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EMERGENCY ITEM AGENDA MATERIAL

Meeting Date: April 14, 2020
Item Description: Save Our Small (SOS) Business Loan Fund
Submitted By: Vice Mayor Hahn and Mayor Arreguin (Authors)
Councilmembers Wengraf and Harrison (Co-Sponsors)

This item is submitted as an urgency item pursuant to the Brown Act under **Government Code Section 54954.2(b)(2)**. There is a need to take immediate action and the need for action came to the attention of the City subsequent to the posting of the agenda for today's meeting.

In order to add this item to the agenda, the council must vote by a 2/3 majority (six yes votes) to add the item to the agenda.

Once the item is added to the agenda (Consent or Action) it must be passed by a simple majority (five yes votes).

The SOS Business Loan Fund is a proposal with the potential to provide access to much needed low- or no- interest loans to local businesses. It is urgent for the Council to consider this measure to expedite development of a potentially important source of capital to help small businesses impacted by the COVID-19 emergency begin to recover as quickly as possible.

Meeting the needs of our small businesses in distress is a matter of great urgency. A delay of several weeks for this item to be considered by the City Council at a future meeting would mean a delay in moving forward, at a time when every day or week of uncertainty and lack of access to capital can mean the end for some of our businesses.

With limited grant funds to deploy at this time and a patchwork of state and federal programs that not all Berkeley businesses will be able to access in a timely manner, it is critical for the City Council to expedite consideration of a program that holds the promise of making low- or no-interest loans available to quickly rebuild our local businesses - and tax base.



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ACTION CALENDAR
April 14, 2020

To: Honorable Members of the City Council
From: Vice Mayor Sophie Hahn (Author) and Mayor Jesse Arreguin (Author);
Councilmembers Susan Wengraf (Co-Sponsor) and Kate Harrison (Co-Sponsor)
Subject: Save Our Small (SOS) Business Loan Fund

RECOMMENDATION

Refer to the City Manager to rapidly explore and, if feasible, pursue the creation of a special structured financial recovery loan fund to provide a supplemental source of capital for Berkeley small businesses impacted by the COVID-19 emergency. Among other considerations, the City Manager is requested to consider whether the City of Berkeley should act as a sponsor of the fund, working with one or more financial institutions to pool capital from private investors and the City of Berkeley to lower the risk of the product and support low interest rates. The City Manager is also recommended to partner with the Haas Business School at UC Berkeley to design terms of the SOS business loan fund and build the viability assessment model on which loan decisions would depend.

SUMMARY

The shutdown of large swaths of Berkeley's economy in response to the COVID-19 pandemic has had severe consequences for small businesses and their workers. Although the City has taken quick and important action to create a relief fund, matched by additional philanthropic dollars, we lack the resources necessary to support the capital needs of Berkeley's small businesses caught in the wake of COVID-19. State and Federal programs to assist small businesses, while helpful, are also likely to be insufficient. Private funding for loans is another important source of capital that the City of Berkeley should help make available to small businesses, on terms that are more accessible than traditional bank loans.

Prompted by a proposal from faculty and students at the Sustainable and Impact Finance Initiative at the Haas School of Business, the City of Berkeley should explore the creation of a public/private loan product to complement local, state and federal grants and loans, expanding options for small businesses to recover from the crisis. Supporting the rebuilding of Berkeley's small business sector will strengthen and rebuild Berkeley's economy over the long run and, by extension, its tax base; Berkeley should pursue all avenues to access and make available the means to rebuild this sector.

BACKGROUND

The outbreak of the COVID-19 pandemic, and subsequent orders to stay at home and practice social distancing, have significantly impacted Berkeley small businesses and their workers. As of March 13, 2020, many Berkeley small businesses had already seen a 25-75% drop in gross receipts since the outbreak began as compared to the previous year. Some small businesses, lacking the financial cushion to absorb such a steep loss of revenue, have closed, reduced services, or laid off workers.

On March 17, the City Council acted quickly to meet the crisis, referring to the City Manager the creation of a tax-exempt special fund of \$3 million dollars to provide gap resources to small businesses, arts organizations, and renters significantly impacted by the COVID-19 emergency. Since the launch of the Berkeley Relief Fund, Berkeley has received more than \$680,000 in grants and philanthropic donations to complement the city's initial \$3 million.

On March 30, the City announced the first phase of the Berkeley Relief Fund program; the Berkeley Business Continuity Grants, an allocation of \$1 million to help mitigate COVID-19 related financial losses suffered by small businesses. Through this program, grants of up to \$10,000 are available to Berkeley-based small businesses and nonprofits to enable continuity through and/or beyond the COVID-19 pandemic.

As of April 7, the Office of Economic Development had received over 1000 applications for relief through the Berkeley Business Continuity Grants program, testimony to the great number of needs in Berkeley. While the Fund continues to raise philanthropic donations and will provide vital assistance to hundreds of small businesses, it is clear that the needs of our local businesses will exceed the City's capacity.

In addition, the State of California and the U.S. Small Business Administration (SBA) are providing financial assistance to small businesses impacted by COVID-19. While these programs should be helpful, they also do not have enough funds to support the medium-term recovery of all small businesses needing help in the State or nation. Nor are the cash funds immediately ready for distribution.

As Berkeley looks to the next phase of relief, it is crucial to put in place all possible measures to help sustain our small businesses as they recover from the COVID-19 shutdown. Private capital, which is more abundant than the amount of public capital that is likely to be made available locally or nationwide, can and should be a resource for viable small businesses. The City of Berkeley can play an essential role in assuring that private capital is brought forward to support our communities and that terms for repayment of debt are not so burdensome that they threaten long term viability of our local small businesses.

A proposal by faculty and students at the Sustainable and Impact Finance Initiative of the Haas School of Business at the UC Berkeley -- the Save Our Small (SOS) Business Loan Fund -- would create a product that the City of Berkeley could offer in tandem with

the Berkeley Business Continuity Grants program, as well as other public grant and loan programs. The initiative is led by a group of experts in the field of small business finance and economics at the Haas School, including Adair Morse, Associate Professor of Finance; Laura D. Tyson, Distinguished Professor of the Graduate School and Faculty Director at the Institute for Business and Social Impact; and Ben Mangan, Executive Director of the Center for Social Sector Leadership.

While many details remain to be explored, the basic elements of the proposed SOS Business Loan Fund are straightforward. Private investors would pool their capital with public dollars in a ratio based on the risk associated with loans to be made. Traditional bank loans to small businesses typically have a failure rate of at least 10%.¹ Assuming a higher failure rate for loans to be made by the SOS fund (e.g., 20%), private investors would contribute approximately 80% of funds and the City of Berkeley would contribute approximately 20%. Loans from the SOS Fund would then be made to viable small Berkeley businesses, based on pre-agreed viability and loan criteria.

Repayment of the loans would go first to private investors, with the City's claim for repayment subordinate. This arrangement would have the effect of providing a deep cushion or "guarantee," allowing the City (or another public agency — possibly the State) to provide a great deal of security to private investors and make possible very low interest rates for borrowers; likely between 0 and 2%.

While the City would take a significant risk with respect to these loans, participation as a quasi-guarantor in the loan pool would also support the availability of significantly more capital than the City could ever deploy on its own. In the above scenario, each Berkeley dollar invested in the fund would be matched 4:1. Should the City, for example, be able to invest \$3 million, private investors would provide an additional \$12 million, creating a fund with a total of \$15 million available to lend to local businesses.

The City's most significant benefit from creation of, and participation in, the loan fund would be the long-term positive impacts on the local economy and, by extension, the City's tax base. The upside for private investors would be capped at one-time repayment of their loaned capital, with interest. By contrast, while the City may be repaid for some (but not likely all) of its own relatively small amount of loaned capital and interest, it will reap 100% of the long term benefits of the full \$15 million in local investments, in perpetuity.

RECOMMENDATIONS FOR IMPLEMENTATION

The City Manager should work with partners at UC Berkeley's Haas School of Business and other experts to evaluate the cost/benefit to local businesses, and to the City of Berkeley, of implementing an SOS Loan Fund based on this proposal, while pursuing a variety of relationships and structures that would support creation of such a Fund. Should the analysis show strong value in establishing the SOS Loan Fund, and viable

¹ <https://fitsmallbusiness.com/sba-statistics-lending/#California>

relationships and structures be developed, the City Manager should move forward to create the SOS Loan Fund as quickly as possible.

FISCAL IMPACTS

This item is a referral to explore creation of a new low-interest loan product to support Berkeley's small businesses as they recover from the economic crisis created by COVID-19. The only costs associated with the item at this time are staff time to rapidly explore and, if feasible, pursue the creation of a special structured financial recovery loan fund.

Should the City Manager determine that creation of the SOS Business Loan Fund is feasible and in the interests of the City, monies may be allocated to the fund through the budget process by the City Council. The amount of funds proposed for allocation to the SOS Business Loan Fund and the risk associated with repayment of loans will be determined and proposed by the City Manager. Should the fund be launched, and significant private capital attracted to leverage the City's investment, the City will benefit from repayment of some of its loaned capital and from the full combined public/private investment in restoration of the City's economic sector, preserving and enhancing the City's tax base and financial viability over the long term.

CONTACT INFORMATION

Vice Mayor Sophie Hahn, Council District 5, 510-981-7150 (ofc); 510-682-5905 (cell)

ATTACHMENTS

1. Save-our Small (SOS) Business Loan Fund - A Proposal from the Sustainable and Impact Finance Initiative, Haas School of Business, University of California, Berkeley Professors Adair Morse, Laura Tyson, and Ben Mangan
2. Letter from the Berkeley Chamber, Downtown Berkeley Association, Telegraph Business Improvement District and Visit Berkeley

March 22, 2020

Save-our Small (SOS) Business Loan Fund - A Proposal

Sustainable and Impact Finance Initiative, Haas School, University of California, Berkeley Professors
Adair Morse, Laura Tyson, and Ben Mangan

Setting:

The shock of the coronavirus shutdown on local economies everywhere has left small businesses and their workforces in peril.

- **Small Business peril & existing programs**
 - Many municipal programs are already helping small businesses to keep the lights on, but in the medium term, small business survival will require more capital.
 - The Federal programs are helpful, but even the small business loan allocation in the \$2 trillion stimulus bill is not enough funds to support medium-term small business survival.
 - In addition to these (and other) short-term survival programs, the small business sector's needs for a low interest (1-2%) loan product are large. Working capital simply will not exist for *viable* establishments to re-start.
 - Note that it is imperative to support viable looking-forward business, that can in turn support our overall economy through owner successes, employee wages, and return on property.
- **Municipalities quandary:**
 - Municipalities face four major constraints:
 - i. a lack of liquid funds for a far-reaching small business loan program,
 - ii. a future financial constraint on debt
 - iii. a design constraint on their ability to implement such a program with repayment terms that are not so onerous that they do not cause borrowers to become insolvent.
 - iv. (some municipalities) an implementation technology constraint
 - Yet municipalities face an economic (future revenues) and moral necessity to provide liquidity into the small business / workforce. Ex post to this crisis, a government needs to have supported the small business sector that will be viable through this crisis and thus provide an economic base for government revenues and to inhibit spillover decline on the community economic generation and property value.
- **Investors quandary:**
 - We view the SOS Bond as a “*A Liberty Bond*” for COVID-19. It would be marketed as such. Investors would be attracted to the idea.
 - However, for financial investors, a low interest, fixed-income-like product to support recovery would have to be largely de-risked to attract capital that these rates.

Product:

What we are proposing is a product that the municipality could offer in tandem with any current grants or loan programs. The design of the loan product would not be a replacement to any federal or SBA lending, but rather a supplemental source of capital for small business. The municipality (and any State or Federal programs) would need to de-risk the product and enable the raising of capital and greater participation of constrained cities.

The ideal product would be available for shutdown-ending data and contain features (adjustable) that include:

FINANCIAL PACKAGE	QUALIFICATIONS	PRIVATE INVESTORS
Term loan of 5 years @2% interest rate	Employees of 1-50 to qualify	Have seniority in receiving payments up to getting capital invested back
Loan sizes up to a working capital need for 3 months (“summer 2020”)	Viability requirements (underwriting that the business has likelihood of survival 2 years forward)	Granted warrants that convert to a small portion of the equity of the small business
Grace period on payments of 6 months	Employment-retaining requirements	(Warrants may include a buy-back clause)

We further offer the Berkeley-Haas Sustainable Finance ecosystem to help municipalities design the terms of their Save-our-Small Business Loan Funds and to build the viability assessment model on which loan decisions would depend.

Authors and Contributors to the Design:

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Distinguished Professor of the
Graduate School, Haas School,
UC Berkeley & Former US
President’s Council of
Economic Advisors



VIA EMAIL
March 13, 2020

Mayor Jesse Arreguin and City Council
City of Berkeley
2180 Milvia St.
Berkeley, CA 94704

To the Mayor and Berkeley City Council,

As you know, Berkeley is a city of small businesses; many of whom have already seen a 25-75% drop in gross receipts since the COVID-19 outbreak as compared to this time last year. The situation is quickly going from bad to worse, with many of our arts and entertainment venues having closed or likely needing to close soon. Many small businesses, nonprofits, arts organizations, and other businesses do not have a cushion in their budget to weather this type of pandemic. It is incumbent upon the City of Berkeley to do what is necessary to help these businesses survive the economic impact of this unprecedented crisis. Hence, we request that the City immediately consider taking the following measures, similar to action recently taken in New York City and San Francisco:

1. Defer, discount or waive (or even refund, or do not deposit recent) business taxes and fees (for nonprofits where applicable) including garbage collection, health inspection, and business license fees.
2. Start a fund for small business and nonprofits with grants for up to \$10,000 to provide immediate relief (e.g., with fewer than five employees and up to 40% of payroll costs for two months).
3. Provide interest-free loans up to \$75,000 for businesses and nonprofits with 25% or more drop in gross receipts, if SBA loans prove insufficient in timing, amount or rate.
4. Request that the Governor declare an economic emergency disaster to activate immediate SBA loans and defer payroll and other taxes.
5. Seek unemployment benefits and additional support at the local, state and federal level for employees and contract workers with significant loss of income.
6. Establish a moratorium on new business regulations (e.g., Fair Workweek, Healthy Checkout, etc).

Sincerely,

Kirsten MacDonald, CEO
Berkeley Chamber

John Caner, CEO
Downtown Berkeley
Association

Alex Knox, Executive Director
Telegraph Business
Improvement District

Barbara Hillman, CEO
Visit Berkeley