

# Lessons Learned From Small Business Lending during COVID-19: A Case Study of the California Rebuilding Fund

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## **Disclaimer**

The views expressed in this report are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of San Francisco or the Federal Reserve System.

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All interviewees without institutional affiliations were interviewed due to their participation with the CASE Task Force or related volunteer efforts; many interviewees with affiliations were also Task Force members. One interview participant requested to remain anonymous.



## Executive Summary

As the COVID-19 pandemic forced California businesses to shut down in March 2020, the fate of small businesses, which often had fewer reserves to draw upon when trying to survive the shutdowns, became particularly concerning. Federal aid measures, including the Paycheck Protection Program (PPP), brought relief to many business owners, but their deployment also confirmed what many small business advocates feared: business owners in the most vulnerable communities and underrepresented business owners often struggled to obtain assistance. At the same time, small business lending capital dried up. Many banks and fintechs slowed their lending. Mission-driven lenders with experience serving underrepresented communities—like community development financial institutions (CDFIs)—received more applications than they could possibly fund and had limited established channels to attract new funding quickly. A coalition that spanned government, universities, small business advocates, lenders, and concerned private citizens came together to design a solution that would leverage public funds with private dollars to provide low-cost capital to small businesses that were rebuilding after COVID-19 via loans from CDFIs. The result was the California Rebuilding Fund (CARF). This report provides a brief history of the creation of the CARF; details its structure, loan terms, and application process; highlights lessons learned from its creation and implementation; and looks forward as this fund continues to operate in California and as other states or localities consider establishing similar funds.

### **Why was the CARF needed?**

At the time the CARF was designed and launched, those interested in assisting small businesses in weathering the economic crisis prompted by the pandemic faced a particular set of problems and constraints: how could they assist the smallest and most vulnerable small business owners as affordably as possible with limited state funding? The CARF designers proposed an innovative solution: combine existing small business loan guarantees and a new infusion of state dollars with private capital to create liquidity for CDFIs to make small business loans. By coupling public and private funding, the CARF was able to leverage a more limited state investment with private funding. At the same time, the state's involvement decreased the risk to private investors, which would increase the willingness of private actors to invest and allow small business owners to access the capital at a lower cost. CDFIs in California were well positioned to serve small business customers, particularly those that were most likely to be struggling to access federal relief efforts. But these institutions faced their own capital constraints that limited the amount of loans they could provide. By providing CDFIs with liquidity, the CARF facilitated increased lending to at-risk small businesses.



## **How does the CARF structure provide affordable capital to small business owners?**

The CARF's goal is to provide credit that is as affordable as possible to a broad array of small business owners. The CARF achieves this through a public-private partnership between the state's Infrastructure and Economic Development Bank (IBank) and private investors, philanthropic organizations, and local governments. The CARF is designed to leverage two different forms of state subsidy: a COVID-19 Disaster Risk Loan Guarantee and a separate infusion of state funding into the CARF. This state funding is then supplemented by loans from private investors and philanthropic capital; in all, more than \$100 million in government, private, and philanthropic capital has been raised to fund small business loans. In both cases, the public funds are the most at risk if small business borrowers default on their loans. This decreases the interest rate required to secure private capital in the fund, which then translates to lower interest rates for small business borrowers. Each infusion of public funds is held in its own structure, allowing for the parameters to change based on the source of capital (currently the guarantee program or the state's investment of first-loss capital) and as lending needs evolve.

CDFIs were chosen as the small business lenders for the program due to their familiarity with serving small business borrowers, especially those that had been left behind in earlier pandemic-relief efforts. Participating CDFIs come from all parts of the state, ensuring that all communities are served by a participating lender. CDFIs have deep experience serving small business borrowers—especially women, minorities, immigrants, and low-income individuals, who were some of the most at risk of not obtaining other types of support during the economic crisis. The CARF also partnered with small business technical assistance (TA) providers to help spread the word about the program and aid small business owners in applying. Applications were routed through a centralized platform built for the CARF that matched small businesses with a participating lender.

## **What are lessons learned from the CARF?**

The CARF (and other funds like it that launched during the pandemic) demonstrates a way to leverage larger amounts of capital through CDFIs to serve vulnerable small business borrowers. Even outside of economic crises, the smallest small businesses—along with those owned by people of color, women, veterans, immigrants, and low-income individuals—often struggle to obtain credit and capital. These businesses are an important part of the economy, and programs like the CARF may be able to continue to provide them with access to credit after the pandemic recovery. As governments and small business advocates across the country consider how to support small businesses and whether programs like the CARF are a match for their goals and needs, several lessons may be learned from the California experience.



**The CARF provides a pilot case for leveraging public and private capital to increase the credit available to small businesses and to lower its costs.**

By using public funds to lower the risk exposure of private investors, the CARF was able to lower the borrowing costs for small businesses relative to what is typically available on the private market. Although borrowing costs are expected to rise as the economy emerges from the most acute strain of the pandemic, the use of public capital can keep costs in line with lending typical of CDFIs while increasing the availability of capital for small business loans. The CARF also provides an example of a centralized platform that offers both investors and small business owners a single touchpoint while enabling a range of CDFIs to participate in the program.

**Despite decreased risk, raising capital can be challenging.**

The CARF was able to raise more than \$100 million in private and philanthropic capital to provide small business loans. Nevertheless, participants noted that momentum for funding small businesses faded as the pandemic progressed, and the amount of time and effort needed to raise these funds surprised some participants. It is possible, however, that once these types of programs become more established (and less unknown to potential investors) and are able to approach capital-raising at scale, some of these challenges may be reduced.

**Standardized loan products are possible for CDFIs, but determining appropriate fees may need further refinement.**

The bespoke lending of the CDFI industry has often been cited as a barrier to reaching larger capital markets. Though CDFI participants in the CARF admitted that the loan parameters within the CARF could differ from their typical products and were, at times, more conservative, the CARF provides a test case that enabling CDFI liquidity through a standardized loan product is possible. However, one remaining potential barrier is ensuring that CDFIs earn sufficient income through origination and servicing fees to make up for the loss of interest income.

**The structure of the CARF itself is flexible and allows for different funding sources and lending terms.**

As a result, it can be adapted to new sources of capital or different economic needs. For example, additional 0 percent interest loans for San Francisco small businesses were made available through an investment of the City and County of San Francisco into the CARF. This structure will also enable the CARF to continue to add new lenders and update lending terms as the economic situation surrounding the pandemic evolves.



**These structures are complex, will vary significantly based on state lending laws, and require partnership of a diverse group of actors; aligning terms can be challenging.**

Though the CARF can serve as a model for similar efforts in other contexts, designing these programs for other geographies will still require considerable effort to align actors and comply with local lending laws. Additionally, as with many multiparty efforts, aligning terms to meet conflicting perspectives can be challenging. Operating from a common set of goals will mitigate these challenges.

**It can be useful and important to coordinate and leverage with other existing government programs to provide a continuum of capital and complementary services without generating confusion for small business owners.**

The CARF was designed and launched at a time when the state of California expected to have limited capital available to serve small business owners and the federal PPP funds had been exhausted. When the state found itself with a budget surplus, it allocated \$4 billion in small business grant relief across several rounds of funding. The type and amount of aid offered varied from the CARF, and the CARF designers viewed these efforts as complementary, allowing small businesses to access grant capital earlier in the pandemic and then pivot to debt capital as they rebuilt for the post-pandemic economy. However, they acknowledged that the existence of the grant program, along with renewed 2021 funding of the PPP, complicated communication efforts surrounding the CARF and required small business owners to evaluate which program would best suit their needs.

**Technical assistance (TA) is an important component of enabling small business participation in these types of programs.**

The CARF partnered with a variety of technical assistance and small business advocacy organizations to educate small businesses about the program and assist them in applying. Several TA providers stressed that early coordination on assistance was important, rather than treating it as an afterthought. Many small business owners experienced challenges in applying, even though the program was targeted to them, and the work of these organizations was important to the program's success.



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## Introduction


As the COVID-19 pandemic forced California businesses to shut down in March 2020, the fate of small businesses, which often had fewer reserves to draw upon when trying to survive the shutdowns, became particularly concerning. Federal aid measures, including the Paycheck Protection Program (PPP), brought relief to many business owners, but their deployment also confirmed what many small business advocates feared: business owners in the most vulnerable communities and underrepresented business owners often struggled to obtain assistance. At the same time, small business lending capital dried up. Many banks and fintechs slowed their lending. Mission-driven lenders with experience serving underrepresented communities—like community development financial institutions (CDFIs)—received more applications than they could possibly fund and had limited established channels to attract new funding quickly. A coalition that spanned government, universities, small business advocates, lenders, and concerned private citizens came together to design a solution that would leverage public funds with private dollars to provide low-cost capital to small businesses that were rebuilding after COVID-19 via loans from CDFIs. The result was the California Rebuilding Fund (CARF). This report provides a brief history of the creation of the CARF; details its structure, loan terms, and application process; highlights lessons learned from its creation and implementation; and looks forward as this fund continues to operate in California and as other states or localities consider establishing similar funds.

## Methodology

Data for this case study were primarily gathered from interviews and occasional email exchanges with interview subjects. This data collection was supplemented with content from IBank public meetings and through review of materials submitted to the record in IBank meetings, as well as publicly available materials, such as websites and news reporting. Thirty-five individuals were interviewed during 27 interviews (30–60 minutes) conducted by videoconference from December 2020 to June 2021. Follow-up interviews were conducted with four participants because clarification was needed. Elements of the CARF evolved over time, and this report reflects details represented during the time of the data collection.

## Identifying the Problem

The nine-county Bay Area issued California's first shelter-in-place order on March 16, 2020; Governor Gavin Newsom's statewide stay-at-home order soon followed, on March 19. According to estimates provided by Professor Robert Fairlie to the California Assembly, the number of active businesses in California dropped by 26 percent between February and April 2020. This number rose back to February



levels by October but fell again during the final months of 2020. Declines between February and April were particularly sharp among Hispanic business owners.<sup>1</sup> Closures were even more severe among small business owners, with one estimate from Opportunity Insights suggesting that the number of small businesses in California declined 45 percent from January to April 2020.<sup>2</sup>

The federal government rolled out the PPP in April 2020, but the first rounds of funding were quickly exhausted. Research indicates that many in minority communities faced unequal access to loans. Research documented that minority business owners received loans later in the summer than White business owners<sup>3</sup> and that majority-minority communities often received fewer loans per capita than mixed or majority-White areas.<sup>4</sup> Matched-pair audit studies indicated that minority business owners both were discouraged from applying to PPP and given incomplete information by bank employees.<sup>5</sup> According to the 2020 Federal Reserve Small Business Credit Survey, Hispanic- and Black-owned firms were less likely to apply for PPP; among those who did, smaller shares received all of the funding they sought, relative to White applicants.<sup>6</sup> In California, businesses in higher-income zip codes were more likely to receive PPP than those in lower-income areas.<sup>7</sup>

Given uncertainty about the course of the pandemic, the economy, and the ability of small business owners to repay loans, many traditional lenders were hesitant to make small business loans, and

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<sup>1</sup> Robert Fairlie, “[The Impacts of COVID-19 on Small Business Owners](#),” Testimony before the California State Assembly Committee on Jobs, Economic Development, and the Economy, February 23, 2021.

<sup>2</sup> Little Hoover Commission, “[First Steps Toward Recovery: Saving Small Businesses](#)” (Sacramento, CA: Little Hoover Commission, December 2020).

<sup>3</sup> Sifan Liu and Joseph Parilla, “[New Data Shows Small Businesses in Communities of Color Had Unequal Access to Federal COVID-19 Relief](#)” (Washington, DC: Brookings Institution, September 17, 2020).

<sup>4</sup> Mark E. Schweitzer and Garrett Borawski, “[How Well Did PPP Loans Reach Low- and Moderate-Income Communities?](#),” *Economic Commentary* (Cleveland, OH: Federal Reserve Bank of Cleveland, May 27, 2021).

<sup>5</sup> Anneliese Lederer et al., “[Lending Discrimination Within the Paycheck Protection Program](#)” (Washington, DC: National Community Reinvestment Coalition, July 15, 2020); Anneliese Lederer et al., “[Lending Discrimination During Covid-19: Black and Hispanic Women-Owned Businesses](#)” (Washington, DC: National Community Reinvestment Coalition, November 10, 2020).

<sup>6</sup> “Small Business Credit Survey 2021 Report on Firms Owned by People of Color.”

<sup>7</sup> Rocio Sanchez-Moyano, “[Paycheck Protection Program Lending in the Twelfth Federal Reserve District](#),” *Federal Reserve Bank of San Francisco, Community Development Research Brief Series*, March 3, 2021, doi: 10.24148/cdrb2021-01.




lending activity by fintechs unrelated to PPP evaporated early in the pandemic.<sup>8</sup> CDFIs have historically served harder-to-reach small business owners, and interviews with CDFIs in California indicated that they were experiencing hundreds of phone calls a day from small business owners looking for support. However, a lack of liquidity and available capital was constraining the lending that many CDFIs could do. CDFIs were constrained in more than one way. They were working with existing customers who may have needed assistance (such as loan modifications or forbearance), as well as fielding a surge in requests for new loans. Many CDFIs were also participating in PPP, leaving limited financial resources and staff capacity to meet the increasing demand.

As this was unfolding, individuals across the state were working on solutions at the same time Congress and the federal government were designing and implementing the PPP and other small business relief programs. Several parallel tracks eventually merged to form a coalition called the California Small Enterprise (CASE) Task Force, which developed the CARF with the support of California's IBank. The primary goal of the groups involved in the CARF was to find a way to facilitate loans for small business borrowers. They were concerned that small businesses had fewer resources to begin with and less time to avail themselves of those resources. They were also concerned with evidence that small businesses were being left behind in PPP, with larger firms taking much of the resources available. Many interviewees stressed reaching underserved small businesses that often have difficulty obtaining capital—those owned by low-income individuals, people of color, immigrants, and women. Once the group settled on CDFIs as the originating lenders of the small business loans, a secondary goal became generating liquidity such that these CDFIs could originate more loans. Though CDFIs were fundraising on their own to raise additional capital to make new loans, being able to fundraise as a group had the potential for much larger-scale lending and would place the burden of fundraising on the lending program rather than on individual, overstretched CDFIs.

On August 26, 2020, the CASE Task Force and its allies presented a proposal to the IBank Board of Directors, with support from the IBank, and received approval and funding for the program. The proposed structure was a small business loan program funded through a public-private partnership. The IBank would provide funding and sit in the riskiest position, enabling more risk-averse investors to

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<sup>8</sup> AnnaMaria Andriotis and Peter Rudegear, "[WSJ News Exclusive: People Need Loans as Coronavirus Spreads. Lenders Are Making Them Tougher to Get.](#)," *Wall Street Journal*, March 28, 2020, Markets section; Peter Rudegear, "[Small Businesses, Hit Hard by Pandemic, Are Being Starved of Credit.](#)," *Wall Street Journal*, December 20, 2020, Markets section; Itzhak Ben-David, Mark J. Johnson, and René M. Stulz, "[Why Did Small Business Fintech Lending Dry Up During March 2020?](#)," Working Paper, Working Paper Series (Cambridge, MA: National Bureau of Economic Research, September 2021), doi:10.3386/w29205.



lend money to the fund. CDFIs would make the loans to the small business borrowers but would be able to transfer the bulk of the loan to the fund, generating liquidity to make more loans (for more details, see the Structure section). Governor Newsom officially launched the program on November 20, 2020.


## Creators of the CARF

The CARF was designed by members of the CASE Task Force. Its ultimate structure, however, was the result of conversations with its key partners in the state of California and among CDFIs, the lenders originating the small business loans. Design elements were also affected by lenders to the fund. Though the CASE team was the primary designer of the CARF, this section starts with the state of California, as the CARF eventually leveraged a program created by the state in early 2020.

### The State of California

Various actors across California's state government had been considering how to support small businesses as the pandemic began to unfold. The California IBank launched a COVID-19 Disaster Relief Loan Guarantee program in April 2020. It was adapted from an existing IBank guarantee program but was targeted, through a network of CDFI partners, at smaller businesses than those traditionally served through the IBank's non-pandemic guarantee program. This program launched at the same time as the federal PPP but originally had limited take-up. Though the IBank guaranteed the loans, CDFIs still needed to have sufficient liquidity to make and hold the loans, and in the late spring/early summer of 2020, CDFIs were also actively engaged in PPP lending and had limited additional capital available to issue loans aimed at the guarantee. One CDFI that was making loans under the Disaster Relief program insisted that the CARF was needed because liquidity constraints limited the number of Disaster Relief guaranteed loans it could originate. An interview with another CDFI suggested that it was hesitant to lend without certainty around having the loan guaranteed, as well as when the guarantee program might run out of funds.

Individuals at the IBank turned to thinking about how to help CDFIs access the capital they needed to make the loans that the IBank could guarantee. The state of California was projecting large budget deficits at the time, so state actors knew there would be limited funds to provide direct capital to CDFIs (the guarantees themselves are funded through the IBank, which is self-sustaining and does not receive state appropriations to fund its traditional programs). Around this time, policymakers at the IBank and others involved with the Governor's Task Force on Business and Jobs Recovery had conversations with various individuals who ultimately became involved in the CASE Task Force (and also played a role in connecting these various actors) and settled on the possibility of a public-private partnership to leverage the limited state dollars that were available at the time. As described in detail in the Structure



section, the CARF was able to essentially utilize the guarantee structure already in use by the IBank but in a way that streamlined the process and provided liquidity to the CDFIs. The IBank additionally provided first-loss capital to support a fund without guarantees, which could be used once the guaranteed fund was depleted. These commitments from the IBank were then leveraged with private and philanthropic capital.

Taking a loss position was a departure from the IBank's general strategy. The decision to put funds at risk was made with the goal of maximizing the total amount of funding available to small businesses by using this loss position as a way to incentivize private capital participation at low interest rates for small business owners, particularly in the uncertain economic environment surrounding the pandemic. During interviews, government individuals referred to these positions not as charity but as investments in the state's small business infrastructure. One interviewee from the state suggested that the program was a proof of concept as to whether by decreasing the risk, private investment would flow into the program, but they also suggested that these loans were not as risky as generally perceived by traditional lenders. This interviewee's hope was that the program could help push conversations around the metrics used to assess small business risk and ultimately demonstrate that these businesses were not as risky as often perceived. Additionally, the intention was to build capacity among the state's small businesses and to help establish banking relationships. State interviewees hoped these businesses could grow and eventually access more traditional lending products or other programs offered by the state that are targeted at larger small businesses.


In addition to supporting the CARF, the state also created a small business grant program after budget revisions no longer projected deep deficits. This program initially allocated \$500 million in grants. The legislature allocated an additional \$2 billion to the program in March 2021 and an additional \$1.5 billion in July 2021. This grant program was capitalized at much higher levels than the CARF and can reach a larger number of small businesses, but the funds available to any individual business are smaller than those in the CARF.<sup>9</sup> One interviewee suggested that the funds were deployed through grants (rather than further capitalizing the CARF), due partly to speed of distribution.

## **CASE Task Force**

State officials at the IBank and on Governor Newsom's Task Force on Business and Jobs Recovery had heard of promising programs in Chicago and New York State that were developed and deployed

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<sup>9</sup> CARF loans can be up to \$100,000, while relief grants range from \$5,000 for the businesses with the smallest revenues to \$25,000 for those with the largest eligible revenues.




relatively quickly to provide loan capital to small businesses during the pandemic and had a conversation with Calvert Impact Capital and Community Reinvestment Fund, USA (CRF), who structured and operationalized the City of Chicago and New York funds.<sup>10</sup> At the same time, a set of faculty at the business school at the University of California, Berkeley, was developing a program that would use local funds to support small businesses in Berkeley (and was having similar discussions with other local entities). Meanwhile, a set of private citizens (the CASE Task Force) had been compiling a resource guide and holding online “office hours” for affected small businesses while simultaneously trying to develop a loan product for these businesses. As each of these groups developed proposals, they were introduced to one another and eventually combined under the CASE Task Force name. These actors continued to work together, meeting weekly as a group and more often as subcommittees.

The CASE Task Force, which started with individuals volunteering their professional expertise to support small businesses in need, included experts in corporate finance, structure, and governance; economic mobility and economic development; impact finance; and fundraising. They were intentional about expanding their expertise, focusing on partners in their networks who were similarly mission-driven and willing and able to work as a set of loosely connected volunteers. The group was flexible and inclusive: their conversations around how to respond to the crisis led them to others working on similar proposals, and these individuals joined the group, combining ideas and efforts rather than creating competing initiatives. Some of the Task Force’s earliest connections were to philanthropic networks in the Bay Area and to CDFIs, some of whom had already begun fundraising around a small business response. They were quickly connected to a set of UC Berkeley professors at the business school working on a similar effort who brought additional expertise in structuring the loan product. They reached out to possible owners and administrators for the fund and eventually settled on Kiva Microfunds as both the owner and administrator of the fund. A founding member of the CASE Task Force is a partner at the law firm Morrison & Foerster; this project became part of their pro bono work and involved both pro bono and volunteer hours from many members of the firm. As the group began to scale, it realized that it needed professional capacity and expertise on fundraising and capital aggregation; it eventually hired Calvert Impact Capital for this role and brought in CRF as the technology services provider.

The group’s earliest efforts included putting together a resource guide with links to local, state, federal, and nonprofit assistance programs. It also held regular office hours in partnership with a TA provider, where a set of volunteer lawyers was available to answer legal questions around applying for funding, negotiating with landlords, and other concerns of small business owners. The office hours also provided

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<sup>10</sup> CRF was involved in both the Chicago and New York funds, while Calvert worked only on New York.




a forum for impacted small businesses to feel connected. These efforts were happening in tandem with those of the group working on developing the CARF structure and doing the initial fundraising.

Part of the conversation around serving small business borrowers focused on technical assistance. The work with TA providers and small business advocates was also part of the CASE Task Force's coalition-building. In addition to building a coalition of CDFIs aligned with the program, TA providers and the Black, Hispanic, and Asian chambers of commerce in California were involved in spreading the word about this program to their members and in voicing their support when the program was presented to the IBank Board. One CDFI participant described the work with TA providers and chambers of commerce as mimicking how they typically operate—a lending and advising model. They saw these partnerships as important in reaching small businesses and in building up the TA capacity for the CARF. One TA provider pointed to the value of this coalition, saying that it was important that small businesses hear about this program both from the top (the government) and from below (organizations like theirs, which are embedded in the community).

## **CDFIs**

CDFIs were selected as the originating lenders to small businesses through the fund for several reasons. The CASE members wanted to particularly target underserved small businesses and had their eyes on lessons learned from the PPP, where reporting suggested that woman- and minority-owned businesses, microbusinesses, and those without existing banking relationships had particular difficulty accessing the program. CDFIs have always served this segment of the market and have deep expertise and relationships within their communities. According to one interview, CDFIs were approached as lending experts in this space and were asked to help identify small business needs and underwriting parameters. Interviewees noted that CDFIs are already engaged and trusted intermediaries in their communities, and several others emphasized that having a broad geographic network of CDFIs helped them reach communities all around the state. Using nonprofit CDFIs as the final lender also simplified some of the legal hurdles related to state lending laws.

Few interviewees expressed a desire for lenders other than CDFIs. Several described CDFIs as hidden gems—organizations with which they had been unfamiliar prior to working on the CARF, but which they saw as well-suited to reaching underserved business owners. One interviewee suggested that perhaps the program could be expanded to other lenders in the future, though this person noted that there would need to be additional rules if fintechs were included. Another noted that while some fintechs may be able to work in the program, most are not rooted in these communities and would exacerbate accessibility problems for businesses that were struggling to complete applications online. One participant, however, pushed back on limiting the program to CDFIs and suggested that it should have



been available to a wider set of nonprofit lenders or TA providers who had experience with local grant programs; another interviewee agreed that it could have been expanded to include other mission-based lenders.


Pacific Community Ventures and Accion Opportunity Fund were the first CDFIs involved in the CASE Task Force as a result of their connection to other CASE members. Outreach to other CDFI participants focused on reaching all portions of the state. CDFI participants in the fund include both statewide lenders and CDFIs that focus on smaller, targeted geographies; one interviewee noted that there was an effort to ensure that each county was served both by a statewide CDFI and a regional one. This interviewee suggested that the statewide CDFIs have more scale and efficiency but that the regional ones can have a nuanced approach that is specific to their geographies. There is also significant overlap between the CDFIs that were already participating in the IBank's Disaster Relief Loan Guarantee program and those that are lenders through the CARF. Interviewees indicated there were no specific criteria (in terms of asset size, existing portfolio risk, etc.) for CDFIs interested in joining the CARF. However, many who were asked also indicated that they were unfamiliar with what the process for new CDFIs to join the coalition might be or why others had not participated, and one interviewee suggested that it might have been better if a clear set of selection criteria existed.

## The California Rebuilding Fund

### Structure of the CARF

The structure of the California Rebuilding Fund (CARF) was designed to address the limited availability of credit to small business owners and the constrained ability of CDFIs to issue additional small business loans. It did so by operationalizing these problems into two main concerns. First, how to provide small business owners with loans at a very low interest rate? Second, how to provide this capital at a low cost (e.g., without incurring significant ongoing fund management and compliance costs)? Traditional private and philanthropic capital providers contributed the bulk of the loan capital. However, given the risk profile of small businesses generally and the uncertainty about economic recovery under COVID-19, additional support was needed to attract these lenders and keep interest rates low. The state of California, through the IBank, provided the risk protection for these traditional lenders that facilitated a low interest rate for the small business borrowers. Grants and donations from a variety of philanthropic sources (foundations, individuals, donor-advised funds) helped to cover other fund structuring and operating costs, and CDFIs served as the originating lenders to the small business borrowers. The creators of the CARF were also aiming for speed; other structures would have necessitated different types of registration and compliance, which would have required additional time and financial






resources. One key designer of the CARF described its structure as the “fastest, least cost of capital, [and] most flexible.”

Typically, public-private lending facilities have either bundled and sold loans or have set up a loan fund. The CARF sits in between these two types of structures (though called the California Rebuilding Fund, it is not, in fact, a fund). The CARF is a public benefit limited liability corporation (PBLLC), which loans money to CDFIs, who then make loans to small business borrowers (on-lending). This on-lending structure differentiates the CARF from the NY Forward Loan Fund, where loans are sold to a loan purchase facility. According to interviewees, there are two ways in which a CDFI may draw funds from the CARF. The CDFI may first borrow money from the fund and make a small business loan. It then transfers the majority of the asset (the small business loan) to the CARF to repay the borrowing within a period of days or weeks. CDFIs may also fund an eligible loan and then transfer the majority of the asset and be refunded. In both cases, the CDFI continues to service the loans. This structure is unique to California because of the state’s lending license laws.

Kiva Microfunds owns 100 percent of the PBLLC that is the CARF and additionally serves as the CARF administrator. Kiva was selected as the owner and administrator of the fund for several reasons. It had experience in lending to intermediaries, like CDFIs, and was also seen as “Switzerland” (as described by an interviewee) because it was not competing with CDFIs to make small business loans. Additionally, because Kiva and the participating CDFIs are all public charities, the fund’s on-lending structure is able to operate within lending laws that apply to public charities. Calvert Impact Capital is the aggregator for the CARF. CRF is the technology services provider for the CARF and manages the front-end platform and matching technology behind the loan application portal.

One motivator behind the creation of a collaborative small business fund was to give philanthropy and investors who wanted to support small businesses a way to easily do so, rather than needing to coordinate directly with institutions, like CDFIs. Similarly, it gave CDFIs the ability to raise capital at a larger scale and not need to individually negotiate with institutional lenders and philanthropy. One interviewee described the collaboration as the sum of the parts being larger than the whole: by coming together and raising funds together, CDFIs in California could collectively operate at a meaningful scale to respond to the economic crisis facing small businesses. At the same time, the CARF did not want to compete with CDFIs for philanthropic capital, which is one reason why the CARF is composed predominantly of loans from investors, rather than grants.

Two related, but distinct, funding structures exist within the CARF, each held within its own special-purpose vehicle (SPV). Each SPV is governed by its own set of documents and allows for different types of capital and capital arrangements to support the same type of small business lending. Currently, in each SPV there is some form of government capital that provides insulation against loss and private



capital, which is the first to be repaid. The first SPV also accepted grants and donations that helped support the CDFIs' fees and keep the borrowing costs low for the small business borrower. The CARF has contractual agreements with the lenders providing the capital and additional contracts with each CDFI participating in the CARF. See Figure 1 for a representation of the CARF's structure.

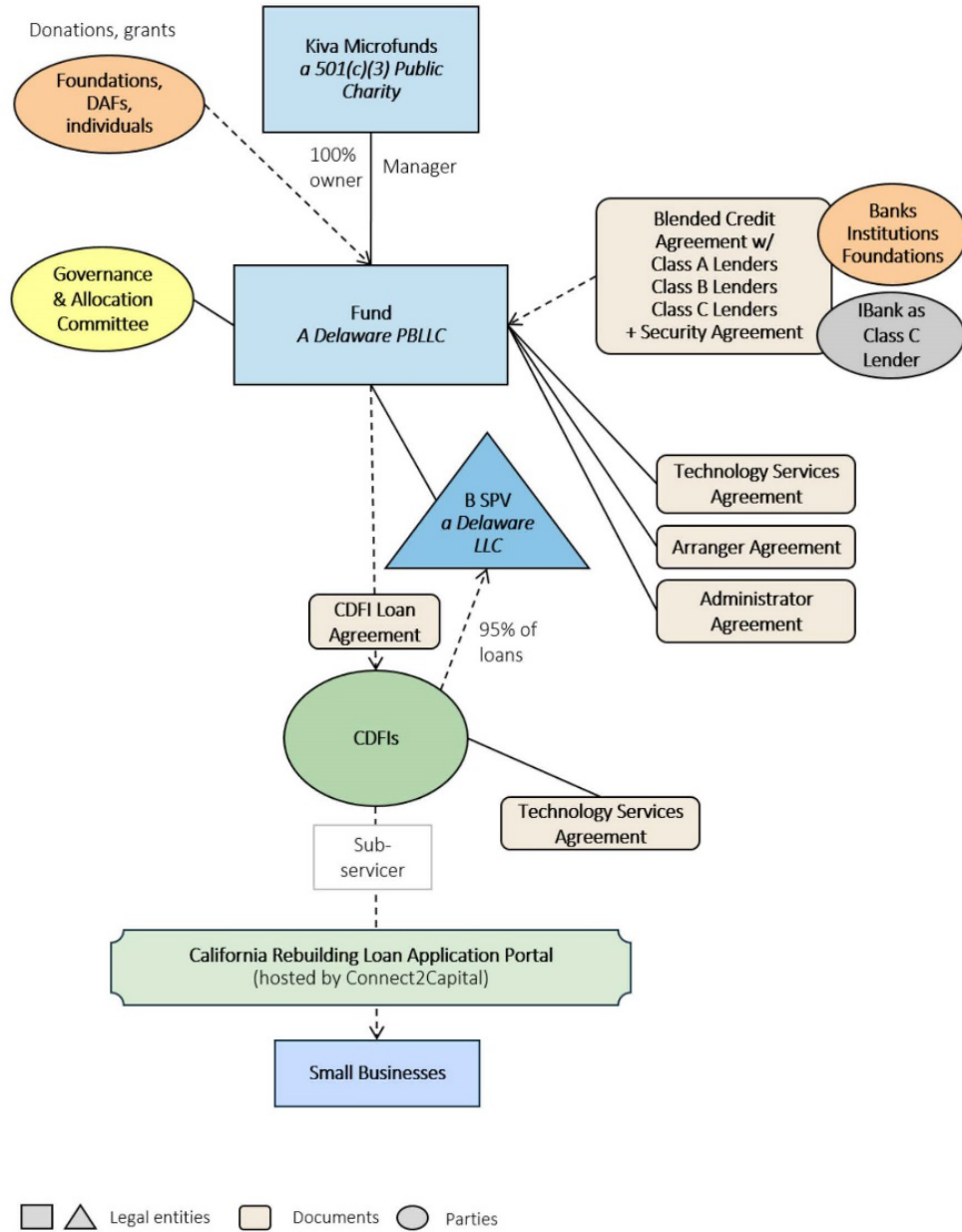
The first SPV is the Guarantee Facility. Small business loans made from this facility are backed by the IBank's Disaster Relief Loan Guarantee program, which guarantees 95 percent of the loan should the borrower fail to repay it. The IBank agreed to guarantee up to \$100 million in loans (allowing for 2:1 leverage of \$50 million in state funding). The first SPV was \$50 million to leverage the guarantee capacity that was still available at the time of the SPV's launch. The fund is capitalized by private and philanthropic capital in two tranches—a senior tranche and a junior (or program-related investment [PRI]) tranche. As described above, grant money is also contributed to the fund, which helps support the guarantee fees and the CDFI's origination fees. The loans to small businesses are made by CDFIs but must be approved by a financial development corporation (FDC)<sup>11</sup> affiliated with the IBank to secure the IBank guarantee.

The second SPV is the Blended Facility. In this facility, there are three classes (A, B, and C) of lenders; Class A lenders will be the first to be repaid, while Class C lenders will be paid last and are most likely to sustain losses if the small business borrowers default on their loans. In the Blended Facility, there is no guarantee, but the IBank has provided \$37.5 million in Class C capital, which helps insulate private lenders from loss. This \$37.5 million can then be leveraged with \$87.5 million in private lending for a \$125 million fund. Class A lenders are more traditional institutional investors, such as banks and insurance companies, while Class B lenders are more likely to be mission-driven investors, such as foundations providing capital in the form of PRIs. In April 2021, the IBank Board approved allowing its \$37.5 million contribution to be withdrawn from the IBank in increments so that the entirety of the private capital did not need to be raised before loans to small businesses could be disbursed; the 30:70 ratio between the IBank's contribution and private capital will be maintained as the fund grows. The blended facility allows for more leveraging of public dollars. The Blended Facility does not involve the FDCs, which decreases the cost and time from the perspective of the CDFIs and the small business borrower.

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<sup>11</sup> FDCs are mission-based organizations that were created to assist the IBank in administering its loan guarantee programs.

**Figure 1: Structure of the California Rebuilding Fund (Blended Facility)**



Note: This image describes the Blended Facility, but the structure is similar for the Guarantee Facility. The main difference is in the credit agreement with lenders, where there are two tranches of investors and the state’s guarantee position.

The subservicer box describes the role of the CDFIs; it does not indicate a separate entity.

Source: August 2020 iBank public meeting, “8a CA Rebuild Fund Resolution-No.-20-15,” Exhibit B.




Originating CDFIs hold 10 percent of the loan in the Guarantee Facility and 5 percent of the loan in the Blended Facility. The Guarantee Facility guarantees 95 percent of the loan, which is shared pari-passu between the portion held by the CDFI and the portion held in the facility. In the case of the Blended Facility, the CDFIs transfer 95 percent to the SPV and do not have loss protection on the portion that they hold. This is partly so that CDFIs have “skin in the game,” and it sends a signal to other investors that the CDFIs stand behind their underwriting of these loans. The CDFIs obtain an origination fee of 4 percent (or a minimum of \$500) per loan and servicing fees of 1 percent of loans outstanding or \$175 per loan, annually, whichever is greater.

The SPV structure allows for later rounds of funding to be slotted in as additional SPVs. Because each vehicle is distinct, terms can be modified in subsequent SPVs. This capital flexibility has also allowed for investments from local governments. Santa Clara County was an early contributor to the fund (making a Class A loan); its funds are used to support loans in the county and boost the county’s regional allocation within the CARF. In July 2021, the City of San Francisco launched a \$12 million, 0 percent interest rate loan program through the CARF. These small business loans were made possible by San Francisco’s providing a Class C loan and additional grant funding to buy down the interest rate.

## **Fund administration and governance**

Though Kiva is the owner and administrator of the CARF, decisions for the CARF are made by the Governance and Allocation Committee (GAC). The GAC is made up of neutral parties (with exceptions for representatives from lenders to the CARF and from the owner/manager of the fund) and includes members representing nonprofit, philanthropy, lending, and governance perspectives. At the time of the interviews, the GAC had seven members, though membership can change over time. The independent governance structure was important to the CARF designers. The selection of different types of stakeholders (nonprofit, lenders, philanthropy, etc.) is dictated in the terms of the CARF approved by the IBank; this variety of members is meant to ensure a holistic perspective. The CARF itself is also intentionally distinct from Kiva and also not beholden to any particular set of funders.

The GAC formally began operations on September 18, 2020; prior decisions about the fund were made by the CASE Task Force. Post-creation, the GAC handles decisions specific to the fund. The CASE Task Force continues to meet, focusing on the broader ecosystem around the CARF, such as policy, how the CARF interacts with other programs, and how to support the small business ecosystem. The GAC is charged with making any needed changes or adjustments to the CARF (e.g., loan terms or decisions around which CDFIs participate), and it also manages the allocation of money from the fund to various CDFIs based on the goals of the fund. The CARF designers were explicit in their goal of equitable distribution of funds across the state; they wanted to avoid a situation where urban areas outcompeted rural ones, or where one region of the state received a disproportionate share of the



funding. As a result, the GAC monitors the geographic distribution of loans being made and can adjust allocations to CDFIs or make recommendations to CDFIs on where to target lending if it becomes geographically unbalanced. Additionally, although the CARF does not have (and legally cannot have) quotas or requirements to reach different demographic groups, it is monitoring the demographics of applicants and can press CDFIs to consider how to reach underserved populations. Kiva and Calvert provide regular reports to the GAC, which facilitates its work. The GAC also serves an oversight function, monitoring both the capital flowing into the CARF and the performance of participating CDFIs.

### **Application process, loan terms, and eligibility**

Small business borrowers initiate an application through a centralized platform, Connect2Capital (C2C). At this stage, the borrowers provide an initial set of information and are screened for eligibility. At the end of the process, if they meet the eligibility criteria, they are matched with one or more CDFIs. Behind the scenes, C2C matches borrowers with CDFIs based on geography and other criteria selected by the CDFIs, such as loan size. Upon reaching the match page, the borrower has the ability to choose which CDFI it would like to work with; the page includes a blurb about each matched CDFI. Once the applicant's information is at the CDFI, the borrower then provides the full documentation required for the loan, and the CDFI determines whether to make the loan. Though the CARF sets the loan terms and the guidelines for eligibility and basic requirements, each CDFI is responsible for underwriting the loan and uses its own underwriting process. Some borrowers will not match with any CDFI on the application portal. The page alerting applicants that they have not matched with a CDFI also lists resources for borrowers, including TA providers.

To be eligible for the CARF's loans, businesses may not have more than 50 employees and must have gross revenues of less than \$5 million per year; there is a limited set of industries that are ineligible for the loans. Because the CARF designers knew that demand would far exceed the supply of funds available, the CARF was envisioned as a rebuilding fund that could allow businesses that had been successful prior to the pandemic to get back on their feet. As a result, businesses are required to have been profitable in 2019, self-certify a certain decline in revenue due to the pandemic, and demonstrate that revenues have started to grow again. Initially, new businesses (those that were started after 2019) were ineligible for the program, but they became eligible in the spring of 2021. However, the amount of the CARF that can be allocated to new businesses is limited to 15 percent.

The small business loans provided through the CARF are below-market for what is typical in the small business lending sector. As outlined in the term sheet from the April 2021 IBank Board meeting (Appendix 1), at the time of this writing, the loans in the Blended Facility have an interest rate of 4.25 percent; if interest rates rise in the future, the interest rate is pegged to WSJ Prime + 1.0 percent. The loans include a



12-month interest-only repayment period before becoming fully amortizing, which gives the small businesses some time to recover before needing to make full loan payments. Costs to the borrower (beyond interest) are restricted to a limited set of third-party fees and expenses. Loan size is limited to the lesser of \$100,000 or an average revenue for a three-month period prior to the pandemic.

Early interviews suggested that the CARF is reaching a broad array of borrowers, with large shares of the applications coming from small businesses that are very small (fewer than 10 employees) and from businesses owned by women and people of color. Though the GAC has the ability to rebalance allocations to ensure that all regions of the state are being served proportionally, the interviews suggested that outreach had been successful in prompting applications from all parts of the state and that more formal mechanisms for allocation had not been needed.

## Reflections on the CARF

### Design constraints and structural advantages

The development of the CARF faced two main sets of constraints. The first set was legal constraints. Lending is regulated at the state and federal levels, and there are additional laws that govern loan pools or funds. Interviewees with legal backgrounds stressed that the program design was particular to California, and though the structure can be replicated elsewhere, state laws could require state-specific changes. Interviewees also mentioned that California has antidiscrimination laws that include provisions against affirmative action, in addition to needing to follow fair lending laws that exist nationwide; this meant that while the program was designed with underrepresented and underserved borrowers in mind, it could not be explicit in targeting lending to specific demographic communities. These legal constraints affected how the fund was structured and what institutions could serve as lenders for and owners of the fund. Finally, California also has strict data privacy laws, which affected how the application portal and referrals through it were designed.

The second constraint the CARF faced was aligning the terms to accommodate the needs of the lenders to the fund while staying true to the goals of the group and the way that CDFIs do small business lending. As in any public-private partnership, there is a tension between reaching as many borrowers as possible by keeping costs low and eligibility requirements expansive while having sufficient incentives to induce the participation of private investors who seek additional return with increased risk. The IBank also had its own set of requirements for guaranteed funds and their first-loss capital. In this case, there was an added hurdle because the default risk was unclear: small business loans are typically perceived as riskier than loans for larger firms in a normal year, but it was particularly difficult to predict how these businesses would adapt to uncertain economic conditions



induced by COVID-19. In addition to having a disparate set of private and philanthropic investors agree to terms, CDFIs also had to come together and agree on a uniform product, something that is relatively uncommon among CDFIs. Ultimately, interviewees typically stressed that they were not far out of alignment when it came to goals for the CARF. However, ironing out the details was still complicated, given the number of parties to the transaction.

Although the loans have favorable terms, compared with what is typical in the small business market, CDFI interviewees regularly commented on aspects of the credit box that they felt were too restrictive or dissimilar to how they would lend outside of the program. One CDFI interviewee suggested that the private lenders were the source of the credit tightness noted by many CDFIs and that these lenders' concerns and parameters pushed whom the program was designed to serve—parameters were “investor-driven rather than need-driven.” This CDFI interviewee was also frustrated by what they saw as a lack of transparency between the investors and those negotiating with them, while acknowledging that they appreciated there was a third party managing the investor relationship. Other CDFIs mentioned that there were negotiations with the lenders to the fund; however, they were less pointed in suggesting that it fundamentally changed the customer base, while acknowledging that it did often result in tighter underwriting than the CDFIs typically do. Interviews indicated that many individuals involved in creating the CARF view small business lending as less risky than traditional investors do, and that CDFIs, because they are used to serving this segment of the market, felt that they could safely lend with wider parameters than those set by the program. One CDFI interviewee said they were not surprised by the investors' framing, but that it was fundamentally different from how CDFIs think. Another interviewee suggested that the initial product was not able to reach the most underserved borrowers, but that this was necessary to get all of the actors on the same page, and as the second round of funding was secured, the product could be adjusted. Conversely, one interviewee suggested that meeting the parameters of the IBank guarantee program affected the design of the credit box more than the requirements of private investors.

At the same time, the CARF structure has several advantages. It created a pipeline through which large investors and philanthropic institutions could reach small business borrowers while keeping the small business borrowers engaged with local lending institutions. Although the CDFIs had to agree to a standardized set of eligibility and underwriting guidelines, they were able to access a large pool of capital without needing to individually fundraise and negotiate the terms with each philanthropic or institutional investor. The agreements and structure of the fund are relatively sophisticated; by acting together, the CDFIs could rely on a joint pool of experts rather than needing to have that expertise in-house (or needing to contract for it). The interest rate to the small business borrower is low because the IBank has provided guarantees or first-loss capital, and other grants to the CARF subsidize the fund as




well. Several interviewees stressed the flexibility of the fund structure. The CARF design itself, with the overarching PBLLC and separate SPVs, is a flexible design that allows for additional rounds of funding to be accommodated in the larger structure. This flexibility also allows for changes in the product (such as eligibility or loan terms) in later rounds of funding. Although the IBank is providing the first-loss capital in California, it need not be a government entity providing this capital; the funding structure can accommodate different forms of investment from other government or philanthropic actors, as indicated by the investments made by the City and County of San Francisco and Santa Clara County.

### **Fundraising experience**

Many interviewees expressed surprise at the difficulty in securing both philanthropic and investment capital. Part of the challenge was aligning all the moving pieces simultaneously: public, private, and philanthropic capital were needed to support the effort, but actors were hesitant to sign on when their counterpoints were still pending. CASE members had significant connections into Bay Area philanthropic networks and were able to secure initial seed funding, but raising the philanthropic capital that was needed for the full fund was more challenging. Several CASE Task Force members who worked with philanthropy expressed that this effort required more upfront communications with potential funders to educate them about how this type of product worked and about CDFIs as lenders. The members suggested that small business efforts did not fit as cleanly into traditional foundation “buckets” (such as climate, for example). One interviewee noted that despite looking for innovative ideas, many philanthropic funders were ultimately risk-averse. An interviewee suggested that many philanthropists are not used to providing investments, rather than grants, and another noted that they initially targeted funders who were more sophisticated and familiar with a variety of funding vehicles. Interviewees also mentioned that philanthropic funders neither wanted to duplicate federal efforts nor fund something that would be ultimately eclipsed by federal efforts.

Similarly, conversations with bank investors went more slowly than expected, despite the guarantees in the initial fund that would essentially insulate investors from losses and a large first-loss position by the state of California in the second SPV. One interviewee noted that multiparty deals are always difficult to execute and that everyone was overstretched in 2020, which made the situation all the more challenging. The CARF also did not have an anchor investor who signed on first and dictated the terms; the CASE Task Force was pursuing several large investors at once and trying to come to terms that worked for all of the investors. One interviewee noted that while the group creating the fund was mission-driven, the investors they approached treated it like any standard commercial deal. Additionally, the product was new, which may have caused more trepidation among institutional actors. As time went on, fundraising also became more challenging—potential investors’ feeling of urgency to assist small businesses was lessened relative to mid-2020, when CASE members first started





discussing the CARF with funders. Fundraising efforts shifted to focus the narrative not just on COVID-19 relief but on long-standing gaps in access to credit for small businesses.

Fundraising efforts on both the philanthropic and private capital sides have focused on finding funders who are a good fit with the CARF in terms of alignment with strategy, structure, and motivations. Though the names of CARF investors and donors have appeared in press releases and on the CARF's website, some CASE Task Force members felt the list of supporters had not been transparent and had resulted in fundraising missteps. One interviewee was critical of the opacity in fundraising efforts and suggested that stronger use of the state's bully pulpit, combined with broader advertisement of CARF investors to nudge similar investors into participating, would have been a better strategy to raise capital. Another interviewee similarly suggested that ideally the fund would have had a bigger launch, with large initial investors creating a signaling effect to crowd in other big players.

### **How the CASE Task Force operated**

As described previously, the CASE Task Force was a group of disparate actors, each working in parallel to try to support California's small business community, who joined efforts as they were introduced to one another. The group was compelled by a sense of urgency because of the pandemic. And in some ways, the pandemic and shelter-in-place order also facilitated the group. The scale of the crisis and the importance of acting quickly to stem small business losses provided the motivation for a large volunteer commitment from CASE group members. One interviewee commented that in some ways CASE members had more time because all of their meetings were happening on Zoom, while previously many group members had spent much time on airplanes. Several noted that replicating this model—either in other states after the immediate crisis ends or as a mechanism to leverage funding for other types of lending—may be challenging without an urgent impetus, such as the pandemic, to provide the motivation for the hours of intense volunteer work that this project required.

The group operated at the “speed of trust,” an expression used by several of the interviewees. Individuals dictated their own involvement, volunteering for as much or as little as they were interested in or had bandwidth for. Central to the groups' functioning was trust—trust in their colleagues' areas of expertise and trust that tasks would be accomplished by the person who volunteered to do them. The relationships with Calvert, Kiva, and CRF were also based on trust. Calvert is paid an arrangement fee by the CARF when new commitments are closed in. In the beginning, however, when there was no entity to hold a contract with, Calvert worked on a volunteer basis. Kiva and CRF worked with CASE in a similar way, volunteering their efforts and expertise until they were selected as the administrator and technology services provider, respectively, of the CARF and until the fund was formalized (along with the administrative and technology services fees).



This trust was particularly important because the group made a deliberate decision to side-step questions of structure and governance for the CASE Task Force itself. This was due to a fear that setting up governance structures for the task force and its volunteers could take months, delaying the design and implementation of a product to help small businesses. The task force instead prioritized speed by avoiding creation of a governance structure. One interviewee described this as operating with a focus on outcomes rather than process: starting with a desired outcome and then working backward to figure out what processes would support that outcome. Another said they were working toward a mission rather than building an organization. One advocate of this no-governance structure stressed the importance that this effort was not “top-down”; it was designed by stakeholders and with its target audience—small businesses and CDFIs—in mind, rather than designed around ease of fundraising or other goals. Though its structure was not formalized, the task force met weekly as a group and was also organized into subcommittees for specific roles, each with individual leads. Most interviewees highlighted this flexibility and motivation in moving the project forward and in being able to leverage the diversity of participants’ experiences, since there were many leads in different workflows. And despite the lack of formal structure, interviews with early CASE members indicate unity and cohesion in how they saw themselves, their relationships with each other, and their roles in moving the product forward. Though the CASE members, for the most part, appreciated this lack of structure, comments from interviews suggest that it also required a specific type of person to be successful. Several respondents noted that there were “no egos,” and another suggested that “high EQ” people were needed.

One respondent, however, pushed back strongly on the lack of structure for the CASE Task Force (both to the task force members and in an interview). This individual argued that the lack of a structure for the CASE Task Force and the fact that it operated by consensus made for a slower and more “clumsy” decision-making process; they suggested that greater management and accountability would have improved the group’s ability to make decisions. Additionally, they believed that the lack of governance would constrain the CARF’s ability to grow and be effective, due partly to a lack of accountability to a body such as a board. (Although the GAC is supervising the fund and has reporting obligations to investors and the IBank, this interviewee did not believe this was sufficient.) The interviewee acknowledged that speed could take priority over governance structure early in the process but believed that ultimately the project’s ability to scale and sustain itself was limited by its lack of governance and accountability structure. Another interviewee suggested that the flexible structure worked only because a task force member stepped into a project manager position to ensure that nothing fell through the cracks. They stepped into this role when they observed bottlenecks, and they noted in an interview that more structure would have eased some of the “bumps” the group encountered. This respondent suggested that there might be a middle ground between formal, stiff



bureaucracy and no governance, noting that the flexibility and fluidity the lack of structure facilitated was beneficial to the outcome and the speed at which they operated. The lack of a formal structure, rules, or bylaws also produced some uncertainty during the process: several interviewees stated that they were unsure how particular decisions were made or how decisions around program expansion could happen and expressed a desire for more transparency in some of the decisions. This less formalized process worked to get a product together quickly, but some interviews suggest that questions of structure and governance needed to be resolved as the product entered its next iteration (in the summer of 2021) and actors consider whether to allot more funding to the CARF (though one interviewee believes that the Governance and Allocation Committee is sufficient).

### **CDFI motivations and challenges**

CDFIs had various reasons (beyond their mission-driven goals) for participating in the CARF, though the reasons varied from CDFI to CDFI. One key advantage of participating in the CARF was liquidity. By being able to transfer the bulk of the loans to the CARF, CDFIs were able to do more lending than if the loans had stayed on their books. CDFIs serving small business borrowers have historically struggled to come together on a standardized product that would allow them to securitize or otherwise generate liquidity by taking loans off their balance sheets.<sup>12</sup> The CARF (and other similar pandemic loan funds) serves as a demonstration that CDFIs are able to do so while still serving the small business borrowers they specialize in reaching. Interviewees from one CDFI additionally noted that the risk-sharing with the CARF allowed them to make loans to borrowers that they otherwise would not have been able to serve.

CDFIs also saw other advantages to participating in the CARF. One interviewee suggested that their CDFI saw this as an opportunity to expand into some local markets where it had a more limited presence. Additionally, this CDFI saw participating in the CARF as a way to experiment with selling loans, since it had been interested in that possibility for some time (though as noted in the Structure section of this report, the loans are not actually sold to the CARF). Many CDFI interviewees noted that CDFIs have very limited marketing budgets and that often small business borrowers know little about them. By partnering together and participating in a government program, they were able to essentially outsource their marketing (for this particular lending product) to the CARF.

Although there are advantages to participating in the CARF, becoming a participating CDFI lender was not necessarily an easy lift for the CDFIs. The structure of the CARF was new, and the contracts required

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<sup>12</sup> Brett Simmons, Jonathan Brereton, and Joyce Klein, “[Addressing the Capitalization and Financial Constraints of CDFI Microlenders](#),” *Community Development Innovation Review* 15 (1) (2021): 43–60.



to participate were not always familiar to CDFIs. Using the IBank guarantees requires partnership with one of seven FDCs that process the loan guarantees; if the CDFI had not already been working with the IBank guarantees, it would have needed to establish this process and relationship. CDFIs also needed to create underwriting guidelines in line with those of this program. One CDFI noted that the underwriting for the CARF was ultimately similar to the underwriting that the CDFI had developed for lending during the pandemic, but had it not been, it would have taken 30–45 days to establish the processes for new underwriting. CDFIs also needed to hire additional staff to deal with processing the loans. One CDFI interviewee stated that their organization had used funds raised elsewhere to hire additional loan officers to be able to process loans quickly, and another noted that they had partnered with an external vendor to handle increased call volumes. One of these interviewees suggested, however, that not all organizations would have the ability to hire additional staff before additional funding (from origination and servicing of the loans) started coming in. Another CDFI shared that it initially accepted applications from only a few counties because it was concerned about whether it would have enough capacity to process the loans from a wider geography. One of the challenges of developing capacity, however, was uncertainty around how long the program would last. There are hopes that the CARF will be extended beyond the two facilities currently approved by the IBank; if those do not come to fruition, however, it would not necessarily make sense for a CDFI to make long-term investments. Additionally, several CDFI interviewees expressed that their participation in the CARF is break-even, at best, under the current fee schedule for origination and servicing. One CDFI interviewee suggested that their CDFI's ability to standardize its processes had allowed it to lower costs and maintain a high loan volume, but they expressed that this may not be true for all participating CDFIs. Another CDFI interviewee suggested that their origination costs were being covered by the current fee structure but that they did not expect to break even on servicing the loans (though perhaps they would with higher loan volumes). This second CDFI interviewee proposed the use of a central servicing agent to help scale and achieve cost-effectiveness. Two CDFI interviewees suggested (in different ways) that while a break-even product may be the right way to respond to an acute economic crisis, it will not allow CDFIs to grow and sustain themselves over the longer term. Participants stressed the importance of supporting the small business community as driving their participation but noted that they did not see the product, as currently structured, as sustainable for the participating CDFIs.

Many CDFIs suggested in interviews that the credit criteria required by the CARF were too strict. As CDFIs began to make loans, they discovered ways in which businesses that appeared well-suited for the program were falling through the cracks regarding eligibility. CDFIs are able to request individual exceptions for borrowers from the CARF administrator, and in areas where several CDFIs have identified issues, eligibility criteria have sometimes been modified for the second loan facility. However,




many CDFIs continued to suggest in interviews that the borrowers they are serving through the CARF often have stronger financial records (absent COVID-19) than their traditional borrowers. Several CDFIs noted that this underwriting process was more rigid than their traditional way of operating. One larger CDFI that often originates slightly larger loans, however, indicated that the underwriting process for the CARF was abridged relative to its traditional underwriting and that the CARF program allowed it to lend to borrowers who would not have otherwise met its credit box.

Beyond the underwriting process and criteria, the CDFIs noted other ways in which this product could look dissimilar from their typical loans. One CDFI reported that it typically makes smaller loans than those allowed by the CARF, while another CDFI that often makes SBA loans noted that its typical portfolio consisted of larger loans than those it was making with the CARF. Additionally, CDFIs must serve low- and moderate-income populations and other target populations or geographies as part of being a certified CDFI. However, the CARF does not have eligibility requirements for target populations, nor does the C2C matching algorithm allow for screening based on these criteria. One CDFI noted that it has been challenging to stay within its mandated thresholds with the CARF loans; another CDFI shared that it set additional eligibility criteria and would direct borrowers that did not meet its target populations/geographies to other lenders. In the short term, CDFIs may be able to balance these goals (participating in the CARF and meeting CDFI certification requirements), but this may become more challenging if the program is extended and begins to comprise a large share of their lending volume.

One CDFI reflected on the tradeoff between its traditional, more flexible underwriting procedures and this standardized product: while the CARF loans have more rigid requirements, they require less intervention on the part of the CDFI, which allows it to serve more customers. This CDFI also noted that the CDFI industry has often contended that these small business borrowers who are not able to obtain lending from traditional banks need more assistance throughout the process. Although discussions with TA providers did suggest that some borrowers are struggling to apply for the program even through its simplified and centralized portal, this CDFI found that a large majority of borrowers were able to navigate the online application with no assistance, which ultimately allowed the CDFI to serve more borrowers. TA providers and CDFIs both noted that it was during the process of providing all of the documentation required for the loan where many small business borrowers needed more help. Another CDFI interviewee, when asked whether losing flexibility in underwriting was worth it to access the CARF product, answered, “Yes, and...,” noting that it continues to have flexibility and make loans outside of the CARF.

CDFIs are seeing different loan volumes through the matching portal. Although the program itself has had a high volume of applications, one interviewed CDFI suggested that it was seeing much lower lending volumes than expected. This CDFI additionally noted that it had funded a relatively low share of




applications. When asked why, it suggested that, both within and outside of the CARF, potential borrowers are filling out many applications, shopping around, and viewing different products. Thus, not all applications are likely to result in a loan. Other interviewees also noted this behavior.

## **Technical assistance**

The ways in which technical assistance (TA) providers were engaged and the timing of that engagement were influenced, in part, by CASE members from CRF and Calvert, who had worked with the New York Forward Loan Fund and brought suggestions with them as to the types of TA that had been needed in that effort. They found that small business borrowers often needed multiple outreach efforts to engage with the fund and often needed assistance with understanding the program and the documentation required (something confirmed in interviews with TA providers for California as well). In addition, the CASE Task Force had deep connections to the small business support ecosystem in California through volunteers from Small Business Majority and the California Association of Micro Enterprise Opportunity and were able to leverage these networks while also leaning on TA expertise from these members and participating CDFIs. TA organizations were engaged before the launch of the CARF, including many train-the-trainer events to familiarize TA providers with the program and its requirements. TA providers, in turn, did outreach in their networks to provide webinars for small businesses, informing them of the fund and assisting them in applying. Part of the assistance to businesses also involved helping them negotiate which of the various streams of capital that were available to them (the CARF, the 2021 round of PPP, California relief grants, etc.) were right for them. CASE Task Force members held regular calls with TA providers and business groups to hear feedback on how the program was going and to provide a forum for questions; questions raised during these calls were then shared with the larger CASE team.

Though the CARF coordinated more with TA providers from the outset than previous funds (according to interviewees), this coordination was about directing borrowers to the CARF and making sure TA providers could support them in applying. At the time of the launch and for several months afterward, there was no formal integration with TA providers on the back end—particularly for borrowers who were not matched to a CDFI. Some TA providers expressed a desire to receive contact information on declined borrowers so that they could reach out to offer assistance or services and expressed frustration that there was no process in place to connect TA providers with declined borrowers directly. They noted that borrowers were being left behind at this stage. There are two main reasons, according to interviews, for why this was not a feature of the online portal. The first is that California has strict online data privacy laws and applicants would need to consent to their information being shared. The second is a related concern: one of the early members of the CASE team expressed a desire to contain the applicant data to the platform and the matched CDFI so that the program would not appear to be



selling applicant information or using applicants' information in a way the applicants would not have anticipated. The CASE team was eventually able to design a way to reach unmatched borrowers while still complying with California privacy laws. On a monthly basis, unmatched applicants are sent a communication with resource partners that can assist them. Through that communication, unmatched borrowers are able to opt into being matched with a TA provider to receive further assistance.

Despite the centralized online platform and the designers' intent to simplify the process as much as possible for small businesses, interviews with TA providers revealed that there is still a subset of small businesses that struggle to apply. Digital access and documentation are often roadblocks. Multiple interviewees mentioned that, despite running successful businesses, not all business owners could easily get online or were tech-savvy. One interviewee gave an example of organizations setting up drive-throughs where employees scanned documents on behalf of small business owners, and another noted that they did outreach door-to-door in a rural community because business owners did not necessarily have email. Several interviewees noted that language barriers were challenging some businesses. Although the CARF application can be (and has been) completed in multiple languages, one interviewee noted that the Spanish version had not worked properly on their computer. CDFI and TA partners have language services available to potential borrowers, and informational webinars were held in more than one language; however, not all English-limited business owners will know how to find these services. Interviewees also noted that there were drop-offs in the application pipeline once potential borrowers reached the documentation stage and that this was often where they needed assistance. Although interviewees noted that this was not atypical for small business lending programs generally (with one interviewee suggesting that CARF was an easier application process than other programs due to the TA outreach and engagement that occurred), it does suggest that there are still small business borrowers who struggle to access credit even when programs are designed with them as a target audience. It is possible that with more assistance, the CARF can reach additional borrowers, but absent significantly reduced documentation and eligibility requirements, some of the most vulnerable small business owners may not be capital-ready. One TA provider suggested, however, that it would not redesign the programs to serve these left-out borrowers; rather, it saw its role as needing to educate small businesses—about how the program worked, about how to apply, about how to keep the records needed for these types of programs, about the existence of CDFIs as an alternative to other lenders. Another interviewee noted that neither CDFIs nor TA alone were sufficient; what was needed was a “strong ecosystem of support” and further integration of TA into the design of new versions of the program.



## Challenges due to timing and uncertainty

The CARF came together relatively quickly during a time of extensive uncertainty and continually moving pieces, as the economy ebbed and flowed in response to waves of COVID-19 and related government mandates, and local, state, and federal policymakers created and adapted programs. Both the speed of development and the uncertainty of the economic and policy environments affected the CARF's design and implementation.

Some of the challenges of the CARF reflect the fact that “we were building this plane as we flew it,” as noted by one interviewee. The CASE Task Force focused on speed, wanting to design a product that could start making loans as quickly as possible, all while designing a new program. Though it drew from lessons that the Calvert and CRF teams brought from the New York and Chicago funds, those programs were also still new, and the CARF had its own unique elements. Improvements based on early learnings from the program have already begun to be incorporated. For example, some modifications in eligibility were made between the first facility (first SPV) and the second, and a workaround was designed to provide unmatched borrowers with TA resources.

Uncertainty about other parts of the pandemic response also complicated efforts. The CARF was, in some ways, overshadowed by the California Small Business COVID-19 Relief Grant Program and the 2021 round of federal PPP funding, which effectively “compete” with the CARF; as a result, these may have decreased initial demand for the program, given their relatively concurrent timings. Small business supporters, including TA providers and CDFIs, had to develop messaging to help small businesses navigate which program was the best fit for their needs and to distinguish the utility of the CARF from the other programs. Many interviewees, however, stressed that they view these programs as complementary. Small business capital needs during the pandemic were so deep that no one program was likely to meet all small businesses' needs. Interviewees expressed hope that small businesses would take advantage of grants and the PPP (which is effectively a grant if the loan is forgiven) and acknowledged that these programs could disburse funds quickly. They viewed the CARF as a longer-term resource that would help businesses rebuild or pivot, and it would remain available long after the grant money had been disbursed. Interviewees acknowledged, however, that the influx of many types of available lending and grant programs made messaging more difficult and confusing; several noted that, if they had to do it over again, they would have wanted the grant program and the CARF to have been more coordinated. One interviewee suggested that they could act as a “continuum of capital” and that even though they were not planned together, they could still be messaged in this way.





## Looking Forward

Most interviewees expressed hope that support for small businesses would outlast the pandemic. Many noted that the lending landscape was already challenging for small businesses prior to March 2020, especially in low-income communities and among underserved business owners. Several interviewees stressed that although the need for assistance was acute among small businesses during the pandemic, it is important to support small businesses outside of the current moment and advocated for a stronger small business infrastructure in the state of California. One interviewee who provides training and education to small businesses noted that the focus is often on setting up small businesses for success, but that the sector does not always prepare small businesses for a downturn. Similar points were made in reference to CDFIs. Several interviewees noted the importance of CDFIs in serving small businesses who may not be able to obtain other types of financing from more traditional lending institutions and hoped that CDFIs would continue to receive support. One interviewee suggested that CDFIs and minority depository institutions are being asked to fill a gap left by the decline of the community banking industry in recent decades; they noted that something more lasting than pandemic-response programs would be needed to support these and other community-based institutions' ability to lend in their communities and scale to meet the need.

Many interviewees expressed a hope that the CARF would live on beyond the pandemic economic recovery as part of an ecosystem to support small businesses in California. The continuation of the CARF would require renewed commitments from the IBank, either in the form of guarantees or first-loss capital, or from other government or philanthropic actors who could provide first-loss capital. One opportunity for a renewal of this funding is the State Small Business Credit Initiative (SSBCI), passed as part of the American Rescue Plan Act in March 2021. In general, approaches like the CARF, where public and private capital are pooled and public funds absorb some of the losses, are possible under SSBCI, but adherence to SSBCI program rules may require changes to programs like the CARF. Though renewed funding for the CARF is not an explicit component of California's SSBCI application, a conversation with the IBank director indicated that it is keeping California's programs under SSBCI flexible and that additional funding for the CARF may occur, depending on the state's needs in 2022. Similarly, the state budget passed by the legislature and signed by the governor in July 2021 includes \$50 million for IBank small business lending programs, which could include the CARF. It would also be possible to rely on another entity for first-loss capital: the Southern Opportunity And Resilience (SOAR) fund, created after the CARF in 15 southeastern states, relies solely on philanthropic support rather than on government capital for the first-loss position.

An extension of the state's support of the CARF and the creation of a more permanent (or at least multiyear) program would change some of the financial calculus around the CARF. On the one hand,




several interviewees expressed concern that outside of the pandemic moment, it may be harder to fundraise for the private and philanthropic capital needed for the fund as investors move on to other topics, and, as noted in the Fundraising section, fundraising became more challenging as time went on. Several individuals (in agreement with the authors of a Little Hoover Commission report on the CARF<sup>13</sup>) suggested that the state needed to use its platform to draw more investors to the fund, and one interviewee noted that additional state commitments would be needed. At the same time, the extension and recapitalization of the CARF might create a different funding strategy, as it could begin to target fundraising at scale. Currently, the CARF has approached investors one by one, but to fundraise at scale, it would pivot to issuing a product. These types of approaches, if successful, access different forms of capital. Interestingly, one interviewee suggested that the challenge is always in raising the risk capital (the capital that sits in the lowest tranche); by continuing its commitments to the CARF, the state of California would be eliminating the largest funding hurdle, in the eyes of this interviewee. Another interviewee suggested that fundraising at scale could make it attractive for governments to continue to invest in these types of structures because they provide large amounts of leverage to government funds. Combining the perspectives of these two interviewees, it is possible that successful fundraising due to an initial continued commitment from the state of California could produce a feedback loop. Funding that was guaranteed for several years would also provide the CDFIs with the certainty needed to invest in additional staff or other resources needed to originate more loans. Using these types of funds (and pushing loans off their balance sheets) is not the way CDFIs typically fund their activities; within these types of funds, CDFIs rely on origination and servicing fees, while the traditional CDFI financing model for small business loans relies more heavily on interest income. It is possible that with multiyear funding commitments and a higher volume of loans, the financial calculus for CDFIs could improve as they are able to adapt to this strategy (though changes in the fee structure may still be needed).

If additional rounds of capital are raised, the CARF can continue to iterate on the eligibility, loan terms, subordination structure, and so on to “right-size it to the current situation.” An interviewee noted that the group expected the interest rates offered to small businesses in the CARF to climb closer to traditional CDFI rates, noting that it did not “want to distort the market for too long” after keeping it very affordable during the acute period around the pandemic. This same interviewee noted that the cost of capital would need to change to be able to scale and to maintain sustainability of the fund. Finally, if the CARF were to continue to be funded and became a significant share of CDFIs’ total lending, CDFIs may need to be careful to ensure that sufficient applications come from their target markets in order to

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<sup>13</sup> Little Hoover Commission, “First Steps Toward Recovery.”




continue to meet CDFI Fund obligations; the CARF may need to allow CDFIs to screen based on these criteria or change its own eligibility requirements to facilitate this.

Absent a continued capitalization of the CARF, there are other opportunities to expand on the CARF's structural design, both within and outside of California. The financial structure of the CARF, with its overarching PBLLC and individual SPVs, is flexible to various forms of capital and can be adopted with any type of entity providing the risk capital. This type of structure could also be used for other types of lending: several interviewees mentioned the model's possible utility in responding to natural disasters. Beyond this structure, both the C2C platform and the unification of CDFIs under one lending product provide opportunities to advance CDFI small business lending. The centralized application platform is a major innovation of the CARF and other similar funds. CRF, the CDFI that designed and manages the C2C platform, sees the emergence of this type of online platform (whether through C2C or another platform) as important in helping CDFIs compete with online and fintech lenders who have larger marketing budgets and show up higher in search results. CRF created an online platform several years ago but was still working to expand its partnerships and use of the site. Its goal was to improve the consumer experience and to help CDFIs reach small business consumers by centralizing what it could but still keeping the local relationships (e.g., loan servicing, loan workouts, business advisory services) that are key advantages of CDFI lending. When COVID-19 hit, CRF thought its platform could work well with aggregated pools of capital and multiple CDFI partners and was working with Calvert Impact Capital. It adapted the platform to meet various funds' needs, first in the City of Chicago, then in New York, and then for the CARF, learning and improving the platform in each iteration. The number of CDFI partners using the C2C platform has grown substantially with the participation in these funds, and CRF hopes that the platform will become an industry tool that will continue to be used beyond these funds. Interviewees from a CDFI appreciated clients' ability to self-serve on the online platform and see this type of self-service as necessary to serve larger numbers of small business customers. Other CDFI participants were interested in this type of platform, but several cautioned that its utility would depend on referral volumes and the cost of participating in the platform (C2C has waived its referral fees within the CARF but has historically had them).

The unification of CDFIs under one lending product also presents an opportunity. The bespoke nature of CDFI loans has been touted as a strength of the sector, and there has often been resistance to standardization.<sup>14</sup> However, standardization of lending terms and underwriting facilitates the use of a common application platform and expands lending and creates liquidity by getting loans off balance

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<sup>14</sup> Simmons, Brereton, and Klein, "Addressing the Capitalization."



sheets, whether through a mechanism like in the CARF or through loan participation sales or securitization. CDFIs' experience with this common product through the CARF acts as a pilot and may increase willingness to participate in common programs in the future. Finally, one interviewee noted how challenging it can be to align organizations outside of crisis moments and was hopeful that the relationship-building between the state, CDFIs, and other actors in the CARF could facilitate responses to future problems. Another interviewee echoed this sentiment and hoped that they would find a way to continue to use the infrastructure and synchronization across organizations going forward.

The eagerness of other states to replicate this model or of California to continue to fund it may ultimately depend on what efforts are undertaken to assess the program's impact. To date, the CARF has been successful in serving mainly historically "un-banked" small business customers,<sup>15</sup> one of the CARF's primary goals. In the short term, the CARF is collecting information on the number of businesses served, the number of jobs created, and the kinds of businesses that are accessing the program. According to one interview, it is also planning a deeper qualitative analysis to understand the small businesses using the program in the medium term, as well as a micro- and macroeconomic analysis once the program has ended to understand the impacts on the small businesses themselves and spillover effects from the businesses receiving the loans. However, as other regions look to this program when considering how to respond to continued economic constraints for small businesses, they are limited to public reporting on the number of loans disbursed and the average profile of businesses served. Additionally, estimating the effects of this program (and others like it) beyond measuring outputs, like number and types of businesses served, can be challenging. One interviewee noted that the existence of the California Small Business COVID-19 Relief Grant Program would also complicate the ability to evaluate whether the CARF was working well.

Finally, though not a challenge for the CARF itself, finding a similar set of stakeholders with the capacity and bandwidth to undertake this type of project may limit replication in other contexts. The CARF came together due to a group of heavily invested volunteers who were also relatively well connected to philanthropic and government networks. The COVID-19 pandemic created a sense of urgency, but it also, in some ways, created space in the schedules of these professionals to tackle a large volunteer activity. One interviewee suggested that relational capital was important in the success of the group that put the fund together and stressed the importance of building the right coalition. An interviewee who is concerned about governance and scalability does not believe the effort is duplicable because of its reliance on this particular set of volunteers, rather than a clear model (outside of the financial

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<sup>15</sup> ["New Funding Program Available For State's Smallest Businesses,"](#) *Escalon Times*, September 23, 2021.



structure of the fund) for another state to follow. A related issue is complexity and legal cost. Though the CARF and other related funds may be able to serve as a template for programs in other states or in response to future crises, the complexities of lending laws and variation in these by state means that a considerable legal effort is needed to create these types of funds. In the case of the CARF, Morrison & Foerster provided a large amount of pro bono legal work; one interviewee familiar with this work suggested it would have been prohibitive to pay for all of it. The state of California was also a meaningful player in the fund's coming together; had it chosen to be more conservative in its willingness to take risks (by, for example, allocating less first-loss capital), the program would have needed to raise more philanthropic capital to secure the same amount of investment dollars. Many interviewees, however, stressed that this model was replicable in other contexts.

## Conclusion

The pandemic shone a spotlight on small businesses and their struggles in accessing credit. Many have suggested that these struggles were present prior to the pandemic, in a financial system that hesitates to make small-dollar loans, particularly for microbusinesses and businesses led by women, people of color, immigrants, and low-income individuals. As the economy began to rebound, small business owners faced new challenges—like labor shortages and supply-chain disruptions—in addition to continued concerns around pandemic safety and when the economy and consumer habits would “return to normal.” Small businesses will need continued access to credit in order to respond to these disruptions and rebuild from the economic losses they suffered during the pandemic. The CARF, and other funds like it, provide one possible model for increasing lending to small businesses, particularly to those who struggle the most in obtaining lending from traditional lending institutions. These funds provide access to affordable capital through the use of government or philanthropic subsidy while leveraging these public and philanthropic dollars with private investment capital, allowing them to reach more small businesses than purely public programs. The public and philanthropic support also lowers the risk to the private capital, enabling investments that have not historically been made.

## Appendix 1 – Loan Terms; Blended Facility

Interest rate	4.25% fixed interest based on WSJ Prime + 1.0%; should the WSJP rate change during the availability period of the Blended Credit Facility, this rate may be adjusted to reflect WSJ Prime + 1.0%. Interest may be paid either by the small business borrower or by Kiva to the extent there is a grant agreement in place providing Kiva funding to buy down interest of certain underlying loans.
Repayment term	A. 60-month term <ul style="list-style-type: none"> <li>· 0–12 months: Interest-only payments, paid monthly</li> <li>· 13–60 months: Interest and principal payments with flat payments on a 48-month schedule, paid monthly</li> </ul> OR B. 36-month term <ul style="list-style-type: none"> <li>· 0–12 months: Interest-only payments, paid monthly</li> <li>· 13–36 months: Interest and principal payments with flat payments on a 24-month schedule, paid monthly</li> </ul>
Prepayment	Borrower may prepay the loan at any time without penalty.
Loan amount	Lesser of (a) \$100,000 or (b) up to 100% of average revenues for a three-month period prior to the COVID-19 outbreak; the three-month period can be any three-month period from 2019 or January to March 2020.
Loan proceeds	<ul style="list-style-type: none"> <li>· Working capital including payroll, operating and emergency maintenance, property taxes, utilities, supplies, rent, etc.</li> <li>· Refinancing of an existing community lender loan is not permitted, but refinancing high-cost debt is permitted.</li> <li>· Loan applicant will be required to detail anticipated use of funds when they apply.</li> </ul>
Security	<ul style="list-style-type: none"> <li>· A UCC lien filing is required.</li> <li>· Personal guarantees will be required for individuals who own 20% or more.</li> </ul>
Fees	<ul style="list-style-type: none"> <li>· Minimal third-party fees and expenses (UCC filing fee, application fees, credit report costs, etc.) can be capitalized into the loan up to \$250.</li> <li>· No other fees paid by the small business.</li> </ul>

Source (lightly edited for clarity and editorial style): April 2021 IBank public meeting, “3.d. CA Rebuild Fund Financing Agmt. Approval Exhibits to Attachment A to Resolution No.21,” Exhibit E-1.



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