

# Capital Program Policy Guidelines for the State Small Business Credit Initiative



## CDFA'S ANALYSIS

On November 10, 2021, the U.S. Department of the Treasury (Treasury) issued [Capital Program Policy Guidelines](#) for the [State Small Business Credit Initiative](#) (SSBCI). This guidance builds upon the original SSBCI program, first funded in 2010, and provides clarity to state agencies (inclusive of states, Washington, D.C., U.S. territories, and Tribal Governments) responsible for the deployment and management of SSBCI funds as well as other SSBCI program stakeholders.

*The Capital Program Policy Guidelines* cover a wide range of topics. Notably, it outlines requirements and considerations for state applications, and states that Treasury will evaluate the operational capacity, skills, and experience of states' SSBCI teams when determining program eligibility. Updated guidance does not cover the technical assistance component of the SSBCI program. Technical Assistance Policy Guidelines are forthcoming.

CDFA's analysis of the November 2021 Capital Program Policy Guidelines is meant to provide a high-level overview of key provisions and is not comprehensive of all updates and changes to the April 2014 policy guidelines. View [Treasury's dedicated SSBCI webpage](#) for full program details.

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### TRANCHING AND DEPLOYMENT OF FUNDS

The updated guidance includes benchmarks and requirements pertaining to the transfer of SSBCI allocations to states, when programs must be positioned, and capital deployment.

- States will receive their main allocation in three disbursements as follows: 33 percent, 33 percent, and 34 percent. The transfer of the first 33 percent will occur promptly following the receipt of the fully signed Allocation Agreement.
- A state must demonstrate that two criteria have been met prior to receiving subsequent disbursements.
  - At least 80 percent of current funds must be expended, transferred, or obligated. Treasury provides examples of what activity constitutes “expended, transferred, or obligated”.
  - Funds have been allocated to or for the account of one or more approved state programs that have delivered loans or investments to eligible businesses; at least two transactions with eligible small businesses must be completed during every 12-month period from program inception.
- The SSBCI statute requires that a CAP or OCSP be fully positioned within 90 days of the execution of the Allocation Agreement to act on providing the kind of financing support that the CAP or OCSP was established to provide.
- Each state must use at least 90 percent of its capital allocation for loans, investments, and other credit or equity support for small businesses headquartered in their state.

### REALLOCATION AND TERMINATION OF UNALLOCATED FUNDS

The updated guidance outlines deadlines for SSBCI allocation transfers to states, and provides details on the treatment of unallocated funds.

- The second and third tranche of funding must be transferred to the state before the end of the 3-year period and 6-year period, respectively, beginning on the date that the state is approved for participation in the SSBCI program.
- Any portion of a state's allocation that has not been transferred by these deadlines may be deemed to be no longer allocated to the state and no longer available to the state. Unallocated funds will either be returned to the general fund of the Treasury or reallocated to other states.

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### TARGETED FUNDING

The American Rescue Plan Act authorized three funding set-asides to ensure access to capital for micro-businesses and businesses owned and controlled by Socially and Economically Disadvantaged Individuals (SEDI).

- \$500 million formula allocation for Very Small Businesses
- \$1.5 billion formula allocation for SEDI-owned businesses
- \$1 billion incentive allocation for SEDI-owned businesses

#### **Eligibility: Very Small Businesses**

A Very Small Business (VSB) is a business with fewer than 10 employees at the time of the SSBCI loan, investment, or other credit/equity support, and includes independent contractors and sole proprietors.

#### **Eligibility: SEDI-owned businesses**

In general, the basis for eligibility can be geographic, demographic, or socioeconomic. A small business may qualify as a SEDI-owned business if it meets at least one of the four criteria below.

1. Business enterprises that certify that they are owned and controlled by individuals who have had their access to credit on reasonable terms diminished as compared to others in comparable economic circumstances, due to their: (1) membership of a group that has been subjected to racial or ethnic prejudice or cultural bias within American society; (2) gender; (3) veteran status; (4) limited English proficiency; (5) physical handicap; (6) long-term residence in an environment isolated from the mainstream of American society; (7) membership of a federally or state-recognized Indian Tribe; (8) long-term residence in a rural community; (9) residence in a U.S. territory; (10) residence in a community undergoing economic transitions (including communities impacted by the shift towards a net-zero economy or deindustrialization); or (11) membership of another "underserved community" as defined in Executive Order 13985.
2. Business enterprises that certify that they are owned and controlled by individuals whose residences are in CDFI Investment Areas (defined below).
3. Business enterprises that certify that they will operate a location in a CDFI Investment Area.
4. Business enterprises that are located in a CDFI Investment Area.

The term "owned and controlled" means, if privately owned, 51 percent is owned by such individuals; if publicly owned, 51 percent of the stock is owned by such individuals; and in the case of a mutual institution, a majority of the board of directors, account holders, and the community which the institution services is predominantly comprised of such individuals.

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A CDFI Investment Area - defined in [12 C.F.R. § 1805.201\(b\)\(3\)\(ii\)](#) - are generally low-income, high-poverty geographies that receive neither sufficient access to capital nor support for the needs of small businesses, including minority-owned businesses. For purposes of SSBCI, Treasury has determined that the entirety of American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands constitute a CDFI Investment Area.

### Allocations

Treasury has elected to use variations and analogues of the main capital allocation formula to determine allocation amounts for targeted funds. The methodology for the main capital allocation formula is provided in the guidance, and allocation formulas for targeted funds are noted below.

#### **\$500 million formula allocation for Very Small Businesses**

The allocations will be determined according to the same formula as the state's main capital allocation. Tribal government governments are not subject to an allocation minimum.

#### **\$1.5 billion formula allocation for SEDI-owned businesses**

Allocations will be based on the percentage of a state's total population residing in CDFI Investment Areas relative to the total population residing in all CDFI Investment Areas. Treasury will use the main capital allocation formula for Tribal governments, except there is no minimum allocation.

#### **\$1 billion incentive allocation for SEDI-owned businesses**

States that demonstrate "robust support" of SEDI-owned businesses can obtain an enhanced amount of funding in each of the second and third tranches of main capital to support SEDI-owned businesses.

A state is not required to establish a separate program for SEDI-owned businesses and VSBs but must maintain records of the total amounts of its SSBCI funds expended for SEDI-owned businesses and VSBs.

## CAPITAL ACCESS PROGRAMS

- Capital Access Programs (CAPs) provide portfolio insurance to lenders that are financial institutions that make small business loans. The guidelines make explicit that states may work together to standardize CAPs, and uniformity across CAPs may result in efficiencies and cost savings for financial institutions interested in servicing multiple states.
- The borrower must have 500 employees or less at the time that the loan is enrolled in the program, and the loan cannot exceed \$5 million.

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- Permissible borrowers may include state-designated charitable, religious, or other nonprofit or philanthropic institutions; government-owned corporations; consumer and marketing cooperatives; and faith-based organizations, provided the loan is for a “business purpose” as defined above. Permissible borrowers may also include sole proprietors, independent contractors, worker cooperatives, and other employee-owned entities, as well as Tribal enterprises.
- The federal contribution may be used to match the aggregate borrower/lender contribution at a level of 1:1. The federal contribution cannot be used to match any amount in excess of the sum of the borrower and financial institution lender contributions.
- The state must apply the same standards for participation in its SSBCI programs to all classes of lenders and not restrict any class of financial institutions from participating in the program.

### Eligible and Prohibited Loan Purposes

Loan proceeds must go toward an “eligible business purpose”. That includes but is not limited to: start-up costs; working capital; franchise fees; and acquisition of equipment, inventory, or services used in the production, manufacturing, or delivery of a business’s goods or services, or in the purchase, construction, renovation, or tenant improvements of an eligible place of business that is not for passive real estate investment purposes.

#### Exception: Passive Real Estate Investment Guidance

Treasury provides a number of examples to illustrate eligible and ineligible activities as it pertains to real estate activity, and provides guidance for eligible “construction loans” and affiliate leasing.

- A passive company that acquires real property using an SSBCI-supported loan may have an eligible business purpose where 100 percent of the rentable property is leased to the passive company’s affiliated operating companies that are actively involved in conducting business operations.
- A “construction loan” with an original principal amount of \$500,000 or less may have an eligible business purpose if (1) the building will not serve as a residence for the owner, their relatives, or affiliates; (2) the building will be put into service immediately; (3) the loan is underwritten and made for the purpose of constructing or refurbishing a structure; and (4) the building has not been and will not be financed by another SSBCI-supported loan.

#### Exception: Refinancing of Existing Loans

Treasury outlines eligibility criteria for SSBCI-supported loans used to refinance an existing loan, line of credit, extension of credit, or other debt, and provides guidance for both new and existing lenders.

- A lender may enroll or refinance loans previously made by another, non-affiliated financial institution under certain circumstances.
- New extensions of credit by an existing lender or its affiliate is allowed under certain circumstances.

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### **Exception: Employee Ownership and Worker Cooperatives**

In general, SSBCI-supported loans cannot be used to purchase ownership interest of any owner of the business. The guidelines provide an exception that allows SSBCI capital to be used for the purchase of an interest in an employee stock ownership plan, worker cooperative, or related vehicle. The transaction must result in the employee stock ownership plan or other employee-owned entity holding a majority interest (on a fully diluted basis) in the business.

### **Capital Access in Underserved Communities**

A state's application for a CAP must contain a report detailing how the state plans to help provide access to capital for small businesses in "underserved communities". The guidance outlines the type of information that should be included in that report.

## OTHER CREDIT SUPPORT PROGRAMS

Other Credit Support Programs (OCSPs) include loan programs, investment programs, or other credit or equity support programs such as collateral support programs, loan participation programs, state-sponsored venture capital programs, loan guarantee programs, or other similar programs. OCSPs are not CAPs, and OCSP lenders and investors need not be financial institutions as defined for CAPs.

- OCSPs are required:
  - To target an average borrower or investee size of 500 employees or less,
  - Not to extend credit support to borrowers that have more than 750 employees,
  - To target support towards loans or investments with an average principal amount of \$5 million or less, and
  - Not to provide credit or investment support if a given transaction exceeds \$20 million.
- Each OCSP must demonstrate that, at a minimum, \$1 of public investment by the state SSBCI program will cause and result in \$1 of new private credit.

### **10:1 Financing**

States must demonstrate a "reasonable expectation" that, when considered with all other approved state programs under the SSBCI, such programs together have the ability to achieve a "private financing ratio" of 10:1 over a 10-year horizon. This means that federal contributions will generate small business lending and investment at least 10 times the federal contribution amount. The private financing ratio is the "private financing" caused by and resulting from the SSBCI investment, divided by the "SSBCI funds used."

States must provide estimates or projections of program parameters that support a 10:1 private financing ratio in their SSBCI application (i.e. ex ante requirement). In addition, states must fulfill ongoing ex post reporting requirements on actual leverage achieved. The guidance provides additional details on these requirements.

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### Private Financing

Funded and unfunded loans or investments from a private source to an eligible borrower or eligible investee, whether occurring at or subsequent to loan or investment closing. Private financiers must have a "meaningful amount" of capital at risk. The guidelines define appropriate risk exposure thresholds for debt and equity contributions.

SBA-guaranteed loans or other financing that is credit-enhanced by federal, state, or local incentives are eligible if (1) the financing is caused by, or is the result of, an SSBCI-supported transaction, (2) the capital comes directly from a private entity, and (3) the lender or investor has at least some of its own capital at risk. The guidelines further describe the relationship between SSBCI and SBA lending programs and other federal loans.

Funds generated from the sale of tax credits are not considered private financing, however these funds may be combined with SSBCI capital. An SSBCI-supported transaction cannot be used by an entity to increase the pool of funds that generates New Markets Tax Credits or Historic Preservation Tax Credits. If, however, a transaction supported with SSBCI funds meets program requirements, an entity may use SSBCI funds alongside a transaction that generates tax credits.

### 1:1 Financing

States must demonstrate that OCSFs are designed to "cause and result in" 1:1 private financing (i.e. \$1 of public investment will cause and result in, at a minimum, \$1 of new private credit.)

- A private investment that occurs prior to the SSBCI investment may count towards the state's 1:1 financing ratio when a state can document that the forthcoming SSBCI funds were the "cause and result" of the private investment.
- Private capital raised within the same funding round as the SSBCI funding may be counted toward the 1:1 financing ratio if a term sheet or similar agreement specifies the inclusion of SSBCI capital and the private financing transaction occurs no earlier than 90 days before the SSBCI investment.

### \$20 Million Restriction

OCSFs cannot support transactions exceeding \$20 million. The restriction cannot be avoided by dividing a larger loan into smaller loans or by creating separate equity instruments within an investment round.

- Loan programs - The restriction applies to the principal amount of the loan directly supported by SSBCI, plus all other loans for the same loan purpose that close on or about the same date.
- Equity investment programs - The restriction applies to a single investment round that includes an SSBCI-funded investment, including all classes of equity instruments that close on or about the same date. The restriction cannot be avoided.

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### Venture Capital Program

The "investor" can be an entity of the state; any private venture capital, seed-stage, mezzanine, or angel fund participating in an approved SSBCI program (but not individual investors in such a fund); or a special purpose vehicle or entity.

Funds from an SSBCI venture capital program must not be used to make an investment in a business in which an "SSBCI insider" has a personal financial interest. The guidelines provide clarity on what constitutes an "SSBCI insider", and provides exceptions under certain circumstances to governmental entities, state-sponsored and independent non-profit entities, and for-profit entities managing or investing SSBCI funds for a VCP.

State-sponsored VCPs may participate in multistate fund structures, but each state must have a separate agreement with the fund manager. When a state provides SSBCI capital to private investment funds, a state's capital must be either held in a separate fund and separately accounted for, or held in a fund with other investors' funds, with each investor's investment accounted for separately.

States may use SSBCI funds to pay fund managers for a variety of services provided to their portfolio companies up to an annual average of 1.71 percent of the federal contribution to a venture capital fund over the life of the state's VCP.

## REPORTING

The guidance provides information on reporting requirements, including frequency of reporting and data points that will be collected.

- States are required to submit the following. View the guidance for additional information on reporting requirements.
  - Quarterly reports
  - Annual reports
  - SF-425 Federal Financial Reports annually
  - Performance results to be submitted with the final annual report
- Treasury will issue additional guidance on reporting requirements pertaining to the following:
  - Technical assistance
  - Demographics of owners of small business that participate in a SSBCI capital or technical assistance program

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### OTHER PROGRAM REQUIREMENTS

#### Eligible Municipalities

If any state of the United States does not submit a complete application by February 11, 2022, municipalities within that state may apply. Applications from eligible municipalities must be completed by March 11, 2022. The approval criteria and program requirements applicable to states apply to eligible municipalities.

#### Contractual Arrangements

The SSBCI application will ask states to explain the steps they will take to promote a fair, competitive, and open selection and contracting process if a state pursues contractual arrangements for the implementation or administration of its capital program with an authorized agent of the state, or with an entity selected and supervised by the state.

#### Joint applications for Tribal Governments

Tribal governments may apply jointly through an organization or other Tribal government representative if each Tribal government applying jointly authorizes the organization or other Tribal government representative to represent the Tribal government for purposes of SSBCI.

#### Program Terms

The interest rate for each individual SSBCI-supported loan, at the time of obligation, may not exceed the National Credit Union Administration's interest rate ceiling for loans made by federal credit unions. The guidance provides additional details on program features that are and are not aligned with National Customer Protection Standards.

#### Administrative Costs

For the first tranche, the administrative costs are not to exceed 5 percent of SSBCI funds. For the second or third tranche, the administrative costs are not to exceed 3 percent for the respective tranche.

#### Un-enrollment

Treasury's written approval is needed for replenishment and un-enrollment of a particular transaction or use of administrative expenses from its SSBCI program account. The guidance details the documentation required for the replenishment of loans and investments.

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### CDFA'S SSBCI RESOURCES

#### **CDFA SSBCI Resource Center**

The central source for information, data, analytics, and programs related to the SSBCI program.

[Visit the SSBCI Resource Center](#)

#### **CDFA SSBCI Coalition**

SSBCI Coalition meetings are held once a month to provide an interactive forum for CDFA members during the State Small Business Credit Initiative (SSBCI) application period. CDFA facilitates discussions that allow for networking, peer knowledge sharing, and problem solving.

[Learn more about the SSBC Coalition](#)

#### **CDFA SSBCI Fact Sheet & FAQs**

An overview of how the SSBCI program works and the top things you need to know about it.

[View the SSBCI Fact Sheet & FAQs](#)

### ABOUT CDFA

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