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Overview of the State Small Business Credit Initiative

PRESENTED TO:

Assembly Committee on Jobs, Economic Development, and the Economy
Hon. Carlos Villapudua, Chair

Assembly Budget Subcommittee No. 5 On State Administration
Hon. Sharon Quirk-Silva, Chair

LEGISLATIVE ANALYST'S OFFICE

Businesses Have Unequal Access to Credit

Small Businesses May Have Less Access to Credit. Lending to small businesses generally is considered riskier, as they often have fewer assets, less credit history, and less established business models. In addition, evaluating a business's creditworthiness is costly and the fees and interest from a larger loan are more likely to offset these costs than a smaller loan.

Racial Disparities in Business Lending. Research has found that Black and Hispanic/Latino business owners face disproportionate challenges accessing credits. They face higher denial rates and tend to be offered smaller loans.

Community Development Financial Institutions (CDFIs) Focus on Lending to Underserved Communities. CDFIs are mission-based private financial institutions that provide financial services to traditionally underserved communities. There are 110 CDFIs across California.

Public Loan Programs

Various Public Loan Programs Aim to Improve Access to Credit. Federal and state loan programs make it easier and less costly for small businesses to borrow money. There are five common types of public loan programs.

Loan Guarantee. A public agency works with participating lenders to guarantee a portion of a business loan. If a borrower defaults on their loan, the public agency pays the guaranteed portion of the outstanding balance.

Loan Participation. A public agency directly lends money to businesses in partnership with a private lender. Typically, a public agency purchases a portion of a loan made by the lender or it makes a second loan to the same borrower that is subordinate to the first loan.

Collateral Support. A public agency pledges cash collateral for borrowers that otherwise lack a sufficient collateral.

Capital Access Program. A public agency insures portfolios of loans made by one or more lenders. Whenever a participating lender makes a loan, the borrower, the lender, and the public agency all add funds into a loan loss reserve fund. In the event that a borrower defaults on their loan, the lender files a claim to the loan loss reserve fund for the outstanding balance.

Venture Capital Fund. A public agency may either directly invest in a business or invest in other venture capital funds that, in turn, invest in businesses.

Federal Government's Role

Federal Government Is the Primary Source of Support for Small Business Lending. The federal government directly administers the most widely used small business loan programs through the Small Business Administration (SBA) and the U.S. Department of Agriculture (USDA). The federal government also is the primary source of funding for a variety of state loan programs.

SBA Is Lead Federal Agency for Aiding Small Businesses. The SBA administers a variety of programs to aid small businesses. Two major loan programs administered by SBA are:

- ***7(a) Small Business Loan Guarantee Program.*** The 7(a) program typically guarantees 75 percent to 85 percent of a small business loan.
- ***504 Certified Development Company Loan Program.*** The 504 program helps to provide long-term financing of real estate and heavy equipment.

USDA Farm Loans Tailored to Needs of Agricultural Industry. The USDA farm loan programs provide loan guarantees and direct loans to farmers, ranchers, and other agricultural businesses.

State Small Business Credit Initiative

Federal Program Funds State Lending Assistance Programs. The federal State Small Business Credit Initiative program (SSBCI), created in 2010, provides flexible funding to states to develop state lending assistance programs.

SSBCI 1.0. $1.5 billion in SSBCI funding was allocated to states in 2010. California received $168 million. Those funds have been committed but continue to be recycled as loans mature.

SSBCI 2.0. The federal American Rescue Plan Act allocated $10 billion for an additional round of SSBCI funds to states. California was awarded $1.2 billion.

Goals to Support Socially and Economically Disadvantaged Individuals (SEDI). SSBCI 2.0 rules set a goal for states to spend at least 49 percent of SSBCI funds to support SEDI-owned businesses. If California does not meet this goal, it's allocation would be reduced by $100 million.

SEDI Designation Based on Voluntary Self Certification. Participating businesses owners voluntarily certify that their access to credit is diminished due to a variety of factors, including race, gender, veteran status, limited English proficiency, or residence in an underserved community.

California's SSCBI Programs

SSBCI Provides Funding to Multiple State Programs. California's SSBCI funds are split evenly across two state agencies: the California Infrastructure and Economic Development Bank (IBank) and the California Pollution Control Financing Authority (CPCFA).

IBank Programs. IBank administers two programs.

- Small Business Loan Guarantee Program.
- Venture Capital Program.

CPCFA Programs. CPCFA currently administers two programs and plans to launch a third, a loan participation program, soon.

- California Capital Access Program.
- Collateral Support Program.
- Loan Participation Program.

Issues for Legislative Consideration

Meeting SEDI Goals. Voluntary certification process appears to be posing challenges for California meeting the federal SEDI goal. How can the state ensure it meets this goal?

Exploring Options to Further Expand Access During an Economic Downturn. What options, if any, does the state have within federal rules to further expand access to credit through SSBCI programs in the event of an extend economic downturn?

Considering the Use of Recycled Funds. Over the next few years, some funds from SSBCI 1.0 and state funded loan assistance will be freed up to be recycled into new assistance. Looking further ahead, beginning in 2030, the same will be true of SSBCI 2.0 funds. What is the best use of these recycled funds?