Localizing the State Small Business Credit Initiative
By
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Small business relief has been a key component of the federal government's historic investments to preserve Americans' health and livelihoods over the past year and a half. The Paycheck Protection Program alone has issued $800 billion in forgivable loans, which, by comparison, represents nearly 20% of the whole federal government's budget for Fiscal Year 2019. While the initial rollout was chaotic, these resources were vital for keeping many small businesses afloat through the pandemic.

As our national outlook now shifts from economic relief to recovery, the most significant program in terms of follow-on investment and inclusive growth is set to come online this summer: the Treasury will begin accepting applications from states for the State Small Business Credit Initiative (SSBCI).

Successfully deploying SSBCI funds and reaching a diversity of entrepreneurs will require states to harness the full energies of local networks and intermediaries. New statutory design allows for greater inclusion than the first iteration of SSBCI in 2010 (SSBCI 1.0). But new design does not ensure effective delivery. This will require a new modus operandi in many states. Below we highlight some of the best examples from SSBCI 1.0, and the lesson is clear: past program success constitutes a two-way street with states leveraging local leaders' knowledge, and local leaders leveraging states' scale.

Right now, the biggest challenge facing inclusive implementation is that many local stakeholders are not yet aware of how best to make use of SSBCI funds. This problem is compounded by the challenge of getting organized around the sheer scale of federal investments elsewhere in the American Rescue Plan (ARPA).

Our point is simple: to drive a recovery that expands opportunity and innovation, local leaders would be well put to think about ways they can maximize SSBCI usage. While "local" may not be in the program's title, its success will ultimately hinge on the hard-won efforts and institutional capacity of local leaders.

To that end, we review the general outlines of the program, highlight examples of success from SSBCI 1.0, and provide our guidance for maximizing the impact of SSBCI 2.0 funds in what follows.

I. "The Most Important Small Business Program You've Never Heard Of"

The first round of the SSBCI program was launched in the shadow of the Great Recession and tapped out in 2017. ARPA rebooted the program in 2021 – this time with seven times the funds. Though less discussed than other parts of the Rescue Plan, the $10.5 billion approved for SSBCI 2.0 by Congress and the Biden Administration this past March represents a golden opportunity for every state to massively invest in bottom-up, inclusive economic growth and to build entire small business ecosystems decimated by COVID-19.

Apart from SSBCI 2.0, ARPA allocated $350 billion in State and Local Fiscal Recovery funds directly to state and local governments. While relatively flexible, these funds must be used to mitigate the impacts of COVID-19 and to get communities back to a pre-pandemic baseline, limiting their use for growth-oriented investments. SSBCI 2.0 dollars, on the other hand, can be put towards a broad set of economic development uses focused on small businesses.

The primary ground rule of SSBCI 2.0 is that states should ultimately leverage these federal dollars so at least $10 of private small business financing is invested for every $1 of SSBCI funds deployed. In short, if it's potential is realized, SSBCI 2.0 will drive more than $100 billion in small business investment – a dramatic move from pandemic relief to post-pandemic recovery.

SSBCI 2.0 also offers states a chance to depart from the status quo. As we wrote in May, the Nowak Metro Finance Lab has partnered with Blueprint Local with support from the Economic Development Administration to identify and scale innovative models of small business finance so they better serve a broader diversity of entrepreneurs. With their requirement for private leverage, SSBCI dollars provide a key vehicle for states to try new products, to widen avenues for sidelined private capital to flow towards inclusive uses through crisis-tested CDFIs and other partners, and to stand up new capital intermediaries that break out of the strictures of traditional small business debt and equity products.

Federal lawmakers have taken preliminary steps to ensure that the SSBCI better addresses racial inequality. They amended SSBCI 1.0 to create a new $1.5 billion set-aside for socially and economically disadvantaged entrepreneurs; in addition, Tribal governments will directly receive their own SSBCI dollars. The legislation reserves a portion of each state's allocation for the very smallest of small businesses – those with fewer than 10 employees – which are more likely to be Black- and Brown-owned, often cordoned off from growth capital. Lastly, Congress created a pot of $1 billion in competitive funds to be allocated by the Treasury in future years based upon states' ability to reach historically excluded entrepreneurs.

These public provisions are the tip of the iceberg for potential investment in closing the racial wealth gap through entrepreneurship. Deployed well, the SSBCI can leverage the billions in corporate, philanthropic, and other institutional commitments made towards redressing racial inequality over the past year.

While the program's design inspires hope, critical questions about delivery remain. Exactly *how* will the dollars reach Black and Brown communities? Which kinds of capital programs will states choose to fund? More fundamentally, will states take this opportunity to break new ground and reach segments of the market historically excluded by traditional finance – overly rigid bank loans and venture capital concentrated on the coasts? The degree to which delivery meets the moment will ultimately rely on the hard, and often unseen, work of state allocating agencies, capital providers and local ecosystems.

The program's past life gives us reasons for optimism. SSBCI 1.0 was remarkably effective: it nearly achieved a cumulative program leverage ratio of 8:1 for every dollar allocated and created or retained roughly a quarter of a million jobs! Analyses of the program give us an indication of what went right in local delivery. The bottom line: States that quickly and effectively deployed SSBCI 1.0 had existing channels – private, public, or mixed – or decisively stood up new entities through which capital could flow. These capital providers, at their best, were locally grounded with deep community networks.

II. Five Lessons for Successful Delivery from SSBCI 1.0: What Went Right?

By virtue of delegating deployment decision-making to the states, SSBCI 1.0 took a "thousand flowers blooming" approach to policymaking. This led to many innovations in reaching under-served businesses and entrepreneurs. Distilling lessons from the Treasury's past reports, we find one common thread: the effective deployment of funds usually required a strong network of local intermediaries. The best community lenders knew their neighborhoods, and states that leveraged and empowered community-based entities performed best in reaching historically under-invested neighborhoods and entrepreneurs. State and local leaders used one — and often a combination of — the following methods for delivering SSBCI 1.0 successfully.

1. Tap into existing networks of capital providers

Many states successfully utilized existing capital provider networks to leverage SSBCI 1.0 for investment. A decade later, the same dictum holds: policy favors the prepared.

Pennsylvania, for example, benefitted from its previous support of its CDFIs. To reach specific under-served communities (urban and rural) with SSBCI dollars, the state issued a request for qualification (RFQ) for state-certified Area Loan Organizations and CDFIs covering specific geographies. Though the RFQ process proved time-intensive, state officials maintain that the vetting process generated high-quality partners and outcomes.

Kansas had an extensive, pre-established vehicle called NetWork Kansas. This network had more than 500 partner organizations across the state: business chambers,

local SBA and USDA arms, university centers of excellence, improvement districts, and a diversity of other entities. The state contracted with NetWork Kansas to oversee the state's SSBCI venture and loan funds. NetWork Kansas, in turn, deputized regional certified development companies (CDCs) to underwrite, close, and service loans. This arrangement gave Kansas numerous benefits: wide geographic reach, exceptional private leverage, and strong presence in under-served communities.

Montana took similar steps to Kansas and Pennsylvania. The state channeled funds through its existing loan participation program partners, using a program that had been operating for four decades. Funds were awarded to CDFIs and non-CDFI loan funds on a first-come, first-served, per-project basis, encouraging swift disbursement. Partners were also able to keep all funds successfully returned, incentivizing prudent lending.

West Virginia represents a unique and powerful model. The state deployed SSBCI 1.0 through its own, 19-year-old public venture capital fund: the West Virginia Jobs Investment Trust. This fund successfully deployed SSBCI equity investments in a state not known for venture capital, supplemented by its highly successful Capital Access Program.

2. Stand up new networks

Not every state has a comprehensive network of small business support organizations, let alone entities with the capacity to underwrite, service, and monitor loans. Some states used SSBCI 1.0 as an opportunity to establish new networks, to great benefit.

Georgia lost many of its community banks during the Great Recession. As a result, the state saw SSBCI funds as an opportunity to stand up a new network by establishing its Funding for CDFIs program. The state contracted with six CDFIs covering the entire state based upon their track record for reaching and providing technical assistance to under-served entrepreneurs. Under Georgia's program, the CDFIs were responsible for marketing, identifying potential borrowers, and recruiting participating banks for low-interest loans. From beginning to end, the CDFIs and Georgia's Department of Community Affairs (the state's lead SSBCI entity) along with the Georgia Department of Banking and Finance and the Georgia Bankers Association, worked closely to design the capital products and conduct outreach among the local lenders for the program. Further, like Montana, Georgia's CDFIs were able to retain funds as borrowers made payments and returned interest. This had a double-impact: it encouraged smart lending and grew the state's future CDFI ecosystem and balance sheets. As of 2015, Georgia had quickly deployed its initial allocation, and invested nearly half its dollars in low-and-moderate-income (LMI) areas, above the national program average.

West Virginia similarly forged a new regional network of economic development agencies for its loan products. This network represented a broad mix of focused economic development agencies — three statewide, three regional, and one county–– in addition to one industry-specific agency (focused on health care). Alongside this, agencies represented a mix of institutions: public authorities, certified development

companies, and other alternative types of lenders. Again, agencies retained payments on SSBCI funds, fostering a virtuous cycle of investment. West Virginia supplemented its SSBCI funds with state-funded marketing dollars to better reach lenders across the state. These public efforts spurred philanthropic support, with a supporting grant coming from the Claude Worthington Benedum Foundation to provide technical assistance to train-up businesses applying for funds.

3. Create new, evergreen, funds

Georgia, West Virginia, and Montana encouraged smart and efficient lending by allowing third-party lenders to keep and reinvest SSBCI funds. These states' experience underscores the importance of using SSBCI funds to stand up new small business investment vehicles, especially for under-banked and -capitalized states. Colorado and Alaska capitalized *publicly-backed evergreen* funds to do just this – both of which are still operational today.

Colorado has been quite successful with its Cash Collateral Support (CCS) program. The state fed its $17 million allocation into the program, from which local CDFIs, rural banks, revolving loan funds, and non-SBA lenders with more flexible terms, could tap into to support loans for small entrepreneurs across the state. With CCS humming through an extensive delivery system, Colorado was the first state to expend its SSBCI 1.0 allocation. The fund continues to serve Colorado entrepreneurs, sustained by its low fees and interest payments and incurring zero losses thus far, creating added flexibility headed into SSBCI 2.0.

Anchorage, Alaska[1] was successful in capitalizing an angel fund. SSBCI 1.0 offered an anchor for venture investment that could crowd-in sometimes disparate angel investors. This presented states with an opportunity to bring typically more risk-loving angel investors under one geographically-focused roof, and create programming to match. Anchorage capitalized its 49th State Angel Fund (49SAF) with SSBCI dollars. This then-new fund provided risk capital, first and foremost, but also eventually fostered the state's entrepreneurial ecosystem, provides networking opportunities, and hosts pitch competitions, among other programs. The fund is still operational today.

4. Provide wrap-around services

[1] Anchorage applied in lieu of the state of Alaska, which withdrew its SSBCI application, an action allowed by the statute for municipalities within states that rejected SSBCI funds; North Dakota and Wyoming also declined SSBCI 1.0 dollars.

Many businesses need much more than capital. Getting businesses capital-ready often requires VC-level coaching and technical assistance. Some states were able to successfully pair SSBCI 1.0-funded capital products with wrap-around services that expanded programs' reach into historically marginalized neighborhoods and improved businesses' odds of success (and repayment). All these wrap-around services can be expanded as SSBCI 2.0 includes a new $500 million set-aside to support state Technical Assistance (TA) efforts.

Georgia, by establishing its Funding for CDFI program, is exemplary. In addition to microlending programs, CDFIs often also offer a suite of technical assistance services, buttressing their capital products. Georgia contracted with its new network of CDFIs based upon their existing TA infrastructure and record for reaching MWBEs and other under-served and under-capitalized communities. This practice paid dividends as the state was able to track MWBE lending and to reach 20 of its most economically challenged counties.

Kansas was also a leader through its NetWork Kansas program discussed above. The extensive network provided by the NetWork Kansas program had built in wraparound support and driving impressive results: by dollar amount, 73 percent of the SSBCI loans were deployed in rural counties, as were an exceptional 26 percent of venture investments.

West Virginia, on the other hand, utilized the philanthropic dollars discussed above to help businesses become application-ready. This created a pipeline of previously excluded and more diverse entrepreneurs.

5. Develop Innovative public-private funds

SSBCI funds allowed states to innovate and create their own fit-to-purpose funds. As we're seeing in our partnership with the EDA and Blueprint Local, small business finance is far from a one-size-fits-all enterprise, and businesses don't grow through a strict yet widely practiced debt/equity binary. This means variety is key to success.

Kentucky used its SSBCI dollars to support Mountain Association for Community Economic Development (MACED), a CDFI focused on strengthening Central Appalachia through sustainable development, especially energy and forestry conservation. MACED created a collateral support program that unlocked new energy-efficient projects, especially for small-scale operations. For example, the added collateral support helped a grocery store in rural Perry County refit its refrigeration and lighting. Grocery stores, for context, operate on notoriously thin margins, and so the energy savings had a significant impact on the business's profitability. MACED helped bolster local businesses' bottom lines, but also advanced environmental and social goals.

New York used SSBCI funds to create a type of loan guarantee program wherein the state could offer added bond surety for state and local government contractors, allowing them to scale and tap into lucrative public contracts. As we have previously written, contracting is an industry with relatively high and growing numbers of minority- and women-owned firms. New York's program was marketed through local networks – state and local agencies, chambers, and advocacy groups – to reach current and potential MWBEs. This program was part of Governor Andrew Cuomo's push to double MWBE state contracting, announced in 2011. By 2014, MWBE representation in state contracts had rapidly increased from 9.2 to 21 percent.

III. Seven Ways to Localize and Maximize SSBCI 2.0

Building on the lessons from SSBCI 1.0, we offer the following advice for states and locals looking to maximize the incoming SSBCI 2.0 funds. We want to underscore that while decision-making responsibility ultimately resides at the state level, effective delivery constitutes a two-way street: states need a variety of local intermediaries to get capital to entrepreneurs, and local leaders will need to connect with states in order to benefit from SSBCI 2.0 capital investment and effectively design programs for wide use.

1. Local leaders should contact states *now* about funds (and vice versa)

State and local officials should be working closely to make sure that (1) states effectively deliver funds through local intermediaries, and (2) capital is able to reach historically excluded entrepreneurs, especially in Black and Brown neighborhoods and rural areas. If done right this partnership leads to a virtuous cycle: states can leverage locals' knowledge, and locals can leverage states' scale.

Local leadership can take various forms: mayors, small business-focused nonprofits, public authorities, chambers (e.g., Black, Latino, Asian-American), and CDFIs (NetWork Kansas, mentioned above, exemplifies this potpourri of local intermediaries). If local leaders have not yet heard about SSBCI funds (we've heard this from many), they should reach out to responsible state agencies ASAP (the most recent list we could find is current as of 2017 and may now be outdated).

This street goes two ways: responsible state agencies should be ready to engage – and be engaged by – local leaders ready to deliver SSBCI-backed capital products.

2. Know that success hinges on the strength of local intermediaries

In SSBCI 1.0, some states had pre-existing networks they could plug into (Kansas and Montana), while others knitted together and bolstered new networks with SSBCI funds (Georgia and West Virginia). All successful states had one trait in common: strong local partners able to deliver funds. This is a vital lesson for success in SSBCI 2.0.

Until state leaders can picture how exactly capital will flow, the Who (capital providers) and the What (capital products/terms sheets), their plans are incomplete. If they have not done so already, states should begin mapping their capital landscape and identifying opportunities to scale existing operations and build new ones, if necessary, with SSBCI funds. This is eminently doable, as the SSBCI 1.0 examples demonstrate. Likewise, as the Georgia case demonstrates, local intermediaries have a role to play in program design, working with states, to deliver appropriate capital to their communities.

3. Try a little bit of everything, don't put all your eggs in one basket

With 7x the funding as SSBCI 1.0, states can afford to implement a range of capital products for a full spectrum of entrepreneurs from loan loss reserves for small loans to venture capital investments in potential billion-dollar unicorns. There is a continuum of small businesses that exist and they have a continuum of capital needs. It would be a tremendous missed opportunity if all this public money went into merely one or two products.

States should plan and build out accordingly. Local leaders should showcase their work and potential capacity to states. But both should also be responsive to their needs and local conditions. For example, VC may only currently serve a subset of entrepreneurs with limited spillover to other neglected parts of the economy. Similarly, dedicating most of a state's funds to loan guarantee programs, for example, may serve only a small range of businesses — missing other firms entirely — and additional dollars could be put to better use elsewhere (e.g., collateral support programs for working capital). In fact, SSBCI 2.0's mandate for targeting high-need businesses almost necessitates the use of a multiprogram strategy, supplementing lower-leverage but high-impact programs with higher leverage VC investments in order to blend and reach the target 10:1 leverage ratio.

SSBCI 1.0 demonstrated a clear delineation between products. Loan loss reserves supported the smallest businesses. Loan guarantee programs and collateral support programs supported scaled this to larger, more sophisticated enterprises. This scaled all the way up to larger loan participations (see Table 1). Between supporting different businesses' capital needs and providing venture equity investments in companies aiming for exponential growth, states have a full buffet of capital support options.

Table 1: Median Loan Principal Supported by Program:

Capital Access Programs: $14,800
Loan Guarantee Programs: $200,000
Collateral Support Programs: $305,000
Loan Participation Program: $495,000

4. Try something innovative.

SSBCI funds will allow for experimentation. Beyond the different flavors of SSBCI products mentioned above, states such as New York and Kentucky demonstrated innovative takes on these program designs, focusing on addressing specific local needs. States can advance a policy priority – racial justice or climate action – through dollars and cents lending.

But there are even more models. As we're identifying in our work with Blueprint Local and EDA, emerging capital products encompass a wide range of new models: revenue-based investments, near-equity designs, and receivables financing. States should take this opportunity to investigate and work these new models and their promise for better-fitting capital into their SSBCI proposals.

This is states' chance to broaden their reach and break new ground. If done right, new models could become regularized, evergreen funds. Local leaders should show their work to states here as well. They may already be onto something, and now is the time to build capacity for and scale a range of capital products.

5. Direct additional state/local/private funding to technical assistance and administrative overhead, if possible

In SSBCI 1.0, states showed notable creativity in matching capital products with technical assistance. They achieved this through CDFIs, local chambers, and other support organizations on the ground. This created virtuous cycles of more capital-ready applicants and, in turn, borrowers more able to repay loans and, most importantly, strengthened cycles of local economic growth.

In addition to utilizing on-the-ground partners, states identified companion funds to provide TA support. They did this through supporting state programs or philanthropic dollars. For SSBCI 2.0, supplemental funding to cover technical assistance and administrative costs, such as fund management fees, may not only magnify the effect of SSBCI funds, but will also ease states' federal compliance burden. Instead of needing to document and report out on responsible use of funds for other activities, states can streamline operations by feeding all SSBCI dollars directly into loan and equity products. Clearly, though, this is a wish list item and not a must-have, and this funding could enhance the $500 million SSBCI 2.0 allocation for TA.

6. Lean into the leverage to achieve social impact

The SSBCI 2.0's emphasis on leverage is very good for states in three key ways.

For one, the rise of more mature CDFIs and a burgeoning impact investment movement now offer significant opportunities for private leverage. By partnering with CDFIs and other local lenders, states can count existing CDFI private funds *and* deal-specific bank

or other dollars towards leverage totals (e.g., counting CDFIs' participation in a deal on top of the private capital bank loan brought in through an SSBCI collateral assistance deposit). In addition, the impact investing sector has grown exponentially since SSBCI 1.0 and presents similar and significant opportunities for plug-in private capital. Given SSBCI 2.0's design, states will want to perform well on private leverage to stay in the game for future, competitively awarded SSBCI allocations from the Treasury.

Leverage also can benefit states in a more specific way: matching loan loss reserve programs. SSBCI 1.0 only matched private contributions to loan loss reserve programs at a 1:1 ratio. This was low compared to existing state match programs. Worse yet, banks and states couldn't commingle existing loan loss reserve funds with SSBCI dollars. Funds had to be raised *de novo*. As a result, even the most effective states struggled to implement loan loss reserve programs and many opted for other products.

Treasury may change these rules for SSBCI 2.0 in their upcoming guidance. If Treasury makes this change, it will unlock capital for a product (loan loss reserves) that is more likely to reach small, under-served businesses, and support jobs based on available data from SSBCI 1.0.

Lastly, the Biden Administration has rightly targeted CDFIs and Minority Depository Institutions (MDIs) as key purveyors of capital in under-served markets. New funding for CDFIs and MDIs further expands the possibility for leverage – and in pursuit of more equitable public policy aims. The Consolidated Appropriations Act of 2021 set aside $12 billion for CDFIs and MDIs, with $3 billion going to the CDFI Fund and $9 billion towards establishing the Emergency Capital Investment Program (ECIP) to grow lending and long-term, low-cost equity products for small and minority businesses and consumers in financial services deserts. This was intended so these firms have access to the capital they need to start and grow a business.

The CDFI Fund is continuing to award dollars with its $3 billion application. It is largely going about this through its newly-created Rapid Response Program and its Emergency Support and Minority Lending Program which targets CDFIs reaching underserved neighborhoods and Black and Brown entrepreneurs. These dollars further expand balance sheets of CDFIs working where traditional banks won't go. Treasury recently stopped accepting applications from CDFIs and MDIs for dollars from the $9 billion ECIP bucket. Depending on forthcoming guidance these funds may not count as private dollar leverage, but states should pay attention to these allocations and tag team potential CDFI and MDI funds to their local intermediaries with their incoming SSBCI funds.

7. Communicate and coordinate with Tribal governments.

One new feature of SSBCI 2.0 is its direct allocations to Tribal governments. Pooling resources to reach underserved Indigenous populations can benefit both Tribal communities and Tribal members within neighboring communities. This won't be a broad-based recovery without Tribal success. Working closely with Tribal governments can only deepen the cultural competency of services and products offered by states, and if funds are pooled, could amplify these new SSBCI investments from Tribal governments. This would defray risk and increase investments at scale – especially in communities long excluded from federal programs and small business investment.

SSBCI 2.0: An Opening Bell for Inclusive Investment

As its name suggests SSBCI is a program implemented through the states. But it magnifies what's true for other federal investments: their effectiveness and broad-based impact ultimately depends on the strength of underlying local ecosystems. Specific programs and pools of money come and go, as we saw with the parade of SBA-directed Covid support programs. Lasting impact, on the other hand, is made by ecosystems and local leaders that can direct resources, connect entrepreneurs and projects with quality capital, and provide coaching and technical support for sustained success. Local ecosystems are the gift that keeps on giving.

As is so often true, the federal government designs policy and locals deliver. The SSBCI is a special case in point since it implicates multiple layers of government and multiple sectors of the economy to drive inclusive growth. As with SSBCI 1.0, effective delivery of SSBCI 2.0 will be a two-way street: *states need a variety of local intermediaries to deliver capital to entrepreneurs, and local leaders will need to connect with states in order to achieve scale*.

Building back better through SSBCI is a chance to do things differently. If done well, states' chance to broaden their reach and break new ground — providing new capital products to new types of entrepreneurs who have previously been locked out of the economy. These new models and funds could become regularized and evergreen. This work will not happen by itself, but we are hopeful about the prospects of SSBCI, alongside the EDA's newly announced suite of programs, to spur a recovery that brings along more neighborhoods, entrepreneurs, and industries.

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The Treasury's SSBCI website and archive, along with CDFA's SSBCI Resource Center, offer in-depth descriptions, reporting, and best practices for policymakers and practitioners looking to implement SSBCI programs. These resources provided much of the research for our analysis, and we encourage others to extensively refer to the information they provide.

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