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REAUTHORIZATION OF SBA FINANCE PROGRAMS AND THE IMPACT OF THE SMALL BUSINESS PROVISIONS IN THE RECOVERY ACT

ROUNDTABLE

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

OCTOBER 1, 2009

Printed for the Committee on Small Business and Entrepreneurship



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REAUTHORIZATION OF SBA FINANCE PROGRAMS AND THE IMPACT OF THE SMALL BUSINESS PROVISIONS IN THE RECOVERY ACT

THURSDAY, OCTOBER 1, 2009

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The Committee met, pursuant to notice, at 10:02 a.m., in room SR–485, Russell Senate Office Building, Hon. Mary L. Landrieu (chair of the committee) presiding.

Present: Senators Landrieu, Vitter, and Risch.

Staff present: Ed Mills, Kevin Wheeler, Matthew Berger, Chris Lucas, and Matt Walker.

OPENING STATEMENT OF EDWARD MILLS, DEMOCRATIC SENIOR POLICY ADVISER FOR BANKING AND FINANCE, COMMITTEE ON SMALL BUSINESS

Mr. MILLS. Good morning, everyone. Senator Landrieu will be joining us at approximately 11:00 a.m., and considering we have a pretty robust agenda, I would like to start and get this underway.

My name is Edward Mills. I am the Senior Policy Adviser for Banking and Finance on the Senate Small Business Committee here. The title of this morning's roundtable is "Reauthorization of SBA Finance Programs and the Impact of Small Business Provisions in the Recovery Act." What I would first like to do is explain the agenda and then we will begin.

The record for this roundtable will be open for 2 weeks, until October 15th, so if any of our participants have anything to add to the official transcript, please submit that to the Committee.

We will start off by going around the dais and having introductions. For the introductions, if you can, please limit it to your name, organization, and title.

What we would like to do for the roundtables, it is a pretty informal conversation. We would like to get as robust of a conversation as possible, and the goal of this particular roundtable is to build a record for the reintroduction of legislation to reauthorize a number of the finance programs at the SBA.

To do this, we will be building on the legislation that the Committee has considered in previous Congresses, including S. 1256, which was the Small Business Lending Reauthorization Improvement Act of 2007; S. 2920, the SBA Reauthorization and Improve-

ment Act of 2008; as well as the child care lending pilot that was offered by Senator Kerry and the intermediary lending pilot offered by Senator Levin; and, obviously, a big part of these discussions will also include initiatives that were introduced this Congress, including S. 1615, the Next Steps for Main Street, introduced by Senator Snowe.

In addition to a reauthorization bill, one thing that we would like to build the record for is the possibility of crafting legislation which would serve as a next steps bill for the Recovery Act.

After introductions, after we go around, I will start by introducing each topic, and I will call the subject matter expert we have here as well as representatives from the SBA and the IG's office. I know a number of participants around the dais are well versed in more than the program that they are officially representing, so we very much welcome you to participate in as much of the conversation as possible. To do that, what I would ask you to do is if you do want to talk, just put your sign up like this; and if you could, please place it where your name is facing up here so I can actually read it, or when the Senator arrives, she can read it. Also, if everyone could put their placard up here so we can see your names.

During our discussion I will also be turning to my colleagues on Senator Landrieu's and Senator Snowe's staff to ensure that they have the opportunity to ask any questions they may have. And, finally, when Senator Landrieu arrives, we will be turning it over to her. She will make some brief remarks and run the roundtable at that point.

If we could start with introductions, and we will start down here with Eric Zarnikow.

Mr. ZARNIKOW. I am Eric Zarnikow. I am the Associate Administrator of the Office of Capital Access at the U.S. Small Business Administration.

Ms. WOJTOWICZ. I am Jean Wojtowicz, Executive Director of Indiana Statewide Certified Development Corporation and the current Chair for our trade association, the National Association of Development Companies.

Mr. FRUGE. I am Andre Fruge. I am President of Louisiana Capital Certified Development Company, Lafayette, Louisiana.

Mr. WEST. I am Dennis West. I am President of Northern Initiatives, and we are based in northern rural Michigan.

Ms. GARVIN. Marianne Garvin, President and CEO of Community Development Corporation of Long Island.

Mr. MONCRIEF. My name is Ray Moncrief. I am Chief Executive Officer of Kentucky Highlands Investment Corporation, and I manage an SBIC, a new markets venture capital program, and a rural business investment company.

Ms. WASSER GISH. Good morning. My name is Joan Wasser Gish. I am Principal of Policy Progress.

Ms. WHEELER. Kevin Wheeler, Democratic Deputy Staff Director for Senator Landrieu.

Mr. LUCAS. I am Chris Lucas. I am Counsel to Ranking Member Snowe.

Mr. WALKER. I am Matt Walker, Deputy Republican Staff Director and Counsel for the Committee. I want to express that Senator

Snowe, although this is a staff-led roundtable, always attempts to make an appearance to committee events. However, today, as I am sure most of you are aware, the Finance Committee is tied up on health care amendments, and that is where she is. So she apologizes for personally being unable to attend this roundtable.

Mr. HEATH. My name is Michael Heath. I am the owner of Ramunto's Brick Oven Pizza in St. Johnsbury, Vermont.

Mr. PALMER. My name is Brett Palmer. I am the President of the National Association of Small Business Investment Companies.

Mr. HARRIS. Glenn Harris, Counsel to the Inspector General, SBA Office of Inspector General.

Mr. CRISPEN. Fred Crispen, Executive Vice President, Borrego Springs Bank. I manage the Small Loan Division.

Mr. WILKINSON. I am Tony Wilkinson. I am the President and CEO of the National Association of Government Guaranteed Lenders.

Mr. CLARKSON. I am Greg Clarkson. I am Executive Vice President, BBVA Compass Bank, and SBA Division Manager, as well as the Chairman for the National Association of Government Guaranteed Lenders.

Mr. MILLS. Great. Thank you very much.

So the first item on our agenda this morning is the 7(a) program. Obviously, this is a flagship program of the SBA. A number of provisions were included in the Recovery Act, and I would like to start off with a brief update from Eric Zarnikow from the SBA on how Recovery Act programs are going, especially as they relate to 7(a), and I will then move on, starting with Greg Clarkson, to get a lender perspective as well as some ideas for reauthorization.

So, Eric.

Mr. ZARNIKOW. Well, first I would like to thank the Committee for holding this roundtable. I think is a very important forum to really discuss what is going on in small business and supporting small business lending activity. And when you think about the 7(a) and the 504 program and you think back a year ago, we really had the credit crunch that hit last fall in the marketplace. We saw a significant decline in SBA lending volume in both 7(a) and 504.

When the Recovery Act was passed in February, there were a number of important elements that helped support the 7(a) and 504 program. We had the fee reductions or eliminations for borrowers and lenders in the 504 program, fee reductions for borrowers in the 7(a) program, and also the 90-percent guarantee in the 7(a) program.

We have really seen a very significant impact from the Recovery Act as we see our lending volume in SBA. And if you look at that period immediately prior to the Recovery Act being signed, the period from the beginning of the calendar year until the Recovery Act was signed in mid-February, and you look at our weekly average loan volume and then you compare our weekly average loan volume subsequent to the passage of the Recovery Act, we have seen that our loan volume has increased by more than 60 percent when you look at 7(a) and 504 combined.

So we have seen a very significant rebound in lending tells us that the Recovery Act really hit the mark as far as what was needed in the marketplace at that time.

Also, one of the important elements of 7(a) lending is the secondary market; 40 to 50 percent of the Government guaranteed portion of 7(a) loans each year is sold into a secondary market. Last fall, with the credit crunch, we did see a freezing of the secondary market where secondary market sales volumes were down by 70 to 80 percent in some cases, and we saw a substantial reduction in premiums.

The good news is there has been a very significant recovery in the secondary market. Part of that we believe is coming TALF and the inclusion of SBA loans as part of TALF, as well as the announcement from TARP that was done in March where TARP has committed to support up to $15 billion—or provide up to $15 billion of support for SBA secondary market loans. And we have seen over the last 4 to 5 months the secondary market loan volume has recovered. It is actually back to the point where it is exceeding the levels prior to the credit crunch, and in addition, the premium levels that are seen in the market have also recovered, and we think that is a very big supporter of SBA lending, particularly 7(a) lending.

In addition, we have seen lenders return to the marketplace. Since the Recovery Act was passed, we have over 1,000 lenders, who had not done a loan since the beginning of the fiscal year, have done a Recovery Act loan, and more than 500 of those lenders are people who had not done a loan in the SBA program since at least 2007. So we think getting additional lenders into our program is really a critical part of supporting access to capital for small businesses.

The obvious question is what is really next for small businesses as we think about the next phase of the recovery, what really is needed. So I am very interested to hear the discussion here today, hear the ideas that come out of this roundtable and what is really needed to help support small businesses in the next phase of the recovery.

Thank you.

Mr. MILLS. Thanks, and if we could have some comments from Greg Clarkson.

Mr. CLARKSON. Thanks, Ed. One of the things I am seeing out in the marketplace is that the borrowers and small business owners continue to have a desperate need for access to capital. I think that that need is not only for capital acquisition, capital expenditures, but there is a great need for working capital. That working capital is not only to grow their business, but to sustain what they have lost over the last couple of years during the economic issues that we have been experiencing.

So a borrower's needs are greater, and I think that that borrower's needs are greater in a time when banks are constricting their lending standards. And one of the things in looking at a bank's analysis for identifying qualified borrowers, they are not only looking at historical performance, but also looking at the information available as it relates to geographic diversity, industry diversity, and spending more analysis or determining whether that borrower can not only continue to pay but grow the business as they continue to succeed. And we are seeing that it is critical that we have programs that support the small business' needs. We are

also seeing that the needs are greater. The size of the loans, the size of the requests are expanding, especially in light of the ability for small businesses to continue to meet conventional lending standards. So we are seeing a need for larger loans as one item.

One of the things that I have noticed also is just making sure that borrowers, as they are looking for additional capital, they have access not only to the SBA programs throughout our institution, but also through other institutions. Very excited that the information that Eric gave with regards to increased participation. We want that as an industry to continue to expand and grow and have more lenders participating, because that does create more opportunity for small businesses to obtain capital.

One of the things from the SBA perspective that I look at is ensuring that the requirements of the SBA program can be met and that the guarantee that we are relying on as a lender is a good guarantee and we can use that as an opportunity to diversify our risk in any individual lending situation.

So the 90-percent guarantee has greatly assisted us in being able to reach more small businesses. I do have a concern, as the stimulus money and provisions expire, what is going to happen to lending and to capital access for small businesses once those provisions expire and the economy has not recovered enough to be able to sustain continued access for small businesses.

Mr. MILLS. Thanks. And we will get into that a little bit more, but before we do that, I just wanted to call on Michael Heath. He is a small business owner who has received a 7(a) loan, and I would like to ask him to explain his experience with the program.

Mr. HEATH. Yes, if it was not for the 7(a) loan, I do not think we would have been able to purchase the business. It was awesome. With the fee reductions and things, it left us enough capital to sustain operations and keep growing.

Mr. MILLS. Prior to applying for it, did you know that there were going to be some fee reductions or that——

Mr. HEATH. I had no idea, starting into the process, that there was even this program out there. Our banker led us in the direction and helped us along in the process.

Once everything came out in the wash and we realized what was going to be happening as far as finance goes, they really made it clear that if it was not for the program, it probably would not have been able to go.

Mr. MILLS. So if you had to pay the fees, would you have been able to afford the loan?

Mr. HEATH. Probably not.

Mr. MILLS. Great. And one thing I would like to talk about here is that there are some concerns out there in terms of this Recovery Act authorization going through September 31, 2010; however, the funds that have been put in to support the higher guarantees and the lower lender fees are scheduled to run out maybe as early as September. I just wanted to get—maybe we can have some cross-conversation about what would happen if in December it does run out, what you think might happen to loan volume and access to capital for small businesses. I would love to hear from the SBA about some steps that it anticipates making to ensure that there

is an orderly wind down if there are not any additional funds available to continue those guarantees and fee reductions.

I do not know who wants to start.

Mr. WILKINSON. May I?

Mr. MILLS. Sure, Tony. You can start and then we will go to Marianne.

Mr. WILKINSON. Well, we are definitely concerned what is going to happen when the stimulus funds do run out. The 90-percent guarantee and the borrower fee reductions have clearly helped drive loan volume. We are just now getting back to the same daily loan volumes we had last year. I think we are pretty close on a daily loan volume in September as we were in September of 2008. But to get there, it took quite a bit of stimulus. It took the 90-percent guarantee. It took the borrower fee reductions—the fees being waived. So we would anticipate that, as the funds run out, we would see a softening in loan demand.

The 90-percent guarantee is important to the banker community today. It is no secret that banks have capital issues, and this is a way that we can leverage the limited capital that is out there and still serve the small business community. So the extension of the guarantee in our opinion is critical.

I do know that the SBA has been guesstimating an end-of-the-calendar-year running out of funds. Our guess is that the closer we get—or the farther we get into this last quarter, the faster those funds are going to get utilized. And I would not be at all surprised if our funds are used up by Thanksgiving.

Mr. MILLS. Marianne.

Ms. GARVIN. I wanted to make a comment about Mr. Heath's remarks. He is a small business owner, and as a practitioner in the field that makes capital available to businesses, what his experience was is what I see, which is a business needs capital. They come to a source. They do not know the programs. They do not know that there is a micro loan program or a CDFI or a 7(a) program. And so there needs to be this range of products out there, and it is not really necessary or important for the business to know which bucket they fit into. But that kind of flexibility of products and capital access is important for us to be able to then respond to all the different types of businesses that come to us and the different types of capital needs that they have. And I think, given the range of programs that this roundtable is going to be responding to, I just thought that highlighting Mr. Heath's comment was important.

Mr. MILLS. Thank you.

Eric.

Mr. ZARNIKOW. Sure. When we rolled out the fee reductions and the higher guarantees back in March, we estimated at that time that we would expect that the money would run out sometime around the end of the calendar year, but also recognizing that, depending on loan volume, that date could either move up or be pushed back.

At this point I would say, based on the volumes we are seeing, that it is likely that 7(a) would run out late November or early December; 504 would maybe run out mid-December to late December.

Obviously, that can and will change depending on what happens with loan volume.

As we talk with lending partners, there have been concerns expressed that as we get closer to that date, we will see a surge of volume and that that might cause that date to move in closer.

At SBA we do have a team and have had a team for a while working on how do we thoughtfully wind down the fee reductions and the higher guarantees. And, obviously, when you think about the structure out there, we have over 2,500 lenders who make an SBA loan in any given year. They work with small businesses. Clearly, communications of that is going to be a critical item in figuring out a thoughtful plan and how to wind down the program in a way that makes sense and can be communicated out to our lending partners and to small businesses as critical.

We do have a team working on that and are hoping to be able to announce that here in the next weeks or a month to be able to communicate that out to the community on how we are going to wind down the fee eliminations and the 90-percent guarantee.

Mr. MILLS. Thanks. I know, Greg, you have your card up. We have a couple more minutes that we can spend on 7(a). We do have a pretty ambitious agenda. If I could ask you to talk a little bit about if we do move a reauthorization bill when we are looking for reintroductions, what are some of the key points you think that we need to address, especially loan size, and if you have any ideas in terms of what loan level in the 7(a) program you would like to see?

Mr. CLARKSON. Sure. In response to Marianne, it is about choices. As a lender, I want to have choices to give to you as a small business owner. Whether it is a conventional loan, whether it is a 504, 7(a), or any other loan, I want to have choices for you, and based on your risk tolerance, based on your needs, for you to be able to make an informed decision.

Anytime that we limit participation in any of the programs, it makes it more difficult for you to have a wide range of options, and conventional lending is constricted by the requirements of a bank's lending policy, but then also regulatory. And then if we have loan limitations, size limitations, anything of that nature, with regards to some of the other guaranteed programs, then we have limited your choices.

So in regards to the reauthorization bill, one of the things that is important, in my opinion, is increasing the loan size, and increasing that—I had originally thought that $3 million was the right size, and the reason why I thought that was because that would take into account inflationary activity, rises in real estate costs, things of that nature, just normal business. But what I am seeing recently is not only the need for the capital expenditures which bring them up to the larger loan size, but also businesses needing not only to take care of their capital asset requirements, but then also the working capital is becoming very important—not for start-up businesses—I mean, it is important for start-up businesses, but the size that we are talking about, having the larger loan for existing job preservation businesses, job creation businesses, really the things that drive the economic recovery.

So, in my opinion, looking at a $5 million loan size to be able to accommodate the borrower's needs in this economy is important. That is one of the most important things that I see.

Mr. MILLS. Thanks. And at this time, I want to turn it over to Senator Snowe's staff to have an opportunity to ask a few questions, then I am going to see if Kevin has any questions before we move on to the next topic.

Mr. WALKER. Sure. I just wanted to follow up on that because the increased loan size is something that has been a priority of Senator Snowe's for quite some time now, and something she has been pushing for. She believes that many small businesses are, unfortunately, priced out of the SBA's lending market because the loans just are not ones that will suit their needs, given the type of business that they do.

I am going to ask a question that I believe I already know the answer to, but I still want to ask it in this sort of a format, so that we continue to get the response on the record. That is, isn't it true that in the SBA's portfolio, the higher loans are actually better-performing loans with a lower default rate?

Mr. ZARNIKOW. In the 7(a) program, we do see that the larger loans tend to perform better than smaller loans. In the 504 program, it is actually the opposite. The larger loans do not perform quite as well as smaller loans.

Mr. WALKER. So relative to the 7(a) loan program, would it then be presumed that the subsidy rate would be lowered, if higher loans were allowed?

Mr. ZARNIKOW. You know, based on the information we have in our existing portfolio, that would be correct. Obviously, the unknown question is when you go to a higher loan limit above $2 million, will those loans perform similar to the larger loans in the existing portfolio or not, and that is obviously a question we cannot answer until we actually get some experience with it.

Mr. WALKER. Okay.

Mr. LUCAS. Also, I had an additional question. One of the things that you touched on was that you were not aware of the 7(a) lending program. And it is a wonderful program, yet I think one of the problems is that people do not always look at it when they look at their lending options.

One of the provisions that Senator Snowe has in her Next Steps Bill is an online lending platform, and I just wanted to ask Mr. Wilkinson and Mr. Clarkson what your thoughts are about an online lending presence. In the general perspective, is it a good idea to raise the visibility of the 7(a) program, so that when borrowers are considering their options, the 7(a) program is something that they consider?

Mr. CLARKSON. Well, I think anything that gets the word out on the program to small businesses is a good thing. I think if it provides information as it relates to what lenders are actively participating in the program, that is a good thing. I think if it includes what lenders—I do not know that you can do it the same way you would interest rates as far as mortgages or something like that, but give the small business the opportunity to direct their focus, to direct their opportunity to go to a lender that is participating in

the type of loan that they need, the type of—whether it is geographic, industry, anything of that nature, to be able to do that.

So I would be in favor of any sort of informational process that gets the word out.

Mr. LUCAS. Great. Thank you very much.

Ms. WHEELER. I just want to ask a few questions. Eric, the answer to the question on the record is that raising the 7(a) loan limit from $2 million to, say, $5 million does not have a cost and it could even have savings?

Mr. ZARNIKOW. Yes, what I would say what we see in our existing portfolio is larger loans tend to perform better than smaller loans. We obviously do not have any experience in our portfolio, or limited experience, for loans about $2 million.

Ms. WHEELER. Okay. To the industry, what are the industries that you are seeing that need these larger loan sizes or the areas of the country? Is it limited to certain areas of the country?

Mr. WILKINSON. I would say that small businesses throughout this country are finding it difficult to access conventional credit. The conventional credit window, while it is still open, is not open very much, and that we are seeing many more small businesses whose really only option to get financing is through the SBA programs. And we are seeing a whole host of industries that could benefit from a much larger loan size. For instance, the Automobile Dealers Association, you know, the $2 million limit today really does not satisfy many dealers' needs. A $5 million loan size would help, and there is a whole list of industries that could benefit from the increased loan size.

Ms. WHEELER. And for the SBA, have you found that that is one of the obstacles to the lenders using—or even the borrowers using—the floor plan financing that you put through?

Mr. ZARNIKOW. We have received feedback from lenders that the $2 million loan limit that we have currently is a barrier to their use of the dealer floor plan loan from a couple standpoints. One is many of the national dealer floor plan lenders tend to have a $5 million minimum that they do on a dealer floor plan. Then, obviously, many dealers have a need that would be greater than $2 million.

Ms. WHEELER. So then we would fill that gap if we were to raise the limit from $2 million to $5 million. If we were thinking about this change, it would be very appropriate to do it as part of a follow-on targeted recovery piece, separate, because it needs to move faster than, say, regular reauthorization? SBA is seeing that need?

We received a letter from ten associations in support of the change. Many of them are associated with automobile dealers and vehicle dealers, in addition to trade associations, like the National Small Business Association and the Chamber of Commerce.

That is what we are hearing from the Committee, but it sounds like you are hearing that at SBA, too.

Mr. ZARNIKOW. We have definitely heard from lenders that there is a need for larger loans. We have seen in our portfolio that the percentage of loans in excess of $1.5 million has been increasing over time. However, you would keep in mind that 80 percent of the dollars are for loans less than $1.5 million, and our average 7(a) loan is about $200,000.

So I think it is important to be thoughtful about, you know, how does that fit into the overall lending market, making sure that as a Government we are not pushing out the private sector, that we are supporting access to capital for small businesses. So I think that is an important thing to consider.

Ms. WHEELER. Along those lines, there was a question raised about whether this would crowd out the businesses needing smaller amounts of capital, the smaller businesses. Would anybody like to answer that?

Mr. WILKINSON. I do not believe it would.

Ms. WHEELER. I know we are not near the program level, but does anyone have an answer as to why it would not crowd them out, aside from the fact that we are not exhausting the program?

Mr. CLARKSON. Well, I think from a lenders' perspective, we look at all borrowers, look at all types of loans, and, you know, it gets back to just having another option.

With regards to the large loans, here is a prime example, a really quick example. I have a borrower that I looked at just this week that needs $2 million on a debt refinance of their existing real estate for their manufacturing plant. They also have a line of credit to the same lender for a million and a half. The lender is not willing to take those loans and refinance them, renew them under favorable terms. So they are asking that borrower to move their loans, and without the SBA program, there is really not an option for that borrower. And since their need is greater than the $2 million, you cannot do one or the other in that instance, and we are seeing that with several of those types of borrowers that have never considered SBA in the past.

Ms. WHEELER. Okay. Thank you.

A last question for SBA. How much money would we need if we were to do the 7(a) piece to continue the guarantee or to do the loan fee waivers? Do we have numbers on those?

Mr. ZARNIKOW. We can provide you those numbers. I do not have them here with me, but we can provide those to you.

Ms. WHEELER. If we did not have money, is there anything we could do within the program that might help keep lending together without touching it, for example, I know we do not like it and it has high defaults, but changing the Express program, would that be an alternative if we did not have money?

Mr. WILKINSON. You know, we have had a pretty long wish list of things that would be helpful to the program, and to their credit, the SBA has been checking them off, the things that they could do through their own regulations. Interest rate indexes, we have been after them; today they have got a new fixed rate index that is going to be very helpful. And they have already taken a lot of those steps.

Absent an appropriation to continue the 90-percent guarantee and the fee waivers, you know, I would say we do need the larger loan size. I think that is critical to a number of borrowers. And then, you know, we need to be prepared that there probably will be some slackening of demand. But from there, the other issues would be to focus on the lender oversight functions that we still find problematic and expensive and inefficient. And then some of the repair and denial issues that have driven a lot of lenders away and that will not be back regardless. I think that is something that

we need to keep in mind that as we do some of these things, that we have—yes, we have got 1,000 new lenders that have not made loans in the last year or two. We have lost a lot of lenders for a whole variety of reasons, and oversight in denials and repairs are a big part of those. And I can tell you that the institution I used to work at has left the program and they will not be back. I think they have closed their division. And there are other institutions out there just like that.

Mr. MILLS. We will get into lender oversight in just a little bit. I do want to stay to the schedule as much as possible, so are you okay or did you want to make one quick comment?

Mr. MONCRIEF. I would like to make one quick comment to Greg about the size of the SBA 7(a) loan. I have several companies that exactly fit the format of just what you said. They heretofore had been borrowers from large regionals, had a line of credit, had fixed-asset financing through real estate, et cetera. And all of a sudden, because of capital requirements at the large banks, the companies, because of the downturn, had had marginal years, and all of a sudden they are not a viable part of that portfolio.

So what is happening, they are coming to practitioners that are doing 7(a)s or people who can originate 7(a)s, and it would be absolutely critical for that loan limit to rise above that $3 million—above the $2 million to perhaps the $5 million, because there are a host of small manufacturing concerns that employ 200 to 250 people in rural environments that are desperate for that type financing. So I echo you and support that greatly.

Mr. MILLS. Next is the Community Express Program. This program has been around for a while as a pilot. Some of the conversation has been: is it time to move it beyond a pilot or is it time to keep it as a pilot in any reauthorization? This is a program that has had some concerns raised about it due to the high default rate.

To start off this discussion, I would like to call on Fred.

Mr. CRISPEN. I definitely think it needs to be continued, preferably as a permanent program, for several reasons, the first of which would be it is hard to get your board to commit assets to invest in infrastructure, people, systems, to do a small loan program when it is still a pilot program. You do not know if it is going to be here today or tomorrow. So I think by making it a permanent program, I think you will actually get more lenders involved in the program from that standpoint.

Under today's current economic conditions, without a doubt there is a drastic need for the program. We are seeing more and more every day existing borrowers along the same lines you are talking about that have been cut off by their large regional bank, and they are coming to us under the Community Express Program for small working capital loans.

One of the other things I think we need to do is to raise the limit that encompasses everybody. Right now anybody in the country is eligible for a loan up to $25,000. Above $25,000 it is a targeted market. Now, I understand targeted markets, but in today's environment, that base rate needs to be raised to at least $50,000 or higher so that we can make working capital available to borrowers out there in the community.

Mr. MILLS. If I could call on Glenn with the IG's office, if you can express your thoughts on this?

Mr. HARRIS. Sure. And for those of you who do not know, the Office of Inspector General is a statutorily created independent office whose mission is to deter and detect waste, fraud, abuse, and inefficiency. And we have a team of criminal investigators and auditors, so we look at all aspects of all of SBA's programs, including the 7(a) and 504 and financial assistance programs.

Community Express I think is a program that potentially has a lot of merit, and I think it helps SBA to move to more of a qualitative type of lending rather than quantitative; in other words, not just looking at the quantity of loans that are made, but also looking at, you know, targeting loans to underprivileged areas that really need that lending assistance. So I think theoretically it has a lot of potential merit.

We have concerns about a pilot program that has now been in existence for, I think, about a decade and that some decision should be made either way, either to make the program permanent or not.

I think what would be necessary is some kind of analysis, which I believe SBA is doing, to determine whether this program is really working. They have given it a lot of thought. They have recently reengineered the program. But I think before they make a decision whether it is permanent or not, they have to be able to do that analysis and say this program is really working as it is supposed to do to try to provide the assistance to these needy borrowers.

We are currently conducting an audit. It is not done. We have not briefed the agencies so I really cannot get into the details of that. But, generally speaking, you know, we do have some concerns with the way the program is being administered, and we do have some concerns with the technical assistance requirements and whether those are, in fact, effectively providing borrowers with the assistance they need to be successful.

Ms. WHEELER. Glenn, when we looked at this last time in the Committee, we wrote to the IG and asked what would be its recommendation. The recommendation came back as—it is premature. Is that still the position of the IG, that it is premature?

Mr. HARRIS. I think it is; at least, you know, we would certainly like to have our audit be completed and have the recommendations that result from that audit for the agency to consider that. I guess if you do not mind, Eric, I would like to see if I can ask him a question as to whether, you know, SBA has undertaken that analysis. We were told when the program was going to be reengineered that SBA was going to look at whether this program was really effectively reaching this borrower. So if that analysis is close to completion, hopefully, I would say that it is premature until that analysis has been done. But I do not have any independent information as to where they are.

Ms. WHEELER. Do you want to give us the status of the analysis?

Mr. ZARNIKOW. Sure. Let me talk just quickly on Community Express. It is really a program that is intended to match financial assistance, the loan, with technical assistance and is focused on serving underserved communities.

We did a pretty major revamp of the program about a year ago. Our thought was make changes to the program. We will see how

the program does. We had goals also to increase the number of lenders in the program, to broaden out the diversification of lenders because we saw a high concentration of loans being made in Community Express by just a handful of lenders.

Obviously, the revamp that we made to the program coincided with a big credit crunch in the marketplace, a very deep recession, so the changes to the program we have not really seen how they work in kind of a normalized lending environment and a normalized economy.

So at this point, we feel as an agency that it is probably premature to make a decision about Community Express. Our plan would be to extend it again, recognizing that it is a pilot program that has been around for a long time, but feeling that it is premature at this point given the changes we made to the program. We had actually asked for the audit that Mr. Harris referred to, so we are interested in seeing those results as we think about, you know, how does the program fit into our overall portfolio and the effectiveness of the program.

Ms. WHEELER. Which leads me to a question: Would it be acceptable to the IG and to the SBA if we were to do a targeted recovery bill to just give it a year authorization? I know that that is tantamount to permanency, but not giving it a long leash.

Mr. ZARNIKOW. I guess our thought has been to extend the pilot program for another year, which would give us additional time to get information about the performance of the program and then look at that point to finish the analysis and make a recommendation about whether to make it permanent or not.

Ms. WHEELER. Are these Community Express lenders hitting their caps right now? Last year, the concern was that they could not do as much as they wanted. Is that problem still here since the regular program is back up and 10 percent proportionately creates a lot more latitude?

Mr. ZARNIKOW. We have been managing the loan volume, and what we did is we set loan caps on the largest lenders to allow also room for additional or new lenders to come into the program or to expand. We have found really that only one of the large lenders has been hitting their loan caps, so the other lenders, it has not been a constraint.

Ms. WHEELER. Mr. Crispen, did you want to comment on that?

Mr. CRISPEN. Yes. We have a much higher actual loan volume in our program. We are averaging right now around $38,000 per loan made. So right now today I do not have a problem with a cap, although this month we funded like 95 loans with an average balance of around $38,000. So it really is going to depend on where that loan cap goes to. Right now it has been raised to 200 a month, but that was through the end of the year. So what happens today? Does it revert back to 100 loans per month? If that is the case, then, yes, I am bumping close to the cap because my volume continues to go up as we continue to push the program.

Mr. ZARNIKOW. We expect that as the year begins to continue at the 200 level. We will obviously have to monitor that as we see what happens with our overall 7(a) volume and the Community Express volume, but we would expect to retain that cap going into the fiscal year.

Mr. CRISPEN. And one other comment I would like to make regarding technical assistance, because Glenn touched on that a second, we use strictly what I consider the SBA partners—Small Business Development Centers, SCORE Chapters, and Women's Business Centers—as our technical assistance (TA) providers for the most part. There are a few municipal-backed nonprofit organizations that are approved by individual districts that we would consider using, but our go-to, our main TAs are the three partners. And I would like to see the program tweaked to the standpoint—right now we are required to have a separate TA provider agreement with those SBDC or SCORE Chapters or Women's Business Centers that I think is totally unnecessary. If we are using those partners, I think that could be eliminated, because if we run into a problem, most of the SBDCs are associated with colleges and universities. Trying to get a TA provider agreement through their legal counsel at the university level is a nightmare. I think it is an unnecessary burden.

Ms. WHEELER. But will changing that TA—yes, I want to recognize Senator Vitter of Louisiana. Did you want to make some comments?

Senator VITTER. Why don't you finish the discussion? Then I will jump in.

Ms. WHEELER. This program has a very high default rate, higher than the other programs. My question is: Do we know why it has a higher default rate?

Mr. CRISPEN. I think part of that is you have got to look at the public policy initiative that got us into the program to begin with. Look at the market we initially targeted and went after. It is an underserved market.

Now, is that the case generally today? Yes, we are still pushing that underserved market. But right now today we have a huge demand for loans from just the general business community, because they have been cut off from loans by their local banks and by their regional banks. They need access to working capital more today than they have at any time in the past.

Ms. WHEELER. Glenn, before I turn to you, I just want to say one thing. It was interesting to the Committee that when we looked at the data from one of the largest lenders in this program, their average credit score for borrowers was 710. To me that is not the targeted market that we were trying to get to, and I do not see if that average credit score is so high—in my mind, that is a pretty good credit score—why the default rate is almost—what—double what the regular program is? Does that make sense?

Mr. CRISPEN. I think once again you have got to look at the market and look at the economic conditions we have been through for the last year, 2 years really—it started a couple of years ago—and look at the targeted market initially so that that loan base was in a tough market.

Ms. WHEELER. I think there would be more agreement that this program was meeting its mission if it was really digging down in that credit box, but that is a pretty high credit score.

Mr. CRISPEN. Well, we use the Fair Isaac small business credit scoring model, which is a model that SBA is familiar with. I think they use it as well. And I would sit here and tell you right now

today our average credit score is not 710, because that model looks at a broad perspective. And it is looking at more than just personal credit scores. It is looking at industry. It is looking at percentage of revolving available to that borrower, how long they have been in business. There are a lot of things that go into that scoring model, and I think it is a very fair model.

But, I mean, you know, if you want to tweak the program, if you want to tweak lenders, give us some additional guidelines as to where you want to see default rates, and we can make adjustments within the model. But when you do that, tell us what you are going to do. You are going to cut out a broad spectrum of people that are looking for capital. And a lot of them are existing. Two years ago, if you had asked me what the percentage of my portfolio was start-up, I would have told you probably around 65 percent. Right now today, I would tell you that 65 percent or more of our borrowers are existing borrowers. A lot of them have been in business 10, 15 years, and they got cut off by their local bank. They need working capital. That is why we need to keep this program and why we need to really increase the base on it to allow me to be able to reach out to more borrowers.

Ms. WHEELER. Okay. Thank you.

Did you want to turn to Glenn for one last comment?

Mr. HARRIS. Just very quickly, I think that you would expect the higher default rate given the nature of the borrowers in this program. The question that I have is: Is this default rate consistent with the riskier borrower base or are there other explanations for this default rate? We are concerned about the high historic default rates in this program, and part of that has been that there is a concentration of lenders who are making these types of loans. But I would hope that that would be part of the analysis that SBA would undertake.

And what we have said for all of these pilot programs is consistently come up with benchmarks as to what the expectations are, then evaluate the program against those benchmarks, and to make a determination whether the pilot program should be extended as a permanent program or not. And, frankly, and with all due respect, we have not really seen that type of program implementation analysis going on.

So we would like to see that, and we would like to see an analysis that shows that this is a justifiable program before the decision is made whether to make it permanent.

Mr. MILLS. Thank you very much. We do want to move on to the next topic. Did you have any final questions?

Mr. LUCAS. No.

Mr. MILLS. My understanding is that Senator Vitter and Senator Risch wanted to have a conversation related to the certified development companies and the 504 loan program, so I will turn it over to Senator Vitter for that.

Senator VITTER. Thanks very much, Ed. Thanks to all of you for being part of this roundtable. This is really important for us, and I think it is a lot more relaxed and flexible mechanism to get a lot of good input and ideas from the real world versus a formal hearing. So thanks for being here. And a special welcome to my friend Andre Fruge from Louisiana, which is a great way to turn to the

504 program because Louisiana Capital that Andre heads is the most active 504 lender in Louisiana.

I wanted to hear Andre's and everyone's comments about that program, what do you see in it during this recession, and I know there are two key proposals out there: one, to increase the lending limit; and, two, to use the USDA rural definition versus the presently used rural definition. So I particularly wanted to hear what those changes would do to the usefulness and effectiveness of the 504 program.

Andre, do you want to start us off?

Mr. FRUGE. Thank you, Senator. I also want to extend my thanks to Donald Cravins for inviting me up here today, to Kevin Wheeler and Ed Mills and all of the staff of the Senate Small Business Committee. I am happy to be here.

I have a list of things that I was going to comment on, but thank you for that segue opportunity. Really, there are three real important issues for us as an industry—reauthorization, of course. I believe and my colleagues believe that, you know, hopefully we are on the threshold of coming out of this recession. We believe that we are going to be—small business is going to be a driving force behind that recovery. For that reason, we need to be reauthorized, number one. And we have presented our ideas about reauthorization levels. We believe that level should be at the recommended level because, as things do get better, we are going to need a higher reauthorization.

A second big issue is we would like, as Tony mentioned, to extend the Recovery Act fee assistance. Statistically, it has been big for our business.

And, thirdly, as Senator Vitter mentioned, we would like to have an opportunity to have a larger debenture size. You know, there are several reasons—and earlier, when Eric was talking about default levels and how 7(a) and 504 worked opposite relative to the larger loan size, I think, you know, the fact that 504 larger loans have had statistically in the last couple of years maybe a worse performance than the smaller loans I do not think is inherent—there is no inherent idea about greater default just because the loan size is bigger. I think it is inherent what we do. We do commercial owner-occupied real estate. And we are in an environment where real estate, as all of you know, has taken some big hits in value. So that has a lot to do with larger loans having higher default rates.

But, importantly, we need a larger loan size so we can do a couple of things. Number one, the million and a half on our side is not enough. I mean, we can go up to 2 million if we meet SBA public policy goals. Well, Senator Vitter, let me give you a couple of examples of names that you might recognize or industries certainly that you might recognize, one being the Don's Seafood people. We have been involved in two projects so far with that family, their restaurants, and we are maxed out on our limit with them. They have had just kind of cursory talks with us about another deal, but we cannot do it. We cannot help them expand. I do not think there are a lot of conventional loans out there for restaurants these days, particularly these days. So that is one reason, some repeat busi-

ness. I mean, and they are good-paying folks. We have had a good history with them.

Another piece of repeat business, a guy by the name of Joel Broussard, who is the offshore vessel business, and he is a solution provider in the Gulf of Mexico, done a 504 loan for one of his supply vessels. And it was a maximum debenture from the get-go. He about 8 months ago had a contract with an oil company to do—it was like a 4-year contract that was going to provide plenty of cash flow for us to do this deal. But, again, we are maxed out.

I guess what I am saying is that in today's world our loan size is too small, and certainly those two examples are some of America's——

Senator VITTER. Just to take those two examples, is there a huge need there specifically because of the credit crunch in this recession? Or would there be that need under more normal times?

Mr. FRUGE. I think there would be that need always, obviously because we did these loans before the credit crunch, but even more so today. I mean, banks' credit has tightened. There are many banks that are not looking for new deals. They are certainly not looking for conventional deals in higher-risk industry like the restaurant business, you know, like the commercial offshore oil and gas vessel business. So they need our assistance, and we cannot do that for them if we cannot make a larger loan.

You know, I think repeat business in any business is what you look for, and we would like to be able to accommodate those customers, particularly those that have a history of paying us.

Senator VITTER. Just in your business, what percentage of the 504 activity do you think is "rural"? And do you know what sort of positive impact it would be specifically to move to the USDA definition, which most people seem to think is more accurate?

Mr. FRUGE. I could not give you a percentage. If I had to guess, it would probably be somewhere along the lines of 20 percent, maybe 25 percent. But, yes, I mean, it would help us to be able to meet that SBA public policy goal, which would then allow us to make from $1.5 million to a $2 million loan.

I am trying to think of an example of who we had, and it is not that important. I am just in my own mind. But I do know that the definition that we use today of what defines a rural area is a lot more cumbersome than that that the USDA uses, and it would benefit us.

Senator VITTER. Does anyone else have any comments to those same topics or questions?

Mr. MILLS. If we could also hear from Jean, who is also here representing the 504 loans.

Ms. WOJTOWICZ. Thank you, and actually a wonderful segue as we look at that rural definition specifically, and my CDC is in Indiana. And I would say probably 40 percent of our portfolio is in rural areas.

As we look at the potential to go to the USDA definition, if nothing else, it gets rid of some of the confusion. What is so difficult when we work with our bank partners to provide solutions to small businesses is when you have multiple programs that all have different definitions. Something like "rural" should be a pretty standard definition, and we certainly think going to the USDA definition

would eliminate some of the confusion and make it easier to market and to provide that assistance to small businesses.

A couple of other points I just wanted to make on these topics, both specific to the Recovery Act provisions as well as the reauthorization.

First, let me say we are so hopeful that we will get a reauthorization bill this year. We have many improvements suggested in our draft legislation that we think would be significant assistance to small businesses, knowing, again, that small businesses are going to drive that recovery. And in our case, because the 504 program is specifically an economic development program, we track jobs, we actually over the period of this program have created over 2 million jobs. That is huge. All we hear about are job losses, and this program actually tracks and verifies employment increases that have occurred as a result of the financing that we provide to those small businesses.

As we look at the Recovery Act provisions specifically, we are very concerned that with the fee relief that we expect to run out before the end of the calendar year, we are going to see a significant drop-off. These businesses are kind of stepping out, willing to take some additional risk as they expand their businesses, and the fee relief has really helped them gain some confidence to go forward. Difficult to give them fee relief on the one hand when today, October 1st, we are hitting them with an increase in fees because of the subsidy rate.

So if there is consideration at the appropriation level to actually get some funds appropriated to extend fee relief, we would certainly like to see that coupled with an appropriation to cover that increased subsidy cost, at least temporarily until we get this recovery on a little more stable footing.

The other item I would like to mention—and we have had a lot of difference here about it—is the possibility of increasing the loan size. As Andre pointed out with some very good examples—and every 504 company you would talk to would have more examples in their portfolio—it is not so much that we want to go out and do the next very large single plant expansion. Those are nice. But the real benefit of our program is that we have multiple expansions in multiple communities that do not have the kind of risk associated with a single plant expansion for those communities.

So I have a borrower that is in the cheesecake manufacturing business. I have done four loans for them. I cannot do their fifth and sixth. And because it is fairly specialized equipment, lenders are not very interested in continuing to help them expand. They are a very large employer in a very small community.

So we have lots of anecdotal stories about why the larger loan size would be important to this part of the business.

We also think there are some opportunities to not only allow borrowers to access the maximum amount of 504 lending, but separate and apart access the maximum 7(a) participation. We should not have to aggregate those to have a single loan limit when there are very different needs and uses for those capitals. Growing businesses obviously have growing working capital needs as well, and we need to help those businesses continue to expand.

As we have studied business ownership in this country, we also know that there are going to be even more business ownership changes occurring over the next decade. We would like to see in the 504 business the expansion to be able to finance stock purchases where the stock prices are supported by specific fixed assets. It just makes sense to give businesses the flexibility to structure a transaction that makes the most sense for them in the way that they need to structure their business for long-term benefit.

Mr. MILLS. Jean, I want to also include a conversation about the child care lending program, but before we do that, one question we have is: Is there a dollar amount on the higher loan limit that you want to recommend?

Ms. WOJTOWICZ. We think a $5 million limit on the normal debenture makes sense, and then with appropriate increases for public policy and manufacturing that we have had in the past.

Mr. MILLS. So you can wrap up, and then we are going to turn to Joan to discuss the child care lending pilot program.

Ms. WOJTOWICZ. That would be fine. I did want to comment; there were some discussions about higher default rates perhaps in larger 504 loans. I think if you really dig down and look at some of the specifics there, a 7(a) loan is liquidated and collected by the local lender, feet on the street, access to information, and we think that has a huge effect on what your recovery rates are.

In the 504 business, we are relying on the central liquidation efforts of the SBA, which are doing a great job. But we in our legislative package have asked that CDCs actually not only have the opportunity but be required to be active in that liquidation process.

I certainly have a better idea of how to collect that loan down the street than somebody half a country away. Coupled with I cannot liquidate a loan if I do not have access to information. And once a loan is repurchased in the 504 business, our access to that data is gone.

So if I wrestle a borrower to get a payment or if I find a buyer for that piece of equipment or that real estate, I cannot even get him a payoff number that day. It may take multiple days. And so our legislation requires—it has a recommendation that we require that that loan accounting continue to be done through the central servicing agent so that I can pull it up at midnight if I need to, if I am negotiating on a sale of fixed assets.

Mr. WILKINSON. Thank you. And we have now been joined by the Chair, Senator Landrieu. We are going to start with going to Joan to discuss the child care lending pilot, and if you can do that, and then we will turn it to Senator Landrieu.

Ms. WASSER GISH. Thank you, and good morning. I want to thank Chairwoman Landrieu, Ranking Member Snowe, Senator Kerry, and Senator Vitter for the opportunity to make the case for inclusion of the child care lending pilot program in the SBA reauthorization bill.

My name is Joan Wasser Gish, and I come from a family of small business owners, and I own and operate my own small business known as Policy Progress. I am also an attorney and a former senior product adviser to Senator Kerry, and that is basically why I am here.

While working with Senator Kerry, I spearheaded a child care small business initiative. We assembled a statewide advisory committee, which included representatives of the small business community. These were the U.S. Small Business Administration's Massachusetts District, the Massachusetts Small Business Development Centers, Massachusetts Association of Community Development Corporations, Seed Corporation, the Center for Women and Enterprise, lenders such as ACCION USA, and the Western Massachusetts Enterprise Fund.

The advisory committee also included a cross-section of stakeholders in the early education or child care industry. These representatives reflected the array of service delivery providers spanning the economic sectors: sole proprietor home-based child care providers, for-profit centers, and also nonprofit providers.

Senator Kerry charged this group with making recommendations to better connect entrepreneurial resources with child care providers, many of whom are women and minority business owners, in order to strengthen the local economy and improve the overall quality of child care programs.

One of the central conclusions reached by this advisory committee was the dearth of lending and other financial resources available to nonprofit child care centers, which disproportionately serve low-income children while their parents or guardians are working. Nonprofits, even during times of free-flowing credit, have barriers to accessing loans through traditional lending institutions. They operate on slim financial margins and often lack the capacity to make a sizable downpayment for capital investments.

Advisory committee members noted that this lack of access to capital had broader economic implications because of the direct relationship between child care, economic growth, community development, and work availability and productivity. It was the recommendation of this committee that Congress extend the 504 loan guarantee program to nonprofit child care facilities, which is the purpose of the child care lending pilot program.

This program is consistent with the purposes of the 504 loan guarantee program because it meets three core goals:

First, it helps to maintain and strengthen the overall economy. Nonprofits comprise 35 percent of all child care establishments with employees and provide care that allows millions of parents to work in our Nation's 6 million small businesses with employees. In Louisiana, for example, the child care services sector cares for the children of 136,000 working parents.

Second, it supports community development. Nonprofit child care centers typically locate in low-income urban and rural areas. In many communities they are the sole source of center-based early education and care. They play a vital role in helping low- and moderate-income workers participate in the labor force. In Massachusetts, for example, where I am from, 90 percent of subsidized child care purchased by the State is from nonprofit providers, and in York County, Maine, about half of all subsidized child care is provided through nonprofits.

Thirdly, nonprofit child care centers promote job creation, worker productivity, and job retention. Nonprofits, as I mentioned, comprise 35 percent of all firms that hire, but they actually hire dis-

proportionately 50 percent of all child care workers. The Bureau of Labor Statistics seasonally adjusted employment numbers are turning upwards since June of 2009 and are significantly exceeding hiring levels in both 2006 and 2007. Job growth in the industry is projected to be 2½ times that of the national rate.

In regards to worker productivity, it is estimated that breakdowns in child care arrangements cost American businesses $3 billion annually. Studies have shown that availability of quality child care can reduce employee turnover by 37 to 60 percent. They also reduce absenteeism, tardiness, and enhance productivity. Moreover, child care is a needed corollary to economic recovery. Parents cannot work or look for work without child care for their children.

These benefits accrue across the Nation, and so as this reauthorization bill is considered, I respectfully recommend that you remove the limitations for eligibility to the 18 States represented on this Committee and instead allow the 7-percent cap on loans and other lending criteria to more appropriately limit the pool of eligible entities.

In general, thanks to the able work of this Committee, there are numerous safeguards in place to ensure that the integrity and purpose of the 504 loan guarantee program is preserved through the child care lending pilot program. And with these safeguards in place, I respectfully urge the inclusion of the child care lending pilot program in the SBA reauthorization bill, and I welcome any questions that you might have.

Chair LANDRIEU. Thank you so very much for that wonderful presentation, and I thank all of you for joining us today. I apologize. I was chairing another meeting earlier this morning, so I was just available to get here at 11:00. I really appreciate the staff and the good work of Ed Mills and Kevin Wheeler for leading this discussion. I thank Senator Vitter for coming, and I understand Senator Risch was here as well, and I really thank you all. And, particularly, it is wonderful to see you, Andre. I know Senator Vitter introduced you already. And also, Ray, I understand you are a Louisiana Tech graduate.

Mr. MONCRIEF. I am, Senator.

Chair LANDRIEU. Good. So we are going to adopt you anyway, even though you are from Kentucky.

[Laughter.]

Or you are now in Kentucky. I just want to say how important the reauthorization of these lending programs is. We have been delayed for several years in their official reauthorization. They are ongoing programs that are generally broadly supported. But, obviously, there are some issues because we have been unable to resolve getting them reauthorized. This roundtable is part of an effort to really flesh out what some of those obstacles or challenges might be, as well as to hear from you all broadly about how they can be strengthened.

I know that Administrator Mills and President Obama and his Administration feel very, very, very strongly about strengthening access to capital for small business in America. And while I do not speak directly for the President, or for the Administrator, I will speak for myself—and I have heard them say basically the same—the recession we are all painfully experiencing will be brought to

an end when small businesses can step up and start hiring, because it is going to be the small, innovative entrepreneurs. And so getting access to capital and to financing is critical. It is critical year in and year out, but it is very, very critical now. Through the programs of the SBA, we think that we play a significant—not controlling, but a significant role in that.

That is why we are spending some time reviewing possible changes. I know that Kevin and Ed have led a very robust discussion, so I do not want to interrupt it, and we will be able to stay for a few minutes more before having to leave for another meeting.

Let me sit back and listen to questions and comments, and I think maybe we will continue on the subject that we are now visiting. Thank you all so much. I will submit my full statement for the record.

[The prepared statement of Chair Landrieu follows:]

Opening Statement for October 1, 2009
Small Business Committee Roundtable:
"Reauthorization of SBA Finance Programs and the Impact of the Small Business Provisions in the Recovery Act"

- I have called this roundtable today for two reasons, to hear directly from participants in small business finance programs on:

    1. What impact the Recovery Act has had on the SBA's financing programs; and

    2. What should be changed within these programs as we prepare to reauthorize them.

- SBA loan programs are vital to the strength of our nation's entrepreneurs, representing 40 percent of all long-term financing.

- But with only 5 percent of small businesses receiving some funding from these programs, the programs need to be more attractive to both small businesses and lenders.

- **In the past year we have seen the worst economic conditions since the great depression, making it more critical than ever for small business owners to have access to capital to buy inventory and keep their workers employed.**

- **To address this concern, Congress Passed and President Obama signed the American Recovery and Reinvestment Act, which included several provisions Senator Snowe and I fought for.** The Act:

    - Temporarily eliminated fees for SBA-backed loans;

    - Raised the guarantee on these loans to as much as 90 percent;

    - Stimulated new lending to businesses with 10 or fewer workers through $50 million in microloans and management assistance;

- Addressed issues with the clogged secondary market and bolstered funding for the surety bond program to increase the number of small businesses competing for Federal contracts.

- **These changes are working. How do we know? The answer is in the numbers:**

  - Since the President signed the Recovery Act, loan volume has increased about 71 percent for the 7(a) program and 56 percent for the 504 program;

  - More than 1,000 lenders who had not made a loan since the credit crunch have begun making SBA loans;

  - And, with the help of these programs, small businesses have created or retained about 325,000 jobs.

- However, because of the success of these programs, the money allotted to them is quickly running out.

- **We should consider ways to preserve the most effective provisions from the Recovery Act and make changes to these programs that will ensure small businesses have access to the size and type of loans they need and, equally important, to encourage lenders to participate in the programs.**

- The last long-term reauthorization of the SBA finance programs was in 2004 and ran for 4 years, through the end of 2006.

- **Since 2006 we have had a series of – eight -- short-term extensions. <u>This has kept the Agency alive, but not as muscular as we need it to be today</u>. The programs need to be current to meet the needs of small businesses that can't access traditional financing.**

- We need a vibrant and strong SBA with modernized programs to give small businesses – the engines of our economy – the tools they need to grow, create jobs, be successful and help dig our country out of this recession.

- I understand you have already begun discussing the SBA's two largest and most-used loan programs – 7(a) and 504.

- Together these programs helped to create or retain more than 824,000 jobs in 2007.

- Unfortunately, their success since then has been tempered by both the recession and some provisions within the programs that need to be updated.

- **Committee members have proposed several changes:**

  - Our Ranking Member, Senator Snowe, introduced legislation in August – S. 1615, "The Next Step for Main Street Credit Availability Act" – which would increase the loan size for the 7(a), 504 and microloan programs and create an online lender platform to allow borrowers to compare rates between lenders.

  - Senator Levin has a proposal that has passed this Committee at least twice in the past that would create an intermediary lending program to assist businesses that need more than the $35,000 a microloan can provide, but less than the $200,000 loan level that many 7(a) lenders are able to make.

  - Senator Kerry, responding to the lack of childcare facilities in our country, has proposed creating a pilot program that would allow the 504 program to be used to lend to non-profit child-care providers. This too has passed the Committee at least twice in the past.

  - And I'm sure many of you here today have your own ideas. I will be interested to hear from my staff what recommendations you have had so far and look forward to hearing others.

- Building on the changes proposed today, I plan on introducing legislation shortly that will reauthorize these finance programs.

  - My goal is to have something to markup and pass in Committee before we break for the year.

  - I would also like to quickly move a smaller, targeted bill that would make technical corrections to the small business Recovery Act provisions, and tailor some of the existing programs. We continue to hear that small businesses can't get credit, and I think

we need to go a step further to continue the momentum we've seen so far.

- Small firms pump almost a trillion dollars into the economy each year, create two-thirds of our nation's new jobs annually and account for more than half of America's workforce. But they can't do any of this without sufficient access to capital.

- **I am committed to doing everything I can to ensure we set the SBA finance programs up for success, so these programs can in turn set our nation's 27million small businesses up for success.**

- I hope we can use this roundtable to dig a little deeper into what we can do – legislatively and through other means – to get capital into the hands of the business owners and workers who will continue to lead this nation back toward economic prosperity.

- The record for this roundtable will be open for two weeks, and I encourage you to submit any follow-up materials you feel necessary for the record.

Mr. MILLS. If we could do some questions on the child care lending program. Do you know—if I could ask this to Joan as well as the Eric—if the SBA allows any other nonprofits to receive loans?

Ms. WASSER GISH. Do you want to take that?

Mr. ZARNIKOW. I do not believe that SBA does lending to nonprofit organizations other than potentially in our disaster loan program.

Mr. MILLS. How about the intermediaries in the micro loan program?

Mr. ZARNIKOW. We do make loans to nonprofit intermediaries as part of the micro loan program, so that is sort of a fundamental piece of that program as our delivery mechanism is through nonprofit micro loan intermediaries.

Mr. MILLS. And then do we know if there has been a CBO scoring on this provision?

Ms. WASSER GISH. There has. CBO has scored it at nothing.

Mr. MILLS. You know, we have some 504 lenders here, and, obviously, this pilot could have an impact on your program. Could we get some comments from you in terms of your kind of——

Ms. WOJTOWICZ. We have reviewed the language that was put into a couple of the prior reauthorization bills, and as an industry, we would certainly have no objection to the pilot as it is proposed.

Ms. WHEELER. May I just add for the record, in fact, we worked very closely with NADCO to address any underwriting concerns so that it would have all the integrity of the regular loans. Senator Kerry has not reintroduced the bill, but it is my understanding that he would retain all of those protections.

Joan, could you please state again for the record what the need is for child care in states like Louisiana and Massachusetts and how the 504 program helps address access to quality child care?

Ms. WASSER GISH. Sure. Thank you. Fundamentally, within the child care industry, there is a need for both for-profits and nonprofits to serve countless numbers of children who are waiting, and there are certain States that maintain wait lists that effectively try to capture what the gap is between supply and demand.

In Massachusetts today, there are 20,698 children on a waiting list in Massachusetts. In Maine, it is estimated that only one child care slot is available for every four children who need it so that a parent can work. And according to the American Community Survey of the U.S. Census Bureau, we are able to get sort of a rough estimate. We know, for example, that there is a gap of about 250,000 between the number of children who we believe are in need of care and the availability both—across all sectors in the child care industry. In New York, that gap is about 166,000. In Louisiana, the gap is more than 30,000 children who are in need of space. And in South Dakota, the gap is about 3,800 children.

So we know that undoubtedly there is pent-up demand, and if that demand continues, the real challenge is that families are having a harder and harder time purchasing it. And both for- and nonprofits are going to play a very important role in supporting families in heading back to work.

Chair LANDRIEU. Joan, let me ask you this, because I have been on this Committee for quite some time and now chairing it, I am interested in this discussion. Is there some fundamental reason

why the SBA has not traditionally lent to nonprofits? Is it just the nature of the way the agency was created and we are making a reach here? Does anybody know?

Kevin.

Ms. WHEELER. Well, SBA's regulations define small business as a for-profit business, but as was noted, there is precedent for doing it. In the disaster loan program, they do it, and in the micro loan program, there is a program that was put in place for welfare-to-work which said that micro loans could go to nonprofit child care providers. So it was not only to the intermediaries, to expand upon what Eric said; it was specifically for child care providers.

And this issue first came to the Committee in about 2000. A 504 lender from Texas named Julie Cripe, I believe—I do not know if she is still with OMNIBANK—brought this to us. It was the only way that they could get financing for a child care center in an African American community in Houston. A church would do it. And we went to the SBA, and it was not allowed. Years later Senator Kerry did a study in Massachusetts that identified a need for capital to child care centers, and the committee has been working on this bill since 2002.

Chair LANDRIEU. I want to say I think it is a very smart idea, and I would argue to my colleagues, both Democrats and Republicans, that using the entrepreneurialship model more for trying to have Government programs be successful is something that I think both parties actually really can support. Republicans—and I am not going to speak for them, they speak for themselves—but they generally want things to be more efficient, more business-oriented, and Democrats like the idea of reaching out and getting the job done.

I would like to really pursue this, and I would love to talk with Senator Snowe about it—and also the particular business of daycare—because it supports and undergirds small business everywhere. Many business owners and their employees are parents, whether they are the wife or the husband, and they cannot do a real good job at their business if they do not have quality daycare.

I think from that perspective, I would love to hear some feedback. The other thing that is coming up to be a big issue here in Washington is this whole new focus of social entrepreneurship. The President is very focused—and it is really very bipartisan as well—on this whole new concept of social entrepreneurship. There are business models that are being directed to solving major social problems, but in a different way than government-run programs—you run them more through a business model. It is attracting a lot of broad-based support around the country, and in thinking about it, the SBA is in a potentially good neutral position because we are not the Department of Health or the Department of Agriculture. We are a neutral agency in that regard. Matt, has Senator Snowe ever made any general recommendations or suggestions to you?

Mr. WALKER. We have not yet. We still want to find out a little bit more about the public policy considerations that may have been in place at the time it was originally formulated. Certainly one can envision concerns of the Federal Government getting into the aspects of what happens if there is a default on these loans. For instance, if the Federal Government would now be in the position of

going into churches, to try to take over property that secured a loan. Similarly, if the loan was for the disabled or the blind or others, the perception behind that would certainly be a very serious public policy concern.

So we just need to delve a little bit further into it to find out what those public policy concerns were when they initially did not allow nonprofits to participate in the program. And, Eric, I would be very interested to hear if you could find out a little bit more about that.

Chair LANDRIEU. Okay. It would be definitely worth pursuing, and I think particularly this idea of nonprofits for daycare. But it could potentially be expanded.

Do any of the lenders want to comment about this, either positively or negatively? Or do you have nonprofits coming in to see you regularly trying to solicit for loans and they are doing good work in the community, I am assuming? Go ahead.

Mr. CLARKSON. Yes. We actually as a full service bank—thank you for asking. We do look at all types of businesses, for-profit, nonprofit, and I think it gets back to an earlier point of giving the small businesses choices. And if we have limited a small business based on their profit status, then we have limited their access to capital. So the more choices that we have, the more ability we will have to reach into the industry and being able to make specific loans to specific borrowing needs.

Chair LANDRIEU. Greg, you are absolutely right. From a banker's perspective, if you can make money on the loan—that is the bottom line. You are going to lend to a creditworthy for-profit or not-for-profit. It would be interesting to get—I do not know if the staff has the employment numbers for nonprofits. It is a huge employer in America. When Americans look at jobs, if they can work for a nonprofit as a good job, they can for a for-profit company as a good job, and perhaps we should be in our reauthorization thinking a little bit more broadly about this. The bottom line is about choice, freedom, jobs, and that is what we want to stay focused on.

Anybody else? Any other lenders who have a similar or maybe different perspective? This would be a great time to speak up or hold your piece.

[No response.]

All right.

Mr. MILLS. I think at this time we would like to move on to the intermediary lending pilot program. We have Dennis West here regarding this issue. This is a proposal that has been put forth by Senator Levin for several years now. It has passed the Committee at least twice. It is set up to fill the gap between the maximum loan amount that a micro loan lender is allowed to do, which is right now at $35,000, and below the level that a typical 7(a) lender might be able to do. It would provide grants to intermediaries and have that paid back at 1 percent over a number of years.

At this time I would like to turn it over to Dennis for a little bit better description and some thoughts.

Mr. WEST. Okay. Thank you very much. To think about the context of how we brought this proposal to Senator Levin, when we think about rural places generally, the Global Entrepreneurship Monitor suggests that about 11 percent of Americans have the atti-

tude and aptitude to run a business. And as we are trying to develop our rural economies, it is important that we try to get as many of that minority who possibly can start a business to be oriented towards starting a business, because as you are quite aware, we have a lot of challenges in terms of maintaining and growing small businesses in many of our rural communities.

So the way that we try to think about this is that we are involved in the character lending process. We are typically dealing with people who often have cash deficiencies, collateral deficiencies, and we are focusing on—and sometimes credit challenges, and the credit challenges come from being in rural communities where it is sometimes hard to maintain quality jobs.

So we are working in that space of trying to help build a bridge to our community banks. So our portfolio of micro loans has a lot of churn in it. We would typically see our loans go out maybe 3 to 5 years, at which time it is in our interest to work with our borrower to get them into a community bank.

When we started working with Senator Levin, the problem we were trying to solve was that sometimes the start-ups that we are trying to build upon are larger in need for equipment or value than what would be available in the micro loan program. So we propose building this second tier which would solve two problems: either the capital requirement or the capital and time requirement that would associate with getting someone to their community bank.

So sometimes it is a matter that you have got to introduce more capital or have more capital to work patiently with the customer to be able to get to a community banking relationship.

An example that I can tell you about is a small business that was purchased in a community in Upper Peninsula. It is a chiropractor business, so it was taken from a man who is retiring to a new person. The new person who is buying the business was not in a position to be able to go to a conventional bank because of student loans, and so we are in a position to help get that business to stay in this community and help this person get started and grow.

Another example is a gun sight manufacturer, also in the Upper Peninsula. In this case, the gentleman was maxed out with their community bank, had a chance to get a large contract from an OEM, and needed equipment to improve processes so that the quality would meet the standards of the OEM. So he needed to make an equipment purchase. So it is above the micro loan limits. It is in that space that is important because of other credit issues. And it helps takes someone who has got 20 jobs with benefits and helps them to be able to grow that business and to be in a position to work with a substantial OEM.

So Senator Levin was helping us to think about that space of working with start-ups, and the big question is more capital and more time that are sometimes required to be able to work with intermediaries.

The idea was modeled after the very successful intermediary relending program that has been done through the USDA. That program has done about $1 billion and has had no defaults. So it is a successful model off of which to build.

In this case, how would this proposal be different from the USDA program? Well, first of all, the USDA program is limited to rural places, so this would be a program that would open up to more communities throughout America who are involved in the micro lending program. The USDA program is highly targeted, so you get additional points for limiting the number of counties in which you work. So as we are trying to work in 44 rural counties through northern rural Michigan, when we go in and we get an intermediary relending program through USDA, we have to limit the number of counties in which we can work. So that makes us unavailable to many of the people that we would be trying to work with.

The third challenge with the IRP program is it is dramatically oversubscribed, and it has about 33 million a year that is available to help grow the credit and capital needs that we are looking at. It was an important piece.

So what Senator Levin helped us propose is a program that solves capital issues, solve capital and time issues, and serves as a bridge to be able to work further with community banks.

Mr. MILLS. Thanks, and I would like to start with Senator Snowe's staff. Any questions?

Mr. LUCAS. Thank you. I had a couple of questions. One of the things that Associate Administrator Zarnikow pointed out was that the average 7(a) loan is around $200,000, so actually we are talking about small loans. When we consider standing up a new program, what is the interplay going to be between a micro lender program that is a little bit larger that might actually stray into the 7(a) space? I wondered if I could get your thoughts on this and what the interplay would be with the 7(a) program.

Mr. ZARNIKOW. Well, as you mentioned, our average 7(a) loan is a little over $200,000, and I think one of the things we would like to understand better or look at is what is that interplay with our regular 7(a) loan program. Is this replacing that, or is this really a market gap or need that is here?

Now, I mentioned earlier today that I was really glad to be part of this roundtable to do a lot of listening to the new ideas and have a chance to go away and evaluate those.

Mr. LUCAS. Excellent. Thank you. And maybe when we are finished——

Mr. MILLS. Dennis, did you have a response?

Mr. LUCAS. Oh, I am sorry.

Mr. WEST. Well, we would clearly see this as a market gap issue, and in some of our rural communities, there are not any lenders doing 7(a), is one issue, and we often find ourselves working with 7(a) lenders as a complement where they see collateral challenges and things of that nature.

Mr. WALKER. Just a quick follow-up on that as well, Eric, I would appreciate it, if you could also look at what the different requirements are for 7(a) as opposed to these. Obviously, different loan levels have different requirements in terms of what needs to be produced for paperwork, for oversight and for other requirements. We want to ensure that we have the information needed to limit potential defaults.

Mr. ZARNIKOW. We would be glad to take a look at that.

Mr. WALKER. Thank you.

Ms. WHEELER. And before I turn to Marianne, I want to ask one question of Dennis. Right now, I believe that the legislation as it was passed in the last two Congresses, makes CDCs, certified development companies, the 504 lenders who are here, eligible to apply for the pilot program as envisioned. Right?

Mr. WEST. That is correct.

Ms. WHEELER. Okay.

Marianne.

Ms. GARVIN. So I just wanted to add that in a market like Long Island, which is not rural, this program would be very valuable to me and other lenders. I have a very recent example. I just approved a loan yesterday for $150,000 to a minority-owned business, an attorney, who got a $1.2 million 7(a) loan to acquire and renovate the inside of a building in a low-mod census tract. But he also wanted to do a facade improvement, and so he came to me from my facade program, which is capitalized by a line of credit from one of my lender partners.

Unfortunately, that lender partner and many of my lender partners are eliminating loans to CDC of Long Island, reducing our lines of credit, which is also happening in the wider environment to for-profit businesses—and I am not-for-profit business. And so I just had $150,000 left, and that is it. My capital is gone, and I have no other place to get it except I am a CDFI so I get some money from Treasury. But I use most of that money for my residential lending programs, my second mortgages, my downpayment assistance, my rehab lending to home buyers or homeowners.

And so when I look at the range of products that I try to offer in my community development lending operation, I need more options to kind of mix and match and offer the products that are needed for the businesses that are coming to me and have that need, and it is primarily targeted to the low-mod census tracts.

So I just want to put in a plug that this would be valuable for perhaps more reasons than you might think.

Mr. MILLS. Thank you. And in the interest of trying to get back onto schedule, I would like to move the conversation to lender oversight. To lead off this conversation, I am going to call on the IG's office, Glenn Harris.

Mr. HARRIS. Okay. Thank you. Well, I think on the issue of lender oversight, you have to sort of put it a little bit in perspective, and I think the agency has made a lot of progress in developing a lender oversight program. The IG's office had a management challenge, which went back to 2002, to the agency to establish a lender oversight program.

Since then, as I said, I think they have made a lot of progress. They have established an Office of Lender Oversight, now called Office of Credit Risk Management. They have gotten issued enforcement regulations which will help their ability to undertake enforcement actions. They have established standard operating procedures and other procedures to be able to implement the lender oversight process. So I do think the agency has made a lot of progress.

Unfortunately, as is often the case at SBA, progress also brings its new set of challenges. We still have a management challenge on

this issue, and we have issued a lot of audit reports that have identified problems with the lender oversight process.

One concern for us is, frankly, whether there is a conflict of interest between the Office of Credit Risk Management and whether that should be properly placed within the Office of Capital Access, where OCA has a goal of trying to promote loan growth, which is a laudable goal. But does that present a conflict in terms of having an effective oversight program?

You know, I think the issue of oversight also has to be looked at in terms of the overall sort of the way the program works. I think there are three components that we see in the IG's office to this.

One, is there a clear set of requirements that lenders are expected to adhere to?

Secondly, is there a process at SBA to effectively oversee whether lenders are, in fact, adhering to those requirements?

And, third, is there an accountability program that is fair and reasonable but also effective at trying to identify lender oversight problems?

And I think you could look at all three of these areas in the lender oversight arena and identify challenges that continue to exist. I think SBA could do a better job at promoting what the requirements are. You have got SOP 5010. Eric has done a considerable amount of work in trying to clarify that SOP and improve that SOP. It is still an extremely large document, and if that is the set of requirements that lenders are expected to adhere to, then do they fully understand what all the requirements are? Are they using technology, for example, to be able to clarify what is expected of the lenders?

For example, having the SOP, it is online, but is it as—you know, does it provide as much information to the lenders as it could?

We do think that SBA could be doing more in its lender oversight program. This is reflected in our audit reports. Some of the problems are, I think, sort of a growing pain as they evaluate the progress that they have made. They have sort of taken a one-size-fits-all approach. If you are a lender over a certain dollar Mauritania, you are going to have on-site reviews. There is considerable emphasis on the risk rating system in LLMS, and obviously lenders have come up with, identified a number of concerns they have with that program.

I think what we would like to see is the agency to develop a more what I consider a holistic approach to lender enforcement. For example, look at a wide range of variables, of risk factors, and have an engagement program that is targeted towards higher-risk lenders. So if you are a lender that is performing well against this matrix of risk variables, maybe you would have less frequent on-site reviews, for example. Maybe you would have some kind of desk review or compliance reviews that would not necessarily be as expensive, would not necessarily be the same type of review that you might get if you were a riskier lender.

Looking at the legislation, I have only had a little bit of time to look at it. I would appreciate the opportunity to be able to sit down with the congressional staff at some point to maybe go over some sort of more granular concerns we have.

But just one general point is I think we need to be careful about in legislation not tying SBA's hands in a way that produces unintended consequences. I think they need to have that discretion and flexibility in how they implement the program so that they are looking at a variety of risks and have a variety of options to be able to address those risks.

Mr. MILLS. Sure. Thank you. Glenn—one thing that comes up a lot is the concern about the reversals of repurchases years after the fact. There have been some proposals out there on whether or not there should be some sort of statute of limitations. When this has come up in the past, my understanding is that U.S. Code provides a 6-year statute of limitations, and it can be extended beyond that for 3 years. It is always a question of when does it start, when does it end.

Could you give me some clarification as to exactly how that works?

Mr. HARRIS. Sure. First of all, in the IG's office, we do understand why lenders would be concerned if SBA has made a decision on a guarantee purchase request, and then there is an audit, and a length of time—and sometimes a considerable length of time—passes, and now all of a sudden they are being told that there were problems with the loan.

Obviously, we understand why lenders would be concerned about that. But I think we have to put this a little bit in perspective, and that is—and our audits have identified a number of concerns with the quality of the guarantee purchase review process. This is another management challenge that we have, and there are a number of concerns as to whether those decisions are being made properly, whether the Herndon center is adequately staffed, whether that staff is adequately trained.

And I think that from our mission, you know, it is our job to identify when the Government—when SBA has made a payment that is improper, and if there is an improper payment that has been made, that reflects—that is money that the taxpayers are paying in a credit subsidy process, or that is money that is going to be reflected in higher fees that are charged in a zero subsidy situation.

So I guess just to be very quick on this, there is a statute of limitations in 28 U.S.C. which provides for 6 years for the Government to go and recover a claim. We would be very concerned about a proposal that somehow gave 7(a) lenders an exemption from that statute to say there was some kind of shorter period so that if an IG audit discovered that there was an improper payment or if there was fraud in a loan, that somehow we would be prevented from going forward with an audit to identify that improper payment or going forward with a criminal investigation to be able to prosecute that fraud.

Mr. MILLS. Thanks, and I know that earlier Tony Wilkinson started off some of the conversation on lender oversight, so I wanted to turn to him and hear some of his comments.

Mr. WILKINSON. Okay. I appreciate that. You know, I think there are a lot of issues that surround the lender oversight program. We clearly have been critics of what is going on. We are not convinced that the lender oversight program is efficient or cost effective, and

we continue to have concerns about post-purchase reviews that are happening years, some of them 11 to 13 years. And I do not see where it is a lender's fault if the SBA was inadequately staffed or trained or that the IG decided not to get around to looking at files for——

Mr. MILLS. Can I just interrupt you? Glenn, can you explain how, if it is 12, 13 years after, how that actually happens? We just discussed that there was a 6-year statute of limitations. How does that happen?

Mr. HARRIS. Well, I mean, I think that if SBA tried to enforce a claim—in other words, tried to go after a lender to recover a guarantee payment 13 years after the fact, I think that would be barred by the statute of limitations.

Now, in terms of—sometimes we do audit, and we have recommendations that say try to recover the money. Sometimes the recommendations are to improve the process so that these mistakes do not occur.

Mr. MILLS. Tony, in your experience, those claims 13 years later, have those been paid, or have those—what has been the experience?

Mr. WILKINSON. Well, first of all, those files are typically gone, so that the lenders—I am hearing this through the lenders' counsel, and I do not know how those have been finally resolved. I try my best not to get into individual cases and try to stay at the policy level.

Mr. MILLS. That is good.

Mr. WILKINSON. But when I am hearing from a lender that, wow, I am being asked for a file that was paid 11 years ago, that is an issue. And I think we need to understand that these kinds of things are what is driving lenders away from the program. So that we get a guarantee paid, how good was the payment? Are we going to have to sit here and wait for years and years and years before somebody comes and says, okay, well, we are going to look at this again? And that is having a significant impact on lender participation.

Mr. MILLS. What type of impact? You say "significant." Can you give us some examples?

Mr. WILKINSON. There have been lenders leave the program due to extended post-purchase reviews where they have been asked to repay claims that they felt like was unreasonable, not timely, and, you know, when they write their check, they close their SBA Department.

Mr. MILLS. And to be clear, obviously no one wants a claim to be paid if there was fraud involved.

Mr. WILKINSON. Absolutely.

Mr. MILLS. How do we draw the line to ensure that when there is fraud involved, the U.S. Government gets the claim paid and the money comes back?

Mr. WILKINSON. There needs to be a time certain that when that passes, it is over. Three years ought to be sufficient for everybody to get all the audits done that they want to get done.

Mr. MILLS. Why should they have 3 years when the regular code is 6 years?

Mr. WILKINSON. I believe it is 6 years from the last time they took an action, so 6 becomes 9. All of a sudden you are out there too far. And the OCC, I believe our file retention requirements in the banking world is 5 years.

Mr. MILLS. Glenn.

Mr. HARRIS. If I could just briefly respond to that, in the IG's office—I just want to make it clear—we do not make management decisions. We do not make the decision to go after a lender to repay a guarantee. We make recommendations. And, frankly, it is not unusual, if we make a recommendation to try to recover a guarantee on a loan that is 6 or 7 years old, that the agency comes back and says we do not think it is enforceable and we are not going to proceed. And there have been a number of instances where that has occurred. That would be point one.

Point two is I think, again, you have to look at the context. I know that a lot of the lender complaints have arisen from some of the audits we did recently. Those audits were looking at a backlog of thousands and thousands of loan files at the Herndon center that the agency was not processing.

Again, to give credit to Eric and his predecessor, they have made a serious attempt to try to reduce that backlog. But——

Mr. MILLS. Do we know where the backlog is currently? The argument is that there was a spike because they are finally working through the backlog.

Mr. HARRIS. It is a one-time—I think it is a one-time, hopefully a one-time occurrence and that is not likely repeated, to have these loans that are 10 or 13 years old. I agree with you on that.

Mr. WILKINSON. That probably is the case. But I think we need to make sure—there are two separate discussions here. There is the post-purchase reviews. Then there is the oversight system that we question——

Mr. MILLS. Does someone want to talk about the oversight system?

Greg.

Mr. CLARKSON. I can. As a lender, I want effective lender oversight. I think effective lender oversight is extremely important. Then the question comes in: What constitutes an effective lender oversight program? And for me, what I would like is when I am examined, whether it is off site or on site, I have some reasonable feedback that allows me to improve my process to the point that I can continue to ensure that my guarantee is good, because if I am relying upon my guarantee, then I need to make sure that when I talk to my executive committee, my board, I can say with certainty, yes, that guarantee is good.

Just back to Mr. Harris' point quickly, I am the one as a lender that is now being asked to bear the brunt of those lags in purchase times, and if it was a documentation error versus a fraud, you know, or I did not provide sufficient documentation, then my files are somewhere else. So I am having to recreate something that should have been looked at, should have been reviewed at the time that that purchase was being taken care of.

But as I go back into effective lender oversight, I think that if the SBA can use a system, can develop a system—they already have the information on my lending activity, my historical perform-

ance, plus where I am lending now, they can see if there are any anomalies in my process and be able to address those with me directly in a timely manner.

And then, also, one of the things that concerns me as far as effective lender oversight is the impact on the thousand new lenders that we have coming into the program who need to have the ability and the opportunity to have somebody in the SBA review their work and have the ability to say that their guarantees are good and that it is something that they can rely upon and grow their program, sustain their program, and can do it in a cost-effective manner. Right now I am not convinced that the current structure of the lender oversight program accomplishes those objectives.

Ms. WHEELER. I have a question. In the interest of attracting lenders to the program, I spoke to the Department of Commerce's Minority Business Development officers, and they said they were specifically having a hard time putting their clients into loans because when they tried to use the SBA products, many lenders told them they would not get into it because of the repurchase problems.

So we are looking for balance here. I do not hear the lenders saying they do not want oversight. We all want effective oversight, but it has come back to this quality of staff. We saw it with the BLX fraud. The audit that came back said the reviewers in Herndon were not adequately trained, and they were often approving repurchases and honors on guarantees that they should not have.

Is that under control? It seems unfair that a lender has to go back and give back money when it was actually a poor decision at the SBA staff level. It seems like the easiest way to solve this is to have better training. Have we made improvements on that?

Mr. ZARNIKOW. If I could address—there are sort of three sets of issues that I think are going on here. One is what is happening at Herndon and guaranteed purchase reviews. You have sort of the oversight, both on site and off site, and how was that managed. And then you have sort of the structural issue of where does oversight reside within SBA. So let me kind of talk to those three pieces.

As the head of Capital Access, you know, my view is have a responsibility to run effective programs. Our programs are intended to help get access to capital for small businesses, so we are interested in getting capital out. But I am also very concerned about the integrity of our programs and managing the long-term integrity, because if we do not have integrity in our programs, we will not have programs. So I am very focused also on appropriate oversight and appropriate risk management.

In fact, as part of the Recovery Act, one of the things we implemented for the Recovery Act provisions is we developed risk management, risk mitigation plans for each of the sections of the Recovery Act. We embedded risk management in the teams that implemented the Recovery Act. And we put together plans to track how we are doing on risk management. Those were shared with the IG and really in a partnership with the IG to get their comments on those plans as well.

So we do in the program office in Capital Access feel a very strong ownership to oversight as well as getting access to capital.

The issue with Herndon we have had is there was historically significant backlogs in Herndon. It was at a point where lenders—we were just taking a long time to pay lenders on prepurchase reviews. We were seeing that it was taking close to 280 days on average to pay lender claims. And we had a very large backlog of postpurchase reviews.

The agency added significant staffing in Herndon. We did a complete reengineering of the process, and we attacked the backlogs. And I am glad to say at this point that, to a large extent, the postpurchase review backlogs have been dealt with. I am not saying they are completely done, but the big surge, if you will, or the big bubble has gone through, and the backlog we have there is much smaller. In addition, on the front end, we have redone our process so that if the lender sends a complete package in, we decision that package within 45 days at the center.

We have also added and are staffing up a quality assurance function within the center to make sure that the reviews are being done properly and that our staff is trained appropriately, and we have a feedback process within the center to help assure that. I would not tell you that is completely done, but that has been a big effort as well to make sure we have the quality of the reviews.

In some cases, in decisioning cases, it comes down to a question of judgment. Cases can be very complex, can be very unknown what really caused the loan to default, what were the factors. So there is clearly a judgmental part of reviewing cases where, if you give it to three people, you may get three very different judgments. So we have tried to make sure we have standards and controls in place to help evaluate that, and we have a process where those disagreements get adjudicated, if you will.

So I think a lot of the problems with Herndon are behind us. I would not say it is completely solved, but there has been a huge effort by the agency, and we have made substantial improvement there.

I would say, too, when we look at our repair and denial rate, it averages about 5 percent. So on a 7(a) guarantee, the repairs and denials are typically about 5 percent where there has been defects in what the lender did as they have gone through the process.

As far as the oversight, we really have a system that is sort of a two-piece or three-piece system. One is we have what we call an off-site monitoring tool, which is basically a system that allows us to look at all of our lenders. So we have close to 5,000 lenders who have an SBA loan on our portfolio, and this tool really allows us to take those 5,000 lenders and narrow the focus of which are the riskiest lenders we believe to SBA to focus our oversight efforts on it, because it is very difficult to monitor 5,000 lenders and do on-site reviews and do effective monitoring. So the off-site monitoring tool really helps us focus our efforts on who do we think are the highest-risk lenders.

We also have on-site reviews that we do for our largest-dollar lenders, and we also have a portfolio monitoring that we do that we monitor our overall portfolio metrics. So it is really kind of a three-tiered oversight system.

I would agree with what Glenn said. I think there has been substantial improvements made in oversight, but I would also agree

there is more to do. And we look at it that this is an evolutionary process. We have substantially increased resources in the oversight area. We wanted with the on-site reviews to get sort of a baseline of what we were seeing with our lenders and then really look to see how do we evolve that process to be even more effective both from an oversight perspective and also from a cost perspective, so we continue to do that evolution.

So it is something that I think is sort of an ongoing work in progress, but I think there has been huge improvements that have been made.

Mr. MILLS. Thanks. Now I would like to turn to Senator Snowe's staff.

Mr. LUCAS. Thank you. I also wanted to point out that there is a GAO study in the works, and it was first requested by Senator Snowe and then Chairman Kerry and then Chair Landrieu was signed on, so that is one of those things where, hopefully when that comes out we will have a little bit more information, a little more knowledge, and that will help us with our decisionmaking process.

Also, I had a quick question for Mr. Harris on the Recovery Act. When the guarantee was increased to 90 percent, one of the concerns was are you going to see an increase in fraud with all these funds going out. And I just wanted to check in and see. Have you seen an increase? If so, what strategies have you used? What is the general picture?

Mr. HARRIS. It is too early to tell, frankly. You know, historically, when the guarantee rate was decreased, not so much fraud but we did see better performance in the programs. We do in the IG's office have a concern with a lender with a 10-percent exposure as to whether they are going to exert a sufficient amount of due diligence.

But at this point, in terms of the Recovery Act, it is really too early to tell. Fraud is basically a lagging indicator. Fraud is usually discovered after the loan defaults and the lender gets into it and finds out that the representations were inaccurate. So at this point, it is too early to tell.

Mr. LUCAS. Thank you.

Mr. MILLS. Great. Tony, did you want to make a final comment?

Mr. WILKINSON. On lender oversight, I do think there have been substantial improvements out at Herndon. They really have worked hard, and that process is working a lot better.

I did want to comment on the on-site and the off-site tools that SBA uses. It is something that the private sector now pays for, and we just do not see the benefit from that payment.

We have issues with the on-site reviews where any lender with a portfolio of $10 million or over gets the exact identical same review. It cannot be statistically valid. It just cannot be.

We hear stories from lenders who are in the same town in a big metroplex where their reviewers drive in, yet the other banks' reviewers fly in because they need one more segment to get a lease status on airlines. Those kinds of things are totally unacceptable. And I would just like to—you know, again, I know the GAO review is out there, and we, too, want to see what it has to say. But there are issues like that that are just driving lenders from the program.

I know Eric says that the repair and denial rate is 5 percent. Well, 5 percent is a big number. The repair and denial rate used to be 0.5 percent. So basically what we are telling lenders is our guarantee is only 95 percent good today. And a lot of lenders find that unacceptable.

And, yes, we have got a thousand new lenders who made loans under stimulus. We lost a lot of lenders who were making a hundred loans, and it is going to take a thousand lenders to, you know, make that back up.

So I think we have to have oversight. It has got to be effective. It needs to be efficient. It needs to do its job. But it also has to realize that there is a public policy purpose, and in some instances, we have driven lenders away and borrowers have less access to capital today because of it.

Thank you.

Mr. MILLS. Thank you. I would like to now move on to the micro loan program, and I will turn to Marianne Garvin.

Ms. GARVIN. Thank you. I want to start by thanking Senator Landrieu and the entire Committee for supporting and increasing funding for the micro loan program for 2010, and I hope that you are successful in that recommendation.

Things are very tough out there on Long Island and across the country with lenders having to pull back because of their capital requirements, and we are finding small businesses coming to us that have been in business for a very long period of time. The most recent micro loan I just approved was $28,000 for a piece of equipment from a small manufacturer of magnets. He had had a banking relationship. In fact, his lender is who referred him to us. A credit score of 772, but was not bankable, according to the lender.

And why was that? Very low collateral coverage and the lenders will not do a loan if they do not have collateral coverage. This particular business needed this $28,000 loan. The piece of equipment was $40,000, and he put a downpayment down and came to us for the rest. He did have cash to buy the entire piece of equipment outright, but he would have been eating into his working capital, and his receivables are coming in later than usual because the people who are buying his magnets are paying later.

So it is just one small example of why the micro lending program is really critical right now.

In addition to that, I have to say that our demand for—our ability to make loans like this has been challenged because the incredible demand that we are seeing for loans from start-up businesses. Because unemployment is so high, people are turning to the idea and to entrepreneurship to start a business, and they are coming to us for a loan, and they are not prepared to start that business and get that capital. And so the good thing about the micro loan program is that we are able to provide TA, technical assistance, to these borrowers and get them prepared.

Another example. I have a tool-and-die manufacturer, and it is a husband and wife team, and they bought the business from their father, who retired, went out of business. The father gave them the equipment. The equipment is aging. But he also turned over to them the customer list, so they are going to be a very good prospect for a loan soon. But they just started this business themselves in

the last couple of months. So I cannot do a loan for them right now, but I anticipate that I will be able to.

So what does that really mean in the big picture when you look at what is happening on Long Island? We are being inundated with requests for technical assistance, and the law as it stands now requires that only 25 percent of our effort go to businesses that do not ultimately get a loan.

We cannot tell which ones are going to get a loan and which businesses are not going to get a loan. And so it becomes a very circulate kind of exercise for us when the business comes in and my TA providers/loan officers—because they do both functions—want to respond to the businesses that are coming to us and have to be concerned about, well, you know, what percentage is this now.

So I think that particular piece of—as you are doing your reauthorization, that limit really does not need to be there, and I think it will stop us from being able to get the capital out, quite honestly.

Mr. MILLS. Thanks. In terms of the overall dollar amount of the $35,000, do you have any recommendations for reauthorization?

Ms. GARVIN. Absolutely. I think the loan limit needs to be increased. I would recommend $60,000. I know on the table is $50,000. But the borrowers right now with the need for additional working capital, with everyone's receivables—I heard this over and over again. Receivables are coming in late. It is not that they will not get them. They will get them. But they have a larger need for working capital.

So I think the loan limit needs to be increased to be more effective. Again, what happens, we get businesses that come to us; they need a $60,000 or a $70,000 loan, and we can only give them $35,000.

Giving them $35,000 when they need $60,000 could ultimately hurt them, and so sometimes we have to say no, we cannot give you the loan because you really need more to make this work.

Mr. MILLS. I said at the beginning that we might be considering a next steps bill. Are there any tweaks or technical changes to the Recovery Act—and this is for Marianne or Dennis or any of the other micro lenders—that you think should be included?

Mr. WEST. A few other things. One would be to increase the average loan size, the $35,000 in the portfolio.

Going along with removing the restrictions on TA, we are working in 44 rural counties, so often we want to be able to use contractors to go teach people how to use QuickBooks. So whereas there is a limitation on being able to use outside contractors as well as the limitation on non-borrowers, so just removing the restriction would help on both sides.

The other is to—currently, there is a 15-percent loan loss reserve requirement that has to be funded by outside sources. You know, that was probably a really great idea when this was a pilot 19 years ago, which also we should try to make this permanent, but now we have a mature group of lenders. We all risk rate. We really do not need to have 15 percent. That is just capital that cannot——

Mr. MILLS. Is it you do not need the loan loss reserve or you do not want the requirement for kind of having that private capital rates that you would be willing to keep the loan loss reserve at 15 percent if you removed the requirement for that private capital?

Mr. WEST. Well, we managed a loan loss reserve, and 15 percent is an extremely high loan loss reserve.

Mr. MILLS. What level would you suggest?

Mr. WEST. It ought to be risk rated.

Mr. MILLS. Okay.

Mr. WEST. It ought to be risk rated based on the portfolio, and if the risk in the portfolio justifies 6 percent, allow it to be 6 percent. It is just now that the program has matured, 15 percent is excessive.

Mr. MILLS. Kevin, you had a question?

Ms. WHEELER. I did. As Ed mentioned, the committee is working both on reauthorization and the Recovery Act provisions, and we really feel an alternative source of financing is needed. So, as part of the Recovery Act, extra money was put in for the micro loan program. But not that many dollars have gone out yet, right, Eric? What is the usage right now out of the $50 million that is available?

Mr. ZARNIKOW. As part of the Recovery Act, we got $6 million of appropriations that supports $50 million of lending. We also had money from the 2009 budget that was available to make loans to the intermediaries as well. So we have utilized the 2009 budget money and have turned to Recovery Act money. At this point we have committed about $15 million out of the $50 million of the Recovery Act money for loans to micro loan intermediaries.

Ms. WHEELER. Okay, because we would really like this to be treated as urgent. Get the dollars out as fast as possible. We were trying to do some tweaks to the micro loan program, and one of them was more flexibility in how you could use the TA. One of the objections that came up when we tried to do that, both on the appropriations bill and more recently on a different vehicle, was—that is what the prime program is for. PRIME is not tied to loan dollars.

We know that there are two different missions for those programs, but can you state for the record why using prime money—assuming you even get it, because it gets so little money—would not be adequate, or would not be a replacement for the micro loan TA?

Mr. WEST. I do not know that there is a prime vehicle in the area that we serve, so I do not think that it is universally available, which is a limitation that many micro lenders would find. So I think that is a key limitation for us.

Ms. WHEELER. Okay, so it is availability. Thank you.

Mr. LUCAS. Thanks. I think one of the big problems getting that money out is the lack of micro lending intermediaries, and there has been all this money put into the program, but it does not seem like there has been a response among the community development entities that would enter the micro lending program.

I just wanted to ask Ms. Garvin what sorts of changes would make micro lending attractive to those types of financial institutions that we want involved in the program so we can get those loans out and grow this program and reach entrepreneurs.

Ms. GARVIN. I think the fixes to the TA grant are really critical because micro—you cannot do these micro lending—you cannot

take the risk with the borrowers that need this capital without providing the TA.

As I testified a few months ago, our portfolio has been experiencing a lot of delinquencies, and our not-for-profit is on the hook for making the payment back to the SBA. And that is a risk that we are willing to take. I mean, this is sort of unprecedented times in the economy, and so we will stand behind that. But removing the TA grant restrictions I think will encourage other intermediaries to step into this.

Supporting the intermediaries who are doing lending already, who are experienced and know how to do this, part of the problem is that they have hit up against the $3.5 million limit, and so we cannot get the money out if we cannot borrow anymore. And so I think removing that restriction as well, removing that, increasing the loan size amount, and removing the restrictions from the TA grant will move the money faster in the communities.

Mr. LUCAS. Great. Thank you very much.

Mr. MILLS. Thank you. And we would like to go to the new markets venture capital program and Ray Moncrief.

Mr. MONCRIEF. Thank you very much, Ed and Kevin, and to all the staff that has put this together.

I appreciate the opportunity to speak about new markets venture capital. By way of introduction, I do run a small business investment company, I run a new markets venture capital company, and I run a rural business investment company. I could probably speak at length about each of the three programs, but I will defer to Brett on the SBIC program, and I am going to hold my comments on the RBIC program. I think I have spoken to Eric sufficiently about the RBIC program.

As pertains to the new markets venture capital program, it was approved in December of 2000 and is a highly targeted, narrow investment vehicle that is under the Small Business Administration. Its purpose was ultimately to invest traditional types of investing in nontraditional areas, more specifically low-income census tracts.

There were six programs authorized. There were six programs approved and licensed in 2003 to 2004. And those six companies have done quite well.

Just some of the measurements, there were six that have invested more than $48 million in 75 companies in low-income census tracts. They have leveraged an additional $136 million to low-income census tracts. There are areas that are not available for investing. For example, there is indeed a venture capital food chain. Years ago, I heard a speech by a guy named Ray Smilor at the Kauffman Foundation about the food chain of venture investing. I did not quite understand it then because I was somewhat of a novice in the venture industry, and there most definitely is a food chain, of which the new markets venture capital is at the very end of the food chain, with large private equity funds being at the top.

I would tell you that as a practitioner of new markets venture capital, new markets venture capital needs to be moved into the mainstream of the SBIC industry. It needs to be treated not as sort of a bump over here on the side that is some nuance that we are dealing with, but it needs to be dealt with as something that is real, that serves a purpose, that has an effective use.

For example, where I practice in eastern Kentucky and eastern Tennessee, the Appalachian counties more specifically, traditional SBICs do not do much work there. It is profoundly rural. It is profoundly poor, and one would think that there are not any investment opportunities in those areas.

As a matter of fact, most of the new markets venture capital firms that have been licensed act indeed as segues or conduits for traditional venture capital into these underserved markets. So I would like to point out that there are several things that we should do.

First of all, it should be reauthorized, most definitely.

Second of all, I would like to see something that gave it some substance, like an Office of New Markets Venture Capital to be established. The traditional SBIC program has three tiers of leverage, although roughly only two are used. The new markets venture capital program is relegated to one and a half tiers of leverage. They ought to be treated as they have the competence to effectively invest more than that.

The third point that I would point out is that the over-line limit should be congruent to that of the SBIC industry. Interestingly, I sat in a room similar to this 2 years ago talking about the very subject of over-line limits for the SBIC industry, which was inclusive of new markets venture capital, rural business investment companies, et cetera. Interestingly, the SBIC industry has enjoyed an over-line limit increase from 20 percent of private capital to 10 percent of combined capital. I would like that same consideration for the new markets venture capital.

There was interesting conversation recently that we were going to do this in the extension bill, but for many reasons, that was pushed to perhaps a technical change that would happen in later months. So I would certainly encourage a look at the over-line limit for new markets venture capital funds.

Fourthly, back when this program was going together, there was a very specific timeline to raise the money. Statutorily, it was 2 years. I shall recall that I was authorized in July of 2001, and I was given until September 30th of 2001 to raise my private equity. An undoable task, in the events, as you might recall, around 2001. We were successful in getting that iterationally pushed out over time. So we should enjoy the 2-year regulatory statutory cap that we have to raise the money.

The other thing that I would say is that this new markets venture capital is highly targeted in areas of low income. The problem is that there is a different definition of low income. For example, I invested in a company in northern Kentucky, Covington, Kentucky, and, incidentally, I used the new markets tax credit program in part to capitalize the new markets venture capital program. I am the only one that used that particular program.

I found that the new markets tax credit definition of low income was different from the new markets venture capital, so that needs to be looked at, and it needs to be harmonized together.

And, lastly, I would point out that one of the key components of the new markets venture capital program is the fact that there is an operational assistance grant that comes from SBA. Heretofore, there has been the requirement that there be a match, that you go

out and raise part of or at least 50 percent of that amount to leverage the operational assistance. It is very difficult to raise soft money like operational assistance in today's market in order to leverage that operational assistance from the SBA.

I think about entrepreneurs like Mr. Heath who would love to have some operational assistance to do a marketing study, to learn how to put in an effective accounting program in his business. In the areas that I invest, in the low-income areas that I invest, the operational assistance is absolutely an incredible tool that we are using to get businesses off the ground, having them work, having them get across the finish line in a good fashion.

I will tell you that I have invested in eight portfolio companies. We have had three exits. We still have five that are performing and expect those five to exit successfully as well.

I think the new markets venture capital program is a worthy program, one that should be given strong consideration, and should be reauthorized.

Mr. MILLS. Thanks, Ray. I think you have really covered the waterfront there in terms of the questions I have, but I do have two quick ones. Just the number of companies you believe that should be in a reauthorization. Originally, there were supposed to be 15 NMVCs. Right now we have six. Do you see any number of what the program should be expanded to?

Mr. MONCRIEF. I do not know what that number is, but I would think that in the industry that I work, there is a pent-up demand for a dozen to 15 more of these companies nationwide.

I know that the person who introduced the legislation was a Congresswoman from Milwaukee, Wisconsin. She would like to see some diversification. She would like to see there to be a more geographic dispersion in the United States for these new markets funds. They are highly concentrated to the East.

Mr. MILLS. You mentioned the match on operational assistance grants. Is there a dollar amount you believe should go to these grants?

Mr. MONCRIEF. I do. The RBIC program, which is a rural program that came from the USDA, is run by the SBA. There is a $1 million grant that goes with each program. And it is much simpler to effectively use the operational assistance as a designated grant than having to raise the match that goes with it.

Mr. MILLS. Thanks.

Kevin, do you have any questions?

Ms. WHEELER. Is there matching for the RBIC?

Mr. MONCRIEF. There is not.

Mr. MILLS. So there is no matching for the RBIC.

Senator Snowe's staff?

Mr. BERGER. I do have one quick question.

Mr. MILLS. Can you use your microphone?

Mr. BERGER. On the new markets program, all the provisions that you listed were in last Congress' SBA reauthorization bill, so if the Committee were to essentially pass that bill again, would that meet your needs? Or is there something else that you would like to see.

Mr. MONCRIEF. No. That would very much meet my needs, and I would like to see that happen.

Ms. WHEELER. May I just clarify for the record? The one thing that was not in there that you would like to see is a difference in the tier matching, right, the 1.5? Julia Sass Rubin had testified from Rutgers that she was seeing evidence that the match needed to be a little larger because the size of the funds should probably be a little bit larger to attract what you need to do your investments. Is that right?

Mr. MONCRIEF. That is correct. There should be more than a one-and-half-tier leverage. You are absolutely correct. That should be in there, Kevin. Thank you for that.

Ms. WHEELER. Okay.

Mr. MONCRIEF. Most definitely.

Ms. WHEELER. And just for the record, Ray, it was from you that we got the idea to change the over-line limit for MBCs, the same as SBICs. We fully intended that it was in the Recovery Act, and it was a drafting error, so we are working to correct that.

Mr. MONCRIEF. Thank you, Kevin.

Mr. MILLS. Thank you. And the last issue of discussion is the SBIC program. I will turn to Brett Palmer, please.

Mr. PALMER. Thank you very much. I will make it quick so I do not stand any longer between you and lunch than I have to.

The SBIC program is one of the oldest programs at the SBA. It has been around for 51 years. It has had some extraordinary successes providing growth capital to small businesses that have grown into American icons. It is not insignificant. It is quite meaningful. The past number of years, the SBIC program has focused on some challenges of its mismanagement, and it has shrunken pretty significantly.

You all were very helpful last year in helping to create some incentive for staying in the program with higher leverage limits and family of funds limits, which we appreciate, and we particularly appreciate the flexibility that this Committee gave to the SBA to allow for greater investments in companies that were experiencing economic shock from the financial collapse last year.

And I also want to thank the Chair and the Ranking Member for the letter that they wrote to the SBA to ensure that the regulations were put in place. Frankly, I do not think the stimulus provisions would have been enacted had it not been for that letter, because it really just is not a priority. I know that there are other, bigger programs that are out there. But it really was helpful, and it really is an important thing.

The SBIC program really can be an important part of growth capital available. When I was hearing Mr. Fruge—correct me if I am mispronouncing your name—talk about how, you know, capital is unavailable for some of the investments he has in Louisiana, there are two SBICs in Louisiana, and they are not prohibited from investing in ship purchases and other asset purchases and financing with it. Many folks do not know about that. But there are way too few SBICs, and so we really do think there is a significant need for reform for the SBIC program.

The biggest problem with the SBIC program right now is the licensing. This has been a longstanding problem, and it is a problem you will not hear from individual SBICs because they are afraid of retaliation from the people that are reviewing them, particularly

ones that are currently in the process. It is not unreasonable—whether those fears are rational or not—or, you know, are justified or not, I do not know. But there are dramatic problems with it. We have repeat licenses that are taking 14 and 15 months to go through. For people that are on their fourth license, exceptionally qualified funds that are just being hung up, that is nuts. I mean, there is a nicer way to put it, but really it should not be. That is just bad public policy. They are driving out good funds and repeat funds from being in this space.

And to that end, we are really proposing a number of reforms which I submitted for the record to keep funds in the program that are established funds and good funds. We want an expedited relicensing process for funds that are in good standing. If you are a fund and you have proven yourself, you have been through the FBI background check, you have a history of success, you really had all the audits and exams and you are doing fine, after a couple of years, if you want to start a new fund and get a new SBIC license, it should not take you 14 or 15 months. It should take you a couple months. You should get a new FBI background check, because that situation could have changed. I hope it does not, but it sure could have. And you should have to document your private capital that you have raised and a couple of other criteria which I can lay out for you. But if the basics are in place, it really should be fairly automatic and consistent as long as you are investing in the same space.

To that end, if we are able to get an expedited relicensing process and keep more funds in the SBIC space, you really need to increase the family of funds limit again because the family of funds limit increase which you put in the stimulus was very helpful for keeping a number of funds from butting up against that ceiling limit. But if you are going to be able to have serial funds to keep these funds that are really specialized in small business in the space, you need to be able to have one at peak, one at start-up, and probably one in their last wind-down phase, which means bumping it up a little bit. Nothing dramatic and not raise an individual fund rate. Just the family of funds rate, again, to keep the serial funds in the process.

Mr. MILLS. It is at 225 now?

Mr. PALMER. It is at 225 now. It is 250 if you have more than half your funds in an LMI area, a low- and moderate-income area, like Ray talks about.

Mr. MILLS. Do you have a dollar amount you would——

Mr. PALMER. I think, you know, somewhere in the 300 to 350 range would be more than reasonable. I do not think you would want to go into the 450. I do not think you want three funds at peak at a time. I think you need to manage your risk profile, but I think you could certainly set a number that with the next relicensing—that would be every 3 to 4 years, I would think, that you would qualify that you could work out that number and do something manageable. And we could work with SBA on that.

We would also like to get more funds in the program. There is a real licensing—the licensing process is such an opaque, bizarre, and slow process that it steers people away and there are very few minority SBICs. There are very few women-run SBICs. The chair

of our board is a woman, but she is rare, and we would like to get more of them in that space.

We would like to bring in more people from the Western United States. There are exceptionally few SBICs in California and the Mountain West, and that is really an underserved area, and we can provide capital in a market-driven fashion that works in quantities greater than some of the other programs allow.

We would like to make sure that there are incentives for coming into the program and not disincentives. There are a number of regulatory compliance issues that can put a fund at a disadvantage as far as enforcements of warrants and as far as your co-investors, what places you are in. There are issues dealing with GAAP accounting versus SBIC accounting, as far as the costs associated with that. And there are a number of technical things that I think we can use to streamline the program to, again, attract people in that do not reduce any taxpayer protections. We want a stable, functioning program. And I think that would be very helpful and something we can do.

Regarding the equity side of the equation, there was an equity program that the SBA had a couple years ago, and, frankly, it was structured in a way that did not work. It cost the taxpayer money. It did have some significant public policy benefits, but it did cost money, and that is a problem.

There really is a dearth of growth capital for early stage businesses now. It is painful what is going on. And in the pipeline, in the continuum of the small businesses, you really have to have everything from the early stage to the buyout be healthy. And a couple of those areas really are unhealthy right now, so I think it is worthy of this Committee and the Administration to take a look at how they can, in a market-driven fashion, have a reasonable and taxpayer-protected equity program, and I think that is something that we can help you with and provide some guidance on if you are willing to engage on that.

We also want to take a look at some of the areas that are in the energy and green space. There is an energy saving debenture and a renewable energy debenture—they were created in 2007—that still have not been implemented. That is a problem. There is also a technical problem with them that the only funds that are able to engage in those debentures, when the regulations eventually come out, are ones that were licensed since last year. That I think is a technical drafting error that we can probably work around.

I think that there may be some new and creative ideas, and I have been approached by some of the funds that want to get into that new space, that we can apply new debentures to meet those needs. We want to make sure that small businesses are able to engage in that green space as well as the big multinationals, and I think that is fairly easily done, again, without taxpayer cost.

The other thing we may need your help with—and this may be appropriate for this reauthorization or maybe, frankly, some help with some other committees, but SBICs do get regulated by the SBA, very intensely regulated by the SBA, and as regulatory reform is being looked at more broadly in the financial services sector, the proposals that are out there right now would create duplicative regulation on top of SBICs. A lot of SBICs are just, you

know, four-, five-, six-man operations, and to have that double regulatory burden on them would require them to hire another person. That is pretty significant, in which case the cost/benefit analysis might be that you just do not become an SBIC. We want to attract more people in the SBIC program.

We also want to, frankly, take a look at some of the bank issues dealing with SBICs. Banks get credit for investing in SBICs. They are not required to capital charge when they invest in SBICs. And some of the regulatory reform proposals would actually accidentally wipe those away. We would like to take a look at how we can maintain those because, again, we want to make sure that there are incentives to invest in small businesses and use the money multiplier of the SBIC program.

That being said, I am very pleased that the SBA has a new head of the Investment Division, who seems to be very competent and very promising, so we are looking forward to working with him. And we also look forward to working with you on the legislative fixes that are needed.

I know I am the last one, and you guys are trying to get to lunch, but I would welcome any questions that you may have.

Mr. MILLS. Thanks.

Kevin, do you want to start?

Ms. WHEELER. No. Go ahead.

Mr. MILLS. Okay. Could you explain a little bit more about the regulatory reforms and how the capital charge could be potentially taken away?

Mr. PALMER. The SBICs are, throughout Federal code and throughout regulation, well beyond the SBA because of the public policy benefit they provide, and so as the proposals exist right now—and it is very much in flux, and this may take some time to do—it would require a full holding of a capital charge for all alternative investments, including SBICs. And that is a concern for us.

There are also issues dealing with clarifying of the Community Reinvestment Act. SBICs are deemed to meet the investment criteria there, and, frankly, just getting that clarified that that is a full dollar for dollar credit would be very helpful.

Mr. MILLS. Can you explain a little bit more about the impact of the Recovery Act provisions now that there are requirements for investments in low-income areas?

Mr. PALMER. Well, I think there are a couple of things in the Investment Act that were exceptionally—the Recovery Act that were helpful. The flexibility for raising the over-line limit was exceptionally helpful and very good. There is a lot of interest in the LMI area piece and the higher leverage limits associated with that. There are some folks who are trying to figure out how to rig their system in their investing structure to make that work.

Part of the problem there is the LMI formula is complicated, and making sure that you match it is not the easiest thing. But there is some interest in doing it. Ray is a classic example of one of our funds who is a very strong believer in investing in underinvested areas.

The other standard that was in there was the increased requirement for smaller enterprises, and that is being implemented. I think there are some—in the regs that were proposed, there were

some complications for certain funds that could actually kick up to 36 percent, but that will pass through with time. And so I think that is a helpful requirement, and it works, and that needs to get fleshed out more. But I think that has yet to be fully seen, the benefits of it. But, again, part of that is the number of SBICs has shrunken pretty dramatically, which limits our ability to provide the up-side risk to the public.

Last year, in 2008, there were six funds licensed. Last year—I guess it is last fiscal year, 2009, there were 11 funds licensed. Of those 11 funds, I think 7 or 8 of them were done by last winter.

And the pipeline—I need to mention this—is really increasing. The number of funds that are looking at becoming SBICs has exploded. I have gone to meetings in Chicago, in New York, where there are sold-out shows. They are just basically explaining the SBIC program. The people in the space that help these applicants go through the licensing process say that they have got pipelines of, you know, between 30 and 45 companies that are doing it. That is very promising. That is very good. The problem with is, again, is still the licensing process is opaque. It is very subjective. And, frankly, there have been some recent developments regarding the access to leverage that you are going to be able to get that has sort of—the licensing process is being used to limit that. And I am concerned that it seems to be—I keep seeing these little data points that would indicate that SBA is actually trying to cut off leverage and limit leverage access, not increase it, per what the stimulus did. The stimulus put a cap on leverage, a dollar-figure cap and a tier cap, so you are not taking out 10 times as much leverage as you have private capital. It is a three-times limit.

Basically, the regulations that were put forth cap it at 2 percent, and the analysts are giving guidance—the SBA analysts are giving guidance to the funds: Do not bother trying to ask for more. Yes, there are criteria by which you can get more. You are not going to get. And that is not particularly helpful. If you cannot get it, just say you cannot get it. But do not set that up, and that is a cause for concern.

Again, it is not appropriate for every fund to get three tiers of leverage. There has to be a relevant-to-risk profile associated with it. But it is not helpful, and as the licensing process goes through, if they are limiting who can get it, I am curious if there is some guidance from senior—either OMB or wherever, with what is going on with the leverage access. Is there a direct intent to limit the exposure to leverage going forward for the SBIC program? Is there anything happening there, Eric? I keep hearing these stories from these SBICs, and I am getting quite concerned.

Mr. ZARNIKOW. Yes, I think obviously in the program the thing you balance is getting access to capital for small businesses versus managing risk. So I think it is really being looked at on a case-by-case basis, depending on the performance of the individual fund managers. So there is no blanket direction that has been given. It is really being looked at on a case-by-case basis.

My understanding is there has been very few funds who have come in and actually asked to get into that higher tier of leverage at this point.

Mr. PALMER. I will tell you what they will not tell you individually, which is they are being told, "Don't." You know, don't try it. And it is that unofficial pushback, it has a chilling effect, and, again, you do not bite the hand that feeds. And so they do not like to complain about it.

I am being much more open about it because I can be. I am not an actual fund. But it is something that does cause some concern that we want to make sure is taken care of.

Mr. MILLS. Senator Snowe's staff?

Mr. BERGER. We had a number of questions——

Mr. MILLS. If you could use your microphone.

Mr. BERGER [continuing]. We have a number of questions with respect to the licensing and relicensing issue. Eric, as you know, Senator Snowe spearheaded a letter with Senator Landrieu on the issue, and we got a response back that says that, "SBA is taking steps to accelerate the process, and we have set goals for processing new applications which should substantially reduce the time frames for processing. Although it is too soon to tell, our initial information indicates that we are making substantial progress in meeting these goals. Additionally, I have instructed the program managers to devise measures where we can accelerate the process even more for applications from existing licenses. I am hopeful that these new guidelines will be available by the end of the month."

Could you comment here for the record as to what specifically is being done with respect to the licensing and relicensing issue and whether or not you feel we need a legislative solution? Because the concern that we have is that only $650 million of the available $3 billion in leverage is being used to help start up small businesses. Given that $3 billion is the current authorization level, we feel that amount of leverage could be used safely. Why not take advantage of that, particularly because it does not cost the Federal Government a penny because it is a zero subsidy program.

Could you just let us know specifically what the SBA is doing with respect to the licensing and relicensing?

Mr. ZARNIKOW. Sure. We have taken steps to look at the licensing process to try and speed that process. It is, obviously, critical to make sure you manage the integrity of the program and you have an appropriate vetting of the licensees or the potential licensees who are coming in.

I would say, too, some of the timeline on how long it takes depends on how responsive the fund is in getting back with additional information requests. So it can be misleading to say the average time is X if it takes months for the fund to respond. But having said that, we recognize that there is a growing pipeline of people we think are going to be applying for licenses. We want to make sure we have an appropriate process that appropriately vets people in a timely manner.

We are specifically looking at a fast-track process for second or third or fourth funds where the fund managers had good performance, have been in compliance with the requirements. And as Brett mentioned, we have recently had come on board a new Associate Administrator for the Investment Division who brings both a private sector background as an investor as well as a business owner and start-up business owner, who is really going to be focused on

the program, focused on innovation, and had really been tasked with looking at that licensing process and making sure that it is appropriate but speeding the process and providing more clarity to the process.

Mr. BERGER. I absolutely agree.

Mr. PALMER. May I add one thing? The SBIC community strongly agrees that they do not want bad actors in and that the risk must be maintained. I mean, they want a stable, workable program, and so we agree with that. And it is certainly fair that some of the delay can be because the SBIC is in that process. But in many cases, it has lost fingerprints five times or three times, you know, not getting the FBI background check for months and months. Granted, it is getting better, and now that there is a person in place—and, frankly, the crisis, the rest of the broader crisis that is facing SBA is getting better. So we are very hopeful.

So I am not trying to beat up on anybody, but there really is a concern here.

Mr. BERGER. I do not think that anybody is looking to legislate unnecessarily in this area, but this is something that we all recognize needs to be addressed. So is there a time frame that you could commit to us where you might be able to roll out one of these programs or give us a status update as to how this is going?

Mr. ZARNIKOW. What I would like to do is maybe come back to you with a timeline and when a status update would be appropriate. As I said, the new Associate Administrator recently came on board. This is one of his very top priorities to look at quickly. I just want to make sure it is a thoughtful process that we can come back with a timeline.

Mr. BERGER. Okay. Can you commit to coming back with a timeline by sometime in November?

Mr. ZARNIKOW. Sure.

Mr. BERGER. Okay. That would be fantastic.

Next, I wanted to turn to this energy debentures issue because that is a big sector of the economy. I think we could do a lot more if we could roll that program out.

Do you know what the hang-up is on getting the regulations to roll that out?

Mr. ZARNIKOW. You know, we have been working on drafting regs on that and actually had drafted regs prior to the economic crisis and the Recovery Act. We have really been working with the Department of Energy on some of the definitions that go into that, and we are following up with them to try and get clarification and, you know, finish the regs. So it has been something we got sidetracked a bit with implementing the Recovery Act, but are turning back to get that program or those regulations implemented.

Mr. BERGER. Absolutely understood. It has been, I think, close to 18 months now since the energy bill was enacted. Is there a time frame that you could give us where the regs are going to be rolled out?

Mr. ZARNIKOW. What I would like to do is come back to you with a time frame on that as well.

Mr. BERGER. Okay. And then last but not least—and I promise not to stand between too many people and lunch. This question is for Brett. One of the issues as we tried to reauthorize this program

during the last Congress is we run up against the argument that you do not need SBICs; there is plenty of private capital out there in the marketplace; so, why are you asking the Government to get involved here?

Could you, for the record, explain why you feel like your program——

Mr. PALMER. Sure. Absolutely. I think it is—I mean, this program was created, you know, over 50 years ago because banks tended to want to invest in larger companies because they were lower risk and higher rate of return for the amount of work they needed to do. That was true then. It is true now.

This program tends to be countercyclical. I mean, right now there is no question a credit crunch, and this is a form of credit that is available to businesses for growth capital that normally in many cases cannot get it from banks. But yet it is required by statute and by regulation to manage their risk to ensure it is zero subsidy.

So it is filling a gap in the marketplace that is real, that is there. That gap is actually growing, not shrinking. We now have a number of funds that are actually, you know, larger funds moving into the space because they see this need that they cannot fill, and so they are willing to take on the burden of the regulatory oversight, which is required and appropriate, and the costs associated with it and the limits on their investments because, otherwise, if they were in the free market, they could do whatever they want. And this one you have to really be honed down because they think that there is a need there that is not being met that they can help me and capital that is not showing up from the private market.

So, again, part of this program, I think it is critical to the market function of it, is it maintaining itself as a market-driven program. It is not a handout. It is not a bailout. When money is lost in the debenture program, it is the private capital that is lost first, and then taxpayer money is at risk second. That keeps funds from gambling with other people's money and keeps it, you know, a functional, sustainable system. And I think that is a key element that should be consistent with anything in the SBIC program where the private capital is at risk first, to make sure that prudent investment decisions are made and that this is not just some subsidy to prop up one industry or another.

Mr. MILLS. Thank you very much. I think Kevin has one last question, and I have one question for Michael, and then we will end the roundtable.

Ms. WHEELER. To Fred, we really are trying to be helpful on this Community Express program. So on this idea, and to the SBA, of a 1-year extension—if 1 year is not unacceptable, would something like a higher pilot limit per lender work? Would that satisfy the SBA need for protecting the portfolio until they can figure out how it is performing and then address the industry's issues of meeting their borrowers' demand and not hitting your caps?

Mr. CRISPEN. Yes. I mean, if what you are asking is if we cannot make it a permanent program today, extend it for a year, but at the same time increase the base that allows everyone to have access to the program up to $50,000, $60,000, whatever the figure would be, would that be helpful? Absolutely. The biggest problem I have right now—and we have streamlined our program, not just

Community Express anymore. We call it Borrego Express Capital. But we incorporated the Patriot Express program into it as well. So if you have got a guy that qualifies for Patriot, he can get a $50,000 loan even if he is not in a low- to moderate-income area. But if you have got a business that is not in a low- to moderate-income area or a HUBZone and they apply for a $50,000 loan, I am sorry, I cannot make you that loan unless I do it as a 7(a), which I tried to do. But when you start getting into regular 7(a) underwriting, it is a whole different ballgame. You cannot credit score anymore. You have to look at collateral, and we do these unsecured up to 50.

So it is a myriad of problems trying to do small loans, and it would be most helpful to raise the limit and extent it for at least a year until we can make it permanent. But it needs to become a permanent program. Even in good economic times, small businesses are forced in a lot of cases to use credit cards for working capital at a much higher and more expensive cost of funds than a SBA loan like we make.

Ms. WHEELER. Okay. Thank you.

Eric, did you want to add to that?

Mr. ZARNIKOW. I think that is something we would want to look at as far as a change to the pilot limit.,

Ms. WHEELER. All right. Well, we will keep working on this. We want to be helpful on it, but making it permanent is really problematic for us. We are trying to find a happy medium here.

Mr. MILLS. Thank you. And for Michael, I just wanted to document for the record, who is the lender on the loan for your 7(a) loan? Do you remember?

Mr. HEATH. It would have been Passumpsic Savings Bank.

Mr. MILLS. The what?

Mr. HEATH. The Passumpsic Savings Bank.

Mr. MILLS. Okay. And from your loan, how many jobs do you believe you either retained or created?

Mr. HEATH. We had about 15 on the payroll when we started. We have about 21 now.

Mr. MILLS. Great. Thank you. I believe this concludes the roundtable unless there are any final comments?

[No response.]

Okay. Thank you very much for everyone's participation. I believe it has been helpful, and we look forward to getting a reintroduction of some reauthorization bill in soon.

Ms. WHEELER. Congratulations to Michael who gets married next week.

[Applause.]

[Whereupon, at 12:44 p.m., the roundtable was concluded.]

APPENDIX MATERIAL SUBMITTED

Testimony of Ray Moncrief, Kentucky Highlands Investments Corporation

Roundtable Reauthorization of Capital Access Programs and the Impact of Small Business Provisions in the American Recovery and Reinvestment Act of 2009

United States Senate

Committee on Small Business and Entrepreneurship

October 1, 2009

Thank you Chairman Landrieu and Ranking Member Snowe for the opportunity to participate in the roundtable discussion on the Small Business Administration's (SBA's) capital access programs and specifically our experience at Kentucky Highlands Investment Corporation (KHIC) working with the SBA's New Markets Venture Capital (NMVC) program.

I applaud you and your staff for convening an experienced and insightful group of practitioners to participate, and for facilitating a powerful conversation about how SBA financing products are helping small businesses and self-employed entrepreneurs to start up, expand and survive in the current economic climate.

I am submitting written comments today to follow up on the comments and recommendations I offered at the Roundtable. While my comments will primarily focus on the NMVC program, I will also share some recommendations on the SBA loan products that allow KHIC to respond to the needs of small businesses in rural Southeast Kentucky.

Background on Kentucky Highlands Investment Corporation

Kentucky Highlands Investment Corporation (KHIC), headquartered in London, Kentucky, was founded in 1968 as a Job Start Corporation as a part of the War on Poverty. KHIC's purpose is "to plan, promote, initiate, and coordinate community, economic and social development efforts." KHIC entered the community development venture capital field in 1976. It has a strong base of capital with a portfolio that allows it to be self-sustaining, a dedicated and experienced staff, a committed and supportive Board of Directors, and a clear definition of its mission and method. It accomplishes its mission by providing both financial support and management assistance to new and existing businesses. It has sought to recruit companies from areas outside the region to provide much-needed jobs for residents of their service area. KHIC started with a nine-county service area and has expanded to twenty-two counties in Southeastern Kentucky.

This hilly, rural Appalachian area has only five population centers with more than 5,000 residents and has chronically high rates of unemployment and poverty.

The investing activities of KHIC include a wide range of instruments such as equity investments, subordinated debt, term loans for real estate and equipment, revolving lines of credit, and micro loans. As one of very few venture capital sources in the area, KHIC plays a unique role in providing funds for highly leveraged, expansion businesses. Because KHIC can put money at risk as equity and subordinated debt, it can go beyond regulated full-service banks in helping portfolio companies. Having this range of investment instruments available allows KHIC to help expanding companies provide jobs to chronically poverty-stricken Appalachian Eastern Kentucky. In total, KHIC has provided over 500 businesses more than $150 million in financing.

KHIC has been an SBA Microlending Intermediary since the program was authorized and over the last 17 years we have borrowed a total of $3,062,000 from the SBA and deployed more than $5,106,270 in Microloans to small businesses in Southeastern Kentucky.

I would like to support the recommendations that my colleague Marianne Garvin with the Community Development Corporation (CDC) of Long Island suggested to strengthen the SBA Microloan Program. KHIC, along with CDC of Long Island, is part of a network of SBA Intermediary Microlenders that have worked together to support the Microloan Program at SBA. It is particularly important that the SBA invest more resources into supporting Intermediary Microlenders like KHIC that are seeing a spike in loan demand as conventional lenders pull back on business lending. During the past fiscal year, we made 12 ½ % more Microloans to small businesses than in the previous year; however, based upon our Microlending during just the first four months of this fiscal year, we believe we will experience an increase in Microloans of approximately 65% in fiscal year 2010. After 17 years, we believe that the Microloan Program and the participating intermediaries have demonstrated the effectiveness of the program, and we strongly recommend that the SBA drop restrictions on how intermediaries can use their technical assistance (TA) grants and see that TA funds can be used to maintain the health of businesses that are already part of an intermediary's portfolio as well as support new business borrowers.

KHIC is also an intermediary lender under the Agriculture Department's Intermediary Relending Program (IRP). We have borrowed approximately $7,375,999 from USDA over the last 18 years and in that time have deployed approximately $15,292,563 to small businesses throughout our service area with loans averaging $150,000.

In the last year alone, we have seen more than an 18% increase in demand for IRP loans. The demand is coming from not only the "unbankable" businesses that have been our traditional client base – but also from businesses that have had their lines of credit pulled or are no longer able to secure conventional working capital financing from a bank.

I stand by my colleague Dennis West, from Northern Initiatives, in supporting Senator Levin's proposal to authorize a new loan product targeting the needs of businesses that have graduated from, or have capital needs that exceed, the limits of a Microlending Intermediary, but yet still lack the collateral to secure conventional loans – even with a 7(a) guarantee. This is a capital gap that I believe the SBA should address and I believe it can be addressed most effectively by using non-profit, mission driven, community based lenders like KHIC.

And lastly, I would like to suggest that the SBA consider instituting a loan guarantee to encourage bank lending into non-profit, mission driven, community based lenders like KHIC to enhance the liquidity of the community based lender to deploy more loans to businesses that are viable and in need of capital, but are unbankable. KHIC would find great value in such a program and we would like to work with the Committee to explore the idea further.

And now, I would like to offer my thoughts regarding the New Markets Venture Capital Program.

New Markets Venture Capital Background

The New Markets Venture Capital Program was modeled after the SBA's Small Business Investment Companies (SBIC) program. However, unlike SBICs, the New Markets Venture Capital (NMVC) companies target investments to high-growth small businesses in poor urban and rural areas, and NMVC investments are tied to the creation of local jobs with livable wages and benefits for low-income individuals.

To date, the SBA has designated six NMVC companies. These companies were selected after a competitive application process, and after raising the required matching funds and closing documents with the SBA, these NMVC Companies began investing in businesses in 2003 and 2004.

When the NMVC program was signed into law, Congress provided $52 million to support NMVC debentures and operational assistance grants for fiscal years 2001 to 2006. These funds were intended to launch at least 15 new NMVC Companies to test the new investments model. In July 2001, half of this money was obligated to support the first six NMVCC companies and in the fall of 2002, SBA was to designate seven

additional NMVC Companies, but Congress unexpectedly rescinded the remaining funds in the Fiscal 2003 Omnibus Appropriations Bill.

Therefore, eight years after the NMVC program was launched there are only six NMVC Companies in operation; however these six NMVC Companies have demonstrated the potential of the NMVC model to successfully target venture capital investments to create jobs, build wealth and benefit poor communities.

The current NMVC Companies are:

1. Southern Appalachian Fund invests in Appalachian counties of Kentucky, Tennessee, Mississippi, Alabama and Georgia.
2. Adena Ventures, LP, headquartered and invests in Ohio, western Pennsylvania, West Virginia and western Maryland and northeastern Kentucky.
3. Dingman New Markets Growth Fund invests in the District of Columbia, northern Virginia and Maryland.
4. Murex Investments, LP makes investments in eastern Pennsylvania, southern New Jersey, and northern Delaware.
5. Pennsylvania Rural Opportunities Fund invests in rural Pennsylvania communities.
6. CEI Community Ventures Fund, LLC invests in Maine, New Hampshire and Vermont.

In a relatively short period of time these six NMVC companies have had a significant impact. Using SBA debentures and operational assistance grants these NMVC companies are proving it is possible to find and invest in strong, high growth companies in low-income, underinvested areas that can generate market-rate returns for investors and foster economic growth and job creation in some of the county's most distressed urban and rural communities.

A 2006 survey of the NMVC companies conducted by CDVCA found the following:

- In total, the six NMVC companies had invested more than $48 million in 75 companies and provided more than $6 million in operational assistance to 163 companies, with all companies receiving NMVC assistance, based in low-income communities;
- NMVC companies had used the $48 million invested to leverage an additional $136 million in investments in the companies and the additional investments were generated from both individual investors as well as other venture funds; and
- NMVC companies had created 368 new jobs and maintained another 1,626 jobs that were at risk.

Southern Appalachian Fund's Experience

Let me share some information about the Southern Appalachian Fund (SAF), the NMVC Company that KHIC launched in 2003. SAF has an office in Oak Ridge, Tennessee, and another in London, Kentucky. We provide equity capital and operational assistance for early-stage and growth companies in low income areas in Kentucky and Tennessee and the Appalachian counties of Mississippi, Alabama and Georgia.

SAF's mission is to generate market-rate returns for its investors while promoting shared and sustainable economic development throughout its target region. SAF seeks to promote economic development and the creation of wealth and job opportunities in low-income geographic areas, and among individuals in our regional and highly rural service area – an area long overlooked by traditional venture capital investors.

We officially launched our investment activities in 2004 after raising $5,000,000. SAF was fully invested by the end of 2006 – and in a geography long overlooked by traditional venture capital investors, SAF has only been able to invest in less than 2% of all the opportunities presented to it since it began investing activities in 2004.

We sought out and invested in early and expansion-stage manufacturing, technology, and software companies, and have invested between $200,000 and $1,300,000 in each of our portfolio companies. Typically, we look to hold investments for between four to seven years and we look to exit an investment after the company is purchased by an outside investor or merged with another company or we are bought out by the internal management team after the company gets to a point of profitability and financial stability.

Capital Under Management: $12.5M ($5.0M private capital / $7.5M SBA leverage)

Amount Invested: $7,888,204 in eight companies as of June 30, 2009

I would like to briefly describe four of the companies that SAF has invested in to illustrate the type of venture we look for and how the NMVC funds have been put to use.

SemiSouth Laboratories, Inc. – Starkville, MS – population 23,856 - low-income and rural (www.semisouth.com)

- Date of initial investment: May 2005
- # of employees at time term sheet was signed: 21
- # of employees today: 49 (82% of which live in low-income census tracts)
- The employees are located in Starkville, Columbus, West Point, Crawford, and Maben, Mississippi, with one employee in San Jose, California, and one in Spicewood, Texas

Smart Furniture, Inc. – Chattanooga, TN. – low-income, HUB Zone (www.smartfurniture.com)

- Date of initial investment: August 2004
- # of employees at time term sheet was signed: 1
- # of employees today: 21 (19% of which live in low-income census tracts)
- The employees are located in Chattanooga, Harrison, Dunlap, and Ooltewah, Tennessee, with two employees in Ringgold, Georgia.

Tricycle, Inc. – Chattanooga, TN. – low-income, HUB Zone (www.tricycleinc.com)

Date of initial investment: August 2004

- # of employees at time term sheet was signed: 3
- # of employees today: 25 employees in the United States
- All of the employees (in the US) are located in Chattanooga, Cleveland, Hixson, East Ridge, Lookout Mountain, and Ooltewah, Tennessee, with one employee in Rossville, Georgia, one Chickamauga, Georgia, and one in Rock Spring, Georgia.
- 10 employees in the United Kingdom (Tricycle, Ltd. is a wholly-owned subsidiary of Tricycle, Inc.)

Protein Discovery, Inc. – Knoxville, TN. – low-income, HUB Zone, and Urban Empowerment Zone (www.proteindiscovery.com)

- Date of initial investment: June 2005
- # of employees at time term sheet was signed: 4
- # of employees today: 18 (11% of which live in low-income census tracts)
- The employees are located in Knoxville, Andersonville, Seymour, Oak Ridge, Clinton, and Maryville, Tennessee, with one employee in Los Altos, California, and one in Walnutport, Pennsylvania.

NMVC Reauthorization Recommendations

I submit the following recommendations based on KHIC's experience operating the Southern Appalachian Fund and the experiences of my five fellow NMVC Companies.

Our overarching recommendation is that the SBA invest in this program and offer the existing and new NMVC companies the support and flexibility they need to make venture capital investments in viable companies, with the potential to create jobs and build wealth in low-income communities that are overlooked by traditional venture capital companies and by the SBA SBIC companies.

I urge the Committee to consider making the following technical changes to the NMVC statute in order to strengthen the program and grow the field of NMVC companies:

- Create an Office of New Markets Venture Capital within the Investment Division of the SBA;
- Increase the government leverage from 150 percent of private capital to 300 percent of private capital as allowed under the SBIC program. This increase would allow NMVC companies to raise larger funds and serve larger service areas;
- Change the calculation of the overline limit to10 percent of the sum of private capital and the total amount of leverage. This change will align NMVC overline limits with those of SBIC;
- Amend current law to ensure that NMVC Companies have two full years to raise private capital;
- Prohibit SBA from charging NMVC companies fees;
- Amend the low-income targeting requirements of the NMVC program to align with the low-income targeting requirements of the New Markets Tax Credit so the two initiatives can work together as intended;
- Eliminate the provision that requires NMVC companies to raise private matching funds in order to secure operational assistance grants from the SBA. This would allow NMVC companies to focus solely on raising investment capital to invest in businesses;
- Expand the definition of Operational Assistance to support activities that benefit not only businesses, but also employees and the environment, such as facilitation of workforce development and wealth building activities for employees and environmental and energy conservation assistance for businesses; and
- Authorize the SBA to provide capacity building grants to experienced providers of technical assistance to the community development venture capital industry in order to build the capacity of existing and potential NMVC companies.

In closing, I want to reiterate that the NMVC Program differs significantly from other federal financing programs, including those administered by the SBA. The NMVC Program is the only SBA program that intentionally directs equity capital to businesses in low-income areas of the nation. Each NMVC Company is required to invest at least 80% of its capital in low-income census tracts, and in fact, thus far, the six existing companies have invested 92% of their capital in such census tracts. While the NMVC Program is modeled on the SBIC, there is no provision in the SBIC Program that requires investment in low-income areas. In addition, the NMVC Program has some special features that make investment in low-income, underinvested areas of the nation possible. Most importantly, the technical assistance component of the NMVC Program provides funds to strengthen and improve the long-term viability of portfolio companies, thereby increasing

the positive economic impact of the program and at the same time protecting public funds. In addition, the NMVC Program requires investment of equity rather than debt, which provides a much more valuable and rare type of financing and drives investment into faster growing companies. The SBIC Program tends to encourage lending rather than equity investment.

I look forward to working with you and your staff as you work to reauthorize the NMVC program and other SBA capital programs that are so critical to the work of KHIC and our fellow community based investors.

Thank You.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

Written Comments
Submitted to the

Senate Committee on Small Business

October 1, 2009

Submitted by
Anthony R. Wilkinson
President and Chief Executive Officer

The National Association of
Government Guaranteed Lenders, Inc.

P.O. Box 332
Stillwater, OK 74076-0332

NAGGL Gets It.



NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

Chairwoman Landrieu, Ranking Minority Member Snowe, and members of the Committee, my name is Tony Wilkinson. I am president and chief executive officer of the National Association of Government Guaranteed Lenders (NAGGL). NAGGL, which is celebrating its 25th anniversary, is a trade association representing over 600 banks, credit unions, and non-depository lenders who participate in the Small Business Administration's 7(a) loan guarantee program. NAGGL members generate approximately 80% of the annual SBA 7(a) loan volume.

NAGGL is pleased to submit information for the record following the October 1, 2009, roundtable on the issues facing small businesses and their efforts to obtain credit. As the roundtable discussion revealed, small businesses continue to have difficulty in obtaining capital to sustain their operations and create opportunities for job growth. The SBA 7(a) program provides a viable solution to obtain credit during these difficult economic times. The primary issues facing capital access for small businesses are as follows:

1. Stimulus provisions in the America Recovery and Reinvestment Act (ARRA) are working but the job is not yet complete. Stimulus provisions need to be extended until the economy returns to a normalized pattern and capital access is more readily available to credit-worthy small businesses;
2. The financial condition of the nation's small businesses has deteriorated as a result of the prolonged economic downturn. Lenders are reacting to the decline in small businesses' financial condition by limiting conventional loan options. The credit issues facing small businesses has created a substantial need for the 7(a) product;

3. The limited availability of conventional credit also creates a need for a larger 7(a) loan size to meet the varied needs of small businesses during this economic period. The larger loan size must be accompanied by a corresponding increase in the guaranteed level to ensure lenders have the willingness and ability to provide meaningful capital to qualified small businesses.

4. In order to ensure that lenders will continue using the SBA guaranty to make more capital available to small business, the SBA process must operate in a manner that maintains lenders' confidence in the payment of loan guaranties. One aspect relates to the SBA's ability to implement an oversight program that provides effective and objective analysis of systemic risk. The system needs to be robust in its approach to providing constructive and timely feedback to lenders in order for confidence in the guaranty to remain acceptable.

5. SBA must take the necessary steps at its Herndon processing center to efficiently honor the lenders' guaranty purchase requests. The process needs to provide timely payments while appropriately considering the lender's adherence to the various procedures and regulations.

Stimulus

The stimulus provisions in the ARRA have worked but more assistance is required. Lenders have returned to the program in substantial numbers providing loans of all sizes to the nation's small businesses. During the month of September 2009, SBA 7(a) volume totaled $1.18 billion representing a 141% increase over the pre-ARRA February 2009 volume of $0.49 billion. The increased guaranty percentage from 75% to 90% has

allowed lenders to diversify risk and provide loans for working capital, business acquisitions and other under-secured loan needs.

The ARRA's elimination of the borrower guaranty fee is another important component of the recovery plan. While the fee elimination does not increase lending availability it does create a more affordable borrowing option for the small business. By reducing the borrowing cost, the small businesses have more funds available to support internal working capital generation and ultimately new job creation.

In order to maintain the positive economic impact created by the 7(a) stimulus provisions, it is imperative that the provisions be extended. Current estimations have the stimulus funding being exhausted as early as November 2009 which is well before the return of solid economic stability and full capital access for small businesses.

Financial Issues of Small Businesses and Conventional Lending Constraints

The overall financial condition of America's small businesses has deteriorated. The economic downturn has reduced the revenues of small businesses as consumers have limited spending. Some small businesses have had to reduce expenses including firing of valuable employees which prolongs the economic downturn. Expense reductions are typically a partial solution and the small businesses must rely upon cash reserves, personal liquidity or additional borrowings to bridge the gap. Unfortunately, these measures further weaken the financial condition of the small businesses.

As part of the credit quality evaluation of small business loan applications, lenders must review historical performance and trends while determining the probability of sufficient future cash flow to meet the applicant's overall obligations. Due to the extended economic issues, the historical trends of most small businesses have been negative. These trends have reduced a lender's ability to confidently assume adequate cash flow is present to repay existing or proposed loans. In these situations, the lender looks for secondary repayment sources to solidify its decision to extend credit.

The secondary source of repayment most commonly relied upon is the underlying collateral securing the loan. However, due to devaluation of commercial real estate and limited value for accounts receivable and inventory, small businesses often do not have sufficient equity in these assets to provide a meaningful secondary repayment source. Also, regulatory limitations on commercial real estate advances prevent small businesses from tapping into any remaining equity following re-appraisal at current market conditions.

The final opportunity for small businesses to support their conventional lending requests is through guaranties provided by the company principals. However, due to declines in personal real estate values, reduced savings, lower investment and retirement accounts, the ability for lenders to rely upon the principal's guaranty to support the loan request is limited.

Each of the issues listed above have limited small businesses' access to capital. This limitation comes during a period in which capital access is critical. Lenders are forced to react to these conditions with decreases or cancellations of existing loans or restrictive covenants that limit advances under credit lines. Other sources of credit are impacted by these conditions including reductions in home equity lines or credit cards. Lenders continue to face their own capital limitations which cause loans to be sparingly granted.

Larger Loan Size

The current economic climate has forced small businesses that have historically relied upon conventional financing to turn to the SBA 7(a) product. Specific situations include small businesses that are faced with limited renewal options on their commercial real estate due to declining property values; small businesses that have restrictive advance parameters on lines of credit supporting manufacturing or export activity; small businesses that have financed their real estate with an SBA loan but now need additional financing to support working capital; and specialty industry needs such as automobile and boat dealers. The current loan size of $2 million is insufficient to meet these needs and support substantial economic recovery.

An increase in the statutory maximum loan size will need to be accompanied by a commensurate increase in the statutory maximum guaranty limit in order to keep the maximum guaranty percentages equal to those now authorized. The larger capital requirements for small businesses concentrate individual loan risk for the banks. Based on the varied needs of the businesses and regulatory constraints of the lenders,

maintaining the maximum guaranty percentage will induce lenders to participate in the 7(a) lending program and spur job creation and economic recovery.

Lender Oversight

A quality lender oversight program should provide a cost effective, statistically valid means of detecting increased risk in the overall SBA portfolio as well as individual lender's portfolio. Initially, this is typically accomplished with a properly functioning offsite monitoring program. Upon detection of adverse trends or deviations from anticipated lending activity, the oversight program should direct knowledgeable SBA personnel to evaluate the situation and provide direction, including a possible onsite review of the institution's asset quality and lending practices to validate concerns, provide corrective actions, or issue enforcement directives. In the case of the 7(a) program, devising an appropriate oversight strategy must also include consideration of how well the SBA's public policy goals of the program are being met and not focus solely on the elimination of the SBA's risk.

Concerns have been raised regarding whether the SBA's current offsite monitoring program provides a cost effective, statistically valid method for detecting increased risk in the portfolio. The SBA has access to significant amounts of data relating to historical loan performance, delinquencies, and lender activity. However, it does not appear that this information is routinely utilized as part of an early warning risk assessment system. Instead, the SBA is relying upon a Dun and Bradstreet computer program which attempts to forecast the percentage of loans in a lender's portfolio at high, moderate, and low risk of default.

The lender oversight program as an early warning system is critical to ensure the new lenders participating in the program are following the various rules and regulations prior to substantial risk of non-compliance. An effective lender oversight program will provide further assurances to the lending community that the SBA guaranty can be relied upon with a reasonable expectation of timely payment.

Guaranty Purchase Process

Concerns over timely payment of guaranties can translate into lenders reducing or eliminating their participation in the 7(a) program. SBA must take steps to assure that guaranty purchase requests are honored on a timely basis, and that any re-examination of purchase decisions conforms with reasonable statutes of limitation for similar civil matters.

Conclusion

The SBA has made positive progress in restoring the value of the guaranty and increasing overall lending. The stimulus provisions of ARRA have laid the foundation for sustainable economic recovery and job creation. Without the continuance of these provisions, the strides that have been made towards providing capital to small businesses may be lost. The current economic stress has created an increased need for working capital financing as well as larger loans and commensurate increase in the guaranty percentage to accommodate small businesses previously obtaining conventional loans as well as traditional SBA loan candidates. With proper oversight, timely guaranty payments, and constructive solutions for the benefit of the nation's entrepreneurs, the SBA 7(a) program can truly be the vehicle to move America's small businesses to prosperity.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

Reauthorization of the SBA Finance Programs & Impact of the Recovery Act

Submitted to the

COMMITTEE ON SMALL BUSINESS

And ENTREPRENEURSHIP

UNITED STATES SENATE

by

Ms. Jean Wojtowicz
Chair
NADCO Board of Directors
&
President
Indiana Statewide CDC

McLean, Virginia

October 8, 2009

The National Association of Development Companies (NADCO) is pleased to provide a statement to the Senate Committee on Small Business about the need to improve access to capital by small businesses through a reauthorization of the SBA lending programs.

NADCO is a membership organization representing the Certified Development Companies (CDCs) responsible for the delivery of the SBA 504 program. We represent more than 260 CDCs and more than 200 affiliate members, who provided more than 98% of all SBA 504 financing to small businesses during 2008, as well as many other small business programs and services in their communities. CDCs are for the most part not-for-profit intermediaries with a statutory mission of community and economic development achieved through the delivery of the SBA 504 and other economic development programs and services customized to the needs of their respective communities.

NADCO's member CDCs work closely with SBA and our lending partners to deliver what is certainly the largest and most successful federal economic development finance program in history (over two million jobs, $44 billion in authorized 504 loans and the leveraging of over $50 billion in private investment since 1986).

NADCO would like to thank Chairwoman Landrieu, Ranking Member Snowe, and the entire Committee, for continued support of small business in America, the CDC industry and the 504 program. The Committee on Small Business has worked closely with SBA and our industry to ensure the availability of this valuable economic development program to small businesses for more than twenty years.

NADCO will provide comments today on the critical needs of the 504 program as we seek to increase access to long term capital by small businesses during and immediately following this recession.

Unprecedented Times for the Economy and for Small Businesses:

The government, private industry, and the American public all agree that this recession has been an unprecedented event for our economy in modern times, possibly with the exception of the Great Depression. Few of us have seen the credit markets "locked up" as they are today for both business and the consumer.

The impact on even such stalwart programs as the SBA loan guarantee programs has caused an unprecedented and rapid decline in loan volume. This has been due to a drop in demand by retrenching small business owners and reduced credit availability from commercial banks. Even as loan volume dropped, loan deferrals, delinquencies, and defaults by borrowers have increased to unprecedented levels. For 504, the critical loan default level has increased from about 1.5% to over 4%. This level of defaults is overwhelming the SBA's ability to gain acceptable amounts of recoveries, leading to higher net loan losses, and increasing borrower fees. Even as SBA increased fees on 10/1/09 for FY10, it's expected that the FY11 borrower fee may reach an unprecedented level once that program subsidy is calculated. This may shut out many borrowers, as both fees and interest rates begin to rise in the future.

GOAL: Reach more small businesses with fresh capital

Even before this recession began, NADCO was developing proposals to greatly expand access to 504 loan guarantees by many more small businesses. Today, the traditional credit markets are in turmoil, and banks are under pressure by every financial regulator to limit, and reduce, their exposure to commercial real estate loans. We believe that 504, as a risk-sharing mechanism using SBA loan guarantees, is an ideal vehicle to provide long term loans to businesses that are again beginning to expand their plants, stores, offices and equipment. This expansion is creating new jobs and the "grease" that funds it is fresh and low-cost capital.

The Congress and the Obama administration have worked hard to put more fixed asset and working capital in the hands of small businesses hard pressed by this recession. Our industry thanks both the Congressional Small Business Committees for taking a leadership role by adding key programs to the stimulus bill earlier this year that are beginning to impact capital access and job creation.

However, our industry believes that more should be done quickly to have even more impact. Even as SBA worked to implement new programs and fee reductions created through the stimulus bill, the loan eligibility and underwriting policies set forth by SBA that are so critical to maximize the effectiveness of these programs were drifting towards more conservative interpretations on numerous issues. NADCO is making a number of recommendations to truly expand the availability of 504 funding to more small businesses. These include:

Increase the maximum 504 loan size: We request that the limit for a regular 504 loan be increased from $1.5 million to $5.0 million, and the limit for critical public policy loans increase beyond that. Commercial real estate construction costs have increased substantially in the last five years, and the program benefit must keep up with these costs for small businesses.

Assist businesses in low income areas: We request that the benefits of the public policy loan limits be made available to small businesses located in low income areas, to include those that would be eligible for new markets tax credits. Many traditional lenders have moved away from making loans in these areas due to perceived added risk. More capital must flow to these small businesses that create jobs in areas of low income and extremely high unemployment. This is a core mission of the 504 program.

Acquisition of stock: Some small businesses being acquired by new owners should be allowed to make the fixed asset transfer through a stock sale, so long as the assets are 504 eligible.

Definition of "rural" areas: SBA continues to apply outdated population parameters to rural areas, which restricts 504 from assisting rural borrowers through public policy loans. We request that the more current USDA definitions of "rural" areas be applied to SBA programs to increase the availability of capital in these areas.

GOAL: More working & long term capital to small businesses

Many successful small businesses are struggling with the high cost of their long term loans on their existing real estate and buildings. Even as American consumers have rushed to take advantage of historic low interest rates to save money on their houses, small businesses have been unable to do so as traditional lending sources dried up in this recession. Thus, many small companies have become starved for working capital, even as they sat on hundreds of thousands of dollars in equity with no means to access it.

NADCO believes that it is a national imperative that we provide access to low cost new capital if we are to save thousands of small businesses that will create millions of new jobs as their customers return and cashflow is restored. Failure to do so will close many firm's doors, and cost jobs; exacerbating an already high unemployment rate in Amercia.

Our legislative proposal includes a series of new and innovative program changes to address two needs:

- 504 could be adjusted temporarily to enable refinancing of old, high cost debt and take advantage of low rates to save businesses interest costs.
- 504 loan regulations could be changed to allow businesses to take out small amounts of cash now locked up in equity to be used as working capital for business purposes.

Maximize both 504 and 7(a) loan eligibility for a borrower: Small businesses typically need added working capital when building a new larger 504 project, yet this is frequently restricted under current SBA regulations. Particularly in this credit crisis, we must make this capital available for inventories, salaries and business operating expenses, in ADDITION to the funds for the building construction.

GOAL: Streamline regulatory restrictions on CDCs and 504 lending

NADCO believes that the SBA loan programs can be made more relevant and productive for American small business. Loan volume for both the 504 and 7(a) guarantee programs has improved since passage of the stimulus act, but many of those benefits are just now being implemented by the SBA. However, in spite of the stimulus bill, both programs are still down as much as 40% from their highest levels two years ago.

A substantial part of this volume loss is clearly due to this historic recession with small businesses pulling back on demand for long term capital. But part may also be due to SBA, and even our own lending industries, failing to fully respond in innovative new ways to the ever-changing needs of small business financing. As we have seen with our inability to convert equity to working capital, and the ever more conservative policies on loan programs, it is possible that SBA's programs are becoming less relevant as small businesses are pushed to find other, and often more expensive, means of funding their growth and job creation.

Each of these guarantee programs is over twenty years old, and an environment of restrictive and potentially unnecessary regulations has evolved within the Federal bureaucracy. With this new administration, and the fresh thinking from senior policymakers it is attracting, NADCO sees an opportunity to break out of some of the old program's structure and bureaucracy. We see the chance to work with this new leadership team, and with the new Congress to expand the reach of the many benefits of both 504 and 7(a) to more borrowers with different capital needs in new and leading edge industries that will be the job creators for the next fifty years.

In order to begin a "re-thinking" of the program, its ability to serve small business, and an expansion of its benefits, NADCO believes that there must finally be established the organizational parameters and control guidelines for Certified Development Companies that deliver the 504 program to the nation. The very definitions of our industry and its financing services should not be left to the sometimes arbitrary evolution of regulations that are designed to control the "lowest common denominator" of the program.

NADCO has carefully evaluated the existing industry structure and concluded that there is a need for codification of key facets of the industry and key program components. We request consideration of the following recommendations to firmly establish guidelines for our industry:

Allow use of HELOCs for owner 504 equity access: SBA had moved to restrict 504 borrowers from using proceeds of their Home Equity Lines Of Credit for their cash injections into their 504 projects, a practice used for over twenty years with no documented increase in credit risk. While this new SOP change has been temporarily placed in abeyance, we are seeking a more permanent solution to this issue. We request that this option for use of borrower's home equity lines be continued through legislated guidance to SBA.

Combine the benefits of certain public policy goals: Small businesses owned jointly by minorities, women, or veterans (all now individually public policy qualified) should be able to qualify for a "combined" benefit if they own at least 50% of the business, rather than the current regulatory restriction of 51%. This will enable many more small firms to obtain added capital.

Enhance & expand the Premier Certified Lender Program: Volume for PCLP has declined over 70% in the past two years. This is due to both the high cost of reserves required of participating CDCs and the substantial improvement of SBA loan processing times for all 504 loans. This program must either be "re-thought", with new goals and processing benefits, or eliminated. NADCO has several recommendations to improve PCLP.

Uniform leasing policy: Small businesses should be able to lease out 50% of their space, whether it is newly constructed or an existing building, for both the 504 and 7(a) programs, and this will actually reduce credit risk while providing added potential expansion space for these growing firms well into the future.

Certified Development Company structure: Low cost program delivery is at the core of 504's benefits for small business borrowers. As SBA and our industry seek to grow the delivery organizations for 504, the program should continue to be delivered by not-for-profit, community-based organizations that are focused on economic development in their local areas. NADCO has

created a series of recommendations that address this goal, and through codification, make it an absolute requirement for all new CDCs. Some of these recommendations mirror beneficial SBA rules, while others are completely new requirements that will maintain the advantages of today's low cost delivery of 504.

CDC management and ethical structure: With the recent corporate "implosions" in the financial services industries that led to many of the reasons for this credit crisis, NADCO strongly believes that there must be codified requirements for the ethical and service standards of the CDC industry. Our industry has a long history of focus on community benefits, rather than the profit goals of traditional private lenders. In order to maintain this focus, we urge that our recommendations be implemented to maintain these standards for the benefit of our future borrowers.

Multi-state service by CDCs: Some of the current industry structure has evolved on a haphazard basis without careful consideration of small business needs in individual communities. "One size" does not fit all communities, and the expansion of CDC services must be carefully structured. NADCO makes a series of recommendations to enable Congress to provide definitive guidance for the future.

504 Debenture definition and clarification: The key component of the 504 program benefits is access to the capital markets for long term loan funding. Our low cost of debt is derived from the program's long term consistency of its funding security structure. Our security's portfolio performance has led to investment attractiveness by a very broad segment of major corporate investors and financial institutions, based both in the U. S. and overseas. This belief in our consistent performance and portfolio structure has directly led to lower interest rates for many years. For example, in spite of this credit crisis, our July 2009 interest rate for our borrowers was the second lowest in the twenty-three year history of 504. So even as Fortune 500 corporations are having trouble finding funds at ANY cost, the 504 program continues to function as the "window to Wall Street" for thousands of small businesses; providing funds on long terms and at the lowest possible cost.

The consistency of the funding security, known as the Development Company Participation Certificate, must be maintained in the future, regardless of the political changes that occur from administration changes. Modification of our security's terms will result in increased interest costs for our borrowers. NADCO requests that Congress maintain the stability of our funding mechanism by codifying the payment schedules of principle and interest for our securities. This will remove the potential uncertainty of the borrower's payment streams, maintain the low interest rates, and insure long term access to the credit markets.

GOAL: Increase recoveries and reduce 504 program loan losses

Loan defaults and losses have increased for 504, as for all other commercial lending – both public and private – during this recession. NADCO believes it is imperative for changes to be made to control these losses in the future. We make the following recommendations to address this goal:

CDC responsibilities for loan liquidation and recovery: SBA's limited liquidation staff is being overwhelmed with loan defaults, which is leading to higher loss rates for 504. In turn, this will result in higher subsidy costs and fees for future borrowers. We urge Congress to enable qualified CDCs to perform liquidation and recovery work, and require that SBA simply compensate CDCs for staff liquidation work from the certain increased recovery amounts, as their own regulations require (which have not been funded by the Administration).

Additional equity injections: To reduce debt service costs, some borrowers would like to have smaller private bank first mortgages (always at a higher cost to the borrowers than the federal government's second position) and larger 504 second mortgages. We request that the requirements for bank participants be more flexible to reduce overall project debt costs, which will enable borrowers to save cash for working capital, and almost certainly result in lower delinquencies and loan defaults.

Collection and accounting for defaulted 504 loans: We request that accounting for defaulted 504 loans, as well as new secondary work-out loans with borrowers, be continued at the program's efficient and highly automated Central Servicing Agent. This will result in timely, accurate loan accounting and portfolio servicing, and enable CDCs to service these notes more rapidly and effectively. This will both reduce costs for SBA and increase overall recoveries from 504 defaults.

Reserve requirements for Premier Certified Lender CDCs: We request that the pilot amortization program for calculation of PCLP loss reserves be re-instated and made permanent. While this will reduce the cash reserve requirements for participating PCLP CDCs, it will attract more CDCs to this program that enables both improved borrower service and reduced loan losses for SBA from defaulted 504 loans.

GOAL: Keep cost of 504 program low for small businesses

The Stimulus Act of 2009 provided funds to reduce the fees that borrowers pay either directly to SBA, or indirectly through banks, for their 504 loans. Small businesses responded almost immediately by applying for new 504 loans, as they perceived that they could save enough money on fees and with low interest rates to go ahead and expand their business fixed assets, even in the depths of this recession.

The increase in loan volume for both 504 and 7(a) demonstrates that our demand is truly elastic, and will respond to lowered fees and rates. As the economy rises from this recession, and while the Federal Reserve and Treasury work to maintain low rates for a period of time, it is imperative that the overall cost of 504 be kept low if we are to promote investment by small businesses. Only through such expansion will new jobs be created, so this must be a major goal of the Congress, SBA, and our industry.

However, SBA has already increased the borrower fees for loans made in FY 2010, and is likely set to do so again in FY 2011. Further, the funding provided by the Stimulus Act is set to run out by year-end. The combination of these fee changes may well drive small businesses back into a "wait and see" corner, with reduced fixed asset investment resulting in fewer new jobs.

NADCO believes that funding by Congress to offset the new, the expected, and the expiring fee changes must be provided quickly. The alternative will almost certainly be a choking off of small business expansion through the 504 program. With little evidence that banks will return to traditional levels of long term commercial lending in the near future, the result will be a stifling of investment and the slowing of the recovery. We urge that Congress act quickly to keep this expansion going.

CONCLUSIONS:

For many years, 504 has been an extremely cost effective capital access program for thousands of growing small businesses that are the core job creators of the American economy. The program was in such demand that for several years its growth rate exceeded 20% each year. As the country slid into recession, many small business owners decided they could not take a risk of continued growth of their firms, so they stopped borrowing all but the necessary working capital to maintain their existing operations.

It is the sense of both SBA and NADCO that "the dam is about to break". That is to say, many small businesses are concluding that an economic turnaround is beginning to happen. You can see it in the growth of the investment markets. We can see it in the calls that CDCs are beginning to get about the loan program. Our "pipeline" of loan projects is beginning to come back. Perhaps it is stimulus working; maybe it is simply the upturn of the American business cycle, but it's there, and it's growing.

The 504 program is over twenty-two years old, in its basic form. But the need for long term capital has not changed in those years, and 504 remains as relevant and important as the day it came out. NADCO has not proposed a radical change of direction for 504, but an incremental update and upgrade of a very successful capital access program that for over ten years has cost the taxpayer nothing.

The changes we urge Congress to make will maintain the stability of the "good", correct the "bad", and get rid of the "ugly". These will make 504 an improved source of capital at just the right time for our economy, as small businesses begin to ask for long term fixed asset and plant expansion funding. With these changes, and rapid implementation by SBA, 504 will be just the right program at just the critical time for small businesses. We ask Congress to pass these recommendations, and work with SBA and our industry to help restore the American dream of business ownership and entrepreneurship.

Thank you for your support for the past twenty-two years. You are responsible for our success today!

Testimony Dennis West, President Northern Initiatives, Marquette, Michigan

Roundtable Reauthorization of SBA Loan Programs and the Impact of Small Business Provisions in the American Recovery and Reinvestment Act of 2009

United States Senate

Committee on Small Business and Entrepreneurship

October 1, 2009

Thanks to Senator Landrieu, Senator Snowe, Senator Levin and the Senate Staff for this opportunity to offer my perspective on certain SBA Programs.

I am Dennis West and I am President of Northern Initiatives, a 501©3 non-profit Community Development Financial Institution, created in 1991 that now serves 44 rural Northern Michigan counties. NI was created with two member groups, Northern Michigan University and ShoreBank.

Northern Initiatives began its lending program in 1994 and has made over 500 loans totaling nearly $28mm. Of those loans 51% have been made to start ups, and 225 have been SBA Microloans.

The type of lending that we do is vital to our rural communities. The Global Entrepreneurship Monitor assesses the entrepreneurial capacity for various countries, considering who has the attitude and aptitude to run a business. Their assessment results show that 11% of Americans possess this entrepreneurial capacity. This is a valuable insight in revealing that there is a minority of us who have the wherewithal to create and run a business. So first we should believe that the pool of entrepreneurs is at best precious and rare and this is also why it is so that when we see someone with an idea and potential that it is important to help them to move forward.

Everyone is not bankable. Some of us lack cash, some of us do not have sufficient net worth to offer collateral, some of us have had bankruptcies (and in rural communities they are often related to unexpected medical costs), and some have had credit problems (perhaps associated with a spouse having lost a job). The challenge becomes that if a town has 1,000 people, then at best 110 have the attitude and aptitude to start a business, and once we begin eliminations of those who are "blemished" we can lose our entrepreneurial capacity. Assessing character and verifying the conditions that created the blemishes is what we do, and in so doing we help communities to reach their entrepreneurial peak.

Some recent examples of how this has worked, a chiropractor practice was available in a town of 7,500 with the owner looking to retire. A young chiropractor was able to buy the business and keep a storefront occupied, keep people employed and offer a service that might otherwise have left the community. He was not "bankable" due to student loans which left him with a negative net worth and little available cash.

A gun sight manufacturer had an opportunity to secure a $600,000 contract with an OEM. The owner knew that in order to maintain the contract and make a profit that he would need to get his scrap rate down which meant buying new equipment. The ability to use the Microloan program to buy the new equipment meant that despite the downturn, a significant contract was secured supporting 20 employees who also have benefits.

Fortunately we have had the ability to use the SBA Microloan Program, which affords intermediaries access to capital and technical assistance grants that can focus the customer's attention to accounting and profitability. The program has shown great success with only a 1% loss rate experience through its nineteen years.

Changes I would like to see happen to the **Microloan Program**

1) The program after nineteen years should no longer be designated a pilot but a permanent program and that the program has helped to create a mature industry which could benefit from other programmatic changes.
    a. The largest loan should be increased from $35,000 to $60,000. The costs of equipment have gone up substantially over nineteen years, this is a reflection of costs rising and it is more common to see loan requests that are growing larger.
    b. Increase the average loan size to $35,000, if (a) is enacted then (b) should follow.
    c. Remove restrictions on the use of TA Funds and allow the allocation to be managed through the budget approved by the SBA staff. Customers needs in a growing portfolio do not always fit the guidelines that were created for the program in its pilot stage. Northern Initiatives for examples is trying to serve a large region. It is conceivable that Northern Initiatives would want to use more contractors than is statutorily allowed. The result is that Northern Initiatives is constrained in its ability to better serve customers when use of a remote technical assistance provider is the best solution. intermediaries therefore need to have the ability to manage to a budget dictated by their realities rather than the limits of the statute. The prospective change would allow intermediaries to propose a technical assistance budget designed around the needs of their customers and that budget would be reviewed and accepted by the SBA staff.
    d. Amend the 15% loan loss reserve requirement and allow the loan loss reserve to be managed on a risk rated basis. This would be done through having intermediaries submit a current portfolio quality report. The effect of a needlessly high loan loss reserve is to take capital from circulation at a time when demand and need are high.

The Small Business Intermediary Lending Program has been proposed by Senator Carl Levin, it has twice been approved by the Committee and once by the Senate. Earlier I talked about the lending that we do which is largely based on character. The other reality of our loan portfolio at Northern Initiatives is that it tends to have a lot of churn. Much of that churn occurs as borrowers become bankable and move to a community bank portfolio. This is often a 3-5 year process. The thinking that led to the

programs' introduction by the Senator is that there are business ideas that require more money or more money and time than is available through the microloan program.

The Small Business Intermediary Lending Program would enable larger start up loans around innovative ideas as well as "follow on financing" to micro borrowers who are not ready to move to a community bank. This is a boutique program but an urgently needed program to help foster innovation and entrepreneurship.

It is modeled after the successful USDA Intermediary Relending Program. The success of that program is that it has provided over $1B to intermediaries and has yet to have a loss or default.

At the same time the proposal offers differences. The SBA program can be used in rural and urban settings and does not have the USDA limitation. The USDA IRP program is targeted geographically, so an intermediary is awarded bonus points for focusing its work. This proposal would allow a microfinance institution to work in a broader area where its customers are. The third issue is that the IRP program is radically oversubscribed and offers only a little over $30mm nationally per year.

In my home State of Michigan, unemployment is the highest in the nation, and the adjustments in the auto industry have stressed small and medium sized manufacturers and rippled through the entire economy. Yet over the past seven years, there has been one area of growth, small Stage One businesses (1-9) employees. Recovery may very well be found in nurturing, cultivating and growing those with ideas, energy and ability, who will begin small. In my State such a program is desperately needed to rebuild community economies.

Finally the Committee should consider some targeting of this program to areas of the Country that have been hard hit by the recession and the credit crunch. High unemployment is generally associated with falling collateral values and therefore some efforts to prop up the capital needs of these areas is critical.

A third idea that the Committee should consider is a **loan guarantee program** involving banks and intermediaries. The concept would allow for a bank to receive an 80% loan guarantee for loans that it makes to a community development financial institution. This could provide capital that an intermediary could relend. A second purpose would be to be a bridge loan. It could conceivable enable a CDFI to close a loan with its "guarantee" capital when it might otherwise need to pass on a loan due to the targeting requirements of its available capital (i.e. A loan request comes in from County A which is not a USDA Intermediary Relending Program eligible county and it is in that program where the Intermediary has capital that it could lend. Other loans being repaid will help to make it possible to close the loan but those repayments will happen over six months. The intermediary could use the guarantee to bride the making of this loan until the lower cost capital is available.

A credit would be important to help manage liquidity and make capital more available. It would also help to strengthen the valuable relationship of community banks and intermediaries.

Thank you once again for this opportunity to share my thoughts on these important matters.



Statement of
Matthew R. Shay
President & CEO, International Franchise Association
United States House of Representatives
Committee on Small Business

October 14, 2009

Good afternoon Chairwoman Velázquez, Ranking Member Graves and members of the committee. My name is Matthew Shay. I am President and CEO of the International Franchise Association (IFA), and I am grateful to have the opportunity to speak to you today about the credit crisis facing small business entrepreneurs and the need for legislation such as the Small Business Credit Expansion and Loan Markets Stabilization Act. During my statement, I will make three key points:

1. The current credit crisis is becoming increasingly more dire for small businesses;
2. The depth of this crisis calls for extraordinary action, and Congress should support changes to SBA programs including increasing the maximum SBA loan limits to $5 million to accommodate the needs of more small businesses; and,
3. A renewed emphasis on loan programs for small business start-ups, expansions and acquisitions will promote faster job creation and lead to a stronger recovery.

The legislation currently before this committee provides a foundation for addressing these goals. There are several additional steps that can be taken to strengthen this proposal. Making SBA lending programs work better for entrepreneurs seeking capital to open, acquire or expand a business will allow the economy to recover faster and provide the necessary bridge to a functioning commercial

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lending market once the recovery is complete. In many ways, franchised businesses are an excellent way to understand what is happening to small businesses during the current recession. Franchising is found in almost every sector that small businesses operate, and it is a clearly defined subset that is more easily tracked and analyzed.

As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted by PricewaterhouseCoopers for the IFA Educational Foundation, there are more than 900,000 franchised establishments in the U.S., providing 21 million American jobs and generating $2.3 trillion in economic output. The business methods, training and support franchise systems provide to their franchisees together with improved access to credit will result in faster and more sustainable job creation.

Under normal circumstances, small businesses can tap financing from a number of different sources, including national and community banks as well as many non-bank lenders. Typically, the SBA loan programs are not the first stop for an entrepreneur, but they serve an essential function as a lender of last resort for business owners who cannot find appropriate financing in the commercial marketplace. During this recession, however, most commercial lenders have dramatically curbed their willingness to assume risk. Prior to 2009, the top small business lenders for franchising were GE Capital and CIT. GE Capital is no longer lending and we all have read about the ongoing struggles at CIT to stay afloat. Some credit might be available at smaller institutions, but the restrictive terms and delays that entrepreneurs are encountering can be staggering. Moreover, many lenders that could now be serving the small business marketplace are not participating in SBA lending programs because they either may lack expertise or they may find the SBA's requirements too burdensome.

Franchised businesses play an important role in the economic health of the U.S. economy, and they are poised to help lead the economy on the path to recovery. IFA Educational Foundation reports show that the franchise industry consistently outperforms the non-franchised business sector, creating more jobs and economic activity in local communities across the country. Released in February, 2008, *Volume 2 of the Economic Impact of Franchised Businesses,* for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses.

The findings of a 2009 study, *Small Business Lending Matrix and Analysis*, prepared by FRANdata for the IFA Educational Foundation, demonstrate that meaningful economic recovery and job creation can start with small business lending. In fact, the study determined that for every $1 million in new small business lending, the franchise business sector would create 34.1 sustainable jobs and generate $3.6 million in economic output.

Earlier this year, Congress and the new Administration worked quickly to address the current economic crisis. The stimulus plan authorized spending of nearly $800 billion, including more than $650 million to support small business lending. The recovery bill made important changes to SBA programs such as a temporary increase in the loan guarantee from 75 percent up to a maximum of 90 percent, and the bill suspended loan fees for borrowers that can add up to 3.75 percent to the cost of a loan. These were crucial first steps, and we would strongly urge you to act to ensure that these temporary provisions are available through 2010.

So far, the 7(a) and 504 loan programs have supported $11.3 billion in lending since the Recovery Act was signed, but there is significant demand for more lending that has not been satisfied. The franchise business community believes that there are several important steps that Congress should

consider to make it easier for entrepreneurs to access capital and create jobs. Most importantly, Congress should increase the standard 7(a) maximum loan limit from $2 million to $5 million and increase the maximum guarantee amount proportionately. The economic downturn has resulted in borrowers having less collateral due to declining home values and reduced investment and savings accounts. Increasing the loan limit will allow more individuals and businesses to take advantage of the 7(a) program, expanding the job creation potential of the program.

A majority of franchised businesses in the United States today are operated by multi-unit owners. Growth beyond the first unit is not just an aspiration for many entrepreneurs in franchising; it is an essential part of helping ensure that their business will reach a level of scalability and sustainability. Businesses that cannot reach a certain level of scalability naturally find it more challenging to survive.

There are over 400 different franchise brands in the United States that have an average initial investment requirement of $750,000 to $2,000,000 per unit. For these franchised small businesses, an entrepreneur reaches the SBA's current loan limit by the time they want to build the second or third store. In the past, the policy of lower loan limits may have ensured that SBA programs assisted only the smallest of small businesses, while businesses reaching a larger scale of operation could reasonably be expected to find financing from many places other than SBA backed loans. In the current credit crunch, however, other commercial financing options may not be available, and the lower loan limits are now operating as a restriction to success for many small business owners. Similarly, lower loan limits are restricting the true job creation potential of our economy.

There are approximately 325,000 franchised businesses in the United States owned by "multi-unit" small business franchisees. Our studies show that these multi-unit operators will be the most successful over time. Fifteen percent of all small business franchisees in the United States own

between two and five units, and this category of franchise ownership is the fastest growing. If these businesses can grow at the five percent annual rate that we saw between 2001 and 2005, franchising will grow 16,250 new businesses per year. These new businesses will create 243,750 to 325,000 jobs (assuming 15-20 direct jobs per store) plus an additional 245,000 to 325,000 indirect jobs. Therefore, we believe that a larger loan limit will enable some of these franchise small business owners to expand into new markets and help the U.S. create between 450,000 to 650,000 new jobs within the next 12 to 18 months.

We urge this Committee to consider examining a market-based loan pricing model for SBA loan programs. In this crisis, the real issue for many small business borrowers is basic availability of start-up capital rather than the cost of capital. Between January 2008 and September 2009, the SBA loan interest rate cap dropped from 9.75 percent to 6 percent. During that same time period, the rate premiums that business lenders offering conventional loans required increased dramatically for those lenders willing to provide conventional business loans. While conventional lending is market driven, SBA lending can be influenced by policy. The highest business risk category—start-ups—are the most credit starved. While a continued 90 percent guarantee certainly helps, further inducement in the form of market based rates or rate buy-downs is necessary to open credit to this group. We understand this is a politically challenging issue; however, we consider this to be a major policy breakdown that is contributing to the credit crisis while undermining economic stimulus efforts.

Banks are reluctant to expand lending through the SBA programs. If banks were clamoring to participate in and make SBA loans, one might assume that the interest rates were an attractive inducement to lend. Today, the opposite is true. Borrowers are clamoring for loans, and banks are reluctant to provide them. The statutory rate sets an artificial price that is too low for the demand. Policymakers, economists and consumers all want small businesses to lead the recovery. Borrowers

are not reporting that SBA loan interest rates are too high or restrictive—they are frustrated that they cannot obtain a loan—SBA or conventional. By addressing the pricing of SBA loans, Congress can deliver on its policy goals of improving access to credit for small businesses in order to lead the economy out of recession.

The IFA strongly recommends that this Committee look at new ways to stimulate small business lending so that funds are available specifically for business start-up and expansion. Much of the increase in SBA lending activity in 2009 has taken the form of refinancing real estate. We believe that this is not the intention of Congress when they enhanced the tools available to small businesses in the Recovery Act. We urge the Committee to consider a set of changes that would specifically promote loan guarantees for start-ups, expansions and acquisitions. To achieve this goal, we suggest that Congress consider re-instituting the borrower fees on all 7(a) loans with amortizations over 15 years while eliminating or reduce lender fees on all 7(a) loans with amortizations under 15 years, or alternatively, on true start-ups with all amortizations. This change would shift the focus of the 7(a) program back toward true business start-ups and expansions. Congress could also consider making the 90 percent guarantee permanent for all loans with amortizations under 15 years, and adding a 100 percent guarantee for first two years of a franchise start-up. For loans with amortizations over 15 years, we recommend that Congress restore the 75 percent guarantee.

We also support congressional efforts to improve SBA audit standards. At the same time that policymakers are encouraging banks to expand their small business lending during a weak economy, we cannot afford to undermine these efforts by creating an environment where banks are questioning the reliability of an SBA guarantee. Stories of loan guarantees revoked due to small errors continue to loom large in the minds of bankers, and we fear that lenders will remain hesitant to participate in all SBA programs unless they can be sure of the guarantee. This is especially true for the repurchase of

existing SBA guaranteed loans that are repackaged on the secondary market. The committee heard earlier this year from the Independent Community Bankers of America, whose members report facing long waiting periods to hear from SBA and refusals to pay the guarantee. If the prevailing perception among lenders becomes a lack of faith in the SBA guarantee, then small business lending will decline further and these entrepreneurs will face a much greater challenge to be the engine of economic recovery. The SBA should work closely with these and other stakeholders to improve communication and develop clearly defined standards.

I want to again thank the members of the Committee for the opportunity to participate in today's important hearing on the Small Business Credit Expansion and Loan Markets Stabilization Act. The IFA looks forward to working with this Committee throughout the legislative process to ensure SBA's programs will work to help our country's small businesses lead us out of the recession.

Thank you.

