



# Policy Proposal: Reforming the SBA Microloan Program to Expand Capital Access

## OVERVIEW

The Small Business Administration's Microloan program is an important component of the federal government's assistance to small businesses. Through the Microloan program, the SBA provides loans to non-profit intermediary organizations, who in turn provide small-scale working capital loans of up to \$50,000 to small businesses for the procurement of materials, supplies, inventory, or equipment. The program targets businesses owned by minority entrepreneurs, women, veterans, and those that operate in low-income areas.

COVID-19 has disproportionately impacted the smallest of the small businesses, especially minority-owned businesses that already faced credit and capital access challenges before the pandemic. From February to April of 2020, the number of active black-owned small businesses declined by 41 percent, active Latinx businesses decreased by 32 percent, and active Asian businesses fell by 26 percent.<sup>1</sup> These businesses will continue to be excessively impacted by the pandemic and an infusion of new, character-based lending practices is needed.

CDFA recommends the creation of a national task force to examine non-traditional, character-based lending practices and the re-launch of a new and reimaged SBA Microloan Program. This program would come with funding of \$5 billion to be disseminated on a competitive basis to development finance agencies (DFAs) and community development financial institutions (CDFIs) for the purpose of microlending.

## IMPACT

The Microloan program is uniquely suited to fill the capital access gap faced by disadvantaged borrowers. Borrowers served by the program often have no credit history or lower credit scores than most applicants for the SBA's 7(a) loan program.<sup>2</sup> The program specifically targets underserved markets, including borrowers with little to no credit history, low-income borrowers, and women and minority entrepreneurs in both rural and urban areas who generally do not qualify for conventional loans or other, larger SBA guaranteed loans.<sup>3</sup>

When funding is available, the program has proven both cost-effective and impactful. Analysis from the Government Accountability Office found that from 2014-2018, approximately 80 percent of microloans to borrowers who identified themselves as women-owned, veteran-owned, minority-owned businesses or businesses in low-income areas.<sup>4</sup> A relatively small appropriation of capital can result in a meaningful impact. In the fiscal year 2020, the SBA received \$5 million for direct Microloan business credit subsidies, which is expected to support around \$46 million in lending to intermediaries.<sup>5</sup>

## PROPOSED REFORMS

With a few reforms, the Microloan program can truly transform the landscape of small businesses' access to capital both during and after the pandemic. The program should be expanded to allow Development Finance Agencies (DFAs) to act as loan intermediaries, leveraging their experience deploying capital and knowledge of local community needs. DFAs are existing anchor institutions ideal entities to address disparities in lending to minorities, women, and businesses in low-income areas. Further, slightly increasing the maximum loan size and strengthening



the impact reporting requirements would improve the program's availability and distribution of working capital for disadvantaged small businesses.

### **Reform 1 – Allow Development Finance Agencies to Act as Loan Intermediaries**

Development Finance Agencies (DFAs) are not currently authorized to act as loan intermediaries, dramatically hindering the reach of the program. In the fiscal year 2019, the SBA only approved 53 loans to intermediaries totaling \$42.3 million.<sup>6</sup> There are thousands of DFAs and CDFIs across the nation standing ready to act as intermediaries for the program and deploy capital immediately to small businesses. For example, 73 percent of intermediaries (122 of 168) in the program from 2014-2018 were also certified CDFIs by the Department of the Treasury.<sup>7</sup> Expanding the pool of eligible intermediaries to include DFAs would increase the availability and distribution of working capital for disadvantaged small businesses.

### **Reform 2 – Increase Maximum Loan Size and Acceptable Default Ratio**

The program should be amended to allow intermediaries to approve and accept larger loan default ratios. The average borrower default rate is a minuscule 7 percent, and given that the loan loss reserve fund is typically sufficient to cover the whole cost of such defaults, the SBA's loss rate for intermediary repayment is usually under 3 percent annually.<sup>8</sup> DFAs also have large loan loss reserve funds so there would be little additional risk to the SBA and taxpayers.

### **Reform 3 – Strengthen Impact Reporting Requirements and Documentation**

The program should also strengthen its documentation and impact reporting requirements for intermediaries. An audit conducted in 2017 by the SBA's Office of the Inspector General concluded that from fiscal years 2014 to 2016, intermediaries did not have adequate documentation to support the origination and closing for at least 9,196 microloans for approximately \$137 million, in accordance with SBA's requirements.<sup>9</sup> DFAs are commonly subject to thorough reporting requirements for the many other financing programs they operate, so allowing DFAs to act as Microloan intermediaries would help mitigate the issue of insufficient reporting.

## **READINESS OF DEVELOPMENT FINANCE AGENCIES**

In the fiscal year 2019, the SBA only approved 53 loans to intermediaries totaling \$42.3 million.<sup>10</sup> DFAs are operating all across the country already, and they have the capacity to provide technical assistance along with the institutional knowledge of using character-based lending practices. By allowing development finance agencies to make microloans, the program would greatly broaden the availability of capital to minority-owned, women-owned, and veteran-owned small businesses, thereby complimenting the SBA's other programs.

## **CONTACT**

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## ADDITIONAL RESOURCES

### [Small Business Administration Microloan Program](#)

Congressional Research Service

### [Seed & Venture Capital Resource Center](#)

Council of Development Finance Agencies

### [SBA Microloan Program: Opportunities Exist to Strengthen Program Performance Measurement, Collaboration, and Reporting](#)

U.S. Government Accountability Office

### [Double Jeopardy: COVID-19's Concentrated Health and Wealth Effects in Black Communities](#)

Federal Reserve Bank of New York

### [CDFA COVID-19: Comprehensive Recovery Strategy](#)

Council of Development Finance Agencies

<sup>1</sup> Federal Reserve Bank of New York, "Double Jeopardy: COVID-19's Concentrated Health and Wealth Effects in Black Communities," p. 1. ([https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy\\_COVID19andBlackOwnedBusinesses](https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses)).

<sup>2</sup> U.S. Congress, House Committee on Small Business, *Full Committee Legislative Hearing on the SBA's Microloan and Trade Programs*, 110th Cong., 1st sess., July 12, 2007, H.Hrg. 110-35 (Washington: GPO, 2007), p. 27.

<sup>3</sup> SBA, "Microloans Help Small Businesses Start, Grow and Succeed"

<sup>4</sup> Government Accountability Office, "SBA MICROLOAN PROGRAM: Opportunities Exist to Strengthen Program Performance Measurement, Collaboration, and Reporting" (<https://www.gao.gov/assets/710/702731.pdf>)

<sup>5</sup> P.L. 116-93, the Consolidated Appropriations Act, 2020; and U.S. Congress, House Committee on Appropriations, *Financial Services and General Government Appropriations Bill*, 2020, 116th Cong., 1st sess., June 19, 2019, H.Rept. 116-122 (Washington: GPO, 2019), p. 88-89.

<sup>6</sup> Congressional Research Service, "Small Business Administration Microloan Program", p. 12.

([https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS\\_2020\\_SBA-Microloan-Program.html](https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS_2020_SBA-Microloan-Program.html)).

<sup>7</sup> Government Accountability Office, "SBA MICROLOAN PROGRAM: Opportunities Exist to Strengthen Program Performance Measurement, Collaboration, and Reporting" (<https://www.gao.gov/assets/710/702731.pdf>)

<sup>8</sup> Congressional Research Service, "Small Business Administration Microloan Program", p. 13.

([https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS\\_2020\\_SBA-Microloan-Program.html](https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS_2020_SBA-Microloan-Program.html)).

<sup>9</sup> SBA, Office of the Inspector General, "Audit of SBA's Microloan Program," p. 1.

([https://www.sba.gov/sites/default/files/oig/SBA\\_OIG\\_Report\\_17-19.pdf](https://www.sba.gov/sites/default/files/oig/SBA_OIG_Report_17-19.pdf)).

<sup>10</sup> Congressional Research Service, "Small Business Administration Microloan Program", p. 12.

([https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS\\_2020\\_SBA-Microloan-Program.html](https://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=CRS_2020_SBA-Microloan-Program.html)).