Catalyze

DREXEL UNIVERSITY
Nowak Metro Finance Lab
Lindy Institute for Urban Innovation

The State of Revenue-Based Financing & CDFIs

The State of Revenue-Based Financing & CDFIs report focuses on the rise of Community Development Financial Institutions and other mission-driven lenders implementing and deploying RBF for businesses in their communities.

OUTLINE

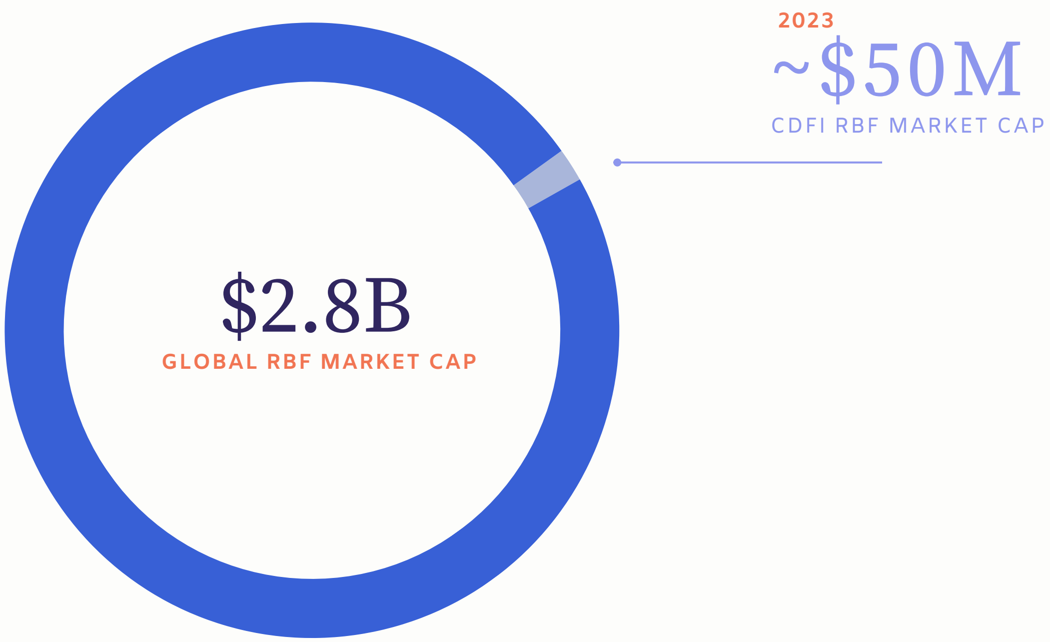
To learn more about RBF for mission-driven-lenders, contact Catalyze at hello@catalyze.community

The Rise of RBF

Revenue-based financing (RBF) has been around in various forms for decades. According to industry reports, the global market cap for RBF was valued at $2.8 billion in 2022, with projections to reach $49 billion by 2028.

Despite a growing global interest in RBF, Community Development Financial Institutions (CDFIs) in the U.S. have been reluctant to adopt this capital product. With a few noteworthy exceptions, CDFIs have not offered RBF for businesses in their communities. However, in recent years, RBF has gained momentum and has been adopted by investors, lenders, and startups across the U.S., including CDFIs.

Catalyze estimates that there are around **20 CDFIs providing RBF** today, with dozens more interested on the sidelines. Additionally, we estimate the outstanding RBF portfolio from CDFIs to be roughly **$50M** in 2023, with a **likely doubling** by 2025.



What is RBF?

There are two primary types of RBF: redeemable equity and revenue-based loans (RBL). For this report, we focus on RBL, which is typically a better fit for CDFIs. A RBL is like a flexible loan with no fixed interest rate. Similar to fixed-rate business loans, investors collect monthly or quarterly payments, but rather than loan payments set at a fixed interest rate, RBL payments fluctuate with revenue.

More specifically, revenue-based lenders provide a business with capital in exchange for a percentage of the business' ongoing revenue—the company makes recurring payments tied to a fixed percentage of revenues (typically 2-5%) and total repayment is capped at a multiple of principal amount (typically 1.4-2x) with term lengths of 3 to 5 years.

A RBL falls between venture capital (VC) + bank debt, making it a good fit for many businesses that don't qualify for bank loans but do not have the growth expectations to fit VC. RBLs are often cheaper than selling equity, but more expensive than bank loans. They usually cost 10–20% IRR, compared to up to 12% for bank loans and 50%+ for VC. However, when founders are able to access a fixed-rate loan and are willing to secure the loan with personal guarantees and collateral, that is typically the cheapest form of capital.

Typical RBL Characteristics

ONE
Structured as a loan (frequently unsecured)

TWO
Principal amount fully funded at closing

THREE
Monthly payments equal a set percentage of monthly revenue (typically 2-5%)

FOUR
Payments continue until a set dollar amount has been paid back, usually 1.4-2x the principal (this multiple is called the "cap")

FIVE
At maturity, which is typically 3-5 years, any unpaid amount of the cap is due

SIX
No collateral or restrictive covenants

To read more about RBLs, check out the [Innovative Finance Playbook's RBL chapter](#).

WHAT IT'S NOT

MCA vs. RBF

Financial technology companies have joined, and often confused, the RBF space with shorter-term capital disguised as RBF.

Merchant Cash Advances (MCAs) are a form of rapid cash for businesses, not loans. Often integrated into and marketed via point of sale (POS) systems, MCAs enable businesses to access funds as soon as the next day. MCAs are not loans; rather, they provide upfront cash from purchases of future revenues plus a finance fee (or "factor").

Like RBF, MCA payments fluctuate based on revenues and are typically calculated as a share of debit or credit card receipts. MCAs and similar products appeal to business owners for their **high approval rates, speed, and convenience.** The Federal Reserve's Small Business Credit Survey found that 90% of MCA applicants were approved for at least some funding, compared to 76% for business lines of credit, 66% for business loans, and 64% for SBA loans. However, compared to RBLs, MCAs are expensive with a 50%+ Annual Percentage Rate (APR), potentially predatory with a lack of regulations and transparency, and carry collateral risk. While MCA and RBLs can look similar at face value with a repayment multiple and revenue share percentage, it is MCA's very fast repayment timeline that can create payday loan-level APRs.

MCA vs. RBL

CATEGORY	MCA	RBL
Use Cases	Emergency cash to cover immediate needs	Flexible, typically loan-like investment for growth
Approval Rates	Very high	Competitive
Underwriting Process	Driven by algorithms and integrated in a point-of-sales system, seamless + rapid approval. Based heavily on credit card transactions	Often higher-touch, multi-step underwriting. Typically some review of historical cash flows and projected revenue growth.
Payment Multiple	Advanced amount plus a "factor"—often between 20% to 50% of that amount (1.2-1.5x)	Flexible payments based on a % of revenue (typically between 2-5%) until a 1.4-2x multiple is met
Payment Timeline	MCAs do not technically include a set term length but are typically repaid within a few months to one year. Payment typically starts immediately.	Typically 3-5 years. Repayment often includes a grace period.
Payment Process	Payment from every transaction; payment taken directly from bank account or credit card sales; may include minimum payment amount	Payment based on monthly revenues
Collateral	Varies: personal guarantees and/or business assets. Breach of terms requires accelerated repayment.	Typically none
Education + Technical Assistance	None	Moderate to high-touch support for businesses from revenue-based financing providers

CDFIs + Revenue-Based Lending

CDFIs provide access to capital for businesses that traditional banks and lenders do not serve in their communities. As CDFIs continue to expand their mission of capital access, many are looking beyond traditional loans to connect more businesses with the right types of capital. As a result, there has been an increasing interest in revenue-based lending amongst the CDFI industry.

For CDFIs and other mission-driven lenders, there are some great benefits to utilizing RBL, beyond just expanding the pipeline of businesses that can be supported.

Payment Flexibility

Payment flexibility can be a benefit for investors as well as for entrepreneurs. Tying payments to revenue results in borrowers who are more likely to make their payments in different market environments.

Risk / Reward

RBF represents an asset class that offers greater returns than more common private credit strategies, but lower risk than VC, offering an attractive risk/reward profile in between those asset classes.

Liquidity

RBLs can provide consistent returns and liquidity with a lower risk profile for investors that do not want to spend all their time and energy searching for “unicorn” businesses.

Founder Alignment

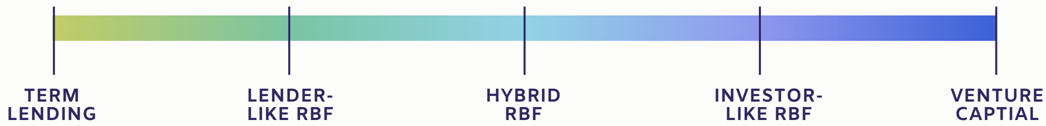
Greater alignment and shared risk between entrepreneurs and investors based on shared goals of revenue maximization and profitability can lead to sustainable growth and access to cheaper debt capital.

A variety of capital providers have adopted RBF to address capital access gaps and opportunities. CDFIs want to expand their investable universe of businesses in their communities and fund entrepreneurs who can’t access bank or equity capital. Some CDFIs have evolved into RBF lenders and added RBLs to their suite of financial products for businesses.

What types of businesses are a good fit for RBL?

For CDFIs that are interested in exploring RBF, they might start to look at businesses in their current pipeline, ranging from early-stage firms to established businesses with sustainable growth but that don’t qualify for term loans.

The RBF Spectrum



RBF is a methodology for repaying capital from borrower to lender. Most RBF providers share some variation of the following structure: borrowers repay lenders' principal plus a set fee, repaid on a recurring schedule as a fixed share of revenues, until the predetermined "cap" (principal + fee) is met. For CDFIs, these RBF offerings almost always resemble a loan structure.

In practice, however, there are a number of different RBF approaches—each with unique characteristics and goals. These approaches can be best envisioned on a spectrum, ranging from "Lender-like" on one end, closely resembling the common use of term loans, to "Investor-like" on the other, more similar to the risk and return profile for equity investors.

Differences in RBF approaches come from various underwriting and operational processes, such as deal selection, post-deal support, portfolio construction, and other factors, not the deal terms themselves. Most CDFIs offer "debt-like" terms with no equity rights for businesses, but implement and deploy RBF with a different philosophy ranging from Lender-like to Investor-like.

CHARACTERISTICS	TERM LENDING	LENDER-LIKE RBF	HYBRID RBF	INVESTOR-LIKE RBF	VC
Use of Funds	Broad, emergency funds, debt refinance, working capital and growth funding	Broad, less growth-oriented	Growth-oriented	Growth-oriented	Growth-only
TA Support	None to minimal	Minimal	Moderate pre + post investment	High-touch pre + post investment	High-touch post investment
Business Fit	Mature / established with recurring / predicatable revenues	Established but can tolerate fluctuating / seasonal revenues	Early to established revenue	Early revenue to growth stage	Pre-revenue to growth stage
Cost of Capital	**10-15% IRR**	**10-12% IRR**	**10-15% IRR**	**15-30% IRR**	**50%+ IRR** Assumes successful exit
Multiple	**1.2-1.4x**	**1.2-1.3x**	**1.2-1.4x**	**1.5-3x**	**10x+**
Underwriting Approach	Conservative	Conservative	Moderate	Risk-tolerant	Very risk-tolerant
Capital Access	High supply but high barriers to entry; minimal risk tolerace	Expanded risk tolerance + borrower pipeline	Suited for contract + project-based businesses	“Missing Middle” between loans + VC	Limited supply + high barriers to entry
Capital Stack	Senior debt	Senior to subordinated debt	Subordinated debt	Subordinated debt to mezzanine	Preferred equity
Collateral + Downside Protection	Substantial downside protection Yes: Personal and/or business collateral	Lender-like downside protection Assets for collateral, typically a UCC/blanket-lien	Blanket/UCC liens but typically no personal collateral.	Typically none	Typically none (unless we want to include pro-rata rights, preferred liquidity, etc.)
Historical vs. Future Cash Flows	Heavy reliance on past revenue + cash flow—needs to be consistent and predictable	Focus on historical cash flows	Shared focus on historical + future cash flows	Focus on future cash flows with baseline historical threshold	Heavy focus on future cash flows
Gross Margins	10%+	20%+	30%+	40%+	50%+
Growth Expectations	Minimal	Minimal	10%+ annual revenue growth	25%+ annual revenue growth	100%+ annual revenue growth
Profitability Expectations	At least near profitability	At least near profitability	Clear path to profitability within 3 years	Clear path to profitability within 5 years	Non-factor
Founder / Owner Credit Scores	Heavily weighed	Moderately weighed	Less weighed	Non-factor	Non-factor
Dilution	Non-dilutive	Non-dilutive	Non-dilutive	Non- to less-dilutive	Highly dilutive
Portfiolio Business Failure Rate	<1%	<1%	<3%	<10%	50%+
Other **Benefits / Solves for Traditional Underwriting**	N/A	Lenders + businesses have aligned incentives for business growth	Incremental product expansion for CDFIs + increasingly tech-enabled, low friction dilligence	Investor-like risk tolerance designed for all portfolio companies to succeed	Pre-revenue risk tolerance + fit for rapid growth businesses
Example Providers	CDFIs, Banks	Innovative CDFIs	Flexible Capital Fund, AltCap, Founders First Capital Partners	Indie.vc, Founders First Capital Partners	VCs, Angels

NO. ONE

Lender-Like RBF

Overview

Lender-like RBF has an underwriting and intake process most similar to a term-lending program. Providers of this sort of RBF are highly reliant on historical cash flows for underwriting, and typically won't fund a deal unless the borrower can demonstrate that their business already has the cash flows or net margins to sustain revenue-based payments beginning immediately.

These providers are also likely to employ more conservative lender-like underwriting practices, like reviewing borrowers' personal credit scores, business and personal tax returns, and other business financial documents. However, these data-driven under-writing needs provide an opportunity for scale. For example, lenders may decrease their reliance on formal business financial documents in favor of cash flow data obtained directly from bank account analysis. RBF offerings at the Lender-like end of the spectrum are best aligned with algorithmic underwriting practices based on analysis of bank account information, a key feature of RBF Software platforms like Ned.

Characteristics

BROAD USES OF FUNDS

Tolerance for uses of funds that aren't necessarily growth related, including debt refinance, working capital needs, repairs and main-tenance, and others. Because existing business cash flows are a critical metric for underwriting, these providers can feel comfortable with a borrower's ability to repay, even if the RBF capital does not **increase** business revenues.

DOWNSIDE PROTECTION

Relative to the rest of the RBF spectrum, Lender-like RBF is the least likely to offer grace periods at the beginning of the loan term, and is the **most likely** to consider assets for collateral; with lenders typically placing a UCC / blanket-lien as a minimum level of securitization.

Underwriting Problems Solved

While it may seem that Lender-like RBF represents only a minor shift from traditional business lending practices, RBF strategies at this end of the spectrum do have the potential to solve some of the most pressing issues in capital markets:

Expanded Risk Tolerance + Borrower Pipeline

Lender-like RBF offers a flexible debt product for entrepreneurs that serves both businesses that would qualify for term loans AND those who might qualify for RBF. Providers need to increase their risk tolerance beyond term loans, but it allows them to expand capital access to more businesses within their communities.

Fluctuating Revenues

It is better suited for businesses with irregular revenue cycles (seasonal businesses, traveling businesses, boom/bust businesses) than term loans.

Aligned Incentives

It can create aligned incentives for mutual collaboration to grow the business' revenues and increase business stability after funding.

Expanded Underwriting Criteria

This RBF approach focuses on historical cash flows over all other formal financial documentation and measures of borrower creditworthiness. If a deal can generate cash flow, and lenders can get comfortable with the stability/trends of historical cash flows, more borrowers can qualify for RBF than would otherwise be eligible for term loans.

Deal Volume

Because the overlap in business fit between Lender-like RBF and term lending is significant, there is a large total addressable market for RBF at this end of the spectrum. This high potential for deal volume means that Lender-like RBF providers have the opportunity to meaningfully change capital access at a large scale.

Competition at National Scale

High-volume, Lender-like RBF has the potential to compete with well-funded fintech platforms that have come to dominate this space (e.g. MCA providers). If Lender-like RBF can operate efficiently at scale, it can allow CDFIs and mission-driven lenders to compete at a national level with the size and pace of these fintech firms.

NO. TWO

Hybrid RBF

Overview

Hybrid RBF may be the most challenging to execute among the various RBF approaches, especially for an organization which already provides term lending at scale. This approach requires providers to adopt some investor-like processes and maintain some term-loan underwriting policies.

An example of a Hybrid RBF approach is **contract financing—a type of business financing that works as an advance payment on a secured contract**. In the instance where a business requires outside capital for costs related to executing on a pending contract, most capital providers often struggle to provide funding. For traditional lenders, contracts for future business revenues are yet-to-be-realized, and are too risky to serve as sufficient proof of revenues for a term loan. VCs would view the business margins, especially for one-off contract transactions, as insufficient for the sorts of meteoric returns that they require. As a result, many businesses don't engage in bidding on larger contracts that would enable growth, or, if they do raise outside capital to cover these costs, the capital is often poorly suited to the business' actual needs.

A Hybrid RBF provider is capable of underwriting against future revenues which have a high degree of security, like signed contractual agreements. Unlike more optimistic revenue projections accepted by Investor-like RBF providers, these future revenues are much more reliable, but the underwriting is still higher-touch and more speculative than the Lender-like RBF providers. The important distinction is the degree of confidence with lenders for future revenue growth - something that contractual or project-based revenue improves significantly.

Characteristics

GROWTH-ORIENTED USES OF FUNDS

It is intended for revenue growth and therefore has a narrower scope of uses of funds. For example, debt refinance, equipment repair and other non-revenue generating uses of capital aren't typically best suited for RBF deals at this point on the spectrum.

MODERATE DOWNSIDE PROTECTION

A general preference for some form of downside protection. With greater risk tolerance comes a higher degree of flexibility in terms of asset security / collateral—but many Hybrid RBF providers will still require some form of "skin in the game" from borrowers. It is unlikely that borrowers will be required to provide personal guarantees or list personal assets as collateral, but borrowers should still expect to see blanket/UCC liens and even asset-specific liens (for certain industries) as common terms.

Underwriting Problems Solved

Suited for Contract + Project-Based Businesses
Certain industries are especially suited for solutions like those presented by Hybrid-RBF, like construction contractors and subcontractors, whose work is typically project-based and who are generally responsible for the entirety of the project's costs long before receiving payment.

Incremental Product Expansion for CDFIs
Hybrid-RBF allows CDFIs and mission-driven lenders a low-risk pathway to financing businesses based on future revenues, due to the high degree of specific and risk-mitigating underwriting that is possible.

Tech-Enabled Diligence
Emerging trends in data-driven contracting platforms and tech enablement of invoicing means that RBF providers will have an increasing opportunity to lean on technology to assist with the underwriting of specific project-finance requests. As digital contracting systems proliferate, corporate providers of contracts can be assigned risk ratings based on past payment performance, enabling these platforms to be used as tools for lenders to access deal flow and increase transparency.

Future Performance Visibility
Hybrid RBF allows capital providers to better match the time frame of their expected returns with a business' revenues—something that neither longer term debt or equity capital providers can offer.

NO. THREE

Investor-Like RBF

Overview

Investor-like RBF most closely resembles the methodologies, frameworks, and operational structures used by equity investors. One key difference, however, is that Investor-like RBF allows capital providers to fund prospective, growth oriented plans for entrepreneurs, **without** demanding the kind of rapid revenue growth that VCs need. Providers of Investor-like RBF require revenue growth as a key component of their decision making, but, unlike VCs, their portfolio construction depends on the majority of deals growing at a modest rate and a low failure rate, as opposed to the VC approach where all deals aim for 100%+ growth rates with a high rate of complete failure.

Investor-like RBF providers are likely to encounter the highest organizational costs at the deal level, due to the high-touch nature of their pre- and post-investment support. Post-investment support is a feature borrowed from equity investors based on the slightly higher risk at the time of investment. Across the spectrum, RBF tends to align entrepreneurs and investors around the shared goal of growing revenues. As RBF providers become increasingly Investor-like with their approach - and therefore more risk-tolerant—this incentive increases, and investors can increase the likelihood of successful repayment with the technical assistance support they provide. While these providers will typically not require the sorts of controls that VCs tend to (i.e. board seats, voting rights, etc.), they can benefit from similar high-touch and highly-nuanced support for businesses. This can lead to higher per-deal organizational costs for providers.

Characteristics

GROWTH-ORIENTED USES OF FUNDS

The uses of funds will typically resemble those that equity investors provide financing for, especially growth. These uses can include business asset acquisitions, expansions, key hires, etc.

SPECULATIVE + UPSIDE ORIENTED

While Investor-like RBF providers will still include prior business financials and borrower information as a part of their underwriting methods, decisions are primarily based on the likelihood of business growth plans. Investor-like RBF is most likely to utilize grace periods at the outset of the loan term - anywhere from 90 days to 1 year in duration. These grace periods allow the growth capital to be put to work in order to grow revenues before revenue based repayments begin. As expected with greater risk exposure, Investor-like RBF will also tend to occupy the position of highest costs and highest write-off risks, relative to other RBF strategies.

Underwriting Problems Solved

Investor-like RBF addresses some of the high-risk and early-stage growth funding gaps that standard equity and debt capital don't:

Flipping the VC "Unicorn" Mentality
Investor-like RBF portfolios rely on a much higher average repayment rate than a VC model. VCs typically choose to reduce their focus on non-unicorn businesses, while RBF providers maintain incentive to support all businesses in their portfolio with sustainable growth over the loan term.

"Missing Middle" Between Loans + VC
Investor-like RBF would be well suited for a local business owner who aims to grow revenues by 3x over the next three years and is likely taking growth risks that a term lender wouldn't be comfortable with, but growth aspirations aren't high enough to attract VC.

Non-Dilutive Growth Capital
Funding growth can be risky and investors often require ownership in a company to compensate them for the risk. Investor-like RBF offers risk-tolerant growth capital with capped participation in the upside that allows founders to retain full ownership of their business.

Risk-Tolerant with Capped Upside
Investor-like RBF is highly risk tolerant but less dilutive and more optionality for founders than VC. It is used to fund businesses with prospective growth plans but, unlike VC, the RBF investors have capped returns and growth expectations are more moderate.

2023

Catalyze RBF Peer Group

In 2023, Catalyze organized a Peer Group of 10 CDFIs and mission-driven-lenders focused on piloting RBF strategies in their communities. Over the course of the year, Catalyze supported the establishment and deployment of a variety of RBF strategies across the US. Members of the Catalyze RBF Peer Group collaborated and shared best practices on RBF themes including: technical assistance, portfolio construction, underwriting, fundraising, data collection, and more.

Members of the 2023 Catalyze RBF Peer Group:

Allies for Community Business · AltCap · cic · CRF USA · DENKYEM co-op · Grow America · lendistry · LISC · tucson ida · WEPOWER

Year to Date*

AS OF AUGUST 2023

49

DEALS DONE FOR $4,640,000

–

~$95,000

AVERAGE DEAL SIZE

Planned*

Q4 2023 + 2024

150

DEALS WITH BUDGET OF $18,190,000

–

~$121,000

AVERAGE DEAL SIZE

4 PEER GROUP MEMBERS planning to deploy their first RBF check by the end 2023.

*Totals not including lending volume from peer group organizations that elected not to disclose

REPORT HIGHLIGHT

RBF Deal Case Studies

Anonymized RBF deal examples from the 2023 Peer Group, highlighting Investor-like, Hybrid and Lender-like deal characteristics.

Investor-Like RBF

Financing Rapid Growth for Metal Fabrication Startup

A husband and wife team recently transitioned their garage-based welding hobby into an official business. The metal fabrication business displayed strong early growth with a comfortable profit margin of 20% and an annual revenue growth of 44%. As demand increased, the founders needed to expand their production to a larger facility and required more sophisticated equipment. They sought outside capital to finance these growth-related costs; however, term lenders were hesitant to extend credit based on the following challenges.

Borrower Challenges

Lack of historical financials due to the age of the business (20 months of formal operations)

—

Lack of personal assets to collateralize loan capital

Solution

The couple was able to secure a revenue-based investment from a local capital provider. The Investor-like RBF invest-ment was a great fit for the couple based on the following:

Alternative Underwriting: The RBF lender based its decision on the couple's narrative, their historical welding expertise, and their business acumen, believing in their potential for success.

Flexible Financing: The $32k investment was made with a 1.28x cap and 6% monthly revenue share.

Adaptability: The repayment period was estimated at 23-38 months, on the shorter side of common RBF terms. The lender expressed a willingness to adjust terms if the business exceeded growth expectations.

Post-Deal Support: The lender remains highly involved by monitoring financials and collaborating closely with the founders to ensure a mutually beneficial partnership throughout the repayment period.

Hybrid RBF

Empowering Sole Proprietor Business through Contract Financing

A sole proprietor with a DJ business meets a CDFI through a local business support program. The founder recently secured a gig at a large festival, but required equipment upgrades and materials to meet the event's requirements, exceeding an amount he could cover with current cash flow or savings.

Borrower Challenges

Inadequate personal or business collateral

—

Insufficient business structure for typical loan underwriting

—

Heavy reliance on a single festival contract for future revenue

Solution

The local CDFI saw RBF as a possible solution for funding this entrepreneur who was otherwise unbankable, based on the following:

Alternative Underwriting: The RBF lender's underwriting focused on the contract revenue generated by the DJ's festival performance. The primary risk was the reliability of the contract's payor, a large festival organizer.

Flexible Financing: The DJ agreed to a repayment plan where the lender would receive 5% of gross revenues, which included his share of ticket sales from the festival prior to the actual performance.

Payment Flexibility: The revenue-based loan was structured in a way that allowed the borrower to continue making revenue-based repayments even after the contract revenue had been collected. The DJ intended to pay
off the loan early with subsequent business income, which the lender allowed without penalties.

Lender-Like RBF

MCA Refinance for Coffee Shop and Roasting Business

A coffee shop and roasting business took a Merchant Cash Advance (MCA) to purchase an espresso machine for $30k. As a result, the MCA provider was entitled to 15% of all of the business' sales until 1.4x of the principal was repaid. This cost created an unforeseen burden for the borrower, who found the additional 15% of gross revenues to hamper growth instead of fuel it, and potentially lead their business down a vicious debt cycle. They sought additional capital with better terms to pay off the MCA debt and stay open.

Borrower Challenges

High cost of MCA, which deducted a large percentage of all credit card sales

—

The need to secure a more affordable financing option to sustain operations with improved financial flexibility

—

Limited collateral and average credit scores made raising a term loan challenging, even from a CDFI

Solution

RBF was a strong and aligned capital solution for this coffee shop, and a CDFI was able to offer RBF based on the following:

Refinancing MCA with RBF: The lender opted to refinance the business' MCA debt with more affordable RBF. The RBF capital paid off the MCA, including a prepayment penalty. In return, the borrower agreed to repay 1.25x the RBF principal amount at a 6% monthly revenue share rate.

Financial Underwriting: The borrower's historical financials and business margins played a vital role in the underwriting process. Advanced software systems facilitated an assessment of the business' financial health. Eliminating the MCA debt expense revealed the business' sustainable profitability.

Affordable + Predictable Repayment: Unlike MCA financing, there was no pressure for rapid business growth. The borrower anticipated repaying the RBF on time without requiring changes to the business model.

Measuring the Impact of RBF

As RBF grows within U.S. capital markets, it will be important to understand the outcomes of RBF as a financial product, especially relative to the status quo options of term lending and VC. Many organizations in the CDFI and CDFI-adjacent industries (a category we broadly describe as "mission-driven lenders") see RBF implementation as a means to achieving additional impact outcomes beyond financial outcomes. Identifying, collecting and reporting on uniform "impact" metrics is more nuanced— especially within a siloed and dynamic market like RBF in the U.S.

In many cases, mission-driven lenders use RBF products to broaden access to capital for entrepreneurs who are underserved by traditional capital markets—typically following national trends of addressing racial, gender, and geographic inequities in access to capital. For mission-driven lenders interested in these economic inequities, there is a need to track RBF's "impact" metrics, beyond the purely economic measures of performance (i.e. repayment/default rates and internal rates of return).

While CDFIs are familiar with impact measurement, often driven by CDFI certification requirements, the industry lacks a common framework for tracking RBF's impact. In an effort to consolidate observations about the current state of RBF impact measurement and to propose a common framework for future measurement, we have collected the following observations from the 2023 RBF Peer Group:

RBF PEER GROUP METRICS

General Observations

Peer Group organizations are tracking basic borrower demographics, including:

- Self-identified race and/or ethnicity
- Borrower home address and business address
- Gender identity

Additional demographic variables are collected by some, but not all, including:

- Age
- Disability
- U.S. Veteran status
- Sexual Orientation

Most RBF providers do collect borrowers' FICO scores, but tend to place less emphasis on them for underwriting purposes

Basics of current business financials are collected by most:

- Year-to-date financial documentation: Balance Sheet, Profit & Loss Statement
- Monthly/annual recurring revenue report (if applicable)

Historical business financial information is collected by some, but not uniformly:

- Profit & Loss history, annual balance sheets, business and personal tax returns
- Prior attempts to access capital: successful and unsuccessful

Peer Group RBF providers track businesses' use of funds, but most do so in an anecdotal and irregular manner—often capturing this information in narrative form, without consistent terms or definitions, nor a unified method of reporting.

General RBF portfolio metrics are tracked by most, including total RBF deals executed and total dollars lent via RBF

Some Peer Group organizations have systems in place to document the internal or external source of an RBF deal

- Organizations that provide both RBF and term loans tend to document when
- a loan inquiry is moved from the term lending strategy to the RBF pipeline. However, few lenders maintain a consistent methodology of documenting the specific reasons for RBF instead of a term loan.
- Organizations that solicit RBF loan applications publicly make use of referral partnerships and consumer marketing to find qualified borrowers, and some,
- have consistent and replicable methods for tracking the sources of these borrowers' applications.

A Minimum Viable Impact Framework for RBF

Moving forward, it would serve the growing RBF capital provider space to adopt a uniform framework for RBF impact measurement. A working draft of an MVP impact framework is below, informed by our work with many RBF practitioners across the country.

A sustainable, standardized impact measurement framework for RBF must be:

Efficient for Capital Providers

Automated or at least heavily supported by technology (survey tools, data capture platforms, aggregation and organization of inputs)

Efficient for Entrepreneurs

Data collection should not create a reporting burden for business owners. Efficiency in reporting requirements leads to greater quality of responses and a better long-term partnership between lender and borrower - a key element of successful RBF.

Repeatable & Consistent

A simple, consistent data collection methodology, collected and reported over the full life cycle of individual deals and RBF portfolios in general.

Collected Comprehensively at the Time of Application

Baseline data on historical financial metrics and the borrower's growth plan/narrative are much more reliable if collected in real-time at application rather than back-filled afterwards. Understanding as much as possible about the full pipeline of RBF applicants at the point of application allows for analysis of the effects of the underwriting and selection processes.

General intake and application forms should act as data capture, not simply filtering mechanisms for moving deals through RBF underwriting pipelines.

MINIMUM VIABLE FRAMEWORK

RBF Impact Metrics

Our proposal: an industry-wide commitment to efficiently collecting and reporting on the following RBF metrics:

Deal-Level Metrics

BORROWER DEMOGRAPHICS

Self Identified Characteristics
- Age
- Race, Ethnicity
- Gender
- Sexual Identity
- Disability
- Veteran Status

Business and Borrower Locations
- Borrower Address
- Business Address

HISTORICAL FINANCIAL INFORMATION*

Years in Business

Primary Borrower(s) Credit Scores

Current Business Balance Sheet

Historical Capital Access Details
- Personal capital contributions
- Raised capital
- Failed attempts to raise capital (partially or completely unfulfilled)

Total Business Employment
PTE, FTE, CONTRACTORS

APPLICATION DETAILS

Proposed Business Use of Funds

Deal Source

Total Funds Requested

TIME TO CLOSE

Date from Initial Application to Deal Close

Estimated TA Time Spent with Borrower Pre-Close

RBF OUTCOMES

Business Growth Rate
MONTHLY, YEARLY

Business Employment
PTE, FTE, CONTRACTORS

Additional Capital Raised
- Capital source, terms
- Total capital raised, post-RBF deal

Portfolio / Fund-Level Metrics

TOTAL RBF INVESTMENTS

Average/median check sizes

Average/median % of revenues

Average/median cap rates

Average/median term lengths

RBF REPAYMENTS

Total repaid (gross and as a percentage of total invested)

Average annual revenue growth

Default statistics
- Late payments, by # and by total $ outstanding
- Late payments by days late (30, 60, 90+)
- Total write-offs by #, $, and overall rate

RBF TECHNICAL ASSISTANCE

Total RBF TA hours provided (annual, monthly, YTD)

Effective cost of TA hours provided

Average post-deal TA per RBF deal

BUSINESS OUTCOMES

Total and average business revenue growth

Total and average business employment growth

Total and average additional capital raised by RBF recipient businesses

RBF providers who implement an effective routine to capture and understand the above impact metrics will stand out as uniquely capable of drawing clear conclusions about the economic and social impact of their efforts. Without a critical mass of RBF providers collecting and reporting on these impact metrics, we cannot claim to have clear evidence of the broad-level impact of RBF, upon which much of the industry's excitement is predicated.

*BORROWER AND BUSINESS

RBF IMPLEMENTATION

Challenges + Resources

The RBF landscape has gained momentum over the past decade, but there are still barriers to entry and roadblocks for RBF to scale across the CDFI industry. Here is a list of the most pressing challenges that will need to be addressed for wide adoption of RBF:

ONE

Tech & Infrastructure

Lack of technology, service providers, CPAs, and attorneys specializing in RBF

TWO

Tax & Accounting

Limited guidance from the IRS on tax and accounting treatment for RBF

THREE

CDFI Regulations

Regulatory concerns for the CDFI industry related to RBF

FOUR

RBF Capitalization

Lack of funding for alternative capital products like RBF

RBF Tech + Infrastructure

CDFIs and mission-driven lenders have a reputation for operating thin-margin businesses, even the largest organizations. Unlike well-capitalized fintech firms or large, for-profit banks, CDFIs face the challenges of serving small and hard-to-reach businesses with relatively small budgets. Efficient operations are essential to the success of a CDFI, and the opportunity to offer RBF comes with opportunities for mistakes and operational inefficiencies. In order to stand up a successful RBF initiative, CDFIs will need to rely on third-party service providers with offerings tailored specifically for RBF. These options are limited today, but will likely grow alongside the RBF market over the next decade. Below are some examples of service providers that exist currently, and those which will be demanded as RBF scales, especially among CDFIs and mission-driven lenders.

ONE

Technology Solutions: SaaS (Software-as-a-Service) for RBF

RBF software solutions can handle everything from loan application and intake, to automated loan amount and underwriting decisions, all the way to portfolio management and repayment processing. An effective RBF SaaS product has the potential to save capital providers a significant amount of time, lower infrastructure costs, and create a streamlined process for borrowers. Two distinct options exist in the marketplace today:

Ned is a standalone, bespoke software solution built specifically for RBF providers. Its clients include many of the 2023 RBF Peer Group members. Its platform relies heavily on automations, and aims to dramatically increase the operational efficiency of RBF providers by reducing manual data collection and borrower communication.

LoanWell provides another RBF SaaS option which, unlike Ned, is built alongside its existing software product that serves traditional small business lenders. While its RBF software is still purpose-built for RBF operations, it is ultimately part of a larger business focused on serving term lenders. LoanWell can serve clients who provide both RBF and term loans.

As the RBF industry grows, and barriers to creating new technology businesses continue to lower, we will inevitably see more entrants into this market, and likely greater competition around prices and offerings.

TWO

RBF Tax + Accounting

Few providers of RBF-specific tax and accounting services exist today. Many RBF lenders work with local providers, in part due to concerns related state-specific lending laws. Regardless, there are few national-level organizations that provide tax and accounting services to RBF providers at scale—a major opportunity for innovation for this industry.

Annual audits for CDFIs and mission-driven lenders are typically either conducted by one of four major U.S. accounting firms, or by smaller, local firms with generalist approaches. This is unlikely to change in the near future, but is an example of the sort of service that could be integrated into the offering for tax and accounting providers that specialize in RBF.

THREE

RBF Underwriting Support

Outsourced underwriters are a common feature of many private lending institutions, especially with the deployment of products like RBF that are highly nuanced and require domain expertise. To date, no national institutions have offered underwriting-as-a-service for RBF providers at scale. However, there are standalone industry experts, a small group of whom have deep experience from the handful of RBF providers that have been operating at scale in the U.S. Examples include Bella Gangnes, an investment consultant with RBF lending experience from Lighter Capital and Founders First Capital Partners, or John Hamilton, a pioneer of RBF with more than 20 years of RBF experience at the New Hampshire Community Loan Fund. Consultants, like John and Bella, are available for hire on an hourly basis for deal-specific underwriting support and general RBF strategy consulting..

FOUR

RBF Legal Support

Several U.S.-based law firms have experience with structuring individual RBF deals and with supporting the formation of RBF funds. Among these providers, those with strong RBF reputations are: Carney Badley Spellman, DLA Piper, RPCK Rastegar Panchal, Dark Horse CPAs, and Blue Dot Advocates. Additionally, borrowers themselves may also need legal representation to help structure and understand accounting and tax treatment for RBF capital. One firm that supports businesses with these services is San Jose-based Early Growth Financial Services. As the U.S. market for RBF grows, so too will the demand for legal services.

FIVE

RBF Marketing + Communications

Entrepreneurial education and awareness is a critical bottleneck that could hamper RBF growth including the way in which capital providers market their RBF product to businesses. CDFIs and mission-driven lenders aren't marketing or public relations (PR) experts, but few marketing and PR firms are well-versed in the nuances of RBF. One noteworthy exception is Seattle-based marketing & PR agency DH. Their team has helped three Seattle-based mission-driven lenders with a comprehensive market analysis and rollout of their blended RBF rebranding strategy, and is available to support additional RBF providers nationwide.

SIX

Additional RBF Resources

Technology tools like Plaid make it easy to view borrowers' bank accounts, allowing for greater underwriting accuracy and increased efficiency with borrower communication.

National marketplaces for mission-driven lender capital, like CRF's Connect2Capital, will offer methods for borrowers to specifically shop for RBF capital.

RBF-specific content creators are adding information and clarity for both borrowers and providers, including resources for borrowers created by NextStreet, and community for providers like the Revenue-Based Financing Newsletter (RBFN) and its associated podcast series.

Catalyze's Innovative Finance Playbook contains a wealth of resources on RBF specifically, including case studies, sample term sheets, and more.

RBF Tax + Accounting

One of the challenges that capital providers face when considering utilizing RBF is the lack of clarity that exists around tax and accounting. There is little consensus from the CPA and legal community on how to treat RBF for taxes which will continue to operate in a legal gray area until the IRS clearly defines it in the U.S. tax code. Based on the RBF Peer Group and other RBF investors, we understand there to be **four commonly used methods for RBF tax and accounting treatment:**

ONE

Straight-Line with Final Adjustment

RBF investors use a simple forecast over the full term of an RBF loan term to straight-line principal and interest payments in the initial years and later adjust payments in the final year to align with actual revenues.

PROS

More simple and flexible approach for both investors and borrowers

CONS

Not scalable for investors, potential usury issues in the final year of RBF loan if borrower repays faster than expected + less alignment with IRS

i. Potential solution for usury issue—investors include APR cap to make sure borrowers are not paying back the RBF loan too quickly

EXAMPLE

3-yr RBF loan with 1.5x cap

Principal: 1x principal / 3 years = 0.33x principal / year
Interest: 0.5x interest / 3 years = 0.17x interest / year
Structure: commercial agreement
Yrs 1-2 | Straight Line: 0.33x principal + 0.17x interest each year
Yr 3 | Final Adjustment: 0.33x principal + 0.17x interest adjusted based on actual revenues

TWO

No Interest, Only Fees

This treatment approach is similar to “Straight Line with Final Adjustment”, except RBF investors charge fees instead of interest for borrowers. Similar to interest payments, RBF fees are deductible for borrowers. RBF investors shared an annual statement with borrowers to break out principal and fees.

PROS

More simple approach + Shariah-compliant financing

CONS

Legal and CPA community likely uncomfortable with loans with fees instead of interest

EXAMPLE

3-yr RBF loan with 1.1x cap (equal to 6.29% annual interest)

Principal: 1x principal / 3 years = 0.33x principal / year
Interest: 0.1x fees / 3 years = 0.033x fees / year
Structure: commercial agreement

THREE

Noncontingent Bond Method

Under this approach, interest accrues on the revenue-based loan as if it were a fixed-payment debt instrument with a comparable yield and a projected payment schedule. RBF investors issue a projected payment schedule at investment and then adjust accordingly at the end of every tax year to break out principal and interest. A positive adjustment results when the actual payment is greater than the projected payment and vice versa for a negative adjustment. Typically, a positive adjustment is treated as interest income by the investor and deductible by the borrower in the tax year; a negative adjustment reduces interest for the tax year and treated as an ordinary loss by the investor and ordinary income by the borrower, but only to the extent of prior interest accruals on the revenue-based loan by the investor or borrower and to the extent of any further excess, is a carry-forward to the next tax year.

PROS

IRS alignment + understood by most attorneys and CPAs

CONS

Less friendly for RBF investors and borrowers with more compliance complexity, less flexibility for tax treatment, and potential for "phantom income" where RBF investors or borrowers pay taxes on income they never received

EXAMPLE

3-yr, $100k RBF loan with 5% of gross revenues + 1.5x cap

Principal: projected payment schedule at investment and adjusted accordingly at the end of every tax year to break out principal
Interest: same process as above to break out interest

FOUR

Upfront Principal + Deferred Interest

This treatment approach takes a more aggressive stance on the RBF payment schedule where all principal payments are made upfront and then interest payments are made thereafter. Typically, this approach has been adopted by more equity-like RBF investors focused on seed- and early-stage businesses.

Equal principal payments upfront and then deferring interest payments thereafter

PROS

Tax mitigation strategy for earlier-stage businesses that aren't profitable at investment

CONS

More aggressive approach from IRS perspective

EXAMPLE

5-yr RBF investment with 3x cap

Principal: 1x principal / 3 years = 0.33x principal / year
Interest: 2x interest / 2 years = 1x interest / year
Yrs 1-3 | Upfront Principal: 0.33x principal each year
Yr 4-5 | Deferred Interest: 1x interest adjusted based on actual revenues each year

CPAs and attorneys will continue to offer various recommendations on the issue of tax and accounting treatment for RBF investors and borrowers, until the IRS clearly defines a standard. We encourage RBF investors and borrowers to consult with their tax attorneys and CPAs before making or receiving their first revenue-based loan, respectively.

Regulations for CDFIs related to RBF

CDFIs interested in offering or exploring RBF products should be aware of proposed changes to CDFI certification standards from the Treasury Department's CDFI Fund. These changes, proposed for adoption in 2023, aim to bring more rigor to the certification process to protect the CDFI brand and ensure CDFIs' community development mission alignment, with an emphasis on the provision of affordable and transparent financial products.

While standards are currently pending, CDFIs interested in RBF should be mindful of interest rate tests and disclosure requirements in the proposed certification standards. One question in the "responsible financing" section of the Annual Certification and Data Collection Report (ACR) asks: "does the reporting entity originate, purchase interests in, offer, market, or service small business loan products (including credit cards and purchased loans) that allow for an annual percentage rate in excess of 36%?" Applicants that do provide loans that allow for a rate over 36% would then be asked a series of secondary questions.

Other questions relate to disclosures of loan terms and payments. Item RFP 22 of the ACR asks whether the CDFI discloses in writing the periodic payment due, and Item RFP 25 asks whether the lender discloses in writing the APR of the loan.

Given the flexible nature of repayments for revenue-based loans, APRs and payments may fluctuate and may be uncertain at loan closing. Accordingly, CDFIs should carefully consult guidance from the CDFI Fund to ensure compliance with the proposed standards.

RBF Capitalization Strategies + Capital Sources

Mission-driven lenders interested in offering RBF products must ensure that their capital sources are aligned with end uses. Given the longer-term nature and flexible repayments of RBF products, this may require patient capital without recurring interest payments.

Public Capital

For organizations interested in public capital, the State Small Business Credit Initiative (SSBCI) may be a potential capital source. Enacted as part of the American Rescue Plan Act of 2021, the SSBCI program provides nearly $10 billion to states, tribal governments, and territories (collectively, jurisdictions) to support small businesses. Jurisdictions administer SSBCI programs within guidance set forth nationally by the U.S. Treasury Department.

SSBCI enables jurisdictions to choose among a range of credit support and equity programs. Credit support programs include capital access programs, which provide loan loss reserves; collateral support programs, which provide cash collateral to enhance borrowers' creditworthiness; partial loan guarantees; and loan participation programs, which enable jurisdictions to purchase a share of a small business loan or issue a companion loan alongside a private lender. Equity programs include direct equity investments and equity fund investments. More information on program types generally and state programs in particular is available on Treasury's SSBCI website.

As of October 2023, Treasury has not yet issued formal guidance regarding the use of SSBCI funds for RBF products. Currently, loans made under SSBCI credit support programs are subject to the National Credit Union's 18% APR cap. **The Nowak Metro Finance Lab published a playbook for entities interested in using SSBCI funds for RBF. That playbook is available on the Nowak Lab's website**.

While there is currently no official guidance from the Treasury on RBF, two state programs currently have characteristics of RBF products.

In Washington state, Grow America (formerly the National Development Council) has contracted with the state's Department of Commerce to operate an RBF pilot program in collaboration with Denkyem Co-Op and Business Impact NW. The program is intended to serve "underbanked communities across the state" and offers a Sharia-compliant capital product. Administering entities use a "true up" process to ensure compliance with the NCUA rate cap. The state has allocated $13 million for the pilot program, which is classified as a loan participation program.

Business Oregon's Royalty Loans program also has RBF-like characteristics. Targeted at traded sector firms unable to qualify for more traditional forms of financing, the program offers loans with repayments calculated as a percentage of sales. Loans of up to $1 million are available, with revenue shares on a deal-by-deal basis and a 2x cap. Repayment is expected over a three to five year period. As of September 2023, one royalty-based deal for a sustainable personal care product company had been completed with SSBCI funds. Before the current iteration of SSBCI, the program made two loans between 2019 and 2022 - one for a seaweed farming entity and another for a digital media company. The program, classified as an "other credit support program", received a $12 million SSBCI allocation split with the state's Angel Loans program.

Another potential source of capital is the U.S. Economic Development Administration (EDA) Revolving Loan Fund (RLF) program. RLFs are locally administered small business loan funds that are capitalized with a federal award from the EDA. There are currently more than 500 RLFs across the country that have made more than 45,000 loans and that have a combined asset base of more than $900 million. Seven years after receipt of their final award from EDA, RLF funds can become "de-federalized," providing increased flexibility that may make them suitable to capitalize local RBF initiatives.

Philanthropic Capital

Entities interested in establishing RBF programs may also source well-aligned capital from philanthropic institutions. As described in the Innovative Finance playbook, philanthropic entities have three main capital tools at their disposal, all of which could potentially capitalize RBF initiatives:

- grants, which do not need to be repaid;
- program-related investments (PRIs), generally below market debt aligned with the organization's philanthropic purpose; and
- mission-related investments (MRIs), or impact investments from the entity's endowment.

Philanthropy has played an important role in capitalizing several RBF initiatives. LISC's place-based products in Massachusetts and Colorado have both been supported by local or regional philanthropic entities. In Massachusetts, BayCoast Bank, Boston Children's Hospital, and Dana-Farber Cancer Institute have all provided resources. In Colorado, the product is supported by the Colorado Health Foundation.

CIC Tucson has capitalized their Success Through Alternative Capital (STAC) RBF program in part with support from Common Future, a national nonprofit intermediary that channels philanthropic capital to local partners. AltCap, a Kansas City-based CDFI, aims to provide capital to entrepreneurs overlooked by traditional markets through an RBF product funded by a $5.3 million PRI from the Kauffman Foundation.

Entities interested in leveraging philanthropic capital to support an RBF initiative should identify mission—and/or geography-aligned foundations to explore options.

Catalyze

GET IN TOUCH
hello@catalyze.community