

JANUARY 25, 2021

The 2021-22 Budget: Small Business Grants



LEGISLATIVE ANALYST'S OFFICE

Pandemic's Effect on Small Business

Most Businesses in California Are Small Businesses. For example, according to data from the U.S. Census, 90 percent (about 700,000) of all employers in California had fewer than 20 employees.

Coronavirus Disease 2019 Pandemic Severely Disrupted California's Economy. The pandemic has forced many businesses to reduce their operations or close. Businesses in the travel, retail, food and hospitality, health and wellness, and personal care services sectors have been especially impacted. Nonprofit organizations and self-employed individuals also have been impacted by the pandemic. For example, most indoor arts and cultural organizations, such as museums and theaters, have been closed during the pandemic and face financial hardship.



Federal Pandemic Relief to Small Businesses

California Small Businesses Have Received Over \$100 Billion in Federal Pandemic-Related Financial Assistance. The federal government has provided a significant amount of financial assistance for small businesses affected by the pandemic. Among the largest federal programs are the Paycheck Protection Program (PPP) and the Economic Injury Disaster Loan (EIDL) program. In 2020, California small businesses and nonprofits received:

- \$68.6 billion in PPP loans—which are forgivable and tax-exempt.
- \$34.5 billion in EIDL loans—which have to be repaid.
- Small business owners also benefited from several changes to federal tax laws.
- The December 2020 stimulus package extended the EIDL program, allowed small businesses and nonprofits to apply for a second PPP loan beginning in January 2021, and created a new grant program for performing arts venues.

More Than 620,000 California Businesses Received PPP Loans Through August 2020. The federal Small Business Administration (SBA) reports that just over 620,000 small businesses and nonprofit organizations in California received PPP loans in the first round that closed in August. The average PPP loan was \$110,120. We estimate that small businesses in California that received a PPP loan contribute roughly \$800 billion to the state economy.



State Business Relief: California Relief Grant Program

Despite having more limited resources, the state also provided pandemic-related financial assistance to small businesses. In December 2020, the state created the California Relief Grant program to award grants to small businesses and nonprofits. This program was created very quickly and very limited information about the program is available. Our analysis reflects our best understanding of the program based on the limited information available to date. We may update our analysis as the administration makes more information available.

Grants Up to \$25,000 for Small Businesses Affected by Pandemic.

The California Relief Grant program awards grants to businesses and nonprofits with annual revenues below \$2.5 million. The grant amounts vary based on the entities' annual revenue:

- Annual revenue \$1,000 to \$100,000: \$5,000 grant.
- Annual revenue \$100,000 to \$1 million: \$15,000 grant.
- Annual revenue \$1 million to \$2.5 million: \$25,000 grant.

Eligible entities must be in operation—or have a clear plan to re-open once the state and county permits re-opening of the business—and they also must certify that their operations were affected by the pandemic and will comply with conditions limiting how the funds may be used.



State Business Relief: California Relief Grant Program

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Targets Underserved Businesses Affected by Pandemic. Grants are not awarded on a first-come, first-served basis. Instead, the program determines which applicants will receive a grant by scoring their applications based on the following factors:

- The change in revenue for the months of April through September 2020 compared to those same months in 2019.
- The location of the business.
- Whether the business is in an especially affected industry, such as travel, retail, food and hospitality, health and wellness, and personal care services.
- Whether the business is considered underserved. An underserved business is (1) at least 51 percent owned by a woman, person of color, or a veteran and (2) located in a rural or low-to-moderate income area. (Whether both conditions have to be met or whether these are two different classes of underserved business is unclear.)

Program Established Very Quickly. The Governor announced the creation of a California Relief Grant program on November 30, 2020. The Office of the Small Business Advocate (CalOSBA) in the Governor's Office of Business and Economic Development received \$500 million in Disaster Response-Emergency Operations Account (DREOA) funds on December 17, 2020 to create the program. CalOSBA quickly selected a third-party vendor, a community development financial institution (CDFI), to administer the grant program. The CDFI received \$25 million, or 5 percent of the total amount, to administer the program. The program began accepting applications for the first round of grants on December 30, 2020—just one month after it was first announced. How much planning or stakeholder outreach occurred over this period is not clear.



Governor Proposes \$575 Million for Additional Grants

More Than Double the Number of California Relief Grants. The Governor's budget includes \$575 million to increase the number of grants awarded through the California Relief Grant program. The Governor proposes the Legislature take immediate action on this item. The administration has not proposed to modify the eligibility criteria or to increase the maximum grant amount. In addition, the administration has not proposed to make any other changes in the way that CalOSBA or the third-party vendor communicate with and receive feedback from stakeholders, accept and process grant applications, or make awards. The administration has not indicated whether the third-party vendor also would receive 5 percent of these funds, or some other amount, for additional compensation.

Grants to Small Cultural Institutions. Of the total \$575 million, the Governor's budget proposes to set aside \$25 million specifically for small cultural institutions. The administration has not specified how it would define a small cultural institution.



Applicants and Partner Organizations Have Raised Concerns

We have heard some concerns from applicants and partner organizations about the first round of applications to the existing program:

- The administration and third-party vendor did not have a plan for outreach and marketing the program to underserved businesses.
- High demand seems to have overwhelmed the application website. Applicants reported difficulty submitting applications and uploading documents.
- While instructions were translated into multiple languages, the application only is available in English.
- Applicants reported difficulty receiving technical assistance from the program's call centers.
- The specifics regarding how the program scored the applications are not clear.
- While nonprofit organizations are invited to apply, the application does not take into account the differences in their mission, structure, and organizational documents.
- The program does not consider increases in business costs due to pandemic-response, only the change in revenues.
- Some applicants were uncomfortable providing confidential information, and so much documentation, in return for a relatively small amount of money.
- Entities that do not use, or are distrustful of, online banking have no alternative way to apply.

Some Problems Might Have Been Mitigated With Better Communication and Outreach. Establishing a brand new program often involves unforeseen implementation challenges. Some of the problems with this program listed above might have happened under other circumstances. However, some stakeholders felt that better communication and outreach from the administration and the third-party vendor could have addressed some potential issues before the program began.



How Well Targeted Is the California Relief Grant Program?

Assistance Should Be Targeted to the Most Impacted Businesses.

In considering how to provide additional state relief to businesses and nonprofits, we suggest the Legislature, to the greatest extent possible, target these funds to those entities most impacted by the pandemic. Targeting is important for two reasons:

- ***Grants Unlikely to Reach All Eligible Entities.*** We do not yet know how many businesses and nonprofit organizations received grants from the initial \$500 million provided in December. We estimate that these funds will provide for between 30,000 and 50,000 grants. Expanding the program by \$575 million could roughly double the total number of grants. Nonetheless, it seems likely that many eligible applicants will not receive a grant under the program as it currently is designed. We estimate there are roughly 200,000 active small businesses in the travel, retail, food and hospitality, health and wellness, and personal care services industries alone. (This estimate does not include nonemployer sole proprietorships.)
- ***Targeting Could Limit Duplication of Federal Assistance Programs.*** The federal PPP and EIDL programs are not available to some kinds of businesses, such as those that have defaulted on federal SBA loans or are owned by undocumented immigrants. As the state has limited resources, targeting grants to businesses that are ineligible for these federal programs could be more effective. For example, the new federal program to provide financial assistance to performing arts venues may exclude some types of cultural institutions, such as museums that do not have a defined performance space.

California Relief Grant Includes Targeting, but Effectiveness Is Unclear. The administration intended for the California Relief Grant program to prioritize businesses located in areas and industries that have been most affected by the pandemic. However, we are unable to assess whether it actually is much better targeted than the federal PPP program because we do not have detailed information about how the program is making grant award decisions. We also have a number of concerns about how, and whether, the state or its third-party vendor will verify the authenticity of the information provided by applicants and put in place processes to detect potential fraud.



Looking Forward

Consider Deferring Immediate Action. The Legislature should consider providing one-time financial relief to California businesses and nonprofits adversely affected by the pandemic so long as these funds can be appropriately targeted. Whether the Governor’s proposal is the best way to do so, however, is not clear. On the one hand, the initial time line and process for awarding grants arguably was justified given the economic and public health context. On the other hand, with the federal government recently making significant new PPP funds available to California businesses and nonprofits, we think it may be prudent for the Legislature to defer action on the Governor’s proposal until the following steps can be taken.

Collect Data on Program to Improve Subsequent Grants. The state should require the third-party vendor to collect and frequently report data on the program’s applications and awards from the first round of grants. Information about the amount of revenue decline, location, and industry of the entities that receive grants would help to determine whether the program is awarding grants to the most impacted businesses and nonprofits. The state also could later evaluate the outcomes of the program and measure these against clear objectives to inform future state efforts to provide financial assistance for small businesses.

Require Additional Transparency. The administration should provide more detailed information about:

- How the third-party vendor was selected.
- What responsibilities and grant determination criteria were specified in the contract with the third-party vendor.
- How the applications are being scored and any other factors used in determining which applicants receive grants.
- How the performance of the third-party vendor will be evaluated and how it will be held accountable.



Looking Forward

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Consider Key Questions. We suggest the Legislature carefully consider the following key questions:

- Given the state’s more limited role, are there ways to complement, and not duplicate, federal efforts? For example, should the state prioritize awards to impacted businesses that did not receive a PPP loan?
- Are the third-party vendor’s processes adequate to verify the identity of the applicants and the accuracy of their information and to prevent fraud?
- Should the program’s definition of small business account for differences across sectors or should it continue to apply a single definition—\$2.5 million in annual revenue? (For example, the SBA defines a small business using either revenue or employee headcount standards that vary by industry.)
- Should the grants be counted as taxable income? (Without action, these grants will be taxed as income for state income tax purposes.)
- Why have a set aside only for cultural institutions? While museums and other cultural institutions are among the most impacted entities, the need to separate funding is unclear. Moreover, given that the administration has not yet defined this group, there is no way to assess whether \$25 million is an appropriate amount.

