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Express Loans for Small Business: Supplementing the CARES Act

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I propose to supplement the CARES Act by enhancing the SBA Express program of the Small Business Administration (SBA). My proposal is inspired by the success of Title I of the Federal Housing Act (FHA) of 1934.

HISTORICAL DESCRIPTION OF FHA TITLE I AND ITS SUCCESS

Title I of the FHA introduced a guarantee for banks and financial institutions on the loans they made under the program. This guarantee covered the first 20 percent of losses in the portfolio of Title I loans in each bank. The federal government was able to create a double incentive—for lenders to extend more loans and for borrowers to take on more debt at lower interest rates—at a fraction of the total loan value. The program was designed to jump-start the construction industry, and it first targeted homeowners, then expanded to long-term tenants and lessees and, importantly, also to businesses, particularly those with a commercial need to improve their façades.[1] Then labor secretary Frances Perkins stated that Title I "was one of the most essential features of the recovery program."[2]

In addition to the guarantee, Title I had two distinct characteristics: deployment through local business networks and unsecured loans. Through an army of salesmen, the FHA promoted these loans through local business organizations, giving this federal program a distinct local flavor. Also, in contrast to Title II, on mortgages, Title I introduced unsecured loans (that is, loans without a collateral asset), something that was very rare in mainstream finance in the 1930s.

Title I was a success. A first batch of loans, from August 1934 to April 1937, included 1.45 million loans for a total amount of $560 million.[3] Of that initial batch, by the end of 1938, nearly

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85 thousand loans had defaulted, and the federal government reimbursed local banks a paltry $19.1 million.[4]

Historian Richard Harris highlights four areas where the program was particularly effective. The program (1) achieved rapid adoption, (2) penetrated broadly with one loan per eight owner-occupied homes by 1937, (3) facilitated installment financing for home improvements, and (4) saw a multiplier, the cascading and indirect benefits, of three as homeowners spent more than they borrowed.[5]

Construction employment, which had fallen from 1,512,000 in 1929 to 877,000 in 1934, rose to 1,1600,000 in 1936.[6] Because Title I was rolled out more quickly than other parts of the FHA, it is likely that it played more than a modest part in that two-year recovery. Miles Colean, the consulting economist who helped draft the legislation that created the Federal Housing Administration, recalls, "[Title I] did get under way very rapidly. It was capable of doing so because it required no special legislation on the part of the states. . . . The commercial banks took it up without opposition or delay."[7]

Economist Carter McFarland observed, inter alia, that the rapid adoption by commercial banks of unsecured consumer installment lending marked one of the most significant achievements of Title I.[8]

Title I had flaws. The program had several restrictions and only half of the institutions that signed up for the program actually issued loans. Regulations also initially reserved loans for property owners and excluded common home-improvement projects, such as buying appliances.[9] In addition, the average interest rate for these loans was 9.7 percent, significantly less than rates common for consumer installment loans.[10] Still, compared to other New Deal lending programs such as FHA Title II (home mortgage insurance), the Home Owners' Loan Corporation (which refinanced delinquent home mortgages), and the Reconstruction Finance Corporation (which provided emergency bank loans and railroad debt restructuring), Title I stands out for its speed and targeted success.[11]

EXPANDING SBA EXPRESS LOANS

During the COVID-19 pandemic, the SBA Express loan program will offer a lifeline to struggling restaurants, doctor's offices, and a myriad of other small businesses across the United States because the loans are approved in 36 hours, which is much faster than the regular lending vehicle of SBA, called 7(a) loans.[12]

Currently, each SBA Express loan carries a maximum guarantee of 50 percent from the SBA, and crucially, the approval decision is made by the lender. No collateral on loans less than $25,000 is required, and lenders use their own collateral requirements on loans greater than $25,000. Lenders negotiate their own interest rate, within a limit set by the SBA, and maturities of up to seven

years.[13] In sum, the SBA Express loan combines flexibility and speed; and now, under the CARES Act, it adds an expanded maximum size of $1 million through the end of 2020.[14] My proposal is to supplement the CARES Act with a set of four policies to be adopted by the SBA.

First, SBA Express loans can be made more attractive to borrowers and lenders through a relaxation of rules. Any financial institution with a state or federal charter should be deemed approved as an SBA Express loan lender and expedited approval granted to other firms.

Second, all collateral decisions should be made by the lenders at their discretion. Regulatory authorities, such as the Federal Reserve (Fed), Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and similar state bodies, should authorize that discretion.

Third, the SBA Express loan program should exchange its current guarantee of 50 percent on each individual loan for a 25 percent guarantee on losses of an institution's entire portfolio of SBA Express loans. Alternatively, the Fed could convert its Main Street Business Lending program into 25 percent portfolio insurance on Express Loans so that the 50 percent SBA guarantee remains in place and the Fed guarantees the next 50 percent of each loan up to a cumulative (between SBA and Fed guarantees) 25 percent of an institution's entire portfolio of SBA Express loans.[15] Neither the SBA nor the Fed can rapidly assess individual borrowers, but each has the resources to guarantee loans. Portfolios of loans should be locked in at the end of 2020 to allow securitization and insurance settlements.

Fourth, the cap should be raised to a maximum of $10 million total in SBA Express loans per borrower, either spread across multiple lenders or multiple loans with a single lender. A $250 billion maximum liability to the SBA, well within the magnitude of the current appropriation, would facilitate a trillion dollars in lending.

CONCLUSION

The existing SBA Express loan program, as expanded by the CARES Act, will provide a much-needed cash injection to small businesses. I believe it can go further. Learning from the experience of Title I of the FHA, policymakers can establish an even broader incentive, committing the federal government to shoulder only a fraction of the lending expansion.

ABOUT THE AUTHOR

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NOTES

1. Gabrielle M. Esperdy, *Modernizing Main Street: Architecture and Consumer Culture in the New Deal* (Chicago: University of Chicago Press, 2008), 55, 97.

2. Richard Harris, "A New Form of Credit: The State Promotes Home Improvement, 1934–1954," *Journal of Policy History* 21, no. 4 (2009): 402.

3. Joseph D. Coppock, *Government Agencies of Consumer Instalment Credit* (Cambridge, MA: National Bureau of Economic Research, 1940), 6.

4. Coppock, *Government Agencies*, 57.

5. Harris, "A New Form of Credit," 410–11.

6. Richard Sutch, "Chapter B a - Labor," in *Historical Statistics of the United States*, Millennial Edition, ed. Susan B. Carter and Matthew Sobek (Cambridge, MA: Cambridge University Press, 2006), 2–112.

7. Miles L. Colean, *A Backward Glance: An Oral History* (New York: Columbia University, 1974), 34.

8. Carter McFarland, "An Economic Evaluation of FHA's Property Improvement Program," *Journal of Land & Public Utility Economics* 23, no. 4 (1947): 404. FHA administrator Stuart McDonald deemed it "the big thing." Coppock, *Government Agencies*, 5.

9. Harris, "A New Form of Credit," 403.

10. Coppock, *Government Agencies*, 27–28. 11,945 financial institutions were approved to make loans, and 6,433 in fact did so. Forty percent of commercial banks participated and Louis Hyman credits Title I with launching the postwar rise in widespread consumer finance. Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton, NJ: Princeton University Press, 2011).

11. On the Home Owners' Loan Corporation, see Price Fishback, Jonathan Rose, and Kenneth Snowden, *Well Worth Saving: How the New Deal Safeguarded Home Ownership* (Chicago: University of Chicago Press, 2013). On the Reconstruction Finance Corporation (RFC), see James Stuart Olson, *Saving Capitalism: The Reconstruction Finance Corporation and the New Deal, 1933–1940* (Princeton, NJ: Princeton University Press, 1988). The brief parenthetical description belies the RFC's scope and the variety of its activities under Jesse Jones. The RFC was everywhere.

12. SBAExpress.Loans, SBA Express Loans home page, accessed March 27, 2020, https://www.sbaexpress.loans.

13. "Types of 7(a) Loans," 7(a) Loans Program, US Small Business Administration, accessed March 27, 2020, https://www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans#section-header-4.

14. Coronavirus Aid, Relief, and Economic Security Act, S. B. 3548, 116th Cong., 2nd Sess., § 1102(i) (2020).

15. Sunny Oh, "Here's How the Fed Is Funneling $4 Trillion of Funds to the Real Economy," *MarketWatch*, March 27, 2020.