SMALL BUSINESS LOAN AND GRANT PROGRAM

Program Overview

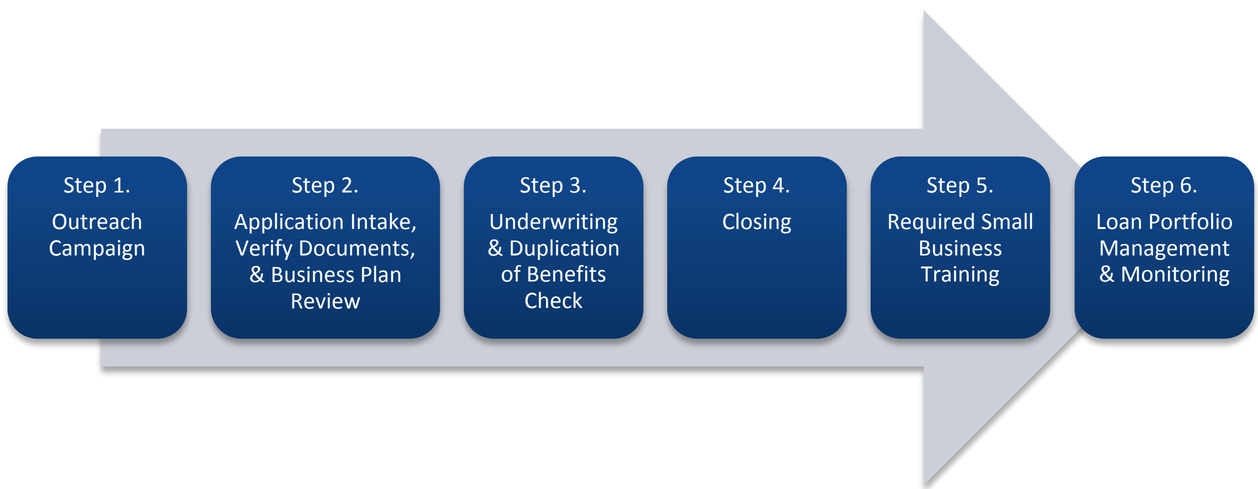
Well-designed, market-driven economic development programs are often key to long-term disaster recovery efforts. Typically, a grantee does not focus on one program, but rather a continuum of overlapping programs that prioritize key industries and/or firm types and provide:

- Access to loan or grant capital for smaller firms
- Access to loan or grant capital for prioritized industries (e.g. research cluster)
- Technical assistance to help companies adjust to the new normal
- Funding to train employees in post-disaster job opportunities
- Funding for industry needs to attract the customer base (e.g. marketing tourism for high-tourist regions)

The crucial goal of these programs is to capitalize on the economic potential of specific industries or types of business to re-build the workforce pipeline and tax base, with an emphasis on creating opportunities for low- to moderate-income individuals.

A typical economic development program for CDBG-DR grantees is a small business loan or grant program. A small business loan or grant program provides low- or no-cost loans to small businesses that have been impacted by the disaster, or are part of a targeted industry for future growth. The goal is create and retain jobs for the community by stabilizing weakened businesses, encouraging businesses owners to re-open or expand their business, and attracting entrepreneur's for growth potential.

The following shows the typical steps in a Disaster Recovery Small Business Loan or Grant Program. Each grantee's program will look slightly different depending upon local needs, capacity and goals.



Program Design Considerations

When CDBG-DR funds are used for economic development, the program designs are as varied as the markets they serve. The design must consider the needs of industries and businesses that were impacted by the disaster as well as the long term economic revitalization needs of the community. Sometimes these two concerns may be in conflict, as pre-existing businesses may not be the strongest investments for the future. Given this tension, **the program must define its goals** in terms of the types of business investments it will make. Post-disaster business development programs may target one or both of the following, depending on which will likely help spur and sustain recovery.

- Existing businesses, inside or outside the disaster affected area, that were impacted by the disaster, either physically or through loss of their customer base;
- Start-up businesses in target industries that support long-term development efforts.

With a program goals and target businesses clearly defined, the program must address the following **key program design decisions**:

- What are the eligibility criteria? For existing businesses, criteria might include a minimum number of years of operation, company's financial strength pre-disaster, or demonstrated marketing acumen to run a business of the size proposed. For start-ups, criteria might include targeted industry familiarity or higher credit scores.
- Will the program provide loans and grants? The choice of mechanism, and their terms and conditions, depends upon the use of funds, the needs of the user, and the goals of the grantee's program. For example, grants may be better for businesses that cannot support any additional debt or are seeking only a small amount of funds. The table below provides a useful summary of the pros and cons of grants and loans.
- What are the loan terms? The risk tolerance for post-disaster loans is much higher than a typical small business loan program due to the variable market conditions post-disaster. Based on the post-disaster conditions, the market is, to some large degree, speculative. Therefore, the terms must match the needs of the targeted industries or individual businesses allowing for a risk-seeking or risk-neutral standard. A business that has lost its customer base may need working capital to help ensure business survival with a loan forgiven if a business re-opens within 6 months. Whereas, a start-up or business that suffered physical damage may need working capital for operations as well as for the acquisition or repair of equipment. In this instance, loans may be forgiven once a business has been operational for a period of time and the equipment is fully operational.
- What are the grant terms? A grant is extremely low risk to the business owner, and may be more appropriate for a very small business needing less than a few thousand dollars as most private lenders will not make loans of this size because it is not cost effective.

Grants vs. Loans: Key Considerations		
	Grant	**Loan**
Definition	Cash infusions to a business that may or may not require repayment.	The provision of a loan to a business or project; and a specified timeframe (term) and/or conditions for repayment.
Pros	• Generally easy to administer; and	• Repayment helps to ensure that the business is fully committed to the project.

	• May be the only source of financing possible for the applicant; such as a small startup business, or a costly, complex deal that meets a community's goals.	• Provides repayment of the expended resource (CDBG-DR) that can be lent out again. • If interest is charged, this interest income can help increase and multiply the overall level of funding available for economic development activities (particularly if the loan repayment is placed in a revolving loan fund dedicated to similar uses).
Cons	• Funds are not replenished (i.e. no repayment of these scare resources); and • May lead to lack of commitment by the business since it is not liable for repayment.	• Requires, on the CDBG-DR Grantee's part, strong underwriting acumen and loan portfolio management in order to reduce risk. • If the loan defaults, business will need procedures, appropriate staff, and funding for legal fees. • For some businesses, an amortizing loan will not be financially feasible, regardless of the interest rate. This is most likely to be true for very small startup companies.

When making these key program design decisions, the grantee should also **consider the following market factors** related to economic development in a post-disaster environment:

- **Small businesses alone will not be sufficient** to stimulate an economy or targeted industry. However, they may provide the first wave of economic revitalization needed for displaced persons to return.
- **Partnerships with local banks or Community Development Financial Institutions (CDFI)** may provide additional capital from a conventional source so that the CDBG-DR funds can assist more business owners.
- **Market realities are difficult to pin down** in a post disaster situation. The customer base is constantly evolving: residents may come and go from the location more than once, disaster response workers rarely stay for the long-term, and economic drivers may have uncertain futures. This will make business planning challenging and small business lending speculative.
- **Business development goes hand-in-hand with a solid housing solution.** Generally grantees must focus on housing first to stabilize the housing market and customer base, but business development efforts must follow rapidly to ensure economic recovery, jobs, and the retention of residents. A lag time will have negative consequences on both fronts.

Finally, **CDBG-DR funds must be closed-out.** Historically, CDBG-DR appropriations require grantees to complete a close-out process. As this may prove quite difficult and taxing on staff to meet this requirement once all programs using CDBG-DR funds are complete, HUD highly recommends closing out programs on a rolling basis. Initiate the close-out process once all funds for each specific program are drawn down, the national objective has been met, and program requirements are complete.

Implementation Strategies

The exhibit below details critical success factors for each step in implementing a strong Small Business Loan or Grant Program. It identifies a few common obstacles that a grantee may encounter in a disaster recovery situation and strategies used by successful grantees to cover these strategies. It also identifies recommended resources a grantee may wish to create, per step, to develop a successful program. Finally, there are seven tools, identified under "Small Business Loan or Grant Implementation Tool" that provide sample language a grantee may edit and adopt to suit their program needs. Each Tool may be found in subsequent documents provided in this Toolkit. The strategies and tools are not exhaustive and depending on the disaster recovery situation, may not be applicable to every grantee's situation.

Step 1: Outreach Campaign	
Critical Success Factors	Outreach efforts must reach to program's targeted beneficiaries. Efforts will vary depending on the focus of the program (existing businesses or start-ups, inside or outside the disaster area). To be successful, outreach efforts must: • Reach its intended recipients • Provide clear information about program goals, products, and eligibility criteria • Make a strong statement about the long term economic viability of the community and the benefits of investment
Potential Obstacle Program does not reach the full range of business owners and entrepreneurs who may be interested in the program.	**Strategy** Develop a partnership with associations such as local chambers of commerce and business improvement districts whose objectives align with the overall program: economic stability for their community, increasing the customer base, and gaining new members. Additionally, local universities and community colleges often have courses, or even centers, on entrepreneurship where targeted marketing events could take place. Lastly, grantees should connect with U.S. Small Business Administration (SBA) Small Business Development Centers (SBDCs)[1] in their regions to partner on marketing campaigns.
Potential Obstacle Business owners and entrepreneurs are reluctant to invest in the post-disaster environment.	**Strategy** As a key component of the outreach campaign, articulate the housing strategy developed for the region, the potential return of displaced households, and the overall population projections. Be transparent in data collection efforts and assumptions. Make the data available through internet portals and media outlets as they become available.
Resources	• Campaign Materials • Marketing Plan
Small Business Loan or Grant Implementation Tool #1	*Notice of Funding Availability (NOFA)*

[1] SBDCs are partnerships between the government and universities to give education services to small business owners. With 63 Lead SBDCs, the free services can vary between each site.

Step 2: Application Intake, Verify Documents & Business Plan Review	
Critical Success Factors	Small business owners are accustomed to filling out forms for funding. However, in a post-disaster situation they may not have all the information to meet the requirements for a complete application. They may have lost documentation due to the disaster and need flexible requirements and deadlines. Or, an applicant may have an insufficient business plan. A successful application intake process that verifies documents will: • Provide different applications for different types of applicants (existing vs. start-ups) • Use SBA's SBDCs as intake locations to introduce applicants to additional resources A successful business plan review should: • Allow alternative interpretations of the customer base that address post-disaster market conditions • Consider the short and long term prospects of the business • Take the competition into account • Consider longer term growth trends • Be based on clear eligibility guidelines that are linked to the community's revitalization goals
Potential Obstacle Intake specialists may lack the requisite knowledge of business planning to provide adequate support to applicants.	**Strategy** Intake specialists do not need to undertake the business plan review. Rather, they should act as case managers who pass off the business plan for an expert review. Grantees will need to contract with management specialists, preferably those with small business experience and/or expertise in post-disaster market conditions, who may provide this in-depth review.
Potential Obstacle Applicants lack skills and knowledge to develop acceptable business plans.	**Strategy** Develop a clear strategy to support potential small business owners. SBA provides information on government –sponsored mentor organizations such as: SCORE, Small Business Development Centers, Women's Business Centers, and Minority Business Development Centers. If these options aren't prevalent in a grantee's communities, or have been adversely impacted due to the disaster, a grantee may consider partnering with agencies to provide the mentors and develop a CDBG-DR funded mentorship program.
Potential Obstacle Applicants submit business plans that are inconsistent with longer	**Strategy** Develop an information portal for applicants and mentors that details key elements of communities' recovery strategies. This portal may already be developed for purposes of educating the entire community.

term recovery strategies.	Add information for small business applicants as they will need more market information than the general public, such as growth projections by industry, population projections (including the ratio of returnees to new households), and targeted geographic areas for revitalization.
Resources	• SBA Business Plan Template
Small Business Loan or Grant Implementation Tool #2 & 3	*Application and Checklist* *Program Guidelines*

Step 3: Underwriting & Duplication of Benefits Check	
Critical Success Factors	Conventional underwriting guidelines will not serve well for post-disaster business ventures because of the program's approach to risk is driven by the imminent needs, a speculative market, and the larger revitalization strategy. Prudent underwriting practices for small business lending in a post-disaster community may be considered risky in the conventional arena or within a stabilized market, yet are necessary to stimulate the post-disaster economy even if there are only short-term results. A flexible process that is consistent with a business's size and activity must acknowledge that: • the post-disaster market is necessarily speculative • a high default rate is not inherently bad • the loan or grant types and terms can flex to applicants' needs • the credit review process with low requirements can be more flexible than the standard credit review
Potential Obstacle Lack of sufficient qualified underwriters.	**Strategy** Hire or contract firms or individuals with financial acumen and train them on the specific underwriting criteria of the program. It is unnecessary to require upfront knowledge typically required in the business lending industry.
Potential Obstacle Underwriters have difficulty adhering to the looser standards of the program.	**Strategy** Establish a continuing education process that defines the criteria and standards and articulates why these standards have been set. Develop a QA/QC process reviewing a larger sample of loans or grants that were denied. Provide ongoing training to underwriters that have unnecessarily high rates of denying applicants.
Resources	• Underwriting Criteria • Underwriting Checklist

Small Business Loan or Grant Implementation Tool #4 & 5	*Duplication of Benefits Affidavit* *Loan and Grant Review Procedures*

Step 4: Closing	
Critical Success Factors	As the closing process is often undertaken by outside sources (title companies) and heavily regulated, grantees can generally use their standard closing process.
Potential Obstacle Program volume can be significant and overwhelm existing systems.	**Strategy** Develop a tight RFP and contracting vehicle with several title agencies. They must be proficient in the local community and state laws, yet be large enough to have robust systems and support to process the volume of assumed applicants. Establish criteria for using each title agency based on their individual strengths and capacity (e.g. proficiency in languages). Automate the closing process by establishing portals that allow for easy transmission of data. To achieve economies of scale, consider releasing the RFP for multiple CDBG-DR funded programs (i.e. housing).
Potential Obstacle Applicants may have difficulty understanding the closing requirements.	**Strategy** Encourage applicants to be accompanied by their mentor who assisted with the business planning process. A grantee may need to train mentors in specific closing requirements and principles if this is not an area of expertise.
Resources	• Loan Agreement
Small Business Loan or Grant Implementation Tool #6 & 7	*Award Letter* *Subrogation Agreement*

Step 5: Small Business Training Requirement	
Critical Success Factors	Small businesses have a high rate of failure and post-disaster conditions prove even more challenging. Training is, therefore, critical to program success. As a condition of funding, a grantee may require proof of attendance at trainings or one-on-one counseling during the first months of establishing, or re-establishing, a business. An effective counseling and training process will: • Be accessible to all program participants • Offer a range of options for varying skill levels and learning styles

	• Cover the full range of topics necessary for business success – finance, marketing, technology, etc.
Obstacle Participants may find it difficult to attend training.	**Strategy** Develop requirements that allow free, online, and/or modular sessions to be eligible. Create a strong partnership with SBA to market their free, online classes. And, at SBA's SBDC, there are additional low-cost training and one-on-one counseling options that a grantee may support with CDBG-DR funding.
Resources	• SBA's On-Line Trainings • Association of Small Business Development Centers

Step 6: Loan Portfolio Management & Monitoring	
Critical Success Factors	A loan portfolio management system provides a central database to manage the CDBG-DR funded loans easily and proactively. Sound system protocols must include: • Internal controls that prevent and detect problems • A monitoring plan that includes a corrective action process for loans that are out of compliance • Clear delegation of authority, using such entities as an appeal committee
Obstacle Volume of loans insufficient to purchase a web-based management system.	**Strategy** Grantees do not necessarily need a unique system to manage these loans. The grantee might choose to: • Collaborate with other government agencies that process loans (e.g. Housing Finance Agencies) • Outsource to a credible loan servicer • Use low-cost, non-web-based database systems (e.g. Access) and develop calendar-based tracking to monitor deadlines
Resources	• Monitoring Plan • RFQ for loan servicing firm