easier for IDA participants with good savings histories to qualify. The maximum loan is $10,000.

Implementation Lessons

In January 2004, LCD started testing the IDA Star Loan by marketing it to current and former IDA program participants. Following are some of the lessons learned about using an integrated savings and credit product with their IDA participants:

- Many of the participants saving for microenterprise had not actually started a business. Some were deciding what business sector was most attractive. Few had thought about how to finance the business, how much capital would be needed, or whether the IDA capital would suffice. IDA participants also had little experience with business credit or with credit in general. By adding the IDA Star Loan process, LCD can offer IDA savers more focused training on growing a business and how responsible use of credit can help. Offering the IDA

[2] The other is the Center for Venture Philanthropy.

Star Loan has also fostered closer linkages between LCD's microloan staff and IDA participants.

- Most of the participants who were ready for a Star Loan had already graduated from the IDA program. Therefore, the Star Loan does not combine the loan payment with the monthly IDA deposit.
- When marketing the new loan product, it is important to reach participants through a trusted source, such as the IDA staff or staff of the IDA collaborative's community partners.
- Developing the IDA Star Loan facilitated the linkage of IDA savers to the type of loan best suited for them, even if it was not the IDA Star Loan. As of January 2005, two IDA participants had used the IDA Star Loan, but six more had received business loans through LCD's Small Business Loan Program. The process of developing the new loan, increasing the amount of education on business credit, and marketing the new product led to a greater interest in business credit.
- Offering the IDA Star Loan became an opportunity to teach IDA staff a different way to look at business credit. As staff offer financial education, they emphasize not taking on too much debt and using debt wisely. They, like participants, learned more about how wise use of business credit can help businesses become more successful.

Recommendations for Replication.

LCD staff have recommendations for others considering an integrated savings and credit product.

1. Organizations may be more successful if they already have well established IDA *and* microenterprise programs. In LCD's case, having an existing microloan program with an investment pool was a key element. They did not have to create the loan process from scratch. They also already had an internal credit authority, so they were able to offer the loans in-house. In addition, integrating the two programs went smoothly because both are managed by the same staff person.

2. Organizations should think through the marketing plan for the new product. Focus groups with potential users of the proposed loan product are helpful to understand how best to market the product. Be sure to include IDA graduates as well as current participants. Keep in mind also that those who are not ready for a business loan now may be ready later, when they are farther along in their planning process.

Alternatives Federal Credit Union

Alternatives Federal Credit Union, in Ithaca, New York [http://www.alternatives.org/], has provided microloans for over 25 years and operated successful IDA and MED programs since 1998, under the name Alternatives Venture Fund. Although considerable overlap between programs already existed, they were ready to take it a step further. Alternatives noticed that some MED participants lacked interest in IDAs because they wanted capital for their business immediately. Some did not have the credit history needed to obtain a loan through traditional channels. The credit union wanted to help small business owners obtain loans and, through the IDA, infuse additional funds into their businesses. They developed two new loan products, the IDA Microloan and the IDA Emergency Loan Fund, and increased integration of microenterprise and IDA training components.

The IDA Microloan

The strategy to increase access to capital and further integrate microenterprise and IDAs was the IDA Microloan, which provides credit to IDA participants who might not be eligible for a traditional microloan. To qualify for the IDA Microloan, the applicant must: 1) have, or open, an IDA—which means they must meet the AFI income and asset eligibility criteria; 2) must include the IDA and the microloan both in the business plan; 3) must submit quarterly financial statements for the business; 4) may make no more than two late payments per year; and 5) may have no delinquencies of more than 60 days.

A key feature of the loan product is relaxation of underwriting criteria. There will be a lower interest rate as well, but what it will be depends on the source of funds. The process links IDA deposits to loan payments. Participants can make one deposit each month, part of which goes toward savings and part of which goes toward repayment of the loan. The integrated product also allows participants to make early matched withdrawals to make purchases for their business in stages.

The IDA Program Emergency Loan Fund

Alternatives staff also noted the need for an emergency loan product for IDA participants. People who qualify for the AFI-funded IDA program earn just 60% or less of the median income for the Ithaca area. Financial emergencies are common for them, leading participants to ask for emergency withdrawals from their IDAs.

The emergency loan fund fulfills two objectives: 1) It is a way to help participants access a low-interest loan to handle the financial emergency so that they can maintain their IDA; and 2) Program staff can model a problem-solving approach to examine other options to address a financial crisis. Loans of up to $500 are possible, with the IDA savings and a loan loss reserve pool from matching fund interest to guarantee the loan.

To qualify for the loan, the participant must: 1) have been in the IDA program for at least six months; 2) have a consistent record of making savings deposits; 3) have enough income to repay the loan; and 4) have a financial emergency that the loan can resolve. Participants may take a "leave of absence" from making deposits in their IDA in order to repay the loan.

Alternatives's emergency loan fund has fulfilled both of its goals. As of June 2005, only eight people have used it. For each, the loan fund has played a critical role in allowing them to stay in the IDA program and continue saving toward their asset purchase. Many more IDA participants have inquired about the emergency loan fund; but after talking with program staff about options, they identify another solution and do not use an emergency loan. Of course, there have also been cases where the participants did not meet the criteria for the loan, for example, because of poor saving records or insufficient income to repay the loan.

Integrating the IDA and MED Training Components

As part of its *Integrating Savings and Credit* model, Alternatives also worked on integrating the IDA and MED training components. Through focus groups with participants of both programs Alternatives staff learned that people in the MED program could benefit from more training on personal finance issues. IDA participants—even those who weren't planning on microenterprise—were interested in information about self-employment. As a result, self-employment is now a module in the financial education curriculum for all IDA participants; and personal finance is integrated into a revised 11-week microenterprise curriculum.

Recommendations for Replication.

Alternative's staff offer the following advice to those considering an emergency loan fund for IDA program participants:

1. Identify a source of funds for the loan loss reserve. The interest on unobligated AFI Reserve Account funds may be used for program purposes, and this is what Alternatives used initially to establish the loan loss pool.
2. It is important to market the emergency loan fund appropriately so that participants know it is available.
3. Spell out the loan criteria in advance so that loans do not appear to be granted arbitrarily.

These AFI Projects, Lenders for Community Development and Alternatives Federal Credit Union, developed synergies between IDA and microenterprise that support the common goal of building wealth and increasing participants' skills in making their money work for them. Other AFI Projects that also offer microenterprise development or who have strong partnerships with organizations experienced in the field may want to consider these and other models.[3]

[3] For more information on the other sites for the Integrating Savings and Credit initiative, contact Michael Torrens at (202) 408-9788. CFED is also designing a toolkit for organizations that want to increase IDA and microenterprise integration. The toolkit will include a framework, strategies, and guidance for implementation and will be available online at http:/savingsandcredit.cfed.org.