Bottom line: Very small businesses in highly impacted industries with lower credit needs aren't addressed in current legislation aimed at helping small firms impacted by COVID-19. They need debt relief, and many will fail, with or without additional capital. CDFI small business lenders are the logical place to focus efforts to address the crisis. By addressing CDFI small business portfolios immediately, a 6x increase in lending for every dollar spent is made possible across all industries.

The COVID-19 pandemic and required social distancing are wreaking havoc on small businesses through no fault of their own. They are strong entrepreneurs that could help rebuild the economy in the years ahead, but instead will have a loan default or unpayable debt on their personal balance sheets.

Proposals from Congress to combat the problem include additional emergency loans, loan guarantees and loan forgiveness if businesses maintain employees. For larger businesses where additional cash flow alone can tide them over, these loans may help. For smaller businesses, or those with massive drops in revenue, a gap likely remains. Additionally, while a channel through SBA 7a is broad and helpful, it will not reach businesses needing smaller loans or who fall outside the strict SBA scoring model or distribution channels.

Demand for credit under $100,000 is highest among black-owned, Hispanic-owned, and women-owned firms.[1] With no revenue and ongoing expense needs for an extended, and unknown period, many will fail. More than half of small and microbusinesses have less than 15 days of cash buffer.[2]

CDFI small business lenders have played a prominent role in filling the gap in small dollar loans, disbursing hundreds of millions of dollars per year before the present crisis.[3] Aiding these lenders as their balance sheets deteriorate will position them to grow rapidly and address the needs of smaller businesses, especially those owned by women and people of color. Any solution that provides payment relief to borrowers but leaves the loans on CDFI balance sheets will significantly hamper a response. If we do not act now, 25-75% of loans on the balance sheets of CDFI small business lenders are likely to default or slow pay, critically weakening a critical channel to serve small businesses.[4] CDFI small business lenders grew significantly in previous recessions to aid entrepreneurs; if a program had been targeted toward the challenged loans they held they could have grown more and allowed low-income individuals and communities to benefit more greatly from the last recovery.

A solution that can scale quickly: The Federal Reserve can work with Treasury to create a special purpose vehicle (SPV) to acquire all loans[5] in the industry categories listed below from CDFI small business lenders

[1] 2017 and 2019 Small Business Credit Survey
[2] https://institute.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/institute/pdf/institute-place-matters.pdf
[3] New Fintech lenders are retrenching and have never faced a recession. Non-profit lenders are best positioned to meet these business needs, which typically require subsidy to deliver broadly.
[4] Review of portfolios from Opportunity Fund, DreamSpring, Justine Petersen, Accion Chicago, LiftFund, and Accion East.
[5] Only loans to businesses with a business purpose. Not to include 7a loans.

through a nonrecourse participation structure where servicing remains at the CDFI, ensuring the client interaction and communication remains local and no transfer process is needed. Loans will have been current as of March 1st to ensure the efforts focus on businesses that have been impacted only as a result of the pandemic. The SPV will pay CDFIs 90% of the loan face value in exchange for all future principal and interest payments. CDFIs who sell, must sell all loans in the industry groups chosen.

At the time of acquisition by the SPV, CDFIs will have clients sign new documents with the following terms: monthly payments of $10 for 6 months (to ensure continued connection to the borrower), interest-only payments for months 7 -12, interest rates of 5.5%, and terms of 10 years or more. The SPV will pay CDFIs $20/loan/month for servicing active loans for the first 36 months, and then $2/loan/month thereafter. There will be no prepayment penalties. The SPV will take advantage of, or mirror the approach with tailoring for small firms, any forgiveness program currently contemplated in legislation.

The impact of this effort would be immediate (15,000-20,000 businesses) and lay the groundwork for a much faster recovery while preserving the important financing provided by CDFI small business lenders.

Vehicle: This could be set up as a partnership between the Fed and Treasury that could also be used to support other SPVs related to small business lending. The Fed could use 13(3) authority to lend to a broad class of SPVs designed to buy high risk small business/micro loans, and Treasury could provide a first-loss backstop. Treasury's backstop would be from the Emergency Stabilization Fund (ESF)--the same fund used to backstop the Fed's MMLF facility for money market funds.

Legislative request: "The ESF is authorized and is hereby appropriated $50 Billion to support small business lending and $1 Billion to support CDFI small and micro business lending."

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List of industries and NAICS codes:

1. **48-49, Transportation and Warehousing**
2. **61, Educational Services**
3. **71, Arts, Entertainment, and Recreation**
4. **72, Accommodation and Food Services**
5. **44-45, Retail (to exclude liquor stores, tobacco stores, gas stations, pharmacies, and warehouse stores)**