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CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS

JOINT HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

AND THE

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

FEBRUARY 26, 2010

Printed for the use of the Committee on Financial Services and the Committee on Small Business

Serial No. 111–104
(Committee on Financial Services)

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CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS

Friday, February 26, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
AND COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The committees met, pursuant to notice, at 9:01 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the Committee on Financial Services] presiding.

Members present from the Committee on Financial Services: Chairman Frank, and Representatives Kanjorski, Waters, Gutierrez, Velazquez, Watt, Sherman, Meeks, Moore of Kansas, Baca, Miller of North Carolina, Scott, Green, Cleaver, Bean, Klein, Perlmutter, Donnelly, Foster, Carson, Minnick, Adler, Driehaus, Kosmas, Himes, Peters, Maffei; Bachus, Royce, Manzullo, Biggert, Hensarling, Garrett, Neugebauer, McCotter, Posey, Jenkins, Lee, Paulsen, and Lance.

Members present from the Committee on Small Business: Chairwoman Velazquez, and Representatives Dahlkemper, Schrader, Nye, Clarke, Halvorson; Graves, Bartlett, Luetkemeyer, and Coffman.

The CHAIRMAN. This hearing will come to order. This is a joint hearing of the Committee on Financial Services and the Committee on Small Business. It is an unusual hearing because we are dealing with a subject of unusual importance. As we look at our economy today, no subject is more important and very few are as important as promoting the flow of lending to businesses, particularly small businesses. It is an essential element in unsticking the job situation. We are going to move fairly quickly. Let me just outline the rules here. First of all, we have three panels. And unusually by standards of the Congress, the regulator panel representing the public officials will not be testifying first; they are on the second panel. We didn't want them to state their case and then leave. We wanted people who have questions that we need them to address to speak first and then others who will speak after.

So we have borrowers first, then regulators, and then the lenders. Because there are a large number of members and it is a tough day, we had originally planned to have this hearing on February 11th. The Chair of the Small Business Committee correctly argued for having it on a day when there would be no time pressures on the members. We would be here all day. Unfortunately, we got

snowed out. And given the calendars and coordinating two committees, this is the best we can do.

So we are going to move. We have agreed that there will be 2 hours for each panel and we will keep the opening statements very, very short. You have just heard mine. And with that, I will now call on the gentleman from Missouri, who is the ranking member of the Small Business Committee, and then go to Ms. Velazquez, and then Mr. Bachus when he gets here, if that is okay. So we will do Democrat, Republican, Democrat, Republican. We will go to the gentleman from Missouri, and then we will go to the gentleman from New York.

Mr. GRAVES. Thank you, Mr. Chairman. I would like to thank you and Chairwoman Velazquez for holding this important hearing on the ability of small businesses to obtain needed capital through the commercial and Small Business Administration lending markets. Given the continued economic difficulties, America will be relying on the innovation, agility, and resourcefulness of this country's entrepreneurs to produce goods and services that are going to create jobs and lead to long-term stable economic growth. To accomplish that goal, America's small business owners need capital, whether it is to purchase inventory, fund the purchase of land and buildings or obtain the latest manufacturing equipment. While an Army might march on its stomach, the American economy is going to march on capital. There is no doubt that the current environment for raising capital is difficult even for the largest businesses with AAA credit ratings when they have to compete against the voracious appetite of the most creditworthy borrower in the world and that is the United States Government.

So I can imagine how difficult it is for small businesses to find capital. The Committee on Small Business has held a number of hearings in which entrepreneurs testified about their inability to obtain needed debt capital. Some talked about longstanding credit lines with banks that were reduced or even severed completely with no explanation. Others mentioned that they simply couldn't find any capital at all.

At those same hearings, bankers testified that they had credit available and were willing to lend. They may have been willing to lend, but apparently they were so concerned about the regulators, that they are still keeping their capital. In these situations, the SBA programs are supposed to kick in and help small businesses obtain needed capital. However, even SBA capital access programs have shown significantly reduced lending activity.

Further evidence to inject capital into the credit markets is going to increase the debt ceiling and Federal borrowing just as we have already seen. So making capital available will be of little use if the cost of such capital is so high that prudent small business owners will not take the risk. I am very interested in hearing from all the witnesses today about their ideas for making affordable capital available to America's entrepreneurs. In addition, I would like to hear what regulatory actions are needed that will allow greater capital to small businesses without unduly raising the risks that created the current situation. Again, I would like to thank you and Chairwoman Velazquez for having this hearing.

The CHAIRMAN. Now, we will hear from the gentlewoman from New York, the Chair of the Small Business Committee, who more than anybody else is the motivating force behind our efforts to deal with this bubble.

Chairwoman VELAZQUEZ. Thank you. And thank you, Mr. Frank, for agreeing to hold this joint hearing. Earlier this week, the FDIC reported that last year saw the largest annual decline in lending since the 1940's. Since that crisis hit, Congress and the Administration have taken a series of steps aimed at restarting the small business credit market: the TARP program was passed to shore up banks; TALF was implemented to clear out the secondary market for small business lending; and the Recovery Act raised the guarantee and cut fees for SBA-backed loans. While these steps have helped to spur the rebound, the flow of credit is nowhere near where we need it to be. A recent Federal Reserve survey found that 10.8 percent of banks have cut small business credit lines over the last quarter and SBA-backed lending is still down 30 percent from 2007. Part of the reason that firms continue to struggle to find credit has been that most efforts today focus on getting banks to lend. If we are truly going to open up financing options for small businesses, we need a more balanced approach. That does not mean doing more for financial institutions and expecting the benefits to trickle through to small firms.

Taking $30 billion and simply handing it to banks in the hopes that they will make loans is not sound policy. And allowing lenders to make fewer loans that are bigger is an equally questionable strategy. Until entrepreneurs can go out and find affordable sources of financing, we are not going to see the type of job growth our economy needs. Small businesses are our best job creators, producing 60 percent of new jobs. During economic recoveries, this job-creating potential is even more important. Following the recession of the early 1990's, small businesses created 3.8 million jobs. That outpaced big business job growth by half-a-million jobs. In today's economy, access to capital is nothing less than the opportunity to create jobs and put Americans back to work. For these reasons, as we pursue policies to get credit flowing again, we must get it right.

Our very economic recovery depends on it. It is my hope that today's hearing will take a hard look at proposals that have been floated and help us make wise decisions as we move forward. Thank you, Mr. Frank.

The CHAIRMAN. I thank the chairwoman. And I would urge the Administration—let me just say the jurisdiction over what the Administration is proposing is shared. Some of it goes to the Small Business Committee, and some to the Financial Services Committee. But is my view that it has to be done together. So I urge the Administration to work closely with the Chair of the Small Business Committee in the interest of our being able to get a package together that can go forward. Now, the ranking member of the Financial Services Committee, the gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, I don't have a statement.

The CHAIRMAN. We will then begin with the panel. And I will ask the gentleman from Idaho to introduce our first witness.

Mr. MINNICK. It is my pleasure to introduce one of the largest and most efficient of the real estate developers of residential real

estate in Idaho, Mr. David Turnbull, who is going to talk about the difficulties of obtaining financing in the current market. Mr. Turnbull?

The CHAIRMAN. Please begin, Mr. Turnbull.

STATEMENT OF DAVID W. TURNBULL, BRIGHTON CORPORATION, BOISE, IDAHO

Mr. TURNBULL. Thank you, Chairman Frank, Chairwoman Velazquez, and members of the committees. I appreciate the invitation and the opportunity to testify before you today. I am the president and owner of a diversified real estate development firm headquartered in Boise, Idaho. In addition to our activities in Idaho, we have projects in Wisconsin, Minnesota, Colorado, and Utah. Our real estate development activities span both residential and commercial real estate development, which makes us a little bit unique. Given the nature of our business, I have been a ground zero witness to a series of economic events that have brought the economy of the United States and the world to its knees. I watched the formation of a residential real estate bubble that was inflated by cheap credit, loose and sometimes fraudulent underwriting practices, and certainly inadequate regulation. Much of it was not supported by underlying economic fundamentals and the correction was inevitable. What was avoidable, however, was the depth of the correction and the associated collateral damage. I watched as prominent government officials and economists opined that the residential real estate calamity was contained and would not spill over into the general economy. I shook my head and wondered.

Everything I saw around me was deeply impacted by the housing market. Housing starts in our market have fallen 80 to 85 percent. It is not a recession for us. This is a depression. Unlike housing, we did not witness the formation of a bubble in the commercial real estate markets. The first office lease I did in 1990 was at a rate of $13.50 a square foot; 18 years later, at the peak of the market, we were doing office leases in superior buildings for $18.50 a square foot at the compounded annual increase of just 1.77 percent. Those are not the kind of numbers that suggest a bubble in the commercial real estate market, at least in our markets. As another example, I sold an office building in 2002 for $2.7 million. The replacement cost on that building, even in today's depressed construction markets, would be $2.2 million. That same building went into foreclosure last month and failed to sell at a credit auction, a foreclosure auction for $1 million, the minimum creditors bid.

That is indicative of what can happen in our commercial real estate markets when it becomes an all-cash market where credit isn't available. The values can fall to below replacement cost by 30 to 50 percent. Those are not fundamental business issues. Securitization, in my view, is the most critical component of the secondary or term loan market. It provides for the democratization of credit. Properly structured securitization should reduce risk and thus provide credit at the most reasonable costs possible. While the TALF program has been effective for reconstituting the AVS market for credit card, auto, and other consumer loans, in my view it is ill-suited and ill-structured to resurrect the secondary credit markets for commercial retail.

The TALF requirements are so complex that it is realistically available only to the most sophisticated and elite borrowers. A reconstituted commercial mortgage-backed securities market must have at least four characteristics that were not required under the now defunct system: One, bond issuers, those that are responsible for underwriting and issuing the debt, must retain a significant level of risk to ensure proper underwriting procedures; two, rating agencies must be accountable for the ratings they issue and they should be compensated by the purchaser, not the issuer of the securities; three, servicers must be authorized and given the tools to effectively deal with troubled assets within the security pool; and four, initially, Federal guarantees will be required to stimulate the formation of a functional CNBS market.

Those guarantees can be phased out over time as the private sector gains confidence in the system, the system that was destroyed recently, and replaces the need for Federal participation. I would like you to consider this. Without the existence of Fannie Mae, Freddie Mac, and the FHA, we wouldn't have a housing market today and we wouldn't be in a full blown depression. The only equivalent we have today for these conduits in the commercial real estate market is TALF, which I submit is the equivalent of the Fed creating not just a jumbo, but a super jumbo market for commercial real estate. If we did that in the residential market, we would be leaving the entry level to medium-priced home buyers dangling with no viable options.

TALF, as it is currently structured, will not solve the problem. Too much time has passed without adequate action to resolve this problem. The President, Congress, and regulatory agencies should move expeditiously to pass the necessary legislation and/or regulation needed to reconstitute the commercial mortgage-backed securities markets. Failure to do so will result in further unnecessary devaluation of commercial real estate assets and the associated damage to our economy. I thank the committee for its time and I welcome any questions you might have.

[The prepared statement of Mr. Turnbull can be found on page 307 of the appendix.]

The CHAIRMAN. Thank you, Mr. Turnbull.

Next, we are going to hear from Ms. Margot Dorfman, who is the chief executive officer of the U.S. Women's Chamber of Commerce.

STATEMENT OF MARGOT DORFMAN, CHIEF EXECUTIVE OFFICER, U.S. WOMEN'S CHAMBER OF COMMERCE

Ms. DORFMAN. Chairwoman Velazquez, Chairman Frank, Ranking Members Graves and Bachus, and members of the committees, I thank you for this opportunity to be here today. I am representing today the 500,000 members of the U.S. Women's Chamber of Commerce. Simply stated, the status of the small business lending is so devastatingly poor that many business owners have given up even trying to secure capital and credit for their businesses. Our members tell us regardless of their personal credit scores, proven business and financial track records, and contracts in hand, their access to capital and credit has become severely limited and the fees and interest rates on their existing loans have risen to loan shark levels.

The consequences of this sudden and now extended contraction in access to capital and credit have had a devastating effect on small businesses. Over the last 2 years, small business losses accounted for 40 percent of the 4.7 million positions cut by firms. The results of a recent survey of our members have provided us with a clear picture of the small business lending marketplace.

The smallest businesses have either been wiped out or are struggling every day to stay in business. Businesses in the $250,000 to $500,000 range have weathered the storm so far and are seeking access to capital to fuel growth. Firms in this range tell us they could grow now and add jobs if they could only access the capital and credit they needed. Many of the businesses in the $500,000 to $1 million dollar range have significant overhead, equipment and raw materials that make growth right now very challenging. And with little or no access to capital, they have no way to leverage their assets to fuel growth.

And firms with over $1 million in revenues have a more diversified set of capital and credit providers, but they tell us they have very little appetite for growth due to the exorbitant fees, interest rates, and uncertainty. Nearly all businesses tell us that consumer confidence is extremely poor and that increased consumer confidence would fuel their business growth.

They also tell us it is important to complete the reform of our health care system and financial market regulations and create a strong consumer financial protection agency so that they will have a clear picture of the future and can plan with confidence. U.S. banks report the sharpest decline in lending since 1942, and another troubling trend is the extreme contraction in SBA-backed lending to women- and minority-owned firms.

Between 2008 and 2009, the percentage of SBA-backed loans going to women-owned firms dropped from 23 percent to 20 percent and the total dollars lent dropped from 18 percent to 6 percent. During the same period of time, the percentage of SBA-backed loans going to minority-owned firms dropped from 33 percent to 22 percent. And the total dollars lent dropped from 32 percent to only 4 percent. The job creation legislation recently passed in the Senate falls woefully short in addressing the size and scope of our problems. The recent FDIC comments on meeting the credit needs of creditworthy small businesses do nothing to change the basic problem. And the President's proposal to distribute $30 billion of TARP funds to local and community banks is simply more of the same.

Clearly, this action would once again benefit the banks with no guarantees of assistance to small business owners. Treasury Secretary Geithner has said these funds should be removed from the TARP program. He says TARP has outlived its basic usefulness because banks are worried about the stigma of coming to TARP and they are frankly worried about the conditions.

Additionally, he said 600 small banks withdrew their applications for TARP money because they did not want to face the restrictions or the perception that they needed the bailout money. Specifically, we recommend: increasing SBA lending guarantees to 90 percent; focusing on 2 sectors with the greatest urgent need, loans under $200,000 and loans in the $200,000 to $500,000 range; and establishing a direct lending program through the SBA allow-

ing the sale back of loans to private sector investors and lenders after a period of time. We strongly encourage Congress to respond with larger-scale solutions to improve the opportunity of businesses to secure capital and credit, to help stabilize costs, to convert expensive debt into fixed-term loans and to assess their current financial condition to make good choices for the future.

Strength, transparency, access to capital, and protection from abuse are vitally important so that our economy may be revitalized, our small businesses brought back to life, and jobs created. Thank you.

[The prepared statement of Ms. Dorfman can be found on page 156 of the appendix.]

The CHAIRMAN. Thank you. Next, Mr. Steve Gordon, who is president of Instant Off, Incorporated.

STATEMENT OF STEVE GORDON, PRESIDENT, INSTANT-OFF, INC.

Mr. GORDON. Madam Chairwoman, Mr. Chairman, and distinguished members of the committees, thank you for inviting me to Washington to testify this morning. My name is Steve Gordon, and I am from Clearwater, Florida. I am honored to be here and to deliver this testimony before the people's Congress. I am here as the voice of regular small business owners who have historically been the largest creator of jobs in our country. We are frustrated with the inability to obtain financing to create critically needed jobs. Jobs can only be created with capital. And the bailed-out banks are not helping the situation.

In spite of the taxpayers' generosity, 2009 saw the sharpest decline in lending since 1942. Further compounding the problem, banks are taking away existing credit lines. While this may be a prudent act of self-preservation, credit reductions lower your credit score, giving the banks a convenient reason to increase your rates. Consider my story. I am the owner of a small business called INSTANT-OFF. We manufacture water saving devices that fit on any faucet and save up to 10,000 gallons of water a year. Instant-Off costs less than $10 and we have sold over 800,000 units. Our U.S. market potential is 50 million units and globally around 200 million units. We can create 25 jobs right now and 75 more over the next 3 years.

As we grow, 25 percent of our employers will be people with disabilities. And we challenge other companies to match this commitment. In addition, we will create jobs for suppliers and distributors. We are ready to move forward and implement our marketing plan, but none of this will happen without the necessary capital. American innovation is what made this country an economic leader. People with innovative ideas grow them at a huge personal expense in pursuit of the American dream. Yet when the time is right to grow beyond their individual means, this creative endeavor is often not judged for its business plan or proven success, not on its management team or what it can do for the country, not on what it can do for the environment, not for the jobs it will create, and for the potential increase in export sales.

It all comes down to your credit score. The current lending model does not work in today's post-crash economy. If we depend on

banks to make business loan decisions, we are in for a long, painful recession. Banks can't even figure out how to solve their foreclosure problem. At this point, we must change our strategy. The government must take responsibility and solve the capital crisis.

Congress lent directly to the banks, directly to the auto makers, and directly to AIG. It is time for a similar program for small businesses. I propose that Congress pass legislation to make the SBA a direct lender to small businesses. Any money approved for small business loans should be kept in a separate account. The American people do not want to give any more money to the banks. The real estate crash, the recession and the banks have lowered credit scores on most Americans. In order to create the amount of jobs we need, credit scores cannot be used as the sole factor in obtaining business loans.

I am proposing a 15-point lending criteria to serve as a guide in evaluating and determining small business loan approval. Some of the key determining criteria are: How many new jobs will the loan create; how many jobs will be created for disabled Americans; will this business help protect the environment or conserve natural resources; will the product or service be produced in the United States and can it be exported; and has the applicant's credit score been damaged by the recent economic downturn?

Again, I urge Congress to pass legislation to make the SBA a direct lender. Capital is the tool that drives American business and we need your help. Please move quickly to resolve this critical issue. And now a brief message from the American people. Congress needs to put an end to its partisan behavior. It is time to drop the "I win, you lose" mentality and find compromises. In the business world, we get things approved with a majority vote. As a reminder, there is no "R" or "D" or "I" in "team." The Americans have been so proud of the Olympic team, Team U.S.A.

The American people request that "team Congress" pick up the pace and immediately take action to solve the job crisis. And, please, pass health care reform for the 45 million Americans who do not have health insurance. Thank you for giving me the opportunity to be heard on these very important issues.

[The prepared statement of Mr. Gordon can be found on page 203 of the appendix.]

The CHAIRMAN. Next, Mr. Todd Zywicki, foundation professor of law, George Mason University.

STATEMENT OF TODD J. ZYWICKI, FOUNDATION PROFESSOR OF LAW, GEORGE MASON UNIVERSITY

Mr. ZYWICKI. Thank you, Mr. Chairman. It is my pleasure to testify today on the subject of the "Condition of Small Business and Commercial Real Estate Lending in Local Markets." As noted in a recent study by former Federal Reserve economist Thomas Durkin, and as he reminds us, many independent entrepreneurial businesses rely on what is conventionally known as consumer credit in starting to build their businesses, things like credit cards, home equity loans, and even auto title loans. These sources of credit are especially important for women and minorities who tend to be excluded from traditional small business lending markets. As a result, a lot of regulations that seem to be ostensibly aimed at con-

sumer lending will also tend to disrupt effectively small business lending as well. Prudent, well-designed government regulation of consumer and small business lending can certainly promote competition, expand consumer choice, and lead to lower choices and overall productive lending. For instance, the original Truth in Lending Act, as it was originally conceived before it got larded up with a lot of regulation and litigation, provides a good example.

But well-intentioned lending regulations may also have a large number of unintended consequences as well. And most relevant to this hearing, one of those unintended consequences is the curtailment of lending, especially to consumers and small entrepreneurial businesses. Unintended consequences are most likely and most severe when legislation and regulation goes beyond the modest goals of improving the market process but instead supplants individual choice and competition through the substantive regulation of particular terms of credit contracts.

It is basic economics that in order to make an economically prudent loan, a bank has two considerations: First, it must be able to estimate the risk of the loan and price the loan accordingly. Regulations that either increase the risk of lending or make it more difficult to accurately price risk will make this task more difficult and expensive.

Second, if the bank is unable to accurately price the loan, it will have to reduce its risk exposure. It can do this either by limiting the number of loans it makes, limiting those to whom it will lend, lending for instance to only lower-risk borrowers or by reducing the amount it lends such as by reducing the size of loans made or credit lines on credit cards. Provisions in recent legislation that has been enacted, such as the Credit CARD Act, have made it more difficult for credit card issuers to price risk efficiently. The consequences of something like the Credit CARD Act have been predictable; in fact, I predicted them.

Credit card issuers have tried to adjust other terms of credit card agreements in order to try pricing risk efficiently and to the extent they have been unable to do so, they have acted to reduce their risk exposure by offering fewer loans, lending to fewer people and reducing borrowers' credit lines. If enacted, proposed legislation such as the proposal for a national interest rate ceiling on credit cards of 6 percent, the proposed consumer financial protection agencies, and the proposal to permit cram down of home mortgages would further exacerbate this credit crunch by further increasing the risk of lending, and make it more difficult to price risk, resulting in a greater curtailment of lending.

Let us talk about the Credit CARD Act for a moment. The Credit CARD Act had some modestly decent proposals in it that may have helped consumers a little bit. On the other hand, there are other provisions of the law that interfered with accurate risk-based pricing, such as new limitations on interest rate adjustments, default provisions and that sort of thing. The market response to the CARD Act illustrates how regulation can disrupt lending markets by interfering with efficient risk-based pricing. Consider just a few of the terms of the credit card. Interest rates, penalty interest rates, annual fees, length of grace payments, the amount of circumstances under which behavior-based fees will be assessed, the

degree of acceptance by merchants—I could go on, but I only have 5 minutes.

I would guesstimate, what, 60, 70, 80 terms have potential for a credit card. The CARD Act placed political limitations on the ability of lenders and borrowers to establish these terms through free-market processes. In order to try to price risk accurately and offset declining revenues from newly regulated credit card terms, credit card issuers have repriced other terms of credit card agreements. As a result, borrowers have seen newer increased annual fees, fixed-rate interest cards have been converted to variable rate cards, frequent flyer and other rewards cards have become stingier, and other fees such as cash advance fees have risen. Most notably, some provisions of the CARD Act make it more difficult for card issuers to raise rates on consumers based on risk and changes in economic circumstances.

Again, the market response has been entirely predictable. Credit card issuers have had to raise interest rates on all cardholders in order to guard against the risk they might need to raise risks later but might be unable to do so as a result of regulation. Most relevant for this hearing, there have been widespread reports that as a result of the CARD Act, credit card issuers have slashed credit lines and cancelled credit lines. Although this reflects many different factors, in part, it reflects the effect of the CARD Act. Thank you.

[The prepared statement of Professor Zywicki can be found on page 322 of the appendix.]

The CHAIRMAN. And I now recognize the gentleman from Michigan, Mr. Peters, to introduce the last witness.

Mr. PETERS. Thank you, Mr. Chairman. We are joined today by a gentleman from Michigan, Mr. Wes Smith, who is representing small manufacturers. As members of both committees know, many small businesses have been impacted by this credit crunch, but it has been particularly acute for our small manufacturers. As a result of this credit crisis, we are continuing to see that happen. Mr. Smith is the owner of E&E Manufacturing Company. He is also a member of the board of a community bank. He brings a unique perspective. He has a company that employs 250 employees and is located both in Michigan and in Tennessee. Thank you, Mr. Smith.

The CHAIRMAN. Mr. Smith?

STATEMENT OF WES SMITH, PRESIDENT, E&E MANUFACTURING, PLYMOUTH, MICHIGAN, ON BEHALF OF THE MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION (MEMA)

Mr. SMITH. Thank you. Again, my name is Wes Smith, and I am the president and owner of E&E Manufacturing. I also serve on the board of a small community bank, so I can bring a unique perspective from both the borrower and the lender. First and foremost, though, I have been a manufacturer for 45 years and appreciate the opportunity to discuss the challenges that small manufacturers in the motor vehicle industry face. My company, E&E Manufacturing, is one of those suppliers located in Plymouth, Michigan, and Athens, Tennessee. My father began the business in 1962. It has since grown its footprint from a small 5,000 square foot job shop

to an over 400,000 square foot world class, full service supplier of highly engineered stamped metal solutions. We were the first metal stamping facility in the Nation to be awarded the star award from OSHA for our outstanding safety program and are determined to continue to provide safe and meaningful employment to our now over 250 employees.

While our current sales projection for 2010 is up over 20 percent of what we achieved last year, it remains only 55 percent of what we enjoyed in 2007. And I can tell you no one was happier to close the book on 2009 than me. Although we were able to turn things around the last half of the year, E&E took a pounding in the first 7 months and we will record a loss for the first time in 40 years. We project that our sales next year could allow us to rehire almost 200 people.

However, access to capital to fund these sales projections could stunt our growth. Just recently, our lender reduced our line of credit to an insufficient amount and changed our loan covenants. Many banks are clearly avoiding manufacturers, especially in the automotive industry, as they aim to reduce their exposure to temporarily impaired companies in a struggling industry. Most small manufacturers enjoy a long history with their lenders, in many cases having successfully worked together for decades. My personal opinion of that and many in our industry is that lenders are under such intense pressure from Federal regulators that they went from one extreme, flooding the market with too many substandard loans, to almost completely closing the faucet. I urge Washington policymakers to work with lenders and borrowers to reach a delicate balance needed to help restore manufacturing in America and stimulate job growth. I don't believe the regulators should ease their standards and oversight of lenders.

I do, however, believe that Congress and the agencies can develop a unique set of guidelines to govern loans to small businesses in a pooler program. This will allow banks to feel comfortable lending to manufacturers while establishing set compliance rules. I applaud the committees on Capitol Hill for holding these hearings and the various proposals from the White House and leaders in Congress are encouraging. It is up to Washington to help create an environment whereby small manufacturers like ourselves can access adequate and timely credit and the lenders can conduct sound transactions without fear of government reprisal. Injecting capital into the market is only one part of the equation.

Banks and borrowers need guidance from Washington to strengthen oversight without stifling economic growth. According to the indication administration, small companies comprise over 98 percent of manufacturing firms in the United States, yet we are often an overlooked segment of our industry. For example, the auto industry is one of the most intricate industrial complexes and one side is the vehicle manufacturer, a dozen or so major original equipment manufacturers that dominate world production, have sales measuring from the tens to hundreds of billions of dollars. On the other side is a dozen or so major material suppliers, the steel, aluminum, and plastic providers that too have sales measured in the tens of billions. Caught in between are some 3,000 suppliers

that produce the over 10,000 parts necessary to make up every passenger car and truck.

Because of drastically reduced volumes and nonfunctional capital markets, financial assistance to suppliers has not provided small manufacturers with the capital and resources to survive. Banks, most with diminished capital positions, are generally not in a position to increase their loan portfolios regardless of the enhanced collateral positions. However, this committee has before it two interesting proposals that collectively will go a long way in addressing the challenges faced by small manufacturers.

H.R. 4629, the Manufacturing Modernization and Diversification Act, and the proposed small business lending fund, taken together are significant and essential steps forward. We will be pleased to work with committee members on the initiatives and legislation laid out in my written statement and I would like to thank you for your time and efforts for making the millions of American manufacturing voices heard. I only hope my message is understood and acted upon before it is too late. Thank you.

[The prepared statement of Mr. Smith can be found on page 271 of the appendix.]

The CHAIRMAN. At this point, I want to ask unanimous consent to introduce into the record a package of materials that were submitted to members, to Mr. Bachus, to Mr. Childers and myself, Mr. Hinojosa, Mr. Kanjorski, Mr. Klein, Mrs. Maloney, Mr. Miller of North Carolina, Mr. Neugebauer, Mr. Perlmutter, Mr. Peters, and Mr. McCarthy of California. These have been looked at by all sides. Is there any objection? If not, they will be put in the record. If there are other documents that members would like to submit—does the gentlewoman from Illinois have a document that she wants in the record? That will be included as well.

Next, as we go to the questioning, we have a large number of members of the panel. What I plan to do on the Democratic side on the Financial Services Committee, of which I can only speak for that, is to give members the choice of which panel they want to talk to. As we get to the member, if you would prefer to defer and ask your questions of a later panel, that would be acceptable. So I am going to do that myself. I am going to save my questions for the regulators and I will, therefore, not be asking questions of this panel. And so I will now—the gentleman from Alabama—and I would say the Democratic members on the Financial Services Committee, if you want to ask this panel, fine. If you would rather defer, you can defer. There is no guarantee we will get to everybody anyway.

Mr. BACHUS. Mr. Chairman, let me get a point of clarification. Can we ask this panel a question and the next panel a question?

The CHAIRMAN. In terms of recognizing Republican members, you can do pretty much what you want.

Mr. BACHUS. I think we will just let everybody—

The CHAIRMAN. Yes, go ahead.

Mr. BACHUS. Ms. Dorfman, your testimony is similar to Mr. Gordon's, and I think part of that testimony is that the SBA should just lend money directly; in other words, bypass the banks. Is that what I am hearing, Ms. Dorfman?

Ms. DORFMAN. Yes. What we find is the banks have not been lending and the best way to get the money into small businesses would be to provide a direct lending program through the SBA so that the small businesses actually access those funds.

Mr. BACHUS. Mr. Gordon, is that—

Mr. GORDON. What I propose—and this is the problem in banking today. You go in for a loan, you deal with a bank officer, he has no idea what you do as a manufacturer. At the SBA, there are so many smart people there. If you just set up a task force for jobs in the SBA and you had 3-member panel, one from a hired—a score member and, two, from an SBA person, they could review and call in and in 30 minutes they could decide if it is a good loan or not.

Mr. BACHUS. What I am saying is, you want the SBA to sort of—

Mr. GORDON. I want the business to be back in business loans. That is the whole point.

Mr. BACHUS. I understand your goal is to create jobs and get lending going. But what I am saying, I think essentially, you want the SBA to come in and loan additional amounts of money because the banks aren't doing it, is that—

Mr. GORDON. Because they are not doing it, because they don't understand business. It is a big problem. Banks do not understand business.

Mr. BACHUS. I understand that.

Mr. GORDON. But that is true. I want the SBA to work on it directly.

Mr. BACHUS. I understand what you are saying. Do you believe that the SBA is as qualified as the banks to make decisions on lending and creditworthiness?

Mr. GORDON. No, I don't. I think they are more qualified. Much more qualified.

Mr. BACHUS. Ms. Dorfman, do you believe that the SBA would make much better decisions as to lending?

Mr. GORDON. I think that if you—first of all, we have such a huge problem out there, we would have to—

Mr. BACHUS. I understand there is a huge problem. I just want to focus on which one is better qualified.

Mr. GORDON. I think we need expanded criteria and the SBA is more qualified to deal with business loans.

Mr. BACHUS. How about it, Ms. Dorfman?

Ms. DORFMAN. I would say what we have seen not just from the economic turndown, but from years prior, is that the banks typically go cherry-picking. They will take the best looking loans. It costs them the same to do a loan for $75,000 as it does $10 million. So in order to move forward, if we take the money and put it to the SBA to allow them to lend—and would we have to put in the program that would help them determine, yes. I think they can do it.

Mr. BACHUS. I understand. So you want the SBA to basically play the role that the banks have, as you say, "not played by not lending?"

Ms. DORFMAN. I would like the SBA to have a direct lending program to small business.

Mr. BACHUS. How big would the two of you visualize that program being to do any good?

Ms. DORFMAN. Well, if we can take the funds that the President was going to give the banks and just turn them over to the SBA—

Mr. BACHUS. All right.

Ms. DORFMAN. —that is a drop in the bucket really.

Mr. BACHUS. $30 billion?

Ms. DORFMAN. Yes.

Mr. BACHUS. Mr. Gordon?

Mr. GORDON. To put it in perspective, $30 billion is 3 percent of the original money for the first stimulus package. So the goal here is to take 3 percent of the money and create 75 percent of the jobs that we need. And it is just not enough; $30 billion is not enough. We would like to start there, but it is just not enough.

Mr. BACHUS. Let me ask you this: If the loans aren't paid back, who is ultimately responsible, from your understanding? Is it the taxpayer?

Ms. DORFMAN. Well, at this rate, there are few default—when you take a look overall of what the SBA lending has done, there is a relatively low default system. What we have seen with the banks—

Mr. BACHUS. No. I understand. But if the loan is not paid back, who—

Ms. DORFMAN. It would be absorbed, of course, by the SBA because we have—

Mr. BACHUS. And where does the SBA get its—

Ms. DORFMAN. We understand that it is taxpayers, but this is an investment in the U.S. economy. It is small business—

Mr. BACHUS. I understand. I am not arguing with you. But it is the taxpayer who ultimately is on the hook if it is not paid back?

Ms. DORFMAN. Correct.

Mr. BACHUS. Mr. Gordon, is that your understanding?

Mr. GORDON. That is exactly right. Right now, the SBA guarantees 90 percent of the loan anyway. So they are guaranteeing 90 percent of something that is not getting done. The other alternative is to continue paying unemployment compensation. There is a 100 percent chance—it needs to be looked at because—

Mr. BACHUS. Let me ask you one other question if I can. Are you all aware we are spending so much we are going to double the national debt in 5 years and triple it in 10 years? Does that bother you? Is that a concern?

Mr. GORDON. Okay. What we are doing here is we are investing in businesses to create jobs for people.

Mr. BACHUS. I understand. I am not asking you that.

Mr. GORDON. It is a very important issue because if you don't understand why we need to make loans, and that is what the banks don't understand, the banks would move quicker if they were paying the weekly check for unemployment. But since they have no expense and the weekly check, they don't.

The CHAIRMAN. The gentleman's time has expired.

Chairwoman VELAZQUEZ. Yes. Ms. Dorfman, as has been discussed, the Administration has proposed the liquidation of the $30 billion fund. And if this proposal moves forward, do you believe there should be penalties for lenders who receive money but do not make loans to small businesses?

Ms. DORFMAN. I absolutely do and I would also like to see some sort of penalty for the banks who are now "providing SBA loans" that are not. What we have seen is that a small business will go in, ask to get a business loan or an SBA loan. They are told they are not to giving them, but what they can do, they are pointed to the higher interest rate credits.

Chairwoman VELAZQUEZ. So your opinion is clear that if this money is supposed to help small business access affordable credit, the banks that take this money should use it to lend to small businesses. Do you believe that there should be a penalty for lenders who use the funds solely to increase profit margins on loans that they would have made anyway?

Ms. DORFMAN. Absolutely, yes.

Chairwoman VELAZQUEZ. And, Mr. Gordon, in the last year, we have seen the government bail out AIG, give lines of credit to GM and Chrysler, and provide capital infusions to our Nation's largest banks, including Goldman Sachs. Now, the Administration is proposing to cut another $30 billion check for banks under the premise that it will trickle down to firms like your own. Do you believe that any of this $30 billion will reach businesses like yours?

Mr. GORDON. Absolutely not. And this is what really bothers Americans. I don't understand, and neither do millions of Americans. Why can't Congress just cut through all of this stuff and work direct? Why in the world would you want to give money to the banks and hope they can do something? Why not just take that $30 billion and put it in an account and have it under government management so that 100 percent of those funds are used for loans?

Why would you give money to banks and hope that they are going to do something when they have proven we don't need more branch signs, we don't need more branches, we don't need more chairs. We want loans and we want—if you are only giving us $30 billion, then we want 100 percent of that money to go to loans. We want that money in a separate account.

Chairwoman VELAZQUEZ. [presiding] Thank you. Mr. Bartlett?

Mr. BARTLETT. Thank you very much. I am pleased to be here. I have a couple of questions. In a former life, I was in small business, and for 12 years, my wife and I every Wednesday met a payroll for a land development and home construction company. So I have been there. I know that the way banks make money is to loan money, and I would think that banks would be anxious to loan money.

I am having some trouble understanding if there are creditable small businesses out there that want to borrow money, why banks aren't loaning money to them. I know they are gun shy, but they have been in this business for a very long time. I am surprised that they aren't devising means of determining whether or not the applicant is creditable so that he is a good risk for a loan.

And I am wondering why they haven't done this. I am very suspicious that the government does not a better job than banks in making these assessments. A second question I have of Ms. Dorfman is, you mentioned that for existing businesses, fees and interest on present loans have risen to loan shark levels. I don't go to Las Vegas and I don't play Russian roulette and I don't understand why a business would have opened themselves up to a vari-

able rate interest loan. Apparently, that is what happened. That is really a gamble if you are a business, to open yourself up to all of the potential problems of a variable interest rate loan. What percent of the loans of our small business community are these variable rate interest loans so that the fees and interest rate can go up?

Ms. DORFMAN. I don't have an exact rate, but what I do know is that we have heard from our members that what has happened is they have gone to apply for a loan because they need to grow their business, but what they are provided with is an alternative lending instrument with high interest fees and they are forced to take it because the economy has had a downturn and that is their only opportunity to either make ends meet or get to the next level.

Mr. BARTLETT. So these aren't really interests and fees on existing loans, that if they want to increase their existing loans, they have to pay higher fees and interest. Is that what you are saying?

Ms. DORFMAN. It really depends on the instrument. There are some loans obviously that are fixed rates and then there are others that are not. And those are the ones that have grown.

Mr. BARTLETT. Thank you very much, Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman from Georgia, who is on both committees, but still only gets 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. I appreciate it. I cannot think of a more important hearing if we want to do something about the jobless rate and the high unemployment because small business is an incubator of our jobs. It creates more jobs than any other level of industry. That is where the jobs come from. But I want to deal with each of you and see if we can't get to the bottom of this. We have a problem here with the core of our financial system and that is—that has been the history of this for the last couple of years. We have been grappling with this financial problem. And that is the failure of the banking system to do its job. That is heart of our financial system. That is the heart pump that pumps the blood out, that pumps it all out. So I want to ask of you, why is it, in your opinion, that the banks don't want to lend money?

Even in the very beginning, one of the reasons we had a problem with the automobile industry was the fact that the poor dealers couldn't get loans. They have been here before you with the same problem. Now we have $30 billion that is set aside here and I would like to get each of your understandings of how this works and particularly, is it your understanding that even if the banks, these small banks that we are going to set this money up for, even come and get some of this money, there is no definitive requirement that they even lend it. The only incentive, it seems to me, for them to lend it is they will get some kind of benefit on a sliding scale.

So, Ms. Dorfman, let me start with you, because I think your testimony and Mr. Gordon's testimony really hit this issue. What is stopping the banks from lending the money and what is wrong with the program of the $30 billion that we have set up there? Your fear that that it will not be lent out?

Ms. DORFMAN. I see two different challenges, sir. The pre-economic challenge where the banks were only doing the cherry-picking in lending—if you want $10 million, we will consider you; if you want $75,000, forget it, it costs too much. The second thing that I see is that once the economic downturn happened, then the banks claimed they have trouble, they need our money. But what they did was balance their books and then also paid the executives the bonuses, but they were not lending.

So the money is still not there. What we are hoping with the direct lending program is that instead of having to deal with whether a bank will or won't lend through the SBA, that we will get the loans out there. Once the administrative costs will be picked up from the SBA side, once they are out there and in a good payment cycle, then perhaps we can sell them off to the banks and then continue to work with the other new lenders.

Mr. SCOTT. Let me ask you this, Ms. Dorfman. Do you know that if we were to raise the level for credit unions from their present 12.5 percent and raise that cap to 25 percent, that might be helpful, that might give some competition to these banks, that might get them to act straight more and that would access more capital to small businesses if we allowed—would credit unions be a help on that?

Ms. DORFMAN. They could be, but once again, do we know that the money is going to truly be lent? And I think what we are concerned about is, are we going to repeat the past, giving money to banks and seeing it not getting out to small businesses? And I also have to say that we have heard a lot from this Administration about the small businesses being the answer to the growth of our economy. We need now to have the money where the mouth is. Put the money at the SBA. Get the money into the pockets of small businesses so we can grow those business, we can create jobs, and we can turn the economy around.

Mr. SCOTT. So you are saying, rather than take this $30 billion and getting it to the banks as an administration of what we are proposing, that we should instead get it in through the SBA?

Ms. DORFMAN. Correct, as a direct lending program.

Mr. SCOTT. I see. Is that your assessment, too, Mr. Gordon?

Mr. GORDON. I think to understand where the problem is, you need to understand where the banks came from. Before the crash, they were totally focused—they weren't doing a lot of business loans anyway. So before the crash, they were focused on mortgage loans. It is really easy to send an appraiser out to a property, find out what the value is, and make a loan decision. It is much more difficult to have the time and the resources to evaluate someone's product potential. If I came to a bank and showed them my business plan, they would say, who is going to review that? They don't have the people qualified to review business plans. They are not set up to do it. You are asking banks to do something they don't feel comfortable with. And that is the problem.

The CHAIRMAN. Thank you. Time has expired. Let me invite the people standing to take these seats. Somebody put things on there that say don't sit here, but I say ignore them. So, please. What happens is, the first row is set aside for people who staff the Federal regulators, none of whom are not allowed to go out without

three people to make sure they don't say what they are not supposed to say. But the current people don't need that. So please feel free—if there is an empty seat, sit in it. I don't like people to have to stand up. With that, I guess—who is—we go to the small business—we did? I apologize. Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I want to thank you, witnesses, for sharing your perspectives. There are many factors impacting lending, but I think one of the biggest issues is the uncertainty created by the government. Small businesses are uncertain about the cost Congress may add on to them and the taxes that they will have to pay and the lenders are uncertain about the changing regulatory environment. I just spent 2 weeks in my congressional district, and over the last 2 months, I have been talking to lenders and have been talking to small businesses and touring a number of those businesses and asking them what they feel like the state of play is. And quite honestly, I hear more about what Congress is doing than what the banks are or are not doing and what the SBA is doing or not doing. I was in a business last week, and they said, "Congressman, we don't know what to do. We are concerned that the government is about to put these new burdens for health insurance, they are going to raise our taxes, the cap and trade or cap and tax bill that may increase our cost of energy in this particular business that uses a tremendous amount of energy, that the huge deficits that are being incurred and how we are going to begin to pay that back and what will be in the environment, the inflationary potential of the Fed monetizing debt."

The list went on and on and on. And when I sat down and talked to bankers, I said, "Tell me why you are not lending." They said, "Randy, we would love to make some loans right now. But quite honestly, our good customers are not coming and asking us for loans right now because of overall uncertainty, and when they do come, the amount of paperwork and regulatory environment is terrible."

Several banks in my district said that they were having problems making home loans and real estate loans to the people in their small communities because of some of the new regulations that are out there, particularly for example, requiring escrow accounts where these little community banks have been making these home loans in their communities for hundreds of years or many years and now have these new requirements.

I want to read you some of the comments that I entered in the record here as the chairman said. This is from a community bank in Abilene: "The increased regulation proposed by Congress and various Federal agencies will continue to make our jobs more challenging and costly. Our hope is that Congress will stop much of this pending regulatory legislation and realize that community banks have not caused today's economic problems and already are overregulated."

From a small business in Abilene, Texas, "With Congress and the Executive Branch planning so many changes that add both uncertainty and decisions and certainty in higher taxes to pay for everything, small business have no choice but the wait-and-see approach to any future growth."

From a community bank in Hereford, Texas, "Those asking why we are having a trouble making loans should get a mirror and understand that it is not that we are not making loans, but we are being driven out of making loans by those who are asking us to make loans."

From a mortgage lender in Abilene, "Is the answer more regulation, more government involvement, more oversight? I tell you it is not. We are here today because our government started manipulating the industry, and the industry quite honestly does not understand. I suggest that free enterprise be allowed to work to bring us out of this financial mess."

And finally, a community bank in Plainview, Texas, "Community banks want to lend. That is how we serve our communities. Increase our capital for growth is what we do. Given the present uncertainty in the economic and political climate, banks are understandably anxious regarding extensions of new credit."

And so I think one of the things that I have been saying is that the best thing that we can do for the economy, the best thing we can do for the American people, the best thing we can do to get this economy going again is quite honestly for the government just to stop all of this nonsense that we have been about. We are creating a huge amount of uncertainty. I am a former businessman. I am a former land developer. And when I look at the environment today of the uncertainty that is created out there, I am not sure I would be out looking for new deals right now.

So I think I am listening to the people in the 19th Congressional District and I think they speak for quite honestly people all across America as they just wish the government would stop it, they wish the Congress would quit trying to micromanage our financial markets and quit this silly stimulus program that we are doing where we are trying to borrow and spend our way into prosperity.

Quite honestly, how we got here was borrowing and spending and a lot of people borrowed and spent too much money and now they are having to pay it back. Some can't pay it back and that has certainly created a great deal of uncertainty in our marketplace.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Michigan.

Mr. PETERS. Thank you, Mr. Chairman. I want to talk to you a little bit about manufacturing here and also build on the previous comments. We have a situation, Mr. Smith, in the manufacturing sector of auto suppliers where we are seeing increasing orders coming in and yet the working capital is not available to ramp up the production necessary in order to meet those orders. So it is a situation where there really is a dysfunctional capital market system here when you have orders coming in, you can hire people, move forward, but the capital isn't there. Perhaps—I know you talked about that in your written testimony. If you could elaborate a little bit more about the challenges of manufacturing, where you are right now, why credit is going to limit your ability to create jobs even though these orders are coming in right now.

And also you talk about the collateral support program and why that is a way to have direct help to you through the banking industry. I know you referenced the Manufacturing Modernization and Diversification Act, which I appreciate, which Mr. Dingell, Mr.

Levin, and members of this committee—Mr. Frank, Dennis Moore, Mr. Kanjorski, and others—have endorsed. If you could kind of flesh some of that out for us, I would appreciate it.

Mr. SMITH. Sure, absolutely. I would have to disagree with what has been said before about the President's plan on injecting $30 billion of capital into the banking industry. I think it is absolutely what is necessary. You know, when I sit on a board of a community bank, I think our situation in manufacturing is really simple. We have a top line situation; we need more sales. I don't know what the banks are going to do. And again what has been said is that the small community banks did not create this issue.

In our particular area, I ran a pure bank report for banks under $5 billion in assets, and this is Genesee, Kent, Livingston, Oakland, Ottawa, Wayne, Macomb, and Washington Counties. And of these, the total capital ratio, the aggregate average capital ratio is 7.7 percent. Well, the FDIC says in its public cease-and-desist order that you require a minimum capital ratio of 8 percent. So what has to happen is that these banks need to raise $45 million in capital before they can make one loan. The real issue is that the banks can't make loans because the regulators have their foot on their necks. They cannot function. I mean the only way that in order to make your capital ratios where they need to be is either you need more capital, and if you don't have access to capital through a program such as what is being proposed, is to shrink the size of your bank. And how you shrink the size of your bank is you just simply don't make loans. That is clearly on the community bank that I am on the board with, that is what we do. We absolutely just don't make loans. We have to shrink the size of our balance sheet.

So if you are a manufacturer or a small businessman, where do you go? So it is a really a twofold process. Number one is the banks have to have the ability to make loans, and this $30 billion, and if you use a typical 10 to 1 ratio for banks, is that $30 billion then becomes 300—you know, 10 times that, which is going to be available for loans that could be created throughout our entire economic—you know, the portfolio that we have, particularly in manufacturing.

The other situation we have is that as companies ourselves, we need to take a look at our deteriorated balance sheets, and that is because banks are under pressure from the regulators, and everything has to be reappraised. So I can tell you that many of my peers have had regulators come in, take a look at their balance sheet, and reappraise all their assets. And all of a sudden, they find that they are taking a third hit to their balance sheet and they don't have the ability to make the loan.

So having a program where your collateral is guaranteed by the government, such as the bill that is being proposed, is absolutely the other part of the step. It is really a two-step process: the banks have to be able to make money; and they have to have their capital ratios restored. The $30 billion is an excellent program. I can tell you for the community bank, it can't come fast enough. And the rules and how this gets disbursed if it is to be disbursed aren't really clear.

In terms of manufacturers, we need to have our collateral positions guaranteed because we have taken such a hit.

Chairwoman VELAZQUEZ. [presiding] Mr. Graves?

Mr. PETERS. Also, I have been hearing from our other suppliers that they have had lines of credit pulled or new loans denied, not because of underwriting concerns, or necessarily risky investments but just because the bank is overexposed to the auto sector.

Has your board position on the Equipment Manufacturers Association, can you tell us a little bit about that?

Mr. SMITH. Absolutely. You know you are almost better off being a really lousy customer to the banks because they can't get rid of you, but if you are marketable, if you are bankable, you are really in jeopardy. So it is almost really worse if you are in better financial shape than worse financial shape.

Chairwoman VELAZQUEZ. Five minutes has expired. Mr. Graves?

Mr. GRAVES. Thank you, Madam Chairwoman. Really quick and then I am going to yield back. Mr. Gordon, you said that if you put together a business plan and take it to a bank, there is nobody there who is qualified to look at it?

Mr. GORDON. There are people there, but what Congress needs to understand is we are in a crisis. We haven't had business loans and liquidity for 3 years. This isn't like a future problem that we are talking about. We are talking about how to solve this problem. Right now, there are businesses going out of business.

Mr. GRAVES. If you put the Federal Government in charge of direct lending, do you think there is going to be anybody in the Federal Government qualified to look at a business plan and make a decision? Just yes or no.

Mr. GORDON. Okay, every single SBA office I go into, there are extremely qualified people there. Some of the smartest people around work for the SBA.

Mr. GRAVES. I am going to yield to Mr. Luetkemeyer.

Mr. GORDON. They are really, really qualified.

Mr. LUETKEMEYER. Thank you, Mr. Graves.

Quick question, I have a number of questions here. Mr. Smith, you have made some great points, and as a former bank regulator, you are right on. I am telling you, you are right on with what is happening right now in our economy with the banking industry and lending dollars.

With your experience with your manufacturing group, have you seen a tightening of credit to everybody across-the-board or is it just good actors, bad actors?

Mr. SMITH. Absolutely it is across-the-board.

Mr. LUETKEMEYER. Ms. Dorfman, I have heard you testify a couple of times in different committees and you keep talking about direct lending. I know Mr. Graves made the comment a minute ago as well. As a regulator, and yes, I am old enough to remember the mid-1970's when I was a regulator, the FHA was in the business of direct lending to farmers. That experience was a disaster, an absolute disaster for agriculture. We wound up getting people in business who had no business being in business, at least the agricultural business, and wound up causing inflation in our real estate prices, our farmland, over production. Once we got them out of

that, and got the government back to guaranteeing loans instead of direct lending, we solved a lot of our problems.

What data or what information do you have to believe that the SBA can be a better direct lender than banks?

Ms. DORFMAN. What we are looking for is making sure that the small businesses are accessing the capital they need. Currently, the banks are not lending. The SBA with the direct lending, and there was a question about are they qualified. Yes, they are qualified to oversee the process. There are numbers of employees who have been let go from banks, who used to do the lending, and could be hired into a program to provide this program.

Mr. LUETKEMEYER. One of the problems that you have with direct lending though is, who is at risk? It is not the SBA; it is the American taxpayer. When the banks are on the hook, it is their stockholders; it is the bank itself that is on the hook. And that is a really big difference between suddenly when you have the government involved and the people lending money they don't care. All you can do is qualify for the loan. If you qualify, you get the money. It is not about whether this is a viable entity that is going to be able to survive down the road and make a good customer and be able to be a good part of the community. If you qualify, you get the money. That is exactly the way it worked back with the FHA program and that is exactly what will happen with the SBA. I have a real problem with this direct lending. I don't see how you can make it work and make it viable for what we need with regards to small businesses.

Ms. DORFMAN. Well, and I would say with the concerns that were talked about the banks being overregulated, it is another answer to removing those regulations from the banks. The banks don't have to be involved. We are putting a program together that would make sure that we followed the 5 Cs of credit, made sure that the businesses were just as viable as if they were the bank. I think it can be done.

Chairwoman VELAZQUEZ. Would the gentleman yield?

Mr. LUETKEMEYER. Sure.

Chairwoman VELAZQUEZ. Let me remind the gentleman that we passed direct lending in the House. It passed with 389 votes. You, sir, voted for it. It is a temporary fix where it treats this economic crisis as a disaster. It will not compete with the private market. It will make the loans like the SBA has done every time there is a natural disaster in this country. The SBA makes all the disaster loans to homeowners and small businesses. This will be a temporary fix, 6 months of performing loans will be again sold in the private market. So it is a temporary fix.

Once we get out of the recession, when unemployment rates go down, the program will cease. Let me remind the gentleman again that you voted for it. Thank you for yielding.

Mr. LUETKEMEYER. Thank you for your comments, but I think my comments are apropos as well. It is a temporary fix; it is not a solution to the problem. And Ms. Dorfman, in my mind, is talking about a permanent fix from her previous testimony at many of the other committee hearings that I have heard her. And I want to make a point that it is a temporary fix as long as it doesn't—but there are problems with that temporary fix and we have to be very

cognizant of those problems. I am trying to point those out this morning that we have to be careful that this is not the road we are going to go down.

You pointed to something as well, Ms. Dorfman, about regulation, and Mr. Smith made the point here that one of the problems that we have with the banking institutions right now is the regulators. He has the exact words, they have their foot on their necks. And you have to remember that most banks are small businesses as well. They have to make a profit and they have to make things work.

I am very concerned, and I appreciate the comments of Mr. Smith. Thank you, Madam Chairwoman.

Chairwoman VELAZQUEZ. Mr. Minnick?

Mr. MINNICK. I must say I agree totally with the comments of Congressman Luetkemeyer, and I would like to add the thought that the suggestion that the Small Business Administration or frankly any government agency could do a better job of commercial lending than banks and credit unions is, I think, naive and totally ill-informed. We must recognize that the reason why our banks are not lending is not that they don't want to, it is a combination, as Mr. Smith and Mr. Turnbull have testified, of pro-cyclical regulations by our regulators who are insisting that banks have greater reserves than are required by their own regulation. It is a combination of that with illiquidity in their loan portfolios, triggered by the fact that there is no secondary market, particularly for commercial loans, and inadequate reserves triggered by distressed sale valuations of the collateral that backs up their loan portfolios.

I would like to ask Mr. Turnbull with respect to the last issue if he agrees or tell us why he agrees that a loan guarantee is a key to unlocking these illiquid portfolios?

Mr. TURNBULL. Mr. Minnick, some comments have been made about the status of the community banking system, whether or not they were the cause of this problem that we are in right now. I would submit that in our market area, we have good community banks and we have bad community banks. We have some bad community banks that were probably part of the problem. But now all of the community banks are kind of in the same soup because of this illiquidity. A large percentage of their loan portfolios are in real estate and they have no place to take those. And so because of that illiquid position, they are capital constrained. They couldn't make a loan if they wanted to. And I know that there has been some guidance issued by the regulators, by the FDIC about how banks should be able to—or regulators should treat these banks, but it is not being uniformly administered.

That is the key to the issue right now, these community banks have to be able to offload their commercial real estate assets to be ale to make lending available again.

Mr. MINNICK. Now, Mr. Turnbull, if we were to institute either through TALF or some GSE a commercial loan guarantee program, would it be feasible to direct regulators to put in guarantees based on some percentage of current replacement market value with that value discounted to probable time of sale as a benchmark to deal with the issue of valuations coming in at 10 or 20 or 30 percent of current replacement value?

Mr. TURNBULL. Absolutely, that is the issue.

Mr. MINNICK. And you think in your opinion that would be the key to getting this market unfrozen so that commercial banks could start lending again and particularly small community banks?

Mr. TURNBULL. Yes, I think there are several things that have to be done, but I think that is the first thing that has to be done. That is the only way we are going to get community banks lending again. I have several—I am a shareholder of a community bank, I have several close friends who are CEOs of community banks and they all tell me the same thing.

Mr. MINNICK. Mr. Smith, would you agree with that statement?

Mr. SMITH. Yes, I would. I think that in the community bank that I am on the board of, it is that issue that we have the revaluation of all the commercial loans that has really dragged the ability to make any loans. And again, when you are shrinking your balance sheet, you are not making loans. I think it is really a two-step process. Banks have to be in the position—again, when the original TARP program came out the government picked winners and losers, and unfortunately, the small community banks which support most of the small businessmen were just left in the dark and they need help. They didn't create the mess; they are just being subjugated to it. So it is a two-step process. The banks have to be healthy to be able to make loans, either that or they have to change the regulation and change the ratios that they are allowed to operate on. One or the other has to happen.

The second thing is we need to improve the collateral position of the lenders. We need to be able to temporarily get that help so that when we are asking for loans and it is collateral-based, there is that guarantee out there.

Mr. MINNICK. Thank you, gentleman. My time has expired. We appreciate your expertise.

Chairwoman VELAZQUEZ. Mr. McCotter?

Mr. MCCOTTER. Thank you. Wes, you and I have known each other a long time. We have faced significant challenges at home in the district throughout Michigan. I think I am the last speaker on our side. What I would really like to do is yield you the balance of my time so that you can tell this committee what you think is important to keeping manufacturing in our district, in Michigan, and in America.

Mr. SMITH. Thank you, Congressman. I think what is really important is, obviously, we are having a heart attack right now, we have to get that solved, and that means we have to be able to have access to cash. So that is number one. And the programs again that are being proposed can't come fast enough, but I think some of the real issues in manufacturing really have to do from my standpoint is, for instance, our trade policies and lack of enforcement. We are just seeing in Michigan, since the recession, 400,000 jobs leave, what I call the recession in 2000, which is really when the recession of manufacturing started. There have been almost 6 million jobs vacated, and again manufacturing jobs are the backbone of this Nation. It has the highest job creation factor. For every Tier 1 automotive job that was in Michigan, it also employed an additional anywhere from 4 to 7 other jobs. They are absolutely key jobs that we need to keep going and particularly in our State. They

are good jobs, high- paying jobs, and they have great benefits programs.

I think manufacturing has been overlooked and particularly not appreciated, not necessarily in the Midwest, certainly as I would say in Michigan is that all of our Congressional Members in Michigan sing from the same hymnal; they just sit in different churches.

The reality is that we understand what is important, what is important for our State to work. Clearly, we have to address our trade policies. We have to address the fact that our trading partners do not behave properly whereas we just kind of open up the doors and say, come on in. And unfortunately, it has put us at a very distinct disadvantage.

One of the reasons banks don't like to make loans to manufacturing is because they understand it, they see that. They clearly understand that you know what, with the pressures we are seeing from low cost countries and the way that they are being coddled and handled by their governments they just suck jobs away from the United States. They know that, they see that, and they clearly understand if Congress won't do anything about it, if the government won't do anything about it, then they are just going to find somewhere else to park their money and that is clearly what we have seen. We have to address this policy. I believe that in my heart, I can just see it. You can see it since—since, you know, 2000. And I can tell you from my standpoint that in 2000 in my industry I have had to deal with 32 customer bankruptcies. Prior to 2000, in the history of our company, we dealt with one. It is absolutely catastrophic and we need manufacturing in the United States, and it is just not being appreciated.

Mr. McCOTTER. Reclaiming the balance of my time, I think that the point you make is absolutely necessary for Congress here. While we support trade on a fair and equitable basis, and I would add with free nations, what we continue to see is what Natan Sharansky told us a long time ago: How a nation treats its own people is how it will treat other nations. When you look at some of the practices engaged in the domestic policies of nations that are our trading partners that the average American would find repugnant, the average American would find it antithetical to the concept of human liberty coming from a creator rather than a central government. I think you can understand why the United States has employers like Wes Smith and others in this country who try to provide a humane and decent job for their workers so they can pursue their happiness. Why we are at a distinct disadvantage because we are a good and decent country when competing or trading with other nations that have no regard for the rights of their people except as pawns to be used in the political game, or to be used in a mercantile strategy to deindustrialize the United States.

Thank you for coming. Wes, I will see you after.

Chairwoman VELAZQUEZ. Time has expired. And let me take this opportunity to thank all the witnesses on this panel. The committee will stand in recess until we—how many votes? So we have seven votes, and we will reconvene right after the votes.

Mr. BACHUS. Madam Chairwoman, let me say one thing, several of you said that the banks want to lend money, but the regulators and the examiners are saying, raise more capital. And I tell you,

I have heard that every day. I talk to bankers from Florida, from different places. They don't know each other, but they say if the examiners would get out of their banks, they would start lending the money.

Chairwoman VELAZQUEZ. If the gentleman will suspend, we are going to have a panel with the regulators, so I guess that you will be making those statements to the regulators.

You are all excused. Thank you.

[recess]

The CHAIRMAN. The hearing will come to order again. I apologize obviously for this delay, but it has been very important.

We have a panel now of regulators who are the second panel, which isn't always the case, but we think it was very important. Let me begin by asking all of you, one of the most frustrating questions we get is—frustrating in that we can't get it answered, to what extent are accounting standards over and above everything else an obstacle here? That is part of our problem. We will not legislate accounting standards, but we have talked to the Accounting Standards Board. Are accounting issues any part of the problem here?

Let's start with Mr. Allison. Oh, I apologize. You didn't give your opening statements. Well, we will have your opening statements first. Mr. Allison, go ahead.

Mr. ALLISON. Would you like me to begin, Chairman Frank?

The CHAIRMAN. Yes, with your opening statement. Ignore me from time to time. The hearing will go better. So just give your statement.

STATEMENT OF THE HONORABLE HERBERT M. ALLISON, JR., ASSISTANT SECRETARY FOR FINANCIAL STABILITY AND COUNSELOR TO THE SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mr. ALLISON. Thank you, Chairman Frank, Ranking Member Bachus, and members of the House Financial Services Committee, as well as Chairwoman Velazquez, Ranking Member Graves, and members of the House Small Business Committee. Thank you for the opportunity to testify today.

The Administration strongly believes that small businesses are critical to our economic recovery. We have listened to small business owners across the country, and we understand that they are facing real challenges in accessing credit. This week, the FDIC reported that lending by the banking industry fell by $587 billion last year, the largest annual decline since the 1940's. While the pace of contraction has slowed, the Fed's Senior Loan Officer Survey has shown tightening credit standards for small business borrowers for 13 straight quarters.

We must improve credit conditions for small businesses. That is why the President proposed authorizing $30 billion for a new Small Business Lending Fund, or SBLF. The program would provide a strong incentive for strong- and mid-sized banks to accelerate small business lending. For example, if a bank used this new capital to increase its small business lending by 10 percent, its cost for this capital would fall to just 1 percent per annum. Additionally, banks could leverage Treasury's investment to increase by more than the

$30 billion dedicated to the facility. It is important to note that the $30 billion is not a cost to taxpayers. It is an investment. We expect that almost all of that investment will be returned to Treasury over time. As you know, Treasury's previous investments in banks are already producing a profit to taxpayers.

The SBLF would be created through legislation to make it separate and distinct from the TARP. While Treasury has the authority to create a small business lending fund under TARP, we are convinced that if we did so, very few banks would participate. Various restrictions under TARP have had unanticipated consequences for small- and mid-sized banks. For example, a small community bank may not be permitted to make severance payments to a bank teller due to the golden parachute prohibition that applies to senior executives and the next five highest paid employees. As evidence of banks' reluctance to participate in TARP programs, when we reopened the Capital Purchase Program for small banks with less than $500 million of assets, 7,000 banks were eligible to participate. Only one new bank took funding during the next 6 months that the program was open.

But simply removing TARP restrictions will not be enough to ensure participation. Many banks believe there is a stigma attached to accepting TARP capital. They fear that competitors will question the soundness of their bank if they take TARP capital, even though all banks receiving TARP funds have had a viability determination from their primary Federal regulator. For these reasons, the Administration strongly believes that an SBLF outside of TARP and under appropriate oversight would draw far greater participation by small financial institutions and thus have the greatest chance of increasing lending.

Small businesses are asking for our help. The Small Business Lending Fund can substantially expand credit for small businesses across our Nation. Treasury looks forward to working with you on this proposal to help small businesses create jobs and contribute to a full economic recovery. Thank you.

[The prepared statement of Assistant Secretary Allison can be found on page 93 of the appendix.]

Chairwoman VELAZQUEZ. [presiding] Our next witness is the Honorable Karen Mills, Administrator of the SBA.

STATEMENT OF THE HONORABLE KAREN G. MILLS, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Ms. MILLS. Thank you very much, Chairwoman Velazquez, Chairman Frank, and members of both committees.

Small businesses continue having problems getting access to capital. This is a situation that must be fixed. Small businesses created 65 percent of the net new jobs over the past 15 years, so we need a robust small business jobs plan that addresses these credit gaps. We have already taken an important step forward. I want to thank Congress for passing the Recovery Act and for the extension of the 90 percent guarantee and reduced fee provisions.

Over the past year, we have been able to leverage $500 million in taxpayer dollars into more than $20 billion in the hands of small businesses. We have also brought more than 1,000 lenders who hadn't made an SBA loan since 2007 back to SBA lending. Com-

pared to the weeks before the Recovery Act, this is a weekly volume increase of more than 90 percent—and we have a slide up there to illustrate this—but we need to do more.

For our small business jobs plan, we have analyzed the gaps in the current small business lending market and we have constructed proposals that address the most critical problems. We are guided by three principles: build on what works; maximize limited taxpayer dollars; and make targeted changes as quickly as possible. Our plan has five key components:

First, for community banks that don't have capital to lend, we need the Small Business Lending Fund that you have just heard described.

Second, for banks that have capital but are still having trouble taking the risk, we have asked Congress for an extension of the 90 percent guarantee and the reduced fees through September. Those funds ran out at the beginning of this week. Already there are 370 loans for more than $140 million in our queue.

Third, for small businesses that need bigger SBA loans to create jobs—franchisees, manufacturers and exporters—we want to increase our top loan limits from $2 million to $5 million, and there is a slide on that.

Fourth, for businesses that can't find access to working capital, they have had their credit lines pulled, we need to temporarily raise SBA express loan limits to $1 million. There is a slide on that as well, and these are in your packages.

And fifth, for owner-occupied real estate of small businesses whose commercial real estate mortgages need to be refinanced, we need to open up our 504 program.

Finally, we know that the chairwoman and others have asked us to look at direct lending. We spent a lot of time working on this, and we have found several important concerns and unintended consequences. We currently have 75,000 branches making SBA loans. Duplicating their reach would require significant new SBA staff, and training and hiring this workforce would take too long. The approach is costly and would increase the subsidy cost from 1 cent to 15 cents per dollar of lending, and we would be competing with and even replacing the private lenders who have now ramped up our SBA lending, including the 1,100 banks we have gotten back.

The problem we are trying to solve is not that small businesses need direct loans. It is that they need direct access to banks that are making loans with our 90 percent guarantee and direct access to counselors that can help them get creditworthy. We today are providing everyone here with some information that should help in that manner. These are going to be the names and numbers of SBA lenders in your State or area and our counselors in your area so that you can help refer those who come to you and give them direct access to these programs that are working.

Again, the principles of these proposals are to build on what works, to maximize limited taxpayer dollars, and to make the targeted changes as quickly as possible. We are confident that with these actions, we can move to fill the credit gaps and meet the needs of America's small businesses. Thank you.

[The prepared statement of Administrator Mills can be found on page 252 of the appendix.]

The CHAIRMAN. Next, Governor Elizabeth Duke of the Board of Governors of the Federal Reserve.

STATEMENT OF THE HONORABLE ELIZABETH A. DUKE, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. DUKE. Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, and committee members, thank you for the opportunity to join today's joint committee hearing to discuss the availability of credit to small businesses.

The timeliness of this hearing is highlighted by findings released just this week in a study by the National Federation of Independent Business. They have found that of small employers who attempted to borrow in 2009, nearly one-half received all the credit they wanted, but almost a quarter received no credit at all. This compares to a similar study in 2005 when nearly 90 percent had most or all of their credit needs met and only 8 percent obtained no credit.

These statistics are concerning to me in my role as a policymaker and a bank supervisor, but they are also distressing to the part of me that spent 30 years as a community banker and a small business lender. I know all too well the anguish of businesses struggling for survival and the bankers trying to meet the needs of their customers in the face of mounting credit losses. While conditions in financial markets continue to improve, access to credit remains difficult for many smaller businesses that largely depend on banks for credit. Risk spreads on small business loans at banks have continued to rise, and the decline in loans outstanding has been stark. A number of factors are contributing to the reduction in bank loans. For instance, in response to rising levels of delinquent and nonperforming loans, banks have reduced existing lines of credit sharply and have tightened their standards and terms for new credit. In addition, banks with capital positions that have been eroded by losses or those with limited access to capital markets may be reducing risky assets to improve their capital positions, especially amid continued uncertainty about the economic outlook and possible future loan losses.

The reduction in the availability of credit, however, is not the whole story. There is also less demand for credit. As businesses reduced inventory levels and capital spending, they tend to pay down debt and build cash positions. And while some potential borrowers seek less credit, others are ineligible to borrow. Weakened balance sheets, reduced income, falling real estate collateral values, and in some cases a recent history of payment problems, have made it difficult for some businesses and consumers to qualify for loans, especially under current stricter standards.

A significant fraction of small businesses rely upon personal assets and consumer credit to fund their operations, thus small businesses are impacted by tight conditions for consumer credit in addition to those for business credit.

And finally, small business lending is often based on relationships that are solidified over time, and when those existing relationships are broken, small businesses find it quite difficult to establish similar arrangements with a new bank.

Improvement in a number of the conditions that depressed lending in 2009, however, lead me to be optimistic that we may begin to see an increase in bank loans later this year. Economic conditions, the most important determinant in the demand for and availability of small business lending, have improved considerably since the early and middle part of last year. In response, bank attitudes toward lending, including small business lending, may be shifting.

In the January Senior Loan Officer Opinion Survey, the number of banks that reported the tightening of credit standards for small business lending no longer outnumbered the banks that reported an easing of lending standards.

The Federal Reserve has been working with banks to foster improved access to credit and prudent underwriting of new loans, and we will continue to do so. I believe that the considerable support we gave to bank lending through accommodative monetary policy and borrowing facilities has been critically important. In addition, to ensure that supervisory policy does not inhibit lending, the Federal Reserve joined with the other banking agencies and supervisory guidance that emphasized the need for banks to continue to meet the credit needs of creditworthy borrowers while maintaining appropriate prudence in lending decisions.

Recent guidance covering commercial real estate lending also encourages banks to work with borrowers to restructure troubled commercial real estate loans in a prudent manner and reminds examiners that absent other adverse factors, a loan should not be classified as impaired based solely on a decline in collateral value.

The Federal Reserve has supplemented and reinforced this guidance through outreach to banks and training for bank examiners in a variety of forums. The reserve banks are also conducting a series of regional and topical meetings on small business access to credit. Some, such as the ones held this week on minority entrepreneurship and SBA lending, will focus on specific topics. Others will focus on identifying regional differences in credit availability. Meetings will be followed by a capstone event at the Board of Governors.

In summary, the Federal Reserve is committed to using all available tools to maintain the flow of credit to the economy, especially the critically important small business market.

We thank you for holding this important hearing, and I look forward to your questions.

[The prepared statement of Governor Duke can be found on page 188 of the appendix.]

The CHAIRMAN. Next, we have John Dugan, the Comptroller of the Currency.

STATEMENT OF THE HONORABLE JOHN C. DUGAN, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. DUGAN. Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, and members of the committees, I appreciate this opportunity to discuss the lending activities of national banks and the OCC's actions to maintain a supervisory climate that facilitates sound lending to consumers and businesses.

Access to credit is critical to the health of our Nation's economy, and national banks play a vital role in meeting this need. The OCC has always encouraged national banks to lend to creditworthy borrowers. In fact, banks cannot be healthy and profitable if they do not continue to focus on making sound loans to businesses and consumers. While there are signs that the economy is beginning to recover, significant stresses continue to restrain both the demand for credit and its supply. The result has been a sharp reduction in the outstanding loans of commercial banks of all sizes and across nearly all loan categories.

In terms of demand, businesses have sharply curtailed capital expenditures and reduced inventories, the typical drivers for commercial bank loans. Indeed, the recent cutbacks in fixed investment inventories and accounts receivable by U.S. nonfinancial companies is unprecedented in the past 55 years for which we have historical data. Consumers, likewise, have cut back on spending and are saving a larger share of their income.

The resulting reduction in loan demand has been pronounced, including for small businesses. Reports issued by the National Federation of Independent Business over the past 2 years have consistently shown that underlying business conditions rather than access to credit is the primary issue facing many small business owners. Still, the decline in loans also reflects the reduced supply of credit. As the deteriorating economy has taken a toll on consumers and businesses, bankers have also become more cautious. Loan underwriting standards generally have tightened across the industry, reflecting in part a return to more prudent practices and in part becoming more conservative. These changes have resulted in higher downpayments, additional collateral, and other requirements that have clearly affected the ability of some borrowers to obtain credit.

We recognize that this environment presents particular challenges to the OCC and the other banking regulators. It is imperative that we take a balanced and consistent supervisory approach to ensure that our actions do not discourage banks from making loans to creditworthy borrowers. Many have questioned whether the regulatory pendulum has swung too far to the point where regulators and examiners are impeding banks' ability to make even prudent loans. This is a matter we take very seriously, and we have taken numerous steps and are continuing to take such steps throughout this credit cycle to ensure that examiners are taking a balanced, fair, and consistent approach across the country. These actions have included interagency statements on commercial real estate loan workouts and small business lending, both of which clarify our expectations and underscore that examiners will not criticize banks for prudent lending activities.

We have reinforced these messages through regular and repeated communications with our examination staff. For example, we have consistently instructed examiners not to tell bankers which loans to approve and which to deny and not to criticize loans based simply on collateral values or a borrower's association with a particular industry or geographic location. Instead, we continue to stress that national banks should do the following: make sound loans to creditworthy borrowers; work with borrowers who are facing difficulties; and recognize and address problem credits by main-

taining appropriate reserves and taking charge-offs when repayment is unlikely.

We also continue to work with Congress, the Administration, and the industry on programs that can provide additional assistance to the hardest-hit sectors. We support a number of small business lending initiatives, and we have worked hard to help bankers understand and more fully use the various programs offered by the SBA.

Finally, let me offer one cautionary note. While we should be very careful not to encourage the banks we supervise to become excessively conservative, we simply cannot turn a blind eye to increasing losses and mounting credit problems—185 banks have failed since the start of the crisis, including 33 national banks. Estimated losses to the FDIC exceed $57 billion already, and we are likely to have even more failures in 2010 than the 140 that we had last year. In this environment, we need to avoid the kind of forbearance that put off problems and caused such huge losses in the savings and loan crisis, an experience that led Congress to enact the prompt corrective action regulatory regime in 1991. That regime reinforced to supervisors how important it is for institutions to realistically recognize losses and deal with them both to avoid further problems, and even more important, to put themselves in a better position going forward to make loans to creditworthy borrowers.

Thank you.

[The prepared statement of Comptroller Dugan can be found on page 159 of the appendix.]

The CHAIRMAN. Next, Martin Gruenberg, who is the Vice Chair of the Board of Directors of the FDIC.

STATEMENT OF THE HONORABLE MARTIN J. GRUENBERG, VICE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, and members of the committees. I appreciate the opportunity to testify on behalf of the FDIC on the state of lending and credit availability for small business and commercial real estate.

Adverse credit conditions and stressed balance sheets have created a difficult environment for borrowers and lenders. Large banks have significantly cut back on lines of credit to consumers and to small business. In addition, small- and mid-sized institutions who tend to make business loans secured by residential and commercial real estate are dealing with the effects of large declines in real estate values which tend to reduce the collateral coverage of existing loans and make it more difficult for household and small business borrowers to qualify for new credit.

In response to these challenging economic circumstances, banks are clearly taking more care in evaluating applications for credit. While this more conservative approach to underwriting may mean that some borrowers who received credit in past years will have more difficulty receiving credit going forward, it should not mean the creditworthy borrowers are denied loans. As bank supervisors, we have a responsibility to encourage institutions regularly and

clearly to continue to make soundly structured and underwritten loans.

Acknowledging this responsibility, the FDIC and the other bank regulators supplemented prior guidance and issued the interagency statement on meeting the credit needs of creditworthy small business borrowers earlier this month to emphasize that examiners follow a balanced approach in assessing small business lending. The statement recognizes that many small businesses are experiencing difficulty in obtaining and renewing credit to support their operations. It is clear that for a number of reasons the small business credit availability has tightened.

The FDIC and the other bank regulators believe that continued sound lending to creditworthy borrowers is critical to the long-term success and health of the small business sector and their lenders. This statement indicates that financial institutions should understand the long-term viability of a borrower's business and focus on the strength of a borrower's business plan to manage risk rather than using portfolio management models that rely primarily on general inputs, such as borrower's geographic location or industry. This new guidance states examiners will not adversely classify loans solely on the basis of a decline in the collateral value below the loan balance or the borrower's association with a particularly stressed industry or geographic region.

I would note that the FDIC has also reached out to the industry to help us frame policies and supervisory procedures that will help lenders navigate through this credit cycle and become more comfortable extending and renewing loans. One of the first steps in this process was to establish the FDIC's Advisory Committee on Community Banking in mid-2009 to better enable our board and senior management to have a dialogue with the industry on how we can improve our supervisory programs and foster improved availability of credit. The advisory committee met most recently on January 28th, where we discussed many of the issues we are discussing today in this testimony, including credit availability and access to capital markets. The advisory committee will continue to meet regularly and provide direct input from community bankers on the many critical issues they face.

Over the past year, through guidance, the examination process, and other methods, the FDIC has sought to encourage banks to maintain the availability of credit while striving to balance these considerations with prudential safety and soundness requirements. Striking the appropriate balance remains our greatest challenge.

Thank you very much.

[The prepared statement of Vice Chairman Gruenberg can be found on page 219 of the appendix.]

The CHAIRMAN. And finally, John Bowman, Acting Director of the Office of Thrift Supervision.

STATEMENT OF JOHN E. BOWMAN, ACTING DIRECTOR, OFFICE OF THRIFT SUPERVISION

Mr. BOWMAN. Good afternoon, Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, and distinguished members of the committees. Thank you for the

opportunity to testify today on behalf of the Office of Thrift Supervision.

I think we all recognize that banks and thrifts remain under tremendous stress due to the continued declines in home prices, high unemployment rates, pressures on commercial real estate, and the improving but still hobbled secondary market for mortgages. We need look no further than high levels of delinquent loans in home foreclosures and the increasing number of financial institutions that are troubled or failing under this strain.

As a counterweight to the stress, financial institutions are building capital levels and loan loss reserves, thereby making fewer dollars available to lend to consumers and businesses. No one wants to return to the days before the recession when too many loans were made using underwriting criteria based not on the borrower's ability to repay but on the value of the collateral, value that we now know was fleeting. But we also recognize the economy will not recover fully until financial institutions resume lending at levels that can help sustain a thriving economy.

Many sources of credit before the recession, such as highly leveraged and underregulated nonbank businesses that often maintained loose underwriting standards, have gone out of business. Their departure from the marketplace leaves borrowers more dependent than ever on regulated banks and thrifts, and as a result, lending by these institutions is more essential.

The question before us today is whether banks and thrifts are tightening credit to an unreasonable level beyond what is prudent for safety and soundness and what regulators can do to ensure that the financial institutions that they regulate strike the right balance between lending and safety and soundness. I have seen some executives at banking institutions quoted as saying that they want to lend more but that their regulators won't let them. In some cases, that is certainly true. An institution with soaring levels of bad loans and insufficient capital faces the all too real prospect of failure if capital and loan loss reserves do not increase.

And to state the obvious, a closed institution doesn't make any more loans. The regulator might be painted as the culprit in restricting lending, but on the other hand, the regulator might also succeed in helping the institution return to a healthy condition so it can resume meeting the financial services needs of families and businesses in its community.

For healthy institutions, let me make clear that the OTS is encouraging all types of loans allowed under the thrift charter as long as thrifts follow prudent underwriting standards to ensure each borrower's ability to repay. The OTS and other regulators have made this position very clear to regulated institutions twice in recent guidance, and at the OTS we have taken several steps outlined in my written testimony to make sure our regional offices and examiners in the field are in lockstep with Washington on this issue.

I also note in my written testimony that small business lending is fully consistent with the mission of the thrift industry to serve America's consumers and communities. However, thrifts are limited by law in the amount of small business lending they can do. This restriction makes less credit available to small businesses,

and although the House Financial Services Committee has voted 3 times to remove the cap on small business lending, and the full House has passed it twice, this provision has never been enacted into law.

Thank you again for having me here today, and I am happy to answer your questions.

[The prepared statement of Acting Director Bowman can be found on page 114 of the appendix.]

The CHAIRMAN. We have 1 hour and 35 minutes with this panel, and I am going to forgo my own questions in the interest of accommodating other members.

Next for the Financial Services Committee, we have Mr. Foster of Illinois.

Mr. FOSTER. Thank you all for appearing today. I will start off by saying that I am a big fan of loan incentives. I am for viable business in the existing conditions. I think that is something we just have to do. And I concur with Administrator Mills' conclusion that we must work with existing institutions, that there simply is no time to bootstrap a new direct loan program because of the staff issues.

So my first question is, do you think that the programs that are being talked about are dealing adequately with a moral hazard that particularly when you start getting into issues like refinancing, really the 504 program and so on, that banks may have an incentive to push off their problem loans onto SBA refinancing? And do you think that moral hazard is being adequately addressed?

Ms. MILLS. Thank you for your question. We have proposed a series of activities that are built on what has been successful so far. So in the past year, we raised our loan guarantees to 90 percent, and we took very seriously this issue, would we experience this moral hazard that you described? Instead, we have found that there is great demand because banks want to make good loans but for various reasons can't take those risks. And as their credit box moved up, ours moved up under them, and in fact, the credit scores on the loans that we did—this $20 billion over this last year—are actually higher than the credit scores from 2007–2008.

In the case of the 504 proposal, we are looking at refinancing owner-occupied real estate, not commercial real estate that has been speculative, but a dentist who owns his dentist office, a manufacturer who might own the warehouse, and that those loans be in good standing. We know there is a significant amount of them that were done in 2005, 2006, and 2007 with 5-year bullet refinancing provisions that will come due in 2010, 2011, and 2012, and this proposal is constructed to meet the needs of those which have been owner-occupied and not been in default, but for various reasons their banks won't be able to take on the refinancing.

Mr. FOSTER. Okay. Thank you. Do any of the other panelists have comments on the moral hazard problem?

I guess the second general question I had concerns the right sizing of these programs. It is obvious that in an efficiently designed program, the larger the program, the deeper you are going to have to reach into less creditworthy borrowers, and at some point that will increase the risk of the government running these programs at a lost. However, strictly from the point of view of the

greedy taxpayer who wants to minimize the national debt when this all plays out, it may make sense for the government to operate these at a loss, particularly because in the case of refinancing, for example, the hole in the economy that exists when a company fails puts people onto unemployment, onto food stamps and so on and so forth. So that when you do the overall optimization, it may make sense for the government to run these at a modest loss.

Has anyone done that sort of analysis to determine the optimal size of these programs?

Mr. ALLISON. Perhaps I could respond to your question, Congressman. From the standpoint of the Treasury and our advocacy of the Small Business Lending Fund, we have sized that program at $30 billion. If you look at the total amount of small- and mid-sized bank lending on their books today, it is about $550 billion. If this program were funded by Congress, we could increase lending, we think, by at least 10 percent. We think that is a reasonable amount. It is prudent. We think the costs of this program—let me stress, this would be an investment in banks. We expect to get almost all of that money back. The cost to the taxpayer we think will be quite low.

Mr. FOSTER. In which case it is too small, put by the line of logic that I just went through.

Mr. ALLISON. Let me say though that we would be investing in viable banks deemed by the regulators to be viable, and that is the vast majority of these banks today. We already have experience with investing in banks. We have invested through the TARP in 700 banks, and to date the taxpayer has obtained a profit, even though that was a very large amount of—

Mr. FOSTER. Would it be possible for you to get back with some sort of estimate of, you know, the other part of that equation that I went through?

Mr. ALLISON. Certainly.

Mr. FOSTER. It would be very valuable in understanding what the rights are.

I guess the third point I would like to raise—

The CHAIRMAN. Your time has expired.

Mr. FOSTER. I yield back.

The CHAIRMAN. The gentlewoman from Illinois, Mrs. Biggert. In fairness to Members, I can see the clock. I didn't realize nobody else could.

Mrs. BIGGERT. Thank you, Mr. Chairman. And I thank all of you for being here today. I appreciate your testimony, but it seems to me—it is unfortunate that what you are saying in Washington is very different from what is happening with your examiners and regional supervisors on the ground and from what I hear from them. Let me just give you a couple of examples.

One of my constituents has said, "Overzealous regulators have swung the pendulum too far toward regulatory overkill, compounding lack of available credit that otherwise would be available to the public. The bank regulators are forcing arbitrary write-downs on performing loans, excessively high loan loss reserve, capital and liquidity requirements. All of these actions reduce the amount of available credit that might otherwise might be available. Every day, bankers are being told by their regulators to not make

loans and in fact reduce their existing loan portfolios. The only viable and practical way to increase bank lending activities is to get the regulators back to a commonsense and realistic approach in their examinations."

And secondly, another bank, "We have encountered an issue during our last exam regarding an unsecured loan that has always been and continues to remain current on its payments. Due to lack of collateral and the borrower's tight cash flow, we had fully reserved for the loan. Thanks to our being so prudent, the examiners made us charge the loan off as a complete loss because it was fully reserved. So why not? Keep in mind we are receiving timely payments but we can't return the reserves to capital. As payments are received for the loan, we have to wait until the full loan is paid off."

And I have heard multiple times about this. Particularly the concern that they have is where they are asked to devalue a loan where they are receiving full payment on the loan and continuing, and the regulator will say, "Well, it is going to go down maybe next year. So you need to devalue it now." And then put that on top of the increase for the FDC in the assessments. We are seeing so many banks that then their ratings are lowered.

So if you could just briefly comment on that. Maybe Ms. Duke or Mr. Dugan?

Ms. DUKE. Thank you, Congresswoman. I hear the same stories over and over and over again, and we are incredibly focused on trying to run down specific instances to make sure that we are communicating with the examiner in the field to make sure that the examiner in the field knows what to do. That was one of the reasons there were so many examples in the commercial real estate guidance. And in fact, I sat down with examination staff and played the part of the banker, and we argued each one of those loans as if it were a loan in my bank.

I think we have to communicate with it. To the extent that you hear that from people in your district and you can identify who the regulator is, we would very much like to know the specific instances so that we can follow them up.

Mrs. BIGGERT. Good. When will we receive the results of the guidelines and the work that you have done recently? I mean, these are not old but they are not yesterday. Will we see a change?

Ms. DUKE. It is very difficult to measure, and we are working on ways that we might be able to measure it. But we do have one sort of preliminary thing, and that is troubled debt restructurings, which are loans that have been restructured, shown on the balance sheets of the banks, increased 32 percent in the fourth quarter of 2009, and this guidance came out in October. So that is one very small encouraging sign that at least some workouts are taking place.

Mrs. BIGGERT. And there was one case too that I have where the field operator okayed everything that they did and then the supervisor came in and changed it, taking away the capital that they had. So I am concerned about that.

Can anybody really define "creditworthy?" Is there a standard definition? You all mention it. But is there? Okay. Well, I won't waste time then.

Mr. Dugan, could you respond, and maybe Mr. Gruenberg, to the question that we have been discussing?

Mr. DUGAN. Yes, to the more general question, not the definition of creditworthy. I agree with Governor Duke's remarks. We have spent an awful lot of time trying to walk through the individual examples with our examiners. And let me say, we have been spending an awful lot of time not just now but coming into the crisis, on dealing with, anticipating, and then working with our examiners to work through the problems. I can't emphasize enough, however, that individual circumstances really do matter.

Remember, we have a ton of banks failing now, and the number on the problem bank list of the FDIC is now up over 700 banks. So you really do have to look hard at the individual circumstances to figure out which are places where there might be some undue stress on the examiner, or where the bankers are not realistically recognizing the problems that they are confronting.

The CHAIRMAN. I am going to ask unanimous consent for 1 minute. The ranking member and I just had a conversation. Mr. Bowman, you jogged our memory. You are right. This committee 3 times—twice under a Republican Majority and once under a Democratic Majority—voted to give an additional 10 percent lending under the qualified thrift lender if it was just small business, the additional 10 percent. We have passed it twice through the committee. It went through the House. We neglected to get to it. I have just spoken to the ranking member and we are going to give that very favorable consideration.

Mr. BOWMAN. Mr. Chairman, I would suggest the bill that passed providing for unlimited small business lending. There would be no cap on it.

The CHAIRMAN. Right. That may be more than we can do, but we will certainly increase—I think there is an agreement that we will, as we have done 3 times before—in fact, the ranking member was chairman of the subcommittee when it was done in the committee in one case. So an increase in the small business lending cap for thrifts will be given very serious consideration.

I thank you for calling this to our attention. The chairmanship has just moved.

Chairwoman VELAZQUEZ. Thank you. Comptroller Dugan, I am curious about Administrator Mills' response to Congressman Foster from Illinois when she emphasized that the Administration's CRE refinancing proposal would only be for performing loans. Thus, a loan's past performance fully indicates a borrower's ability to repay, particularly on CRE loans.

Mr. DUGAN. Okay. I am sorry. And the question is whether—

Chairwoman VELAZQUEZ. If past performance by itself will indicate a borrower's ability to repay, so that they could use the 504 to refinance?

Mr. DUGAN. I don't know the particulars of the 504 standards. But at least the way we look at loans, it is certainly very relevant what the past performance has been, but it is not the only thing. It has to do with what is the current projection of the cash flows to support repayment on the project, which is critical to understanding whether it is a—

Chairwoman VELAZQUEZ. Ms. Duke?

Ms. DUKE. I would agree. The standards for the 504 program are very different from the way we look at it. But there are some provisions in the CRE guidance to take a loan—say you had a loan for $1 million. The cash flow would support $800,000, to refinance that loan into a performing piece, the A piece, and then the less performing piece, the B piece, and treat those two pieces separately.

Chairwoman VELAZQUEZ. Well, in addition, I will remind the Administration that the 504 loans cannot be used for the refinancing of maturing debt.

Mr. Allison, we are here because the banks are saying that you, the regulators, are responsible for the lack of financing provided to small businesses by financial institutions. Under the Administration's $30 billion proposal for small business lending, should we all expect that this is going to trickle down and that it will incentivize institutions to lend to small businesses?

Given that in the past when we discussed the TARP money, we didn't see the results of that money trickling down to small businesses, what would keep lenders from hoarding this money or using it to cover potential losses from commercial real estate?

And I guess that you were all looking and listening to Chairman Bernanke when he talked about the next wave of defaults in the real estate area.

Mr. ALLISON. Yes. Chairwoman Velazquez, thank you very much for that very important question, your first question being, why will banks lend more under this new Small Business Loan Fund than they did under the TARP capital programs?

One very important difference is that TARP was intended to provide capital for banks to assure their viability going forward under stressful conditions. This program has been designed to provide a powerful incentive for banks to lend because, as you know, the dividend rate on this new capital can drop dramatically if and only if the banks lend incrementally beyond where they are today.

A couple of other points, the small banks we are talking about have done a pretty good job of maintaining lending balances during this very difficult recession. We think many of them are eager to lend, and by providing them with more capital—in this case, capital that could increase their Tier 1 capital by 30 to 50 percent—they should be more confident about being able to support their existing assets and increase their lending at the same time.

Chairwoman VELAZQUEZ. You know, it just brings back memories of when Chairman Paulson was sitting right there, telling us, don't worry, don't put any restrictions on any of these funds, because I can guarantee that lending from financial institutions will happen for small businesses. And today, a year later, we are seeing the consequences.

Let me ask you, what will be plan B if the $30 billion doesn't produce what you are expecting?

Mr. ALLISON. Chairwoman Velazquez, we have designed this program after consultations with many banks around the country and with banking associations, and we have been assured by them that they would view this plan as quite different. Now what is very important is that this lending fund be authorized outside of TARP because, as I mentioned in my testimony, many banks are extremely reluctant to take part in any TARP program because of what is

called a TARP stigma. I am the person who is responsible for the TARP. I can tell you that a TARP program would not be nearly as effective to achieve your goal of stimulating lending as a program would be outside of TARP. So I would urge respectfully the Congress to enact new legislation so the banks would be willing to take the money.

Mr. BACHUS. Mr. Chairman, could I just ask for a clarification?

The CHAIRMAN. Sure.

Mr. BACHUS. You were talking about being responsible for the TARP. Are you talking about the Capital Purchase Plan? Are you talking about the whole TARP?

Mr. ALLISON. Sir, I manage the Office of Financial Stability within the Treasury which oversees all of the TARP programs.

Mr. BACHUS. Okay.

The CHAIRMAN. The Republican side on Small Business.

Mr. GRAVES. Mr. Coffman?

Mr. COFFMAN. Thank you, Mr. Graves. My question is—well, let me express a concern first. I think some of you have stated that we have to achieve a regulatory balance, and that is very difficult to do. But it seems as if we have shifted in a way where we are trying to establish a risk-free environment, and I am not sure in a free-market system if you can do that. And I think that, you know, when I hear from some of you about the range of options available, that when the underlying asset has gone down in value, but the loans are performing loan, that you don't need to write down that loan. But a lot of the regulators from my understanding—at least in my congressional district—are.

Congressman Perlmutter and I did a kind of joint roundtable with a lot of our community bankers, and they certainly expressed concerns for the regulatory environment in terms of their ability to loan in particular to small business. I would like to defer the balance of my time to Congressman Perlmutter to talk about what we are working on here.

Mr. PERLMUTTER. Thank you. Mr. Dugan, you hit right on it, about forbearance. We have one bill that would allow—if somebody has continued to pay on time and hasn't missed anything but their collateral has been written down—that they still continue to—that there be forbearance against the banks so the bank can forbear with its customers so they can get to the light at the end of the tunnel. I will just say to you, if we were operating under the same standards in the 1980's, which you mentioned, in Colorado that we are today, we wouldn't have any banks in Colorado. They would have all been gone. There was a forbearance opportunity. We ended up with half of our banks. We lost half our banks. We kept half our banks.

So I think Congressman Coffman and I, based on our roundtable and what we have experienced here, is that we think that there ought to be some kind of forbearance. So I am going to let you respond because I know you don't agree, but let the committee know why you don't agree.

Mr. DUGAN. Okay. I am happy to do that. I guess I disagree with the conclusion that you wouldn't have had any banks. I think the conclusion that most of us took who lived through that time in the 1980's was that the forbearance caused problems to be delayed and

not resolved on time. And as a result, the costs escalated dramatically to over $200 billion.

Mr. PERLMUTTER. But I would respond and say that virtually every bank that stayed alive was operating under a memorandum of understanding. So there was forbearance. Then you had your RTC costs, but we have already put $700 billion through the TARP program to try to keep things alive so that we can get to the light at the end of the tunnel.

Mr. Coffman and I had a little company called Big Papa's. They had two restaurants, and they were going for a third restaurant. They went to 40 banks to just get a $250,000 line of credit, and they couldn't get it because of tightened regulations. And I would turn to Ms. Mills, even under the SBA, for whatever reason, they couldn't get it. Eventually, because of the work that we did, they got it. We got 50 new jobs. This isn't just a credit cycle issue. This is a demand cycle jobs issue, and we have to get our people back to work. And I know you and I have had this debate probably over the last year now, the balance between prudence and lending. But there is a whole another thing that the Congress has to consider, and that is getting people back to work.

So Ms. Mills, have your SBA guidelines tightened up over the last year-and-a-half? Or have they eased up at all?

Ms. MILLS. Our job at the SBA is actually to provide credit elsewhere. So we come in when a bank can't make the loan without a little bit of help. We have continued to do that and, as you can see from our charts, expanded to really fill a large part of the gap as banks have pulled back on their credit.

The second thing, I would just say in answer to your issue, is that we share your concern that banks at the ground level need to fully know these communications that we are hearing here because we hear the same issues and confusions. But we stand ready to help them mitigate the risk because with a 90 percent guarantee, that portion is not considered to be risk capital on the bank's books, and therefore with an SBA guarantee, they can take a lot of that risk out. We just need to be able to—with the increased loan size—do something, for instance, for a third restaurant. That is usually a loan size issue for us.

The CHAIRMAN. Does the gentleman want another 15 seconds?

Mr. PERLMUTTER. I will yield back to my friend from Colorado.

The CHAIRMAN. You yielded him back nothing.

Mr. PERLMUTTER. When it comes back to my time, then I will yield to him.

The CHAIRMAN. I will now recognize the gentlewoman from Illinois. But I just have to say two things. First of all, I know people are coached from time to time to say, oh, thank you for that question. If all the witnesses would stop saying, thank you for the question, we would get another 20 minutes. Because we don't believe you anyway that you are really that grateful, and you shouldn't be.

But more importantly, I tell you this is my frustration, when we raise anyone's question, you are there running your agencies. We are listening to people. You can make a very good defense of every single thing you did. But if all we are getting is a defense of every single thing you have ever done, there is no change in the status quo, and we have a problem. So I urge you not to be totally defen-

sive. It is entirely possible that you have done very good things in a very difficult situation, but we still need to do a little extra. And the frustration is, when we get it, as I said, issue by issue, decision by decision, a perfectly plausible defense of what has happened. But then people go away saying, I guess there is no change.

The gentlewoman from Illinois?

Ms. BEAN. Thank you, Mr. Chairman. Thank you all for sharing your expertise and your experience with us today on such an important topic. I particularly want to acknowledge the great work and efforts that you have done at the SBA to Karen Mills, and your staff does a really good job in Chicago and in Illinois. When we have done—even in the suburban district that I represent—forums, which I regularly do with our area businesses, we have invited the SBA to participate. They educate people on the loan programs that are available. They direct them to the increasing number of banks that are now participating in the SBA loans. I have been advocating for a new and improved SBA since I came to Congress. I think you are really delivering against that, and I am glad you are asking for additional resources.

What was most disconcerting about your testimony was when you talked about the $90 million that has already been approved in the queue but you are running out of funds. So we need to continue to provide that support so those loans can continue.

Now in your testimony, you talked about your principles for supporting job growth and economic growth, build on what works, maximize effectiveness, protect taxpayer dollars, and make targeted changes quickly. Given that my understanding is that to build the type of infrastructure that you would need to support the direct loan program that some are advocating for would not only take longer—in other words, to establish the necessary organization—but that it would cost 15 times more. Am I correct on that? How does that align with what we are all trying to do in getting—as you have already gotten $20 billion of loans since the stimulus—out to small business? Does this align with those goals?

Ms. MILLS. As you mentioned, our principles are to try to build on what works. And what has been working is the Recovery Act, 90 percent guarantee, and the fee reductions. But there is still a gap. And that is why we have taken each piece of the gap and tried to fill it with a program that addresses what we have heard as we have gone around the country and gotten the problems from the banks.

So there are still gaps out there, and we have an array of things that we want to get at. We have a pretty good track record so far in going through our 75,000 banks. We have 1,000 of them that stepped back up. That is why we are saying, we can get out faster using the tools we have.

Our issue is not really direct lending. A borrower doesn't care where the money comes from. They care that they are not getting it right now. So we want to really push the throttle forward on this direct access issue, which is we need to get those borrowers connected to the bank networks that are lending in the communities. That is why the capital helps us. That is why the increased guarantees help us. That is why the increased loan sizes help us. And

if we do that and we still have somebody who is not bankable, we want to get them into our network of counseling.

We found in North Carolina that 60 percent of the people we got into our Small Business Development Centers who were rejected from the banks, we could actually get them bankable by helping them with their package. They might not have done their business plan so correctly, and maybe 2 years ago you didn't need a business plan to get a loan. Well, now you need that.

So we are going to accelerate those efforts.

Ms. BEAN. I have one other question for you, and then I would like to go to Comptroller Dugan. My other question for you is, it is estimated SBA-backed loans account for about 10 percent of the small business lending marketplace. How would you categorize recent changes with your plan of what overall share of lending in the small business marketplace has been in the past year and moving forward?

Ms. MILLS. Well, as Chairman Frank has suggested—and I take this opportunity to identify something that we would like to have that we don't have today, which is more data. We actually have very little data to size the small business lending market. That said, we estimate that we used to be about 10 percent. We think we are a much greater share at this moment. And with these programs as—it is hard to differentiate what is demand-driven and what is supply-driven. But we estimate that with these programs, we should be able to close those gaps and be a larger share of the market.

Ms. BEAN. Thank you.

For Comptroller Dugan, the Administration has proposed temporarily opening up the SBA 504 program to commercial mortgage refinancing. Given the growing concerns over what is happening with the commercial real estate market, and the number of maturing loans on the books about to come due, many of which have fallen in value and may continue to fall, is there more that we should be doing to address that?

Mr. DUGAN. Congresswoman, I do think there is more. The bankers that we talk to think that increased SBA lending limits, on the 504 program in particular, would be something that would cause them to do more lending than they otherwise would. We have gotten our bankers together to sit down with Treasury as they have tried to suggest what are real-world practical issues with the current SBA program that could be addressed. I think that was a helpful set of discussions that I think led to some productive, proposed changes.

Ms. BEAN. I appreciate it. I yield back.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Mr. Chairman, I was going to ask Mr. Gruenberg a question. I have heard from several banks out in California that they are concerned with the treatment of commercial real estate loans, and I think we are talking about roughly $3 trillion in commercial real estate loans right now that are either on the books of the banks' balance sheets or securitized through MBS. And if the figures are right, I think roughly $1.4 trillion across the country is scheduled to roll over between now and 2013?

Mr. GRUENBERG. I don't know that number, Congressman.

Mr. ROYCE. Maybe Mr. Dugan would know.

But what I have heard from local banks is that once the term of a loan rolls over, let's say typically 5 years, the lender is required to do a new appraisal of the property's value. And some of the banks have conveyed to me that, while they would like to roll the loan over, because the revenue coming from the property remains strong, they are being discouraged from doing so by the examiners because, frankly, the appraisal value obviously of the property is not coming in at what it was. And I would like to get your assessment of this potential dilemma here.

If a property has dropped in value but the revenue stream coming from the property is consistent, how should the loan be treated? I understand these loans need to be treated on a case-by-case basis, but, in general, I would like to ask Mr. Dugan and Mr. Gruenberg of the FDIC, should the bank make that assessment? Or is that a question for the bank's judgment? Or do we suggest instead that, because of the current appraisal, that we basically have the regulators lean in and send the message to the bank that—

Let me just ask you forthrightly, how do you think that should be resolved, if you have that judgment question?

Mr. GRUENBERG. Well, in the first instance, on an individual loan we would defer to the judgment of the bank. It is really the bank's responsibility to make an assessment on the quality and creditworthiness of the loan and a judgment as to how to proceed if the term is expiring.

As a general matter, and this is really one of the key issues in the guidance that we have issued, we have tried to send a clear message to examiners that if there is a drop in the collateral value, but the borrower is otherwise in a position to carry the loan, the guidance is very clear that the collateral alone should not be the basis for evaluating the borrower's position. That is a message we have gone to great lengths to communicate to our examiners across the country. There may be individual cases where that is not being followed. But the final impression is that examiners are trying hard to work with bankers on that issue.

Mr. ROYCE. There are certainly some individual cases, or at least as represented to me there were. And I don't know exactly—I wasn't there to hear how it was communicated, but maybe there was just an insistence that things be better capitalized in there. But the representation I heard was that there was this message.

I would ask Mr. Dugan for his thoughts on this, too.

Mr. DUGAN. I agree with what Mr. Gruenberg said. I think the issue that we will always look at and we expect the banks to look at in the first instance is, is the cash flow adequate, accompanied by the secondary sources if there are guarantors to repay the loan. That is the key issue.

Mr. ROYCE. But let me give you an example. Because in talking to one banker he said the theory was that the cash flow was currently adequate, but in that particular market the presumption was that in the future it might not be adequate. And the question to me was this: Does the banker get to make that decision, or is that suggestion being made to the regulator?

Yes, currently—currently, indeed, you have a performing asset—or whatever terminology is used. You have the income flow. But we

anticipate that with the implosion, let's say, in the Inland Empire in California, that come next year you may not. And, therefore—this is what I am trying to discern. Because we all hear anecdotal information about this, and getting to the root of it is interesting.

Mr. DUGAN. And we hear that anecdotal information as well, as you might imagine.

There certainly is no policy to say that because of a speculative future drop in income that the examiner says that that is the cause of why you have to write this down. But we also do expect our banks to stress their portfolios and make sure they are taking into account potential real-world issues that are going on currently in the marketplace. It is hard to respond without having the particular instance in front of us, but I would say we welcome that discussion. And if it is not happening at the field level, we welcome them taking it up the chain, both informally and also, if necessary, to our ombudsman.

I hear the same issues, and I am constantly talking to our supervisors and examiners: Are we getting this right? And we constantly then will go back and ask questions. This recent guidance did try to get at a number of these specific issues with real-world examples that I hope would be good ones.

If I could just say one other thing. I think we have a hard time getting across the message that even if a loan is criticized, it doesn't mean you still don't continue to work with the borrower. We expect criticism of loans—that is a technical term—to go up during tough times. But it doesn't mean that we expect bankers and borrowers not to work through those loans.

Mr. ROYCE. Thank you.

The CHAIRMAN. Thank you. And I thought we would let that one go because it is at the heart of it.

I just want to report—I double checked. Mr. Bowman, you were correct in your recollection. In the 109th Congress, under Republican Majority with a bill of Mr. Hensarling's, we took the cap off small business lending entirely. It was a 10 percent business cap but none for small business, and that passed the House in the 109th Congress when the Republicans were in the Majority.

And then in the previous Congress, with the Democrats in the majority, Mr. Kanjorski was the sponsor of it, and it also passed the House.

So the House has twice now sent to the Senate legislation to remove that cap, and maybe the third time will be the charm. I think we might get bipartisan efforts to do that. As Members know, charm is not my special area, but we will see if it works.

I believe we are now up to Mrs. Dahlkemper.

Chairwoman VELAZQUEZ. Mrs. Dahlkemper?

Mrs. DAHLKEMPER. Thank you, Madam Chairwoman.

Thank you to the witnesses for being here today.

Certainly this is an issue of great importance to my district in Pennsylvania and to small business access to capital across this country. During these difficult times, I think it is paramount to the American economy to help our small businesses access capital.

Ms. Mills, as you are aware, I, along with Congresswoman Bean, recently introduced legislation aimed at increasing access to capital through the Small Business Administration's 7(a) Express Loan

program, and I want to ask you a couple of questions regarding that program.

First of all, what is the SBA's view on increasing the loan size for the 7(a) Express Loan program and how do you see this as fitting into the larger picture of the SBA lending programs?

Ms. MILLS. The SBA Express Loan program is designed for businesses to give them working capital; and, as you know and as in the bill you introduced, one of the most severe problems right now is that small businesses have had their lines of credit withdrawn or cut back. And now, as they begin to see that next order come, they don't have the inventory and they don't have the cash flow to expand and take that on without working capital lines.

The SBA Express program is very popular because it actually allows the bank to use its own paperwork. There is no incremental paperwork, and that allows a much faster result for the borrower. So we see that as a very good vehicle that is up and ready today. It is currently about 55 percent used by community banks, and we see community banks as a very important conduit to these small businesses who are growing. We asked for an increase in size to $1 million. The current cap is $350,000.

I want to point out that the default rates on the SBA Express are higher than usual in the small amounts, and they are actually lower than usual in the larger loans up to the $350,000. So the modeling and expectation is that these actually will have lower default rates than our 7(a) program.

Mrs. DAHLKEMPER. Where is the cutoff that you are seeing the difference in terms of the default rate?

Ms. MILLS. There is a chart in your materials, and I think we had it up on the screen earlier. And I think, if we look at that, we can see it is about in the middle. So it is below—we have data up to the $350,000. But this is the chart, and the sort of line going down is the—and it is about—it looks like it is about at the $100,000 level.

Mrs. DAHLKEMPER. So moving up from the $350,000 up to the $1 million, which is what our legislation has, would be actually—you would see a lower default rate, according to your research?

Ms. MILLS. That is what the data indicates.

Mrs. DAHLKEMPER. One other question on that. Is there anything that would keep our community banks or credit unions from fully participating in the 7(a) Express loan, should they choose?

Ms. MILLS. No. They participate very robustly now. And particularly in 2009, as we have brought these thousand community banks back to lending, they participated in this as well.

Mrs. DAHLKEMPER. And is there a need, an outcry for the larger amounts?

Ms. MILLS. Absolutely. There is a real gap in the credit market right now for working lines of credit and there is demand there. We are seeing it both in our SBA Express increase in volumes and in our 7(a) increase in volumes.

Mrs. DAHLKEMPER. I have one final question, for whoever would like to answer this, but it is about credit unions. And I have certainly talked to the credit unions in my area who are very well capitalized, and they would like to see their ability to lend go from 12.5 to 25. Would somebody like to address that in terms of what

you think that could do in terms of getting credit out to our small businesses throughout our communities?

Mr. ALLISON. Speaking for Treasury, we are in a dialogue with the credit unions right now to understand their needs better, and we are going to continue that dialogue in the days to come, and then we can get back to you about that.

Mrs. DAHLKEMPER. Well, my credit unions tell me that they have billions of dollars that they are ready to lend to businesses today, if allowed to.

So thank you. I yield back the remainder of my time.

The CHAIRMAN. Mr. Luetkemeyer is next.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I appreciate the opportunity to discuss with you this afternoon something that I think is very important with regards to our small business folks being able to have access to capital. As a former regulator myself, a bank examiner—I saw heads turn when I said that; that is interesting—I understand what you are talking about, I think, and I have some concerns from the standpoint that it is nice to see that you finally acknowledged that we have a huge disconnect between what is going on here in D.C., and what has actually been going on in the field. Because I brought this matter to the attention of all three regulators last spring and asked for a meeting with all three—Comptroller, Fed, and FDIC—and FDIC was the only one who accepted my invitation to come to our office and discuss this matter with our entire banking organization and the Bankers Association.

I thank you, Mr. Gruenberg, for showing up. The other ones didn't take advantage of that.

I am very disappointed from the standpoint that Congressman Royce made a very good point a while ago and was pretty articulate about explaining the problem that we have which is going on still today, which is that the examiners are coming in with little or no forbearance and taking a look at the thing we are talking about today, which is commercial real estate lending, and just blanket classifying everything there. And you guys know that if you are on a watchlist—you know what a watchlist is—automatically you are going to have to include more capital, which means it takes money out of the profits, has to be stuck away in loan loss reserves or in additional capital itself to be able to keep the bank afloat. This is devastating to the small businesses, which banks are, as well as small businesses to lend to.

I think that it is very concerning to me. And, Mr. Gruenberg, if you would answer, please, how are we addressing this right now?

Mr. GRUENBERG. Congressman, there is nothing we spend more time on than trying to work with and communicate with our examiners in the field. It is not a perfect process because we have a couple thousand examiners to deal with.

The FDIC has 85 field offices around the country. Last week, we brought the supervisor of each of those offices to Washington for a week. We spent time working through with them all the directives and guidance that we have issued to our examiners, particularly in regard to CRE and commercial loans. We directed them to exercise flexibility and judgment and, as best they can, assist in the workouts of these loans.

Now, you can't always get the results for the institution and the borrower that you would like. But this issue about the disconnect between Washington and the field, that is something we always hear. And I guess I have been on the FDIC Board now for almost 4 years. To a certain extent, it is in the water. This is always a sort of part of the nature of having a large national operation.

But I can tell you we have really made every effort to communicate and work on a regular basis to make clear to our examiners what they are supposed to be doing.

Mr. LUETKEMEYER. I am sure you are aware that, as an examiner myself, I know you are very responsive to supervisors over you all the way up the line from the standpoint that if you don't do a good job of examining this institution this time and you miss a lot of stuff, it is a reflection on your ability to do your job.

Right now, with the economy the way it is, going in the wrong direction, it is pretty easy to go in there and see what you anticipate happening rather than what is actually happening right now. And I think that is one of the problems, is we are doing a lot of anticipating, which is very concerning to me from the standpoint that you have—anecdotally, there has been a lot of this already discussed with regards to folks who are already doing a good job with regards to their business. They are hanging on. Lifetime depositors or borrowers of the bank and no problems in the past. Now, all of a sudden, they are in trouble because of collateral values.

And, to me, without a little forbearance and a little discretion on the part of the examiners, you exacerbate the problem from the standpoint that, by going in and restricting the ability of these folks to lend, you cause less lending to happen which causes less demand for the real estate which lowers the price, which suddenly now the collateral value of everything goes down, and you have a spiral going the wrong direction and, quite frankly, you guys are a part of the problem.

And it is very concerning to me that if we don't have some sort of effort to try and work out a program—I hope that you guys are doing this. I am concerned because I keep following up on local institutions at home, and the examiners have still not really gotten to the point where they are actually working with the banks in what in my judgment is in the best interest of not just the banks but the community and the whole economy as a whole here. So I am very concerned.

Ms. Mills, one of the statements you made a minute ago was with regards to the SBA's job is to make credit available elsewhere. One of the earlier witnesses—

The CHAIRMAN. The gentleman's time has expired. So if we can get a quick response.

Mr. LUETKEMEYER. My question just simply was one of the witnesses a while ago made a comment that they liked direct lending from the SBA. And, obviously, from your comment, you would rather be guaranteeing the loans versus direct lending. Your response?

Ms. MILLS. Yes. Our job is to make loans and loan guarantees when the market is not providing it. So, therefore, there are a number of market gaps that are out there today.

As I said earlier, we did assess direct lending. It ended up with a cost 15 times as much, and we would have to train a new force.

It has been suggested we use our disaster force, but our disaster force is actually not trained for business loans and is busy doing disasters. So we have looked at that option fairly closely but believe that we have a very strong infrastructure in our network of banks. And if we can increase our ability to do credit elsewhere, we can meet the gap.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, for your forbearance.

The CHAIRMAN. The gentlewoman from Florida. Well, at least you got forbearance somewhere.

Ms. KOSMAS. Thank you, Mr. Chairman. Thank you to the presenters today.

I, too, am concerned about the issues raised about forbearance and particularly the impending $1.4 trillion of commercial lending that much of which is performing and compliant and is stuck in the gap that has been earlier discussed. So I certainly hope that—

I know, Mr. Dugan, you said avoid forbearance. The economists we talked to yesterday said forbearance is necessary. Somewhere along the way, we have to find the right balance.

But I have a specific question for you, Mr. Dugan.

In October 2008, you advised the National Bank Examiners along the following lines—and this is a quote from you: "I think it is just wrong to say that any bank that fails and costs the deposit insurance fund money could have been closed sooner at less cost. While the assertion could be true with respect to a particular bank, it is just as possible and, frankly, more likely that the latter option of letting a bank remain open sometimes produces a positive result that avoids failure and loss altogether."

I just want to suggest to you that I have been hearing reports in my community and throughout the State, frankly, that, in practice, the OCC has not been exercising discretion not to close banks whenever they fall into the gray area of capital deficiency. With the escalation of the number of banks on the FDIC trouble list now totaling 702 and with many of them, if not most of them, community banks and with the recognition that community banks are the main source of small business lending, how can we be sure that those who actually make the life-or-death decision for a bank are following your advice to weigh both options?

Mr. DUGAN. We have spent an awful lot of time on this. We have had 183 banks fail; 33 of them have been national banks.

The quote that you referred to was a notion that there is judgment at times because there are circumstances in which even a very troubled bank may have potential buyers. We try to find a circumstance in which we can control the risk of that institution when they are in strained circumstances. One lesson we did learn from the S&L crisis was when institutions have little capital and not much downside risk from taking risk, that is when you have to be most careful with those institutions.

Sometimes buyers can come in and will help the bank turn around. But if they are not available, it is the policy of the agency to close the institution. It is a judgment call. We have a lot of experience in this. We work very closely with the FDIC and their Division of Resolutions when we do this. We try very hard to call them as we see them.

Ms. KOSMAS. I guess, as a follow-up either to you or Mr. Gruenberg, when you find a bank in this situation and they are required to raise capital within certain timeframes, how much flexibility do you actually use in determining other factors for their potential to succeed rather than to be bought out or to be closed out? Because there are many who feel that their operations are good. They might have a quarter during which their capital drops below some standard, which also is a problem, because sometimes it seems arbitrary and hard to determine what is the factor that you use to determine the capital requirement.

And so I guess the question is two-part: What is the criteria that you use in order to determine that capital requirement, and why is it different in some places for some institutions than for others? And how much discretion do you use really in analyzing other operating procedures and income streams and assets that would, given a little bit of time, allow these banks to continue to operate, to be profitable, and to succeed?

Mr. DUGAN. I will start, and then I will be be happy to turn it over to Director Gruenberg.

When in 1991 Congress passed FDICIA, the Federal Deposit Insurance Corporation Improvement Act, they put together and put in place a statutory regime to force regulators to take action when capital drops below certain levels called the Prompt Corrective Action.

Ms. KOSMAS. Is this something you think maybe should be updated?

Mr. DUGAN. We have people criticizing us for not going fast enough. As for going too quickly, all the way from inspectors general to others. So we do try to call this.

But in answer to your question, we look at all different ways with the FDIC at viable plans to see if there is some way to get the institutions to survive without FDI assistance and potentially other kinds of government assistance. We exhaust all of those remedies on a routine basis and work very hard and closely with the FDIC to do so.

The CHAIRMAN. Time is up.

Mr. Gruenberg, we probably would like to have you comment on this as well.

Mr. GRUENBERG. As John points out, there are statutory requirements relating to when a bank falls to a critically undercapitalized position. We don't have a lot of discretion in that scenario.

I will tell you that closure of the bank is the last recourse as far as the FDIC is concerned, because an open-bank solution will avoid a loss to the Deposit Insurance Fund. We go to exceptional lengths in working with the institution to see if there are investors available on an open-bank basis to raise the capital to keep the institution functioning. If the institution is not in a position to raise the capital, if it has really reached a critically undercapitalized position, then the law is clear and there is a public interest in moving directly to address this situation.

The CHAIRMAN. The gentleman from Alabama.

Mr. BACHUS. Thank you.

Let me ask the regulators this. You heard a statement I made a little earlier that we are hearing from the banks that their job

is being complicated by examiners. And I know you are folding your arms, Mr. Gruenberg, but we hear this every day. And, as ranking member, our members refer bankers to me or small businessmen, and they actually—

The CHAIRMAN. One of the most of fun parts of the job.

Mr. BACHUS. Right. You know, I had three yesterday, one from Mr. Mica's office, one from an Iowa Congressman, and they mentioned various things. Like, for instance, one banker—and I have heard this twice in the last week—said that the examiner said you have too many owner-occupied loans. Another one: You have too much commercial real estate. Different things of that nature. But, generally, if they have it, they have it.

And the other thing that I have noticed is that you actually say they are not healthy so you restrict their lending. But I am just wondering, if they are not healthy—and I guess by "not healthy"—I don't know what CAMEL rating you are assigning them, whether that would mean whether that is a four or five. But, generally, there are areas of the country where there are a tremendous amount of banks. I would say in Florida there are not that many one or two rated banks, are there?

But my question, I guess, is, you all are now saying—and a lot of the things you said today will be very helpful where you said we ask that they not—if the appraisal is dropped on the property, that we won't call that loan or whatever. But how are you communicating that to the examiners to show some leniency? Because I think it is very, very, very important.

Mr. DUGAN. Well, I will start, Mr. Bachus.

We get on nationwide conference calls on a frequent basis with our examiners to go over very significant nuts-and-bolts issues about exactly the kinds of questions that you are getting. Because, just as you get all these questions, I get them, too, and I do my own set of banker outreaches to banks of all sizes and get a number of these questions. So we try to structure the calls to reflect the kinds of questions we are getting, to give the advice, to communicate the message of balance as best we can.

And, as I said before, it is not something new that we have been doing. We have really been concerned about the build-up of commercial real estate and the risk that would happen if we started to have a real estate recession like we are having now. So we started down the path several years ago to try to get banks to be aware that they are going to need to do more things to get ready for what was coming.

As the problems have hit and as we get issues, we have a very quick system for getting it back up the chain, collecting information about what are problems, and then having a call to talk about the issues. I don't know any other way than the hard blocking and tackling of just keeping at it, hearing the things, going back to them and trying to get—

Mr. BACHUS. But I am talking about with your own examiners.

Mr. DUGAN. Correct. This is with our own examiners.

Mr. BACHUS. With your own examiners.

Mr. DUGAN. With our own examiners.

Mr. BACHUS. And are you getting feedback from some of the banks? Are they able to call you and say, look, I am talking with this examiner. I don't want you to tell him—

Mr. DUGAN. I welcome that.

And, as I said, I just went to a meeting with 20 bankers in Denver a few weeks ago from our western district where we had a very good, candid discussion with them about some of the problems. It was a mixture, frankly, of stronger and less strong banks, and we had quite a robust discussion. I always get things out of those meetings that I try to bring back to the supervisors and incorporate into what we tell our examiners.

Mr. BACHUS. Let me ask one other thing. The small business lending fund, Mr. Allison, again, there are regions of the country where many of the banks are fours and fives, and those are probably the regions where the small businesses are hurting the worst. I would imagine there is probably some correlation there. What banks will be eligible for these funds?

Mr. ALLISON. Congressman Bachus, all the banks are eligible to apply. They have to apply through their regulator, and the regulator makes a determination as to whether that bank is viable and can be then referred to Treasury for funding.

Mr. BACHUS. With some of the largest institutions, we injected money into them or loaned them money because they were failing. Some of the smaller institutions, they didn't get money because they had problems. I think there is a feeling out there that there was a double standard, and I wish you all would look very carefully at it if you are going to do that. Some of the banks that need the most help are those that are not healthy.

Chairwoman VELAZQUEZ. Ms. Clarke?

Mr. ALLISON. May I just quickly respond to the Congressman? Very quickly. Actually, the overwhelming majority of the banks that did receive funding are small banks and mid-sized banks.

Mr. BACHUS. I am just talking about percentage-wise.

Chairwoman VELAZQUEZ. Ms. Clarke?

Ms. CLARKE. Thank you very much, Madam Chairwoman, Mr. Chairman, ranking members, and thanks to each of the witnesses on the panel for being here today. This topic is clearly a very crucial topic and crucial to a solid and healthy economic recovery, and I appreciate the spirit of cooperation between the Administration and the Congress in finding solutions to this lending freeze. I look forward to working with each of you as well as my colleagues in Congress to pursue policies that will improve the lending environment for American small businesses.

My first question is, of course, to Administrator Mills. I want to thank you for being here. In your testimony, you expressed your central principles related to improving access to capital. You said that we should: one, build on what works; two, maximize limited tax dollars; and three, make targeted changes as quickly as possible.

As we have discussed previously, I am a great proponent of CDFIs. The CDFI fund, which was established in 1994, has been instrumental in supporting institutions that operate in underserved areas, and I would argue that it has been working well despite limited funding. It has maximized limited taxpayer dollars by

leveraging 15 to 19 for each dollar of taxpayer capital. And there is also pent-up demand for CDFI fund assistance, and more resources could quickly be deployed to where it is sorely needed.

So I am saying all of this to ask—and we have spoken about this before—has the SBA begun the process of exploring partnerships with CDFIs for its lending programs and teaming with the CDFI fund at Treasury to explore ways that we can work together better to serve small businesses in underserved areas?

Ms. MILLS. The SBA is actively engaged right now with about 30 percent of the CDFIs. We find those relationships very beneficial, and we are looking to expand. We are currently in discussions with CDFIs in Treasury about how to increase the overlap. We believe one of—well, one of our missions is to serve underserved communities. Our network into underserved communities is in part through the CDFIs, and we think they are very strong and potentially good partners to increase.

Ms. CLARKE. And then this question is for whomever on the panel. I am just wondering, going forward, how we can better serve the CDFI fund together? What can Congress do to increase more lending to minority- and women-owned businesses in underserved areas through CDFIs? And what is being done in the Administration to better serve CDFIs and promote lending in underserved areas?

Mr. ALLISON. Let me address your question, Congresswoman.

The Treasury, of course, has worked very closely with Ms. Donna Gambrell in the CDFI Fund. We have recently established a facility exclusively for CDFIs to provide them with capital at very low rates. In fact, the dividend rate is only 2 percent.

The response from the CDFI community has been tremendous across the country. We are anticipating very high participation, and I think this is going to go a long way to assuring that the CDFIs during this very difficult time are able to survive and serve their communities.

Ms. DUKE. If I could, the focus of the Federal Reserve is on a very wide basis, and so we brought together the researchers that are in the Fed as well as our community affairs people who have the relationships with the CDFIs. And the series of meetings that we are doing are actually going to very specific communities to find out what very specific needs on underserved areas, working with CDFIs, working with borrowers, working with lenders, and trying to get pictures of all the different ways, and then blue sky that into whatever thoughts we can come up with on ways to solve it.

Ms. CLARKE. I want to thank all of you for your efforts in this regard. This is music to my ears. I serve a district where these institutions have been really just sort of lifesavers for many of our small mom-and-pop businesses, many who are actually poised for growth if they can access the type of capital that CDFIs afford them. So thank you all very much.

Madam Chairwoman, I yield back the balance of my time.

Chairwoman VELAZQUEZ. Mr. Bartlett?

Mr. BARTLETT. Thank you. Several years ago, before his retirement, I was talking with my friend Nevin Baker, president of a small community bank, who had been in that banking business for more than half a century, and he was lamenting what he saw as

the stifling presence of the bank examiners and the regulators. And he told me about banking in bygone days, when he would meet Joe on the street corner in Frederick, Maryland. Joe would say, "Nevin, I need some more money and this is how much and this is what it is for." And Nevin would say, "Joe, I will put that money in your checking account. When you have a chance, come by the bank and sign the papers."

Now, Nevin could do that because he knew Joe and he knew Joe's business and he knew Joe's father who had started the business, and he knew that if Joe dropped dead of a heart attack, that Joe's wife would come by the bank and sign the papers. I think that kind of personal knowledge and judgment may be more meaningful in deciding who is a good credit risk today than your regulatory checklists. And I guess my question is, there is really not much of a role for that kind of knowledge and judgment in today's world, is there?

You don't need to answer the question, because I think the answer is very obvious. So let me yield the rest of my time to my good friend, Don Manzullo.

Mr. MANZULLO. Thank you, Roscoe.

We have three different panels representing three different interests. The guys who need the money testified. They are gone, or some are back there. You are the ones who do the regulations. You will testify, and you will be gone. And the guys with the community banks will come in and testify. And the problem is that the three groups need to get together. Let me give you an example.

Here's the guidance interagency statement. It says: "Banks are becoming overly cautious with respect to small business lending. Financial institutions that engage in prudent small business lending after performing a comprehensive review of that borrower's financial condition would not be subject to criticisms for loans made on that basis."

And the next panel of community bankers will testify, "While Washington policymakers exhort community banks to lend to businesses or consumers, banking regulators, particularly field examiners, place restrictions on banks well beyond what is required to protect bank safety and soundness. The banking agencies have moved the regulatory pendulum too far in the direction of overregulation at the expense of the lending."

And then you have the little guys out there, Steve Gordon who testified from INSTANT-OFF. He says, "I can create 25 green jobs right now and 25 percent of those would be for people with disabilities, etc., etc., but nobody will lend to me."

You know, this is not a situation where you have good guys and bad guys. You have three groups of totally honest people who are working very diligently, who returned calls of Members of Congress very diligently, and everybody has a great desire to get involved.

But here is the problem. The choke-point for recovery in this Nation is this: The Institute for Supply Management now says it is above 50 and climbing for the 7th month in a row. This is the natural recovery of manufacturing.

And I know of firms back home, a food processing—there is a company back home, Ibsen. They make the world's only portable vacuum heat processing machine. If you want it high end, it is

lined with libidon. If you want it low end, it is lined with carbide. It sells for less than $250,000. People are itching to get it. It is already programmed in a hundred languages. People are itching to get their hands on it. And the manufacturers go to the banks, and the banks say, you know, it is the regulators.

But let me tell you what one bank told a constituent of mine who has about 8 to 1 of equity to debt. He said, "We can't lend to you because your sub-S is not showing a profit." Now, I want you to think about how stupid that statement is. But the bank that had been with this family for 30 years said the regulator told them that the sub-S is not showing a profit; therefore, I am going to classify the loan.

Sub-S companies are not supposed to show profits. They are all pass-throughs. And the two brothers who ran the business said, "Congressman, what is going to happen to our family business?"

I would like to see this panel—and I know you have been here a long time. When the guys come up, I would like to see you sit behind them and listen to what is going on. Because you sat and listened to the first group.

And now, here we are. We are on the brink of recovery. We are right at the edge of recovery. Orders for manufacturing are coming in. I have probably 2,000 manufacturers in my district. I am probably the only Member of Congress who has ever gone to warehousing school to learn supply chain management. We are right there. We are at the recovery. We don't need more government programs to create jobs. These guys want to go back to work. Something has to be done, and I don't know what it is going to take.

And, John, you called me back immediately. Sheila Bair called me back. And Chairman Bernanke here this week said we will meet with your people. But you have to have some plan, and I don't hear it. And it is not because of lack of—bad faith. It is just—it is not getting done.

Thank you, Mr. Chairman.

The CHAIRMAN. I extended. I think the gentleman from Illinois was speaking for a very large number of Members of Congress in that and not pointing fingers negatively but expressing the anguish people feel. And let me say, I do appreciate it. We structured this hearing precisely so that the regulators would be the sandwich.

I apologize that because of prior commitments, I am going to have to leave shortly. I just want to announce that at 2:00, the bank panelists will come in. So other members here or other members who are listening, we will have time to have that additional panel.

We will finish up with more questions here. But I think the gentleman from Illinois has done a pretty good summary of what is the prevailing sentiment that I hear in the Congress.

The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman.

I would to associate myself with the comments from the gentleman from Illinois as well. I have had similar circumstances, and I fully understand.

Quickly, if we assume that the question is which is best suited to use this $30 billion to increase lending to small businesses,

banks or the SBA, I want to get some clarity to make sure we all understand where we are.

Mr. Allison, would you say banks or the SBA?

Mr. ALLISON. I would like to turn to my colleague, Administrator Mills, for her answer first. And I will be happy to—

Mr. GREEN. Because time is of the essence, I am going to have to ask that you answer, please.

Mr. ALLISON. I believe, for a program of this scale, it can best be administered through this—

Mr. GREEN. Sir, I hate to press you, but I have many questions. Banks or SBA? That is what the public wants to know. Banks or SBA?

Mr. ALLISON. For a program of this scale, I think the banks are best to get the money to businesses quickly and—

Mr. GREEN. I understand. The rationale is great. I just need to know whether you are saying banks or SBA. I take it you are saying banks?

Mr. ALLISON. I am saying banks.

Mr. GREEN. All right. Ms. Mills?

Ms. MILLS. Both banks and the SBA loan guarantee programs are needed. There are two reasons.

Mr. GREEN. For this $30 billion—because we need some clarity from you as to where you are—are you saying banks or the SBA for the $30 billion?

Ms. MILLS. There are two problems we are trying to solve.

Mr. GREEN. I understand the problems. Can you give me—what I want is your position on whether the banks—this is what we are trying to come to some conclusion about. Banks or SBA? If you give me nebulous notions, when you leave I won't know exactly where you are. So would you kindly tell me, banks or SBA?

Ms. MILLS. We support $30 billion from Treasury to banks—

Mr. GREEN. I am going to take it that I cannot get a direct answer. Let's go on to Ms. Duke, please.

Ms. DUKE. I believe that the biggest problem is the credit risk the banks aren't willing to take. And, therefore, I will say SBA.

Mr. GREEN. SBA.

Ms. DUKE. SBA, and particularly the 504 program—

Mr. GREEN. That is fine. You are an SBA person.

Mr. Dugan?

Mr. DUGAN. SBA.

Mr. GREEN. Mr. Gruenberg?

Mr. GRUENBERG. I don't think I am in a position to make a judgment on that.

Mr. GREEN. No position.

Mr. Bowman?

Mr. BOWMAN. Banks and thrifts.

Mr. GREEN. Banks and thrifts. All right. Thank you very much.

Now, let me come back to you, Ms. Mills, for something else. And I am not badgering you. I have learned that if I don't ask questions that give me a yes or no answer, I sometimes assume people mean yes when they actually have been trying to communicate no in a very nice way.

So now, with this said, you mentioned a 90 percent loan guarantee. Is it important to indicate and let the public know that this

is not a 90 percent guarantee of the loan but rather 90 percent of the loss? Because if there are assets to cover losses that may make the loan totally covered with the assets, the losses, then the government doesn't lose any money, the taxpayers don't lose any money. Is that correct?

Ms. MILLS. It is 90 percent of the loan.

Mr. GREEN. Of the loan. Not of the loss.

Ms. MILLS. Correct.

Mr. GREEN. So if the loan defaults and the borrower has assets that are going to be used to satisfy some portion of the loss, don't you subtract that from the loss itself?

Ms. MILLS. It is pari passu for the whole loan. So we take 90 percent and the bank takes 10 percent.

Mr. GREEN. I understand. But I am talking about how it actually works. Won't the assets that are available be taxed as well as a part of the loss?

Ms. MILLS. Yes. And—

Mr. GREEN. As an offset?

Ms. MILLS. As an offset for 90 percent going to the SBA, guaranteed 10 percent to the bank.

Mr. GREEN. So what I am trying to communicate is that there are assets that will be used to offset some of these losses as well.

Ms. MILLS. Correct.

Mr. GREEN. That is important. Because it can come across as though we are talking about 100 percent of the 90 percent being used and that there will be no offsets with assets. That is what I am trying to get into the record. All right. Thank you very much.

Now, Mr. Allison, you mentioned that Tier 1 capital would be used—some of this $30 billion could be used for Tier 1 capital. Is it true that Tier 1 capital is not capital that you lend but rather capital that you maintain to be fully capitalized?

Mr. ALLISON. Tier 1 capital refers to the amount, the base of the—

Mr. GREEN. Do you lend Tier 1 capital?

Mr. ALLISON. You can lend Tier 1 capital. But Tier 1 capital can be leveraged to support a great deal more lending.

Mr. GREEN. I understand. When we capitalized the big banks, they took that money and they did not use it for lending. They used it to become fully capitalized to help prevent runs on banks. Is this true?

Mr. ALLISON. In some cases, yes.

Mr. GREEN. Okay. Is this money that, the $30 billion, will the banks be able to lend it, or will they be able to—will they use it to become fully capitalized or will they use it for both?

Mr. ALLISON. We have talked to many of the banks. We are confident that if they receive this capital, given the incentives in this program where the dividend rate drops dramatically if they use the money for lending, we are confident that they are going to use this money and help to lend to small businesses. We expect a significant increase in their lending, because this amount of capital can increase their total capital by 30 to 50 percent.

Mr. GREEN. My time is up, and I don't want to encroach. Thank you, Mr. Chairman and Madam Chairwoman.

Chairwoman VELAZQUEZ. Mr. Manzullo?

Mr. MANZULLO. Thank you.

The National Association of Manufacturers commissioned the Milken Institute to do a report on the impact of manufacturing and the recovery. It is nothing less than staggering. We can't buy our way out of this recession. We have to manufacture our way out of it. We have to restart the supply chain. We have to get people back to work to the jobs they had before, in many cases.

I know of situations where manufacturers have gone to banks with an order from a manufacturer offering to let the bank factor to pay for their own materials, to pay the subcontractors, and then to receive the check from the final manufacturer and make distributions, taking out, of course, the proceeds of the loan. But even then, the examiners balk.

I guess you have to visit—and I know many of you have—the factory floors that I have to see the total frustration of people who have been in manufacturing for years, see orders coming in, and—listen to this very clearly—because they can't get operating capital, those orders are going to China. And jobs are being lost as a reduction of our manufacturing defense base because the capital simply cannot come.

I know in the guidance it says examiners will not classify loans solely due to the borrower's association with a particular industry or geographic location that is experiencing financial difficulties. This is the last sentence in the November 12th guidance. But that is not what is taking place out in the field. And, you can bring in all the people you want from around the country for a week of training in Washington, but unless they understand the sweet smell of machine oil, you will never be able to get these manufacturers going.

The question is, it is a fact, is it not—and the examiners can answer the question—that decisions are being made that a bank may have too many commercial real estate loans, too many manufacturing loans, too many agricultural loans; and then the examiners will say, well, you have to balance this because we know that manufacturing is sliding, those jobs are going, and this loan may not perform.

Would that be correct? Does anybody want to touch that?

Mr. GRUENBERG. It is fair to say that if a bank is concentrated in a single line of lending, concentrations in a particular loan category can pose a risk.

Mr. MANZULLO. But at what point are manufacturing loans a risk? Is it 25 percent? Is it 50 percent?

Mr. GRUENBERG. I think the concentration would require the examiner to review the book of loans and make a judgment.

Mr. MANZULLO. But, see, that is the problem. The problem is this. You read manufacturing is on the demise—because people don't understand. They don't know what the Institute for Supply Management—and probably neither do the examiners. They can't read trends. They can't take a look at an order from somebody like Ford Motor Company, for example, that pays its bills. And here you have a supplier begging, just begging to get the money, offering to factor it, and the examiners are saying no. That can't continue.

Mr. GRUENBERG. I will make this point, Congressman, in regard to the guidance. One of the things the guidance points out is that

90 percent of the reduction in lending in the fourth quarter of last year was from institutions with assets over $100 billion. Many of those large institutions utilize, in effect, models to make judgments about how they provide credit to certain communities. So rather than examining the actual creditworthiness of the borrowers, you have models making judgments about credit availability. And one of the things the guidance specifically addresses is that—and you pointed it out—that should not be the basis on which lending decisions are made.

Chairwoman VELAZQUEZ. The gentleman's time has expired.

Mrs. Halvorson?

Mrs. HALVORSON. Thank you, Madam Chairwoman.

I am going to try to make a complicated issue as uncomplicated as I can. And I doubt if that is possible.

First of all, I would like to make an observation, Mr. Dugan and Mr. Gruenberg. At one point during our panel—because I have been here the entire time—I saw you folding your arms. Now I know that you are not sending any body language issues or anything. You are probably just making yourselves comfortable, right?

I want to tell you a story of somebody in my district, the nicest man in the world, a banker. He was there with an examiner, sitting there, just folding his arms because he was comfortable. The examiner sitting there across from him demanded that he stop being on the defensive and unfold his arms. Now, come on. They just demanded that he unfold his arms. Well, that is not something I think is their job to say, and that is just kind of what is happening.

I also heard during this that you have absolutely no discretion, that you are pretty much—your hands are tied. But yet I am also hearing that everything that your examiners and your regulators are doing is all subjective. It is not objective.

Everybody wants to blame somebody else, and we are here because we have to stop blaming other people because we want to come out of this.

The stories I hear as I cover my eight counties in my district are all the same. I don't care if it is the rural, the urban, or the exurban. The bankers want to help our small businesses. The small businesses have never missed a payment. They are doing everything they can. They are good people in their communities. But their lines of credits are being pulled, and they are having to go find credit somewhere else, and they can't. And these are people who want to invest in their companies. Most of them have made a profit, and now they are going to have to shut their doors because they can't even find a way to completely pay their bills or their employees.

So we are sending these double messages that we want our companies to invest, we want our local banks to lend, and, no, we are not doing anything.

So then we want to talk about the fact that we are helping our SBA, Small Business Administration, loan more. Well, our banks don't want to work with the Small Business Administration because of the paperwork. So we say that we are fixing the paperwork.

But then my bankers say that takes 4, 5, 6 months to get a loan and who wants to wait that long for a loan. Now, it doesn't matter if any of this stuff is true. If it is perception, it becomes reality. So what I am looking for here is flexibility. Again, I hear there is no flexibility. Everybody's hands are tied. So, okay, you don't have flexibility.

Tell us, what can we do? This is ridiculous. If we are American and we want to invest in our company, we want to recover, we are right there, tell us, help us how we can recover, how we can provide our banks, our small businesses with some flexibility that is not tied up in all this bureaucracy. I may be new. I am in my first term, but I am more commonsense. I just want to do it. I want to tell my small businesses you can invest, that we are going to help you with your loans and I want to tell my banker, you weren't the problem, you didn't cause this problem.

And I want to tell all of you, please help us through this because we are the ones who are on the ballot. We are the ones who are out there listening to our constituents, morning, noon, and night, and yet we are having to deal with this bureaucracy everywhere we go. So the only thing I want to do is maybe—I don't know if it is Ms. Duke, Mr. Gruenberg, but who can help us, where can we find the flexibility, and where can the three of you groups work together so that we can make this all work? Otherwise, you are going to put businesses out of business; there are going to be more people out there looking for health care because they are not going to have a job and they are going to be strapped to the rolls of government.

So we have to do something and, please, if there is anybody there who can help me with a little of this commonsense that we need? Who wants to start?

Mr. ALLISON. May I please start?

Ms. HALVORSON. Yes, please.

Mr. ALLISON. Let us assume that the businesses want to borrow, the banks want to lend, and the regulators want to make sure that the banks are lending responsibly and have adequate capital to support their lending. We can solve all three if the Congress will approve and increase this new capital fund so that we can provide this capital to banks so that they can increase their capital base dramatically. I think without being presumptive of my colleagues, who are the regulators at this table, that should make regulators more comfortable about the strength of the banks and they will be able to lend more.

I think we have to act quickly and I think that it is important that leaders in Washington and the governors offices and the mayors make the point to the banks that they should look carefully at taking this capital and fulfilling their responsibilities to their communities by lending.

Chairwoman VELAZQUEZ. Time has expired. Let me take this opportunity also to remind Mr. Allison that back in 2008, there was an interagency memo that Mr. Manzullo made reference to and apparently the banks and examiners didn't get the memo because here we are—3 weeks ago, another interagency memo was sent, and that is my concern. If we are going to put all the eggs in one basket and give all this money to the banks without any strings attached to it, that will require for the banks, if you take the

money that is supposed to be used for lending for small businesses, it has to go for that. But we are providing—what we are doing is giving a blank check again. Mr. Posey?

Mr. POSEY. Thank you, Madam Chairwoman. You and your agents probably, to a greater degree than that of the banks themselves, will determine how many more survive and how many more fail. Following up on the comments of my colleague previously, most of the bankers that I talk to—and we have had numerous financial roundtables in the counties I represent and surrounding counties—would actually prefer a little dose of commonsense to the infusion of more money, believe it or not.

They mostly swear to me that if they are allowed to work through some issues without some monolithic bureaucrat beating them over the doggone head, they can work out of this thing. They are very confident about it. And they are very confident there are going to be massive failures if they are not allowed to do that and let me add that you are giving quite a few mixed signals here today. You are all against forbearance, but you are in favor of using common sense. I don't know where you draw the line there. I really don't. At every roundtable they have also mentioned, and it has just about been unanimous, that they heard the rumor that the Fed wants to dramatically reduce the number of small banks in this country so there would be a more manageable number, easier to regulate and probably to manipulate.

So I would like each one of you who has heard anything like that to raise your hand right now. And let the record show that none of you have heard that and none of your raised your hands. Just to make sure that I have this on record perfectly, if you have not heard that, please raise your hand, you have not heard anything like that ever one time signal. And two of you are absolutely stone deaf. You have not heard and you haven't not heard. That is, I think, what Mr. Green was getting to a little while ago. That is very unfortunate. In your interagency statement, you all said for most small business loans, the primary source of repayment is often the cash flow of business.

Let me drop down to examination reviews. Examiners will not discourage prudent small business lending by financial institutions, nor will they criticize institutions for working in a prudent and constructive manner with small business borrowers. That really sounds great. And again, that would appear to invoke common or uncommon sense as the case may be. But on the ground, the reality is clearly different.

I think we have heard that, every member of this committee has heard that, I am sure. A question that I would like to ask each of you, and if time runs out on me as it probably will, I would like to ask each of you to please respond directly if the Chair has no objection.

To the Chair, I am going to copy the members. We certainly want to avoid more after-the-fact hearings about community banks which could have or should have been saved if only additional time had been provided for some of these problems to resolve themselves to full financial stability. And so I want to know what your plans are specifically, not generally, we are going to be helpful. I want to know what your specific plans are for helping institutions other

than closing them or forcing them to be purchased by larger institutions, which, in many cases have received TARP funds and are now being given FDIC assistance in the form of loss coverage on the acquired assets of those transactions.

I want to know what policies you have in place to make sure examiners take into account the short-term and long-term impact on the communities, the businesses, and the households served by these locally oriented institutions and ultimately to the taxpayers of this great country. How do you make sure these policies are being effectively implemented as well? Anybody can jump in there. I see you are all anxious.

Ms. DUKE. First of all, I would like to say categorically that the Federal Reserve does not have a plan to reduce the number of banks in the country. We are working not only with the guidance but also looking at gathering data within the institutions to find out what troubled debt restructurings are working, what workout practices are working, looking for statistical ways to measure the impact of guidance and to look for call report changes that we can do. The most important thing to do is to improve the economy.

Mr. POSEY. How are you doing that? How are you going about it? Are there bureaucrats out there who are tasked in the next couple of years to figure this out? What is an action item? How do they really get rolling? How does the real world tell you what they need and then you accept that this is realistic where it is a commonsense approach? For example, they tell me, almost every banker, they have a loan, it has never not been current. But if the father-in-law makes a payment or another company owned by the same principal makes a payment, it is off the books.

So that is collateral that they can't make money on. They have to make a higher interest more loans there and it is money now that cannot go into the community and help another business. So it is a cycle that just perpetuates the downfall of our economy. How would you suggest we address an issue like that?

Ms. DUKE. Again, by making our expectations clear, by communicating those to the frontline level of the examiners by talking to bankers, by talking to borrowers, by talking to examiners, by gathering information on what things are working and looking at the overall impact because the idea is not necessarily forbearance, but to get the businesses and the banks to the point where the economy has improved.

Mr. POSEY. Thank you. Madam Chairwoman, I look forward to the written response of all of them.

Chairwoman VELAZQUEZ. Without objection. Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. Thank you, Madam Chairwoman. I was very skeptical a year ago that this stress test for the 19 biggest financial institutions would be seen as credible as a rigorous test of their soundness and when some of those institutions were told that they had to raise more capital after the stress test, I thought good luck with that. But I was very surprised at how easily and quickly they did raise the additional capital. We have heard that regulators are telling a lot of the smaller banks, the regional banks and communicate banks to raise more capital and it appears not to be happening. What is the difference? Are they trying? Are there questions about what is really on their books? Chairman

Bernanke said yesterday that part of it is their commercial real estate exposure, but the 19 big institutions obviously have some problems with their assets too. Why are they not raising capital? How important is that to dealing with the supply side problem with credit? Anyone who wants to answer that.

Ms. DUKE. I think, first of all, the smaller the bank, the less access they have to capital markets. There is another piece where there is in some cases concern about putting capitals into the banks and the banks fail and the capital gets lost. Or in cases where banks are trying to really just sell themselves, there is a concern that perhaps if they wait long enough depending on the stress of the bank, they may be able to buy the bank cheaper after failure.

Mr. MILLER OF NORTH CAROLINA. Is that because they are small enough to fail? Is that one difference between the 19, is they were seen as "too-big-to-fail" and the others are small enough to fail?

Ms. DUKE. I am not certain that all of the 19 were considered to be "too-big-to-fail," but they were certainly large enough to have access to a wider spectrum of investors to put capital into them.

Mr. MILLER OF NORTH CAROLINA. Governor Duke, I should note for the record that despite your unfortunate name, you are a graduate of the University of North Carolina.

Ms. DUKE. Yes, I am.

Mr. MILLER OF NORTH CAROLINA. The 19 banks, the biggest banks that were subject to the stress test, they represent something like 80 percent of the banking system's assets and they appear not to be—they say they are lending, they say the problem is all on the demand side with respect to them and not on the supply side. That seems to be a questionable claim. What is the problem there? Why are they not lending and some of them took the TARP funds, which is a capital infusion and used it for paying cash bonuses, paying dividends, even buying back their own stock, which is going 180 degrees in the wrong direction. Why are they not lending? Or are they lending?

Ms. DUKE. The decrease in the loans outstanding has been more pronounced in the large banks than it is in the small banks. But it is not clear with the larger banks who have larger customers, how much of that is due to the fact that their customers also have access to the debt markets and have, in some cases, issued debt and paid down on the loans that they have with the banks. We don't have good data on the breakout between loans to smaller businesses and loans to larger businesses. We only have data on small loans, not necessarily loans to small businesses, and historically, we only have that once a year. We are now putting into place a process where we will get that information on quarterly basis.

Mr. MILLER OF NORTH CAROLINA. Mr. Dugan?

Mr. DUGAN. Yes, if I could add to that. That is right. As you said, they have the biggest chunk of the assets in the banking system, also have the biggest chunk of the decline and disproportionately it is somewhat larger for larger institutions than smaller. What the larger institutions tell us is what you said: number one, demand has significantly weakened; and number two, they have tightened their underwriting standards because they believe in this climate of recession.

Mr. MILLER OF NORTH CAROLINA. They want to get paid back. I want them to get paid back.

Mr. DUGAN. What we don't tend to hear from the larger institutions is that there is a regulatory component.

Mr. MILLER OF NORTH CAROLINA. Is there anything we can do to help the smaller banks attract more capital? Not just the $30 billion in the Treasury's proposal, but attract private capital. I have heard from investors that there is money out there and they don't feel the confidence to invest it in community and regional banks.

Mr. DUGAN. One thing I think that the regulators have looked at—and this is a controversial area—is that they have relaxed the rules to let private equity come in and purchase institutions. There are issues associated with that, both at the holding company level, whether it is the Federal Reserve or the OTS or if it is an assisted transaction from the FDIC. But there has been absolutely an exploration in trying to widen the circle of potential capital investors with some success so far.

Mr. MILLER OF NORTH CAROLINA. No one else? I will yield back.

Chairwoman VELAZQUEZ. Time has expired. Mr. Lance?

Mr. LANCE. Thank you, Madam Chairwoman. Good afternoon to you all. I have no questions. I just wish to associate myself with the comments of Mr. Manzullo and with Chairman Frank. And I think, Governor Duke, you have hit the nail on the head in your testimony on page 5 where you state, "Some banks may be overly conservative in their small business lending because of concerns that they will be subject to criticism from their examiners. While prudence is warranted in all bank lending, especially in an uncertain economic environment, some potentially profitable loans to creditworthy small businesses may have been lost because of these concerns, particularly on the part of small banks. Indeed there may be instances in which individual examiners have criticized small bank loans in an overly reflexive fashion."

This is certainly true in the district I represent as it is true I believe of almost every member of this committee I have had in my office in New Jersey small businessmen and women who are on the verge of tears because they cannot receive appropriate amounts of loans. And I commend all of you for your fine work and we have to work together out of this crisis particularly for the small business community which I believe is the engine of the creation of jobs in a revitalized America. I yield back the balance of my time.

Chairwoman VELAZQUEZ. Thank you. That concludes this panel. And I want to thank all of you for your insight and for the great exchange that we have been able to have today. With that, we excuse the witnesses, and we will ask the third panel of witnesses to please come forward.

Mr. DUGAN. I promise I won't fold my arms again, Madam Chairwoman.

Mr. MINNICK. [presiding] Gentlemen, please take your seats. The committee is still in session. We appreciate all of you being here and apologize for the congressional schedule deferring your appearance. I appreciate you staying here.

And we will begin our testimony of this, the third panel, with Mr. Andrews.

STATEMENT OF STEPHEN G. ANDREWS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANK OF ALAMEDA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. ANDREWS. Mr. Minnick, thank you very much for the opportunity to come here today. I am Steve Andrews, president and CEO of Bank of Alameda. It is a bank in the San Francisco Bay area of Oakland. I am a State-chartered bank operating in the State of California with roughly $250 million in assets. I am pleased to be here today to address the panels as well as the committees with respect to the state of small business and real estate lending in local markets. I am also very pleased to represent 5,000 community bank members and the Independent Community Bankers of America. Bank of Alameda is like most small banks. We specialize in small business lending, we specialize in real estate lending, we specialize in relationship lending. Community banks across the Nation, some 8,000 community banks stand ready and prepared to continue to lend into their communities and support those businesses that require stimulus and recovery. My bank faces serious challenges. We just heard from a series of regulators up here about their work trying to mitigate some of those challenges. But the fact remains that community banks are operating in the toughest economic climate and the most severe regulatory climate we have seen in over 2 decades.

We have heard about the pendulum, if a puny bank's perspective, that pendulum has moved too far into the category of overregulation alter the expense of lending. And we see the result of that with many of your constituents coming into your offices and worrying about the allocation of credit. The regulators are questioning real estate values. They are making subjective calls on the street and in community banks. And that is creating an atmosphere where many banks are reticent to make viable commercial small business loans.

While the economy has suffered, and certainly some of those CRE borrowers you see out there are having trouble financing and making their payments, regulatory burden has added another category of stress to the situation. We also have fairly healthy economies that exist in the United States, but even in those areas, community banks are suffering because regulatory constraints are asking them to reduce overexposure in the CRE area. The regulatory environment is tough. Some of our best clients in the Bay Area come into us and cite it is not only that, it is that we are concerned to invest today.

So yes, there is an element of our borrowers who are concerned to invest and take out additional credit because they are not sure as all of us here today are when this recovery will take effect. I want to concentrate the balance of my remarks mostly with the regulatory environment. I do see, and believe me I represent 130 bankers in California, I represent the CIB, California Community Bankers, Independent Community Bankers and the ICBA that banking regulators are making tough decisions in the field. This guidance is relatively new out in November, but anecdotally, I am seeing that the regulators do have their feet on bankers' throats in some cases, as we heard from the first panel.

In my specific example, regulators came into the bank, they raised our leverage ratio from the 5 percent statutory minimum to 10 percent. In that case, what happens is you have to adhere to those agreements and it inhibits our ability to lend. Our bank has had to reduce its balance sheet, loans outstanding at the end of 2007 were roughly $248 million, today they sit at $200 million. That is not a way to make the economy recovery.

Although my bank meets the higher 10 percent thresholds, it does come at a heavy toll. Field examiners, when they come out today, are getting mixed messages. They are hearing from Congress, they are exhorting the banks to lend. I think sometimes they are also hearing that they need to remain tough and make sure that they have a tough regulatory environment so we get through this rough patch. It is not an easy job and I felt a little sorry when the regulators were in the room, but the reality is that they are making it very tough on community banks to lend.

And banks are reticent, especially when they have these high capitals imposed on us and also when we are asked to bring our loan loss reserves to exceedingly high thresholds, that impairs our ability to allocate capital into lending.

In closing, I would like to say that the Independent Community of Bankers fully endorses the $30 billion fund we have chatted about. We think that is a very prudent idea. At the same time we also want to make sure that some of the stigmas attached to the TARP financing is not placed with this. I think Herb Allison when he spoke, spoke correctly that there is reticence upon bankers to jump into a fund like that if there is going to be a lot of looks into that. Bankers do not want to see the deal change after it is out. Thank you for your time.

[The prepared statement of Mr. Andrews can be found on page 99 of the appendix.]

Mr. MINNICK. Thank you, Mr. Andrews.

Mr. Bridgeman?

STATEMENT OF DAVID BRIDGEMAN, CHAIRMAN AND CEO, PINNACLE BANK, ORANGE CITY, FLORIDA

Mr. BRIDGEMAN. Thank you. Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, and members of the committees, it is an honor to be here today. I am sort of the poster child of SBA lending of community banking, and I am also a receiver of TARP funds. So I am a rarity in community banking. Ladies and gentlemen, I have never been to Wall Street, but I have lived and I work on Main Street. I have never made a subprime loan. I can barely say derivatives, let alone put it on my books. We do not compete with loans at the local level with our "too-big-to-fail" banks. We do not. They do not come into our communities and ask for loans, but they do come into our communities and they ask for deposits. Currently, community banks make up 11 percent of the total financial network.

We at community banks make 38 percent of the small business loans that fuel our economy. It is the small business loans and the small businesses that put 60 percent of the new jobs together for this country. You have asked the question as to why we are not lending to small businesses. There are two primary factors.

First, small businesses have taken a pounding in the last 2 years. Their financial statements are in chaos and they do have a tough time qualifying for credit under prudent policies and practices. Additionally, the businesses that do qualify are very concerned about their future and whether they should be lending—whether they should be going out and seeking credit or not. Small businesses are currently concerned about the economy, what is happening with health care and taxes. The other side of the problem is the regulatory burden as has been mentioned here today several times. Regulators are taking a myopic view of every bank they look at. When they look at a bank, they are looking at it as if it is an independent institution without regards to what is going on in the larger picture of the country and the economy. I would point out that the letter written by Congressman Frank, chairman of this committee, and also Congressman Minnick, that I have here spells it out very, very clearly what your problems are.

And I would tell you that every banker who read this letter stood up and applauded because it is dead on as to what the problems are from the regulatory point of view. There are two primary hindrances that are affecting what banks can do in lending. One is the higher capital ratios. They have arbitrarily and unofficially raised the capital ratios in this country in community banks to 12 percent; it used to be 8 percent and a 10 percent minimum. With these excessive ratios, we are not able to lend. It hampers the ability of us to loan.

Second, they have decided that reserves need to be raised to excessive levels, ratios that are therefore taking capital out of the ability to lend. They are also asking us to write off credit, they are making us take impairments that are excessive and basically reducing portfolios is a real result of that. I have had to shrink my bank, even though I am well capitalized. I have shrunk my bank on the loan side. And we are working diligently to get our capital ratios which are very well capitalized by all regulatory standards. We are well reserved by all standards and we are taking those up. Some comments that I have had in my recent examination from the examiners are TARP funds are used for the purposes of increasing capital and increasing loan loss reserve.

That is not the reason that TARP funds were ever created. They were there for lending. And we did loan. We created almost $20 million in new credit. And we were criticized by the regulators for growing our institution. We were criticized for having a concentration of owner-occupied credit, commercial credit. We were criticized for that. We were also criticized for having troubled debt restructured loans. Those loans, TDRs as they are referred to, are how we are helping our customers continue to operate and keep people employed.

Some of the concerns I have are that lending has ceased and that no jobs are going to be created right now. Our economy is struggling and I will tell you my community is struggling as well. My concerns are also that if we continue to run again into the commercial real estate problems, we are going to have a second dip in the economy. I will tell you that the regulators have a lot of control at this point with community banks in determining where the econ-

omy will go. In conclusion, I am a community contractor. I build communities and that helps build our country.

[The prepared statement of Mr. Bridgeman can be found on page 129 of the appendix.]

Mr. MINNICK. Thank you very much.

Mr. Bartlett, do you want to introduce the next witness?

Mr. BARTLETT. It is my honor and privilege to introduce our third witness, Mr. William B. Grant. He is from Garrett County, Maryland. If you rolled the mountains flat in Garrett County, it would be the biggest county I have the honor of representing and it has the smallest population. So you know that Garrett County is a rural county, and Mr. Grant really understands community banks. We are glad you made it here, sir. Your county has had 20 feet of snow. The snow in his yard is above his waist and he is pretty tall. And they are currently in the midst of another 2-foot snowstorm. We are glad you made it out. Thank you for coming.

STATEMENT OF WILLIAM B. GRANT, CHAIRMAN, CEO, AND PRESIDENT, FIRST UNITED BANK & TRUST, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)

Mr. GRANT. Thank you very much, Congressman Bartlett. It is a real pleasure to be here. Congressman Minnick, Chairman Frank, Chairwoman Velazquez, Ranking Members Bachus and Graves, and members of the committees, as Congressman Bartlett noted, my name is Bill Grant, and I am chairman and CEO of First United Bank & Trust. My bank is a 109-year-old community bank located in the Appalachian Mountains serving 8 counties in Maryland and 4 counties in West Virginia.

This recession is one of the worst we have ever faced. While the statisticians will say that the recession has ended, that is of little comfort to our region and elsewhere in the United States, which still suffers from high levels of unemployment and business failures. The impact of the downturn is being felt by all businesses, banks included. The cumulative impact of 8 straight quarters of job losses over 8 million jobs nationwide since the recession began is placing an enormous financial stress on many individuals and many businesses. This has caused business confidence to drop and loan demand to fall. Many businesses either do not want to take on additional debt or are not in a position to do so, given the falloff of customer business

There are, however, some positive signs. We have heard from bankers that small businesses are now returning to test the market for loans. It will, of course, take time for this interest to be translated into new loans. Previous recessions have shown it takes generally 13 months for credit to return to prerecession levels. Banks have many pressures to face in the meantime.

The commercial real estate market will pose a particularly difficult problem for the banking industry this year. The CRE market has suffered after the collapse of the secondary market for commercial mortgage-backed securities, and because of the economic slowdown, that has caused office and retail vacancies to rise dramatically. This has made CRE takeout financing very scarce and leaves banks with loans that are stressed. Regulators will continue to be

nervous about the trends in CRE lending and will continue to be highly critical of back CRE portfolios.

We have heard anecdotes from our members about examiners who take inappropriately conservative approaches in their analysis of asset quality and who are consistently requiring downgrades of loans whenever there is any doubt about the loan's condition. This is especially true of CRE loans. Examiners need to understand that not all concentrations in CRE loans are equal and that setting arbitrary limits on CRE concentrations has the effect of cutting off credit to creditworthy borrowers exactly at the time this Congress is trying to open up more credit.

The American Bankers Association appreciates the initiative of President Obama, which he outlined in his State of the Union address, which would provide additional capital to small banks who volunteer to use it to increase small business lending. A key factor to this proposal is removing it from the rules and regulations of the TARP stigma that we have talked about. As this program is developed, ABA recommends that Congress and the Administration create criteria that will allow all viable community banks to participate. Further, we propose that Treasury offer assistance to those banks that did not qualify for the Capital Purchase Program fund, but that can demand the ability to operate safely and soundly and survive if given a chance with this necessary capital. The focus should be on whether the bank is viable in an investment basis, otherwise Congress will miss the opportunity to help the customers and communities of many banks across this country.

We also appreciate the work this Congress has done to increase the guarantee of the SBA's 7(a) loan program. Subsequently, the SBA expanded eligibility to small businesses by applying the broader standards used currently in the 504 program. These very positive changes mean that an additional 70,000 businesses will be eligible to participate in the 7(a) program. The success of small businesses in local economies depends in large part on the success of the community banks. We must work together to get through these difficult times. And I would be happy to answer any questions you might have. Thank you very much.

[The prepared statement of Mr. Grant can be found on page 206 of the appendix.]

Mr. MINNICK. Thank you very much, Mr. Grant.

Mr. Covey?

STATEMENT OF RONALD COVEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ST. MARYS BANK CREDIT UNION, MANCHESTER, NEW HAMPSHIRE, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. COVEY. Mr. Chairman, members of the committees, thank you. My name is Ronald Covey, and I am president and CEO of St. Mary's Bank Credit Union in Manchester, New Hampshire. I am testifying on behalf of CUNA. St. Mary's Bank Credit Union is a member-owned, not-for-profit financial cooperative and was the first credit union established in the United States. We are very, very proud of our heritage. For just over a century, we have been helping New Hampshire residents with a full range of affordable financial services. The idea behind the credit unions is very simple:

People pool their savings and make loans to neighbors and co-workers in order to help each other achieve a better standard of living. That is why we help out small business owners.

Our credit union involvement in small business lending dates back to the first days of our movement. It is in the credit union's DNA. St. Mary's has a track record of granting member business loans that dates back to our early years. We provide business loans for working capital, inventory, accounts receivable, equipment loans, seasonal loans, commercial real estate loans, and energy loans. We are an approved SBA lender and active in all their programs. We also use several State programs through the business finance authority in the State of New Hampshire. The average business loan size at our credit union is under $200,000. We have 960 business loans totaling $75 million and 2,200 business members.

Our potential to make more small business loans is much, much greater. Business loan demand does exist, but credit unions are subject to a statutory cap on business lending. Our cap at St. Mary's is $85 million. Currently, we have a business pipeline and a new business loan request of about $15 million that if approved we would exceed our cap by $5 million. Let me emphasize that. I do not see a scarcity of creditworthy borrowers. I have the funds to lend and nearly $5 million of loan requests that may go unfilled because of an arbitrary cap enacted 12 years ago without any economic or safety and soundness rationale. Given the demand we see, it is difficult to understand why we should not be able to put more money back into the community into the hands of hard working business owners so they can employ more people and create more opportunities.

There are several hundred letters here that I have from small businesses across the country who have received loans from credit unions, many after having been rejected by banks, big banks and community banks. These members have experienced firsthand the value in credit unions providing business loans. Restricting our business lending does a great disservice to business owners everywhere and stymies job growth.

Some have suggested that an increase in credit union business lending could increase the risk of the National Credit Union Share Insurance Fund. However, the facts are otherwise. First, our business loan loss rate is just one-fifth that of loss rates at banks and lower even still than our own losses in residential mortgages and consumer loans. Second, increase in the business lending cap gives well capitalized credit unions a way to further diversify their portfolio, ultimately lowering the overall risk.

Third, the NCUA has full authority to supervise credit union business lending as the NCUA chairman recently emphasized in a letter to the Treasury Secretary. And from my own experience, the NCUA and State examiners thoroughly review my business loan portfolio annually. For us, increased business lending would be a very, very low risk. The President has proposed giving community banks access to $30 billion in TARP funds to encourage additional lending to small businesses. Credit unions have not sought inclusion in this program. That is because the chief impediment to credit unions increasing availability of small business credit is not the

lack of capital. The chief impediment is a statutory cap on business lending. There is no economic or safety and soundness rationale for the cap when it was enacted and there is none that exists today.

The small businesses need credit unions today. Banks that have been serving them in some cases for years are pulling back access to credit. This is leaving many creditworthy business owners high and dry, unable to get funds they need to operate and expand. Representatives Kanjorski and Royce have introduced legislation that would increase the credit union member business lending cap from 12.25 percent to 25 percent of assets. This legislation would add an additional $100 million of business lending capacity to my credit union. Nationally, we estimate that credit unions could lend an additional $10 billion to small businesses in the first year of enactment and help them create over 100,000 new jobs. H.R. 3380 is a smart bill that will help small businesses and support communities and I encourage Congress to enact this legislation as soon as possible. Mr. Chairman, I thank you for being here and I look forward to questions.

[The prepared statement of Mr. Covey can be found on page 137 of the appendix.]

Mr. MINNICK. Thank you, Mr. Covey.

Mr. Wieczorek?

STATEMENT OF RICK WIECZOREK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MID-ATLANTIC FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. WIECZOREK. Good afternoon, Chairwoman Velazquez, Chairman Frank, Ranking Members Graves and Bachus, and members of the committees. My name is Rick Wieczorek, and I am testifying today on behalf of the National Association of Federal Credit Unions. I serve as the president and CEO of Mid-Atlantic Federal Credit Union headquartered in Germantown, Maryland. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the condition of small business and commercial real estate lending in local markets. At Mid-Atlantic, we are proud of our track record in helping our members and their small businesses. We have been an SBA-approved lender since 2004 and just last year became an SBA express lender.

We currently have closed or have pending 12 SBA loans that total approximately $8 million. Mid-Atlantic has just over $28 million in member business loans, putting us at or very near the credit union member business lending cap. We believe that the success of our member business lending program is because of the expertise we have on staff at our credit union. Our top business lending personnel have over 85 years of combined SBA business and commercial loan experience, including receiving awards from the SBA. Credit unions believe that we can play an important role in the economic recovery. Credit unions have fared well in the current economic environment and as a result many have capital available. A number of small businesses who have lost lines of credit from other lenders are turning to credit unions for the capital that they need. With this in mind, NAFCU strongly supports the passage of H.R. 3380, the Promoting Lending to America's Small Businesses

Act of 2009. This bill would raise the member business lending cap to 25 percent of assets while also allowing credit unions to supply the much needed capital to underserved areas. The legislation would also change the definition of a member business loan from $50,000 to $250,000. This is a significant step for as this panel knows, one of the biggest declines in lending has been for loans under $250,000. Credit unions have been making business loans for decades.

However, the Credit Union Membership Access Act established a statutory cap for the first time in 1998. The same bill also directed the Treasury Department to study the need for such a cap and in 2001, the Treasury Department released its study in which it included credit unions business lending currently has no effect on the viability and profitability of other insured depository institutions. The National Credit Union Administration has a strong track record for overseeing credit union business lending. Just 2 days ago, NCUA chairman Debbie Matz wrote Treasury Secretary Geithner to assure him that if the arbitrary cap was modified, NCUA would promptly revise their regulations to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns.

Finally, while some have falsely tried to tie the arbitrary member business lending cap to the credit union exemption, I would point out that credit unions were tax exempt for nearly 80 years before any cap was put in place. So there is no correlation. Additionally, we also support the continuation of a 90 percent guarantee in fee waiver on SBA loans through at least the end of 2010. While some have proposed raising the maximum SBA 7(a) loan amount from $2 million to $5 million, we do not believe that this is a good idea. Maintaining the $2 million limit allows the SBA to guarantee a greater number of loans, thereby helping more lenders, small businesses, and communities. As this panel is aware, earlier this month, the President proposed creating a new $30 billion with money remaining from the TARP to make capital infusions in the community banks to encourage loans to small businesses. As a program is currently proposed, most credit unions would be eligible and statutorily unable to participate in it due to how capital is defined in a Federal Credit Union Act.

We applaud the Administration for its focus on increasing job growth and small business lending and we believe that the Administration should also find ways to include credit union business lending in its efforts. Raising the arbitrary credit union member business lending cap would make it easier for small businesses to have access to loans. Furthermore, this could be done without costing the American taxpayer a time. Many credit unions such as mine are approaching the cap and have the funds available. In conclusion, the current economic crisis is having an impact on America's credit union, but they continue—and we continue to provide superior products and services to their members. Credit unions stand ready to help our Nation's small businesses recover from the current economic downturn. Legislation before Congress such as H.R. 3380 and the proposals to extend the fee waiver and 90 percent SBA loan guarantee would aid credit unions in their efforts to help our Nation's small businesses.

Additionally, as new programs are proposed, we hope they are designed to include credit unions. I thank you for the opportunity to appear before you today on behalf of NAFCU, and I welcome any questions that you may have.

[The prepared statement of Mr. Wieczorek can be found on page 312 of the appendix.]

Mr. MINNICK. We thank you, Mr. Wieczorek.

Ms. Nash?

STATEMENT OF CATHLEEN H. NASH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CITIZENS REPUBLIC BANCORP, MICHIGAN, ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION (CBA)

Ms. NASH. Good afternoon, members of the committees. My name is Cathy Nash and I am president and CEO of Citizens Republic Bancorp. We are are a $12 billion institution headquartered in Michigan and serving the upper Midwest. In 2009, we approved $2.9 billion of loans, and we are very proud to have been named the number one SBA lender in Michigan for 2 years in a row. I am also a member of the board of directors of the Consumer Bankers Association, and this association, for more than 90 years, has been the recognized voice on retail banking issues in our industry, including small business lending.

Our members collectively hold two-thirds of the industry's total assets. I am pleased to have the opportunity to appear before you today to discuss the issues surrounding small business and commercial real estate lending. As we seek to continue to move our economy and indeed our country back on the path of stability and prudent growth. It is important to seek input and engage in vigorous debate with focus on those who are most able to influence that path.

In my positions with Citizens Republic, as well as with the CBA, I see the challenges we face in serving our clients, protecting our depositors and navigating through the current economic climate. Those problems have been magnified. As a bank, we ask how much capital is enough. Some would say in view of the crisis we have experienced that a bank can never have too much capital. With an uncertain view of the near future, regulators must focus on protecting banks' depositors. The best way to do that is to require banks to hold more capital. Every dollar of capital a bank requires to cover a potential bad loan is a dollar that cannot be lent to a business owner. It is a dollar that cannot help a community recover and grow jobs. It is exactly the holding of more capital that adds to this cycle's length and severity.

By holding capital and therefore making fewer loans or actively shrinking a bank's balance sheet to preserve even more capital, businesses cannot grow and hire because their capital access has been restricted. As banks have navigated through this cycle, it is clear that some of the practices of the last decade must be curtailed and this impacts those businesses seeking to borrow today. In the past, banks competed vigorously for new loan clients. While most banks have strong credit criteria and policies, too often those were overridden to win a deal.

In today's environment, we have not loosened nor tightened our standards. We are holding every loan opportunity against those standards. This may feel to a borrower as if a bank is getting more restrictive when in fact we are following long-established policies. In our markets, we saw some banks close credit lines via letters that clients brought into our branches. We have seen competitors exit industry segments and geographies.

For business clients, we look at each borrower discreetly. Based on their plans and forecasts, we have tried to size our lines of credits based on their business needs. For example, for a long standing client with a $2 million line of credit that they have never used, we might work with that client to reduce that line of credit to a more reasonable level based on their business plans and forecasts. To some clients this feels like a significant reduction, but our goal continues to be that we meet our clients' needs and manage our capital requirements.

Commercial real estate lending is driven by lower occupancy and lower rents paid by tenants. Or on the building side, slower sales that result in lower prices. These factors in turn drive the appraisal of the properties and our ability to lend to the level that we originally thought we could. For example, we have a client who wants to build an office building and it is a $10 million project. Presales did not come through and those that did were at lower rent rates. Our clients believe the market will come back but as yet are unwilling to put in additional money to maintain the loan-to-value that we look for in our credit policy.

And this is a typical example for us. Recent changes in proposal have been made—should have a positive impact and we support the SBA proposals both in the express loans, the 504 program and the 7(a) loans because we believe they will help our industry. The ARC loan program was well intended, but it may not be enough to get bankers to use it, because it essentially asks bankers to certify that borrowers are in financial hardship at the same time they need to certify that they are able to pay back the debt and most bankers won't be willing to do that.

In your invitation, you asked how banks can, as a practical matter, best fulfill their fundamental role as intermediaries in the credit market consistent with prudent lending standards and strong capital requirements. In a period of extreme financial economic stress, this is indeed the key question, good borrowers who have the willingness and capacity to repay will always find a loan. Those borrowers with weaker financials will find it more difficult in this environment to obtain financing. The fundamental capacity and willingness to repay must be established once again as a hallmark of lending activity. This will happen, one borrower at a time, by bankers who know and understand them. We thank you as you continue to look for ways to improve small business and commercial real estate lending and the CBA is committed to working with members of both committees to meet that goal.

[The prepared statement of Ms. Nash can be found on page 256 of the appendix.]

Mr. MINNICK. Thank you very much.

Mr. Hoyt?

STATEMENT OF DAVID HOYT, HEAD OF WHOLESALE BANKING, WELLS FARGO & COMPANY

Mr. HOYT. Madam Chairwoman, Mr. Chairman, Ranking Republican Members, and members of the committees, I am David Hoyt, head of wholesale banking at Wells Fargo & Company. Thank you for the opportunity to be here today to discuss lending and credit, topics that are critical to business owners, or business at Wells Fargo and economic recovery. Wells Fargo is the number one small business, middle market, and commercial real estate lender in America serving more than 2 million small businesses, and 15,000 middle market basis nationwide. We bank approximately 1 out of every 10 small businesses and 1 out of every 3 middle market basis in this country.

In many cases, we have had banking relationships with customers that have spanned multiple economic cycles. We proactively work with borrowers who may be experiencing difficulties and encourage them to have conversations with us as early as possible so that we are able to explore alternatives.

Many business owners in America are hurting. At Wells Fargo, we are doing our part to get businesses back on their feet. In 2009, we extended over $40 billion of new credit to our business borrowers. We continue to read media stories and hear directly from business customers who are concerned about being able to obtain the credit they need to run their businesses. We also see that the demand for business credit has remained soft through the fourth quarter of 2009.

In our opinion, the reality of weaker loan demand as well as the perception of a lack of availability of credit is rooted in several factors: First, the economy has taken its toll on the credit and financial capacity of many businesses reducing the cash flow and the capacity to repay debt. Second, asset values have declined from much higher levels which existed at the top of the economic cycle; businesses that relied on the value of these assets to borrow can't borrow as much against them today. Third, given the uncertainty of the economic environment, we see our borrowers being more conservative, stocking less inventory, and making few capital investments, which reduces the need to borrow.

And finally, loan structures and terms are more conservative now than at the peak of the economic cycle, and we believe rightfully so. The increasingly aggressive extensions of businesses credit were partially responsible for the current financial crisis. Borrowers that access credit on those terms find the terms of credit extended today to be more restrictive.

Turning to the commercial real estate market, asset values have decreased significantly, leaving many borrowers and lenders in a position where the loans exceed the value of the property securing them. During the last decade, commercial real estate saw a substantial amount of liquidity enter the market, reaching an all-time high in 2007. As a result, valuations increased. As the economy slowed, returns reverted to normal levels. Adding to the problem, weaker tenant demand and tenant failures are resulting in declines in cash flow generated by individual properties. The combination of these issues has resulted in declining property values, in many cases 40 to 45 percent. Our recent experience is that there is sub-

stantial liquidity available in the market to deal with these issues on a macro level, although these resolutions are often economically painful to individual owners and lenders.

In our opinion, this is not a short-term problem and our expectation is it will take some time for the problem of the overvaluation of commercial real estate to work its way through the system. We want to be part of the solution, so we are hiring bankers, providing educational tools to customers, doing outreach to women and diverse business owners, and extending SBA loans.

When lending to small businesses, we are taking the time to reevaluate the loans we declined. We take a second look at declined loans because we want to make every good loan we can. There are positive signs in the market. While loan demand is soft, it has improved over the last several months. Businesses applying for credit are stronger, competition for well underwritten loan opportunities is increased, and liquidities in the market have also improved.

As we all travel along the road to economic recovery, Wells Fargo maintains our commitment to help businesses owners, large and small alike, succeed financially. Madam Chairwoman, Mr. Chairman, and members of the committee, thank you, and I will be happy to answer any questions.

[The prepared statement of Mr. Hoyt can be found on page 238 of the appendix.]

Mr. MINNICK. Thank you, Mr. Hoyt.

We will now hear from Mr. McCusker.

STATEMENT OF CHARLES McCUSKER, CO-MANAGING PARTNER, PATRIOT CAPITAL, L.P., ON BEHALF OF NASBIC

Mr. MCCUSKER. Chairwoman Velazquez, Chairman Frank, Ranking Member Graves, Ranking Member Bachus, and members of the Small Business and Financial Services Committees, thank you for the opportunity to testify today on behalf of the National Association of Small Business Investment Companies regarding the state of small business lending.

My name is Charles McCusker, and I am a founder and managing partner of the Patriot Capital family of investment funds. Patriot Capital holds three small business investment company licenses. Non-bank lenders such as small business investment companies, or SBICs are an important and often overlooked part of the small business equation. Patriot Capital, for example, has provided investment capital, long-term investment capital to 64 businesses, small businesses. And the Patriot Capital portfolio companies employ over 10,000 people in 23 States. Seventeen of these investments have been made since mid-2008. Six thousand of the 10,000 people we employ were—jobs were created as a direct result of our investments.

SBIC is a very small, highly regulated, private investment fund that invests exclusively in domestic small businesses primarily through long-term capital investments. Under the program SBIC funds raised private capital from institution and individual investors, and upon licensure from SBA can access low-cost leverage to multiply the amount of capital available for small business investment. The program is getting capital to the market.

When the Treasury and the Small Business Administration held a summit on small business financing in November, the only small business participant at the small business forum who said he had adequate access to capital was a small business investment company backed company.

At Patriot Capital, for example, we have a recycling company in the Midwest that has struggled, but survived the economic downturn, met every expectation laid out to the bank, and yet the bank continues to reduce the amount of credit available to this company. And while debt capital would be available if the company were a larger scale, small businesses like this recycler are having serious problems accessing capital. Patriot Capital provided capital when the bank would not.

SBICs can and do fill the capital void in the marketplace, function in the symbiotic relationship with the banks. Banks are not competitors but are major investors in our funds and are sources of daily credit for the businesses in which we invest. SBICs fill an important and unique role in providing capital to small businesses. SBICs generally provide long-term non collateralized investment capital in the 500,000 to $5 million range, a range in which banks often are not comfortable lending particularly smaller community banks.

SBICs also invests in small businesses which, despite being solid companies, have collateral considered too risky for banks to consider worthy of credit.

In addition, in Fiscal Year 2009, SBICs made over 20 percent of their investments in low- and moderate-income areas, and over 90 percent of investments held by SBICs were in smaller enterprises. Furthermore, related banks, banks are often more comfortable lending to small businesses with SBIC's as long-term capital investors.

Patriot Capital has businesses in multiple industries and very few are immune to the current lack of liquidity in the marketplace. Several very solid, well-managed companies in our portfolio from the Midwest paper recycler I mentioned to a southeastern trucking company, to a woman-owned and managed East Coast telecom manufacturer, to a rural provider of natural gas would have been put out of business and liquidated, put out of business and liquidated by their banks if not for the banks and the FDIC program and the capital to support these businesses.

In approximate numbers, these four companies alone represent over $100 million in revenue and 600 American jobs. These may not seem like large numbers, but they are huge numbers to their employees and their hometowns. Also when you consider that these four companies represent only 4 percent of our port and Patriot Capital while collectively one of the largest SBICs is only 2 percent of program, you have to multiply those numbers by a thousand to understand the impact. 600,000 American jobs.

Stories like this can be told by every one of the SBICs in the marketplace. It is definitely a fact that it is faster and easier to save and create jobs in a solid small business than to create them from scratch. Recent actions by—and proposed actions by banking regulators and the Administration are cutting off capital to SBICs and small businesses.

The day after the President proposed the Volcker Rule, many banks suspended investments in SBIC formation, even before Gramm-Leach-Bliley banks were allowed to invest in SBICs. A clear message needed to be sent to banks that they are not only allowed but encouraged to invest in SBICs. Also, recently inexplicably banking regulators, particularly the OCC have inadvertently cut off new investments in SBICs by removing certainty that the banks will receive CRA credits for investing in small business investment companies. There has been no legal or regulatory change, but the actions of a few examiners are cutting off capital to small businesses. CRA credit for SBIC investments needs to be explicitly memorialized.

On the incentive side, the $30 million of TARP capital if just 3 percent of that were allocated to community banks to invest directly in SBICs that capital can be leveraged by the SBA and, in turn, invested in companies for providing long-term investment capital.

Finally we do encourage—

Mr. MINNICK. The gentleman's time has expired.

Mr. MCCUSKER. Thank you for the opportunity to testify today, and I welcome any questions.

[The prepared statement of Mr. McCusker can be found on page 246 of the appendix.]

Mr. MINNICK. Ms. Robertson?

STATEMENT OF SALLY ROBERTSON, PRESIDENT & CEO, BUSINESS FINANCE GROUP INC., FAIRFAX COUNTY, VIRGINIA, ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES (NADCO)

Ms. ROBERTSON. Good afternoon. My name is Sally Robertson, and I am a board member of the National Association of Development Companies. Additionally, I am the president of Business Finance Group, it is a Virginia-based, nonprofit provider of SBA 504 loans—504 is a public private partnership that leverages 40 percent Federal loan guarantees to induce commercial lenders to provide 50 percent financing for long-term commercial real estate projects. Those projects are job creators and are done at no cost to the Federal Government.

I am pleased to provide comments this afternoon on the state of commercial real estate lending and the need to improve access to capital for small businesses. NADCO applauds both committees for examining CRA issues before the pending crisis overtakes us.

Independent studies by Deutsche Bank, Credit Suisse, and the Congressional Oversight Panel reveal that at least 1.4 trillion NCRE will mature in the next 5 years. Of this, about 750 billion is held by small and medium community banks, representing as much as 300 percent of their main capital and reserves.

The recession and pressures from bank regulators have forced smaller banks to focus on rebuilding capital rather than on making small business loans. The loss of the CMBS market for the sale of CRE loans has added to the liquidity issues for those banks. If steps are not taken soon, the rate of bank failures is predicted to increase as the crisis worsens. Without capital even successful businesses cannot grow. Without new sources of long-term capital,

businesses that cannot refinance their commercial homes will risk shutting their doors, adding their employees to the ranks of the unemployed.

One of the larger loans we have done is for a second generation commercial laundry facility. The project financed equipment while the borrower financed the building through a conduit as the equipment loan maxed out their SBA eligibility. The conduit will mature shortly, and if a renewal is not available conventionally, our business may fail since the equipment cannot be readily moved causing the loss of 131 jobs.

Through two rounds of stimulus, Congress and the Administration have worked hard to put more fixed asset financing and working capital into the hands of small businesses. A 50 percent increase in 504 volume through January 31st of this fiscal year over last fiscal year speaks to its success, but the current stimulus package is ending. An extension of the stimulus provisions is critical to access to capital for small business and has been supported by AD organizations in a letter to Congress, but we must all do more to expand capital sources and induce community banks to get back in the lending business.

We believe that many small businesses either need access to larger guaranteed amounts or have already used up their allocated maximum for 504 under current law. The Credit Suisse study cited above indicates that the majority of CMBS loans coming due are between $2 million and $5 million, demonstrating a disproportionate impact on small business. And the current loan size limits are frequently too low to assist many successful small businesses that can expend and create the most new jobs.

We recognize the House Small Business Committee for passing H.R. 3854 and the SBA Programs Reauthorization bill with numerous beneficial program changes. Foremost among these changes is the proposal to increase the maximum 504 loan size from $1.5 million to $3 million and the limit for critical public policy loan would increase from $2 million to $4 million. However, the expanding CRE financial crisis has increased the demands for capital beyond the House passed new 504 loan limits.

As President Obama has advocated, and small business and lending associations have endorsed, we support the urgent need to provide even greater levels of capital access to healthy growing small businesses.

As stated in H.R. 4302, we urge support for a total credit limit tomorrow a single borrower $5 million for regular 504 projects and public policy projects at a $5.5 million limit for manufacturers and energy efficient projects. Our industry also strongly recommends that the committee support H.R. 4302 for the proposed temporary expansion of 504 refinancing provisions.

There are three distinct needs each of which affects of jobs outlook. Maturing debt, small businesses even those who can make their payments may be unable to renew their loans for their business real estate which could lead to foreclosure. Losing 504 to attract a commercial lender to the refinancing project could save those jobs.

High cost debt. Many small businesses have older loans done when rates were high. By refinancing these loans at today's lower

interest rates, the savings on debt cost can be used to expand inventories and hire more workers.

Access locked up real estate equity. In spite of the decline in real estate values, many small firms have significant equity in their business real estate. Refinancing those existing mortgages while providing them with more operating cash will enable them to reinvest it in business operations, expand and create jobs for their communities. Again, thank you for the opportunity, and I look forward to your questions.

[The prepared statement of Ms. Robertson can be found on page 264 of the appendix.]

Mr. MINNICK. Thank you, Ms. Robertson.

I would like to thank all of you on the panel for your thoughtful comments. The favor we have done all of you by asking you to come late Friday afternoon is that our questions will be mercifully brief. I would like to start by turning the committee over to the ranking member, Mr. Bachus, for 5 minutes.

Mr. BACHUS. Thank you. Let me ask, I guess particularly the bankers on the panel, have the recent policy statements and the guidelines that have been issued jointly by the Federal regulators provided you any clarity or maneuverability in making loans?

Mr. ANDREWS. I will address that, Mr. Bachus. I believe there is some clarity in those guidelines. But at the same time, I do have a lot of peers that I speak with and that clarity is not fully disseminated yet to the field examiners. And so within those guidelines, there also remains a fair amount of examiner discretion and so that is a problem from time to time that we have not seen the problem mitigated and we still see a severe regulatory environment. There is some clarity in there in the spirit of that, but the implementation is still lacking a little bit.

Mr. BRIDGEMAN. Congressman Bachus, I would say that having recently experienced an examination in the month of December, there is a disconnect between what is being put out from Washington in the form of the guidances and what is actually being delivered to the community bankers at the grassroots level. There is clearly some subjectivity that seems to be going to the excessive overzealous side.

Mr. BACHUS. Mr. Grant?

Mr. GRANT. I would just like to echo what Mr. Bridgeman and Mr. Andrews said. There still is that message out in the field that hasn't gotten through yet. We heard some comments about the examiners today that certain things that just don't generally apply in practice once you get out in the field. So I would just echo what has just been said.

Mr. BACHUS. Mr. Hoyt?

Mr. HOYT. Yes, we would view that as being—the guidance as being a reiteration of some long-standing guidance that the OCC has had. And I would take a bit of different of a different view, I think our examinations have been consistent with the guidance that has been provided.

Mr. BACHUS. There does seem sort of a disconnect between your experiences, that the lending needs of small businesses are being meet, is that what I heard you say?

Mr. HOYT. I can't speak for the needs of all small businesses, but I can certainly tell you that it is something that we are trying very hard to meet. We are hiring more bankers, we are making more loans and we are clear in the fact we want to do every good loan we possibly can.

Mr. BACHUS. Do you think there is an unmet need among credit or the small businesses for loans or for refinancing or among developers, say, for refinancing? Do you think—I mean, you have heard what some of your fellow panelists have said?

Mr. HOYT. We have seen, I would say, an increased competition for lending particularly over the last few months. And in most cases, we are seeing competition between multiple financial services providers competing for individual loan opportunities.

Mr. BACHUS. As opposed to—are the loans available or are they just at a higher rate than small businesses want to pay?

Mr. HOYT. I would say that the loan availability harkens back to a number of the issues that I mentioned in my testimony which relates to the fact that I think small businesses are under more stress. I think that in many cases, borrowers, or most cases, borrowers aren't able to access credit on the same terms that they were able to access credit on 2006, 2007 creating the perception of a change. So I believe the credit is available.

Again, we are trying very hard to find all the opportunities and who want to do more in the small business area, but there clearly is an availability issue relating I believe to the creditworthiness in some cases, and rates and terms available to small businesses owners. And many small business owners are under a lot of economic stress.

Mr. BACHUS. Let me ask you this, and I am particularly interested in, say, a bank the size of Wells, and this is anecdotal evidence, but from time to time we do hear small businesses, and when I say "small," I am talking about those employing maybe 100 employees, saying that some of the banks, the larger national banks are not that interested in making small loans. Would maybe any of the panelists like to comment on—Mr. Hoyt, is that—

Mr. HOYT. I don't think anything could be further from the truth for our institution. As I mentioned, we now bank about 1 out of every 10 small businesses in the United States. Last year, we hired an additional 1,500 bankers to fund small business loans, and we intend to hire at least another 700 this year. As I mentioned before, we made $40 billion in new loans to our business customers last year.

Mr. BACHUS. Are those small businesses?

Mr. HOYT. Small business, about $13 billion.

Mr. MINNICK. Thank you, Mr. Hoyt. The gentleman's time has expired. I call on Chairwoman Velazquez for 5 minutes.

Chairwoman VELAZQUEZ. Thank you, Mr. Minnick. I would like to ask Mr. Andrews, Mr. Bridgeman, and Mr. Grant the following questions and I would like yes or no answers.

If the Treasury's proposed $30 billion small business lending fund were enacted today, would you apply for funding?

Mr. ANDREWS. Yes.

Mr. BRIDGEMAN. Yes.

Mr. GRANT. Yes.

Chairwoman VELAZQUEZ. I would like to ask you whether you will commit to using the money you receive solely for the purpose of small business lending, Mr. Andrews?

Mr. ANDREWS. Yes.

Mr. BRIDGEMAN. Yes.

Mr. GRANT. Yes, we will.

Chairwoman VELAZQUEZ. Will you also be supportive of fees or other penalties for banks who take the money and do not use it to make small business loans? Mr. Andrews?

Mr. ANDREWS. I would be supportive of how Herb Allison outlined it in his testimony.

Chairwoman VELAZQUEZ. I am sorry.

Mr. ANDREWS. I would be supportive of how Herb Allison outlined his testimony with the incentives.

Chairwoman VELAZQUEZ. Is that a "no?"

Mr. ANDREWS. Would you rephrase the question for me?

Mr. BRIDGEMAN. That would be a no.

Mr. GRANT. No.

Chairwoman VELAZQUEZ. Mr. Wieczorek, there currently are some, but let me ask you, you want to do more small business lending, both of you, Mr. Covey and Mr. Wieczorek, right?

Mr. WIECZOREK. That is correct.

Chairwoman VELAZQUEZ. What would be your answer if you are allowed to receive money from the $30 billion, will you take it?

Mr. WIECZOREK. Well, we can't, this is all.

Chairwoman VELAZQUEZ. I know, I know, but let's say you can.

Mr. BACHUS. Some of these are sort of theoretical questions.

Mr. WIECZOREK. Yes.

Mr. COVEY. No, we would not.

Chairwoman VELAZQUEZ. Mr. Wieczorek, there are currently some who are proposing that we increase the maximum size on 7(a) loans as much as 2½ times the size to $5 million. Have you seen any real demand for loans this large from small businesses, or is this something that is more likely to benefit large banks?

Mr. WIECZOREK. I have not seen that demand, but I agree that it would be more in tune with larger institutions.

Chairwoman VELAZQUEZ. Mr. McCusker, equity capital can be a vitally important part of the small business capital structure. Do you think that the Administration has missed an important part of the solution by focusing only on lending programs?

Mr. MCCUSKER. Thank you for the question. I believe that both equity and long-term investment capital, whether it is in the form of equity or long-term debt, is a vital solution to the growth of the American economy, absolutely.

Chairwoman VELAZQUEZ. Let me ask you, Mr. McCusker, have you seen a demand for loan sizes as much as $5 million?

Mr. MCCUSKER. We invest in the areas of $500,000 to $5 million, so we do see a demand for loans in those areas. Mostly in longer term investment categories though, either equity or unsecured debt. Not so much in terms of short-term capital.

Chairwoman VELAZQUEZ. Do you think the proposal to increase the 7(a) loans to $5 million is duplicative of what the SBICs already do?

Mr. MCCUSKER. Well, I am not exactly an expert on what that SBA loan program is. But I do know it takes the same amount of time and effort to do a $5 million loan as it does a $50,000 loan. So I am afraid the result may be more money but less loans to less small businesses. As I understand it, I am not as supportive of it.

Chairwoman VELAZQUEZ. Okay, thank you.

Mr. MINNICK. Mr. Bartlett?

Mr. BARTLETT. Thank you. Increasingly, small businesses will be coming to the traditional lenders, the community banks and credit unions. If this recession is like past recessions, the companies that will lead us out of the recession will be small companies. Maybe for the last recession, I think said more than 90 percent of all the new jobs were created in the companies of 1 to 4 employees, those are really small companies. They will be coming to the community banks and credit unions. Community banks and credit unions, as far as I know, have made few or no subprime loans, they are financially sound. You are different than the banks that have made this plethora of subprime loans that are in financial difficulty. And yet you are burdened by what may be excessive response to this crisis with the regulatory changes.

You are different, why shouldn't you be treated differently? If you aren't, I am afraid that this recovery is going to be stifled because you will not be able to make the loans that you know would be good loans to the people that you know could repay them that would create jobs and that would bring us out of this recession. If you are different, why shouldn't you be treated differently?

Mr. ANDREWS. I think we should be treated differently. I think that there should be a 2-tier system of sorts that favors community banks. I think community banks did not create the problems of Wall Street and we would be in favor of regulatory relief. And we would be in favor of a change in the attitude as far as capital ratios are concerned too.

Earlier in the panel, we heard a situation where how come community banks can't attract capital, it is because the 19th largest banks in the world were backstopped by the U.S. Government and there is a disparity of "too-big-to-fail" out there, you create an unlevel playing field and I think that needs to be addressed.

Mr. GRANT. I would like to respond also, and say that I think in our economy, we need banks of all sizes. In reality, an awful lot of the misery that was caused by the recession was really from nonregulated financial institutions. And to a great extent, regulated financial institutions, regardless of their size, really do not contribute significantly to the downturn. Having said that, we certainly applaud appropriate financial regulations. I don't think that the current regulated institutions—be they large banks, small banks or credit unions—in my opinion, there is more than adequate regulatory supervision of those institutions. We would apply some sort of regulatory scheme that is placed on the nonregulated financial institutions that really brought about this problem.

Mr. BRIDGEMAN. I would say that the number one thing that I would like to see is consistency in the regulations because with the current environment right now we are getting mixed signals on capital ratios, reserves, they are inconsistent. There is differences

in capital ratios even between States what are being considered the new thresholds, so to speak, even though they are unofficial.

So there needs to be consistency and there also needs to be an understanding that a lot of examining body at this point has never been through this kind of downturn. A lot of the bank examiners are very young.

As a matter of fact, I have been a banker in many cases longer than some of the bank examiners have been alive. So when you take that into consideration there needs to be some common sense applied, some reason. I not saying that we have to be regulated differently, just fairly.

Mr. COVEY. Congressman, credit unions are being treated differently now because we have an artificial cap on how many loans we can do as a percentage of our assets. And as we approach that cap, we have capital and resources but the cap is preventing us from doing more business lending.

Mr. WIECZOREK. I agree that I think we should—we are being treated differently and one of the things that I wanted to clarify about, a hypothetical question about—

Mr. BARTLETT. To the detriment of the borrower, are you not?

Mr. WIECZOREK. I feel it is benefiting the borrower. We are out there lending.

Mr. BARTLETT. I said there were caps you were up against that prohibited you from making loans you would like to loan.

Mr. WIECZOREK. That is correct, let me say one thing really quickly about the hypothetical, though, question about the TARP funds, and I just wanted to make sure that my intention there was that because we can't raise capital, it would be nice if we could get that capital injection. And I think that is how we getting treated, that is also preventing us from growing and going out and doing what we need to be doing.

Mr. MINNICK. The gentleman's time has expired.

Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. MINNICK. Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I think all the regulators have left, which is disappointing to me from the standpoint that all of you sat through their testimony. I think it would be important of them to listen to you. It reminds me of a headline I saw in The Washington Times today with regards to the health care summit, so I will paraphrase. They were listening, but they were only listening to themselves. So along that line, I am just kind of curious the bank folks I know that you have been hammered with an FDIC insurance premium. How impactful has that been to your ability to lend?

Mr. BRIDGEMAN. Well, I will tell you that any time you lose earnings, you lose the potential to lend. My FDIC insurance premium from 2006 to 2009 at the same level of ratings that we had went up 1,205 percent. It went from $36,000 annually to $444,000 annually, and that is a significant impact. It impacted me in my ability to lend into my community. So that is how it affects us.

Ms. NASH. Yes, from our point of view, we had to cut expenses to pay that FDIC premium. It hasn't really impacted our lending ability or our willingness to lend, we simply had to cut expenses to pay the premium.

Mr. Andrews?

Mr. ANDREWS. We have been able to absorb that, but at the same time the industry stands behind the insurance fund and it was probably necessary.

Mr. LUETKEMEYER. Mr. Grant?

Mr. GRANT. I would echo similar remarks. I do think the FDIC took pains to make sure the impact was spread over a number of years. To emphasize what Mr. Andrews said, the FDIC fund has always been funded by banks; it has not cost the taxpayer any money at all. And so this is the same as property and casualty: when the losses go up, the premiums go up. It certainly was a tough nut for us, and like Ms. Nash, we have had to cut expenses. We just sent a $10 million check off to the FDIC at the end of last year. And that hurts your earnings a little bit but you carry on from there.

Mr. LUETKEMEYER. Just a little? Okay.

Mr. Andrews, in reading through your testimony, I notice that you had a couple of ideas there about net operating loss, carry back and sub-tip duress, income tax cap at 35 percent. Would you like to elaborate on that just a little bit of how important you think that is to the viability of community banks and how it impacts lending?

Mr. ANDREWS. Well, I think you find a lot of community banks right now in a lost position. So earlier in panel one, we actually had a question regarding accounting. And we had net loss operating carry backs. If I think we were to extend that, it would be very beneficial. Another thing that has come up to bite banks has been deferred tax assets where you have a difference between accrual accounting on your annual statement plus your tax returns. And a lot of those tax deferred assets that had built up over the years were being wiped out and that is a direct hit to capital.

But in my written statement yes, we are in favor of extending the net loss carry backs, I think that would be very beneficial.

Mr. LUETKEMEYER. Can you explain the income rate cap on sub S?

Mr. ANDREWS. On sub S, sure. On sub S, I think that there are a lot of small community banks that are out there that will organize themselves as sub S. And you obviously have Tax Code issues with the corporations that you heard earlier where you had a borrower that was in a loss position. And so we think we are to provide relief for these small businesses in the form of sub S accounting and tax breaks that that would help stimulate and make the franchise more valuable and also lend in the community. So we are in favor of some relief on the tax side.

Mr. LUETKEMEYER. Okay, the examiners who were here a while ago made comments to the effect they were concerned about or I think a discussion held anyway with regards to their—the way that they were being advised to do things and I think that one of you, a number of you made the comment about the disconnect. I was curious about regards to the examiners that you are experienced with have experiences with, are they looking—whenever they review your loan portfolio, are they looking at what is going on now, trying to guess what is going to happen in the future or are they looking at your loan portfolio now, and what the environment is today, and

how you need to be looking at that and trying to succeed in that environment?

Mr. GRANT. I think it is a combination of both.

Mr. LUETKEMEYER. You don't have a crystal ball, is that what you are saying?

Mr. GRANT. And there is an awful lot of that they utilized the world, while we want you to stress current situations. So, as I think was indicated earlier, you get a situation where things may be okay now, but as you go through various stress tests, then all of a sudden they deteriorate. And then they take the position, well, because of that prospect of deterioration we want you to go ahead and classify the asset and possibly take charges or allowance for it.

Mr. MINNICK. Thank you, Mr. Grant. The gentleman's time has expired.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. MINNICK. I would like to ask the community bankers here a question, and I will start with Mr. Andrews. We had testimony in the first panel from at least two of your customers, collective customers that the inability of their lenders to make loans was not just a function of lack of demand, but was very importantly influenced by a combination of procyclical regulation by the regulators wanting more than minimum capital requirements and reducing their lending based on experience that in many cases they had caused, combined with illiquidity portfolios, asset portfolios, combined with inadequate capital that was caused importantly by appraisals based on distressed sale values that had caused loans to be classified and reserves to be created that were not necessary based upon any intelligent valuation of the assets used as collateral.

I would like to ask you to what extent is—are those three factors influencing your and your members ability to function in this difficult environment?

Mr. ANDREWS. Well, included in my written and oral testimony, I touched on those areas. I do think that we are in a tough regulatory environment as I mentioned the roughest we have had in over 2 decades. You are seeing loan loss reserves increase with dramatic rates. Many of my peers will consider them to be excessive levels. You also are seeing capital ratios being raised by the examiners in the field.

In my oral testimony, you heard my leverage ratio went from 5 percent to 10 percent. That limits our ability to lend, it forces us to look at our balance sheet and possibly shrink that. You heard in my oral testimony loans of $248 million which shrunk to $200 million.

Mr. MINNICK. And what is happening to you is typical of what is happening to all your members and the community bankers?

Mr. ANDREWS. I think that it is typical of what happens in various regions of the country, the west coast, Oregon, Washington, Florida. Certainly, there are States that are suffering more than others. All my peers have certainly happening with that they are crying the blues, it is difficult.

Mr. BRIDGEMAN. I would mirror Mr. Andrews in a lot of his comments. I would tell you that the regulatory environment is signifi-

cantly impacting our ability to lend. And I think that some of the write downs that are being placed on banks for because of the appraisals dropping, the real estate is going down significantly. And because of that we are taking more money into reserves. We have very, very strong reserve at our bank along with very good capital ratios, but to keep those and maintain those and work through the problem credit is going to impactability of us to borrow—excuse me, to lend to qualified borrowers.

Mr. MINNICK. So if the bank examiners were to value assets at approximating fully functioning market values and were not to insist on excess capital over and above the regulatory requirements you would be making more loans?

Mr. BRIDGEMAN. I would be able to make more loans, yes, sir.

Mr. MINNICK. Thank you. I would like to ask you the same question, Mr. Grant.

Mr. GRANT. Yes, I would respond in total agreement with Mr. Andrews and Mr. Bridgeman and add a few other things. The illiquidity—we have circumstances, the regulators come in and say here are the classified loans. They are impairing your ability to lend, but yet there is really no avenue for off placing those loans. You have to work through them, and indeed, I think the tenor of the entire day has been an attitude of working with the small customers.

The other thing I would also add is the concentration levels. The regulators now require a significant amount of slicing and dicing, if you will, of the loan portfolio and will suggest that you must not lend any more of this type of loan or that type of loan. And sometimes based on the markets you serve that certainly could impede it. Some of the criterion that they use with the levels of capital they indicate are guidelines, but by the time it comes into the field, they are pretty much requirements.

Mr. MINNICK. Thank you. Ms. Nash, I only have another 40 seconds.

Ms. NASH. I will be quick. We have a little bit of different experience. Our regulators have been quite complimentary of us in terms of building our loan loss reserves and the way we take and analyze our risk. I think what we do see though is we understand we are in Michigan which has experienced probably the worst part of recession of any State in the country. I will give maybe a little bit to California on the other end of table there. But the fact is what we see is there is a future uncertainty risk and I think Mr. Grant mentioned in his comments as well that we do see a little more emphasis on that. We have quite frankly a lot of support about our credit analytics and our approach around our credit to date.

Mr. MINNICK. My time has expired. Others can respond in writing, if you wish. I ask Mr. Bachus for a concluding comment.

Mr. BACHUS. I appreciate that. One of the things we were talking about is the gaps and the regulations and the fact that many of the banks did not engage in subprime lending. One thing that we were—I won't say misled by, but we did talk to several large banks and they said we are not doing subprime lending, but their unregulated affiliates were. So I think it is one of the things important about any bank reform is that we do close those gaps and regulation. And if they regulate it, an institution is going to have to buy

an unregulated affiliate which can engage in all sorts of risky behavior. I don't mind risky behavior unless you are going to bail folks out. But that obviously is problematic. So I think we—and I think had we passed in 2005 which some of us proposed that we license and register all mortgage brokers we would at least solve some of the later problems that we see because there was a lot of fraud.

My second comment, Mr. Hoyt, I want to convey my appreciation to Wells Fargo for your purchase of Wachovia which included SouthTrust Bank in Birmingham, Alabama, one of the largest banks. You did so at 3 times the purchase price that the Federal regulators had engineered and agreed to by city. And you did so without any Federal loan guarantees and that is something that has never really been looked into. It would be an interesting hearing for this committee, that the Federal regulators actually came to an agreement to sell a bank for basically a third as they were liquidating a third of what Wells came in and offered. And then you did so without any Federal guarantees and that I commend you, but boy that really is troubling, that whole deal.

And then I think Wells was threatened with a lawsuit for "interfering with that federally insured purchase." So I do appreciate that. A lot of people in Alabama ended up with three times as much money in their pockets as they would have. They still took a tremendous loss with that. I thank you for that.

And I thank all the members of the panel for their attendance today. We are—obviously the country is in a difficult economic atmosphere. And the only thing we had not mentioned is that as we move forward, I do think that in many cases, attempts by this Congress and even the regulators to micromanage the economy and institutions has been counterproductive because banks are going to make decisions that they think are best for themselves and their customers, and are only going to lend money when they think there is a promise of being repaid which good for the banks and lenders.

I think we are going to see some unintended consequences of these—not only have we seen it from the TARP thing where we put all sorts of restrictions on it and made it pretty unbearable, but we are seeing it maybe from the credit card legislation. And depending on what we pass—what the Senate sends back to the House and was passed on financial regulation, I think you are going to see some that the Congress may do more harm than good, which is often the case. But I do appreciate your attendance and wish you well because of the viability and strength of the financial industry is essential for properly functioning economy. So thank you.

Mr. MINNICK. I would like to echo the ranking member's comments and to thank all of you for being here. We are sorry we didn't have a fuller panel, maybe there aren't many people here asking you questions, but we very much appreciate you being here, and your thoughtful comments. I ask unanimous consent that all members have 30 legislative days to submit statements and other extraneous material for the record. With that, I thank you all again. The hearing is adjourned.

[Whereupon, at 3:31 p.m., the hearing was adjourned.]

A P P E N D I X

February 26, 2010

Full Committee and the Committee on Small Business Joint Hearing
Condition of Small Business and Commercial Real Estate Lending in Local Markets

Congressman Adler's Opening Statement:

Financial Services Full Committee and the Committee on Small Business Joint Hearing:

I want to thank Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus and Ranking Member Sam Graves for holding this incredibly important hearing. Additionally, I want to thank all the witnesses for taking time out of their busy schedules to testify here today.

Over the past year, I have hosted dozens of public events, including town halls and small business summits to hear from consumers, small business owners and local officials about the status of New Jersey's economy. I hear about the condition of the credit markets and difficulty small businesses are having accessing capital. Loans to small businesses are especially vital to our economy, as they employ nearly 40 percent of the private sector workforce. Today, we must iron out the communication lapses between the federal regulators in Washington, examiners on the ground, banks and small businesses.

The health of our capitalistic economy depends on the ability of consumers and businesses to access credit. I understand that due to the financial downturn many bankers have become more conservative in how they evaluate potential borrowers and distribute their financial products. However, local small businesses in my district cannot access loans and oftentimes banks are cutting off their existing lines of credit which force them to lay off employees and threaten their ability to keep operating. This development is especially problematic for small businesses, given that they typically lack access to public capital markets. Banks counter that they are under pressure from regulatory examiners who are preventing them from making loans they would normally make. Solving these problems require no government spending and will significantly add to the ability of small businesses to expand and create jobs.

Additionally, I hope our panelists suggest what legislative, regulatory or other solutions can be changed to increase the availability of small business credit. New Jersey residents want to go back to work, add to the productivity of our economy and see Washington work on a bipartisan basis to solve the problems impacting their communities. We must help Americans tap into their entrepreneurial spirit our country is known for.

Again, I want to thank all our witnesses for testifying today and look forward to tackling ıese issues as a member of the House Financial Services Committee.

CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS
Friday, February 26, 2010
House of Representatives, Committee on Financial Services, Joint with Committee on Small Business.
Washington, D.C.

Statement of Congresswoman McMorris Rodgers

I would like to thank our panel of witnesses testifying before the Committee today. It is critical to have the three major stakeholders – borrowers, lenders, and regulators – involved in the discussion. Much of what we have heard today is not entirely surprising. The comments mirror those from the small business owners back in Eastern Washington. Existing business owners who are finding it hard to access credit and those entrepreneurs who would like to start a business but are finding it near impossible to obtain a loan.

Two weeks ago, I spent time with Eastern Washington's small business community. The resounding theme was that everyone wanted to expand, create jobs, and boost the local economy. But, they can't. The regulatory burdens associated with extending credit are overly restrictive. Others told me that they would be willing to expand if they had more certainty from Washington. Certainty as to what future policies they could expect – policies that would help them expand or would force them to cut back.

This is not only concerning to me but frustrating to the small businesses in Eastern Washington. Most importantly, it's devastating our economy. We have the ability to economically recover, build our communities, and encourage entrepreneurship. Yet, we have hindered this growth opportunity by enacting policies that spend money we don't have. Moreover, the problem has been compounded by spending that has focused on government expansion – not on supporting the private sector. We need to focus on ways to stimulate job creation, which can be accomplished through less government spending, lower taxes, and working to lower the deficit.

Thank you again to our panel for testifying on this important issue.

Assistant Secretary for Financial Stability
Herbert M. Allison, Jr.
Written Testimony before the House Financial Services Committee and
House Small Business Committee
"Condition of Small Business and Commercial Real Estate Lending in Local Markets"
February 26, 2010

Chairman Frank, Ranking Member Bachus, Members of the House Financial Services Committee, Chairwoman Velázquez, Ranking Member Graves, and Members of the House Small Business Committee, thank you for the opportunity to testify today.

The challenges facing small financial institutions, commercial real estate, and small businesses throughout the country are critically important and I appreciate your commitment to working with the Administration in seeking methods to alleviate the strain felt by these institutions.

The Administration believes strongly that small businesses and the community banks that finance those businesses are critical to our economic recovery. Over the past 15 years, small businesses have created roughly 65 percent of the new private sector jobs in America. Small businesses are an important part of our local communities and have a meaningful impact on job growth and productivity.

The Administration has adopted a wide range of measures to stimulate economic growth and promote liquidity in the credit markets. Treasury has strived to protect the health of smaller financial institutions throughout the implementation of the TARP. The very first, and largest, program implemented under TARP, the Capital Purchase Program

(CPP), was designed to provide capital to financial institutions of all sizes.

Treasury has invested in over 650 small and medium-sized financial institutions through the Capital Purchase Program (CPP). By providing capital, Treasury has helped these institutions absorb losses from bad assets and continue to provide financial services to businesses and individuals. Most small banks extend the majority of their business loans to small businesses and provide these loans in a higher proportion of overall business lending than larger financial institutions. Moreover, because most small businesses cannot directly access the capital markets, many have few other options for financing outside of bank loans, making community banks that much more critical to the future of these businesses. These capital programs have been effective and our financial system is more stable because of them.

Treasury also took steps to improve the health of securitization markets, which provide key avenues of credit for small businesses, by facilitating the purchase of SBA-backed securities under the Term Asset-Backed Securities Loan Facility (TALF). TALF has helped spreads on asset-backed securities (ABS) come down by 75% on average. ABS is an important component to providing consumer and business financing.

Additionally, the American Recovery & Reinvestment Act is driving expansion of economic activity and has provided targeted efforts to support small businesses. The legislation cut taxes for small businesses, allowing them to write off more of their expenses and to earn an instant refund on their taxes by `carrying back' their losses five

years instead of two. The Recovery Act also temporarily raised the SBA maximum guarantee and eliminated certain fees on eligible SBA loans.

Though we have seen signs of improvement in the credit market, there is also a need for further steps to make credit more available. Small businesses continue to face challenges accessing credit and the data show there has been a broad-based decline in lending. On February 23, 2010, the FDIC reported that lending by the banking industry fell by $587 billion in 2009, the largest annual decline since the 1940s. While the latest data indicate that the pace of tightening has slowed, the Fed Senior Loan Officer Survey has shown net tightening for small business borrowers for 13 straight quarters.

During periods of extreme economic stress, market uncertainty rises, driving institutions to review their lending practices, tighten underwriting standards, and review their capacity to meet demand. Small banks, in particular, are facing uncertainty over their commercial real estate assets that may prevent them from lending more to their small business customers.

The effects of the real estate market downturn have also hit small businesses particularly hard. Approximately 95% of small employers own at least one of the following three types of real estate: (i) a primary residence, (ii) their business premises, or (iii) investment real estate. Approximately 76% of small businesses occupy commercial real estate, either as owners or renters, the value of which has declined by 50% or more in some cases. Depressed values have damaged balance sheets and hurt

their access to collateralized credit, even if their businesses are otherwise strong.

The federal banking regulators recently issued guidance on small business lending that should yield greater consistency among the agencies and help banks provide prudent small business lending.

Ultimately, it is critical to recovery that we ensure adequate credit availability for small businesses. For this reason, the President recently proposed a new $30 billion Small Business Lending Fund (SBLF). Under our core proposal, the SBLF would support lending among community and smaller banks with assets under $10 billion. Banks with less than $1 billion in assets would be eligible to receive capital investments up to 5% of their risk-weighted assets. Banks between $1 billion and $10 billion in assets would be eligible to receive capital investments up to 3% of their risk-weighted assets.

The proposed design of this new program would provide a clear economic incentive for smaller banks to increase small business lending – as their lending increases, the dividend rate payable to Treasury gets reduced, to as low as 1% for banks that increase lending by 10% from a baseline set in 2009. Additionally, our investment could be leveraged to increase lending by considerably more than the $30 billion we dedicate to the facility.

The Administration's proposal would, through legislation, create a new facility to support small business lending. To encourage participation, the SBLF would be separate

and distinct from TARP and participating banks would not be subject to TARP conditions. Indeed, while Treasury has the existing authority and funding today to create a small business lending facility under TARP, we are convinced that if we did so, the number of small and medium-sized banks willing to participate would decline dramatically.

Previous TARP programs may have seen reduced participation as a result of several factors, including certain statutory restrictions. Smaller institutions, in particular, have struggled with the executive compensation restrictions that are the same for all institutions, regardless of size. While the imposition of restrictions by Congress on institutions receiving assistance under EESA was entirely appropriate, the fact that the statute requires uniform application of such restrictions has presented challenges for program implementation. This creates a situation where, for example, a small community bank may not be permitted to make severance payments to a bank teller or secretary due to the "golden parachute" prohibition that applies to senior executives and the next five highest-paid employees. Banks with few employees wind up disproportionately affected.

Moreover, after conducting extensive consultation, our view is that even if we removed some of the restrictions described above, many lenders would decline to participate due to a belief that a "stigma" is associated with the TARP program. This belief – as well as fear that by virtue of being a TARP recipient, an institution could be subject to retroactive disadvantages, such as exclusion from future Congressional tax

relief available to non-TARP recipients – would likely have the impact of discouraging participation in the program even if the lender might otherwise have taken part.

We have already seen the impact this stigma can have on participation among smaller banks, as many banks cited fear of association with TARP as a reason for withdrawing their applications from the Capital Purchase Program. In some cases, we have even heard reports of certain financial institutions attempting to call a competitor's soundness into question by featuring the "TARP recipient" label in negative advertising – even though institutions receiving an investment through the Capital Purchase Program, for example, have been required to receive a viability determination from their primary federal regulator to participate.

For these reasons, the Administration strongly believes that a small business lending plan outside of the existing TARP, accompanied by strong oversight, would draw the greatest participation by small financial institutions and thus have the greatest chance of success.

Small businesses are asking for our help. The Small Business Lending Fund would be a significant step toward addressing their concerns. Treasury looks forward to working with Congress on this proposal to help small businesses generate jobs and support a full economic recovery.

Testimony
of
Stephen G. Andrews
President and CEO, Bank of Alameda

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services
and
Committee on Small Business

Hearing on
"Condition of Small Business and Commercial Real Estate Lending in Local Markets"

February 26, 2010
Washington, D.C.

Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves and Members of the Committees, I am Stephen Andrews, President and CEO of the Bank of Alameda, Alameda, California. The Bank of Alameda is a state chartered bank operating in California with approximately $248 million in assets. I am pleased to address the Committees on the "State of Small Business and Commercial Real Estate Lending in Local Markets." I am also privileged to represent the Independent Community Bankers of America and its 5,000 community bank members at this important hearing.

The Bank of Alameda, like almost all community banks, specializes in small business, relationship lending. Community banks serve a vital role in small business lending and local economic activity not supported by Wall Street. Even during these challenging times, our nation's nearly 8,000 community banks remain committed to serving their local small business and commercial real estate customers, who are pivotal to our country's economic recovery.

But, my bank and all community banks face serious challenges that can hinder our ability to make new small business and commercial real estate (CRE) loans and to refinance existing loans. First, community banks confront the toughest regulatory environment in more than two decades. While Washington policymakers exhort community banks to lend to businesses and consumers, banking regulators, particularly field examiners, place restrictions on banks well beyond what is required to protect bank safety and soundness. The banking agencies have moved the regulatory pendulum too far in the direction of overregulation at the expense of lending. We need to return to a more balanced approach that promotes lending and economic recovery in addition to bank safety and soundness.

While the tough regulatory environment is inhibiting new loans in many instances, community banks have also witnessed a decrease in demand for loans from qualified borrowers. Many of our best small business and real estate customers cite their uncertainty about the recovery as their key reason for not seeking additional credit.

Commercial real estate lending presents special challenges for the community banking sector. Many community banks rely on CRE loans as the "bread and butter" of their local banking market. Community bank CRE portfolios are under stress. The downturn in the economy affects the ability of CRE borrowers to service their loans. Regulatory overreaction adds further stress to community bank CRE portfolios. For example, field examiners continue to require community banks to classify and reserve for performing CRE loans solely because collateral is impaired, despite guidance from Washington to look beyond collateral values. Community banks all over the country, even those located in areas that have relatively healthy economies, are under regulatory pressure to decrease CRE concentrations.

Community banks are the key to economic recovery. It is vitally important that policymakers create an environment that promotes community bank lending to small businesses, rather than inhibiting lending. We have several recommendations to improve the commercial lending environment and address problems related to CRE.

- Our country needs a balanced regulatory environment that encourages lending. In a balanced environment, regulators do not exacerbate credit availability through pro-cyclical increases in bank capital requirements. And, bank examiners consider the total circumstances of loans and borrowers, and not just collateral values, when determining the value of loans in banks.
- The Term Asset Liquidity Facility (TALF) should be expanded to cover purchases of a wider range of Commercial Mortgage Backed Securities (CMBS) Extending TALF for a five-year period would help the debt refinancing of CRE, and help stabilize the CRE market;
- The American Recovery and Reinvestment Act (ARRA) contained several tax relief and SBA reform measures to help boost small businesses. Congress should adopt the Small Business Committee legislation to extend these beneficial measures.
- The entire amount of the allowance for loan and lease losses (ALLL) should be included as part of risk-based capital. The risk-based capital rules should take into consideration the entire amount of ALLL and not just the amount up to 1.25% of a bank's risk-weighted assets. This would encourage banks to reserve more and recognize the loss-absorbing abilities of the entire amount of the ALLL.
- The FDIC Transaction Account Guaranty (TAG) Program has been an important tool for protecting and promoting the interests of small businesses by guaranteeing payroll accounts and providing community banks additional liquidity to make loans to creditworthy borrowers. It should be extended another 12 months beyond its June 30th termination date.
- SBA reforms should be enacted to meet the needs of community bank SBA lenders. For example, the SBA "low-doc" program should be revived to help smaller banks that do not have a dedicated SBA lending staff.
- As policymakers decide the status of Fannie Mae and Freddie Mac going forward, a reasonable value should be given to community banks for the preferred shares, which were rendered worthless by the government's takeover of the GSEs. Additionally, dividend payments should be resumed for preferred shares.
- ICBA applauds the recent expansion of the net operating loss (NOL) five-year carryback for 2008 or 2009. ICBA recommends extending this beneficial NOL reform through 2010. This would allow many more small businesses to preserve their cash flow and ride out this difficult business environment as the economy recovers.
- The law governing Subchapter S banks should be amended to permit IRA investments in Subchapter S banks without regard to timing and to permit Subchapter S banks to issue preferred shares. These reforms would give Subchapter S banks new sources of capital at this critical time.
- Congress should preserve the top marginal tax rate for Subchapter S income at 35 percent and maintain parity between corporate and individual tax rates to prevent costly shifts in business forms for Subchapter S businesses, including Subchapter S banks.

Administration's Small Business Lending Fund

In addition to these ideas, ICBA is strongly supportive of the proposal announced by the President and Treasury to further stimulate lending to the small business sector through community banks. ICBA believes the program could be successful, if structured properly. ICBA has made several recommendations for a successful program, including allowing community banks to participate in the new program without the restrictions associated with the TARP Capital Purchase Program (CPP). This would encourage broad participation. All of ICBA's recommendations for the new small business program are discussed more fully below.

Small Business and Community Banks Key to Recovery
America's small businesses are the key to supporting our economic recovery. Small businesses represent 99% of all employer firms and employ half of the private sector workers. The more than 26 million small businesses in the U.S. have created the bulk of new jobs over the past decade. With many of the largest firms stumbling and the U.S. unemployment rate at nearly 10 percent, the viability of the small business sector is more important than ever.

Community banks serve a vital role in small business lending and local economic activity not supported by Wall Street. For their size, community banks are prolific small business lenders. While community banks represent about 12 percent of all bank assets, they make 40 percent of the dollar amount of all small business loans less than $1 million made by banks. Notably, nearly half of all small business loans under $100,000 are made by community banks. In contrast, banks with more than $100 billion in assets -- the nation's largest financial firms – make only 22 percent of small business loans.

Community-based banks have played a vital role in the stability and growth of each of the fifty states by providing a decentralized source of capital and lending. This wide dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness, and stability of our entire financial system.

With that said, the positive attributes of our nation's community banking sector are currently at risk. While the overwhelming majority of community banks are well capitalized, well managed and well positioned to lead our nations' economic recovery, there are certain hurdles in place that are hindering our efforts.

Examination Environment Hinders Lending
Indeed, the mixed signals that appear to be coming out of the banking agencies have dampened the lending environment in many communities. On the one hand, a November 12, 2008, Interagency Statement on Meeting the Needs of Creditworthy Borrowers established a national policy for banks to extend credit to creditworthy borrowers as a means to help our nation get back on its economic feet. It stated that, "The agencies expect all banking organizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers." Again, in November 2009, the banking agencies issued the Guidance on Prudent

Commercial Real Estate Loan Workouts, which was intended to ensure that examiners look at factors other than just collateral values when evaluating commercial credits and to ensure that supervisory policies do not inadvertently curtail credit to sound borrowers. Two weeks ago the regulators repeated some of these same messages in the context of small business lending generally in another interagency statement.

Field Examiners Second Guessing Washington

However, these messages seem to be lost on examiners, particularly in parts of the nation most severely affected by the recession. In California, the tough regulatory environment is forcing my bank and most other banks to avoid making good loans that we would have made in the past. As a result of capital standards above those required by regulations, questionable loan valuation and loan loss reserve policies, and overly strict implementation of CRE concentration guidance, my bank has reduced the amount of its loans from $248 million at the end of 2007 to about $200 million today.

But California banks are not the only banks to feel these regulatory pressures. In a recent informal survey conducted by ICBA, 52 percent of respondents said they have curtailed commercial and small business lending as a result of their recent safety and soundness examinations. Also, 82.5 percent of respondents answered that the Federal banking agencies' guidance on CRE loan workouts has not improved the examination environment for CRE loans.

Higher Regulatory Capital Standards

Bank examiners are raising required capital levels well above the capital standards established by statutes and regulations. As a result, community banks with sufficient capital to be considered "well-capitalized" are being classified as only "adequately capitalized." Examiners have increased the leverage ratio requirement that my bank must meet in order to be considered "well-capitalized." Instead of the five percent leverage ratio called for by statute, the bank examiners have increased our leverage benchmark to ten percent. Although my bank meets the higher ten percent standard imposed by the examiners, it has done so at the cost of reducing lending.

Being downgraded to "adequately-capitalized" impacts a bank's liquidity, and its ability to make loans and raise new capital from investors. "Adequately capitalized" institutions may not accept brokered deposits or pay above market interest rates on deposits without a waiver from the FDIC. The FDIC is being very tough on granting brokered deposit waivers causing further liquidity problems for banks. The interest rate restrictions limit many banks' ability to attract good local deposits. These deposits will likely migrate out of the community to other financial firms not subject to this restriction. In addition, to meet the higher capital standards, banks decrease the number of loans on their books and are forced to turn away quality borrowers. As noted above, lending at our bank has

decreased by 20 percent over two years. The higher examiner-imposed capital standard is a major reason for the decrease.

The examiner-imposed capital standards may force my bank to seek additional outside capital. Raising unnecessary capital dilutes the interest of existing shareholders, which erodes wealth that could be deployed by the shareholders to support other economic activities in the local economy. Furthermore, the prospect that regulators might increase capital requirements in the future makes raising capital difficult as potential new investors consider whether their investment in the bank might be diluted in the future.

Aggressive Writedowns of Loans; High Loan Loss Reserves

While the banking regulators in Washington have been very willing to discuss their safety and soundness examination policies with the ICBA and have reassured us that they are taking measures to ensure their examiners are being reasonable and consistent with recent guidance, ICBA continues to hear from community bankers that their examinations are unreasonably tough.

For example, despite the guidance on CRE loan workouts, community banks continue to report that they are forced to write down performing CRE loans based solely on appraisals and absorption rates (lots sold). In those cases, examiners are ignoring the borrower's ability to repay its loan, the borrower's history of repaying other loans with the lender, favorable loan-to-value ratios and guarantors. When a recent appraisal is unavailable, examiners often substitute their own judgment to determine collateral value.

Further, commercial credits that show adequate cash flow to support loan payments are being downgraded because of collateral values, or because the examiner believes the cash flow will diminish in the future. Other bankers complain that otherwise solid loans are being downgraded simply because they are located in a state with a high mortgage foreclosure rate. This form of stereotyping is tantamount to statewide redlining that ignores any differences among markets within a state.

Many community banks report that examiners are not only requiring an aggressive write down of commercial assets, they are also requiring banks to establish reserves at historically high levels. Banks, which were rated CAMELS 1 or 2 on prior examinations and had loan loss reserves of 1 to 1.5 percent of total loans, report that they are being required to more than double their loan loss reserves. Aggressive write-downs of commercial assets and large loan loss reserves have a serious negative impact on bank earnings and capital and the ability of community banks to meet the credit needs of small businesses.

Banks May Avoid Good Loans to Satisfy Regulators

Examiner practices not only undermine the fundamental goal of the interagency policies, they are costing community banks money, leading to a contraction of credit, and forcing many of them to rethink their credit policies. Under this climate, community bankers

may avoid making good loans for fear of examiner criticism, write-downs, and the resulting loss of income and capital. In my bank's case, we have been forced to turn away developers, to whom we would have provided financing in the past, for both new projects and refinancing of existing projects.

Moreover, the examination environment is driving down the amount banks are willing to lend on a project, when they do decide to provide financing. Two years ago, a bank such as mine would have been willing to finance 75 to 80 percent of the cost of a project, but under today's circumstances, my bank could only finance 65 percent of a project, at most, out of concern about future downgrades of the loan.

Demand for Credit Down

Community banks are willing to lend, that's how banks generate a return and survive. The tough regulatory environment is inhibiting community banks from making new small business loans in many instances. But, community banks have also witnessed a decrease in demand for loans from qualified borrowers. It is a fact that the demand for credit overall is down as businesses suffered lower sales, reduced their inventories, cut capital spending, shed workers and cut debt. Small business loan demand is down as well. In a recent National Federation of Independent Business (NFIB) survey, respondents identified weak sales as the biggest problem they face. Only eight percent of respondents said access to credit was a hurdle. In a recent ICBA survey, 37 percent of banks responding said lack of loan demand was constraining small business lending. The FDIC Quarterly Banking Profile showed a $129 billion decline in outstanding loan balances in the fourth quarter 2009 after a record $210.4 billion quarterly decline the previous quarter. Net loans and leases declined across all asset size groups on a quarterly basis in the second half of 2009.

All community banks want to lend more. Less lending hurts profits and income. Many community bank business customers cite the key reason for not seeking credit is their uncertainty about the economic climate and cost of doing business going forward. Until their confidence in the economic outlook improves, businesses will be unlikely to seek more loans.

Commercial Real Estate

One issue of increasing concern in the community banking sector is that of commercial real estate and the potential for overexposure. Many community banks rely on commercial real estate (CRE) as the "bread and butter" of their local markets.
The degree of borrowers' ability to service their CRE loans is closely tied to the performance of the overall economy, employment and income. Notably, retail sales declined 0.3% in the important December 2009 figure and unemployment remains near a 26-year high. So the sales at stores and businesses occupying commercial space is under stress and rents are suffering, putting increased pressure on paying loan and lease commitments. Until individual spending (which makes up 70% of GDP) and employment numbers improve, CRE loans set for renewal are likely to see continuing rising defaults.

This adds stress to the community banking sector as they rely on commercial real estate as a significant portion of their overall portfolio. However, bank regulators have much more aggressively examined community banks for CRE concentration dating back to 2006. For example, an institution whose total amount of reported construction, land development, and other land loans represents, approaches, or exceeds 100% or more of the institution's total capital will be subject to greater regulatory pressure and oversight. An institution whose total CRE loans represent, approach, or exceed 300% or more of the institution's total capital and whose outstanding balance of CRE loans has increased by 50% or more during the prior 36 months will also come under even greater regulatory scrutiny.

It is not uncommon to have community banks exceed the 100% of regulatory capital threshold, but few have seen very rapid growth in CRE exceeding 50% in the past 3 years. Many community banks survived the CRE stress in the 1980s and 1990s, and have much better controls over their CRE concentration. Community bankers report today's CRE troubles are nowhere near the magnitude of the late 1980s and 1990s.

CRE credit in the economy has already shrunk by about $45 billion from its 2007 peak. However, CRE exposure will be a significant reason banks will remain under stress in 2010 and is a key reason 702 banks are on the FDIC problem bank list.

That said, community banks report they underwrite and manage these commercial real estate loans in a conservative manner, requiring higher down payments or other steps that offset credit risks and concentrations. Community banks believe they do a better job monitoring CRE loans than do large nationwide lenders because they are more likely to work one-on-one with the customer, and they have a better understanding of the economic conditions in their communities. The vast majority of community banks have the capital to ride out the depressed CRE market. However, community banks all over the country, even those located in areas with relatively healthy economies, are under regulatory pressure to decrease CRE concentrations.

Should real estate prices stabilize with economic growth, the CRE concerns will abate. Many community banks report that CRE loan payments are regularly being made (so the loans are performing) but their underlying collateral value has declined. Therefore, as CRE loans are due for renewal, borrowers as well as banks are often forced to put up increased capital to be able to refinance and prevent default.

ICBA's Recommendations

Community banks are the key to economic recovery. Despite a 4th Quarter 2009 decline of net loans and leases at an 8.2% compared to the previous year among all banks, community banks with less than $1 billion in assets showed only a narrow year-over-year decline in net loans and leases of 1.4% after being the only group to post increases in each of the previous three quarters. Our nation's biggest banks cut back on lending the most. Institutions with more than $100 billion in assets showed an 8.3% decrease while $10-100 billion-asset-banks had net loans and leases decline at 11.4% compared to the

previous year. Policymakers need to create an environment that promotes community bank lending to small businesses, rather than inhibiting lending. We have several recommendations to improve the commercial lending environment and address problems related to CRE.

Regulatory Relief is Top Priority

Community bankers' top concern is that bank regulators have swung the pendulum too far toward regulatory overkill, inhibiting new small business lending and making the small business and CRE problems worse rather than helping resolve the problem. The bank regulators are forcing write-downs on performing commercial loans and treating all loans in many hard hit states the same regardless of a loan's performance. Also the FDIC practice of dumping properties at "fire sale" prices onto a market can trigger a counterproductive downward spiral in real estate values and further bank write-downs. Banking regulatory staff in the field are ignoring the policies established in Washington put in place to promote lending. Field examiners are imposing arbitrary capital standards on community banks, requiring those banks to shrink their assets rather than increase lending.

If community banks are to increase small business lending, the regulatory environment needs to change. Our country needs a balanced regulatory environment that encourages lending and economic recovery, in addition to bank safety and soundness. In a balanced environment, regulators do not exacerbate credit availability through pro-cyclical increases in bank capital requirements. And, bank examiners consider the total circumstances of loans and borrowers, and not just collateral values, when determining the value of loans in banks.

Extend and Expand TALF Program

The TALF program was designed to keep the secondary markets open and vibrant for a variety of loan and investment products. Secondary markets for commercial debt must be robust so CRE debt refinancing can take place at reasonable borrowing rates. Like residential real estate, commercial real estate loans were bundled into securities, pooled and sold. Specifically, the market for CMBS has not fully recovered. Expanding the TALF to cover purchase of a wider range of CMBS and extending TALF for a five-year period would help the debt refinancing of CRE, and help stabilize the CRE market. Notably, community banks can sell very few of their whole CRE loans; more likely they are engaged in loan participations, so policies should focus on stabilization of CRE valuations.

Extend Small Business Changes in the ARRA

The severe economic recession justified a sizable economic stimulus, including tax relief measures for individuals and small businesses. ICBA was pleased the American Recovery and Reinvestment Act (ARRA) enacted last February contained several tax relief and SBA reform measures to help boost small businesses. Specifically, the major

SBA loan program enhancements enacted are all helping many small businesses ride out this deep recession. We also support the extension of the key incentives for SBA 7(a) and 504 lending programs.

ICBA also applauds the Small Business Committee's legislation to extend the beneficial SBA enhancements included in ARRA. Specifically:

- Extending the SBA fee reductions through fiscal year 2011;
- Extending the higher guarantee levels through fiscal year 2011;
- Making permanent the SBA secondary market facility authority.

If enacted, these measures would all help community banks expand their SBA lending to small businesses and would stimulate much-needed economic activity and job creation.

SBA Reforms

ICBA supports additional measures to enhance SBA lending. The key to meeting small business capital needs is to have diversity in SBA lending options. The SBA should be able to meet the needs of both large and small SBA loan program users. This was our objection to the SBA's elimination of the successful "LowDoc" program. It was used most often by banks that did a small number of loans and did not have the dedicated SBA loan staff.

Because there are more than 8,000 community banks nationwide they can support a large number of SBA loans if community banks are more easily able to use the SBA. In other words, we do not want an SBA with a one-size-fits all cookie cutter approach that only the biggest-volume SBA lenders can fully use. Before this financial crisis hit, nearly 60% of all SBA loans were concentrated in just ten banks. If we are concerned with supplying small businesses with a steady source of capital, the SBA needs to do a better job of embracing the more than 8,000 community banks nationwide so all lenders can easily participate.

Enhancements to Community Bank Capital

Of course community banks and small businesses rely on raising capital in this difficult capital market. Therefore, we would like to recommend several reforms that can help community banks and small businesses preserve and raise capital.

Restore Reasonable Value to Fannie Mae and Freddie Mac Preferred Stock

Community banks were encouraged by their bank regulators to hold Fannie Mae and Freddie Mac preferred stock as part of their Tier 1 capital and were severely injured when the U.S. Treasury placed these entities into conservatorship in September 2008. Some $36 billion in Fannie Mae and Freddie Mac capital held in banks, including many community banks, was largely destroyed by Treasury's action. As policymakers decide the status of Fannie Mae and

Freddie Mac going forward, at a minimum, a reasonable value should be given to the preferred shares. Dividend payments should be resumed for these preferred shares. Importantly, this will help restore capital needed for additional small business lending. For each dollar of value restored some eight to ten dollars in new lending can occur.

Extend the 5-Year NOL Carryback Through 2010

ICBA applauds the recent expansion of the NOL five-year carryback for 2008 or 2009 that President Obama signed into law on November 6th. The FDIC reports that 30 percent of banks had a net loss for 2009. ICBA recommends extending this beneficial NOL reform through 2010. This would allow many more small businesses to preserve their cash flow and ride out this difficult business environment as the economy recovers.

Specifically, ICBA recommends allowing community banks and small businesses with $10 billion in assets or less to spread out their current losses with a five-year carryback allowed through tax year 2010, including TARP- CPP programs participants to increase small business lending. It makes little sense for Congress to encourage community banks to lend more to small businesses by participating in the TARP program and then to punish them by not allowing the potential use of the NOL five-year carryback tax reform. Allowing all interested small businesses with $10 billion or less in assets to use an expanded NOL through 2010 will help free up small business resources now to help support investment and employment at a time when capital is needed most. Expanding the NOL five-year carryback to include tax year 2010 and allowing TARP participant banks with $10 billion in assets or less simply allows these businesses to accelerate the use of allowable NOL deductions that can be claimed in future years under current law. However, by accelerating the use of NOLs it will free up much needed cash flow now when businesses need it most.

A recent report by the Congressional Research Service helps support the net operating loss tax relief. The May 27 CRS report notes most economists agree that U.S. companies would benefit from a longer net operating loss carryback than the current two years period. The CRS report says the carryback period should last through the typical business cycle (six years) to help smooth the peaks and valleys in income.

The Entire Amount of the ALLL Should be Included as Part of Risk-Based Capital

Under the current risk-based capital rules, a bank is allowed to include in Tier 2 capital its allowance for loan and lease losses (ALLL) up to 1.25% of risk-weighted assets (net of certain deductions). Consequently, some community banks are now being downgraded based on capital inadequacy even though they have excess amounts of ALLL. The risk-based capital rules should take into consideration the entire amount of ALLL and not just the amount up to 1.25% of a bank's risk-weighted assets. This would encourage banks to reserve more and recognize the loss-absorbing abilities of the entire amount of the ALLL.

Extending the FDIC TAG Program One Additional Year

The FDIC Transaction Account Guaranty (TAG) Program, which guarantees noninterest bearing transaction accounts, certain NOW accounts and IOLTA accounts, has been an important tool for protecting and promoting the interests of small businesses by guaranteeing payroll accounts and providing community banks additional liquidity to make loans to creditworthy borrowers. Banks pay a separate fee to the FDIC for this additional coverage. Accounts guaranteed under the TAG are not considered in determining the deficit in the FDIC's Deposit Insurance Fund, so continuing the TAG would not increase the deficit in the DIF or affect the FDIC's regular insurance premiums. We are concerned that an expiration date of June 30, 2010, would not provide enough time to restore and maintain liquidity and customer confidence in the banking system. Particularly in those areas of the country like Georgia, Florida, California and the Southwest, it is very important that this program continue an additional 12 months to allow additional time for those areas to stabilize. The TAG program ensures that community banks are not at a competitive disadvantage in this fragile economy. The safety of transaction accounts continues to be one of the most important concerns for customers. The public perceives that too-big-to-fail institutions can provide unlimited protection because these banks will ultimately be bailed out if they become financially unstable. Community banks should be afforded the same opportunity to guarantee their customers' transaction accounts.

Allow New IRAs as Eligible S Corporation Shareholders

The challenging economic and credit markets make it difficult for many community banks to raise additional capital to support small business lending. Unfortunately, Subchapter S community banks are disadvantaged in raising additional capital by onerous shareholder restrictions. Current law restricts the types of individuals or entities that may own S corporation stock.[i] S corporation community banks seeking to raise capital may not allow new IRA shareholders. Traditional and Roth IRA stockholders are permitted only to the extent that that IRA stock was held on or before October 22, 2004. Therefore, Subchapter S community banks are put at a disadvantage relative to other less restrictive business forms in their ability to attract capital due to the rigid IRA shareholder restriction.

ICBA recommends that new IRA investments in a Subchapter S bank be allowed regardless of timing. We believe this reform will grant more community banks the needed flexibility in attracting IRA shareholder capital, especially from existing shareholders.

Allow Community Bank S Corporations to Issue Certain Preferred Stock

Another obstacle preventing S Corp. banks from raising capital is the restriction on the type of stock they can offer. Current law only allows S corporations to have one class of stock outstanding.[ii] C corporations that want to make the S corporation election must eliminate any second class of stock prior to the effective date of the S corporation

election. Likewise, issuing a second stock class by an S corporation terminates its S corporation status. Community banks must maintain certain minimum capital ratios to be considered a well-capitalized institution for regulatory purposes. As a community bank grows in size, its earnings alone may not provide sufficient capital to fund its growth. Banks needing more capital can raise additional capital by issuing common stock, preferred stock, or, in some cases, trust-preferred securities.

Many community banks avoid issuing additional common stock to fund growth so that they can protect their status as an independent community bank and serve their local community lending needs. Instead, they frequently use preferred stock to fund growth and retain control. However, S corporation banks are not allowed to issue commonly used preferred stock because preferred stock is considered a second class of stock. This prevents small community banks from having access to an important source of capital vital to the economic health and stability of the bank and the community it serves.

ICBA recommends exempting convertible or "plain vanilla" preferred stock from the "second class of stock" definition used for S corporation purposes. This would help more community banks become eligible to make the S corporation election as well as help those that currently are S corporations seeking to raise additional capital. Allowing community bank S corporations to issue preferred stock would allow them to reduce the burden of double taxation like other pass-through entities and, at the same time, fund future growth.

Preserve 35% Top Marginal Tax Rate on Subchapter S Income

Small businesses are facing difficult economic times. A troubled credit market combined with a slowdown in U.S. economic growth, high energy prices, and sharp inflationary costs across-the-board for inputs are crimping small business profits and viability. Maintaining cash flow is vital to the ongoing survival of any small business and taxes are typically the second highest expense for a business after labor costs. As pass-through tax entities, Subchapter S taxes are paid at the individual income tax level. Marginal income tax rates do play a critical role in a small business' viability, entrepreneurial activity, and choice of business form. Today more than half of all business income earned in the United States is earned by pass-through entities such as S corporations and limited liability corporations.

The top corporate income tax rate and individual income tax rate are currently set at 35%. Much discussion has been given to addressing the corporate tax rate for international competitiveness concerns and raising the individual income tax rate. Significant shifts in the existing marginal tax rates and parity between corporate and individual tax rate can trigger unwanted and costly shifts in business forms. It is important to consider maintaining parity between the top corporate and individual income tax rates in the Code. Additionally, during this difficult economic period, at a minimum, the current top tax rate of 35% should be preserved on both small business Subchapter S income and C corporation income, not increased.

Administration's Small Business Lending Fund

ICBA is strongly supportive of the proposal announced by the President and Treasury to further stimulate lending to the small business sector through community banks. ICBA believes the program could be successful, if structured properly. ICBA has made several recommendations to the Administration for a successful program:

- The new program should impose no TARP-like restrictions on community banks that participate in the program. For example, the program should not require stock warrants, restrict compensation or bank dividends, or limit access to tax benefits like the NOL carryback.
- The government should not have the right to change the contract to impose unilaterally new conditions and requirements.
- Bank dividend payments to the government should be suspended for one year until the small business loans can be underwritten and put in place.
- Community banks should be able to repay the government's investment without penalty and should be able to retain the government's investment for at least five years or more to support long term small business loans.
- The broadest number of community banks should be eligible to participate. We recommend that CAMELS-rated 3 banks be automatically eligible and that 4-rated banks be allowed to participate on a case-by-case basis. When considering applications to participate in the program, a bank's post investment capital position should be used to determine eligibility.
- Special consideration should be given to minority banks given their role promoting the economic viability of minority communities.
- Treasury should have the ability to make the final capital injection decision after consultation with the banking regulators.
- The eligibility criteria and approval process must be well defined and transparent so bank access to the program will be fair and transparent.
- All forms of banks, including Subchapter S and mutual banks and mutual bank holding companies, should be included in the program.
- Existing TARP CPP participants should be able to transfer to the new program and be relieved of the TARP restrictions.
- All participants should be allowed to treat the investment as Tier 1 capital.
- Agricultural loans should be included within the program.
- Reporting of small business lending should be made simple.
- Finally, credit unions should not be allowed to participate in the programs because credit unions commercial lending is restricted, in the first place, and secondly, because credit union lending is already subsidized through a broad tax exemption.

Conclusion

Community banks serve a vital role in small business lending and local economic activity not supported by Wall Street. Community banks form the building blocks of our communities and support small businesses around the country. The community banking industry is poised to serve as an economic catalyst to lead our nation's economic recovery. They are ready, willing and

able to meet the credit needs of small businesses and the communities that they represent. But, we need to move away from an overly restrictive, pro-cyclical regulatory environment to one that actually promotes small business and CRE lending in community banks. In addition, we believe that our other recommendations, if adopted, would go a long way to strengthen the community banking sector and increase small business lending. We look forward to working with Congress and the Administration on these and other initiatives to support small business and CRE lending by community banks.

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[i] Internal Revenue Code §1361(b)(1).
[ii] Internal Revenue Code §1361(b)(1)(D).

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February 26, 2010, at 9:00 a.m.

Statement of

John E. Bowman
Acting Director, Office of Thrift Supervision

regarding

Condition of Small Business and Commercial Real Estate Lending in Local Markets

before the

Committee on Financial Services and
the Committee on Small Business
United States House of Representatives

February 26, 2010

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W.
Washington, DC 20552
202-906-6288

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Testimony on

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I. Introduction

Good morning Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves and distinguished Members of the Committees. Thank you for the opportunity to testify on behalf of the Office of Thrift Supervision (OTS) on the issue of credit availability for consumers and businesses in the United States.

As we are all aware, credit is the lifeblood of the economy. The imperative to serve the credit needs of consumers, small businesses and neighborhoods lies at the heart of the U.S. thrift industry. The thrift charter was created to support consumers and communities and to ensure that credit would be available for American homeownership in good times and bad. It is the long-held position of the OTS that thrifts should never turn away good customers.

It is clear that the recession has driven lending down across the financial services industry from its peak before the crisis. This constriction is due in part to the current proliferation of loan defaults and losses in consumer, small business and commercial loans, which necessitate a heightened sensitivity to the risk that each institution is able to bear. However, the OTS and other regulators must be vigilant to ensure that the pendulum does not swing too far by denying credit to creditworthy borrowers and slowing the economic recovery.

The severe harm done to communities and financial institutions by the economic crisis reinforces the importance of achieving equilibrium between providing adequate credit and ensuring the safety and soundness of financial institutions and the entire financial system. This should be of utmost concern to banks, thrifts, regulators, legislators and anyone else involved in the effort to resolve this crisis.

In addition to supporting homeownership, OTS-regulated institutions are committed to making loans for small businesses. Small business lending is fully consistent with the purpose of the thrift charter and is a cornerstone of lending in communities. Loans are underwritten based on the borrower's personal ability to repay. For large commercial loans, such as those secured by high-rise office buildings and strip malls, sophisticated systems use criteria such as occupancy rates and income streams as underwriting considerations.

In our testimony today, we will present some of the factors we believe may be contributing to tightened credit, before discussing possible solutions. We will also address the Committee's questions regarding private equity investors.

II. Factors that Impede Extension of Credit for Consumers and Small Businesses

The condition of the economy is a major cause of the constriction in credit. The fallout from the economic deterioration has had an impact on credit availability in a variety of ways.

For example, fewer businesses are offering credit than before the recession. Many highly leveraged, under-regulated nonbank businesses that engaged in consumer, business and commercial lending — often with loose underwriting standards — have gone out of business. As a result, small business borrowers are more dependent on bank and thrift funding.

Unemployment, stock market declines and the downturn of the housing market have also had major impacts. Americans who do not have jobs have a hard time paying their mortgages and other bills. Declining home values have decreased consumers' net worth by cutting into home equity. Some would-be borrowers cannot afford down payments for home loans, while others are unable to qualify for loans.

The weak economy has driven consumer confidence lower and many consumers are trying to shore up their finances by spending less and saving more. Many consumers are reluctant to borrow for homes, cars or other major purchases; they are hesitant to spend money on anything beyond daily necessities.

The decline in consumer spending has, in turn, created weaknesses in the small business and commercial sectors. Evidence of weakness in these sectors can be seen in rising business bankruptcies, a slowdown in business expansion, increasing vacancy rates in commercial real estate and mounting commercial loan delinquencies.

U.S. financial institutions are feeling the effects of the stress among consumers and businesses in the form of rising levels of delinquent loans. Continuing decreases in asset quality, and increases in delinquencies and charge-offs for mortgages, credit cards and other types of consumer and business lending, require institutions to build their loan loss reserves and augment capital to preserve safety-and-soundness. Although these needs may place a strain on institutions' ability to lend, strengthening capital and reserves provides a critical foundation for maintaining institutions' stability and continued health.

Financial institutions have also learned a hard lesson about the merits of returning to the basics of sound loan underwriting. Lapses in loan underwriting can have severe, negative impacts on financial institutions, consumers and the economy. In the mid 2000s, the lending trend swung in the direction of easily available credit, sometimes to borrowers who could not demonstrate an ability to repay their loans, especially in an

environment of declining real estate values. Given this history, some tightening in credit is expected and needed. At the same time, we must ensure that the trend does not move too far and restrict credit availability to creditworthy borrowers. It is very much in the self-interest of lenders to welcome qualified small business borrowers with good credit and solid cash flows.

Credit availability is enhanced when financial institutions making loans for mortgages, consumer credit, small businesses and other types of credit transfer these loans off their own balance sheets by securitizing and selling them to third-party investors. The result is increased liquidity in the market and a transfer of some of the risk from the financial institutions. Before the current crisis, a large percentage of all types of loans in America were securitized. Without a vibrant securitization market, lenders and borrowers have had to find other sources of funds. Except for government-sponsored enterprises, such as Fannie Mae and Freddie Mac, the secondary market has not yet returned as a viable source for funding new credit. It will take some time for a fully functioning credit market, augmented by a strong secondary market, to reemerge. In the meantime, financial institutions must keep more of their loans in portfolio, creating the need to maintain higher capital levels to cushion against potential losses. This need for higher capital constricts lending.

The challenges that financial institutions face in the current financial environment have resulted in a marked increase in formal enforcement orders by the OTS related to safety-and-soundness. Under such actions, institutions are often required to maintain

capital levels above the well-capitalized standard. The OTS imposes these requirements on an institution-by-institution basis as necessary to provide a counterbalance to the elevated risks confronting these institutions. Although these types of cases are increasing, they remain relatively few in number.

There are also some operational issues that may also contribute to the difficulty for some consumers to get loans in a timely fashion. In reaction to the fallout from the current crisis, some financial institutions may have diverted resources from loan origination duties to loan servicing activities to handle defaults, foreclosures and foreclosure prevention initiatives, such as loan workouts and modifications. As resources are redirected back to lending operations, we would expect credit availability to improve.

Finally, uncertainties about the direction of public policy reforms may be having an impact on financial institutions' lending policies.

The Committee asked whether supervisors are specifically discouraging depository institutions from particular kinds of lending. To the contrary, the OTS is encouraging thrift institutions to make all types of loans allowed by statute, provided they are prudently underwritten to creditworthy borrowers.

Banks will increase credit supply when the economy improves, markets stabilize and banks are adequately capitalized to operate in their current economic environment.

However, there are actions that I believe can improve credit availability in the short term without sacrificing practices that promote safe and sound lending.

III. Recommendations and Actions to Expand Lending

As the regulator of an industry of savings associations dedicated to meeting the needs of the communities they serve, the OTS recognizes the critical role thrifts play in providing credit to small businesses and encourages them to continue to serve this important sector of the economy. Small manufacturers, retailers and service companies drive employment. Taxes paid by the businesses and employees support infrastructure, schools, social services and other activities in communities.

The OTS and other federal banking agencies issued guidance twice in recent months to prevent any possible overreaction by financial institutions that would make credit less available at a time when borrowers most need loans for small businesses and commercial real estate (CRE). To send a clear message to financial institutions and examiners, the agencies issued the "Policy Statement on Prudent Commercial Real Estate Loan Workouts" on October 29, 2009, and the "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers" on February 5, 2010.

The interagency Statement on Prudent Commercial Real Estate Loan Workouts is intended to promote supervisory consistency, enhance the transparency of CRE workout transactions, and ensure that supervisory policies and actions do not inadvertently curtail

the availability of credit to sound borrowers. It also states that examiners will take a balanced approach when reviewing an institution's CRE loans and workouts. The guidance states:

> *The regulators have found that prudent CRE loan workouts are often in the best interest of the financial institution and the borrower. Examiners are expected to take a balanced approach in assessing the adequacy of an institution's risk management practices for loan workout activity. Financial institutions that implement prudent CRE loan workout arrangements after performing a comprehensive review of a borrower's financial condition will not be subject to criticism for engaging in these efforts even if the restructured loans have weaknesses that result in adverse credit classification. In addition, renewed or restructured loans to borrowers who have the ability to repay their debts according to reasonable modified terms will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that is less than the loan balance.*

The OTS believes this statement sends a clear message to financial institutions that they will not be criticized for making prudent CRE loans or for working with existing CRE borrowers who need to refinance or restructure their loans as long as they do it in a prudent manner.

We have limited data on how effective the guidance has been thus far; however, we are confident that it will have a positive effect over time.

The OTS, other federal financial regulatory agencies and state bank supervisors issued a second statement in February to encourage credit for creditworthy small business borrowers. The "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers" underscores the responsibility of a regulated institution to understand the long-term viability of the borrower's business and to focus on the strength of a borrower's business plan, including its plan for the use and repayment of borrowed funds. This includes an understanding of the competition and local market conditions affecting the borrower's business and not just national market trends, especially when local conditions may be more favorable. Further, while the regulators expect every institution to effectively monitor and manage credit concentrations, an institution should not automatically refuse credit to a sound small business borrower solely on the basis of the borrower's particular industry or geographic location.

We believe the interagency statement will support and encourage institutions in their individual assessments of each small business borrower's creditworthiness, and thus promote the prudent extension of credit to this sector of the economy.

The OTS ensures nationwide consistency in its guidance to the industry, taking steps to make certain that its regional offices do not discourage OTS-regulated institutions from lending by imposing on them stricter underwriting and examination practices than those prescribed by OTS policies. The OTS ensures that its regional offices implement national guidance consistently through several mechanisms. The agency holds monthly Regional Manager Group meetings where the Regional Directors

discuss supervisory and examination issues with senior management from Washington, D.C. The agency also holds bi-weekly conference calls with its Regional Deputy Directors to discuss problem bank cases, emerging issues, and to reinforce and discuss new guidance.

For example, OTS issued an internal staff bulletin on October 30, 2009 regarding CRE lending and CRE loan workouts. The bulletin announced the interagency policy statement on CRE loan workouts, provided a synopsis of how examiners should implement the guidance and also notified examination staff of an agency-wide policy conference call to discuss the guidance. OTS held the staff conference call for all examination and supervisory staff on November 19, 2009. The agency also published the presentation on its internal website for future staff reference. In addition to the internal communications, OTS released a Chief Executive Officer Memo (CEO Letter #325) to announce the new guidance to all OTS-regulated financial institutions. Through the combination of internal staff bulletins, external CEO memoranda, and internal staff briefings, the agency takes proactive steps to ensure consistency across the OTS regions in implementing guidance.

It is important to recognize that thrift institutions, as community-oriented lenders dedicated to serving the credit needs of the communities in which they lend, should be primary sources of credit to small businesses. OTS-regulated institutions make diligent efforts to serve the needs of these businesses and have been successful to a certain

degree. However, statutory caps on thrifts' small business lending sometimes make it difficult for them to fulfill these needs.

The Home Owners' Loan Act currently caps the aggregate amount of credit that thrifts can lend for commercial purposes at 20 percent of a savings institution's assets. Any commercial loans in excess of 10 percent must be small business loans.[1] Due to these limits, some thrifts are discouraged from entering this line of business altogether because they believe they will be unable to achieve sufficient economies of scale.

A legislative proposal that OTS supports would remove the cap entirely on small business lending and increase the cap on other commercial lending from 10 percent to 20 percent. This change would be completely consistent with the focus of the thrift charter on consumer and community lending. The existing ceiling on small business lending limits the pool of credit available to small businesses and limits thrifts' ability to provide credit that would help them serve the important needs of their communities.

A statutory change included in previous legislation and supported by OTS, which passed the House Financial Services Committee in the 108th, 109th and 110th Congresses and passed the full House of Representatives twice, would have increased credit for small-to medium-sized businesses by lifting these limitations on small business lending. We appreciate Chairman Frank's leadership in this effort and hope that this change can be included in future legislation.

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[1] 12 USC 1464(c)(2)(A).

The Committee has asked for the views of the OTS on the pledge that President Obama made in his State of the Union address and again at a recent town hall forum in New Hampshire to provide an additional $30 billion to community banks for lending to small businesses. The OTS fully supports the Administration's goal to stimulate small business lending to the extent that this can be done in a safe and sound manner with prudent underwriting.

IV. Private Equity Investors

Finally, the Committee asked for the agency's views on possible impediments and barriers private equity investors encounter in attempting to invest in failed and failing banks. An entity seeking to acquire control of an OTS-regulated savings association is subject to a variety of laws[2] and regulations[3]. OTS's enforcement of these laws and regulations ensures that the entities seeking control of an insured institution possess the necessary managerial and financial resources, both currently and prospectively, and that the controlling parties will operate the insured institution in a safe and sound manner that does not pose an insurance risk to the Deposit Insurance Fund. These laws also prevent new affiliations between entities that control savings associations and commercial firms, as required by Section 401(a) of the Gramm-Leach-Bliley Act. Further, OTS regulations set forth a process for entities seeking to rebut a determination of control that requires support of their contention that no controlling relationship will result from their ownership of the insured institution.

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[2] Sections 10(c) and (e) of the Home Owners' Loan Act.
[3] 12 C.F.R. Parts 574, 583, and 584.

In the OTS's opinion, the greatest impediment private capital investors face is a general misconception that these investors engage in risky activities that are inherently unsafe and unsound, and therefore incompatible with the fundamental principles of banking. The OTS does not accept, nor has it ever accepted, this blanket mischaracterization. The OTS continues to support the infusion of private equity capital into the financial system in appropriate circumstances.

On August 26, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) adopted and issued the "Statement of Policy on Qualifications for Failed Bank Acquisitions." The statement sets forth the terms and conditions that the FDIC deems necessary for private capital investors to be eligible to bid on a proposed acquisition structure through the FDIC's resolution process. These criteria include, among others, requirements on capital commitments, continuity of ownership and business structure. Prior to the issuance of this statement, both the OTS and the Federal Reserve Board approved transactions involving private equity. Our recent experiences indicate that private equity applicants remain interested in investing in and acquiring control of insured institutions. These investors have expressed some concern, however, about the impact of the statement on their opportunity to provide good capital to a financial system that continues to require support.

Applications by private equity investors will continue to receive stringent scrutiny by the OTS to ensure compliance with applicable laws and regulations, and to ensure that control by such entities is consistent with safe and sound banking practices.

V. Conclusion

I have tried to put the current broad credit issues in some perspective and to make suggestions to hasten the return of adequate credit to the markets. However, while the economy is starting to show some positive signs and pockets of stability, it will take more time for a full recovery.

Again, we appreciate this opportunity to testify today on behalf of the OTS and look forward to working with you on these important issues in the future.

Testimony of
David Bridgeman
Chairman and CEO
Pinnacle Bank
Orange City, FL

Before the
United States House of Representative
Committee on Financial Services
And
Committee on Small Business

Hearing on Lending
February 26, 2010
Washington, DC

Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves and Members of the Committees, my name is David Bridgeman, and I am the CEO and President of Pinnacle Bank in Orange City, Florida. I have risen through the ranks in community banking, starting out as a teller 28 years ago. I have been with Pinnacle Bank since it opened for business in 1999, and became the CEO in 2003. I care deeply about the success of the Bank, small-business customers, and my community.

I am honored to have this opportunity to share my experiences and give you a current capsulized assessment of community banking, and the challenges impacting small business and commercial real estate credit availability. Community banks are the life blood for small business in America. It is the community banker that makes the $10,000 loan for equipment, inventory, or working capital--not the TBTF (too big to fail) banks. I do not compete against the TBTF institutions for the small owner-occupied real estate loan or small business loan; however, I compete every day for the deposits that those institutions are taking out of my community.

Although community banks hold only around 11% of total industry assets, community banks originate 38% of all small business and farm loans. According to the Federal Deposit Insurance Corporation ("FDIC"), banks with less than $1 billion in assets make more than half their loans to small businesses. In such a precarious point in our economic cycle, cutting lending to small businesses and farms could exacerbate existing pressures on the economy, leading to an increased probability of a double-dip recession.

Community banks understand the economic problems facing their respective communities. We know our customers by name. For example, recently a man sat across from me and wept because his business was struggling to the point that he had to lay off several long-term employees. We see first-hand what is happening to the small businesses in our communities. Community banks across my state and around the nation are seeing the same crisis as their business customers. It is the small business person who creates 60% of the jobs in this country and, therefore, it is through the efforts of the community banks that local economies, and ultimately our national economy, will be revitalized.

Pinnacle Bank

Pinnacle Bank is a state non-member bank regulated by the FDIC and the Florida Office of Financial Regulation, with $220 million in total assets. Pinnacle did not make the subprime or exotic risky mortgages nor did we invest in complex derivative securities that led to the current economic crisis. Pinnacle Bank ranks well in asset quality among its Florida peers. Pinnacle Bank has always been an active business oriented institution, providing credit to small businesses, the creators of most jobs in communities. The focus of our lending has been toward owner-occupied commercial real estate and C&I loans, with the loan portfolio mainly consisting of loans to local businesses. Pinnacle Bank is also one of the most active SBA lenders in Florida.

In spite of the economic turmoil of the last two years, we have continued to lend. In November and December of last year, Pinnacle Bank was the second largest SBA lender in North Florida. Our modest loan growth, however, was criticized as being too aggressive by the FDIC field examiners during our most recent examination.

In April 2008, Pinnacle Bank chose to participate in the TARP Capital Purchase Program to infuse $4.4 million into capital. We did not need a bailout. To qualify for the TARP-CPP, unlike the TBTF banks, a community bank had to be in a strong position in terms of capital, composite ratings and other factors that regulators use to determine a bank's condition. We saw the capital as a way to continue lending--as traditional sources of capital ceased to exist. During our recent examination exit meeting, however, the FDIC Examiner in Charge advised our Board of Directors that "TARP-CPP funds should specifically be used for increasing capital ratios and loan loss reserves." We understand that Congress' intent for TARP was to ensure access to credit for business customers. There exists a glaring disconnect between Congress and the field examiners' message to community banks.

We ended 2009 in a strong capital position. Pinnacle Bank is a "Well-Capitalized" institution by all regulatory measures. For year-end 2009, the Bank had a Total Risk-Based Capital to Assets Ratio of 11.61%, a Tier 1 Leverage Ratio of 8.14% and a Tier 1 Risk-Based Capital Ratio of 10.34%. To be considered well capitalized under regulations, a bank should have a total risk-based capital ratio of 10%, a Tier 1 leverage ratio of 5% and Tier 1 risk-based ratio of 6%. Despite the Bank's strong capital position following its field examination, the FDIC field examination staff is recommending that our capital status be downgraded to "Adequately Capitalized." Why, because we are a Florida bank, with Florida real estate as collateral. We believe this arbitrary capital downgrade will impede lending and place Pinnacle Bank under unnecessary stress. This example of heavy handedness from the regulators is ultimately obstructing the economic recovery.

Challenges

There are several challenges for community banks to continue to lend to small businesses. First, there is a shortage of small businesses that can qualify for loans. Small businesses throughout the country have suffered significantly during this recession and their financial statements are in shambles. Viable businesses with good credit histories and reasonable equity cannot obtain loans because their income and liquidity to support debt repayment are not sufficient for banks to make a loan using prudent underwriting standards. We believe attempts by community banks to lend to these viable businesses are being met with significant criticism from the regulators.

A second challenge to community banks is the current regulatory environment. I would like to refer to the letter written by Congressmen Barney Frank and Walt Minnick dated October 29, 2009. Their letter very accurately describes what I and many of my CEO peers have experienced, that the field examiners have become "overzealous." My bank was examined in November / December 2009.—The FDIC field examiners, in my opinion and the opinion of external auditors, were unduly harsh in their examination. They used PCA (Prompt Corrective Action) as a tool to require subjectively higher capital ratios, as well as much higher unjustifiable loan loss reserves.

Additionally, the FDIC examiners are downgrading other components of a bank's CAMELS ratings, based solely on deteriorating asset quality without recognizing the significant economic down-turn that has negatively impacted our entire nation. The examination manuals require that examiners take into account the current economic environment that a bank is operating under, but from our recent experience, this does not appear to be happening. Instead examiners rate the bank without considering the effect

of the economy and then express concern about the bank's condition and future in light of the economy, applying a double effect of the economic environment to the bank. These actions have forced community banks to stop lending in an effort to meet these new higher ratios in an attempt to correct regulatory criticisms.

After the toughest examination in my 28 years in banking, Pinnacle Bank, which is well-capitalized and well reserved by all measures provided in the regulations, is about to find itself in the position of having to suspend lending to satisfy unwritten capital and reserve requirements imposed by FDIC examiners. If we are to get our economy growing, we need to support community bank lending to small businesses, not impose arbitrary regulatory barriers to lending and unreasonable criticism for working with our customers.

Policies set in Washington and the policies that are enforced in the field by the federal examiners should be one and the same. Congress, the Administration and the heads of the banking agencies have designed programs and instituted regulatory policies to encourage community banks to lend to small businesses and to work with existing borrowers. As an example, the FFIEC policy statement entitled *Prudent Commercial Real Estate Loan Workouts* dated, October 30, 2009, encourages banks to work with our borrowers in an effort to keep businesses open and people employed. The FDIC examiners during my examination, however, were critical of work out arrangements (Troubled Debt Restructures – "TDR's") with customers even though our customers were paying as agreed, keeping businesses open and people employed. We were told these businesses were highly likely to fail and, therefore, have a negative impact on the Bank.

Another problematic regulatory issue for small business lending is the Community Real Estate ("CRE") Guidance. The CRE Guidance is for measuring risk in loan portfolios and developing policies and procedures to monitor and mitigate those risks. Currently, regulators are taking categories of concentrations within loan portfolios and criticizing banks for having too much concentration in areas that they deem to be risky, even if the risk has been mitigated and proper monitoring put in place. Federal regulators are taking the CRE Guidance and applying it as though it were a regulation. Federal regulators are using CRE concentrations as a yardstick for risks inherent in the portfolio, even if the portfolio is geographically diversified. Federal regulators are also recommending that community banks reduce CRE lending and even sell some existing CRE loans that have been rated "Substandard" or worse. Of course, any loan sales in the current real estate environment yield only a fraction of the value of the loan and cause community banks to take additional losses. This action, combined with arbitrarily higher capital requirements and higher reserve requirements, is again forcing banks to cease funding on lines of credit, demanding that lines be paid and withdrawing funding from new or existing commercial real estate projects.

Summary

The current regulatory environment is having a debilitative affect on local lending. Regulators must take a more positive approach to the examination process and understand that their actions are having a profoundly negative effect on the economy, communities, and job creation. It is imperative that the goals of Congress, the Administration and the federal banking regulatory agencies be the same— regrettably today they are not. Community banks want to lend to our small businesses and be a

catalyst to economic recovery, but the federal regulators need to change their Supervisory Policy toward community banks to allow viable community banks to work through their issues and these difficult economic times.

Thank you for the opportunity to allow me to express my views on some of the more pressing challenges facing community banks.

David L. Bridgeman
Chief Executive Officer
Pinnacle Bank
Orange City, Florida

CUNA & Affiliates

Credit Union National Association, Inc.
601 Pennsylvania Avenue NW
South Building, Suite 600
Washington, D.C. 20004
(202) 638-5777

TESTIMONY OF
RONALD COVEY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
ST. MARY'S BANK CREDIT UNION
ON BEHALF OF
THE CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE COMMITTEE ON FINANCIAL SERVICES AND
THE COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON
"CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE
LENDING IN LOCAL MARKETS"

FEBRUARY 26, 2010

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FEBRUARY 26, 2010

Chairman Frank, Chairwoman Velazquez, Ranking Member Bachus, Ranking Member Graves, Members of the Financial Services Committee and Small Business Committee: Thank you very much for the opportunity to testify today regarding the condition of small business and commercial real estate lending in local markets. My name is Ronald Covey, and I am President and Chief Executive Officer of St. Mary's Bank Credit Union[1] in Manchester, New Hampshire. I am testifying on behalf of the Credit Union National Association (CUNA)[2].

St. Mary's Bank Credit Union – a member-owned, not-for-profit financial cooperative – was the first credit union established in the United States. We are proud of

[1] St. Mary's Bank Credit Union was founded in 1908 as La Caisse Populaire Ste. Marie, to serve the Franco-American population living in Manchester, NH. The French name loosely translates to The People's Bank. In 1925, the credit union's charter was amended to use both the French and English versions of the name. In recent years, the credit union has only used St. Mary's Bank. St. Mary's Bank Credit Union serves 75,000 members; its total assets were $660 million as of September 2009.

[2] CUNA is the nation's largest credit union advocacy organization representing nearly 90% of America's 7,800 state and federally chartered credit unions and their 92 million members.

our heritage. For just over a century, we've been helping New Hampshire residents with a wide range of affordable products and services, including checking accounts, personal loans, real estate loans, business financial services, and savvy financial planning.

My testimony today focuses on the history of credit union business lending at St. Mary's Bank Credit Union and nationally, the safety and soundness of credit union business lending relative to similar loans made by banks, the demand for small business lending that we are seeing in New Hampshire and nationally, and our reaction to the President's proposal to create a $30 billion Small Business Lending Fund. Additionally, I will discuss our support for legislation, H.R. 3380, which would permit credit unions to inject as much as $10 billion into small businesses this year, helping them create over 100,000 jobs, at zero cost to the taxpayer and without increasing the size of government.

Business Lending is a Part of the Core Credit Union Mission and St. Mary's Bank Credit Union Has Been Fulfilling That Mission For Over a Century

The idea behind credit unions is very simple: people pool their savings together and make loans to neighbors and coworkers in order to help each other achieve a better standard of living. Following this basic principle of "people helping people," we improve communities and generate opportunities for those most in need. We have always considered supporting local business as one of the key factors in creating healthy communities. That is why we have always taken, and continue to take, the initiative in helping business owners.

Credit union involvement in business lending dates back to the first days of the credit union movement. The earliest credit unions were founded so that people could borrow money to buy goods at lower cost and sell them for a profit.

The founders of the American credit union movement very specifically noted the important role credit unions should play in providing access to credit for small businesses. As Alphonse Desjardin said in 1908, as he encouraged the founding fathers of St. Mary's Bank Credit Union to organize the United States' first credit union:

> "There are not only the manual laborers, whether of industry or of the land, who need credit and who, very often, are forced to suffer the extortions of the Shylocks of usury: There is also a very interesting class of small merchants, of humble industrialists, of modest entrepreneurs whose financial status does not permit them to have access to the large banks where their well enough known fellow businessmen go to stock up in order to enjoy the benefit of a checking account. To all of them as well, the cooperative offers financial assistance that is most precious."[3]

Business lending is part of the credit union DNA. St. Mary's Bank Credit Union has a track record of granting member business loans that dates back to our early years. St. Mary Bank Credit Union even provided vital loans during the Great Depression, when economic conditions forced many other financial institutions to close. According to the minutes of our Credit Committees during this time, St. Mary's Bank Credit Union granted business loans for apartment buildings, commercial real estate, working capital, time notes, and equipment loans. The businesses ranged from lumber yards, convenience stores, and heating oil companies to hardware stores and retail outlets.

Member business lending has continued at St. Mary's Bank Credit Union through our current recession. We still provide business loans for working capital (lines of credit)

[3] *L'Avenir National* (Manchester, N.H.), Vol. XXI, No. 67, 28 November 1908, p. 4-5.

inventory, accounts receivable, equipment loans, seasonal loans, commercial real estate loans, and energy loans. St. Mary's Bank Credit Union is an approved Small Business Administration lender and participates in the Business Express program, SBA 7(a) Loan Program, and SBA 504 Program. We also utilize several New Hampshire state programs through the Business Finance Authority of New Hampshire.

St. Mary's Bank Credit Union member business loans today provide:

- Critical financing for multi-family residential housing, much of which is in low-income areas;
- Working capital and equipment loans for small manufacturing companies and sub-contractors that provide jobs and economic stability in our market;
- Commercial real estate loans and rehab loans for business growth and expansion; and
- Working capital and equipment loans for entrepreneurs, small service, and professional organizations.

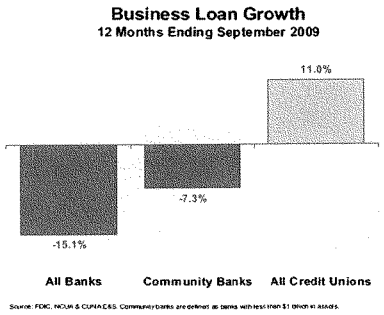
St. Mary's Bank Credit Union's average business loan size is under $200,000. We have 959 business loans, totaling approximately $75 million and 2,201 business members. Our potential is much greater!

Business Lending Demand Exists

St. Mary's Bank Credit Union's aggregate limit for net member business loans is $85.3 million based on the 12.25 percent of total assets cap in the Federal Credit Union Act. At the current time, we have a new business pipeline of $7.6 million and an additional $7.5 million in business loan requests that, if approved, would exceed our aggregate limit by $4.8 million. We will attempt to place the additional requests that exceed our cap at other financial institutions; failing that, business members will have to wait until other business loans are paid down. Either way, these business members will likely experience a delay in receiving funds that could drastically affect their business activities, their financial wellbeing, and their employees – a delay that we are hoping to prevent by being here today.

Let me emphasize this point: I do not see a scarcity of creditworthy business borrowers. I have the funds to lend, and nearly $5 million of loan requests that may go unfilled because of a statutory cap that was enacted twelve years ago without any economic or safety and soundness rationale. Given the demand we see, it is difficult to understand why we should not be able to put money back into the community, into the hands of hard working business owners, so they can employ more people and create more opportunities. That would simply be following through on the credit union mission.

On a national level, we know there is demand for business loans because credit union business lending actually grew in 2009 while bank business lending contracted. If there was a scarcity of demand for business loans, all lenders would have seen contraction, not growth, in business lending.



We also know that there is demand for business lending because our members tell us there is. I have with me several hundred letters from business owners from across the country who have received loans from credit unions, some after having been rejected by banks – big banks and community banks. These individuals have experienced first-hand the value in credit unions providing business loans; they see it as part of our mission.

We are simply asking for the opportunity to fulfill our potential as a business lender to our members. We have the resources to continue promoting business growth in our communities. We want to serve their needs. It would be disheartening to have to tell a qualified borrower that we cannot make a loan because of an agenda put forth by banks like the one that closed his line of credit or declined her original application. Limiting our cap to 12.25% of total assets does a great disservice to business owners everywhere, and stymies the kind of economic stimulation and job growth this country truly needs right now.

Credit Unions Stand Apart from Other Financial Institutions

Mr. Chairman, it is important to note that we would not be here talking about this issue if all financial institutions had behaved like credit unions. Credit unions did not contribute to the sub-prime meltdown or the subsequent credit market crisis.

Credit unions truly are Main Street financial institutions – small, local, and community-focused. The average credit union has roughly $110 million in total assets whereas the average banking institution is fifteen times larger with $1.7 BILLION in total assets. (The median size credit union has just $15 million in total assets and the median size bank is about ten times larger with $150 million in total assets).

Credit unions are careful lenders. And, as not-for-profit membership cooperatives the overriding operating objective at credit unions is to maximize member service. Incentives at credit unions are aligned in a way that ensures little or no harm is done to the member-owners. As we have seen, the incentives outside of the credit union sector are aligned in a way that can (and often does) cause harm to consumers. In the case of toxic mortgages such as sub-prime mortgages, entities operating outside of the cooperative sector focused on maximizing loan originations (specifically fee income from those originations) even though many of the loans originated were not in the borrower's best interest.

Credit Unions Lend to Their Business-Owning Members Safely and Soundly

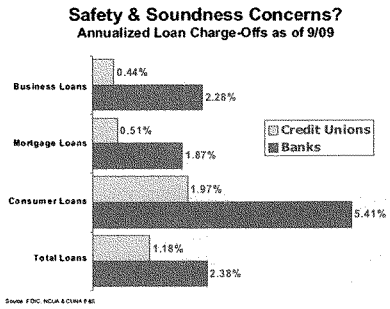
Some have suggested that an increase in credit union business lending could increase the exposure to the National Credit Union Share Insurance Fund (NCUSIF). However, the facts suggest that concern is misplaced.

First, as described below, our business loan loss rate is lower than that of banks, and lower even than our own losses on mortgages and consumer loans. Second, increasing the business lending cap gives well-capitalized credit unions a way to further diversify their portfolios, ultimately lowering overall risk. Third, the NCUA has full authority to supervise business lending by credit unions, and current rules severely limit business lending by credit unions which are not adequately capitalized. In fact, just this week, the Chairman of the NCUA Board wrote Treasury Secretary Geithner reiterating the agency's commitment to strong regulation of member business loans.[4] Increased business lending by credit unions would not be risk free, but it would certainly be very low risk.

Like most other credit unions, St. Mary's Bank Credit Union has a strong track record for sound business loan underwriting and performance. Our average business loan delinquency rate over the last 24 months was around 0.5%. Our net business loan charge-offs rate over the same 24-month time period has averaged about 0.32%

Credit unions, in general, have lower charge-off rates and lower delinquency rates on business loans than banks.

[4] A copy of this letter is attached to this testimony.



Considering all loans, in the first three quarters of 2009 the credit union loan loss rate was about half that of banks (1.18% vs. 2.38%). For business loans in particular, the credit union loan loss rate was only one fifth of the same rate at banks (0.44% vs. 2.28%). Among the three major categories of credit union lending (residential mortgage, consumer, and business), business lending has the lowest loss rate.

The President's Proposal to Create a $30 Billion Small Business Lending Fund Does Not Address the Chief Impediment Facing Credit Union Member Business Lending

During his State of the Union Address, the President proposed giving community banks access to $30 billion in TARP funds with the intention that those funds, which would count as capital for the banks, would be used to encourage additional lending to small businesses. Credit unions have not sought to be included in this program; however, even if credit unions were envisioned to be eligible to participate, current statutory restrictions related to credit union capital would prohibit using these funds and counting them as capital.

However, while we strongly support Congress considering capital reform for credit unions, the chief impediment to credit unions increasing the availability of small business credit is **NOT** a lack of capital. The chief impediment is the statutory cap on credit union business lending in the Federal Credit Union Act. This cap, which is essentially 12.25% of the total assets of a credit union, was enacted in 1998 as part of the Credit Union Membership Access Act (CUMAA). CUMAA was designed to permit multiple common bond credit unions to continue to serve their members in the wake of a ruling by the Supreme Court in a case, brought by the American Bankers Association, which overturned an NCUA interpretation of the Federal Credit Union Act. It is important to note that for the 90 years credit unions were in existence prior to the enactment of the cap, there was no statutory limit on the amount of business lending credit unions could do, and the business lending market share held by credit unions at the time of the cap was extraordinarily small.

There was no economic or safety and soundness rationale for the cap when it was enacted, and none exists today. At the time of CUMAA's enactment, the rationale for the cap, as stated by the Senate Banking Committee, was "to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers... through an emphasis on consumer loans rather than business loans."[5] Of course, credit unions have been and continue to be clearly focused on meeting the lending needs of consumers. Raising the cap would have a negligible effect on credit union lending to consumers. Any increase in business lending would for the most part replace investments rather than consumer loans. The average credit union has a total loan to

[5] Senate Report 105-193. p. 9

asset ratio of about 65%. Excluding the 5% held in fixed and other assets, that leaves about 30% of assets in cash and investments. If all of the additional business lending capacity were used, that would still leave about 18% of assets in cash and investments without any reduction in consumer lending. Even for the minority of credit unions with much higher loan to asset ratios, raising the cap would very likely not decrease consumer lending, or at least not by much. Just because a credit union could make more business loans does not mean it would forsake existing consumer loan demands to meet new business loan demand.

Small businesses need credit unions today because banks that have been serving them, in some cases for years, are pulling back access to credit. The Congressional Oversight Panel's February 2010 oversight report concludes that as many as 3,000 banks could be forced to curtail business lending. These actions leave many creditworthy business owners high and dry, unable to get the funds they need to operate and expand. It is frustrating to both the credit unions as well as the small business owners that additional resources would be available at credit unions but for a statutory cap on business lending which was enacted twelve years ago as a concession to the bank lobby on a bill designed to permit credit unions to continue to serve their members.

Representatives Kanjorski and Royce have introduced legislation (H.R. 3380) which, if enacted, would increase the credit union member business lending cap from the current level of 12.25% of total assets to 25% of total assets. It would also increase the de minimus amount of a credit union business loan from $50,000 to $250,000. This legislation would add an addition $100 million of business lending capacity to my credit

union. We could fill our outstanding loan requests and be there to help our community even more.

CUNA estimates that if H.R. 3380 were enacted into law, credit unions could lend an additional $10 billion to small businesses in the first year, helping small businesses create as many as 108,000 new jobs.[6] **H.R. 3380 is a job creation bill that would not cost the taxpayers a dime and would not increase the size of government.**

Some have suggested that increasing the credit union business lending cap is politically controversial. However, voters disagree. According to a recent survey by Voter Consumer Research[7], 62% of consumers identify jobs and the economy as the most important issues facing our country. When respondents were presented with a proposal

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[6] CUNA conservatively estimates that credit unions would increase member business loans (MBLs) by about $10 billion in the first year following expansion of MBL authority.

The estimated $10 billion, first year increase in lending is derived using three key assumptions:

1. We assume that "grandfathered" credit unions (i.e., the approximately 150 credit unions that are currently above the 12.25% cap) do not increase their lending when the cap is raised.
2. We assume that credit unions that are not currently engaged in MBL activity would enter the market in an amount, on average, equal to 1% of total assets under the new authority. Our conservative estimate assumes that 40% of the increased level of activity would occur in the first year.
3. We assume that all other MBL credit unions lend in an amount equal to their current "use" rate. Our conservative estimate assumes that 40% of the increased level of activity would occur in the first year.

We assume that the new loans would largely be loans that would not otherwise be made by banks. We further assume that the $10 billion increase in lending would be a "new normal" - that the 1st year-addition would represent a permanent addition to loan volume in credit union portfolios. In this regard, the increase in lending can be viewed as American Recovery and Reinvestment Act (ARRA)-like stimulus similar to direct spending. Thus, we assume that the additional lending would produce jobs at a rate that is similar to the estimates published by the Council of Economic Advisors (CEA) in its May 2009 estimates of job creation. See: http://www.whitehouse.gov/administration/eop/cea/Estimate-of-Job-Creation/

Using these assumptions and rounding, each $92,000 in additional MBL lending on the part of the nation's credit unions will create one additional job. Therefore, expanded credit union MBL authority will result in an estimated first-year increase of 108,000 new jobs nationally.

[7] The survey of 1,000 registered voters, 42% of whom identified themselves as credit union members, was conducted by Voter Consumer Research from January 24-28, 2010.

that would let credit unions pump $10 billion into small businesses and create over 100,000 jobs as well as leading banking arguments that the cap should not be removed because credit unions do not pay taxes and it would give them an unfair advantage, 63% of those surveyed responded favorably to the credit union proposal, while only 27% opposed. When respondents are reminded that bankers—after receiving taxpayer bailout money—are paying themselves bonuses and not making small business loans, nearly 70% side with credit unions and only 20% side with banks.

A growing list of small business associations and think tanks support lifting the cap on credit union business lending, including the following[8]:

Americans for Tax Reform
Competitive Enterprise Institute
Ford Motor Minority Dealer Association
League of United Latin American Citizens
Manufactured Housing Institute
National Association of Mortgage Brokers
National Cooperative Business Association
National Cooperative Grocers Association
National Association of Realtors
National Farmers Union
National Small Business Association
NCB Capital Impact
National Association of Professional Insurance Agents
National Association of the Self-Employed
National Association of Manufacturers
National Council of Textile Organizations
Council of Insurance Agents and Brokers
Center on Risk, Regulation, & Markets at the Heartland Institute

H.R. 3380 is a common sense bill that will help small businesses and support communities, and I encourage Congress to enact this legislation as soon as possible.

[8] A copy of an open-letter that these group have sent to Congress is attached to this testimony.

Before concluding, I do want to make a comment regarding the concerns raised by some that credit unions should not have additional business lending authority because they are tax-exempt organizations. This concern ignores both the history of credit unions having and using unlimited statutory business lending authority for the first 90 years of their existence at the same time they have had a tax exemption. As Congress has reaffirmed several times over the last seventy years, most recently in 1998, the tax status is a function of the structure of credit unions as not-for-profit, democratically-controlled, member-owned, financial cooperatives. The tax status has nothing to do with the powers of credit unions, and everything to do with how credit unions are organized.

The credit union structure is unchanged over the past 100 years and we continue to fulfill our mission of serving especially those of modest means. For example, according to Home Mortgage Disclosure Act data, minorities and lower income Americans are much more likely to have their home mortgage loan applications approved at credit unions than at other lenders.[9]

In the business lending arena, the Treasury's 2001 comprehensive analysis of credit union business lending showed that 25 percent of member business loans were made to members with household income of less than $30,000 -- and that these loans totaled 13 percent of the outstanding member business lending balances. Another 20 percent of the loans (with 15 percent of the outstanding loan balance) went to households with incomes reported to be between $30,000 and $50,000.

[9] Since 2005, credit unions have approved an average of 68% of applications from low/mod income borrowers, whereas other lenders approved an average of only 51% of these applications. Moreover, since 2005, an average of 26% of total credit union mortgage originations were to low/mod income borrowers while low/mod income originations represented only 23% of total originations at other lenders.

The irony is that bankers have repeatedly criticized credit unions for not doing more to serve the underserved, while at the same time repeatedly used the courts and persuading Congress to keep credit unions from being able to do more. The time is now to set aside the banker rhetoric. We urge Congress to permit credit unions to do what they were established to do – serve their members, including those who own small businesses. We have the willingness to help. We have the capacity to help. But, we need Congress to act.

Mr. Chairman, thank you very much for the opportunity to testify today. I am happy to answer any questions the members of the Committee may have.

National Credit Union Administration

Office of the Chairman

February 24, 2010

The Honorable Timothy F. Geithner, Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

I am writing as a follow-up to the recent discussions our agencies have had about credit union member business loan limitations.

The Federal Credit Union Act limits the amount of member business loans (MBLs) the great majority of credit unions can grant to the lesser of 1.75 percent of net worth or 12.25 percent of assets. Congress presently contemplates legislation that would raise or eliminate that statutory limitation by enabling credit unions to grant more MBLs. Should the legislative process result in an increase to or elimination of the current MBL limitations, I assure you NCUA would remain vigilant in carrying out our supervisory responsibilities.

NCUA has long exercised caution in monitoring MBLs from the standpoint of safety and soundness. We routinely issue guidance to ensure the credit union community and agency staff understand the risks associated with MBLs. For example, last month, the agency released NCUA Letter to Credit Unions 10-CU-02 ("Current Risks in Business Lending and Sound Risk Management Practices"). This guidance reminds credit union officials of the importance of ensuring that risk management practices must continue to evolve as the size and complexity of MBL portfolios increase. NCUA also plans to provide extensive MBL training to our field staff in the coming months.

NCUA recognizes that successful MBL programs depend upon credit unions limiting products to only those consistent with the capabilities of their respective lending staffs and the principles of sound risk management. In consideration of these precepts, NCUA already has efforts underway to strengthen the regulatory qualifications that credit union officials must have to serve as business lenders.

Let me assure you: **If legislative changes increase or eliminate the current aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns.**

1775 Duke Street - Alexandria, VA 22314-3428 - 703-518-6300 – 703-518-6319-Fax

As one of the most important changes, NCUA would only permit credit unions to increase their MBL capacities on a gradual basis by adopting a tiered approval process. In addition to other regulatory changes, the agency would develop procedures to fully monitor MBL growth.

Earlier this month, NCUA joined the other Federal Financial Institution Examination Council members in advocating prudent lending to creditworthy small businesses. We recognize the importance of small businesses in leading our nation's recovery efforts. As such, we support efforts to allow credit unions to provide businesses additional avenues of credit when appropriate under a comprehensive regulatory framework.

Sincerely,

Debbie Matz
Chairman

CC: Michael Barr
Assistant Secretary for Financial Institutions

An Open Letter to President Obama and Members of the House and Senate from Those Who Create Jobs

Dear Mr. President, Senators and Members of Congress:

As you focus on overcoming the challenges of our nation's economy, it is important to assemble and use all the tools at your disposal. To date, the primary focus has been both a taxpayer financed rescue and economic stimulus package.

Despite these measures, credit continues to be a problem for businesses of all sizes - businesses which create jobs. We would like to suggest another step that could inject up to $10 billion into the economy according to those associated with credit unions.

We urge you to allow credit unions to expand lending to their business members.

- **Credit unions continue to lend even when banks have cut back;**
- **Credit unions play a vital role in providing capital to underserved communities and small businesses; and,**
- **Credit Unions understand the special needs of their business members and can make loans that banks will not.**

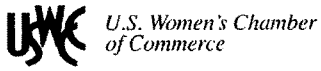
Easing business lending limits on credit unions will cost taxpayers nothing, and will provide much needed credit into our economy. We urge you to support lifting the lending cap.

Americans for Tax Reform
Competitive Enterprise Institute
Ford Motor Minority Dealer Association
League of United Latin American Citizens (LULAC)
Manufactured Housing Institute
National Association of Mortgage Brokers
National Cooperative Business Association
National Cooperative Grocers Association
National Association of Realtors*
National Farmers Union
National Small Business Association
NCB Capital Impact
National Association of Professional Insurance Agents
National Association for the Self-Employed
National Association of Manufacturers
National Council of Textile Organizations
Council of Insurance Agents and Brokers*
Center on Risk, Regulation, & Markets at the Heartland Institute *

* New Signatories

America's Credit Unions.
Serving their 90 million members everyday.

For more information, visit www.CUNA.org



Testimony
of
Margot Dorfman
Chief Executive Officer
U.S. Women's Chamber of Commerce

Before the House Small Business Committee
and the House Financial Services Committee

"Condition of Small Business and
Commercial Real Estate Lending in Local Markets"
9:00 a.m., February 26, 2010, 2128
Rayburn House Office Building

Chairwoman Velázquez and Chairman Frank, Ranking Members Graves and Bachus, Members of the Committees, I am here today representing the 500,000 members of the U.S. Women's Chamber of Commerce. Over three-quarters of our members are small business owners.

Thank you for this opportunity to update your committees on the condition of small business lending in local markets. Simply stated, the status of small business lending is so devastatingly poor that many business owners have given up even trying to secure capital and credit for their businesses. Our members tell us, regardless of their personal credit scores, proven business and financial track record, and contracts in hand – their access to capital and credit has become severely limited, and the fees and interest rates on their existing loans have risen to loan shark levels.

The consequences of this extended contraction in access to capital and credit have had a devastating effect on small businesses. Over the last two years, small business losses accounted for 40 percent of the 4.7 million positions cut by firms in total.[1] The results of a recent survey of our members have provided us with a very clear picture of the small business lending marketplace:

- The smallest businesses have either been wiped out or are struggling every day to stay in business.

[1] ADP National Employment Report, February 3, 2010.
<http://www.adpemploymentreport.com/pdf/FINAL_Release_January_10.pdf>

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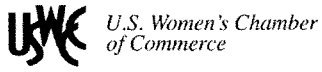

- Businesses in the $250 – 500K range have weathered the storm so far – and are seeking access to capital to fuel growth. Firms in this range tell us they could grow now – and add jobs – if they could only access capital and credit.

- Many of the businesses in the $500K – 1M range have significant overhead (equipment, raw materials) that make growth right now very challenging. And with little or no access to capital they have no way leverage their assets to fuel growth.

- Firms with over $1M in revenues have a more diversified set of capital and credit providers – but tell us they have very little appetite for growth due to the exorbitant fees, interest rates and uncertainty.

Nearly all businesses tell us that consumer confidence is extremely poor and that increased consumer confidence would help fuel their business growth. They also tell us it is important to complete the reform of our healthcare system and financial market regulations, and create a strong consumer financial protection agency so that they will have a clear picture of the future and can plan with confidence.

While U.S. banks report the sharpest decline in lending since 1942[2], another troubling trend is the extreme contraction in U.S. Small Business Administration (SBA) backed lending to women- and minority-owned firms. Between FY2008 and FY 2009, the percentage of SBA backed loans going to women-owned firms dropped from 23 percent to 20 percent and the total dollars lent dropped from 18 percent to 6 percent. During the same time period, the percentage of SBA backed loans going to minority-owned firms dropped from 33 percent to 22 percent and the total dollars lent dropped from 32 percent to 4 percent.[3]

We strongly encourage Congress to improve the opportunity for businesses to secure capital and credit, reduce the cost of credit, help small businesses to convert high interest debt into fixed term loans with reasonable interest charges, and help small business owners to assess their current financial condition and make good choices for the future.

We ask you to come up with solutions that match the scale of the challenge and address the real problems. The problems in the small business lending marketplace have been growing over the last decade. The resulting damage imperils not just small business owners – but every single American alive today and for generations to come. We cannot afford to send more of our taxpayer money into the hands of banks hoping they will do the right thing.

The job creation legislation recently passed in the Senate falls woefully short in addressing the size and scope of our problems. The recent FDIC comments on meeting the credit needs of

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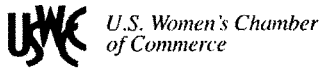
[2] Michael R. Crittenden and Marshall Eckblad, "Lending Falls at Epic Pace," *Wall Street Journal*, February 24, 2010.
[3] National Association of Government Guaranteed Lenders, http://www.naggl.org/am/Template.cfm?Section=SBA_Statistics



creditworthy small businesses do nothing to change the fundamental problems.[4] And the President's proposal to distribute $30 billion of Troubled Asset Relief Program (TARP) funds to local and community banks in an effort to re-energize lending to small businesses is simply more of the same. Clearly this action would once again benefit the banks – with no guarantees of assistance to small business owners.

Treasury Secretary Geithner has said these funds should be removed from the TARP program first to assure bankers they will not face the disclosure and compensation restrictions that financial institutions faced when they accepted the bailout funds. He says, "TARP has outlived its basic usefulness because banks are worried about the stigma of coming to TARP, and they're frankly worried about the conditions." Additionally, he said 600 small banks withdrew their applications for TARP money because they did not want to face the restrictions or the perception that they needed a bailout.[5]

It is time to stop worrying about the banks and start worrying about the people. It is time for the SBA to support small businesses and job creation through a direct lending program. Very solid strategies have been established that would enable the SBA to loan directly to small businesses allowing for the sale back of loans to private sector investors and lenders after a period of time.

The arguments made that the SBA as a direct lender would be competing with private sector lenders are hollow – as one cannot compete with lenders that are not even seeking to compete and whose objectives are at odds with the needs of our country. The arguments that the SBA would have to hire and train people are true – a small price to pay for our economic future. Hundreds of qualified individuals have been laid off from lenders. We are confident these individuals would welcome the opportunity to step up and help save the future of our country.

Specifically, we recommend:

1. Increase SBA lending guarantees to 90 percent.
2. Focus on two sectors with the greatest urgent need – loans under $200K and loans in the $200 – 500K range.
3. Establish a direct lending program through the SBA allowing for the sale back of loans to private sector investors and lenders after a period of time.

Our problems are big and will affect the economic wellbeing of our great country for generations to come. We ask you to really see what is happening in America and respond to the scale and scope of these problems. New models are needed to lift us from our current recession and return us to a vibrant financial future. Strength, transparency, and affordable access to capital are vitally important so that our economy may be revitalized, our small businesses brought back to life, and jobs created.

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[4] Federal Deposit Insurance Corporation, "Interagency Statement on Meeting the Credit Needs of Creditworthy . Small Business Borrowers," February 5, 2010. <http://www.fdic.gov/news/news/press/2010/pr10029a.pdf>.
[5] Jim Kuhnhenn, *BusinessWeek*, February 24, 2010
<http://www.businessweek.com/ap/financialnews/D9E2LE6O0.htm>

For Release Upon Delivery
9:00 a.m., February 26, 2010

TESTIMONY OF

JOHN C. DUGAN
COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

and the

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

February 26, 2010

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Frank, Ranking Member Bachus, Chairwoman Velázquez, Ranking Member Graves, and members of the Financial Services and Small Business Committees, I appreciate this opportunity to discuss national banks' lending activities and the OCC's actions to provide a supervisory climate that facilitates sound loans to businesses and consumers. The OCC supervises 1,462 insured national banks, which comprise about 18 percent of the 8,012 insured depository institutions (IDIs) in the United States, holding approximately 63 percent of all IDI assets. In terms of size, national banks constitute 12 of the 19 banks with assets over $100 billion, including the six largest banks in the United States; 35 percent of mid-size banks, with assets ranging from $5 billion to $100 billion; and 18 percent of community banks, with assets less than $5 billion.[1]

Access to credit is critical to the health of our nation's economy, and national banks play a vital role in meeting this need. While there are signs of a recovering economy, there continue to be significant strains that are affecting both the demand for credit and its supply. Many businesses and consumers have become more cautious, reducing their demand for and use of credit. Likewise, many bankers have become more conservative in how they evaluate potential borrowers and structure loan products. Despite these factors, lending remains a core business of national banks, and from my discussions with bankers, I believe they remain committed to meeting the credit needs of their customers.

The first part of my testimony addresses patterns and trends in bank lending, where there has been a general reduction in the total amount of loans by banks of all sizes. The second part discusses the demand and supply factors contributing to this result, that is, the reduced demand for credit by creditworthy borrowers resulting from the recession, and the

[1] Figures are based on 12/31/2009 data and include all FDIC-insured institutions, but do not include federally insured credit unions.

reduced supply of credit resulting from tightened underwriting standards. The final part addresses the role that regulators are playing and should play in facilitating credit availability, specifically including credit to small businesses.

Ensuring that national banks meet the credit needs of their communities and customers in a safe and sound manner is central to the mission of the OCC. It requires us to take a balanced and consistent supervisory approach, especially in this environment, to ensure that our actions do not discourage national banks from making loans to creditworthy borrowers. Many have questioned whether the regulatory pendulum has swung too far, to the point where regulators and examiners are impeding banks' ability to make even prudent loans. We take this matter very seriously, and as a result, have taken and continue to take a number of steps to ensure that OCC examiners are applying supervisory policies in a balanced and consistent manner across the country. We also have worked with the other banking regulators to reinforce our policies and expectations to both the industry and examiners regarding sound lending.

Our messages to bankers have been, and continue to be, the following:

- Make new loans to creditworthy borrowers, using prudent underwriting standards;
- Work constructively with borrowers who are facing difficulties; and
- Realistically recognize and address problem credits by maintaining appropriate reserves and taking appropriate charge-offs when repayment is unlikely. Recognizing and classifying a problem credit does not mean that a banker can no longer work with, or extend credit to, the borrower. We expect bankers to work with troubled borrowers.

Our direction to examiners and the policies they apply has remained consistent. We instruct our examiners not to dictate loan terms, and not to instruct bankers to call or renegotiate loans. Rather, the examiner's role is to determine that banks:

- Make loans on prudent terms, based on sound analysis of a borrower's financial and collateral information and ability to repay;

- Recognize weaknesses in existing credits and work with those borrowers to develop reasonable workout plans wherever possible;
- Have adequate risk management systems to identify and control risk taking;
- Maintain sufficient reserves and capital to buffer and absorb actual and potential losses; and
- Accurately reflect the condition of their loan portfolios in their financial statements.

We focus greatest attention on sectors that have been particularly hard hit by the economic crisis. Given the concerns expressed about how examiners were assessing troubled commercial real estate loans, we and the other banking regulators issued guidance last October to provide greater clarity and certainty to the industry and examiners on our policies and expectations for commercial real estate (CRE) loan workouts.[2] We believe this guidance, with the real world examples it contains, has been useful in providing greater consistency in how examiners apply key supervisory principles.

More recently, on February 5, we and the other agencies issued a statement on lending to creditworthy small businesses. This statement addresses the important role of small businesses in the economy, their dependence on banks for credit, and the recent difficulty experienced by some small businesses in obtaining new credit or renewing existing credit.[3] As with our recent CRE guidance, this statement is intended to facilitate small business lending and provide bankers with more regulatory certainty by outlining our expectations for prudent underwriting practices. In both statements we reiterate our policies that examiners should take a balanced approach in assessing banks' underwriting and risk-management practices and should not criticize banks that follow sound lending practices.

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[2] *See*: "Policy Statement on Commercial Real Estate Loan Workouts," at: http://www.occ.treas.gov/ftp/release/2009-128a.pdf.
[3] *See*: "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers" at http://www.occ.treas.gov/ftp/release/2010-14a.pdf.

Finally, we continue to work with the Administration, Congress, and the industry on programs that can provide additional assistance to the hardest hit sectors. We support the Administration's various small business lending initiatives. We have a number of resources for bankers to help them understand and more fully use the various programs offered by the Small Business Administration (SBA). We continue to be actively involved with the Administration's mortgage modification programs to assist troubled homeowners, and the information we collect through our Mortgage Metrics program helps assess the success of these efforts and determine where further adjustments may be needed.

As we discuss credit availability and the critical need for a balanced supervisory approach, I think it is very important to keep in mind the limits on what banking regulators can and should do. While we should be very careful not to encourage the banks we supervise to become excessively conservative, we simply cannot turn a blind eye to increasing losses and mounting credit problems. Last year, 140 banks failed, 25 of which were national banks, the most since the record numbers of failures in the late 1980s and early 1990s. Thus far in 2010, 20 banks have failed, three of which were national banks. Estimated losses to the deposit insurance fund since the start of the crisis two years ago are over $57 billion and growing, with nearly $7.5 billion coming from failed national banks. The FDIC's problem bank list has swelled to 706 as of December 31, 2009, and we are likely to have even more failures in 2010 than we did last year.

In this environment, some have talked about the need for regulatory "forbearance," where supervisors allow troubled banks to ignore credit problems in the hope they will go away over time. Unfortunately, we know from the painful experience of the savings and loan crisis of the 1980s that regulatory forbearance can and has made problems far worse, causing the deposit insurance fund and the taxpayer to sustain tens of billions of dollars more in losses

than would have resulted from prompt regulatory action. That experience caused Congress to enact the Prompt Corrective Action regulatory regime in the Federal Deposit Insurance Corporation Improvement Act of 1991, or "FDICIA." This statutory regime expressly rejected regulatory forbearance, and reinforced to supervisors how important it is for institutions to realistically recognize losses and take the necessary steps to repair themselves to avoid further problems – and ultimately be in a better position to make loans to creditworthy borrowers.

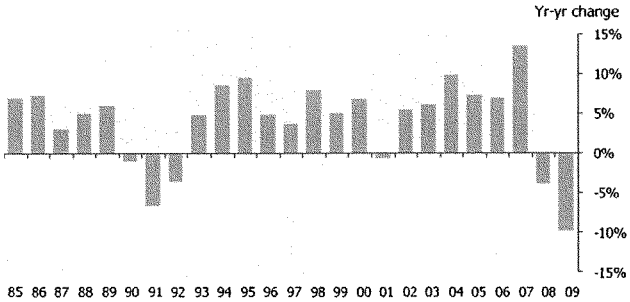
In short, the right supervisory approach to promote sound credit availability is, by all means, to avoid excessive conservatism. But it is also to avoid the kind of forbearance and tolerance for loss deferral that can lead to bigger future losses, more severely troubled banks, even more constrained lending, and increased bank failures.

II. Trends in National Bank Lending

After two years of extreme economic stress and financial disruption, there has been a notable decline in the level of loans outstanding within the commercial banking sector. This decline has occurred at banks of all sizes, both for national and state-chartered banks. While such declines are common in recessions, this recession has been much more severe than the typical downturn. The resulting slowdown in bank lending has been especially pronounced, including for national banks, as measured by the annual percentage change in loans outstanding shown in Chart 1. This decline is particularly striking because it followed a decade of sustained credit expansion – including the largest increase in 25 years during 2007 – an expansion that financed economic growth, but also reflected increasing use of leverage by businesses and consumers.

Chart 1

National Banks: Total loans on balance sheet



Source: Integrated Banking Information System (OCC)

Data are merger adjusted and held-constant on a 1-year rolling basis.

Drilling down to specific loan categories reveals some variety in the timing and scale of reductions in outstanding loans by category (see Table 1). In 2008, the decline was led by a reduction in residential mortgage loans, concentrated in the largest banks, which were the predominant on-balance sheet lenders for such loans (although the overwhelming majority of first mortgage loans are held by third parties as the result of securitizations by both government-sponsored enterprises and private financial institutions). This decline continued at a substantial, if somewhat slower pace, during 2009. Construction loan balances at national banks also fell during 2008, by $6.3 billion, and the decline accelerated to $45 billion in 2009. Other major loan categories, including commercial and industrial (C&I) loans, commercial mortgages, and consumer loans – home equity, auto, and credit cards – increased in 2007 and 2008 before declining in 2009, with a particularly notable $223 billion decline in C&I lending. Commercial mortgage loans (including loans for multifamily housing) actually

continued expanding on a year-over-year basis through September 2009, but then fell off sharply in the final quarter of the year.[4]

Table 1

National Banks
Yr-Yr Change in Loans Held on Balance Sheet, $ Billions

	2007	2008	2009
Commercial and industrial	171.5	5.9	-223.0
Commercial mortgage*	29.5	12.1	-7.3
Construction	24.4	-6.3	-45.3
Residential mortgage	91.2	-183.7	-100.8
Consumer	74.5	22.8	-48.9
All other loans	65.9	-47.0	-32.9
TOTAL	457.0	-196.1	-458.4

*includes multifamily and nonresidential property

Data are for FDIC-insured national banks. Historical data for growth calculations include non-national bank loan balances acquired by national banks via mergers.

National banks are significant providers of small business credit, but discerning trends in small business lending is more difficult due to the variety of lending facilities that small business owners use for financing. One proxy for a portion of small business lending is the data collected every June – soon to be collected every quarter – on commercial loans of less than $1 million, which tend to be to smaller businesses. The June 2009 data showed national banks providing $292 billion dollars of credit in this form, including C&I loans, agriculture loans, and commercial mortgages (see Table 2). Agricultural loans were only three percent of this total, with the remainder about evenly split between commercial mortgages and C&I loans. Larger national banks, those with assets over $1 billion, accounted for eight out of

[4] These loan growth figures and those in Table 1 reflect the following methodology: Loan balances that were originally on the balance sheets of non-national banks (thrifts, state banks, investment banks, etc.) that converted, merged, or were acquired by national banks, are added to historically reported national bank loan balances to achieve a true measure of loan growth without the confounding influences of charter changes. This merger-adjustment process does not adjust for the transfer of loan balances that occur outside of charter acquisitions or conversions.

every ten dollars of small commercial loan volume provided by national banks. Based on the most recent data, smaller national banks showed a modest year-to-year increase in total small denomination commercial loans, whereas these loans declined about five percent at the larger banks. The modest gain at smaller national banks was entirely due to growth in commercial mortgages. Small C&I loans declined at both small and large national banks – a trend that mirrored commercial banks as a whole.

Table 2

National Banks
Small Denomination Commercial Loans

	June 2009, $ billions			Yr/Yr change		
	Commercial Mortgage	C&I	TOTAL*	Commercial Mortgage	C&I	TOTAL*
Banks with assets under $1 billion	28.7	18.4	52.8	3.2%	-4.0%	0.2%
Banks with assets $1 to $50 billion	28.5	28.5	58.4	-0.2%	-10.3%	-5.5%
Banks with assets over $50 billion	79.2	98.9	180.4	-3.7%	-5.8%	-4.7%
TOTAL	**136.4**	**145.8**	**291.7**	**-1.6%**	**-6.5%**	**-4.0%**

* Total includes agriculture loans under $500k C&I = commercial and industrial loans

Source: June Call Reports, Sched. RC-C. Data are merger-adjusted and for banks in continuous operation from June 2008 to June 2009.

Of course, the category of "commercial loans of less than $1 million" reflects only a portion of the overall small business credit provided by banks, as many small business owners have relied on credit cards and their personal home equity lines of credit as primary sources of credit financing. The use of such loans for small business lending is not currently captured by the Call Report, but as shown in Table 1, there has been a reduction in consumer loans in the aggregate. More granular data that we obtain through our on-site supervisory activities

suggests some of this decline in consumer loans is attributable to a decline in small business credit use.[5]

Several important qualifications apply to using a decline in outstanding loan balances at banks as the direct equivalent of a decline in the amount of credit made available by those banks. First, because this is a point in time measure, changes in outstanding balances do not fully reflect the volume of loans being originated, since some loans are being paid down through normal reductions in loan principal.[6]

Second, part of the decline in reported outstanding loan balances results from the amount of troubled loans that banks charge off. Such actions, which are necessary when repayment becomes unlikely, have nothing do with the amount of new credit being made available to creditworthy borrowers. As shown in Chart 2, net charge-off rates have exceeded recent peak levels for nearly all major loan categories at national banks, and the total net charge-off rate for commercial banks is on track to be the third highest annual rate on record.

When banks charge off loans, the loans are no longer reported on their balance sheets, even though the loans have not been extinguished. During 2009, national banks charged off $126 billion in loans, an amount equivalent to 27 percent of the total decline in outstanding loans for the year. For certain types of credit, the impact has likely been greater; for example, the $49 billion decline in non-mortgage consumer loans during 2009 includes the impact of $45 billion in charge-offs. We believe that charge-offs to address asset quality problems are a painful, but critical, step in restoring the health of banks' balance sheets and their capacity to

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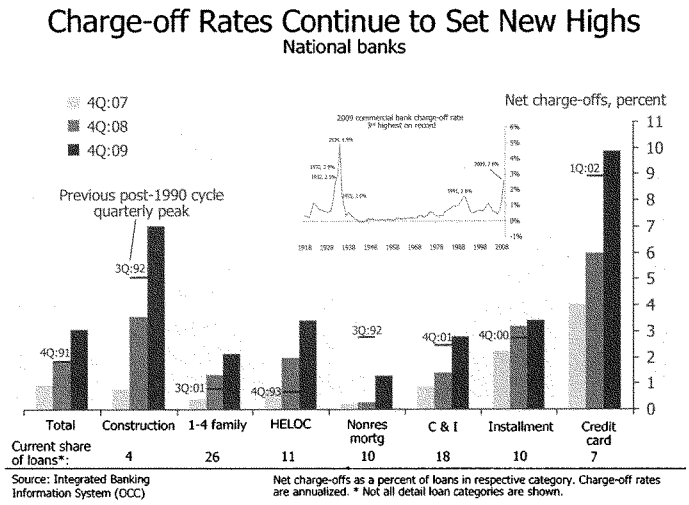
[5] The largest TARP recipients are required to submit monthly data to the U.S. Treasury on their lending activity. The February 2010 report for the 11 large institutions that as of June 2009 had not repaid their TARP funds showed that the total loan balances for small business loans declined by $9 billion from July to December 2009 (from $178 billion to $169 billion). *See*: "Monthly Lending and Intermediation Snapshot," February 16, 2010.

[6] For example, although the monthly TARP data reported to Treasury show a decline in small business loan balances of $9 billion from July to December 2009, the data also show $34 billion in small business loan originations during that period at those same firms. *See*: "Monthly Lending and Intermediation Snapshot," February 16, 2010.

lend – but they do not result in an actual decline in borrowers' credit obligations to banks, even though they are reported that way, and they are not really relevant to whether banks are extending new loans to creditworthy borrowers.

Chart 2



Finally, the level of outstanding loans on banks' balance sheets understates the amount of credit that banks have made available to borrowers as it does not capture the amount of unused credit lines. These credit lines reflect commitments of credit that banks have extended to customers, allowing them to decide exactly when and how much to borrow by drawing down the line. While it is true that many banks have reduced unused credit lines, the level of unused credit lines at national banks remains substantial, totaling $4.4 trillion at year-end 2009. The level of untapped lines of credit means that many retail and commercial borrowers have access to additional credit beyond the reported amount of loans outstanding. Unused credit card lines and home equity lines of credit at national banks totaled $2.5 trillion and

$376 billion, respectively, at the end of 2009. Likewise, national banks had $1.5 trillion in unused commitments for loans other than credit cards and home equity lines, an amount that far exceeds the $781 billion in total C&I loans outstanding.

III. Demand and Supply Factors Affecting Bank Lending

As previously mentioned, credit availability is affected by both demand factors – the extent to which borrowers seek new credit – and supply factors – the extent to which lenders are willing and able to supply that credit. As discussed below, the recent decline in bank lending reflects a significant decline in both credit demand and credit supply.

A. Demand Factors

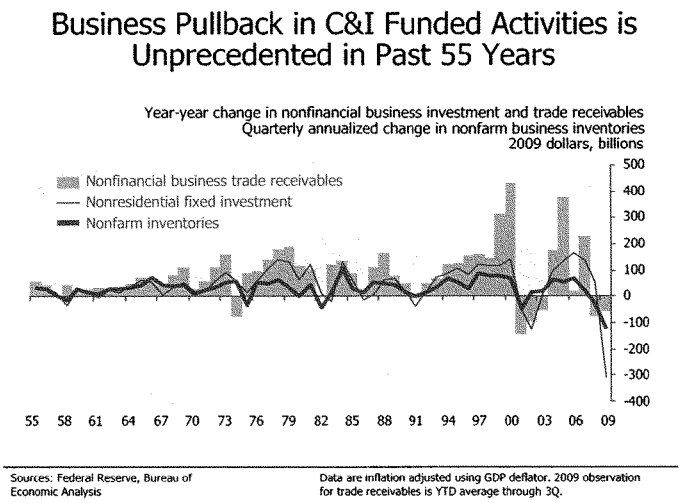
A variety of measures and reports indicate that, as a result of the sharp decline in underlying economic conditions, the demand for credit by both businesses and consumers has correspondingly declined. While it is difficult to apportion with certainty the extent to which a particular factor has caused a decline in credit availability, most bankers point to slack demand as the single most important factor. For example, although respondents in the Federal Reserve's most recent Senior Loan Officer Survey reported some improvement in loan demand, many of the demand measures remain very weak. For commercial loans, 34 percent of the banks reported weaker loan demand, while only nine percent reported stronger demand. On the consumer side, weakness was even more pronounced; for example, nearly half of the banks reported weaker demand for home equity lines of credit, with only seven percent reporting stronger HELOC demand from consumers.[7]

Many businesses have cut back on activities that are typically funded by bank loans, such as inventory investment and capital expenditures on plant and equipment, and have less need to fund accounts receivable due to the weak pace of sales. As shown in Chart 3, the

[7] *See*: The Federal Reserve Board, "The January 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices," at: http://www.federalreserve.gov/boarddocs/snloansurvey/201002/fullreport.pdf.

recent reductions in fixed investment and inventories is unprecedented over the past 55 years of historical data, while the decline in accounts receivable by U.S. nonfinancial companies also has been quite pronounced.

Chart 3



These three activities are the predominant drivers of commercial loan demand, and help to explain the abrupt decline in C&I lending by national banks during 2009. In addition, many larger companies have taken steps to strengthen their own balance sheets and lock in low funding costs by replacing short-term bank borrowings with longer-term corporate bonds, thereby tending to further reduce the overall demand for traditional bank loans.

Similar factors are evident in commercial real estate lending, as major segments of the income producing commercial real estate sector have experienced rising vacancy rates, falling rental rates, and weak sales. Likewise, demand for residential construction loans has weakened substantially due to the considerable overhang of housing supply.

Weak sales and uncertainty about the economy are also factors affecting small business lending. Reports issued by the National Federation of Independent Business Research Foundation (NFIB) over the past two years have consistently indicated that underlying business conditions, rather than access to credit, is the primary problem facing many small business owners. For example, the percentage of respondents that have reported "finance" as their number one business problem has held remarkably steady over the past two years, at only two to six percent.[8] In its most recent report, released this week, the NFIB reported that only five percent of small business owners reported financing as their top business problem, whereas 31 percent cited poor sales. This is in contrast to pre-1983 when as many as 37 percent cited financing and interest rates as their top problem. The report further states "[H]istorically weak plans to make capital expenditures, to add to inventory and expand operations also make it clear that many potentially good borrowers are simply on the sidelines," and that while 11 percent of owners reported that their borrowing needs were not satisfied (up three percent from December), the remaining 89 percent "either obtained the credit they wanted or were not interested in borrowing."[9]

Similarly, more cautious consumers are contributing both to the lack of loan demand by commercial borrowers and to the slowdown in overall consumer loans. Households are saving more and spending less (see Chart 4), and many have taken steps to reduce their use of debt. High unemployment and the general uncertainty about the economy have also taken a toll, as reduced spending has led to lower levels of revolving credit use (see Chart 5), both for borrowers who pay off their balances in full every month, as well as for those who regularly carry a balance.

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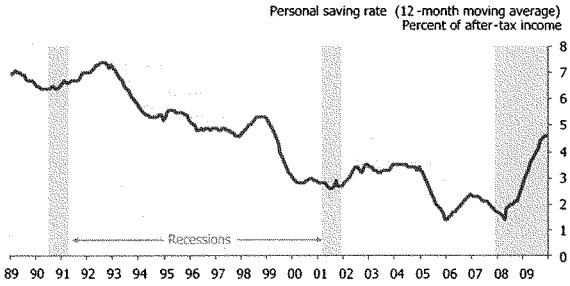
[8] See for example, NFIB Small Business Economic Trends *Monthly Report,* February 2010, pages 2 and 18.
[9] NFIB Small Business Economic Trends, *Monthly Report*, February 2010, page 2.

All of these indicators of loan demand gibe with what we hear consistently from bankers: demand from creditworthy borrowers continues to be weak. As previously noted, these reports mirror the findings of the Federal Reserve Board's latest Senior Loan Officer Survey. Indeed, in response to a survey question about the number of inquiries from potential business borrowers for new credit or increases in existing credit lines, only 12.7 percent of the banks reported seeing any increase, with roughly twice that many reporting a moderate or substantial decline in the number of inquiries from potential borrowers.[10]

Chart 4

Consumers' Increased Saving Means Less Spending and Use of Consumer Debt

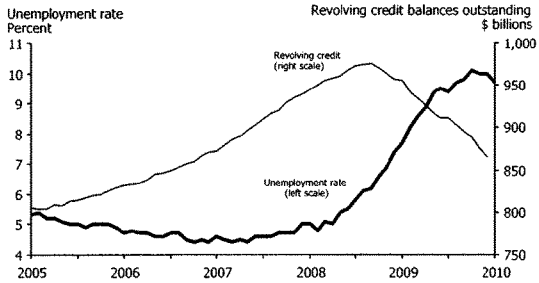


Source: Bureau of Economic Analysis, data through December 2009

[10] *See*: The Federal Reserve Board, "The January 2010 Senior Loan Officer Opinion Survey."

Chart 5

Weak Labor Market Weighing on Personal Spending and Revolving Credit Use



Sources: Federal Reserve (G.19), Bureau of Labor Statistics

Revolving credit data through Dec 2009; unemployment data through Jan 2010

B. Supply Factors

Reduced loan demand has not been the only contributor to reduced bank lending, however. Banks have also reduced the supply of credit through tightened underwriting standards.

In response to deteriorating credit and economic conditions, many bankers have become more risk averse and selective in their lending. Many borrowers that may have been able to make debt payments when the economy was expanding now face constrained income, cash flow, and debt service capacity that limits their ability to take on additional debt and, in some cases, to meet existing debt obligations (see Chart 2). Faced with a riskier pool of current and potential borrowers, some bankers have elected to reduce their risk exposures. They have also taken steps to reduce excessive concentrations that built up during boom conditions, particularly with respect to commercial real estate. As reflected in the OCC's

annual underwriting surveys of national bank examiners and the Federal Reserve Board's quarterly senior loan officer surveys, both national banks and commercial banks more generally have tightened their underwriting standards over the past two years.[11] Our 2010 survey is underway, but we expect that we will see similar trends to those found in the Federal Reserve's most recent Senior Loan Officer Survey, *i.e.*, that for many, but not all, types of loans, much of the adjustment in underwriting standards has been made.

As would be expected, evidence shows that the more stringent underwriting standards are having an adverse effect on small businesses' ability to access bank credit. For example, the previously mentioned NFIB surveys indicate that some regular borrowers (those accessing capital markets at least once a quarter) continue to report difficulties in arranging credit, with a net 14 percent (down one point from December) reporting that loans are harder to get than in their last attempt.[12] The NFIB reports that while this is the highest frequency since 1983, "this is not nearly as severe as the financial distress reported in the pre-1983 period."[13] Part of this difficulty may stem from the increased risk in some small business credits. According to the Federal Reserve's most recent Senior Loan Officer Survey, nearly 65 percent of surveyed domestic banks indicated that at the end of the fourth quarter of 2009, the delinquency rate on their outstanding loans to small firms was higher than the rate on outstanding loans to large and middle market firms.[14]

With the significant increase in non-performing and delinquent loans, many bankers have shifted substantial resources from loan generation to working with troubled borrowers. In addition, banks struggling with serious asset quality issues are less likely to have the

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[11] See for example, OCC's Survey of Credit Underwriting Practices, 2007 and 2008, available at: http://www.occ.gov/cusurvey/2008UnderwritingSurvey.pdf and http://www.occ.gov/cusurvey/2009UnderwritingSurvey.pdf.
[12] NFIB, February, 2010, page 2.
[13] NFIB, January 2010, page 2.
[14] Federal Reserve Board, January 2010 Senior Loan Officer Opinion Survey, page 9.

capacity to be strong lenders. In fact, among national banks with less than $10 billion in assets, those with a lower percentage of noncurrent loans[15] – specifically, the 937 with a noncurrent loan ratio below three percent of total loans at the end of 2009 – actually *expanded* their lending as a group during the year. In contrast, total loans at the 406 national banks with higher noncurrent loans ratios fell by 10 percent during 2009.[16]

In general, we believe banks' stronger underwriting standards reflect a return to more prudent practices. But these changes have affected the ability of some borrowers to obtain credit. In many cases, riskier borrowers will be required to have higher down payments for home mortgages, have more cash equity in a project, provide additional collateral, or face additional loan covenants. Rather than cut off credit to commercial borrowers who are facing strains, some national banks are expanding their asset-backed lending programs. These programs allow companies to use their inventories and accounts receivable as collateral to obtain credit, although at higher rates of interest. Because this type of lending entails more risk, it tends to be very resource intensive and requires strong internal controls and frequent contact with borrowers.

While much of the tightened underwriting that banks have engaged in to respond to recent market developments and asset quality problems is appropriate and to be expected, it is also very possible that in some cases they have overreacted. With the uncertainties banks have faced in the severe downturn and stressed financial markets, some may have become too conservative and denied credit to truly creditworthy borrowers. And some may also have tightened too much in response to supervisory actions that they perceive to be inappropriate – a serious concern addressed in the next section of the testimony.

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[15] Noncurrent loans are loans that are 90 days or more due or are on nonaccrual.

[16] These figures are based on a set of national banks with assets under $10 billion, excluding trust and credit card banks, that is "held-constant" to adjust for the effects of entry, exit, and mergers and excludes banks in operation less than three years.

The natural counterweight to excessive conservatism is that bankers have a strong self-interest in making loans, because lending is the core of the commercial banking business and the main source of income for most banks. Over the past 25 years, loan income has accounted for about 60 percent of gross revenue at national banks; this share is even higher for smaller banks that do not generate significant non-interest income.[17] If banks don't make loans, they forego their primary source of profitability. And indeed, most national banks are extending credit and making new loans, just not at the pace or level that preceded the economic downturn.[18]

Bankers also recognize an obligation to meet the credit needs of their communities and customers. In this regard, a number of the largest national banks have recently made public commitments to increase their lending to small- and medium-size businesses. This includes a pledge to increase lending by $5 billion by Bank of America, and by up to $4 billion by JPMorgan Chase. Similarly, Wells Fargo has indicated that it will increase its new loan originations to small business by 25 percent.

In summary, we have been in a phase of the credit cycle where many businesses, consumers, and lenders took steps to repair their balance sheets, reduce their leverage, and rein in excesses that built up during the last credit cycle. Restoration of bank lending to more normal levels will require adjustments to a variety of supply and demand factors and ultimately hinges on improvements to the underlying economy and renewed confidence by businesses, consumers, and bankers. In some sectors, most notably C&I lending, such a

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[17] Although capital markets activities are an important source of revenue for a few of the very largest national banks, trading and investment banking fees have accounted for less than five percent of gross revenue for the national banking system since 2000.

[18] For example, the February 2010 Monthly Lending and Intermediation Snapshot report for the 11 largest TARP recipients indicates that total monthly loan originations by these institutions was 17 percent higher in December 2009 than had been the case one year earlier. During this twelve-month period, loan originations and loan renewals by the largest national banking organizations included in the report (Bank of America, Citigroup, PNC Financial Services Group, Key Corp, and Wells Fargo) totaled $1.9 trillion. This data is not merger adjusted. *See*: "Monthly Lending and Intermediation Snapshot," February 16, 2010.

rebound could occur relatively quickly as firms start to replenish their inventories. For other sectors, most notably construction and commercial real estate, the recovery will likely be more prolonged, and may not occur until lease rates and cash flows stabilize.

IV. Role of Regulators in Fostering Credit Availability

One of our primary goals as a bank supervisor is to ensure that national banks will have the balance sheet capacity and financial strength to meet renewed increases in loan demand. Over the past two years, we have directed national banks to strengthen their capital and loan loss reserves, to recognize and deal with their asset quality problems at an early stage, and to address risk management and underwriting weaknesses. A key objective of our directives is to provide a strong foundation within the national banking system to support renewed economic growth. Net capital levels in the national banking system have increased by roughly $141 billion over the last two years, and net increases to loan loss reserves have exceeded $97 billion. While additional reserves may still be needed by some banks as they work through their asset quality problems, we believe the increases in capital and reserves that have occurred have greatly strengthened the capacity of the national banking system.

Some have questioned whether our actions have become a further impediment to banks' ability or willingness to lend. We are acutely aware that our actions – both on the policy side in Washington and in the field through our on-site examinations – can and do influence banks' behavior and their appetite for taking risk. We also have heard complaints that overzealous regulators and examiners are exacerbating the contraction of credit. Given these concerns, I want to more fully explain our approach to supervision; steps we have taken to ensure we maintain a fair and balanced approach; and mechanisms we have in place when a banker may disagree with our examination findings. I then will explain in some detail the role

of examiners in evaluating credit and, finally, actions that we are taking to facilitate and encourage small business lending.

A. OCC's Approach to Balanced Supervision

One of the lessons we learned from the early 1990s was the detrimental effect of waiting too long to warn the industry about excesses building up in the system, resulting in bankers and examiners slamming on the brakes too hard when the economy experienced problems. We also learned that it is critical that our expectations for bankers be clear and consistent, that the "rules of the game" under which banks operate not be changed abruptly, and that changes in regulatory policies are made in an open and transparent manner that provide bankers with reasonable timeframes to make necessary adjustments.

Throughout this credit cycle, we have strived to take a balanced and measured approach in our supervision, alerting banks as early as September 2003 when we started to see signs of increasing risk embedded in their loan portfolios. These alerts were followed by more specific and targeted supervisory guidance and on-site examinations. We conducted numerous outreach sessions with bankers and bank directors to discuss our concerns and outline our expectations. Our goal in taking these actions was to ensure that bankers recognized potential problems at an early stage so that they could take steps to mitigate potential risks that were building up in banks' portfolios.

Equally important are the steps we take with examiners to ensure that they understand and apply our policies in a consistent manner across the country. While our examination force maintains a local presence in the communities national banks serve, our examination policies and emphasis are established and coordinated on a national level. Our examiners are alerted to new policy issuances via weekly updates. When warranted, we supplement these issuances with targeted supervisory memos that provide additional direction on how

examiners should implement those policies or guidelines on a consistent basis across the country. The messages are reinforced and clarified through periodic national teleconferences that our senior management team in Washington holds with our field staff. In addition, we have national commercial and retail credit committees that bring together field examiners and policy staff to exchange information, discuss emerging issues, and promote consistency in the application of examination policies.

We also have various mechanisms in place to help ensure consistency in our examination findings and any attendant supervisory actions. For example, each report of examination is reviewed and signed off by the applicable deputy comptroller or assistant deputy comptroller before it is finalized. Supervisory enforcement actions are reviewed by district and, for certain cases, headquarters supervisory review committees. We have quality assurance processes that assess the effectiveness of our supervision and compliance with OCC policies and procedures. These reviews are augmented by independent oversight conducted by the OCC's Enterprise Governance unit.

Because bank examination requires judgment, there will be instances when reasonable minds may differ on certain conclusions drawn from examination activities, or where there are additional facts and circumstances that a banker believes were not given full consideration. I and my management team have stressed a policy of open communication with bankers. I encourage any banker that has concerns about a particular examination finding to raise those concerns with his or her examination team and with the district management team that oversees the bank. Our assistant deputy comptrollers and deputy comptrollers expect and encourage such inquiries. Should a banker not want to pursue those chains of communication, we have an independent Ombudsman's office that bankers may use to appeal a supervisory action or decision. In addition to receiving formal complaints or

appeals, the Ombudsman's office provides bankers with an impartial ear to hear complaints, and a mechanism to facilitate the resolution of disputes with our supervisory staff.

B. OCC's Examination Messages and Actions

As we work through this stage of the credit cycle, our messages to examiners continue to be these: Take a balanced approach; communicate concerns and expectations clearly and consistently; provide bankers reasonable time to document and correct credit risk management weaknesses; and encourage bankers to work with troubled borrowers in a prudent manner and to extend new credit to creditworthy borrowers. This does not mean that examiners are giving bankers a "free pass" to ignore or delay recognition of their credit problems. If a banker does not or cannot identify and take appropriate action to manage the risks in the bank's credit portfolio, examiners will direct bank management to take corrective action. At some institutions where bank management has not sufficiently identified or addressed their loan problems, our reviews may result in a bank needing to make additional loan loss provisions; to charge off loans that are deemed loss; or to place loans on nonaccrual where full collection of principal and interest is in doubt. Similarly, some banks may be directed to strengthen their credit underwriting or risk identification and management practices.

With this background, let me address some of the specific concerns and allegations I have heard about examiners' actions.

- *Examiners are barring loans to certain borrowers or industries, or are criticizing loans simply because they are located in a state with a high mortgage foreclosure rate or to an industry experiencing problems.*

Deciding which borrowers or businesses a bank should lend money to is not part of our examination process, provided the business is lawful and the bank is meeting the credit

needs of its communities. We do expect banks to have robust credit underwriting and risk management processes, which among other things, monitor and control the bank's overall exposure to a particular borrower and industry segment. We also expect bankers to assess how borrowers and industries may perform in stressed economic environments to ensure that they will continue to have the capacity to perform under the terms of their loan obligations. However, examiners do not criticize loans simply because a borrower is located in a certain geographic region or operates in a certain industry. Each loan must be evaluated based on its own structure, terms, and the borrower's willingness and ability to repay the loan under reasonable terms. Market conditions, however, can influence a borrower's repayment prospects and the cash flow potential of the business operations or underlying collateral, and these are factors that we expect bank management to consider when evaluating a loan.

When bankers say that the examiners are telling them not to extend credit to certain borrowers or businesses, what they often mean is that the examiners are "classifying" certain loans. When a borrower's ability to repay its loan deteriorates or becomes impaired, we expect the bank to "classify" the loan to recognize the increased risk. This means that they move the borrower from a "pass" designation into one of four other categories, ranging from a potential problem to a more serious actual one. Loans falling into one of these categories generally require more rigorous loan review and administration. Although some bankers may infer that they are no longer allowed to extend credit to those borrowers, this is simply not the OCC's position. We expect and, in fact, encourage bankers to continue working with "classified" borrowers who are viable. An increase in classified loans does not automatically trigger supervisory action – we expect banks to have higher classified loan ratios during economic downturns – provided that bank management is being realistic in its assessments,

has reasonable workout plans, and is maintaining adequate loan loss reserves and capital ratios.

- *Examiners are classifying loans to borrowers that are current and can meet their debt obligation – what has sometimes been referred to as "performing non-performing" loans.*

The OCC does not direct banks to classify borrowers that have the demonstrated ability to service their debts under reasonable payment schedules. There are instances, however, where liberal underwriting structures can mask credit weaknesses that jeopardize repayment of the loan. A common example in today's environment is bank-funded interest reserves on CRE projects where expected leases or sales have not occurred as projected and property values have declined. In these cases, examiners will not just accept that the loan is good quality because it is current; instead, they will also evaluate the borrower's ability to make future payments required by the terms of the loan. The agencies' October 2009 policy statement on CRE loan workouts addresses these situations and provides examples of when classification would and would not be appropriate.

- *Examiners are criticizing loans or borrowers simply because the current market value of their collateral has declined and are forcing bankers to write down loans to current distressed market values.*

Examiners will not classify or write down loans solely because the value of the underlying collateral has declined to an amount that is less than the loan balance – a point that we reiterated in the October 2009 CRE policy statement and the recent statement on small business lending. For many CRE projects, however, the value of the collateral and the repayment of the loan are both dependent on the cash flows that the underlying project is expected to generate. Because of this linkage, current collateral values can be an important

indicator of the project's viability and can signal adverse changes that will adversely affect the cash flow available to service or repay the loan.

In making loan classification or write-down decisions, examiners first focus on the adequacy of cash flow available to service the debt, including cash flow from the operation of the collateral, support from financially responsible guarantors, or other bona fide repayment sources. However, if these sources do not exist, and the only likely repayment source is sale of the collateral, then, consistent with generally accepted accounting principles (GAAP), examiners will direct the bank to write down the loan balances to the value of the collateral, less costs to sell. In applying the concepts of market value (a valuation concept with a foundation in appraisals) and fair value (an accounting valuation concept), we follow the standards set forth in GAAP and appraisal regulations. These standards direct that these values should reflect the probable price expected to be received if the property were to be exposed to sale in the current market for a time to allow for typical marketing efforts. Thus, these valuations are expected to reflect the overall state of current market conditions and not simply ignore them or assume them away.

- *Examiners are unduly overreaching and are second guessing bankers and professional independent appraisers.*

One of the areas of greatest controversy during the last significant real estate downturn was the practice of examiners making adjustments to real estate appraisals. We have taken steps to minimize the need for such adjustments during the current cycle. In 2008, in a nationwide teleconference and supervisory memo, we reiterated to examiners that it is management's responsibility to have updated borrower information and current real estate appraisals. We also noted that a new appraisal may not be necessary in instances where an internal evaluation by the bank appropriately updates the original appraisal assumptions to

reflect current market conditions and provides an estimate of the collateral's fair value for impairment analysis. As noted in the October 2009 CRE policy statement, appropriately supported assumptions are to be given a reasonable degree of deference by examiners. Provided that the appraisal is reasonable, our examiners will not make adjustments or apply an additional haircut to the collateral.

- *Examiners are arbitrarily applying de facto higher regulatory capital requirements, constraining banks' ability to lend.*

In anticipation of rising credit losses, over the last two years the OCC has urged banks to build loan loss reserves and strengthen capital. It is our longstanding policy that the regulatory capital levels are minimums, and that some banks may need to hold higher capital levels to adjust for risks such as significant credit concentrations. Indeed, if a bank simply maintained its capital at the minimum level defined by regulation and then incurred unexpected losses, the resulting decline in its capital ratios would immediately trigger the provisions of Prompt Corrective Action that would constrain the bank's activities. Thus, there are instances where we have directed, and will direct, bank management to maintain higher capital buffers if they choose to have significant risk concentrations. Such decisions, however, are not made unilaterally by a field examiner. Any such directive is reviewed and approved by our district supervision management teams.

C. Facilitating Small Business Lending

The OCC recognizes the vital role that small and medium size businesses play in our nation's economy and the need for these businesses to have access to credit. We have therefore taken a number of steps to encourage lending to these businesses. For example, as previously noted, on February 5, 2010, we and the other financial regulators issued a statement reinforcing the importance of small business lending to the economy. In addition,

the number and dollar volume of loans to small businesses, particularly those with annual revenues of less than $1 million, are considerations in our evaluations of a national bank's performance under the Community Reinvestment Act (CRA). And through our *Community Development Investment* newsletter and *Community Development Insights* reports, we have highlighted opportunities for national banks to provide credit to small businesses; for example, our Fall 2008 edition of the *Community Development Investment* letter illustrated various ways multi-bank community development corporations have collaborated to provide financing to small businesses.[19]

We actively encourage national banks to participate in various government programs that are designed to support small business lending. The SBA loan guarantee program is one of the best known of these programs. Last fall we convened a meeting with bankers who are active small business lenders and representatives from Treasury to discuss ways that SBA programs could be enhanced. A number of the recommendations that bankers made for enhancing these programs were addressed in the American Recovery and Reinvestment Act of 2009. These included eliminating and reducing fees for borrowers on 7(a) loans and lenders on 504 loans, and raising the guarantee on 7(a) loans. Late last year we sponsored a national telephone seminar in partnership with the SBA to promote bank participation in these two flagship programs and to alert bankers to these important program changes. Based on feedback we have heard from examiners and bankers, these changes have been well received.

To enhance our ability to monitor credit conditions facing small businesses, effective March 31, 2010, the OCC and other federal banking agencies will be requiring banks to report small business loan data on a quarterly, rather than an annual, basis in the Call Reports that each bank must file. In addition, the agencies will begin collecting data on unused credit card

[19] A copy of this report can be accessed at http://occ.gov/cdd/resource.htm.

lines in two separate components: unused consumer credit card lines and other unused credit card lines that include businesses and other entities. This information will allow us to better monitor credit flows in this important sector.

V. Conclusion

The OCC is acutely aware of the pivotal role that bank credit plays in the health of our nation's economy, and we are encouraging bankers to make loans to creditworthy borrowers. As I have described, there are a variety of forces that have made businesses, consumers, and bankers more cautious and that have contributed to a slowdown in lending. While many of these are beyond the direct control or influence of bank supervisors, it is incumbent upon us to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound borrowers. We are committed to do just that. We have and will continue to take steps to ensure that our policies are clear, and our supervision balanced and fair.

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Statement of

Elizabeth A. Duke

Member

Board of Governors of the Federal Reserve System

before the

Financial Services Committee

and the

Committee on Small Business

of the

United States House of Representatives

February 26, 2010

Chairman Frank, Chairwoman Velázquez, Ranking Member Bachus, Ranking Member Graves, committee members, thank you for the invitation to today's joint committee hearing to discuss the availability of credit to small businesses as well as the steps being taken to help ensure that the credit needs of creditworthy borrowers are met. As you are well aware, the Federal Reserve has taken significant steps to improve financial market conditions, and has worked with the Treasury and bank and thrift supervisors to strengthen U.S. banking organizations. We remain attentive to the need for banks to remain in sound financial condition and to continue to lend prudently to creditworthy borrowers. Loans to small businesses are especially vital to our economy, as they employ nearly 40 percent of the private sector workforce.

First, I will discuss the overall state of small business lending and address the causes of reduced lending to small businesses. I will then discuss the improving prospects for small business lending in 2010, key preconditions of which include a sustainable economic recovery, financial stability, and the overall safety and soundness of the banking system. Finally, I will discuss measures taken by the Federal Reserve, including recent guidance issued in cooperation with other bank regulators, to ensure that supervisory policies do not impede credit availability for creditworthy borrowers.

The State of Small Business Lending

While conditions in financial markets continue to improve, access to credit remains difficult for many small businesses that largely depend on banks for credit. Lending by commercial banks dropped precipitously in 2009. With the exception of consumer lending in the early part of the year, lending of all types declined. Between June 30, 2008, and June 30, 2009, outstanding small loans to businesses and farms declined by more than $14 billion, a reduction of

nearly 2 percent. Commercial and industrial (C&I) loans, including loans to small businesses, fell particularly rapidly, declining by double-digit percentages during 2009.[1] Commercial real estate (CRE) and credit card lending, categories that include loans to small businesses, also fell throughout the year.

Notably, the contraction in lending has been less severe at smaller banks, which tend to cater to small businesses. For example, banks with less than $10 billion in total assets reduced their business loans (including C&I and CRE loans) at about a 12.8 percent annual rate in the fourth quarter of 2009, while at larger banks business loans dropped at a pace of more than 20 percent. Although the pattern of reduced lending differed across banks, in aggregate, banks of all sizes have reduced their business loan portfolios. This development is especially problematic for small businesses, given that they typically lack access to public capital markets.

The terms of the small business loans that are being made also have tightened considerably since the beginning of the recession. Responses to the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) indicate that banks, on net, have significantly tightened credit standards on C&I loans to small firms over the past few years. In addition, the pricing of C&I loans to small businesses became more stringent last year. Data from the Federal Reserve's Survey of Terms of Business Lending show that interest rate spreads on loans between $100,000 and $1,000,000 increased by about 100 basis points during 2009, reaching their highest levels in more than a decade. However, pricing for large loans has tightened as well, with spreads on loans from $10 million to $25 million also increasing about 100 basis points in 2009.

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[1] The most recent data from the Federal Reserve's Flow of Funds report indicate that, for example, C&I lending by commercial banks declined by about 24 percent. Declines for other categories of lending in the same period were about 9 percent for commercial real estate and residential real estate, and 5 percent for consumer lending.

The Causes of Reduced Lending to Small Businesses

Numerous factors have contributed to the reduced lending to small businesses. For instance, for most commercial banks, the quality of existing loan portfolios continues to deteriorate even as levels of delinquent and nonperforming loans remain on the rise. Throughout 2009, loan quality deteriorated significantly for both large and small banks, and the latest data from the fourth quarter indicate continuing elevated loss rates across all loan categories. Anecdotal information suggests that, while consumer delinquencies may be close to peaking, other types of lending such as CRE and small business lending are likely to see delinquencies and charge-offs continue to rise for some time to come. In response to a special question in the January SLOOS, a large net fraction of banks reported that the credit quality of their existing C&I loans to small firms was worse than that for their loans to larger firms in the fourth quarter. In addition, respondents did not, on net, anticipate an improvement in the performance of their small loan portfolio over the next year. Accordingly, banks have reduced existing lines of credit sharply and tightened their standards and terms for new credit. While some businesses are being denied credit due to a recent history of payment problems, even businesses with excellent payment records may find credit restricted or unavailable due to weakened balance sheets, reduced revenues or falling real estate collateral values. Further, businesses that qualified for credit under more accommodative conditions may not meet new tighter standards. Credit conditions may be particularly tight for small businesses because their finances are, in many instances, very closely intertwined with the personal finances of their owners. Data from the Federal Reserve's 2007 Survey of Consumer Finances showed that approximately 11 percent of households own and actively manage a small business.[2] Of these households,

[2] "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin,* February 2009, page A35.

about 18 percent used personal assets to guarantee or collateralize loans for their businesses and a similar fraction made at least one loan to the business. Thus, the condition of household net worth is often relevant to the ability of some small businesses to obtain credit. With declines in house prices since 2006 and consequent weakened household balance sheets, the ability of many small business owners to borrow has likely been impaired.

Despite general improvements in financial market conditions and in bank stock prices and earnings during the second half of 2009, lending is likely inhibited by various problems afflicting many banks, both large and small. Banks with capital positions that have been eroded by losses or those with limited access to capital markets may be reducing risky assets to improve their capital positions, especially amid continued uncertainty about the economic outlook and possible future loan losses. Indeed, with the number of problem banks having risen to 702 institutions with $402.8 billion in assets, many firms are capital constrained and may be unable to increase lending. And, even though deposits are now plentiful, some banks have funding concerns. Bank funding markets were badly impaired for a time, and some banks have accordingly decided to hold larger buffers of liquid assets than before. A number of other factors are also likely in play. Higher deposit insurance assessments increase funding costs. Some securitization markets remain impaired, reducing an important source of funding for bank loans. Finally, changes to accounting rules, beginning in 2010, will require many banks to move a large volume of securitized assets back onto their balance sheets, perhaps putting further pressure on bank capital.

During the financial crisis, a number of lending relationships have been severed as individual banks sought to reduce loan portfolios, or concentrations within those portfolios, or as banks failed or merged. Established banking relationships are particularly important to small

businesses, who generally do not have access to the broader capital markets and for whom credit extension is often based on private information acquired through repeated interactions over time. When existing lending relationships are broken, time may be required for other banks to establish and build such relationships, allowing lending to resume.

Some banks may be overly conservative in their small business lending because of concerns that they will be subject to criticism from their examiners. While prudence is warranted in all bank lending, especially in an uncertain economic environment, some potentially profitable loans to creditworthy small businesses may have been lost because of these concerns, particularly on the part of small banks. Indeed, there may be instances in which individual examiners have criticized small business loans in an overly reflexive fashion. As I will discuss later in my testimony, the Federal Reserve has worked with other bank and thrift supervisors to ensure that supervisory policy does not unnecessarily constrain credit to creditworthy borrowers.

The reduction in the availability of credit, however, is not the whole story. There is also less demand for credit. The most severe economic downturn since the Depression, resulting in high levels of unemployment and following significant increases in personal debt levels during the past decade, has suppressed demand for goods and services produced by all businesses, including smaller firms. Many businesses are, in turn, reluctant to make new investments until they are confident that consumer demand will continue to strengthen. Business inventories, a key component of gross domestic product over the business cycle, unexpectedly declined 0.2 percent in December after rising by a revised 0.5 percent in November. It is notable that banks report utilization rates of existing lines of credit to be at historic lows, despite the fact that, in many cases, this credit is already approved and generally priced attractively.

According to recent surveys conducted by the National Federation of Independent Businesses (NFIB), financing conditions continued to be ranked as the top business concern by only a modest fraction (less than 5 percent) of small businesses; in contrast, about one-third of respondents cited poor sales as their most important problem. Commercial bank responses to the SLOOS continue to indicate reduced demand for loans from small businesses. Similarly, a poll conducted by the Independent Community Bankers of America on January 8 revealed that a lack of loan demand was the factor most frequently cited by member institutions as constraining small business lending.

Improving Prospects for Small Business Lending in 2010

Improvement in a number of the conditions that depressed lending in 2009, however, lead me to be somewhat optimistic that we may begin to see an increase in bank loans later this year. *First,* economic conditions, the most important determinant in the demand for, and availability of, small business lending, have improved considerably since the early and middle part of last year. In particular, spending by businesses and households appears to have gained some momentum. However, unemployment remains high, and concerns about the pace of job creation this year may restrain the consumer spending that is essential to overall business confidence. Encouragingly, financial market conditions have become more supportive of economic growth, with notable declines in many risk spreads, some resumption of securitization activity, and a rebound of equity prices since their market low in early 2009.

While financing conditions certainly remain tight for many small businesses, conditions would be considerably worse were it not for the action taken by the Federal Reserve and other government agencies in response to the financial crisis. Beginning in September 2007, the Federal Reserve sharply reduced its target for the federal funds rate, which influences interest

rates throughout the economy, and since December 2008, the target has been near zero. To improve mortgage market functioning and support housing markets and economic activity more broadly, the Federal Reserve has purchased large amounts of debt and mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae in addition to purchasing long-term Treasury securities to help improve conditions in private credit markets.

In the context of the enormous stress in many markets that characterized the financial crisis, the Federal Reserve also established new lending facilities and expanded existing facilities to respond to the unusual absence of liquidity in important markets and thereby enhanced the flow of credit to businesses and households. In particular, the Federal Reserve has provided support to securitization markets, which had been an important source of funding for loans to households and businesses. Securitization markets (other than those for mortgages guaranteed by the government or government-sponsored enterprises) essentially shut down in mid-2008. In response, the Federal Reserve, with the support of the Treasury Department, developed the Term Asset-Backed Securities Loan Facility (TALF). The TALF promotes the issuance of securities backed by loans to households and small businesses, including auto loans, credit card loans, student loans, and loans guaranteed by the Small Business Administration (SBA). In 2009, the program was broadened to allow investors to use the TALF to finance both existing and newly issued commercial mortgage-backed securities (CMBS).

The TALF helped restart securitization markets and increase the availability of credit to small businesses and consumers. To date, the TALF program has helped finance 480,000 loans to small businesses, 2.6 million auto loans, 876,000 student loans, more than 100 million credit card accounts, and 100,000 loans to larger businesses. Included among those business loans are 4,900 loans to auto dealers to help finance their inventories. About half of the SBA securities

issued in recent months--corresponding to roughly $250 million in loans a month--were sold to investors that financed the acquisitions in part with TALF loans. In an encouraging sign, rate spreads for asset-backed securities (ABS) have declined significantly, and a substantial amount of ABS are now being brought to market and purchased by investors without TALF financing. Thus, the TALF and other Federal Reserve programs provided critical liquidity support to the economy until the financial system stabilized. With the extraordinary stress on liquidity in many markets having abated, many of these programs either have been or are scheduled to be wound down.

A *second* reason to expect some improvement in credit conditions for small businesses is that bank attitudes toward lending, including small business lending, may be shifting. The January SLOOS showed that bank tightening of credit standards for small business C&I lending appeared to be nearing an end with similar numbers of banks reporting tightening and easing of their lending standards.

There is also some tentative, anecdotal evidence that many bankers may be devoting considerably more energy toward extending new loans in 2010, as contrasted with their overwhelming preoccupation in 2009 with collecting on or writing down loans already on their books. With respect to small business lending in particular, some banks have instituted so-called "second look" programs that--as the name implies--involve a reconsideration of loan applications that would not be pursued based on a credit scoring model alone. Some banks are also increasing lending through the use of SBA guarantees. Finally, the more noticeable improvement that has already taken place in credit conditions for larger companies should, to some degree, pass through in the form of trade credit to the smaller suppliers or distributors for the larger firms.

Still, as with improvement in macroeconomic conditions, the impact of the turnaround in bank attitudes and strategies will likely be gradual. As noted earlier, the January SLOOS also revealed that the credit quality of loans to small firms in the fourth quarter of 2009 was worse than for loans to larger firms, so many banks may move cautiously in making new loans.

Additional Steps to Meet the Needs of Creditworthy Small Business Borrowers

Despite these prospects for improvement, credit conditions for many small businesses are likely to remain challenging this year. That is why the Federal Reserve has been placing particular emphasis on ensuring that its supervision and examination policies do not inadvertently impede sound small business lending. If financial institutions retreat from sound lending opportunities because of concerns about criticism from their examiners, their long-term interests and those of small businesses and the economy in general could be negatively affected, as businesses are unable to maintain or expand payrolls or to make otherwise profitable and productive investments.

On February 5, the banking agencies issued guidance to examiners that reinforced a simple message--institutions should strive to meet the credit needs of creditworthy small business borrowers, and the supervisory agencies will not hinder those efforts.[3] For the reasons noted earlier, we recognize that the ongoing financial and economic stress has resulted in a decrease in credit availability, including loans to small businesses, and has prompted institutions to review their lending practices. Although current loss rates would indicate that a measure of tightening was appropriate and necessary, some institutions may have become overly cautious in their lending practices. Thus, while prudence must remain the watchword for both banks and

[3] Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers (February 2010); http://www.federalreserve.gov/newsevents/press/bcreg/20100205a.htm

their supervisors, we do not want our examiners to take an overly mechanistic approach to evaluating small business lending.

The Federal Reserve has directed examiners to be mindful of the effects of excessive credit tightening on the broader economy. As a general matter, we do not expect examiners to adversely classify loans based solely on a decline in collateral value where, for example, the borrower has stable revenue streams and thus the ability to repay the loan. We have implemented training for examiners and outreach to the banking industry to underscore this expectation. We are aware that bankers, as well as examiners, may become overly conservative in an attempt to ameliorate past weaknesses in lending practices, and are working to emphasize that it is in all parties' best interests to continue making loans to creditworthy borrowers.

The most recent guidance is the latest in a series of actions taken by the Federal Reserve and the other banking agencies to support sound bank lending and the credit intermediation process. In an effort to encourage prudent CRE loan workouts, the Federal Reserve led the development of interagency guidance issued in October 2009 regarding CRE loan restructurings and workouts.[4] That policy statement provides guidance for examiners and for financial institutions who are working with CRE borrowers experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties, particularly as the loans on those properties mature and need to be refinanced. The statement is especially relevant to small businesses because owner-occupied CRE often serves as collateral for small business loans.

Prudent loan workouts are in the best interest of both financial institutions and borrowers, particularly during difficult economic conditions. Accordingly, the CRE policy statement details

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[4] Interagency Policy Statement on CRE Loan Restructurings and Workouts (November 2009); http://www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm

risk-management practices for loan workouts that support prudent and pragmatic credit and business decision making within the framework of financial accuracy, transparency, and timely loss recognition. We hope that the detailed examples in that guidance will be of particular use to examiners, who themselves face the difficult task of assessing bank credit practices in this uncertain environment.

Immediately after the release of the CRE guidance, the Federal Reserve conducted a System wide teleconference with examiners to underscore the importance of this new guidance and promote its consistent application in all regions. In conjunction with the other federal and state banking agencies, Federal Reserve staff has participated in a number of teleconferences with various industry groups to discuss the guidance, which have reached several thousand bankers to date. Examiner training and industry outreach will continue, and specific activities related to the guidance issued in early February targeting small businesses will augment existing examiner training.

In January, the Federal Reserve launched a comprehensive Systemwide training initiative to further underscore our expectations regarding CRE. These initiatives themselves build off of guidance that the Federal Reserve and other federal banking agencies issued in November 2008 to encourage banks to meet the needs of creditworthy borrowers--in a manner consistent with safety and soundness--and to take a balanced approach in assessing borrowers' abilities to repay and to make realistic assessments of collateral valuations.[5] Achieving this balance will not always be easy. We certainly do not want to lay the seeds for future bank problems by encouraging or permitting imprudent lending today. That is why we have emphasized to both

[5] See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2008), "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," joint press release, November 12, www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

bankers and our examiners the importance of careful analysis of the circumstances of individual borrowers.

While aggregate figures are useful to policymakers in assessing overall trends in the financial system, they do not tell the whole story. Determining whether supervisory policies and practices are appropriately balanced also requires a close examination of specific circumstances--for example, through evaluating particular loans that banks were discouraged from making. Ongoing outreach will thus be essential as the regulatory agencies and the industry continue to work through the many difficult issues brought about by the financial crisis. Members of the Board and senior supervisory staff have met with bankers, including community bankers, to elicit examples of supervisory policies or actions that bankers believe may have inhibited prudent lending and to discuss in detail some examples of the supervisory agencies' responses to specific lending situations. It is important that we identify cases in which examiners may be too cautious and to further clarify our general guidance. It is equally important that we reinforce those cautious instincts where the circumstances of an application for credit indicate excessive risk.

In addition to our outreach to banks and bank examiners, the Federal Reserve has conducted several forums in recent months to better understand the difficulties faced by small businesses. In mid-November, the Board and the Federal Reserve Bank of San Francisco, in conjunction with the SBA, held small business forums in San Francisco and Los Angeles. We are now conducting a series of meetings on small business access to credit hosted by the Reserve Banks. The meetings will be followed by a capstone event at the Board of Governors. These forums examine the evolving difficulties faced by small businesses and will inform additional efforts to help this important sector. Meetings this week focused on minority entrepreneurship

and SBA lending. Some of these meetings will focus on a specific aspect of small business lending such as credit gaps with respect to small business credit products, types of financial institutions, or demographic groups (including minority borrowers). Others will employ a standard agenda in different parts of the country to ascertain regional differences in small business access to credit and support services.

Finally, in your invitation letter you asked that we discuss actions taken by the Administration to assist small business owners. As you know, the Administration has undertaken a number of actions aimed at improving small businesses' access to credit. Since the signing of the American Reinvestment and Recovery Act in February 2009, SBA 7(a) and 504 loan volumes have increased quite substantially relative to the period immediately preceding the bill's passage. Most recently, the Administration announced a small business lending initiative to provide low-cost capital to community banks that submit a plan to increase their small business lending and to Community Development Financial Institutions that serve the hardest-hit communities. A number of these small business lending initiatives are new, and their effects on small business lending cannot yet be measured. Nonetheless, a number of programs have been established to assist small businesses and the regulatory agencies recently issued guidance that strongly encourages banks to meet the needs of creditworthy borrowers. We will closely monitor credit conditions to consider whether additional measures may be needed to insure that the funding needs of qualified small businesses are met in the coming months.

Conclusion

While financial market conditions have improved in the United States, the overall lending environment remains strained, and significant concerns have been raised about the availability of credit to small businesses. The Federal Reserve, in collaboration with the other banking agencies, has worked to ensure that the banking system remains safe and sound and is able to meet the credit needs of our economy. We also have aggressively pursued monetary policy actions and have provided liquidity to help restore stability to the financial system and support the flow of credit to households and businesses.

It will take time for the banking industry to fully recover and to serve as a source of strength for the real economy. The Federal Reserve is committed to working with the other banking agencies and the Congress to promote the concurrent goals of fostering credit availability for creditworthy borrowers and ensuring a safe and sound banking system.

Thank you again for your invitation to discuss these important issues at today's hearing. I would be happy to answer any questions that you may have.

From:
Steve Gordon
President of INSTANT OFF, INC.
4400 118TH Avenue North, Suite 204
Clearwater, Florida 33762

Email: steve@instant-off.com (727) 366-4114

Testimony: Joint Hearing of the House of Representatives
Committee on Small Business and Committee on Financial Services
"Condition of Small Business and Commercial Real Estate Lending in Local Markets"
Friday, February 26, 2010 10:00 am Room 2128 Rayburn House Office Building

Thank you for inviting me to Washington to testify this morning.

My name is Steve Gordon and it's an honor to deliver this testimony before the people's Congress. I speak for millions of SMALL business owners who through the years have been the largest creator of jobs in our Country. We are all struggling to stay afloat and create jobs in this difficult recession.

I also represent those small businesses who are frustrated because we can create JOBS immediately but are unable to get the financing we need.

Wall Street was lent money direct from the Federal government, AIG was lent money direct, the automobile companies were lent money direct and so were the banks. Small businesses needs the same opportunity as the big guys. We want Congress to create a level playing field.

Most Jobs are created by new start-up companies or existing small businesses that want to expand their operations. Start-ups and growth can only occur with capital. American companies have been going out of business or laying workers off because we have been operating in a capital vacuum for the past three years.

It's time to start thinking of small business in America as an endangered species. The reason is credit. Not only is it impossible to obtain new credit, but the banks are compounding the problem by taking away existing credit. They are implementing blanket credit reductions, without regard to the effect it is having on our economy and jobs.

Low Credit scores are preventing a huge number of companies from obtaining the necessary working capital to stabilize their company, prevent additional layoffs and create jobs

All across America, the same banks and credit card companies that were bailed out, are reducing the credit lines of prime borrowers. My close friend with an excellent credit score recently had his business line of credit cut by American Express without cause. That one credit reduction led to a drop in his credit score. With a lowered credit score, the other banks followed suit and reduced their credit lines, further impacting his credit rating. Without operating capital, he has been unable to buy equipment, and had to lay off employees. The banks simply do not care about the real world consequences of their predatory practices.

We are now in the middle of the worst job crisis since the great depression. Millions of Americans struggle every day just to pay their expenses, put gas in their cars and feed their kids.

This jobs crisis cannot and will not be solved by the banks. The Banks can't even solve the foreclosure problem. The job crisis can only be solved by American businesses either starting up or expanding that's what creates jobs which can only occur when there is capital available through business loans.

If we depend on the Banks to make business loans then we are in for a long recession. Millions of Americans will remain unemployed or underemployed.

The banking system is NOT working for small business. We need immediate action to end the suffering of millions of Americans.

Any money approved for small business loans should be kept in a separate account managed by the SBA. NO more money should be given directly to the banks. Congress should remember how the banks used the TARP money and avoid repeating the same mistake. We don't have any more money for the banks to open new branches, buy new signs or to give out more bonuses.

It is our government's responsibility to solve the jobs crisis NOT the banks. I am requesting the Congress to pass legislation to make the SBA a direct lender to small business. It will be much more effective to direct government employees to take on a new, extremely important mission than to plead with the banks and hope that they listen.

Most businessmen would much rather work with the professional staff of the SBA than with a bank officer who just views you as another credit score.

To move ahead and create the most jobs possible there must be a move away from using the FICO score as the sole determining factor in obtaining business loans.

I am the owner of INSTANT-OFF. We make water saving devices for faucets. INSTANT-OFF replaces the aerator on any faucet and each unit can save up to 10,000 gallons a year. Our market potential in the US is estimated at 50 million units and globally between 100 and 200 million units.

We can create 25 green jobs right now and 25 per cent of those jobs will be for people with disabilities. By 2015 we estimate that we will have as many as 150 employees and will have created approximately 200 more jobs through our suppliers and distributors. None of these jobs will be created without capital. YET I CAN'T GET A LOAN.

For these reasons it is important to expand the lending criteria so that every company who can create jobs has a fair opportunity to receive a loan.

I propose a 15 point system for the SBA to review in granting a direct small business loan:

1. Is the business plan well thought out and viable?
2. What product or service does the company provide or want to provide?
3. How many years has the company been in business?
4. What is the market potential for this product or service?
5. Does the management team have the experience to be successful?
6. Is there a good potential that the company will be successful?
7. How many jobs can be created with the loan?
8. Will any jobs be created for disabled Americans?
9. Is this a product or service that helps protect the environment or conserve natural resources?
10. What percentage of the business operation is made, assembled or packaged in the U.S.?
11. Is this a product or service that can be exported to other countries?
12. Is the company a start-up or an existing business?
13. Is there sufficient profit margin to pay the loan back in seven years?
14. What is the credit rating of the individual applying for the loan ?
15. Was this person's credit rating affected by the real estate crash or the current recession?

As a small business owner, we want close to the same DEAL that Wall Street got. Remember those 2 per cent loans? Small Businesses should not be charged more than 3% interest.

Again, I urge Congress to pass legislation to make SBA a direct lender so that any company who wants to can apply directly to the SBA for a loan. I'm not suggesting that all banks are bad or that banks should be prevented from making SBA loans. I am proposing that loans approved by the SBA would be closed and serviced by the community bank chosen by the borrower.

Please move faster to solve this critical issue. Capital is the tool that drives American businesses – and Small Business has been the backbone of new job creation in America.
DO NOT let America's future be stuck in a bank loan committee!!!

Thank you for allowing me the opportunity to be heard on this very important issue.

February 26, 2010

Testimony of

William B. Grant

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

and the

Committee on Small Business

United States House of Representatives

Testimony of William B. Grant
on behalf of the
American Bankers Association
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United States House of Representatives
February 26, 2010

Chairman Frank, Chairwoman Velázquez, Ranking Members Bachus and Graves, and members of the Committees, my name is William B. Grant, Chairman CEO, and President of First United Bank & Trust. My bank is a 109-year old community bank, headquartered in Oakland, Maryland – a rural town in Appalachia with a population of about 2,000. We have assets of $1.7 billion, and serve four counties in Maryland and four counties in West Virginia.

I am pleased to be here today on behalf of ABA. The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over two million men and women.

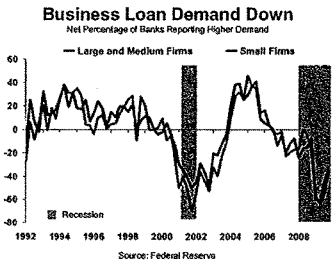
We are pleased to share the banking industry's perspective on the condition of small business and commercial real estate lending in local markets. As President Obama recognized in his recent State of the Union address, it is imperative to find ways to ensure that small businesses get the credit they need. Small businesses of all kinds – including banks – are suffering from the severe economic recession. While some might think the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, over 3,000 banks (41 percent) have fewer than 30 employees.

This is not the first recession faced by banks. Most banks have been in their communities for decades and intend to be there for many decades to come. First United Bank & Trust has survived many economic ups and downs for more than a century. We are not alone. There are 2,556 banks – 31 percent of the banking industry – that have been in business for more than a

century; 62 percent (5,090) of banks have been in existence for more than half a century. These numbers tell a dramatic story about the staying power of banks and their commitment to the communities they serve. My bank's focus, and those of my fellow bankers throughout the country, is on developing and maintaining long-term relationships with customers, many of which are small businesses. We cannot be successful without such a long-term philosophy and without treating our customers fairly.

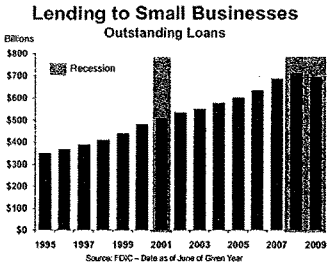
This recession is certainly one of the worst we have ever faced. While the statisticians will say the recession has ended, that is little comfort to areas in our country that suffer from very high levels of unemployment and business failures. The impact of the downturn is being felt by all businesses, banks included. As the economy has deteriorated, it has become increasingly difficult for consumers and businesses to meet their financial obligations. The cumulative impact of eight straight quarters of job losses – more than 8 million since the recession began – is placing enormous financial stress on some individuals. With jobs lost and work hours cut, it does not take long for the financial pressure to become overwhelming. This, in turn, has increased delinquencies at banks and resulted in losses and reduced the capital of banks.

In this severe economic environment, it is only natural for businesses and individuals to be more cautious. Businesses are reevaluating their credit needs and, as a result, loan demand has fallen dramatically since the recession began. Banks, too, are being prudent in underwriting, and our regulators demand it. With the economic downturn, credit quality has suffered and losses have increased for banks. Fortunately, community banks like mine entered this recession with strong capital levels. As these committees are aware, however, it is extremely difficult to raise new capital in this financial climate.



The difficult recession, falling loan demand, and loan losses have meant that loan volumes for small businesses have declined somewhat this year. Let me be very clear here: even in a weak economy there are very strong borrowers. Every bank in this country is working hard to ensure that our customers – particularly the small businesses that are our neighbors and the life blood of our communities – get the credit they deserve. The Small Business Administration (SBA), in partnership

with America's banks, can play an even larger role in helping small businesses meet the challenges of this economic downturn by expanding their guarantee program and by reducing some of the restrictions currently built into the system.



The success of many local economies – and, by extension, the success of the broader national economy – depends in large part on the success of community banks. We believe there are actions the government can take to assist viable community banks to weather the current downturn. Comparatively small steps taken by the government now can make a huge difference to banks, their customers, and their communities – keeping capital and resources focused where they are needed most.

In my statement, I would like to focus on the following points:

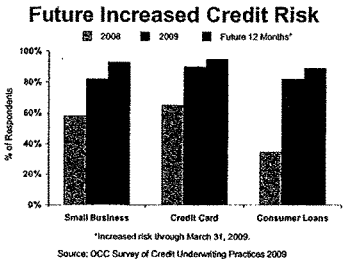
- Lenders and borrowers are exercising a prudent approach to credit.
- Small business capital investments for community banks will facilitate the economic recovery.
- Changes that enhance bank participation in SBA programs have made strides in creating opportunities for small businesses, yet more needs to be done.
- Changes in the regulatory environment will improve the situation for small business lending.

I will address each of these points in turn.

I. Lenders and Borrowers are Exercising a Prudent Approach to Credit

In every community, banks are actively looking for lending opportunities. Business confidence is down, of course, and many businesses either do not want to take on additional debt or are not in a position to do so given the falloff of their customer base. Thus, loan demand has fallen dramatically since the start of the recession. This continues even today, although with some signs that the economy is stabilizing, the fall off of loan demand is moderating. The National Federation of Independent Business (NFIB) explains in its November survey that: "Overall, loan demand remains weak due to widespread postponement of investment in inventories and record low plans for capital spending." [1]

There are some positive signs beginning to appear. We have heard from bankers that small businesses are returning to test the market for loans, even though they may not wish to borrow at the moment. It will take time for this renewed interest to be translated into new loans made, however. Previous recessions have shown that it typically takes 13 months after the recession for business confidence to return and credit to return to pre-recession levels.



Both banks and their regulators are understandably more cautious in today's environment. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they examine. Given the economic conditions, it is clear that the risk of lending is much greater today than several years ago when the economy was much stronger.

This means that the credit terms are different today, with higher downpayments required, and smaller loans consistent with diminished collateral values. Banks are looking at the risk of a loan and re-evaluating the proper pricing of that risk. This is a prudent business practice and one expected by our bank regulators. But it means that some projects that might have been funded when the economy was stronger may not find funding today. The NFIB recognized this, stating, "[T]he continued poor earnings and sales performance has weakened the credit worthiness of many

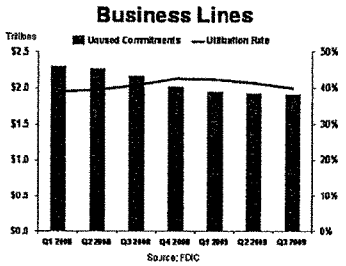
[1] *NFIB Small Business Economic Trends*, November 2009. National Federation of Independent Business.

potential borrowers. This has resulted in tougher terms and higher loan rejection rates (even with no change in lending standards)."[2]

Moreover, access to credit is not a driving concern of most businesses. In a recent survey of 750 businesses by Discover, only 5 percent said the main issue facing their business was access to capital.[3] NFIB's survey confirmed this finding: "Although credit is harder to get, 'financing' is cited as the 'most important problem' by only four percent of NFIB's hundreds of thousands of member firms." NFIB notes that this is extremely low compared to other recessions. For example, in 1983 – just after the last big recession – 37 percent of business owners said that financing and interest rates were their top problem.

We recognize that there are some consumers and businesses in the current situation that believe they deserve credit that is not being made available. We do not turn down loan applications because we do not want to lend – lending is what banks do. In some cases, however, it makes no sense for the borrower to take on more debt. Sometimes, the best answer is to tell the customer no, so that the borrower does not end up assuming an additional obligation that would be difficult if not impossible to repay.

To help manage the risk of loss, lenders have lowered credit lines for businesses and individuals. However, even with the cutbacks in lines of credit, there is still $6 trillion in unused commitments made available by FDIC-insured banks to businesses and consumers. The utilization rates have declined for business lending, particularly, reflecting the decreased demand.

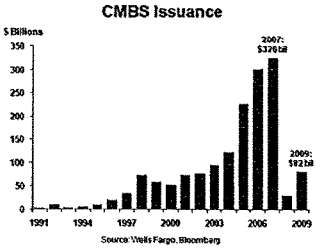


The commercial real estate (CRE) market will pose a particularly difficult problem for the banking industry this year. The CRE market has been the victim of a near total collapse of the secondary market for commercial mortgage backed securities and of the economic slowdown that has caused office and retail vacancies to rise dramatically. These stresses will affect many small

[2] *Op cit*
[3] *Discover Small Business Watch*, October 2009. Discover Financial Services.

banks, as CRE lending has been an important part of the portfolio for community banks for many years.

Typically, a commercial real estate project in the construction and land development phase receives bank financing with an loan maturity between three to seven years. After the project is completed, it is common for take-out financing to come from insurance companies or through the Commercial Mortgage Backed Securities (CMBS) market. This take-out financing focuses on income-producing properties and, thus, usually occurs once there are stable and sufficient cash flows for full debt servicing.



This highlights the current dilemma: as market conditions have deteriorated, vacancies have increased, valuations have plummeted, and rent renewals have slowed. This in turn has made take-out financing increasingly scarce, leaving banks with loans that are stressed and facing refinancing. With transaction prices down dramatically, appraisal values have also fallen, making refinancing of loans much more difficult without significant additional equity contributions from borrowers – which, of course, are difficult if not impossible for many borrowers to put forward in this economic climate.

As I will discuss in the last section of this testimony, regulators will continue to be nervous about the trends in CRE lending as the economy struggles to regain its footing and will be critical of banks' CRE portfolios. The 2009 guidance from the regulators signals a prudent but flexible approach. However, we continue to hear that the translation of the guidance to the field examiners has been missing. However, we remain hopeful that this guidance could help banks work with borrowers to find solutions.

As the economy begins to improve, we expect loan demand to increase, and with it, credit volumes as well. ABA's Economic Advisory Committee (EAC) forecasts that non-residential fixed investment will increase 3.8 percent in 2010, and businesses will begin to expand and grow inventories. The EAC believes this will coincide with an increase in business lending, which it expects to increase modestly this year at a 2.3 percent rate. The group also expects consumer credit to grow at a rate of 3.2 percent. ***As the economy grows and loan demand increases, the ability***

of banks to meet these needs will be stunted if adequate capital is not available to back increased lending. This is the subject to which I will now turn.

II. Small Business Capital Investments for Community Banks Will Facilitate the Economic Recovery

Capital is absolutely critical to any bank, as it is the financial underpinning of any loan that is made. While conditions have improved over the past year in the economy overall, many community banks are seeing elevated levels of loan delinquencies and loan losses as a result of the lagging impacts of job losses, business failures, and declines in property values. The result has been stresses on bank capital. Given the severity of the downturn, particularly in certain parts of this country hardest hit by the recession, it is very difficult if not impossible for community banks to find new sources of capital.

ABA appreciates the initiative President Obama outlined in his State of the Union address that would help to resolve this issue by providing additional capital to small banks who volunteer to use it to increase small business lending. A key factor to this proposal is removing it from the rules and restrictions of TARP. Hundreds of banks that had never made a subprime loan or had anything to do with Wall Street took TARP capital with their regulator's encouragement, even though they did not need it, so they could bolster their lending and financial position. Then within weeks, they were demonized and subject to after-the-fact restrictions. Community banks will be disinclined to participate if there is any possibility of TARP-related stigma being attached to it.

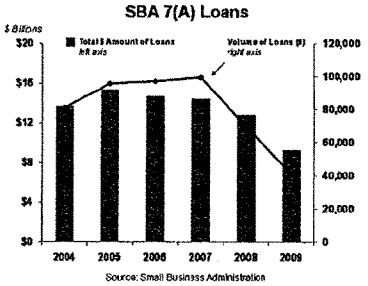
As this program is developed, ABA recommends that Congress and the Administration create criteria that allow viable community banks to participate. First United has benefitted from this program, and ABA believes that many more banks could benefit from it. We propose that Treasury offer assistance to those banks that did not qualify for Capital Purchase Program (CPP) funds but that nevertheless can demonstrate the ability to operate safely and soundly and survive if given the chance to obtain necessary capital. The focus should be on whether a bank is viable on a post-investment basis. Otherwise, Congress will miss an opportunity to help the customers and communities of many banks across the country.

Community banks, like mine, are the backbone of our economy and are critical to the overall improvement of our economy. For a nominal investment by Treasury, viable community

banks can be preserved, which in turn would provide more resources for lending and would help create jobs in our communities.

III. Changes that Enhance Bank Participation in SBA Programs Have Created Opportunities for Small businesses, Yet More Needs to Be Done

The SBA program has struggled over the last several years. SBA's flagship 7(a) loan guarantee program reported a 41 percent decline in volume from its 2008 to 2009 fiscal year, after reporting a 30 percent decline from 2007 to 2008. The dollar amount outstanding declined 28 percent from its 2008 to 2009 fiscal year, following an 11 percent reduction over the previous year. The changes made have helped to stem the reductions and show promise for more should the program, as we recommend, be extended. In particular, the changes have helped to facilitate 12,374 loans made totaling $3.8 billion in its first fiscal quarter of 2010.



In order to show further improvements, the SBA needs go beyond an increase in the amount of the guarantee; it needs to offer an improved value proposition. Current restrictions involving cost, collateral, refinancing, and prepayment penalties, among others, should be addressed.

Although many improvements are needed, much has already been done. This Congress has consistently worked to maintain the integrity of the 7(a) program and we applaud your efforts on the Recovery Act to enact the small business provisions.

The act temporarily increased the guarantees to up to 90 percent on SBA's 7(a) loan program, which have been helpful as banks work to extend credit during the recession. It also temporarily cut fees for borrowers on 7(a) loans and reduced fees for both borrowers and lenders on 504 Certified Development Company loans. SBA Administrator Karen Mills noted that average weekly loan volume has increased both in the 7(a) program and the 504 program following passage of the Act, and that participation among banks had likewise increased.

Further, the SBA expanded eligibility to small businesses in the 7(a) program by applying the broader standard used currently in the 504 program. Now, businesses will be able to qualify with a net

worth that does not exceed $8.5 million and an average net income under $3 million (after federal income taxes) for the preceding two fiscal years. These very positive changes mean that an additional 70,000 among the largest of our small businesses will be eligible to participate in the 7(a) program.

Other provisions from the Act include provisions that raised the maximum contract that can qualify for an SBA Surety Bond guarantee from $2 million to $5 million, and additional funding to microloan intermediaries, as well as funding for the technical assistance needed to accompany these loans.

All of these initiatives help small businesses during this recession, and should be funded and continued past their current authorization periods in order to reach even more small businesses. Moreover, there are a number of improvements that would provide additional incentives to small businesses and banks that would enable even broader participation:

- ***Extend the Provisions of the Stimulus Package***

  As part of the economic stabilization package, Congress increased the loan guarantee level in the 7(a) program to 90 percent and also decreased the fees for both the borrowers and the lenders. Both actions have provided a much needed boost for lender participation in the program. Funding for the guarantee and fee relief will be exhausted at the end of the month. We believe these provisions that expand both the guarantee and fee relief should be funded and extended for an additional two years beyond the 2010 expiration date. While we are all hopeful that the economy will regain its footing over the next 12 months, we are also realistic in understanding that the recovery may be very slow. The more that we are able to supply additional capital to our country's small businesses, the better chance we have at keeping businesses alive, which in turn will prevent further layoffs. Additional capital through lending will create an environment where small businesses will begin to rehire or add new jobs. Maintaining the 90 percent guarantee, with lower fee levels, through fiscal year 2012 will assist in that effort.

- ***Eliminate or Reduce the Restriction on Refinancing***

  The SBA allows no refinancing of existing debt by the bank that currently holds the debt. This restriction often prohibits the borrower from obtaining new financing critical to continued success. In many circumstances banks would like to make new and consolidated advances, but if the bank already has a deal on the books, that loan cannot become part of

the new deal. This restriction often causes the bank to write new loans without the help of the SBA, or ask the borrower to seek help from another lender.

- ***Improve the Quality of the Guarantee***

  The SBA guarantee is only valid if certain conditions are strictly adhered to. The collateral assets, and often the business, must be liquidated prior to payment on the guarantee by the SBA. This process can be delayed by bankruptcy, by difficult repossession issues, and other factors. The SBA also sends the claim to their legal department where lawyers seem to seek ways to find the bank in violation of the guarantee agreement. This disincentive to participate can be removed by strengthening the quality of the SBA guarantee.

- ***Improve the SBA Guarantee Approval Process***

  Generating the information and documentation required by the SBA is not easy. Many small banks have found it necessary to seek the help of third party "packagers" who help with gathering the data necessary to gain approval. This only creates additional time and expense for the borrower. This process could be significantly streamlined.

- ***Enhance the Human Resources Capacity of the SBA***

  There is a very practical barrier to the success of these programs: having the staff necessary to implement, promote, market, and manage the many initiatives of the SBA. We request that the Committees investigate the human resource needs of the SBA. Over the last eight years, the SBA staff has been reduced by nearly 1,000, roughly one-third of its employees. This has been done through consolidation, retirements and attrition. Since January 2009, the SBA has taken on many new loan programs and seen a sizeable increase in their budget allocation to implement and carry out these programs. Yet, the number of staff assigned to carry out the old and new programs has not been increased and, in fact, the program responsibilities of these employees have increased. SBA has thousands of partners and many more that desire to establish or reestablish a relationship with the agency. Without adequate levels of personnel to meet the needs of these partners, the small businesses that they serve will suffer.

The initiatives and new programs launched by the Administration and by Congress have great potential to help thousands of small businesses. These programs should be improved further and given the time to work. In addition, the SBA must be given the human resources to implement these initiatives, many of which are new to the SBA. ABA is prepared to work with Congress to find ways to improve the SBA program, with the goal of enhancing credit availability to small businesses throughout our nation.

IV. Changes in the Regulatory Environment Will Improve the Situation for Small Business Lending

As I noted above, banks are not immune from the economic downturn; job losses and business failures have resulted in greater problem loans and much higher loan losses. Nonetheless, banks are working every day to make credit available. Those efforts, however, are made more difficult by regulatory pressures and accounting treatments that exacerbate, rather than help to mitigate, the problems. The ABA has raised the issue of overzealous regulators in hearings last year and through letters to the agencies. We are pleased that on February 5, 2010, the federal financial regulatory agencies and the Conference of State Bank Supervisors issued a joint statement emphasizing that financial institutions that engage in prudent small business lending after performing a comprehensive review of a borrower's financial condition will not be subject to supervisory criticism for small business loans made on that basis. This joint statement, along with earlier statements concerning lending and loan workouts, can give bankers a powerful tool to help them in their exams.

ABA will work to make sure that this announcement is meaningful in the field, as we have seen numerous examples of the similar agency policies emanating from Washington not being carried out during field exams. The challenge should not be underestimated, as the reaction of regulators in the current economic environment has been to intensify the scrutiny of community banks' lending practices. For example, we have heard anecdotes from our members of examiners who continue to take an inappropriately conservative approach in their analysis of asset quality and who are consistently requiring downgrades of loans whenever there is any doubt about the loan's condition.

This inappropriately conservative approach is nowhere more visible than in the supervision of commercial real estate (CRE) loans. We are hearing from our bankers that the 100 percent and 300 percent ***thresholds are being applied by examiners as caps***. ABA foresaw this problem

when the guidance on CRE concentrations was released in 2006, and we were assured that the thresholds would be applied judiciously. Examiners need to understand that not all concentrations are equal, and that setting arbitrary limits on CRE concentrations has the effect of cutting off credit to creditworthy borrowers, exactly at a time when Congress is trying to open up more credit.

Just as too much risk is undesirable, a regulatory policy that discourages banks from making good loans to creditworthy borrowers also has serious economic consequences. Wringing out the risk from bank loan portfolios means that fewer loans will be made, and that only the very best credits will be funded.

Worsening conditions in many markets have strained the ability of some borrowers to perform, which often leads examiners to insist that a bank make a capital call on the borrower, impose an onerous amortization schedule, or obtain additional collateral. These steps can set in motion a "death spiral," where the borrower has to sell assets at fire-sale prices to raise cash, which then drops the comparable sales figures the appraisers pick up, which then lowers the "market values" of other assets, which then increases the write-downs the lenders have to take, and so on. Thus, well-intentioned efforts to address problems can have the unintended consequence of making things worse.

What the regulators want for the industry is what the industry wants for itself: a strong and safe banking system. To achieve that goal, we need to remember the vital role played by good lending in restoring economic growth and not allow a credit crunch to stifle economic recovery. We must work together to get through these difficult times. Providing a regulatory environment that renews lines of credit to small businesses is vital to our economic recovery. We are hopeful that the joint statement from the state and federal bank regulators will establish the framework for a more positive regulatory approach to bank lending in these difficult times.

Conclusion

I want to thank the Committees for the opportunity to present the views of ABA on the challenges ahead for the banks and the communities they serve. These are difficult times and the challenges are significant. We stand ready to work with Congress and the Administration on finding ways to facilitate credit availability in our communities.

I am happy to answer any questions the Committees may have.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

MARTIN J. GRUENBERG
VICE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS

before the

COMMITTEE ON FINANCIAL SERVICES AND
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

February 26, 2010

2128 Rayburn House Office Building

Chairman Frank, Chairman Velazquez, Ranking Member Bachus, Ranking Member Graves and members of the Committees, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on the state of lending and credit availability for small business and commercial real estate.

The events surrounding the financial crisis of late 2008 have taken a heavy toll on real economic activity across our nation. The extraordinary policy responses to that crisis were highly effective in stabilizing global financial markets and laying the foundation for economic recovery. However, the large dislocations that have taken place in real estate and credit markets continue to inhibit the pace of that economic recovery, contributing to persistent high unemployment and slow growth in consumer and business spending. Resolving these credit market dislocations will take time. Still, the pace of the economic recovery can be enhanced by policies that promote the prompt and orderly workout of existing problem loans and that enhance the ability of lenders to make new credit available to qualified households and businesses.

Adverse credit conditions and stressed balance sheets have created a difficult environment for both borrowers and lenders. The weakened economy has contributed to an overall decline in both the demand for and the supply of small business credit. Large banks have significantly cut back on lines of credit to consumers and small businesses. In addition, small and mid-sized institutions, who tend to make business loans secured by residential and commercial real estate properties, are dealing with the effects of large declines in real estate values, which tend to reduce the collateral coverage of existing

loans and make it more difficult for household and small business borrowers to qualify for new credit. This dynamic is contributing to persistent weakness in local economic conditions that is placing further stress on credit performance at small and mid-sized banks that serve those communities.

In response to these challenging economic circumstances, banks are clearly taking more care in evaluating applications for credit. While this more conservative approach to underwriting may mean that some borrowers who received credit in past years will have more difficulty receiving credit going forward, it should not mean that creditworthy borrowers are denied loans. Unfortunately, in such a difficult environment, there is a risk that some lenders will become overly risk averse.

As bank supervisors, we have a responsibility to encourage institutions, regularly and clearly, to continue to make soundly structured and underwritten loans. Acknowledging this responsibility, the FDIC and the other federal banking regulators supplemented prior guidance and issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* earlier this month to emphasize that examiners will follow a balanced approach in assessing small-business lending. The Statement recognizes that many small businesses are experiencing difficulty in obtaining and renewing credit to support their operations. It is clear that for a number of reasons small business credit availability has tightened, particularly at the largest institutions. The FDIC and the other banking regulators believe that continued sound lending to

creditworthy borrowers is critical to the long-term success and health of the small business sector -- and their lenders.

The Statement indicates that financial institutions should understand the long-term viability of a borrower's business, and focus on the strength of a borrowers' business plan to manage risk rather than using portfolio management models that rely primarily on general inputs, such as a borrower's geographic location or industry. This new guidance states that examiners will not adversely classify loans solely on the basis of a decline in the collateral value below the loan balance, or the borrower's association with a particularly stressed industry or geographic location.

In my testimony, I will briefly describe credit quality at FDIC-insured institutions, trends in the availability of credit, and conditions currently creating obstacles to credit availability. I also will address concerns that banks are receiving mixed messages from their supervisors. Finally, I will discuss the efforts the FDIC is making to encourage prudent lending by the institutions we supervise.

Credit Quality and Lending Activity at FDIC-Insured Institutions

Expenses for troubled loans continue to weigh heavily on the industry. The industry earned less than $1 billion in the fourth quarter, essentially just breaking even. During the quarter, insured institutions added $61.1 billion in provisions for loan and lease losses to their reserves, although this was $10.0 billion less (-14.1 percent) than

they set aside in the fourth quarter of 2008. Net charge-offs of loans and leases totaled $53.0 billion, an increase of $14.4 billion (37.2 percent) compared to a year earlier. The annualized net charge-off rate in the quarter was 2.89 percent, which is the highest rate in any quarter in the 26 years for which quarterly charge-off data are available. The amount of loans and leases remaining on banks' balance sheets that were noncurrent rose by $24.3 billion (6.6 percent) during the quarter.[1] At the end of December, 5.37 percent of all loans and leases were noncurrent. This also represents a 26-year high. However, fourth quarter 2009 was the third consecutive quarter that the rate of increase in the volume of noncurrent loans slowed.

Major loan categories exhibited high levels of charge-offs and noncurrent loans. The highest net charge-off rates in the fourth quarter were for credit cards (9.16 percent annualized) and real estate construction and development loans (7.77 percent). The net charge-off rate for real estate construction and development loans represented a record high and the net charge-off rate for credit card loans is near the record high set last quarter. Construction and development loans also had the highest noncurrent rate at the end of December (15.95 percent), followed by 1-4 family residential mortgage loans (9.31 percent), both record high levels.

Larger institutions had higher charge-off and noncurrent rates than smaller institutions. The average net charge-off rate on all loans and leases for community banks (institutions with less than $1 billion in assets) was 1.70 percent in the quarter, compared to an average of 3.09 percent at larger institutions. The ratio of noncurrent loans and

[1] Noncurrent loans are those that are 90 days or more past due or on nonaccrual status.

leases to total loans and leases for community banks as of December 31 was 3.43 percent, versus 5.68 percent for larger institutions. Some of the difference in credit quality performance reflects differences in the composition of loan portfolios at large and small banks. Large institutions have higher proportions of retail loans (residential mortgages and consumer loans) while community banks have larger relative shares of loans to commercial borrowers. Consequently, the impact of falling housing prices and rising unemployment and bankruptcies has been greater in the loan portfolios of large banks. Further deterioration in commercial real estate (CRE) markets would have a greater proportional impact on the performance of small and medium-sized institutions.

Tighter underwriting standards, deleveraging by institutions seeking to improve their capital ratios, and slack loan demand have all contributed to declines in loan balances at many institutions. Total loan and lease balances at FDIC-insured institutions declined by $128.8 billion (1.7 percent) during the fourth quarter. This is the sixth consecutive quarter that aggregate loan balances have fallen. In 2009, loan balances declined by $587.3 billion, or 7.5 percent, which was the largest percentage decline since 1942.

Much of the decline in loan balances occurred at larger institutions. Institutions with total assets greater than $100 billion as of December 31st reported an aggregate net decline in total loans and leases of $116.8 billion in the quarter, or over 90 percent of the total industry decline. On a merger-adjusted basis, at community banks that filed reports as of December 31st, total loan and lease balances decreased $4.3 billion during the

quarter. A majority of institutions (53.2 percent) reported declines in their total loan balances during the quarter.

Table 1. Loan Growth by Asset Size Groups, Fourth Quarter 2009
(Dollar amounts in billions)

Asset Size	Number of Institutions	Number Not Reporting Increase in Loans	Number Reporting Increase in Loans	Aggregate Net Change in Loans ($ Billions)	Percent Change
> $100 Billion*	48	40	8	(116.8)	-2.82%
$10 - $100 Bill.	77	55	22	9.6	0.74%
$1 - $10 Billion	554	372	182	(16.9)	-1.78%
< $1 Billion	7,333	3,794	3,539	(4.3)	-0.41%
All Insured Institutions	8,012	4,261	3,751	(128.4)	-1.73%

Note: Reflects changes in loan balances for institutions categorized by size group as of December 31, 2009. Changes in these groups are adjusted for mergers and acquisitions. The difference between the net decline on this table ($128.4 Billion) and the industry aggregate net decline ($128.8 Billion) reflects institutions that closed during the quarter but were not acquired by another institution.

Source: Call and Thrift Financial Reports.

*The > $100 billion asset size category includes insured depository institution affiliates that would otherwise fall in smaller size groups.

Factors Affecting Small Business Lending

Weak economic conditions have created an extremely challenging business environment, which particularly affects small businesses. After real GDP posted four consecutive quarters of decline during the second half of 2008 and first half of 2009, economic activity is now showing some signs of recovery. Consumer spending rose in both the third and fourth quarters of 2009 after declining in three of the prior four

quarters. Even the housing sector showed some signs of stabilization in sales and prices during the second half of 2009. However, the unemployment rate remains high -- 9.7 percent as of January 2010 -- and persistent labor market weakness poses ongoing risks to the business outlook. Small business optimism remained near record low levels in December, according to a survey by the National Federation of Independent Business (NFIB).[2]

This weakness in business conditions has had significant effects on both credit demand and supply. The demand for business credit tends to vary over the business cycle with the level of spending on new capital equipment and inventories. Small businesses reported that capital spending levels remained near record low levels in December 2009, as did the demand for credit to finance such projects.[3] Similarly, in the Federal Reserve's most recent *Senior Loan Officer Opinion Survey*, banks again noted weaker loan demand from business borrowers, especially from small businesses. At the same time, access to credit remains difficult, as lenders raise credit standards in response to higher loan losses. Banks continued to report net tightening of their lending standards on business loans in January 2010, although the pace of that tightening has slowed.[4]

Surveys of small businesses suggest that while small business loans have clearly become harder to obtain, deteriorating business conditions appear to represent an even larger problem. In the NFIB's December 2009 survey, the percent of respondents who

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[2] "NFIB Small Business Economic Trends," January 2010.
[3] "NFIB Small Business Economic Trends," January 2010.
[4] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, January 2010, http://www.federalreserve.gov/boarddocs/SnLoanSurvey/

said that loans were "harder" to get in the last three months outnumbered those who said loans were "easier" to get by 15 percentage points, near the record high in 1980. In addition, the percent of respondents citing "finance and interest rates" as their single most important business problem stood at just 4 percent, compared to 3 percent one year ago. By comparison, a 34 percent plurality of respondents cited "poor sales" as their biggest business problem, up from 27 percent a year ago. The percentage of respondents who said that sales were "lower" in the last three months outnumbered those who said sales were "higher" by 25 percentage points.[5]

Ensuring that creditworthy small business borrowers have access to credit remains critical to sustaining the economic recovery. FDIC-insured institutions are a major source of financing for small businesses, supplying over 60 percent of the credit used by small businesses to run and grow their businesses. Community banks have a particularly important role in lending to small businesses. As of June 30, 2009 (the most recent data available), community banks accounted for 38 percent of small business and farm loans, even though these institutions represented only 11 percent of industry assets.

Recent initiatives and proposals to support small business financing will help to sustain local communities and community banks. For example, the American Recovery and Reinvestment Act (ARRA), signed into law last February, temporarily raised the guarantee levels on Small Business Administration (SBA) 7(a) loans and eliminated upfront borrowing fees on SBA loans in the 7(a) and 504 programs. ARRA also provided a range of tax cuts and tax incentives for small businesses, helping them to cope

[5] "NFIB Small Business Economic Trends," January 2010.

with the unusually harsh economic environment. In addition, the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) was authorized to provide financing for SBA-backed loans. After these measures were implemented in early 2009, both the volume of SBA loan originations and the volume traded in the secondary market have risen above pre-crisis levels.[6] Further efforts to support small business financing will also provide important benefits to the overall economy.

Commercial Real Estate

The deep recession, in combination with ongoing credit market disruptions for market-based CRE financing, has made this a particularly challenging environment for commercial real estate. The loss of more than 8 million jobs since the onset of the recession has reduced demand for office space and other CRE property types, leading to deterioration in fundamental factors such as rental rates and vacancy rates. Against a backdrop of weak fundamentals, investors have been re-evaluating their required rate of return on commercial properties, leading to a sharp rise in "cap rates" and lower market valuations for commercial properties. Finally, CRE financing has been harder to obtain since last year's financial crisis. There were no commercial mortgage-backed securities (CMBS) issued between July 2008 and May 2009 and only $5.1 billion has been issued since then. Commercial mortgage lenders are also reassessing their underwriting standards. According to the Federal Reserve's *Senior Loan Officers Survey*, a majority of lenders surveyed reported tightening underwriting standards during the financial crisis in

[6] U.S. Department of Treasury, "Treasury, SBA Host Small Business Financing Forum," November 18, 2009, http://www.treas.gov/press/releases/tg411.htm

late 2008 and into 2009. Even according to the most recent survey in January 2010, more than one-fourth of lenders surveyed continued to report tightening underwriting standards, while none reported easing underwriting standards.[7]

Nationally, prices for CRE properties as measured by the Moody's/REAL Commercial Property Price Index are more than 40 percent below their October 2007 peak. As of fourth quarter 2009, quarterly rent growth has been negative across all major CRE property types nationally for at least the past year. Asking rents for all major CRE property types nationally were lower on a year-over-year basis.[8]

The most prominent area of risk for rising credit losses at FDIC-insured institutions during the next several quarters continues to be in CRE lending. While financing vehicles such as CMBS had emerged as significant CRE funding sources in recent years, FDIC-insured institutions still hold the largest share of commercial mortgage debt outstanding, and their dollar volume exposure to CRE loans stands at a historic high. As of December 31, 2009, CRE loans totaled almost $1.8 trillion, or 24.9 percent of total loans and leases. In terms of concentrations of credit, CRE at FDIC-insured institutions represented 133 percent of total risk-based capital, lower than the 151 percent seen one year earlier, but still significantly higher than levels at the beginning of the decade.

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[7] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, January 2010, http://www.federalreserve.gov/boarddocs/SnLoanSurvey/

[8] Property and Portfolio Research

The large and widespread decline in the value of residential and commercial real estate over the past two to three years represents a major dislocation to certain lending markets. Small firms tend to borrow on a secured basis because it helps them obtain more credit on more advantageous terms than would be the case for an unsecured loan. As of September 2009, just over half of the total liabilities of nonfarm noncorporate businesses (many of which are small businesses) took the form of mortgage loans.

It is clear that the decline in the value of collateral impacts the ability of business borrowers to obtain new credit or renew existing lines. In many instances, this can result in fewer new loans being granted, less additional credit being made available under existing lines, and demands for additional collateral. Declines in real estate values have reduced the collateral coverage for many secured loans, raising their effective loan-to-value ratio.

The widespread problem of eroding collateral positions represents a serious dislocation in small business loan markets at present. It is also a problem that the federal banking agencies have directly addressed through the October 2009 *Policy Statement on Prudent Commercial Real Estate Workouts.* While these efforts to help banks and borrowers work together can help to reduce unnecessary foreclosures and preserve credit relationships in many cases, they can do little to correct the underlying problem of lower asset values. This is a problem that can only be resolved over time, as problem loans are dealt with and market conditions return to normal.

Losses in CRE portfolios thus far have been most prominent in construction and development (C&D) loans. As noted previously, noncurrent and net charge-off rates for C&D loans are both at record high levels. Outside of construction portfolios, losses on loans backed by CRE properties have been modest to this point. Net charge-offs on loans backed by nonfarm, nonresidential properties have been just $11.3 billion over the past eight quarters. Over this period, however, the noncurrent loan ratio in this category has nearly quadrupled to 3.82 percent, and we believe it will rise further. It is likely that increased vacancy rates and lower rental income will translate into more borrowers unable to cover their debt service. The ultimate scale of losses in the CRE loan portfolio will very much depend on the pace of recovery in the U.S. economy and financial markets during the next few years.

The Role of Bank Supervision

As federal supervisor for nearly 5,000 community banks in the U.S., the FDIC and its examiners uniquely understand that bank lending is the lifeblood of our local and national economies. We share Congress' and the public's belief in making credit available on Main Street and working with borrowers that are experiencing difficulties.

The FDIC's bank examiners work out of duty stations located in 85 communities across the country, and are both knowledgeable of local conditions and very experienced in their profession. Many have seen more than one previous economic down cycle and recognize the critical role that banks play in credit availability. We believe that our

examiners do their jobs with a keen understanding of the economic environment and real estate conditions where banks operate.

Concerns have been expressed by small businesses, trade groups, and members of Congress that the bank supervisors may be contributing to the lack of credit availability, and that examiners are discouraging banks from extending small business and commercial real estate mortgage loans. There are assertions that examiners are instructing banks to curtail loan originations and renewals, and are criticizing sound performing loans where collateral values have declined. We also have heard criticisms that regulators are requiring widespread re-appraisals on performing commercial real estate mortgage loans, which then precipitate write-downs or a curtailment of credit commitments based on a downward revision to collateral values.

We recognize that the supervisory process mirrors the underlying economic, financial, and managerial challenges that many banks are facing. Even at the most troubled institutions, our primary goal is to help the institution return to financial health and sound operation.

I would like to emphasize that FDIC examiners are not directly involved in bank credit decisions. Accordingly, the FDIC provides banks with considerable flexibility in dealing with customer relationships and managing loan portfolios. We do not instruct banks to curtail prudently managed lending activities, restrict lines of credit to strong borrowers, or deny a refinance request solely because of weakened collateral value. In

addition, we encourage banks to be knowledgeable of local market conditions and closely review collateral valuations when a borrower's financial condition has materially deteriorated and a sale of the collateral may be necessary. We would not require a re-appraisal for a healthy performing loan. We leave the business of lending to those who know it best -- the community bankers who provide credit to small businesses and consumers on Main Street. The FDIC believes that bank supervision should avoid interfering with banks' day-to-day credit operations.

To reiterate the importance of bank lending at this critical stage in the economic cycle, we have an on-going dialogue with our regional directors about credit availability. It has been re-emphasized that examiners should encourage banks to originate and renew prudently underwritten commercial loans and work cooperatively with borrowers facing financial difficulties. Examiners will not criticize financial institutions for making good loans or entering into prudently structured workout arrangements. These expectations are consistent with the FDIC's bank examination process and policy guidance that has been issued to the institutions we supervise.

The crux of many of the complaints about refinancing commercial loans seems to center on what is a performing loan. We hear that loans are considered to be in performing status by many borrowers because they are current on the interest payments. However, in some cases, the interest payments are coming from the loan proceeds -- often because the borrower is in a deteriorating financial condition. It is difficult for the bank, and the examiner, to not consider this situation a potential problem. In other cases,

borrowers complain that examiners are telling banks that more equity is needed when the collateral goes down in value. To be clear, FDIC examiners focus on borrower cash flow as the primary source of repayment during our credit reviews -- not on collateral support which serves a secondary or tertiary source of repayment. When reviewing loans during our examinations, we look at collateral documentation, but also closely focus on the borrower's financial strength, as well as other critical elements of credit support such as guarantor support, business cash flow and prospects. The borrower's willingness and ability to keep payments current, especially when economic conditions are stressed, is always the primary evaluative criterion for our loan reviews.

We have also reached out to the industry to help us frame policies and supervisory procedures that will help lenders navigate through this credit cycle and become more comfortable extending and renewing loans. One of the first steps in this process was to establish the FDIC's Advisory Committee on Community Banking in mid-2009 to better enable our Board and senior management to have a dialogue with the industry on how we can improve our supervisory programs and foster improved availability of credit. The Advisory Committee met most recently on January 28th where we discussed many of the issues we are discussing today in this testimony -- issues facing the community bankers including credit availability and access to the capital markets. We also discussed interest rate risk exposure, funding issues and other topics of interest to community bankers in this current financial environment. The Advisory Committee will continue to meet regularly and provide direct input from community bankers on the many critical issues they currently face. Our expectation is that, together, we can come up with creative

solutions to address some of the difficult challenges facing the industry. Community banks are the lifeblood of their communities, making loans to countless individuals, small businesses, not-for-profit organizations and other community-based organizations, so we must ensure the continued viability of well-run community banks.

From a banking policy perspective, the FDIC has issued several statements that encourage financial institutions to continue making prudent CRE loans and working with borrowers that are experiencing difficulty. We have been providing this encouragement since the onset of the current crisis. In March 2008, we issued a Financial Institutions Letter on *Managing CRE Concentrations in a Challenging Environment* which reiterated supervisory guidelines for managing CRE portfolios, while encouraging banks to keep prudent CRE credit available in their markets. At the time, we recognized that credit for small business and commercial real estate had become relatively scarce, and our goal was to support banks' efforts to continue lending despite difficult market conditions.

In November 2008, the FDIC joined the other federal banking agencies in issuing the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* to encourage banks to continue making loans available to creditworthy borrowers and work with mortgage borrowers that are having trouble making payments. The banking agencies remain committed to this Statement as it promotes lending to creditworthy customers, working with mortgage borrowers that need relief, and implementation of appropriately structured compensation programs.

More recently, in October 2009, we joined the other financial regulators in issuing the *Policy Statement on Prudent Commercial Real Estate Workouts*. This Policy Statement encourages banks to restructure commercial real estate loans, applying appropriate and long-standing supervisory principles in a manner that recognizes pragmatic actions by lenders and borrowers are necessary to weather this difficult economic period.

As I mentioned earlier, the regulators have also issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* on February 5th, to encourage prudent lending and emphasize that examiners will apply a balanced approach in evaluating small business loans. We believe this statement will help banks become more comfortable extending soundly underwritten and structured small business loans.

We will continue our dialogue on credit availability with the banking industry, members of Congress, and the public in 2010. As I stated earlier, bank lending is an essential aspect of economic growth and will be vital to facilitating a recovery. Our efforts to communicate supervisory expectations to the industry should help banks become more comfortable extending and restructuring loans, and in turn strengthen business conditions and hasten a much-awaited recovery.

Conclusion

FDIC-insured banks are uniquely equipped to meet the credit needs of their local markets, and have a proven tradition of doing so, through good times and bad. However, in the wake of the longest and deepest recession since the 1930s, large dislocations in real estate and credit markets are contributing to an economic recovery that is characterized by weak private demand and persistent high unemployment. While it will clearly take time to fully resolve these credit market dislocations, there is a clear need for policies that promote the prompt and orderly workout of existing problem loans and that enhance the ability of lenders to make new credit available to qualified household and business borrowers.

In concert with other agencies and departments of the federal government, the FDIC continues to employ a range of strategies designed to ensure that credit continues to flow on sound terms to creditworthy borrowers. Banks are being encouraged to work with borrowers that are experiencing difficulties during this difficult period whenever possible. While many challenges remain before us, I am confident that the banking industry as a whole is moving in the right direction -- toward sounder lending practices, stronger balance sheets, and a greater capacity to meet the credit needs of their communities.

Testimony of David Hoyt
Head of Wholesale Banking
Wells Fargo & Company
House Financial Services Committee and House Small Business Committee
February 26, 2010

Chairwoman Velazquez, Chairman Frank, Ranking Member Bachus, Ranking Member Graves, and Members of the Committee, I'm David Hoyt, Head of Wholesale Banking at Wells Fargo & Company.

Thank you for the opportunity to be here today to discuss lending and credit – topics that are critical to business owners, our business at Wells Fargo, and the economic recovery.

For 158 years, Wells Fargo has focused on working with customers and building long-term relationships in the communities where we do business. As the number one small business, middle market, and commercial real estate lender in America, we have tens of thousands of people in our company dedicated to serving the needs of these business owners.

At Wells Fargo, we have small business lenders throughout the United States located in our 6,600 stores in 39 states. We also have 95 offices nationwide solely dedicated to serving the needs of middle market companies.

Wells Fargo serves more than two million small businesses and has relationships with over 15,000 middle market businesses nationwide. We bank approximately one out of every ten small businesses and one out of every three middle market businesses in the country. When businesses need credit, we are prepared and eager to lend to them.

In many cases we have banking relationships with customers that have spanned multiple economic cycles. We proactively work with borrowers that may be experiencing difficulties and encourage them to have conversations with us as early as possible so that we are able to explore alternatives.

Many business owners in America are hurting. Our recent Wells Fargo/Gallup Small Business Index surveyed in January showed us that business owners' current financial situation – which in our survey, is comprised of business owners' perceptions on cash flow, revenues, capital spending, credit availability and job hiring – is at a seven-year low.

At Wells Fargo we are doing our part to get consumers and businesses back on their feet by making credit available to credit-worthy borrowers in the communities where we do business. In 2009, we extended over $40 billion of new credit to our business borrowers.

While credit availability has improved since early 2009, we continue to read media stories and hear directly from business owners who are concerned about being able to obtain the credit they need to run their businesses. We also see that demand for business credit has remained soft through the fourth quarter of 2009.

In our opinion, the reality of weaker loan demand as well as the perception of the lack of availability of credit is rooted in several factors.

First, the economy has taken a toll on the credit and financial capacity of many businesses, reducing their cash flow and capacity to repay debt. At Wells Fargo, we rely on the fundamentals of sound credit underwriting and, as a responsible lender, only extend credit to borrowers that demonstrate the ability to repay it.

Second, asset values have declined from much higher levels which existed at the top of the economic cycle. In particular, the commercial real estate market has seen significant declines – which I will discuss later. Businesses that relied on the value of these assets to borrow can't borrow as much against them today.

Third, given the uncertainty of the current economic environment, we see our borrowers being more conservative – stocking less inventory and

making fewer capital investments – which reduces their need to borrow. On average, utilization rates of our middle market customers' lines of credit have dropped from normal rates in the 40s to 35 percent.

This behavior is consistent with prior economic cycles and we would expect both line usage and demand for credit to normalize as the economy improves.

Finally – loan structures and terms are more conservative now than at the peak of the economic cycle – and we believe appropriately so. The increasingly aggressive extensions of business credit were partially responsible for the current financial crisis. Borrowers that accessed credit on those terms find the terms of credit extended today more restrictive. We believe that a return to more prudent lending standards is important to a sound financial system.

Turning to the commercial real estate market, we hear a lot of concern about the availability of credit. The commercial real estate industry has been particularly impacted as asset values have decreased significantly leaving many borrowers and lenders in a position where loans exceed the value of the property securing them.

During the last decade, the commercial real estate market saw substantial amounts of liquidity entering the market which reached an all time high in 2007. As a result, valuations increased as investors were willing to accept a lower return on a given stream of cash flow. Returns to investors – which generally had been in the eight to nine percent range historically– dropped to six percent or less – a level which, in our experience, was unsustainable. As the economy slowed, returns reverted to normal levels. Adding to the problem, weaker tenant demand and tenant failures are resulting in a decline of cash flow generated by individual properties. The combination of these issues has resulted in declining property values, in many cases 40 to 45 percent. Lenders and property owners alike are now faced with the difficult reality of significantly lower asset values.

Our recent experience is that there is substantial liquidity available in the market to deal with these issues on a macro level – although these resolutions are often economically painful to individual owners and lenders. In our opinion, this is not a short-term problem and our expectation is that it will take some time for the problem of overvaluation of commercial real estate to work its way through the system.

Being Part of the Solution

There is work to be done and we want to be a part of the solution for individual business owners and the economy in general.

More than ever, our bankers are staying close to their customers to understand and help them with their current circumstances as well as their future borrowing needs.

Over the last year, Wells Fargo hired 1,500 store bankers to service the needs of our customers. We expect to add at least 700 more this year.

When lending to small businesses, we are taking time to re-evaluate the loans we have declined. We take a second look at declined loans because we want to make every good loan we can.

We are also educating small business owners so they can make better financial and credit decisions. Through the education section of our dedicated small business website we offer a comprehensive library of online advice tools including videos covering important business topics such as credit, financing, retirement planning, expense control and revenue growth. Additionally, through Wells Fargo's Diverse Business Services programs, we are providing outreach and education to the fast-growing women and diverse business owner segments.

We also support provisions in the America's Recovery and Reinvestment Act of 2009 intended to incentivize small business lending. Specifically, we have

found that the fee waivers on the SBA 7(a) and 504 programs, as well as the 90 percent guarantee, have proven to be successful and effective in helping small businesses owners access the credit they need. We encourage Congress to extend the reauthorization and funding of these provisions when they expire at the end of the month.

Moving Forward

There are some positive signs in the market. While loan demand is still soft, it has improved over the last several months.

- **Businesses that are applying for credit are generally stronger than a year ago.**
- **Competition for well-underwritten loan opportunities has increased over the last few months – leading to healthy and strong competition between financial services providers.**
- **Liquidity in the markets has also improved – particularly in the commercial real estate industry.**
- **Business owners reported in our last Small Business Index that they are more optimistic about the future and expect future revenues, capital spending and cash flow to improve over the next 12 months.**

As we all travel along the road to economic recovery, Wells Fargo maintains our commitment to helping businesses owners – large and small alike – succeed financially.

Madame Chairman, Mr. Chairman and Members of the Committee, thank you and I would be happy to answer questions.

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Testimony of Charles McCusker
On Behalf of the National Association of Small Business Investment Companies
Before for a Joint Hearing of the Committees on
Small Business and Financial Services
February 26, 2010

Chairwoman Velazquez, Chairman Frank, Ranking Member Graves, Ranking Member Bachus, and Members of the Small Business and Financial Services Committees, thank you for the opportunity to testify today on behalf of the National Association of Small Business Investment Companies (NASBIC) regarding the state of small business lending. Clearly banks are critical to small business lending, but non-bank lenders, such as Small Business Investment Companies (SBIC) are an important and often overlooked part of the equation. When the Treasury and the Small Business Administration held a summit on small business financing last November, the only small business participant at the small business forum who said he had adequate access to capital was backed by an SBIC. Small businesses need more SBICs.

My name is Charles McCusker. I am a founder and a managing partner of the Patriot Capital family of investment funds. Patriot Capital holds three Small Business Investment Company ("SBIC") licenses and in conjunction with its predecessor funds, has been investing in small businesses for two decades. Under its three licenses, Patriot Capital has provided investment capital to 64 small businesses and the Patriot Capital portfolio of companies employs over 10,000 people. 6,000 of these jobs were created as a direct result of our in investments.

SBICs are very small, highly regulated private investment funds that invest capital exclusively in domestic small businesses, primarily through long-term debt investments. The SBIC program has been operating with bipartisan support since 1958. Under this program, funds raise private capital from institutional and individual investors and, upon licensure by SBA, can access low cost leverage to multiply the amount of

capital available for small business investment. Through fees and interest payments, the SBIC Debenture program operates at a zero subsidy rate and does not require or receive annual appropriations from Congress to provide leverage. One of the keys to the success of this program is the fact that all taxpayer dollars are repaid to SBA before investors begin to receive any return of their investment capital. Unlike some other types of private equity, SBICs generally provide growth capital and expertise to support small business owners and managers. SBICs have provided some of the early capital for such well-known companies as Federal Express, Intel, Outback Steakhouse, Staples, Quiznos, and hundreds of companies that are listed on the NASDAQ.

In the autumn of 2008 small business lending dramatically tightened following the financial meltdown. Credit lines for many companies were reduced or pulled entirely and many small businesses were immediately limited in how their businesses could operate. Across most industries, the result was decreased production, increased unemployment, and a substantially reduced taxpayer base. Access to senior debt, usually provided by banks, largely disappeared and many small business transactions froze. Almost eighteen painful months later, the capital access problem for small businesses remains. It has thawed to a degree – senior debt may be available but it is very restrictive. For example, we have a recycling company in the Midwest that has struggled but survived the economic downturn, met every expectation that they laid out to the bank and yet the bank continues to reduce the amount of credit available to this company. And while debt capital would be available if the company were on a larger scale, small businesses like this paper recycler are having serious problems accessing capital. While there have been some recent signs of bank credit availability for small businesses increasing, there are still reasons for concern as small businesses still have limited access to long-term capital.

This is where SBICs fill the capital void in the marketplace. SBICs function in a symbiotic relationship with banks. Banks are not competitors, but are major investors in our funds and are sources of daily credit for the businesses in which we invest. SBICs fill an important and unique role in providing capital to small businesses. SBICs generally provide long-term capital in the $500,000 to $5,000,000 range, a range in which banks are often not comfortable lending, particularly smaller community banks. SBICs also invest in small businesses which, despite being solid companies, are considered too risky for banks to consider worthy of credit. For example, in FY 2009 SBICs made over 20% of their investments in Low and Moderate Income areas and well over 90% of investments held by SBICs were in smaller enterprises. In addition, banks are

often more comfortable lending to small businesses with SBICs as long-term capital investors. The country needs more SBICs in total and more SBICs in underserved markets. For example, some very large states only have two active SBICs and some smaller states have none.

Over the last decade, our three Patriot Capital funds collectively have invested over $200 million in 64 domestic small businesses in 23 states (AZ, CO, CT, FL, GA, IL, KY, LA, MD, NC, NJ, NV, NY, OH, OK, OR, PA, SC, TN, TX, UT, VA) and these businesses employ over 10,000 people. Over 6,000 of these jobs were created as a direct result of our investment. We have businesses in multiple industries and very few are immune to the current lack of liquidity in the market place. Several very solid, well-managed companies in our portfolio, from the Midwest paper recycler to a Southeastern trucking company to an East Coast telecommunications manufacturer to a rural provider of natural gas equipment, would have been put out of business and liquidated by their banks if not for the SBIC program and the capital we can bring to support these small businesses. In approximate numbers, these four companies represent over $100 million in revenue and over 600 American jobs. These may not seem like large numbers, but they are huge numbers to their employees and their hometowns. Also, consider that these four companies represent only 4% of our portfolio and Patriot Capital, while collectively one of the largest SBIC licensees, still represents less than 2% of the SBIC program. Stories like this can be told by every one of the SBICs in the marketplace. It is a fact that it is faster and easier to save and create jobs in a solid small business than it is to create them from scratch.

Thanks to the leadership of Chairwoman Velazquez and the Small Business Committee, last year Congress passed a number of SBIC improvements that were signed into law via the Recovery Act. Last fall, the Small Business Committee passed a bipartisan reform of the SBIC program that is still pending in the Senate. With these Congressional actions and the Administration's appointment of quality officials at SBA, the SBIC program is experiencing a renewal that should release billions of dollars to small businesses without any additional cost to the taxpayer. In 2008 only six SBIC licenses were issued. Only a few months into FY 2010, SBA has already issued eight new licenses. Further, there are approximately 50 more funds currently in the application pipeline. If most of these funds are licensed it is reasonable to expect that billions of dollars will soon be flowing to small businesses, again at no cost to the taxpayer. If the House passed SBIC improvement legislation is enacted, that number could increase by another couple of billion dollars.

However, without private sector investment these SBICs in formation cannot get their licenses and cannot get capital flowing.

Despite the laudatory efforts of the Administration and Congress to fully utilize the SBIC program to facilitate capital flowing to small businesses, there are a number of issues which are currently chilling institutional investment in SBICs and therefore denying small business access to credit. The key to the 52-year success of the SBIC Debenture program is the fact that private capital leads and SBA leverage follows. No taxpayer money is at risk until the private money is lost (a very rare occurrence). Policymakers should remove barriers and create incentives for private investment in SBICs.

Bank Investment in SBICs

The day after the President announced his proposal to ban all bank investment in private equity, a number of banks immediately suspended their investment commitments to SBICs in formation. Banks do not want to invest in SBICs and a few months later find out that they may have to divest their positions. Some SBIC funds have 100% of their capital coming from banks. While 100% is no the norm, 40-50% is common. If bank capital is banned from SBICs, then the wave of SBICs currently in formation will have a much harder time raising the required private capital – many will not get licensed. The result will be fewer SBICs and the loss of over $2 billion of capital to small businesses. As an important matter of legislative history, prior to Gramm-Leach-Bliley, when banks were severely limited in their ability to take equity stakes in companies, bank investments in SBICs were explicitly allowed and encouraged. Bank involvement in highly regulated SBICs is completely unrelated to hedge funds or other unregulated financial investment funds and offer no systemic risk.

CRA Credit for Investment

The Community Reinvestment Act has been an effective incentive for banks to invest in SBICs and needs to be strengthened significantly. To oversimplify a bit, about 25% of a banking institution's CRA score is derived by the bank examiners' review of bank investments. Given the nature of the SBIC and their limitations to exclusively invest in small business, banks have received dollar for dollar credit for investing in SBICs. In the past nine months that has changed – although there has been no change in regulations or statute. Suddenly a few banks are being told by their regulators that the amount of CRA investment credit they will receive is far from certain. The net effect of this unexplained change in direction by a handful of

regulators is that some banks have stopped investing in SBICs. One major bank has stopped investing entirely and another major bank is actively considering ceasing investing in SBICs. This change is cutting off capital to small businesses. This policy change is particularly damaging to underserved areas because many states do not have any SBICs or have too few for their size. Causing confusion on CRA credit limits the creation of new funds and therefore limits increases in the diversity of new SBIC licenses. As mentioned before, if SBICs do not have access to this institutional investor group, this important small business program will be in jeopardy. Regulators should reaffirm that bank investments in SBICs will receive full credit for the investment portion of their CRA score.

Community Bank Capital – TARP

In addition to the above mentioned reasons for reductions in bank investment in SBICs and despite the excellent returns on invested capital, there is another reason for reductions in bank investment and lending – they simply don't have or don't want to put more money to work while their regulators are aggressively scouring their books. Banks are being asked to lend more while be required to reserve more. It is this very reason, that the Obama Administration recently proposed providing $30 billion in unused TARP funds to community banks expressly for small business investment. This promising proposal should help community banks lend more and is a welcomed development. However, this proposal also presents an opportunity to use the billions in dormant SBIC leverage that could help thousands of small businesses and result in job creation. If community banks were provided legislative incentive to invest only three (3%) percent of this money in CRA-eligible SBICS then the SBIC mechanism would quickly release nearly an additional two billion dollars in capital for growing small businesses without any additional cost to the taxpayer. At a minimum, the Administration or Congress should issue public guidance to banks that they are allowed to use these new funds to invest in SBICS. Setting aside a fraction of this capital for community banks to invest in SBICs would be even more beneficial to small businesses.

Capital Gains

Although your two committees do not have direct jurisdiction over tax policy, it is important to discuss the President's proposal for zero capital gains for qualified small business investments. This proposal is a healthy incentive to provide private capital to small businesses. However, this proposal could have a much bigger impact if it were to specifically include SBICs. Because of the money multiplying nature of the SBIC

program, applying this tax incentive to SBICs would triple the benefit to small businesses. We would encourage that SBICs be explicitly included in this tax provision.

Thank you for the opportunity to testify at this joint hearing. I would welcome the chance to share my first hand small business knowledge and answer any questions you may have.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of Karen G. Mills
Administrator
U.S. Small Business Administration

Before the

Committee on Small Business
Committee on Financial Services
United States House of Representatives

Small Business and Commercial Real Estate Lending

February 26, 2010

Thank you, Chairwoman Velazquez, Chairman Frank, and Members of both Committees.

Many small businesses continue to have problems getting access to capital. We know this is a situation that must be fixed. Small businesses have created about 65 percent of the net new private jobs over the past 15 years, so we know we need a robust small business jobs plan that addresses these credit gaps

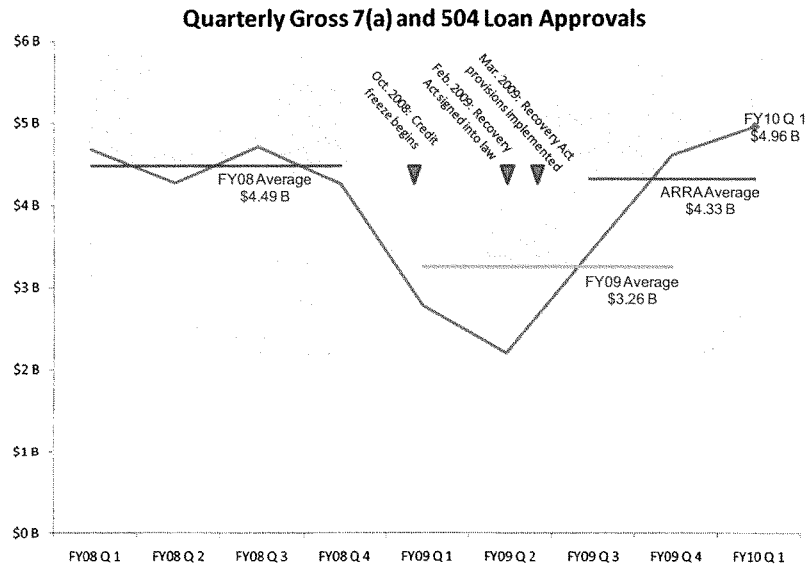
With your help, we've already taken an important step forward. I want to thank Congress for passing the Recovery Act and the subsequent extension of SBA's 90 percent guaranty and reduced fee provisions. Over the past year, this helped us leverage $500 million in taxpayer dollars into more than $20 billion for small businesses. This also helped bring back more than 1,100 lenders who hadn't participated in SBA lending since at least 2007. Compared to the depths of the recession in the weeks before the Recovery Act – when lending was at rock bottom – that reflects a weekly volume increase of more than 90 percent.

These provisions have helped, but we know gaps still exist. Small businesses and their lenders are asking SBA to step up in even more ways. We analyzed the issues in today's credit market, and we have constructed a targeted series of proposals that fill the most critical gaps that exist.

The resulting Jobs Plan is guided by three key principles: build on what works, maximize limited taxpayer dollars, and make targeted changes as quickly as possible. The plan has five key components.

The first problem is that some community banks which make the most loans to small businesses don't have the capital to lend. That's why the President proposed a $30-billion Small Business Lending Fund to provide community banks low-cost capital with incentives to increase their small business loans beyond 2009 levels.

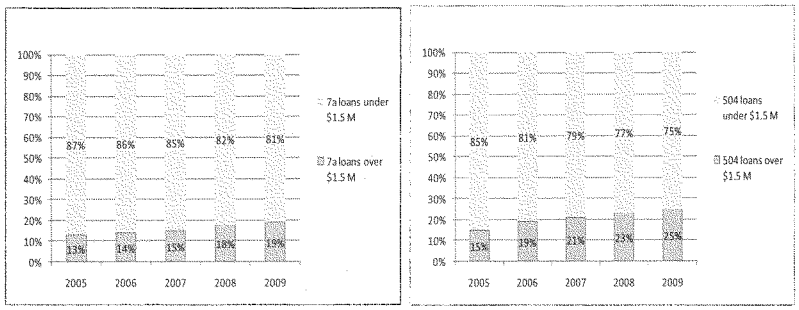
The second problem is that many banks are still having trouble taking risk even with creditworthy small businesses. That's why the Administration and small businesses have spoken out in support for extending the 90 percent guaranty and reduced fees through this fiscal year. These funds ran out this week and we are working with Congress to secure additional funding for an extension through September. Since Monday, there are about 250 loans totaling more than $90 million in our queue awaiting this possibility.



The third problem is that many small businesses need bigger SBA loans, including franchisees, manufacturers, exporters, and others. By increasing our top loans from $2 million to $5 million, we can help them create jobs quickly.

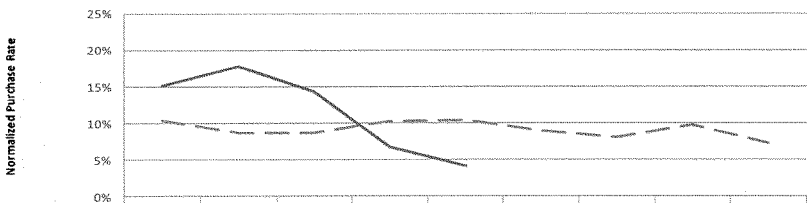
Percentage of SBA Loans Over $1.5 Million
(FY 2005 - FY 2009)

7(a) Program **504 Program**



The fourth problem is that small businesses can't find access to working capital. Many small firms are seeing an uptick in sales and need to make hires or restock shelves quickly. By temporarily raising SBA Express loans from $350,000 to $1 million, we can help them regain traction and growth.

Comparison of SBA Express and Overall 7(a) Loan Program



	Amount =< $25K	$25K < Amount =< $50K	$50K < Amount =< $100K	$100K < Amount =< $150K	$150K < Amount =< $350K	$350K < Amount =< $500K	$500K < Amount =< $1M	$1M < Amount =< $1.5M	$1.5M < Amount =< $2M
Regular 7a	10.4%	8.7%	8.7%	10.3%	10.4%	9.0%	8.1%	9.8%	7.2%
SBA Express	15.1%	17.7%	14.3%	6.7%	4.2%				

The fifth problem is commercial real estate mortgages are set to mature in the next few years for many owner-occupied small businesses. It's important that we prevent creditworthy firms from facing unnecessary foreclosure and lost jobs. That's why the President proposed temporarily opening up SBA's 504 program for refinancing. This will allow small businesses that are current on existing debt to lock-in stable, long-term financing in the face of declining real estate values, while freeing up banks to make even more small business loans.

We know that a critical part of our job at SBA is to facilitate the connections from entrepreneurs and small business owners to private lenders – we call this approach Direct Access. We need to make sure that creditworthy small businesses can find their way to banks that are lending. For example, we are working to get all of you the names and contact information for SBA lenders in your areas – and to make this information more readily available to your constituents online, in our offices, and through our resource partners.

And when an entrepreneur or small business owner is not creditworthy, we are committed to providing free counseling services through our extensive network of volunteer and affiliated counselors. Each year, they help thousands of small business owners refine their business plans and strategies not only to become more creditworthy, but also to be more successful and create more jobs in the long run.

Again, our principles are these: build on what works, maximize limited taxpayer dollars, and make targeted changes as quickly as possible. We know that problems in the credit market still exist, but we are confident that – with this plan, and hard work and outreach from our SBA infrastructure and throughout the Administration – we can fill those gaps and meet the needs of small businesses.

I look forward to your comments and questions about the Jobs Plan and SBA's efforts to help ensure that small businesses can continue to lead America to full economic recovery.

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Testimony of

CATHLEEN H. NASH

On Behalf of the

CONSUMER BANKERS ASSOCIATION

Before the

Committee on Financial Services

And the

Committee on Small Business

United States House of Representatives

February 26, 2010

TESTIMONY OF CATHLEEN H. NASH
PRESIDENT & CEO, CITIZENS REPUBLIC BANKCORP
ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION
BEFORE THE COMMITTEE ON FINANCIAL SERVICES
AND THE COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

"CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS"

Good afternoon Chairman Frank, Chairwoman Velázquez, ranking member Bachus, ranking member Graves and members of the Committees, my name is Cathy Nash and I am the President and CEO of Citizens Republic Bancorp (a $12 billion bank headquartered in Michigan and serving the upper Midwest). I am also a member of the Board of Directors of the Consumer Bankers Association (CBA). For more than 90 years, CBA has been the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in all areas of consumer financial services, including small business lending. CBA members include most of the nation's regional and super community banks, as well as the largest bank holding companies that collectively hold two-thirds of the industry's total assets.

February 26, 2010

I am pleased to have this opportunity to appear before you today to discuss the issues surrounding small business and commercial real estate lending. As we seek to continue to move our economy, indeed our country, back on the path of stability and prudent growth, it is important to seek input and engage in vigorous debate with those most able to influence that path.

In my positions with Citizens Republic and CBA, I see that the challenges we face in serving our clients, protecting our depositors and navigating through the current economic climate have been magnified. As a bank we ask, how much capital is enough? Some would now say, in the view of the crisis we experienced, that a bank can never have too much capital. With an uncertain view of the near future, regulators must focus on protecting the bank's depositors. The best way to do that is require banks to hold more capital. However, every dollar of capital a bank carries to cover a potential bad loan is a dollar that cannot be lent to a business owner. It is a dollar that cannot help a community recover and grow by adding jobs.

It is exactly the holding of more capital that adds to the cycle's length and severity. By holding capital and therefore making fewer loans, or actively shrinking the bank's balance sheet to preserve even more capital,

businesses cannot grow and hire because their capital access has been restricted.

As banks have navigated through this cycle, it is clear that some of the practices of the last decade must be curtailed and this impacts those businesses seeking to borrow today. In the past, banks competed vigorously for new loan clients. While most banks had strong credit criteria and policies, too often those were overridden to "win" a deal. In today's environment, we have not loosened nor tightened our standards. We are holding every loan opportunity up against those policies. This may feel to a borrower as if the bank is getting more restrictive when, in fact, we are following long-established policies.

In our markets, we saw some banks close credit lines via letters that clients brought into our branches. We have seen competitors exit industry segments and geographies. For business clients, we look at each borrower discretely. Based on their plans and forecasts, we have tried to size our lines of credit based on their business need. For example, a long standing client with a $2 million line of credit that has never been drawn down causes the bank to hold capital against that line, although never used. So we might work

with that client to reduce the line to better match their business needs and forecasts. To some clients, this may feel like a significant reduction. Our goal continues to be to ensure we meet our clients' needs and manage our capital requirements.

Commercial real estate lending is driven by lower occupancy and/or lower rents paid by tenants or on the building side, slower sales that result in lower prices. These factors in turn drive the appraisal of the properties and our ability to lend to the level that we originally thought we could. For example: we have a client who wants to build an office building -- a $10 million project. Presales did not come through and those that did were at lower rent rates. Our client believes the market will "come back" but is unwilling to put in additional money to maintain the loan-to-value that we look for per our credit policy.

Recent changes and proposals have been made that should have a positive impact. Last fall, the FFIEC's policy statement on Commercial Real Estate Loan workouts was issued. I do not believe this was issued with the intention to increase commercial real estate lending, but rather to provide guidance on how to manage those commercial real estate clients you have that

are faced with devalued property. Simply put, we don't have to move a project that has cash flow into non-performing simply because the appraisal of the property is lower. We were encouraged to complete the analysis of our portfolio by our regulators. As to whether the regulators supervision has been consistent – we are just entering our loan review exam with our regulators, so that remains to be seen.

Finally, the president's recent proposal and HR 3854, with proposed changes to SBA loans, are also positive steps. Providing revolving working capital – this primary use of SBA express loans is more critical today than ever – by increasing the limit to $1 million on those loans, allows us to work with an even greater pool of borrowers to properly position them to successfully navigate the next few years in this cycle.

The president's second proposal, to allow for refinancing of owner occupied commercial real estate loans under the SBA 504 program, is also a very positive move. Today, those loans cannot be used to refinance maturing debt. This change opens the door for borrowers to access long term fixed rates (20 year fixed for 40% of the loan need), something very important in an uncertain time and a view of rates eventually rising.

Without going into a review of each HR 3854's provisions, generally the increase in 7(a) loans from $2 to $3 million is good, but could have a much greater impact, since it is allowable for debt refinance, if it was expanded to $5 million. The 90% guarantee on the 7(a) loans as well as simplifying the process will get more banks participating in the program, so that is also a positive.

The ARC Loan program is well intended but may not be enough to get bankers to use it, as it essentially asks the bank to certify that the borrower is in financial hardship and at the same time certify that the borrower will be able to pay the debt back to qualify for the loan.

In your invitation, you asked how banks can, as a practical matter, best fulfill their fundamental role as intermediaries in the credit markets consistent with prudent lending standards and strong capital requirements in a period of extreme financial and economic stress. That is indeed the key question. Good borrowers, who have the willingness and capacity to repay, will always find a loan. Those borrowers with weaker financials will find it more difficult to meet the credit requirements of their bank. The fundamentals of capacity and willingness to repay must be established once again as a hallmark of

lending activity. This will happen, one borrower at a time, by bankers who know and understand them. We thank you for continuing to look for ways to improve small business and commercial real estate lending. The CBA is committed to working with the members of both committees to achieve this goal.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

Condition of Small Business and Commercial Real Estate Lending In Local Markets

Submitted to the

COMMITTEE ON SMALL BUSINESS

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Sally Robertson
President & CEO
Business Finance Group, Inc.
Fairfax, VA.

February 26, 2010

The National Association of Development Companies (NADCO) is pleased to testify before the House of Representatives Committee on Small Business and Committee on Financial Services about the condition of commercial real estate lending and the related need to improve access to capital by small businesses.

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 250 affiliate members, who provided more than 95% of all SBA 504 financing to small businesses during 2009, 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 to provide community and economic development through the delivery of the SBA 504 loan program and other economic development programs and services customized to the needs of their respective communities.

NADCO would like to thank Chairman Barney Frank, Ranking Member Spencer Bachus, Chairperson Nydia Velazquez, Ranking Member Sam Graves, and the two Committees, for continued support of small business and small business lending in America, and for your focus on the critical need for access to capital in order to restore growth to our economy. We would like to especially thank Chairperson Velazquez for her leadership in gaining passage in the House of H. R. 3854, the Small Business Financing and Investment Act of 2009, late last year. This bill contains many program enhancements our industry has long advocated, and we have urged the Senate to carefully consider passage of many of these program changes.

NADCO's member CDCs work closely with SBA and our lending partners (generally banks and federal credit unions) to deliver what is certainly the largest and most successful federal economic development finance program in history (since 1986, over two million jobs have been created via the authorization of $50 billion in 504 loans that leveraged over $90 billion in private investment).

How the Small Business Commercial Real Estate Sector is Different

Commercial real estate financing is different from residential financing in several key ways. First, commercial real estate financing for small business is part of a much larger market of overall commercial real estate, which includes investor-owned hotels, office buildings and even multi unit residential properties. For small businesses that own their own properties, these commercial properties are the "homes for their businesses", so the fate of the financing on these properties has serious ramifications, not only on the businesses that own them, but also on the lenders that loan on them, and on the employees whose jobs are provided by these companies.

Second, unlike SBA loans, conventional loans to small businesses for commercial real estate, are structured very differently from residential financing. While the typical residential home loan is a 30 year loan, these loans typically have long amortizations, but drastically shorter due dates—essentially balloon note financing. Whether fixed or variable rate, these loans are generally written with 5, 7 or 10 year terms, at which time a balloon payment comes due. The historic assumption is that at loan maturity, a lender will renew or re-write the loan for another 5 or 10

years. However, this will not be the case for many small businesses seeking to renew their conventional commercial real estate loans over the next several years.

What the Experts Say

Experts have been raising significant concern about the condition of the commercial real estate market in this country for over a year now.

► In April of 2009 Deutsche Bank issued a study titled "The Potential Refinancing Crisis in Commercial Real Estate". In this report Deutsche Bank identified that over the next 4 years, there would be approximately $1.2 Trillion of commercial real estate financing coming due from commercial mortgage backed securities ("CMBS"), insurance companies and banks. They point out that many of these loans, whether performing on payments or not, may not be renewed. The report indicates that..."To date, most market participants have dismissed the seriousness of the future refinance issue claiming that lenders will simply extend maturities for loans that fail to qualify. Such an approach might prove fruitful where non-qualifying loans were a small portion of the total. However, our analysis suggests that the percentage (of non-qualifying) loans is likely to be 60 to 70% or more [of those loans coming up for renewal]."

► In October of 2009 at the request of our industry, Credit Suisse conducted a study titled "What About Small Loans?" In order to estimate the effect of the crisis predicted by the Deutsche Bank study on small business commercial real estate loans, the Credit Suisse study looked at commercial loans made prior to 2008 using commercial mortgage backed securities or "CMBS". Their analysis concludes that "...Almost 10,000 CMBS loans will mature prior to 2014." This study did not include the number of or amount of other conventional commercial real estate loans to small businesses that would be added to that total.

► Also in October of 2009, Mark Zandi, Chief Economist at Moody's Economy.com testified before the Joint Economic Committee on the state of the economy, one aspect of which he referred to as the "commercial real estate bust". In his testimony on this issue he indicated that..."More disconcerting is that even commercial property owners with substantial equity, solid tenants and positive cash flow are unable to refinance mortgages as they come due....Unfortunately, the CMBS market remains closed and traditional portfolio lenders such as banks, insurance companies and pension funds are not offering to refinance..."

The Effects of the Economy on Small Business Real Estate Lending:

504 financing traditionally provides long term fixed rate financing to companies that are established and ready to implement a program of substantial growth. A CDC's 504 loan clients are those small firms that are successfully growing their companies, expanding their businesses, locations and plants, and hiring new workers. These firms have historically created an average of one new job for every $65,000 in 504 loan amount (historical job creation average exceeds this requirement).

Although a record number of 504 borrowers have been adversely affected by the recession, it is not 504 or SBA borrowers that are at risk from losing their performing loans because of a

balloon payment or a commercial property valuation. The companies that will be most effected by this commercial real estate financing crisis are those with conventional loans—loans with balloon payments coming due over the next several years. In addition to the challenges summarized above, these companies, and as a result their lenders are faced with a "perfect storm" which includes the following.

For business financing in general a combination of the recession (resulting in lower sales) and the credit crisis (resulting in a near-collapse of credit availability) have severely restricted access to capital for small businesses for all types of uses, including commercial real estate. The downturn in sales and business revenues has resulted in declining net income and weaker financial statements making it harder for companies in every business sector to qualify for the financing they need.

The credit crisis and what is deemed by regulators to be a significant concentration of commercial real estate lending has forced banks to focus on rebuilding of their capital, rather than lending it out. This is particularly true for small and regional community banks that tend to traditionally hold a larger share of commercial real estate on their books compared to large money center banks. Additionally the credit crisis has effectively destroyed the secondary market for conventional bank loans. This is a market that many large and virtually all community banks have relied on for decades for a source of funds and liquidity through sales of their loans.

As a reaction to the above, it is no surprise that lenders of all types have become far more cautious in granting loans to static, or even shrinking, small businesses. Historically it is a natural response to an economic downturn for lenders to become more conservative. However in this combination of a severe recession and major capital markets crisis, CDCs are experiencing banks of all types tightening their credit boxes to unprecedented levels.

Solutions for Providing More Small Business Loans:

To get America out of this recession, we must help small business stabilize and then get small businesses growing again and creating new jobs. It is well recognized that it is small business that is the perennial job creating segment of our business infrastructure. Yet, the focus of so many federal stimulus efforts has been on large businesses that often create few, if any, new jobs for our economy. This approach is not optimal policy and leaves America's most dynamic sector, small business, out in the cold.

The "grease" that gets the small business jobs engine going is capital: both short term and long term funding to pay for business plant and store expansions and for inventory, raw materials, and labor costs. Without funding, businesses cannot grow. With funding, businesses can finance their growth and hire new workers. The fact that the unemployment and under-employment rates are so high is an indicator that many small businesses are not yet growing again.

SBA has existing loan guarantee programs that meet the needs of small business with both short and long term capital. The 504 program provides long term funds to businesses to finance fixed assets by accessing the low cost funds provided by investors through the public markets. This program is delivered by a low cost industry of non-profit Certified Development Companies,

which has historically delivered billions in long term capital to thousands of growing small businesses each year.

Today, that CDC industry is providing loans to businesses in every state, but due to lack of demand during this very severe recession, the industry is working at less than its capacity. In both the Senate and the House, bills have been introduced that would enable our CDC industry to provide capital to more small businesses and to meet their long term financing needs.

Reach Out to More Small Businesses With New Capital:

Congress and the Obama administration have worked hard to put more fixed asset and working capital funding 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.

We also recognize the House Small Business Committee for passing H. R. 3854, an SBA programs reauthorization bill with numerous beneficial program changes. Foremost among these changes is the proposal to increase the maximum 504 loan size from $1.5 million to $3 million, and the limit for critical public policy loans would increase from $2.0 million to $4.0 million.

However, as the Deutsche Bank and Credit Suisse studies show, the on-going financial crisis has increased the demands for capital beyond the House-passed new 504 program loan limits. As President Obama has advocated, and many banking and industry groups have endorsed, we now support the urgent need to provide even greater levels of capital access to healthy, growing small businesses. As stated in H. R. 4302, we urge support for a total credit limit to a single borrower of $5 million for regular 504 projects and public policy projects, and $5.5 million for small manufacturers and energy-efficient projects.

While such limits would not often be used for a single 504 project, they would be most applicable to the provision of added capital to those successful small businesses that are already "maxed out" on their 504/ 7(a) eligibility at the current loan levels. History demonstrates that successful small businesses that can expand further are those that will create the most new jobs in new locations, while minimizing risk of default and potential losses for the 504 program.

Refinance Conventional Maturing & High Cost Debt:

Our industry strongly recommends that the Committees support the H. R. 4302 proposals to assist small businesses by including a temporary expansion of refinancing provisions. There are three distinct needs for this program enhancement:

1. Maturing debt: Studies have shown that substantial small business real estate debt now held by commercial banks, or in the public markets through CMBS pools, will mature in the next several years. With pressure from regulators, and deteriorating loan portfolios, many banks have either tightened their credit standards, or completely withdrawn from small business financing. Small businesses, especially those in rural areas, may have no

sources of funding to roll over their loans for their business real estate, which can lead to lender foreclosures. This occurs for even good firms that can pay their debt costs, but just cannot locate sources of funds.

2. High cost debt: Many small businesses have owned their real estate for years. These loans were done when rates were very high, compared to the record low interest rates available today. These firms need to conserve cash for working capital and job creation, rather than paying high debt costs. By enabling access to today's lower interest rates, debt costs can be decreased and firms can use the savings to pay salaries, expand inventory, and hire more workers, rather than pay interest costs.

3. Access locked up real estate equity: In spite of the decline in real estate values, many small firms still have significant equity in their business real estate. They simply have no way to access it if they cannot refinance their existing mortgage debt. Enabling these companies to both refinance their real estate while providing them with more operating cash is a double win for these companies and our economy and will enable them to re-invest it in their business operations, expand, and increase job creation and retention for their communities.

We believe that through the benefits offered by H. R. 4302, SBA, the banking industry, and our own industry can work together to craft means to assist in these situations and provide fresh capital to these small businesses, while retaining sufficient real estate collateral to protect both the banks and the taxpayer. We urge Congress to pass legislation to make regulations more flexible, especially during this recession in which businesses are collapsing due to lack of working capital, even as they sit on substantial real estate equity that they cannot access due to a crisis in the nation's capital markets.

We also believe that the downside of not taking this action is too great. The Congressional Oversight Panel in their February report, Commercial Real Estate Losses and the Risk to Financial Stability, "...expresses concern that a wave of commercial real estate loan losses over the next four years could jeopardize the stability of many banks, particularly community banks." And that "...a significant wave of commercial mortgage defaults would trigger economic damage that could touch the lives of nearly every American. Because community banks play a critical role in financing the small businesses that could help the American economy create new jobs, their widespread failure could disrupt local communities, undermine the recovery and extend the already painful recession."

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 this deep 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 many small businesses are beginning to experience an economic turnaround. We can see it in the calls that CDCs are getting about 504. Our "pipeline" of loan projects is coming back. Certainly the stimulus enacted by this Congress is working, beginning a slow but steady upturn of the American business cycle and the economy is beginning to move forward.

The proposed program changes we have discussed will dramatically improve 504 as a more flexible and effective 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 rapid implementation by SBA, 504 will be the right program at just the critical time for small businesses. We ask Congress to pass H. R. 4302 to provide immediate access to capital for small businesses, and work with the Senate to finalize a comprehensive small business bill to help restore the American dream of having a job and establishing and owning your own business.

Thank you for your support of this legislation, and of small businesses across America.

Testimony of the

Motor & Equipment Manufacturers Association

Before the

U.S. House of Representatives

Committee on Financial Services
and
Committee on Small Business

"Condition of Small Business and Commercial Real Estate Lending in Local Markets"

26 February 2010

The Motor & Equipment Manufacturers Association (MEMA) represents nearly 700 companies that manufacture motor vehicle parts for use in the light vehicle and heavy-duty original equipment and aftermarket industries. MEMA represents its members through three affiliate associations: Automotive Aftermarket Suppliers Association (AASA), Heavy Duty Manufacturers Association (HDMA), and Original Equipment Suppliers Association (OESA).

Motor vehicle parts suppliers are the nation's largest manufacturing sector, directly employing over 685,000 U.S. workers and contributing to over 3.2 million jobs across the country. Every supplier job creates another 4.8 jobs in local and state economies. Automotive suppliers are the largest manufacturing employer in eight states: Indiana; Kentucky; Michigan; Missouri; Ohio; Oklahoma; South Carolina; and, Tennessee. Furthermore, suppliers are responsible for two-thirds of the value of today's vehicles, nearly 30 percent of the total $16.6 billion automotive research and development investment, and are providing much of the intellectual capital required for the design, testing, and engineering of new parts and systems.

Over the past year, significant and unprecedented government and industry actions have prevented a collapse of the automotive industry, the largest manufacturing sector in the United States. But without specific attention to the future of the supply base, we will lose important manufacturing jobs and capabilities. Over the past three years, MEMA estimates that the country has lost over 100,000 supplier jobs; while the Bureau of Labor Statistics estimates that automotive suppliers alone will lose an additional 100,000 jobs over the next decade. Forecasters generally estimate that 2010 North American vehicle production will increase by at least two million units or 25 percent (about 10.5 to 11 million units), but a recovery will not be sustainable without a stable supply base. The future expansion, employment, economic contributions and structural viability of the supply base are dependent on continued access to credit. Only through continued coordinated action by the motor vehicle industry, the financial community, and the government will the industry be able to ramp-up and retooling costs be minimized.

Access to credit continues to be a pervasive issue for parts manufacturers – particularly small suppliers. Even with the improving economy and, specifically, vehicle production schedules, 25 percent of OESA members report that bank lending terms have actually tightened over the

past three months. (See Attachment 1). Without an increase in lending activity, the fragile economic recovery is at risk, along with employment growth.

Despite the recent Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices that showed a decrease in demand for small business loans, a pilot loan enhancement program in Michigan clearly shows there is pent up demand for borrowing by automotive suppliers and general manufacturers that is being underserved by commercial banks. The fact is, for months, automotive suppliers in great need for capital have not been served by traditional lenders. Eventually, these borrowers give up on commercial banks, causing a perceived slack in demand. However, the need has not gone away. Suppliers are forced to turn to alternative private equity or other financial sources that may come with undesirable terms or management control provisions.

There remain three fundamental sources of systemic risk in the automotive industry: production volumes, asset valuations and supply base consolidation. The State of Michigan has a program that addresses these three critical impediments for the suppliers and the bankers:

- ***Cash Flow*** – Even though production will increase in 2010, production will remain at least 500,000 to 1 million units below 2004-2005 levels for the next five years. These volume levels will constrain revenues and cash flow. This public/private program addresses these shortfalls by purchasing a portion of a commercial credit facility and offering preferred terms for up to 36 months to borrowers.
- ***Collateral Value*** – While auto physical asset valuations and real estate prices have recovered slightly from the first half of 2009, valuations remain too low to support automotive asset backed lending. This issue is addressed by supplementing the collateral value on loan requests and depositing cash pledged to the bank.
- ***Transitional Risk*** – Consolidation of the supply base continues and often a decision criteria to de-source a supplier is not known by an individual bank. By creating a mezzanine (bank of banks) model, the risk of a supplier being consolidated out of business can be spread among several lenders and offer both debt and equity investment opportunities.

Michigan started its program in June of 2009 and was flooded with applications. The first program appropriation ($12 million) was fully committed within the first five months and was

oversubscribed by nearly 300 percent. A second round began in January 2010 and it too became inundated with applications. The program has been successful in generating new loans by improving the health of the borrower from an underwriting perspective. In order to induce new loans in this environment, even healthy banks have to get comfortable with the borrower's cash flow and collateral coverage – the two biggest obstacles to loan approval today. The Michigan program is extremely effective in improving this calculus.

The Manufacturing Modernization and Diversification Act, H.R. 4629, creates a Michigan-type program on a national scale. We appreciate the Chairman's support and co-sponsorship of H.R. 4629 and we would like to thank Representatives Peters, Kanjorski and Dennis Moore for co-sponsoring the legislation. Slight changes may be necessary to make this legislation work for motor vehicle suppliers, but the goals and intents of the bill are important. In addition, MEMA supports the Administration's efforts to unlock credit for small businesses and to improve the effectiveness of the Small Business Administration.

The Administration's Small Business Lending Fund proposal is a good first step to opening up credit for small manufacturers. MEMA supports the efforts led by Representatives Peters, Levin and Dingell to combine these two legislative proposals and urges Congress to pass both pieces of legislation quickly.

Additionally, MEMA supports other efforts of Congress and the Administration. MEMA believes that the proposed increase in 7(a) loan limits, which is called for by S. 1817, will be particularly useful. We greatly appreciate the leadership of Congressman Peters in the passage of H.R. 3246, the Advanced Vehicle Technology Act, which was supported by many members of the Committees here today when it passed the House with bipartisan support. Finally, we support S. 1617 and H.R. 3083, the IMPACT Act, co-sponsored by Congresswoman Kilroy. These bills will provide greater access to near- and long-term funding for the supply base.

The Current Situation

Throughout 2009, MEMA, OESA, and other industry analysts warned about an impending implosion of the supply base. The risk was real. Because of this, the industry, the government,

and the financial communities all contributed to prevent this implosion. The following events were critical in preventing such an implosion:

- The U.S. Government provided debtor-in-position (DIP) funding for GM and Chrysler bankruptcies preventing these companies from liquidating;
- The U.S. Treasury Auto Supplier Support Program assisted several hundred suppliers;
- Virtually all GM and Chrysler production suppliers were granted essential supplier status in bankruptcy and were paid 100 percent of their cure amounts;
- GM paid its June 2 payables on May 28, supporting the cash flow of many suppliers;
- Industry production volume ramp-up was delayed until the Car Allowance Rebate System ("Cash for Clunkers") took effect in July and August; and,
- Major suppliers filing for Chapter 11 obtained DIP financing from traditional and non-traditional sources preventing liquidation of major component suppliers.

Even with these noteworthy actions, over 50 U.S. suppliers filed for bankruptcy in 2009 and up to 200 suppliers may have liquidated (see Attachment 2). Significantly more bankruptcies did not occur because:

- Many suppliers liquidated without filing for bankruptcy protection;
- OEMs announced plans to source only 50 to 75 percent of their current supply base on future programs, yet these shifts have not fully occurred; and,
- Many other companies are undergoing out-of-court restructurings with drastic cost-cutting measures.

To survive through this period, suppliers have dramatically reduced their cost structures. Surveys of our member companies indicate that over the course of 2009 suppliers reduced their estimated North American production break-even point (the level of industry production where profitability begins) by 1 million units or almost 10 percent. Such dramatic reductions in a short time period are significant. In fact, a recent Towers Watson survey shows that automotive suppliers took significantly more radical actions to control human resource costs than the broader, national industries. A few of the Tower Watson findings include:

- **Salary Reductions** – 71 percent of OESA member companies implemented versus 16 percent of the national sample;

- **Increased Health Care Premiums** – 43 percent of OESA member companies implemented versus 25 percent of the national sample;
- **Reduced employer 401(k) match** – 57 percent of OESA member companies implemented versus 22 percent of the national sample;
- **Mandatory Shutdowns** – 69 percent of OESA member companies implemented versus 18 percent of the national sample; and
- **Reduced Workweek** – 74 percent of OESA member companies implemented versus 19 percent of the national sample

This means that even with a modest increase in production, suppliers, on average, should be above their breakeven point in 2010. However, currently there is significant pressure on the entire system to access adequate working capital as production levels increase. There is no existing excess cash or inventories in the companies and the supplier industry must look to financial institutions to provide this capital.

Overall, lending continues to be constrained because, in part, there is significant industry risk from on-going supplier rationalization actions, volatile production schedules and historically low collateral asset valuation levels. All analysts expect an increase in light vehicle production in 2010 and there must be increased access to capital through the entire supply chain – from the largest Tier 1 supplier to the smallest family-owned firm – in order to:

- Rehire workers and purchase raw materials for production increases;
- Retool for new programs; and,
- Restructure internal operations and consolidate external capacities.

On a case-by-case basis, the lending situation is improving. Still, the pace at which lending is improving may not be fast enough to support the industry. As one OESA member stated, "I pay my employees weekly, my leases every four weeks, my vendors every six weeks, and my customers pay me every eight weeks." Access to capital is the cushion that keeps our supply base liquid.

Longer-term capital needs for restructuring, for new model launches, and for technology development projects is of particular concern. It is very typical for a $100 million supplier to have $5 to $10 million in customer tooling costs on their own balance sheet. There should be

exploration of a national industrial bank to provide stable manufacturing funding in the future for tremendous re-tooling needs of the suppliers as well as all manufacturers.

While there has not been a widespread failure of the system as suppliers have restructured or liquidated, issues regarding access to capital are showing up and an inordinate amount of attention is required to keep the supply base running. These are just a few examples from our membership:

- A minority-owned supplier, which just was announced as an addition to an OEM joint research development program, can only obtain a one-year line of credit;
- A supplier looking for tooling capital for a strong performing OEM was turned down by traditional lenders and nearly 100 alternative sources of funds;
- A number of purchasing executives remain worried about smaller manufacturers in their supply base as banks are considering eliminating available credit;
- A smaller metal fabricating business could not get a loan to purchase equipment for a new line to deepen his capital base and keep his Midwest workforce competitive; and,
- A small metal fabricator could not raise additional capital to invest in his Michigan operations and lost the business to Mexico.

These are not examples of supplier capacity in need of rationalization. These are examples of suppliers that are looking to invest in the U.S., to compete against global competition, and to support a profitable, productive domestic auto industry.

Given that the parts supplier sector is operating just above 50 percent capacity utilization, we believe that there will be a continued stream of bankruptcies and closures through 2010. MEMA expects ongoing closures as the industry continues to operate at low – albeit increasing – production volumes. Although much of this is to be expected in an industry in transition, adequate capital is necessary to consolidate the industry in a rational, effective manner. A majority of OESA members surveyed in January of this year did not report confidence that sufficient credit existed for merger and acquisition opportunities. Production disruptions and failure of companies with critical capabilities may ensue and the restructuring of the supplier industry will cause needless job losses and economic upheaval in communities already hard hit.

Focus on Smaller Suppliers

Given the industry's significant capital requirements and the general mismatch of funding, a steady access to lines of credit and asset-backed loans is essential for the survival of the supply base. For example, many small suppliers invest $2 to $4 million for the design, engineering and tooling for a component on a new vehicle program. However, typically suppliers receive payment for this investment after the launch of production through the piece price of the component. The supplier might not begin receiving any cash flow on their investment for 12 to 24 months and will not completely be reimbursed until the product ends production in another 36 to 60 months. Again, these needs may be served through a national industrial bank arrangement that could blend private and public sources of capital to effectively address the needs of this capital intensive industry and its inherent risk profile.

Most analysts project that Tier 2 and 3 suppliers will require additional assistance with capital in 2010. A January survey of OESA members indicates that 9 percent of companies with revenue under $150 million (compared to 5 percent of all respondents) anticipate being out of compliance with commercial loan covenants during the first six months of 2010. Although Tier 1 suppliers and some vehicle manufacturers may continue to support working capital needs of suppliers in their supply base, this is hardly a long term solution. This practice continues to weaken an industry that is already under considerable stress.

Fitch Rating has forecasted a modest recovery for the U.S. automotive supplier industry in 2010 based primarily on higher projected light vehicle production. However, Fitch goes on to report:

> *" ... Another credit concern for the suppliers is focused on working capital requirements. With vehicle production expected to rise, suppliers will need liquidity to fund working capital needs. Most suppliers should have ample liquidity but some Tier 2 and Tier 3 suppliers may continue to face liquidity challenges for greater working capital.*

Without a healthy parts manufacturing industry, the United States will lose a significant portion of this country's manufacturing innovation and employment base. The financial health of families and communities nationwide and the promise of a domestic 21st century motor vehicle industry depend on a strong supplier sector. MEMA strongly believes a program

specifically aimed at the capital needs of small manufacturers must be the first step taken to address these challenges.

Conclusion

Manufacturing is essential to this nation's economy. The jobs and technology in the manufacturing sector provides for stable communities throughout this country. At this juncture, parts manufacturers need the support of our financial system to sustain a viable future. This support will require Congressional action.

MEMA understands and supports the need to consolidate the industry. However, we believe that without sufficient capital to provide a stable environment in which to restructure, the industry and its employees will witness unnecessary disruptions. Without assistance, this country will needlessly lose manufacturing capacity, technology development, and jobs. In addition to the legislation currently before Congress, MEMA would urge this Committee to consider the formation of an industrial bank to provide for stable manufacturing funding in the future.

In conclusion, parts manufacturers remain in a period of significant industry-wide transformation. Smaller firms at the foundation of the supply chain pyramid are continuing to have difficulty accessing capital. Given the supply base's significance to the economy and innovation, it is imperative that the government, the industry, and financial communities work together to provide access to credit at reasonable terms. In parallel, given the number of technology options the industry needs to develop and commercialize, all parties must work together to clarify these technology paths and reduce the investment risk for the development and manufacture of these advanced technologies so as to encourage capital back into the industry.

# # #

Attachment 1

OESA
Automotive Supplier Barometer

January 2010

OESA
1301 W. Long Lake Road, Suite 225
Troy, MI 48098
248-952-6401
www.oesa.org

Attachment 1

January 2010 OESA Supplier Barometer Summary

- Coming in at 73.1, the OESA Supplier Sentiment Index remained solidly optimistic about the next 12 months. While it was expected that the index would slip back as respondents changed their views from becoming more optimistic in the November survey to "no change" in the current survey, 75 percent of the respondents noted they were "somewhat more" optimistic than they were two months ago.
- Respondent quotes show optimism being driven in three specific areas:
  - **Automotive revenue growth**: "There has been a marked increase in demand for current products and we have seen positive new business wins during the period."
  - **Diverse market revenue growth**: "We landed non-automotive and automotive work that will make 2010 positive regardless of car build levels."
  - **Competitive cost structures**: "We have dramatically lowered our breakeven point and expect the next 12 months to continue above this level."
- The financial health of the suppliers appear to have stabilized – at least in the short term. Only 10 percent of the respondent report that they are in violation of their loan covenants. This was as high as 25 to 30 percent in the 2nd quarter 2009. However, the crisis is not behind the industry as 5 percent of the respondents who are not in violation report that they may be in violation in 2010.
- The cost and availability of credit remains an industry concern. While the majority of respondents state their banking terms have remained unchanged over the past three months, over 20 percent of the respondents note tightening terms in their maximum size of credit lines, the cost of credit lines, commercial loan interest rates and commercial loan collaterization requirements

Attachment 1

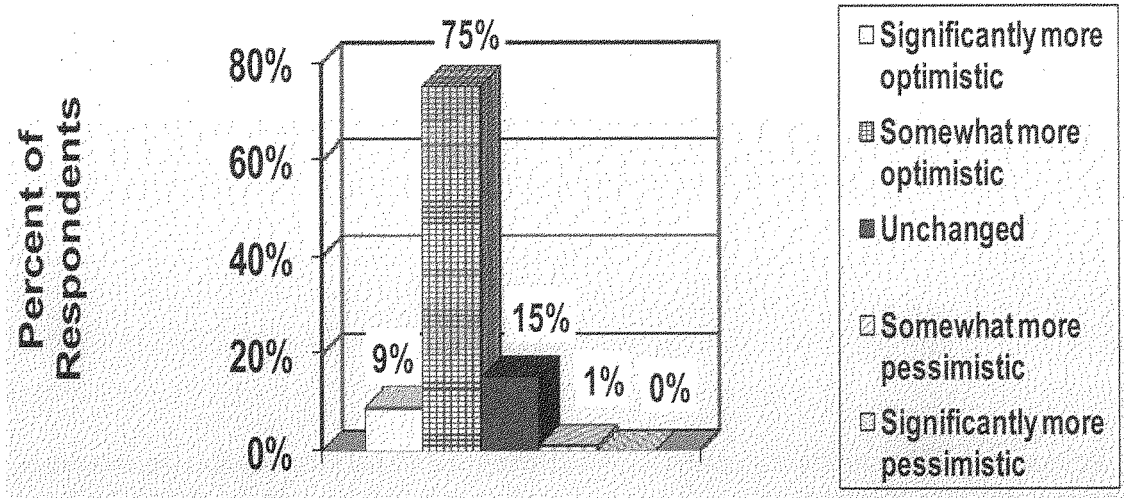
January 2010 OESA Supplier Barometer Summary (continued)

- Overall, the sample is confident they will have access to capital required for inventory financing, plant and equipment investment and other working capital needs. The greatest concern is adequate capital for merger and acquisition transactions.
- The Barometer probed issues suppliers expect to encounter as industry volumes return over the first quarter 2010. The most significant issues include:
  - Production overtime premiums (76 percent of respondents)
  - Outbound/inbound premium freight (51 and 62 percent of respondents, respectively)
  - Raw material shortages (56 percent of respondents)
  - Finished component shortages (40 percent of respondents)

  In addition, 40 percent of the respondents expect skilled labor shortages. Surprisingly, only 8 percent of the respondents believe liquidity issues will be a concern.
- The concept of running assembly plants around the clock on three shifts is being explored. Here, the suppliers have the greatest concerns around workforce staffing, production schedule stability, raw material availability and supply chain capabilities.
- Capacity rationalization continues to be a critical issue. Overall, for their primary product, the respondents estimate that 15 percent of capacity was rationalized in 2009. To reach full capacity in a 15 million unit production market, the respondents estimate another 18 percent needs to be taken out. As shown in questions 7a and 7b, there is a wide deviation around the "average" estimate of rationalization.
- Finally, a full 35 percent of the respondents believe they will need to change their benefit packages to reflect the health care reforms being proposed in Washington.

Attachment 1

Question 1: Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:



Responses = 133

Attachment 1

Question 1 Comments: Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

Significantly More Optimistic

- "Increased focus during 2009 has resulted in strong consideration for future business awards."
- "We have dramatically lowered our breakeven point and expect the next 12 months to continue above this level."
- "Orders are picking up about 15%."
- "We landed non-automotive and automotive work that will make 2010 positive regardless of car build levels."
- "There has been a marked increase in demand for current products and we have seen positive new business wins during the period."

Somewhat More Optimistic

- "Seeing stronger volumes through the first quarter than we anticipated!"
- "The level of automotive purchases during November and December were very positive news - providing a good book of business for us in January and February. Optimistic that levels will increase further as we move into spring and early summer."
- "Production forecasts are more stable and we have seen a gradual improvement in production volumes in Q4 2009. The forecasted volume in Q1 shows the gradual improvement continuing.

Attachment 1

Question 1 Comments (continued): Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

Somewhat More Optimistic (Continued)

- "A bit cautious, but more optimistic."
- "First quarter order book continues to hold firm."
- "First quarter releases and outlook are stronger than we expected. We hope it is sustainable."
- "JOEM releases continue to be strong while their vehicle inventories are good (<60 days)."
- "We are seeing better-than-expected strength in the North American market, and a good bounce-back in our non-automotive businesses in growth markets.
- "Stronger and more consistent vehicle production forecast is expected."
- "Releases are stable if not improving a bit."
- "Gradually improving NA production volumes are providing some lift."
- "Improved SAAR rates the past two months provide some optimism that the gradual improvement trend will hold through the 1st quarter."
- "Very concerned about reduced Detroit 3 production and lack of opportunity to substantially grow New Domestic business because of legendary and ongoing nationalistic sourcing practices."
- "1st quarter schedules are holding firm at 4th quarter 2009 levels."
- "We see an up-tick in volumes."

Attachment 1

Question 1 Comments (continued): Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

Somewhat More Optimistic (continued)

- "NA light vehicle sales have stabilized, and production forecasts have followed suit. New vehicle financing has thawed considerably following a year during which absolute inventory levels has been pulled down by about 50% and vehicle sales have been below the scrappage rate for a full year. This signals some upside in demand."
- "Volumes have improved, some production stability has returned. Still relatively low to historical levels, but small improvements can now make a significant impact."
- "It appears the market has stabilized and we are working on a number of new products that promise growth."
- "Economic indicators as well as customer releases seem to show stabilization in the market."
- "Ability to see he releases into 2010 gives us more confidence on what we had heard would be taking place in early 2010."
- "Customer requirements appear firm through Q1."
- "Orders are up for our automotive customers as well as other customers in other markets."
- "Sales orders are starting to increase."
- "Cautious optimism. I still feel the heavy truck sales will fall again."
- "Volumes are rebounding faster than forecasted."

Attachment 1

Question 1 Comments (continued): Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

Somewhat More Optimistic (continued)

- "New product which adds to vehicle content."
- "I am concerned about raw material increases. Reductions saved us in 2009."
- "Volume has stabilized, new business is getting closer to launch and new program activity remains strong."

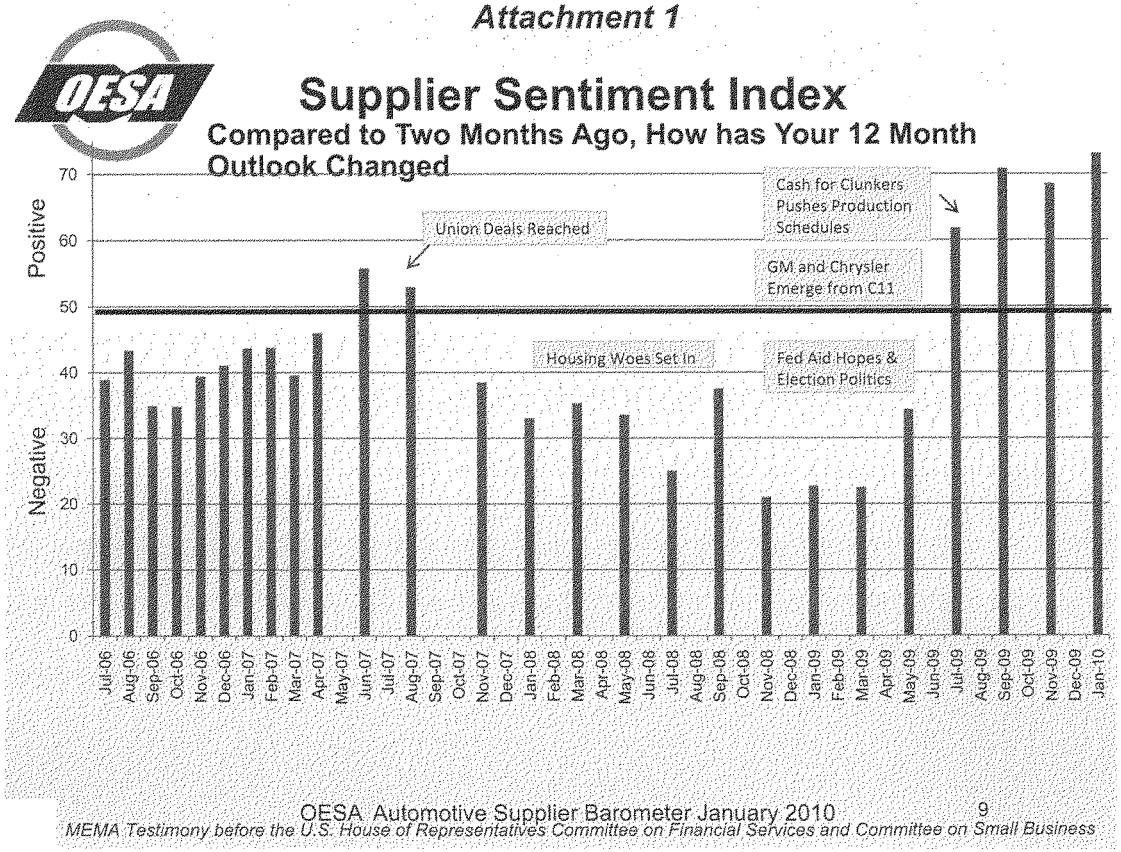
Unchanged

- "We are directly impacted by product launches and freshening. The future of new products is still very volatile regarding timing and certainty."
- "Slightly more optimistic for NA, slightly more pessimistic for Europe - on balance unchanged."

Somewhat More Pessimistic

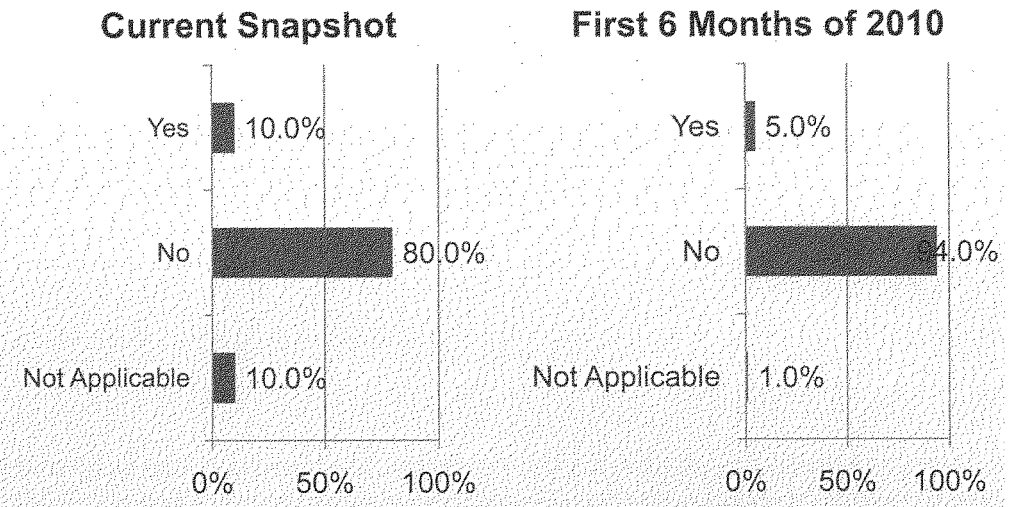
- "It appears class 8 truck orders for the new 2010 compliant engines is dismal. We will be encountering a cliff event starting late in the first quarter."

Attachment 1



Attachment 1

Question 2: Is your company currently out of compliance with its commercial loan covenants? If NO, do you anticipate your company being out of compliance in the first 6 months of 2010?



Responses = Current snapshot: 134; First 6 months of 2010: 113

Attachment 1

Question 3: Considering your lead commercial bank, over the PAST three months how have your terms of your commercial loan or credit line applications changed?

	Tightened Considerably	Tightened Somewhat	Basically Unchanged	Eased Somewhat	Eased Considerably
	1	2	3	4	5
Maximum Size of Credit Lines	5 %	16 %	72 %	4 %	3 %
Cost of Credit Line	9%	16%	71 %	3 %	2 %
Maximum Maturity of Credit Line	2 %	6 %	87 %	4 %	1 %
Maximum Size of Commercial Loan	3%	12 %	79%	5%	1 %
Commercial Loan Interest Rate	6 %	16%	75%	3 %	1 %
Commercial Loan Covenants	3 %	14%	76 %	5 %	2 %
Commercial Loan Collaterization requirements	6 %	14 %	77 %	2 %	1 %
Maximum Maturity of Commercial Loans	3 %	7 %	87 %	2 %	1 %

Responses = 115

Attachment 1

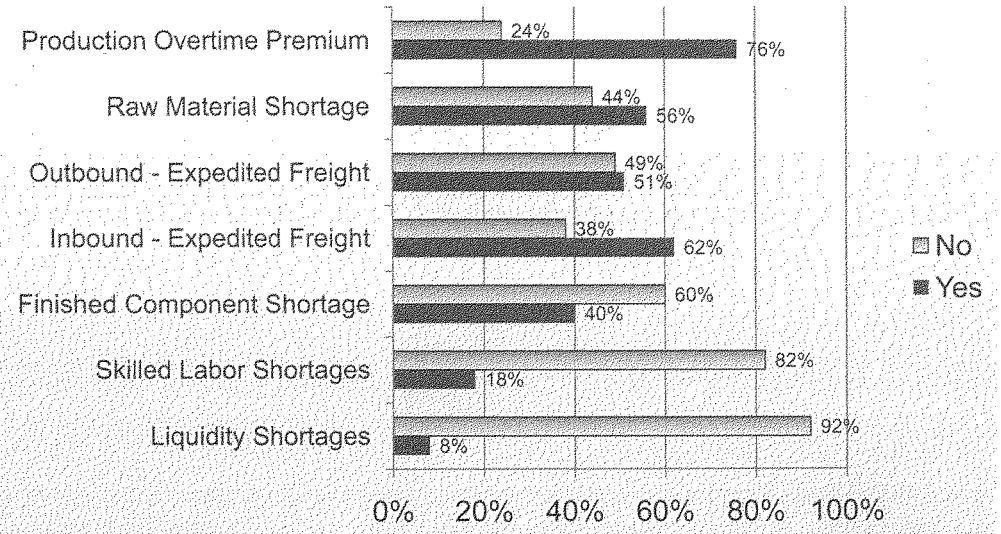
Question 4: Over the NEXT three months, do you have confidence that you will be able to access required levels of capital at appropriate costs for the following uses?

	Significantly Confident	Moderately Confident	Neither Confident or Unconfident	Moderately Unconfident	Significantly Unconfident
	1	2	3	4	5
Inventory Financing	46%	37%	15%	1%	1%
Accounts Payable Financing	44%	37%	17%	2%	0%
Plant and Equipment Investment	31%	35%	17%	15%	2%
Other Working Capital Needs	38%	33%	22%	6%	1%
Merger & Acquisition Opportunities	18%	29%	27%	19%	7%
Program Consolidation Opportunities	27%	33%	29%	9%	2%

Responses = 126

Attachment 1

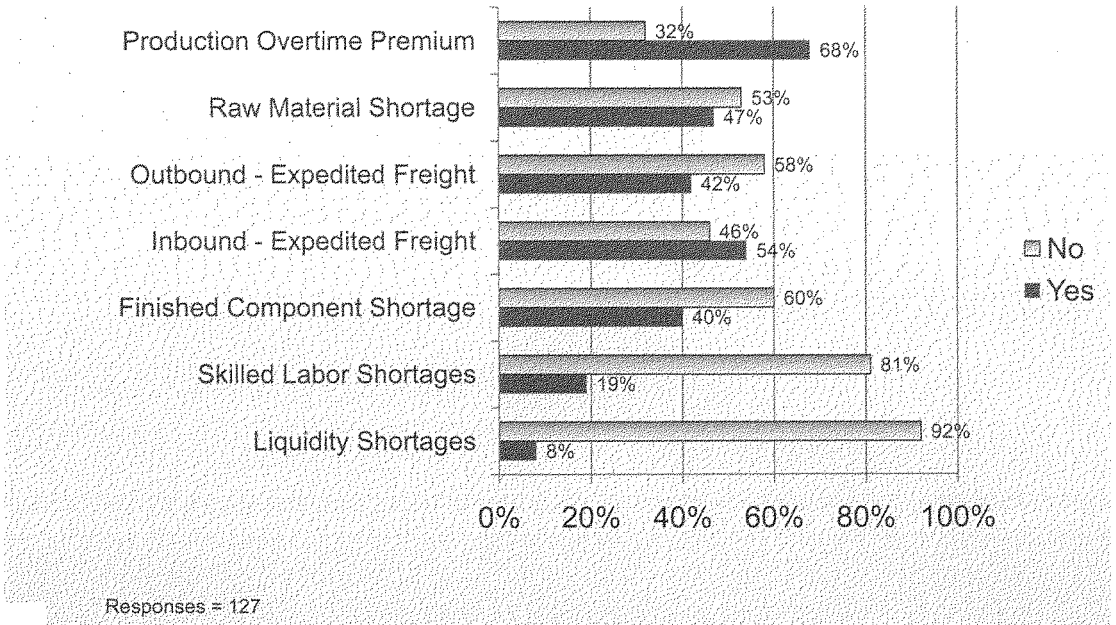
Question 5a: Over the PAST 3 months, what issues have you faced in meeting increased levels of production?



Responses = 130

Attachment 1

Question 5b: Over the NEXT 3 months, what issues have you faced in meeting increased levels of production?



Responses = 127

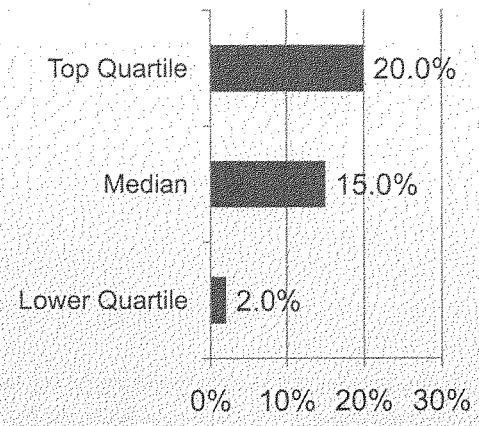
Attachment 1

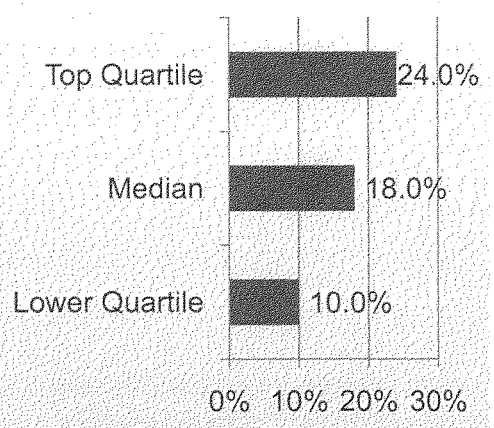
Question 6: GM has announced it will expand its Kansas, MO; Ft. Wayne, In; and Delta Twp., MI assembly plants to three shift operations. What are the three most significant implications to supplier operations to support three shift operations?

1. **Workforce Issues (35 mentions for greatest issue; 21 second place;**
   - Available skills, scheduling, overtime premiums, need to add shifts, training, etc.
2. **Production schedule stability (12 mentions for greatest issue; 5 second place;**
   - Sufficient lead times, stability, validity
3. **Raw material availability (10 mentions for greatest issue; 12 second place;**
   - Shortages, order lead times, etc.
4. **Supply chain support (8 mentions for greatest issue; 10 second place;**
   - Procurement planning, qualification of additional suppliers, component shortages, etc.
5. **Working capital and plant capital investment (6 mentions for greatest issue; 4 second mention;**
   - Need for increased working capital, plant expansion requirements, etc.
6. **Logistics (4 mentions for greatest issue; 2 second place;**
   - Transportation scheduling, sufficient packaging, etc.
7. **Equipment maintenance (3 mentions for greatest issue; 1 second mention;**
   - Maintenance, downtime, etc.
8. **Operations Planning (0 mentions for greatest issue; 5 second place mentions;**
   - Ramping up productions, achieving planned production, etc.
9. **None (10 mentions in first place)**

Attachment 1

Question 7a and 7b: According to your most significant product, how much excess capacity has been taken out of the industry in your largest product area in 2009? Estimate how much more capacity needs to come out of the industry in your largest product area to achieve full capacity utilization in a 15 million North American production year?

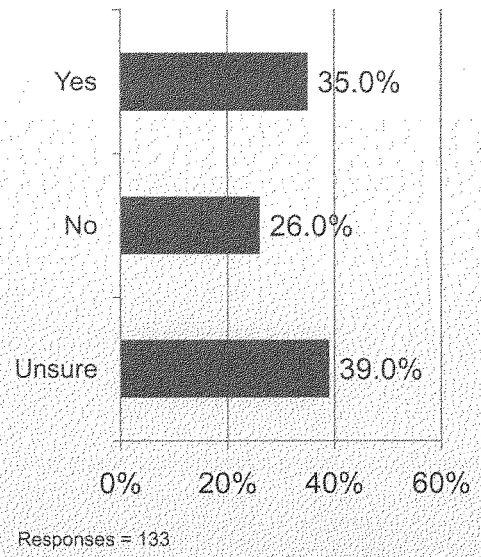




Responses = 2009 rationalization n = 109; future rationalization n = 102

Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?



Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?

YES – We do foresee changes

- "Our coverage is way too rich for what will be required."
- "Cost of labor manufacturing in US structural costs of the full organization due to health care benefit plans and employees coverage ."
- "We had a very strong health care benefit plan until it was significantly downsized in 2009 as a means to reduce costs and continue in business. We will be very slow to restore the benefits and will closely look at government sponsored actions / plans that might reduce our cost structure."
- "Public option."
- "Benefit content. Higher costs for less benefits. Punitive fees/taxes imposed by the Feds."
- "If the Government provides more, companies will provide less. Just like other countries."

Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?

YES – We do foresee changes

- "Right now, we don't have a Cadillac program as specified by the bill but see loop holes created to pull us in as having a Cadillac program. When this happens we would have to make coverage adjustments to reduce our cost/coverage."
- "No changes planned yet although we're concerned about fees and or additional taxes placed on self insured plans which may require us to change our employees costs."
- "We will look hard at the final legislation's impact on employer total cost and revise our 2011 health care programs for non-bargained and bargained (must negotiate) employees accordingly."
- "I am sure once the final bill is fully understood there will be changes ."
- "There are too many variables to give a definitive answer yet. Should the Plan be adopted in a manner that makes it less competitive for us to keep our existing plans, we will change as needed."
- "Do not know specifics of plan but likely would further reduce company provided benefits to offload costs to employee and government plan if passed."

Responses = 133

Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?

YES – We do foresee changes

- "Too early to tell what our specific changes would be, but I think it is pretty clear that we will react to the new legislation."
- "\Will need to change self-directed plans such as HRA'."
- "We are concerned that any plan that is fair to employees will be deemed a "Cadillac"; plan and invoke the new tax. We are exploring modified health and wellness plans for our employees so as to maintain benefits while avoiding the tax."
- "We will go the most cost effective plan."
- "If there is a cheaper government plan, employees will have to bite the bullet and accept it."
- "Our current health care plan would fall into the Cadillac plans which would be taxed under the current proposal ."

Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?

NO – We do not foresee changes

- "We provide our hourly and salary employees health care benefits. We do not expect the proposed legislation will have an effect on our plan."
- "Too early to tell about everything, but we already offer health care and don't expect major changes."
- "We already made aggressive changes in 2010: a high deductible plan with 70/30 co-pay."
- "We just moved to a National Carrier."
- "Our plans far exceed what the government has proposed."
- "I will not develop a plan until I understand the impact of the final approved health care reform legislation."
- "Seriously consider cost implications of production in USA, versus our other locations, in support of future programs."
- "Easy to say no at the moment, but if the industry shifts all will be forced to consider."
- "Due to labor union in place."

Attachment 1

Question 8: Given what you know about the proposed health care reform legislation, do you foresee changing your health care benefit plans or coverage specifically due to the proposed legislative provisions?

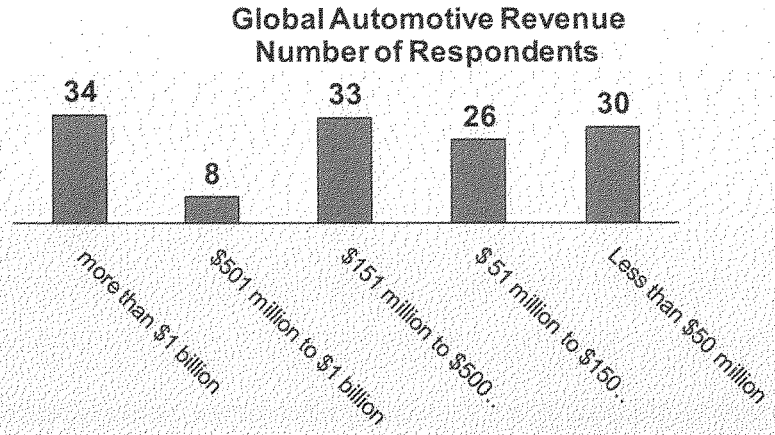
Unsure – If we will need to make changes

- "Have to see details."
- "I expect cost to go up and we will adjust benefits within allowable rules to keep our cost where they are today."
- "I am not sure how the plan being presented stacks up to our current plan. Government running anything can't be a good thing."
- "Too many potentially moving pieces yet."
- "There is limited detail and the bill is continuing to be refined."
- 'Waiting to see how they reconcile the bills."
- "Unclear on what the legislation is."
- "With no final version it is only a guess at this time."
- "Too many of the details are being kept secret to know the impact on our business. Do I think our healthcare plan will change because of this reform legislation and the answer is Yes!"

Attachment 1

Respondent Profile

There were 133 individual respondents from 112 OESA member companies. The January 2010 OESA Automotive Supplier Barometer was conducted between January 11 – 13, 2010.



Responses = 133

Attachment 1

THANK YOU FOR YOUR PARTICIPATION

The OESA Automotive Supplier Barometer survey is published every-other month. The next survey will be launched on Monday, March 8, 2010 and will be released, Friday, March 12, 2010.

For comments and suggestions for future Barometer surveys, contact:

Dave Andrea, Vice President
Industry Analysis and Economics
OESA
1301 W. Long Lake Road, Suite 225
Troy, MI 48098

248-952-6401 x 228
dandrea@oesa.org
www.oesa.org

Attachment 2

Supplier Bankruptcy Filings for 2009

No.	Company	Date	Assets (Millions)	Debt (Millions)	Revenue* (Millions)	Ownership	DIP Financing (Millions)	Components Produced	Bankruptcy Case Number
1	Fuba Printed Circuits GMBH	1/15/2009			$84			Printed circuit boards for automotive, industrial, and telecommunications.	Filed in Germany
2	Checker Motors Corp	1/16/2009	$24.5	$21.8	$9.4			Stamping and welding for hood assemblies, rear panels and other parts	U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42392.
3	Von Weise Inc.	1/16/2009				Sun Capital Partners Inc.			U.S. Bankruptcy Court, District of Delaware, No. 09-10186
4	Smurfit-Stone Container Corp	1/26/2009	$7,450	$5,580	$7,500		$750	Corrugated packaging maker (paperboard and paper-based packaging)	U.S. Bankruptcy Court, District of Delaware, No. 09-10235
5	Contech LLC	1/30/2009	> $100	> $100	$222.8	Marathon Automotive Group, LLC Marathon Asset Management		Light-weight cast components for cars and trucks It also produces forged steel automotive components, and fabricates tubular steel components.	Contech U.S., LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42392 Contech, LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42405 MAG Contech, LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42409
6	Edscha AG	2/2/2009			$1,080 (Euros)	The Carlyle Group		Door hinges and door checks in the Hinge Systems Division; Convertible Roof Systems; Driver Controls - foot controls and parking brakes	Filed in Germany
7	Mathson Industries	2/4/2009	$2	$8				Powder injection molded, plastic and ceramic components	U.S. Bankruptcy Court, No. 09-42894-TJT
8	Fluid Routing Solutions Inc	2/6/2009	$10 - $50	$10 - $50	$211.5	Sun Capital	$12	Hoses and other parts	U.S. Bankruptcy Court, District of Delaware, No. 09-10384
9	Court Valve	2/6/2009				Court Holdings Ltd. of Beamsville		Manufactures power train transmission components	Filed in Canada
10	Aleris International	2/12/2009	$4,900	$4,200	$5.91	TPG	$1,075	Producer and recycler of aluminum products	U.S. Bankruptcy Court, District of Delaware, No. 09-10478
11	Foamex International Inc	2/18/2009	$363.8	$379.7	$980		$95	Polyurethane foam for bedding and cushions	U.S. Bankruptcy Court, District of Delaware, No.09-10560
12	Wittec Industries	2/25/2009						Precision machined parts	U.S. Bankruptcy Court, District of Minnesota
13	Plastal Group AB	3/5/2009						Injection-molded and surface-treated plastic to the automotive industry	Filed in Sweden
14	Fabtech Industries, Inc	3/9/2009						Suspension systems and accessories for off-road	U.S. Bankruptcy Court, Central District of California, No. 09-14185
15	Milacron Inc	3/10/2009	$523.3	$752	$175	Avenue Capital Group and DDJ Capital Management LLC	$135	Largest U.S. maker of plastics machinery — also makes industrial fluids used in metal cutting.	U.S. Bankruptcy Court in Cincinnati, Ohio & Canada Filing did not affect DME
16	Pelican Metal Products	3/27/2009						Manufacturer of Welded and Painted Shipping Racks and Containers, and Custom Formed Products for Automotive and Related Industries	U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-49428
17	Silicon Graphics Inc	4/1/2009	$390.5	$526.5	$354			Servers and data storage products	U.S. Bankruptcy Court, Southern District of New York, No. 09-11701
18	AE Group AG	4/3/2009			$200			Automotive aluminum die castings	Filed in Germany
19	Lindenmaier AG	4/6/2009			$113			Machining and Assembly - Powertrain components	Filed in Germany
20	Karmann	4/8/2009						Convertible tops	Filed in Germany
21	LKI Enterprises, Inc. d/b/a Superlift Suspension Systems	4/8/2009						Manufactures and supplies suspension systems	U.S. Bankruptcy Court, Western District of Louisiana, No. 09-30674
22	B & C Corporation d/b/a JR Engineering	4/10/2009	$42	$25				Specializing in high-volume production of difficult precision components for both OEM and aftermarket applications	U.S. Bankruptcy Court, Northern District of Ohio, No. 09-51455
23	Noble International Ltd.	4/15/2009	$190.8	$38.7				Laser-welded tubes, roll-formed products and other steel components	Noble International - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-51720 Tailor Steel America LLC - U.S. bankruptcy Court, Eastern Michigan, No. 09-51752
24	LyondellBasel	4/24/2009	$33,800	$30,300		Access Industries	$8,000	Fuels, chemicals and plastics	U.S. Bankruptcy Court, Southern District of New York, No. 09-10021 & 09-10023

Attachment 2

Supplier Bankruptcy Filings for 2009

No.	Company	Date	Assets (Millions)	Debt (Millions)	Revenue* (Millions)	Ownership	DIP Financing (Millions)	Components Produced	Bankruptcy Case Number
25	Mark IV Dayco Products	4/30/2009	$500	$1,000	$1,200	Sun Capital Partners Inc	$90	Power transmission, air intake and cooling, and information display systems	Mark IV Industries, Inc. - U.S. Bankruptcy Court, Southern District of New York, No. 09-12795 Dayco Products, LLC - U.S. Bankruptcy Court, Southern District of New York, No. 09-12803 F-P Technologies Holding Corp. - U.S. Bankruptcy Court, Southern District of New York, No. 09-12805
26	Hayes Lemmerz	5/11/2009	$1,300	$1,400	$1,900		$200	Steel & aluminum wheels	U.S. Bankruptcy Code, District of Delaware, No. 09-11655
27	Sanderson Industries	5/11/2009	$12.9	$16.5				Metal stampings and welded components to Tier 1 and Tier 2	U.S. Bankruptcy Court, Northern District of Georgia, No. 09-72311
28	Visteon Corp	5/27/2009	$4,580	$5,320	$9,544			Climate systems, interior parts, lighting and electronic systems	U.S. Bankruptcy Court, District of Delaware, Lead Case No. 09-11786
29	Metaldyne	5/27/2009		$929	$1,570	Asahi Tec Corporation	$18.5	Components, assemblies and modules for transportation-related powertrain and chassis applications	U.S. Bankruptcy Court, Southern District of New York, Lead Case No. 09-13412
30	Fort Wayne Foundry Corporation	6/3/2009	$1 - $10	$10 - $50		Cole Pattern and Engineering Co. (who also filed for bankruptcy)		Aluminum Sand Castings	U.S. Bankruptcy Court, Northern District of Indiana, No. 09-12423
31	Tricon Industries	6/8/2009			$19			Injection molding	Shutdown and auctioned. No filing found.
32	Advanced Nitriding Solutions, LLC	6/15/2009						Ion Nitriding for Surface hardening on Crank Shafts & Die Casting Molds	U.S. Bankruptcy Court, Southern District of Indiana, No. 09-92060
33	Kiekert & Nieland	6/25/2009			$11			Automotive stampings	Filed in Germany
34	Advanced Accessory Holdings Corporation	6/26/2009	$0	$72		Castle Harlan		Manufactures roof racks, towing hitches and pickup truck rails	U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-60110
35	Grede Foundries, Inc	6/30/2009	$144	$148				Ductile/gray iron and specialty metal parts. One of the largest US cast-iron foundries.	US Bankruptcy Court, Western District of Wisconsin, No. 09-14337
36	Global Safety Textiles Holdings LLC	6/30/2009	$100 - $500	$100 - $500		International Textile Group Inc		Automotive airbag fabric	U.S. Bankruptcy Court, District of Delaware, No. 09-12234
37	Proliance International Inc.	7/2/2009	$50 - $100	$133.5	$350			Radiators	Proliance - U.S. Bankruptcy Court, District of Delaware, No. 09-12278 Aftermarket LLC - U.S. Bankruptcy Court, Southern District of New York, No. 09-12281
38	Advanced Materials Group	7/2/2009						Advanced metals manufacturing & processing	Advanced Materials Group - U.S. Bankruptcy Court, Central District of California, No. 09-16529 Advanced Materials, Inc. - U.S. Bankruptcy Court, Central District of California, No. 09-16548
39	Lear	7/7/2009	$1,300	$4,500	$13,570		$500	Automotive seating systems, electrical distribution systems and electronics	U.S. Bankruptcy Court, Southern District of New York, No. 09-14326
40	e International Metals & Chemicals Gro	7/7/2009						Manufactures and markets non-ferrous metals and chemicals	U.S. Bankruptcy Court, Eastern District of Pennsylvania
41	J.L. French	7/13/2009	$100 - $500	$100 - $500			$15	Aluminum die-cast auto parts	U.S. District Court, District of Delaware, No. 09-12445
42	RathGibson Inc.	7/13/2009	> $305	$319		DLJ Merchant Banking Partners		Global manufacturer of stainless steel and high-alloy tubing products	U.S. Bankruptcy Court, District of Delaware, No. 09-12452
43	Stant Corp.	7/27/2009	$50 - $100	$50 - $100			$11	111-year-old maker of automotive fuel systems, fuel and radiator caps and thermostats	U.S. Bankruptcy Court, District of Delaware, No. 09-12647 (Stant Parent Corp.)
44	B&C Machine Co., LLC	7/27/2009				96% owned by Bilinovich family rest - B&C Partners LLC		Manufacture, heat treatment, finishing and assembly of precision-machined components	U.S. Bankruptcy Court, Northern District of Ohio, No. 09-53294
45	Vincent Industrial	7/29/2009						Plastic injection molded components used on virtually every vehicle made in North America	

Attachment 2

Supplier Bankruptcy Filings for 2009

No.	Company	Date	Assets (Millions)	Debt (Millions)	Revenue* (Millions)	Ownership	DIP Financing (Millions)	Components Produced	Bankruptcy Case Number
46	Cooper-Standard Holdings Inc.	8/3/2009	$1,700	$1,830	$2,600	Goldman Sachs and Cypress Group LLC each own 49.2 percent	$175	Sealing and fluid systems as well as parts to cut down on noise and vibration in cars and trucks	U.S. Bankruptcy Court, District of Delaware, No. 09-12743
47	Meridian Automotive	8/7/2009						Bumpers and lighting parts	U.S. Bankruptcy Court, District of Delaware, No. 09- 12806
48	FormTech Industries LLC	8/26/2009	$100 - $500	$50 - $100				Provider of forged metal components to the automotive light vehicle, heavy truck and industrial markets in North America.	FormTech Industries, LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-12964 FormTech Industries Holdings LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-12965
49	Auto Cast Inc.	8/24/2009	$1-$10	$1-$10			$4	Aluminum and zinc die cast	U.S. Bankruptcy Court, Western District of Michigan, No. 09-9958
50	Alternative Distribution Systems, Inc. (ADS Logistics)	9/1/2009	$0-$.05	$10-$50				A metals targeted logistics company that facilitates supply chain management of metals products	U.S. Bankruptcy Court, District of Delaware, No. 09-13099
51	Gertz Schiele Holding GMbH	9/11/2009						Automotive forgings	U.S. Bankruptcy Court, Eastern District of Michigan
52	Holley Performance Products	9/28/2009	$100 - $500	$100 - $500				Carburetors, manifolds and other tuning parts for street, marine, and race applications.	U.S. Bankruptcy Court, District of Delaware, No. 09-13333 (Holley Performance Products) U.S. Bankruptcy Court, District of Delaware, No. 09-13334 (Holley Performance Products Holdings) U.S. Bankruptcy Court, District of Delaware, No. 09-13336 (Holley Performance Systems) U.S. Bankruptcy Court, District of Delaware, No. 09-13337 (Nitrous Oxide Systems, Inc.) U.S. Bankruptcy Court, District of Delaware, No. 09-13338 (Weland Automotive Industries)
53	Accuride Corporation	10/8/2009	$682	$847				Steel & aluminum wheels	U.S. Bankruptcy Court, District of Delaware, No. 09-13449
54	Recticel Interiors North America LLC Recticel North America Inc.	10/30/2009	$10 - $50	$100 - $500	$28			Coatings for interior components including dashboards and door panels	Recticel Interiors North America LLC: U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-73419 Recticel NA: U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-73411

Other known failures:
May & Scofield did not file Chapter 11, but were foreclosed by Bank of America January, 2009
Player Wire Wheels Ltd., filed chapter 11 on March 21, 2009

Updated Dec 07, 2009
Note: This listing and details are as complete as currently known by OESA .

* At the end of the last fiscal year

Testimony of David W. Turnbull
to the
Committee on Financial Services
&
Committee on Small Business
U.S. House of Representatives
Washington, D.C.
February 26, 2010

Mr. Chairman and Members of the Committee:

I appreciate the invitation and opportunity to testify before you today.

I am the president and owner of a diversified real estate development and investment firm headquartered in Boise, Idaho. In addition to our business activities in Idaho we have projects in Colorado, Minnesota, Wisconsin and Utah. Our real estate development activities span residential land development, home building, and commercial development including retail, office and industrial properties.

I have been asked to address a number of topics, but first I would like to make a couple of observations. Given the nature of my business, I have been a ground-zero witness to a series of economic events that has brought the economy of the United States and the world to its knees. I watched as a residential real estate bubble inflated seemingly overnight by cheap credit, loose and in some cases fraudulent underwriting practices, and certainly inadequate regulation. Much of it was not supported by the underlying economic fundamentals and a correction was inevitable. What was avoidable, with proper policy response, was the depth of the correction and the associated collateral damage.

I watched as prominent government officials and economists opined that the residential real estate calamity was "contained" and would not likely spill over into the general economy. I shook my head in wonder. Perhaps I was too immersed, too close to the residential real estate market and gave undue weight to its significance to the overall economy. But everything I saw in our local economy was deeply impacted by the health of housing.

Few could have forecast the scope of the housing crash we've experienced over the last 4 years. In spite of my cautious outlook at the time, my worst case scenario for our market was a 50-60 percent correction in housing starts, a forecast met with skepticism by many of my colleagues. But I was too optimistic. Housing starts in our markets have fallen 80 – 85 percent. To us, this is not a recession; it's a depression.

It is now widely acknowledged that the economic impact of the housing market downturn was not "contained" and that it is the primary cause of the current recession – the worst recession in most of our lifetimes.

Although one of the topics of today's hearing is the state of commercial real estate lending in local markets, I think it's important to draw attention to the fact that this all started with the residential markets. Even though there are some parallels between the residential and commercial real estate markets, our experience is that commercial real estate lending markets were not out of line with underlying fundamentals. I can assure you that each of our loans was meticulously and conservatively underwritten, but I am sure there are other loans, particularly in the larger metropolitan areas, that were underwritten with less conservative criteria, such as pro-forma rents instead of actual rents.

I'll refer to a few data points to illustrate my assertion. The first office lease I did in 1990 was at $13.50 per sq. ft. 1990 was not a particularly good year for commercial real estate. In 2008 – 18 years later and at the height of the market - I was leasing office space in superior buildings for $18.50 per sq. ft., a compounded annual rate of increase of just 1.77%. These are not the kind of numbers that suggest a bubble in commercial real estate in our market, yet we are still being devastated by the global lack of credit for commercial real estate, which I'll illustrate with another personal example. An office building that I sold in 2002 for $2,700,000 recently failed to sell in a foreclosure auction for the creditor's minimum bid price of $1,000,000. The replacement cost of the building, even with today's lower construction costs, is in excess of $2,200,000. This is not an isolated example and it is indicative of what can happen to the value of commercial real estate when it becomes a cash market. Values can drop 30 to 50 percent below replacement cost. The markets have clearly ceased to function and normality won't be restored until we have reconstituted credit markets, primarily in the form of the securitization model.

Now I would like to address some of the questions put to me in the invitation to testify before you today.

The President has announced a new proposal to provide capital to small banks designed to increase small business lending. Please discuss your views on this proposal, including the effect you expect it would have on the financial condition of small banks and how it will be helpful in increasing lending to small businesses.

We have several prospective businesses that would like to further invest in their companies, including purchase buildings from us, but they are having difficulty obtaining the credit to do so, even in the SBA loan program. Since small business is the primary source of new jobs in our economy I think it is very important to provide the credit and liquidity to them to make it all possible. The perception on Main Street is that nearly everything done to-date has benefitted Wall Street and the big companies and very little of that has directly benefitted small business. I believe that perception has some merit.

What general challenges do small and mid-sized businesses face in obtaining commercial real estate credit? In your view, are depository institutions contributing or in a position to help turn around the local economy? Why or why not?

It is my observation that the liberal monetary policy available to depository institutions via the Fed and the Treasury has alleviated the most severe credit dislocations, including the markets for credit cards, auto and other consumer loans, but the benefits are not fully filtering down to the end users of credit. Many banks have instituted interest rate floors and other provisions that were not prevalent a few years ago, thus increasing their net interest margin and making credit to borrowers more expensive. Major financial institutions are said to be engaged in the mother of all carry trades, wherein they obtain funds through the discount window or from deposits at near zero interest rates and invest the funds in safe and secure Treasury instruments for a generous yield. This carry trade, financed by the Fed and the US Treasury, is not exactly what the taxpayer or perhaps Congress had in mind when it approved the TARP and TALF programs. The incentive for banks to take risk is exceedingly low and thus, while the most credit-worthy customers can still obtain financing, albeit at a greater cost, most businesses are being shut out of the credit markets.

Of course, many depository institutions are in a position to provide additional credit to small and mid-sized businesses, both for commercial real estate credit and for ordinary operations. But there are many banks that are not. The expeditious consolidation of banks that have severely compromised capital positions is important. We do not want to repeat the Japanese experience. At the same time, I know of well capitalized banks that are under extraordinary regulatory pressure to curtail lending and reclassify loans seemingly in contradiction to stated policy guidance and representations from agency directors.

Discuss your views about the liquidity being provided by the secondary commercial real estate markets, particularly the commercial mortgage-backed securities (CMBS) markets. Please also discuss your views about whether the Term Asset-Backed Securities Loan Facility, administered by the Federal Reserve, is providing support to the commercial mortgage-backed securities markets?

The disintegration of the CMBS market is one of the two most serious issues facing commercial real estate markets, the other being the general economic environment. While the TALF program has been effective for reconstituting the ABS market for credit card, auto and other consumer loans, in my view it is ill-suited to resurrect the secondary credit markets for commercial real estate. The TALF requirements are so complex that it is realistically available only to the very sophisticated and elite borrowers.

Securitization, in my view, is the most critical component of the secondary or term loan market. It provides for the democratization of credit. Properly structured, securitization should reduce risk and thus provide credit at the most reasonable cost possible. A reconstituted CMBS market must have at least four characteristics that were not required under the now defunct system:

1. Bond issuers, those that are responsible for the underwriting and issue the debt, must retain a significant level of risk to ensure proper underwriting procedures.

While an up front fee may be appropriate, the issuer's compensation should be based on performance of the asset over time.

2. Rating agencies must be accountable for the ratings they issue and should be compensated by the purchaser, not the issuer of the security.
3. Servicers must be authorized and given the tools to effectively deal with troubled assets within the security pool.
4. Initially, federal guarantees will be required to stimulate the formation of a functional CMBS markets. Those guarantees can be phased out over time as the private sector gains confidence in the system and replaces the need for federal participation.

Too much time has passed without adequate action to resolve this problem. The President, Congress, and regulatory agencies should move expeditiously to pass the necessary legislation and/or regulation needed to reconstitute the CMBS markets. Failure to do so will result in further unnecessary devaluation of commercial real estate assets and the associated damage to the economy.

What legislative, regulatory or other impediments are hindering the ability of banks to increase the availability of small business and commercial real estate credit? What more can be done on either a regulatory or legislative basis to help increase credit availability for commercial real estate generally?

The primary obstacle to banks providing needed credit to legitimate borrowers is the legacy assets that encumber their balance sheets with no good conduit to dispose of them. The best solution, in my estimation, is for the government to provide a securitization model to move new originations off the balance sheet, with the following provisions:

1. The government could use existing GSE's by expanding their charter to include commercial real estate. For example, Fannie Mae already underwrites commercial real estate in the form of multifamily housing. It has the structure in place to expand that program to include office, industrial and retail properties.
2. The GSE would set forth underwriting standards and loan criteria.
3. The banks would be allowed to earn a reasonable origination fee up front.
4. The interest spread would be earned over time based on the performance of the asset, thus instituting a pay-for-performance model with the proper incentives.
5. Existing loans that meet the criteria could also qualify within the standards established.

Consider this: Without the existence of FNMA (Fannie Mae), FHLMC (Freddie Mac), and FHA, we wouldn't have a housing market today and we would be in a full-blown depression. The only equivalent we have today for these conduits in the CRE market is TALF – the equivalent of the Fed creating a super-jumbo market for residential real estate while leaving the entry level to median priced home buyers dangling with no viable options. It will not solve the problem.

Is there a scarcity of demand for small business or commercial real estate borrowers? If so, is that because credit standards have become more stringent, potential borrowers are more financially constrained, or some combination of both.

In my opinion, loan demand has decreased due to the state of the economy and the general need of businesses to deleverage. However, there is not a scarcity of demand for credit and the demand that does exist is too often going unfulfilled because of tighter credit standards and the general state of the economy placing severe pressure on the balance sheets of even the best businesses.

The financial regulators of the Federal Financial Institutions Examination Council issued a policy statement entitled *Prudent Commercial Real Estate Loan Workouts* on October 30, 2009. Does this statement and other statements of the FFIEC relating to commercial lending provide sufficient guidance regarding the need to increase credit availability while maintaining prudent lending standards? Has such guidance been helpful? Has bank supervision been consistent with the guidance?

I believe that the October 30, 2009 policy statement has provided excellent guidance to banks and regulators in dealing with a variety of complex and sometimes difficult loan scenarios. In my discussion with several bank CEO's about this matter, it seems that the policy is not being uniformly implemented by the regulators. Some banks' experiences have been satisfactory and some have not.

There is considerable anecdotal evidence, particularly in the commercial real estate and small business sectors, and in other businesses generally, that long standing customers of banks with existing lines of credit are having that credit pulled altogether, or significantly reduced on roll-over, even for projects or businesses in which substantial capital investments have been made. Please discuss.

My experience is that banks have generally acted responsibly in dealing with their customers but I'm sure there are plenty of anecdotes that would suggest otherwise, sometimes fairly and sometimes not. We are in a deleveraging process and it is not always pretty, not always fair, and oftentimes painful.

I thank the committee for its consideration.

Testimony of

Rick Wieczorek
President/CEO
Mid-Atlantic Federal Credit Union

on behalf of

The National Association of Federal Credit Unions

"Condition of Small Business and Commercial Real Estate Lending in Local Markets"

Before a joint hearing of the

House Small Business Committee

and

House Financial Services Committee

United States House of Representatives

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Introduction

Good afternoon, Chair Velazquez, Chairman Frank, Ranking Members Graves and Bachus and members of the committees. My name is Rick Wieczorek and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the President/CEO of Mid-Atlantic Federal Credit Union (MAFCU), headquartered in Germantown, Maryland.

Mid-Atlantic Federal Credit Union was founded in 1968 by a group of IBM employees. As the company down-sized in the 1990s, Mid-Atlantic converted to a community charter and currently serves all of Montgomery County, Maryland. I have been involved in the credit union community for over 26 years, and have been with Mid-Atlantic for the last six years, first as CFO, and then, for the last two, as President/CEO.

NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU–member credit unions collectively account for approximately 64 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the "Condition of Small Business and Commercial Real Estate Lending in Local Markets."

Historically, credit unions have long served a unique function in the delivery of necessary financial services to Americans including those operating small businesses. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to those who would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to

meet a precise public need—a niche credit unions fill today for nearly 93 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 7,600 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have grown steadily in membership and assets, but in relative terms, they make up a small portion of the financial services marketplace. Federally-insured credit unions have approximately $874 billion in assets as of September 2009. By contrast, Federal Deposit Insurance Corporation (FDIC) insured institutions held $13.2 trillion in assets. The average size of a federally-insured credit union is $114.4 million, compared with $1.636 billion for banks. Over 3,000 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, at just 2 percent as of December 2008.

Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and the community. While credit unions may have grown, their relative size is still small compared with banks. Even the world's largest credit union, with $40.1 billion in assets, is dwarfed by the nation's biggest banks with trillions of dollars in assets.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes."

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Mid-Atlantic FCU and Business Lending

At Mid-Atlantic, we are proud of our track record in helping our members and their small businesses. Our website has a Small Business Services section where we provide a range of important information to current and potential small business owners regarding steps they should take, from developing marketing plans to planning for cash flows.

We have been an SBA-approved lender since 2004, and became an SBA express lender just last year. We currently have 12 SBA loans closed or pending, the majority of which have been done in the last year, for a total of nearly $8 million.

Mid-Atlantic currently has just over $28 million in member business loans, putting us very near the arbitrary credit union member business lending cap of 12.25%. We believe that the success of our member business lending program is attributable to the expertise we have on staff at our credit union and our credit union service organization, Mid-Atlantic Financial Partners, which works with us in the business lending process. Our top business lending personnel have over 85 years of SBA, business and commercial loan experience, and have been recognized by the SBA for their commitment to excellence.

Credit Unions in the Current Economic Environment

It is widely recognized by leaders in both parties on Capitol Hill and in the Administration that credit unions did not cause the current economic downturn. We can however be an important part of the solution. Credit unions have fared well in the current environment and, as a result, have capital available. Surveys of NAFCU-member credit unions have shown that many are seeing

increased demand for mortgage loans and auto loans as other lenders leave the market. A number of small businesses who have lost important lines of credit from other lenders are now turning to credit unions for the capital that they need. While credit unions are meeting these demands to the best of their ability, more can still be done.

One action that would allow more to be done is the increase of the arbitrary cap on credit union member business lending. Despite the fact that credit unions have long been engaged in member business lending, in 1998 the *Credit Union Membership Access Act* (CUMAA) for the first time established an statutory cap on credit union member business lending of 12.25% of assets. CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study, entitled "Credit Union Member Business Lending," in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." The same study also found that over 50 percent of credit union loans were made to businesses with assets under $100,000, and 45 percent of credit union business loans go to individuals with household incomes of less than $50,000.

The current economic crisis has demonstrated the need for capital availability to help our nation's small businesses. Many credit unions have the capital to provide small businesses with low-cost sources of funds that other lenders are not positioned to in this current environment, but are hamstrung by this arbitrary limitation. As noted previously, at Mid-Atlantic, we are approaching the arbitrary MBL cap. This means that despite the fact that we have the capital and expertise needed to make loans to small businesses to hire workers and create jobs in Montgomery County, we may soon face a situation where our efforts are curtailed arbitrarily.

It is with this in mind that NAFCU strongly supports the passage of H.R. 3380, the *Promoting Lending to America's Small Business Act of 2009.* Introduced by Representatives Kanjorski and Royce, this important piece of legislation would raise the member business lending cap to 25% while also allowing credit unions to supply much needed capital to underserved areas, which have been among the hardest hit during the current economic downturn. The legislation would also raise the definition of what constitutes a member business loan, from $50,000 to $250,000. This is a significant step, for as this panel knows, one of the biggest declines in lending has been for loans under $250,000. This change will make it easier for all credit unions to provide loans and lines of credit up to $250,000 to America's small businesses, even if they are not approaching the arbitrary cap.

It should be noted that the banking industry's claims for imposing and maintaining the arbitrary cap were refuted as far back as 2001, when the Treasury Department released the aforementioned study and found that "...credit union's business lending currently has no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "...relaxation of membership restrictions in the Act should serve to further increase member business lending..." (p. 41). Furthermore, while the banking industry—in their shameless opposition to this bill—mistakenly claims that credit union business loans are more risky, *the Treasury study concluded just the opposite*: "We found that member business loans are generally less risky than commercial loans made by banks and thrifts..." (p. 41). The National Credit Union Administration (NCUA) has a strong track record of overseeing credit union business lending, and

for the banking trades to suggest that raising the cap or adjusting an artificial limitation on the definition of a member business loan (that has not been adjusted for inflation since the last century) will lead to a potential taxpayer bailout of credit unions is simply absurd. Just two days ago, NCUA Chairman Debbie Matz wrote Treasury Secretary Timothy Geithner to assure him that if the arbitrary cap was modified, NCUA would "promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns."

NAFCU also strongly supports the reintroduction of the *Credit Union Small Business Lending Act*, which was first introduced by Chair Velazquez in the 110th Congress. This bill would have exempted credit union participation in Small Business Administration (SBA) lending programs from the MBL limits currently in place. These particular programs are invaluable tools, helping many Americans to successfully start and run their own businesses.

By exempting credit union participation in these programs, small businesses throughout the nation will have greater access to capital at a time when it is needed most. While we believe SBA loans should permanently be exempted from counting against a credit union's MBL cap, we also support a continuation of the 90% guarantee and fee waiver on SBA loans through at least the end of 2010. We view these changes, which allow credit unions to do more to help our nation's small businesses, as an important step to help our nation recover from the current economic downturn.

Additionally, while some have proposed raising the maximum SBA 7(a) loan amount from $2 million to $5 million, we do not believe that this is a good idea. We believe that a better approach would be to maintain the $2 million amount, which would allow the SBA to guarantee a greater

number of loans, thereby helping more lenders, more small businesses, and more communities. Credit unions have not seen a demand for higher guaranteed loans.

The President's Small Business Lending Initiatives

As the panel is aware, earlier this month the President proposed creating a new $30 billion fund. The fund would be created with monies remaining in the Troubled Asset Recovery Program (TARP) to make capital infusions into community banks. In turn, community banks would use that money to make loans to small businesses, in exchange for lower dividend payments. As the program is currently proposed, most credit unions would be ineligible and statutorily unable to participate in it, based on how credit union capital is defined in the Federal Credit Union Act.

While we applaud the Administration for its focus on increasing job growth and small business lending, we believe that the Administration should also find ways to include credit union business lending in its efforts. Raising the arbitrary credit union member business lending cap would make it easier for small businesses to have access to loans, all without any cost to the American taxpayer. Many credit unions, such as mine, are approaching the cap but have funds available to make more small business loans.

If Congress were to move ahead with the President's proposal for community banks, we believe it should be coupled and moved in tandem with relief from the arbitrary MBL cap for credit unions. If Congress opts to craft a new program to help spur lending to small businesses, we urge that it be one that includes credit unions as well.

Since credit union member business loans guaranteed by a government agency are exempt from the arbitrary cap up to the level of the guarantee, another approach Congress should consider is to use any new fund to establish a 100% guarantee on all credit union and community bank business loans that meet certain standards for a period of time. In order to have maximum impact, it would be important for such a program to be set up to include as many institutions as possible (i.e. not just SBA lenders) and not to create high regulatory hurdles that would only limit participation.

Conclusion

In conclusion, the current economic crisis is having an impact on America's credit unions, but they continue to provide excellent services to their members. Credit unions stand ready to help our nation and our nation's small businesses recover from the current economic downturn. Legislation before Congress, such as H.R. 3380, the Promoting Lending to America's Small Businesses Act, and the proposals to extend the fee waiver and 90% SBA loan guarantee, would aid credit unions in their efforts to help our nation's small businesses. Additionally, as new programs are proposed, we urge that they be designed to include credit unions.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.

TESTIMONY OF
PROFESSOR TODD J. ZYWICKI
GEORGE MASON UNIVERSITY
FOUNDATION PROFESSOR OF LAW
MERCATUS CENTER SENIOR SCHOLAR

3301 Fairfax Dr.
Arlington, VA 22201
Phone: 703-993-9484
Fax: 703-993-8088

Before the
United States House of Representatives
Committee on Financial Services
Committee on Small Business

Hearing on
Condition of Small Business and Commercial Real Estate Lending
in Local Markets

Friday, February 26, 2010

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2128 Rayburn House Office Building

TODD J. ZYWICKI is George Mason University Foundation Professor of Law at George Mason University School of Law and Senior Scholar of the Mercatus Center at George Mason. He is also Co-Editor of the *Supreme Court Economic Review*. From 2003-2004, Professor Zywicki served as the Director of the Office of Policy Planning at the Federal Trade Commission. He has also taught at Vanderbilt University Law School, Georgetown University Law Center, Boston College Law School, and Mississippi College School of Law.

Professor Zywicki clerked for Judge Jerry E. Smith of the U.S. Court of Appeals for the Fifth Circuit and worked as an associate at Alston & Bird in Atlanta, Georgia, where he practiced bankruptcy and commercial law. He received his J.D. from the University of Virginia, where he was executive editor of the Virginia Tax Review and John M. Olin Scholar in Law and Economics. Professor Zywicki also received an M.A. in Economics from Clemson University and an A.B. cum Laude with high honors in his major from Dartmouth College.

Professor Zywicki is also Senior Fellow of the James Buchanan Center, Program on Politics, Philosophy, and Economics, at George Mason University, a Senior Fellow of the Goldwater Institute, and a Fellow of the International Centre for Economic Research in Turin, Italy. During the Fall 2008 Semester Professor Zywicki was the Searle Fellow of the George Mason University School of Law and was a 2008-09 W. Glenn Campbell and Rita Ricardo-Campbell National Fellow and the Arch W. Shaw National Fellow at the Hoover Institution on War, Revolution and Peace. He has lectured and consulted with government officials around the world, including Iceland, Italy, Japan, and Guatemala. In 2006 Professor Zywicki served as a Member of the United States Department of Justice Study Group on "Identifying Fraud, Abuse and Errors in the United States Bankruptcy System."

Professor Zywicki is a member of the Board of Directors of the Bill of Rights Institute, the Governing Board and the Advisory Council for the Financial Services Research Program at George Washington University School of Business, the Executive Committee for the Federalist Society's Financial Institutions and E-Commerce Practice Group, the Advisory Council of the Competitive Enterprise Institute, and the Program Advisory Board of the Foundation for Research on Economics and the Environment. He is currently the Chair of the Academic Advisory Council for the following organizations: The Bill of Rights Institute, the film "We the People in IMAX," and the McCormick-Tribune Foundation "Freedom Museum" in Chicago, Illinois. He serves on the Board of Directors of the Bill of Rights Institute. Since 2009 he has been a member of the Board of Trustees of Yorktown University. From 2005-2009 he served as an elected Alumni Trustee of the Dartmouth College Board of Trustees.

It is my pleasure to testify today on the subject of the "Condition of Small Business and Commercial Real Estate Lending in Local Markets." Other members of this panel will address this question with respect to the economic and financial practicalities of lending at the local level. I will address my remarks to the negative impact of recently-enacted and contemplated future legislation in interfering with a well-functioning lending market and in creating an environment of uncertainty that discourages lending.

It is well-known that many independent entrepreneurial businesses rely on consumer credit in starting and building their businesses, such as credit cards, home equity loans, and even auto title loans. As a result, regulations ostensibly aimed at consumer lending will also tend to disrupt small business lending as well. Thus, in my testimony, while I will usually refer to consumer lending, it should be understood that my remarks apply to many small businesses as well.

Prudent and well-designed governmental regulation of consumer and small business lending can in some instances promote competition, consumer choice, and overall productive lending. For example, a statute like the original Truth-in-Lending Act—at least as it was originally conceived and designed and before it became encrusted with mounds of regulation and litigation—can expand consumer choice and improve the operation of the lending market by standardizing and simplifying disclosures so that borrowers can compare among competing offers.[1]

But lending regulations may have a large number of unintended consequences as well—and most relevant to this hearing, one of those unintended consequences is the

[1] *See* Thomas A. Durkin & Gregory Elliehausen, Truth in Lending: Theory, History and a Way Forward (Forthcoming 2010, Oxford University Press).

curtailment of lending, especially to small, entrepreneurial businesses. Unintended consequences are most likely and most severe when of legislation and regulation goes beyond the modest goals of improving the market process but instead supplants individual choice through the substantive regulation of particular terms of credit contracts.

In order to make an economically prudent loan, a bank has two considerations. First, it must be able to estimate the risk of the loan and price the loan effectively. Regulations that either increase the risk of lending or make it more difficult to accurately price risk will make this more difficult and expensive. Second, if it is unable to accurately price the loan accurately, it will have to reduce its risk exposure, either by limiting those to whom it will lend (to only the lowest risk borrowers) or by reducing the amount it lends (by reducing the size of the loans made or the credit lines on credit cards).

Provisions in recent legislation, such as the Credit CARD Act, has made it more difficult for credit card issuers to price risk efficiently. The consequences have been predictable: credit card issuers have tried to adjust other terms of credit card agreements in order to try to continue pricing risk efficiently and to the extent that they have been unable to do so they have acted to reduce their risk exposure by offering fewer loans and reducing borrowers' credit lines. If enacted, proposed legislation such as a proposed national interest rate ceiling on credit cards, the proposed Consumer Financial Protection Agency, and the proposal to permit cramdown of home mortgages, would further exacerbate this credit crunch by further increasing the risk of lending.

The Credit CARD Act

Last summer Congress enacted the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Credit CARD Act"). Some of the terms of the legislation were relatively minor (such as rules governing the timing of the receipt of bill payments) or imposed relatively minor costs with modest potential offsetting benefits. On the other hand, other provisions of the law interfered with accurate risk-based pricing, such as new limitations on interest rate adjustments and default provisions.

The market response to the CARD Act illustrates how regulation can disrupt lending markets by interfering with efficient risk-based pricing. Credit cards have multiple terms including (as a small sample) interest rates, penalty interest rates, annual fees, length of grace periods, the amount and circumstances under which behavior-based fees will be assessed, degree of acceptance by merchants, fixed versus annual interest rates, customer support responsiveness, rewards, cash-back, frequent flyer miles, affinity terms, additional benefits like car rental and purchase price protection, international transaction fees, fraud protection, effective liability for theft, cash-advance fees, telephone payment fees, and probably many others.

The CARD Act placed political limitations on the ability of lenders and borrowers to establish these terms through free market processes. In order to try to price risk accurately and offset declining revenues from newly-regulated card terms, card issuers have re-priced other terms of credit card agreements. As a result, borrowers have seen new or increased annual fees, fixed-interest rate cards have been converted to variable-rate cards, frequent flyer and other rewards cards have become stingier, and other fees (such as cash-advance fees) have risen.

Most notably, some provisions of the Credit CARD Act make it more difficult for card issuers to raise rates on consumers as economic circumstances change except in connection with the expiration of an introductory period. Again, the market response has been entirely predictable: Credit card issuers have raised interest rates on *all* cardholders in order to guard against the risk that they might need to raise rates later but might be unable to do so as the result of regulation. In some instances, card issuers have responded by increasing their use of cards with low introductory rates but higher permanent rates. It is not clear why this particular mix of terms should be encouraged by regulators rather than lower interest rates for all.

More relevant for the subject of this hearing, there have been widespread reports that as a result of the CARD Act credit card issuers have slashed credit line and canceled credit cards. Although this reflects several different factors, in part this reflects the negative effect of the CARD Act, which has interfered with the ability of card issuers to price risk effectively. Where it becomes more difficult to price risk accurately, lenders will respond by reducing their risk exposure—which, in this case means reducing credit lines and the number of people who can obtain cards. Many of those who have seen their credit lines reduced or cards canceled have reportedly been forced to turn to payday lenders or pawnshops to make up the difference.

National Usury Ceiling on Credit Cards

Several news reports have highlighted a new subprime credit card with a 79% APR.[2] According to news stories, the card issuer says that the card used to have higher up-front fees but a much lower APR of 9.9%, an arrangement that was prohibited by the

[2] *Mandatory Usury in One Lesson*, WALL ST. J. p. A10 (Jan. 2, 2010).

Credit CARD Act. It is not obvious that consumers have been made better off by the switch—and if they preferred the card with a 79 percent interest rate and lower up-front fees, presumably a card issuer would have been happy to offer it to them.

Perhaps partially in response to the announcement of this card, there are reports that certain members of Congress have proposed legislation that would institute a national interest rate ceiling of sixteen percent on credit cards. Such a move would almost certainly generate a return of high annual fees, higher behavior-based fees, more pressure to sell ancillary products (such as credit insurance), and a decline in card quality (such as fraud protection and card benefits). It is little wonder that for centuries usury regulations have received the near-universal condemnation of economists.

The most thoroughly studied recent episode was that of the disruptive impact of state usury regulations during the high-interest rate period of the 1970s and early 1980s that limited consumer interest rates below the rate that would prevail in a free market.[3]

Banks responded by altering other terms of the cardholder agreement or bundling lending with other services. Banks in states with strict usury regulations restricted their hours of operation, reduced customer service, tied their lending operations to other products and services not restricted in price (such as requiring checking or savings accounts), or imposing higher service charges on demand deposit accounts or checking account overdrafts.[4] Most importantly, to evade usury regulations credit card issuers

[3] Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79, 151-55 (2000).
[4] A. CHARLENE SULLIVAN, EVIDENCE OF THE EFFECT OF RESTRICTIVE LOAN RATE CEILINGS ON PRICES OF FINANCIAL SERVICES (Credit Research Center Working Paper No 36, 1980); *see also* RICHARD PETERSON & GREGORY A. FALLS, IMPACT OF A TEN PERCENT USURY CEILING: EMPIRICAL EVIDENCE 33 (Credit Research Center Working Paper No. 40, 1981).

imposed annual fees on credit cards, usually ranging from $30-$50.[5] Credit card issuers adjusted other terms of the credit contract to compensate for the inability to charge a market rate of interest, including adjusting grace periods and using alternate methods for calculating interest charges.[6] Credit card issuers also rationed credit card privileges to only the most credit worthy consumers.[7] Economists have noted that the welfare effect of term re-pricing is almost invariably negative, because if the borrower and lender had preferred the new mix of terms to the old mix, in a competitive market they would likely have done so already.[8]

But there was a still more important type of term re-pricing at work that affected most consumers. For consumers, bank-type credit cards are generally superior to credit cards offered by particular department stores because unlike a store card a bank card unhooks the consumer's choice of payment from the seller of the goods or services, thereby encouraging heightened competition and consumer choice in both realms

Thus, during this period of strict interest rate regulation store cards remained the predominant form of consumer credit, not because they were superior in quality to bank cards but rather because department stores were able to engage in term re-pricing more efficaciously than bank cards.[9] While banks tried to offset losses on interest rates by imposing annual fees and the like, credit-issuing department stores had an even more

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[5] *See* Zywicki, *Economics of Credit Cards*, *supra* note 3, at 152. Because this fee was assessed on revolvers and transactors alike, it effectively resulted in transactors subsidizing lower interest rates for revolvers.

[6] DAVID EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 28 (1st ed. 2000); MARTHA L. OLNEY, BUY NOW, PAY LATER: ADVERTISING, CREDIT, AND CONSUMER DURABLES IN THE 1920S at 132 (1991) ("State usury laws were ineffective; lenders managed to increase effective rates of interest through various fees, penalties, required insurance, and so on.").

[7] Glenn B. Canner & James T. Fergus, *The Economic Effects of Proposed Ceilings on Credit Card Interest Rates*, 73 FED. RES. BULL. 1, 2 (1987).

[8] Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 238 (1986).

[9] PETERSON & FALLS, *supra* note 4.

effective way of evading usury restrictions—they could simply hide the credit losses by charging a higher price for the goods they offered.[10] For instance, in those states with the strictest usury restrictions, consumers also paid significantly higher prices for major appliances, almost all of which then (as now) were purchased with installment retail credit.[11] Retailers in states with strict usury regulations also reduced their services to consumers, such as charging for delivery and gift wrapping or offering fewer choices in their stores.[12] This ability to cross-subsidize between credit and goods transactions provided large retailers with a substantial comparative advantage over smaller retailers who could not afford to establish and maintain their own credit operations.[13]

Finally, to the extent that it becomes too difficult to price the terms of the loan accurately to make the loan feasible, lenders will curtail their issuance of credit cards. For example, if the presence of a regulation makes in impossible for a borrower to gain access to credit card credit, in many situations the borrower will turn instead to a less-preferred type of credit, such as payday lending, rent-to-own, or pawn shops. Again, empirical evidence supports this finding. During the 1970s, states with lower interest rate ceilings (thus foreclosing more consumers from credit cards and other preferred types of

[10] *See* SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 428 (3d ed. 1991); *see also* LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 177 (1999) (noting practice of door-to-door peddlers in early-twentieth century America who catered to immigrant families and marked up the price of the goods sold to cover implied high interest rates). Similarly, pawn shops can simply adjust the discount price of the goods that are pawned as collateral.
[11] Canner & Fergus, *supra* note 7, at 11.
[12] Peterson & Falls, *supra* note 4, at 35 n.5.
[13] Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 238 (1986).

lending) had more pawn shops than in states with less-binding constraints.[14] Some borrowers may even be forced to resort to illegal loan sharks.[15]

Recent experience with the turmoil in credit markets—even prior to the imposition of new regulations that would shrink lending still further—has provided a timely reminder of how restricting access to preferred types of consumer credit can lead to product substitution. According to news reports, reduction in the availability of credit card credit has led consumers and small businesses to increase their use of inferior and archaic types of credit such as payday lenders, pawn shops, and layaway. Further regulations that would make more highly-preferred credit (such as credit cards) still more uneconomical will likely prompt still further greater use of these alternative types of credit.

CFPA

The proposal for a Consumer Financial Protection Agency is probably the most dangerous of the various proposals being contemplated in terms of its likely disruptive effect on lending markets. This is because of its vast reach potentially touching almost every consumer credit transaction, its vaguely defined mission and charter, and its disconnect of consumer protection from issues of safety and soundness. With a massive new, virtually unconstrained and unaccountable bureaucracy like the CFPA, it would become extremely difficult for lenders to predict the associated with a loan, especially to small entrepreneurial businesses and less-proven borrowers. It would also potentially

[14] RICHARD L. PETERSON & GREGORY A. FALLS, IMPACT OF A TEN PERCENT USURY CEILING: EMPIRICAL EVIDENCE (Credit Research Ctr. Working Paper No. 40, 1981).
[15] *See* POLICIS, THE EFFECT OF INTEREST RATE CONTROLS IN OTHER COUNTRIES (2004); POLICIS, ECONOMIC AND SOCIAL RISKS OF CONSUMER CREDIT MARKET REGULATION (2006).

increase the costs of lending operations by increasing the red tape and administrative costs of lending. Finally, by disconnecting consumer protection from safety and soundness regulation it would interfere with the ability of lenders to price risk efficiently and thereby lead them to further curtail lending operations.

First, the CFPA would impose the potential for major new liability on lenders. While the details remain up in the air, it appears that it is being contemplated to empower such an agency to impose new fines and penalties. Moreover, in addition to prohibiting lenders from engaging in fraud and deception in lending, the CFPA would have the power to prohibit and punish "abusive" lending—a wholly novel and undefined term. Presumably this term could apply to any loan with higher than average costs or any other term that the regulator might subsequently deem to be "abusive" in some subjective sense. This would cast a cloud of uncertainty over all but the most generic loans made to the safest of borrowers, a certain recipe for further constriction of lending.

Second, the CFPA holds the potential for increased administrative and red tape costs for lenders. Again, it is not exactly clear how such an agency would work. But it is doubtful that any such agency would *reduce* the administrative costs of lending. Again, to the extent that the agency requires a higher degree of paperwork or other hurdles for all but generic loans, this will likely deter lending. Some commentators in the media, for example, have contended that the CFPA would have the power to ban or regulate certain fees on credit cards not covered by the Credit CARD Act or would be able to place limits on the power of lenders to cancel credit cards or reduce credit lines.

Finally, by disconnecting consumer protection from safety and soundness, the CFPA could make it more difficult to price risk accurately, thereby leading to a further

constriction of credit. Consider just two areas identified by the White House as possible areas of action by the CFPA: a proposal to ban (or strongly discourage) prepayment penalties and banning "yield spread premiums" in mortgage products. Both of these actions would likely prove counterproductive and harmful to consumers.

Prepayment penalties are a common term in many subprime mortgages, although they remain uncommon in most prime mortgages in the United States. Prepayment penalties are also included in most commercial loans and are present in virtually all European mortgages. Yet the White Paper contemplates banning prepayment penalties in mortgages. This reasoning is based on faulty economic logic and fails to recognize the overwhelming economic evidence supporting the efficiency of prepayment penalties.

The traditional American right to prepay and refinance a mortgage is relatively unique in the world. Available empirical evidence indicates that American consumers pay a substantial premium for this unlimited prepayment right. Borrowers pay a premium for the unlimited right to prepay of approximately 20 to 50 basis points (.2 to .5 percentage points) with subprime borrowers generally paying a higher premium for the right to prepay than prime borrowers because of the increased risk of subprime borrower prepayment.[16] Borrowers pay this premium to compensate lenders for the risk of having to reinvest funds at lower market interest rates when interest rate falls. Where prepayment penalties are banned lenders also take other precautions to guard against the risk of

[16] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 18-20 (2009) (summarizing studies); Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages*, 60 J. ECON. & BUS. 33, 34 (2008) (reviewing studies); Chris Mayer, Tomasz Piskorski & Alexei Tchistyi, The Inefficiency of Refinancing: Why Prepayment Penalties Are Good for Risky Borrowers (Apr. 28, 2008). Term sheets offered to mortgage brokers similarly quoted interest-rate increases of approximately 50 basis points in those states that prohibited prepayment penalties.

prepayment, such as charging increased points or upfront fees at the time of the loan, which raise the initial cost of the loan.

Nor is there any evidence that prepayment penalties are excessively risky for consumers. Empirical evidence indicates that prepayment penalties do not increase the risk of borrower default. In fact, subprime loans that contain prepayment penalty clauses are less likely to default than those without such clauses, perhaps because of the lower interest rate on loans with prepayment penalties or perhaps because the acceptance of a prepayment penalty provides a valuable and accurate signal of the borrower's intentions.[17] Acceptance by a borrower of a prepayment penalty may also provide a credible signal by the borrower of his intent not to prepay the loan, thus overcoming an adverse selection in the marketplace and permitting a reduction in interest rates. Borrowers obviously have greater knowledge than lenders about the relative likelihood that the borrower will prepay the mortgage, especially in the subprime market where prepayment tends to be highly idiosyncratic and borrower-specific.[18]

Finally, the ability of American consumers to freely prepay and refinance their mortgages may have exacerbated the current mortgage crisis—and banning prepayment penalties might thus exacerbate a similar situation in the future. When home prices were rising, many consumers refinanced their mortgages to withdraw equity from their homes. These "cash-out" refinancings became increasingly common during the duration of the housing boom—from 2003 to 2006 the percentage of refinances that involved cash-out

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[17] Christopher Mayer, Tomasz Piskorski, and Alexei Tchistyi, *The Inefficiency of Refinancing: Why Prepayment Penalties are Good for Risky Borrowers*, Working Paper (Apr. 28, 2008); Sherlund also finds that the presence of prepayment penalties does not raise the propensity for default. Sherlund, *The Past, Present, and Future*.

[18] *See* Zywicki & Adamson, *supra*.

rose doubled from under 40 percent to over 80 percent[19] and among subprime refinanced loans in the 2006-2007 period around 90 percent involved some cash out[20]. In fact, even though there was a documented rise in LTV ratios between 2003-2007, even that may underestimate the true increase in the LTV ratio if appraisals for refinance purposes were inflated (either intentionally or unintentionally), as appraisals are a less-accurate measure of value than actual sales.[21] The ability to freely prepay and refinance one's mortgage may help to explain the higher propensity for American consumers to default than in comparably-situated countries where prepayment is more difficult and thus cash-out refinancings are not as common.

This suggests that a ban or limitation on contractual agreements for prepayment penalties would encourage even more refinancing activity and further equity depletion that would otherwise be the case—thereby having the unintended consequence of *increasing* the number of foreclosures.

New restrictions on mortgage brokers would also likely be counterproductive for consumers. First, it should be noted that the fixation on the "yield-spread premium" for mortgage brokers is obviously misplaced: this is nothing more than the difference between the wholesale and retail cost of funds. Every loan from a depository lender also has an implicit yield-spread premium embedded in it.

More fundamentally, the White Paper's apparent hostility to mortgage brokers fundamentally misunderstands the nature of competition and consumer choice in this

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[19] Luci Ellis, *The Housing Meltdown: Why Did it Happen in the United States*, BANK FOR INTERNATIONAL SETTLEMENTS BIS WORKING PAPER 259 at 22 and Fig. 9 (Sept. 2008), *available in* http://www.bis.org/publ/work259.pdf.

[20] C J Mayer & Karen Pence, *Subprime Mortgages: What, Where, and To Whom*, NBER Working Paper no. 14083.

[21] Ellis, *The Housing Meltdown*, at 22; Chris Mayer, Karen Pence, and Shane M. Sherlund, *The Rise in Mortgage Defaults* at 6.

market. New regulations that might result in a reduction in the number of mortgage brokers, and thus an attenuation of competition, will likely result in harm to consumers. Both economic theory and empirical evidence in this area strongly suggest that greater competition among mortgage brokers results in better loan terms for consumers.

Mortgage brokers are confronted with two distinct incentives. First, mortgage brokers have an incentive to maximize the "spread" between the rate at which they can acquire funds to lend to consumers (essentially the wholesale rate) and the rate at which they can lend to borrowers (the retail price). But second, mortgage brokers face competition from other brokers trying to get a borrower to borrow from them. The net result of these two factors—one pushing toward higher rates and one pushing toward lower rates—is ambiguous as an *a priori* matter.

Early studies have found various different results, some finding that brokers offer better terms on average than depository lenders and others finding that brokers charge higher prices on at least some elements of the transaction.[22] The explanation for these differing results appears to result from differences in the number of mortgage brokers competing in a given market.[23] Where mortgage brokers are numerous and thus competition and consumer choice is greater, consumers generally receive lower interest rates from brokers (the competition effect predominates); but where there are a smaller number of brokers and less competition, consumers typically pay higher interest rates

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[22] *Compare* Amany El Anshasy, Gregory Elliehausen & Yoshiaki Shimazaki, The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders (July 2005) (working paper, *available at* http://www.chicagofed.org/cedric/files/2005).
conf_paper_session1_elliehausen.pdf); *see also* Gregory Elliehausen, The Pricing of Subprime Mortgages at Mortgage Brokers and Lenders (Feb. 2008) (working paper) (updated results confirming the initial findings) *with*.WOODWARD, *supra* note 143, at ix (concluding that loans made by mortgage brokers have higher costs of $300 to $425).

[23] M. Cary Colins & Keith D. Harvey, *Mortgage Brokers and Mortgage Rate Spreads: Their Pricing Influence Depends on Neighborhood Type*, J. REAL ESTATE FIN. & ECON. (Forthcoming 2009).

(the broker interest effect predominates). Empirical studies indicate that overly-restrictive broker regulations may also lead to a higher number of foreclosures overall.[24] The lesson seems to be clear—regulators should be wary of adopting overly-stringent regulations that will substantially reduce the number of mortgage brokers in a given market. Similar findings characterize many industries where overly-stringent regulations result in higher prices and other welfare losses for consumers.

Cramdown of Home Mortgages

Another proposal that would increase the risk of lending and lead to further constriction of credit would be the proposal to allow cramdown of home mortgages in bankruptcy. That this would increase the risk of home mortgage lending is obvious. Less obvious, but no less important, is that this would increase the risk of other types of lending such as credit cards and auto loans.

Cramdown in bankruptcy differs from mortgage modification outside bankruptcy in that if a consumer files bankruptcy in order to cram down his mortgage, the impact is not limited merely to the mortgage debt. Bankruptcy sweeps in all other types of debt as well, including credit cards, auto loans, and personal finance loans. By permitting mortgages to be modified in bankruptcy instead of foreclosure, permitting cramdown of mortgages in bankruptcy would certainly lead to an increase in the number of people filing bankruptcy. This would, of course, increase the amount of other types of consumer debt pulled into—and eventually discharged—in bankruptcy. More generally, any proposal that led to an overall increase in the number of bankruptcy filings inevitably

[24] Morris M. Kleiner & Richard M. Todd, *Mortgage Broker Regulations That Matter: Analyzing Earnings, Employment, and Outcomes for Consumers* (working paper Nov. 2008).

would lead to an increase in the amount of consumer debt discharged in bankruptcy and an increase in risk.

BNB Bank, National Association – Member FDIC

Daniel Cardone
Executive Vice President

2024 Center Avenue
Fort Lee NJ 07024
(201) 592-7474
Email: danielcardone@bnbbank.com

February 5, 2010

The Honorable Robert P. Casey, Jr.
United States Senate
393 Russell Senate Office Building
Washington, D.C. 20510-3804

The Honorable Robert Menendez
United States Senate
528 Hart Senate Office Building
Washington, D.C. 20510-3002

The Honorable Kirsten Gillibrand
United States Senate
478 Russell Senate Office Building
Washington, D.C. 20510-3203

The Honorable Charles E. Schumer
United States Senate
313 Hart Senate Office Building
Washington, D.C. 20510-3201

The Honorable Frank R. Lautenberg
United States Senate
324 Hart Senate Office Building
Washington, D.C. 20510-3003

The Honorable Arlen Specter
United States Senate
711 Hart Senate Office Building
Washington, D.C. 20510-3802

The Honorable Barney Frank, Chairman
House Committee on Financial Services
United States House of Representatives
2252 Rayburn House Office Building
Washington, D.C. 20515-2104

The Honorable Chris Dodd, Chairman
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
448 Russell Senate Office Building
Washington, D.C. 20510-0702

The Honorable Charles B. Rangel
United States House of Representatives
2354 Rayburn House Office Building
Washington, D.C. 20515-3215

The Honorable Richard Shelby, Ranking Member
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
304 Russell Senate Office Building
Washington, D.C. 20510-0103

Dear Congressional Leader,

The intent of his letter is to bring to your attention certain unintended consequences of the current bank regulatory environment, which hinder the country's economic recovery. This atmosphere could completely frustrate economic recovery efforts and may well promote the failure of many more banking institutions.

BNB Bank is a very unique community institution founded in 1986. We are a small bank, with just under $400 million in assets, maintaining offices in New Jersey, New York and Pennsylvania. Our mission, for the past seventeen-years, has been to provide financing to small businesses in our region, in partnership with the U.S. Small Business Administration. As a minority institution, we embraced the SBA program in the early 1990s and acquired the requisite skills in this area, which were then used for the benefit of the communities and people we serve. As our expertise in SBA lending grew, so too did our outreach to small business.

We are extremely proud of our accomplishments, which include numerous awards from both the New Jersey and New York districts of the Small Business Administration and recognition by those SBA districts over many years as the #1 small bank lender in our region, which encompasses New Jersey, New York City and the Philadelphia area. As you are well aware, 2009 was a year when banks, in general, did not make credit available to this sector. One of the major factors contributing to our success as an SBA lender in 2009 was the recognized reluctance of larger institutions to lend to small business.

We take particular pride in our SBA lending performance in 2009, a year in which we were the:

- *# 1 SBA Lender in the New York District*
- *# 2 SBA Lender in the New Jersey District*
- *# 2 SBA Lender in the Philadelphia District*
- *# 1 SBA Lender multi-state lender in New York, New Jersey & Philadelphia*
- *# 11 SBA Lender in the country*

We were fortunate to have been permitted to participate in the U.S. Treasury's Capital Purchase Program (TARP) and that indeed helped us to continue serving our markets, as it was intended to do. Not only did BNB Bank step-up for small business, but we actually increased our SBA lending performance, as compared to prior years.

There is, however, an unfortunate negative aspect to small business lending. The toll that the economic situation has taken on small businesses in the past few years is well known. We have worked diligently to assist our borrowers in getting through this crisis, but many are barely hanging on and several of them have been unable to survive. BNB Bank, as a partner to many of these businesses, has also not been spared from these economic problems.

Due to the high percentage of typically weaker SBA loans in our portfolio and the recent economic downturn, our asset quality and earnings have suffered. Nonetheless, we are making every effort to strengthen the bank and are working through a number of remedial actions in full cooperation with our primary regulator, the Office of the Comptroller of the Currency. One of those remedial actions, which places BNB Bank "in harms way" is the imposition of higher minimum capital requirements by the OCC. The effect of that action is the automatic classification of BNB Bank as ***less than well capitalized***; despite the fact that our capital ratios would ordinarily categorize us as ***well capitalized***. This classification, by its very definition, triggers additional consequences, as follows:

1. Access to funding becomes very restricted. Since a ***less than well capitalized*** institution is automatically ineligible for non-traditional funding sources (such as brokered CDs), a community bank, such as BNB, must rely solely on its ability to attract local deposits for which it must compete with other institutions in its immediate market. This, as you might imagine, places great emphasis on a given bank's ability to generate deposits through the offering of interest rates competitive in its market place, and ours, the Northern New Jersey/New York City area, is a fiercely competitive market place.

2. The mandating of these higher minimum capital requirements by the OCC causes the automatic imposition of statutory restrictions on deposit interest rates, under the new provisions of Section 337.6 of the FDIC Rules and Regulations, effective January 1, 2010. These *new* interest rate limitations restrict the rates we can offer to the public for deposits, unless the Bank operates

within a "high rate area." Despite the fact that we operate in one of the most competitive of the world, we are informed by the FDIC that we are not operating in a "high rate area." This causes the Bank to be limited to the "national rate cap" in setting deposit rates.

As President Obama pointed out, following his recent meeting with community bank representatives, community banks are particularly vulnerable to over regulation by bank regulators. The imposition of higher minimum capital ratios creates a chain reaction of events, which, if not remediated, will severely impact bank liquidity and may cause the failure of many community banks, such as BNB. Because of these restrictions:

1. *We will be forced to pay nearly one-half percent less, on most of our deposit products, than the average rate paid by our local competitors, who are not similarly classified as* ***Less Than Well Capitalized****. At this juncture, with bank deposit rates already very low, a .50% variance is extremely significant to most depositors.*
2. *Our ability to attract new deposits to our institution will be greatly impaired.*
3. *Our ability to retain maturing/existing deposits will be dangerously hindered.*
4. *Our viability as a bank may be threatened, due to a liquidity crisis resulting from these limitations.*
5. *A potential bank-failure will be created by the automatic application of rules intended to strengthen, and not harm, the banking system.*
6. *At the very least, without local sources of funding, we will be unable to continue our mission to serve small business and to make credit available to that sector.*

We are not suggesting that regulators lower the capital requirements for community banks without justification. We are suggesting that the unintended ramifications of the automatic interaction of certain regulations, which were likely intended, in good faith, to implement the will of the Congress, be revisited and reconsidered. This technical change may remedy a result that could seriously impair the banking system of the nation and cause catastrophic numbers of community banks to fail. It is doubtful that these regulations were intended to have such a negative impact on so many.

We have brought this matter, in summary form, to the attention of President Obama. This is an extremely urgent situation that necessitates prompt investigation by you, the Congress and bank regulators to avoid this calamitous result of these automatic triggers, which we believe to be the unintended consequence of a good faith attempt to regulate banks safely. On behalf of our senior management and board of directors, I now urge you to review the facts I have presented and to verify the points that have been made. Your interest in this matter could very well prevent further harm to our already fragile economy and to this country's community banks.

With deep appreciation for your valuable time, I am,

Very truly yours,

cc: Sheila C. Bair, Director, Federal Deposit Insurance Corporation; John C. Dugan, Comptroller of the Currency; Camden R. Fine, President and CEO, Independent Community Bankers of America

SBA Performance 2009

New York

Rank	Bank	Amount	Item
1	BNB BANK, NATIONAL ASSOCIATION	35,799,700	75
2	TD BANK, NATIONAL ASSOCIATION	19,786,300	43
3	NEWBANK	19,015,000	49
4	JPMORGAN CHASE BANK, NATIONAL ASSOCIATION	17,979,200	195
5	NEW YORK BUSINESS DEVELOPMENT CORPORATION	15,054,900	48
6	BANKASIANA	11,150,000	24
7	NARA BANK	9,685,000	19
8	PNC BANK, NATIONAL ASSOCIATION	7,756,300	12
9	COMMUNITY NATIONAL BANK	6,750,000	12
10	MANUFACTURERS AND TRADERS TRUST COMPANY	6,516,600	61

New Jersey

Rank	Bank	Amount	Item
1	TD BANK, NATIONAL ASSOCIATION	$ 60,725,000	168
2	BNB BANK, NATIONAL ASSOCIATION	$ 51,684,000	109
3	NEW JERSEY BUSINESS FINANCE CORP	$ 33,323,000	48
4	CENTRAL JERSEY BANK	$ 17,690,000	41
5	TRENTON BUSINESS ASSISTANCE CORP	$ 15,287,000	22
6	PNC BANK	$ 13,188,600	30
7	BANKASIANA	$ 9,355,000	27
8	THE PROVIDANCT BANK	$ 9,283,100	20
9	UNITY BANK	$ 7,261,700	19
10	LIVE OAK BANKING COMPANY	$ 7,000,000	4

Pennsylvania (Philadelphia District)

Rank	Bank	Amount	Item
1	Continental Bank	20,807,900	28
2	SUSQUEHANNA BANK	19,863,300	42
3	BNB BANK, N.A.	18,149,000	24
4	TD BANK, N.A.	15,185,700	30
5	Manufactures & Traders Trust Co.	11,461,200	136
6	National Penn bank	10,331,900	41
7	PNC BANK, N.A.	7,920,700	26
8	CIT SMALL BUSINESS LENDING CORP.	6,517,000	7
9	Metro Bank	5,515,300	55
10	Penn Liberty Bank	5,113,000	16

Coleman Report --- October 26, 2009

2009 Top 100 7(a) Lenders

2009 Rank	2008 Rank	2007 Rank				# Loans	Gross Loan Volume	Average Loan Size
1	2	2	WELLS FARGO BANK	MINNEAPOLIS	MN	2,347	$827,151,900	$352,429
2	3	4	U.S. BANK	MINNEAPOLIS	MN	1,896	$261,602,982	$137,976
3	18	36	COMPASS BANK	BIRMINGHAM	AL	615	$171,617,500	$279,053
4	30		LIVE OAK BANK	WILMINGTON	NC	149	$159,217,500	$1,068,574
5	7	15	TD COMMERCE BANK	PORTLAND	ME	380	$145,353,100	$382,508
6	12	22	EXCEL NATIONAL BANK	BEVERLY HILLS	CA	136	$141,454,700	$1,040,108
7	15	20	HUNTINGTON NATIONAL BANK (THE)	COLUMBUS	OH	992	$141,398,400	$142,539
8	14	10	PNC BANK	PITTSBURGH	PA	460	$138,884,600	$301,923
9	5	3	JPMORGAN CHASE BANK	NEW YORK	NY	1,250	$136,576,000	$109,261
10	11	12	ZIONS BANK	SALT LAKE CIT	UT	1,310	$128,213,000	$97,873
11	23	30	BNB BANK	NEW YORK	NY	219	$110,061,700	$502,565
12	13	11	BB&T BANK	WINSTON-SALE	NC	539	$108,861,500	$202,006
13	1	1	CIT SMALL BUSINESS LENDING	LIVINGSTON	NJ	142	$104,902,200	$738,748
14	64	86	FIRST FINANCIAL BANK	EL DORADO	AR	294	$100,879,900	$343,129
15	21	27	KEY BANK	CLEVELAND	OH	475	$87,293,000	$183,775
16	22	32	MANUFACTURERS & TRADERS TRUST	BUFFALO	NY	779	$87,235,275	$111,984
17	31	17	UNITED CENTRAL BANK	GARLAND	TX	176	$79,981,100	$454,438
18	6	5	BANCO POPULAR	SAN JUAN	PR	361	$79,768,000	$220,964
19		386	FIRST CITIZENS BANK & TRUST CO	RALEIGH	NC	81	$79,029,000	$975,667
20	41	38	FIFTH THIRD BANK	TOLEDO	OH	292	$60,345,500	$206,663
21	44	51	MAIN STREET LENDER	CHEVY CHASE	MD	67	$59,294,000	$884,985
22	19	29	SMALL BUSINESS LOAN SOURCE	HOUSTON	TX	126	$56,343,000	$447,167
23	16	19	INNOVATIVE BANK	OAKLAND	CA	1,016	$56,011,700	$55,130
24	49	92	CELTIC BANK	SALT LAKE CIT	UT	97	$54,570,100	$562,578
25	27	18	WILSHIRE STATE BANK	LOS ANGELES	CA	165	$53,941,500	$326,918
26	45	42	RIDGESTONE BANK	BROOKFIELD	WI	83	$53,571,877	$645,444
27	20	23	COMMUNITY SOUTH BANK	ADAMSVILLE	TN	71	$49,982,800	$703,983
28	69	108	FIRST CHATHAM BANK	SAVANNAH	GA	41	$46,623,200	$1,137,151
29	50	43	ASSOCIATED BANK	GREEN BAY	WI	488	$45,514,300	$93,267
30	48	110	BORREGO SPRINGS BANK	BORREGO SPRI	CA	578	$44,410,800	$76,835
31	10	16	UPS CAPITAL BUSINESS CREDIT	HARTFORD	CT	49	$43,121,200	$880,024
32	39	26	CITIZENS FINANCIAL GROUP	PROVIDENCE	RI	709	$40,394,500	$56,974
33	67	71	NEW YORK BUSINESS DEVELOPMENT	NEW YORK	NY	103	$39,370,776	$382,241
34	114	143	COMMUNITY BANK OF MISSISSIPPI	BRANDON	MS	147	$39,016,222	$265,416
35	57	54	CITIZENS BANK	FLINT	MI	184	$38,674,900	$210,190
36	79	74	GLACIER BANK	KALISPELL	MT	256	$38,402,767	$150,011
37	54	81	REGIONS BANK	BIRMINGHAM	AL	187	$38,376,600	$205,222
38	66	78	SUNTRUST BANK	ATLANTA	GA	377	$37,750,900	$100,135
39	40	57	*CAPITOL BANCORP*	LANSING	MI	127	$37,497,200	$295,254
40	71	88	LIBERTY BANK	SPRINGFIELD	MO	145	$35,010,980	$241,455
41	81		PEOPLE'S BANK	BRIDGEPORT	CT	181	$34,454,400	$190,356
42			BRIDGE BANK, CALIFORNIA GENERAL BANK, PLAZA BANK, BANK OF MANHATTAN	IRVINE	CA	39	$33,868,600	$868,426
43	43	44	COMMUNITY WEST BANK	GOLETA	CA	73	$33,592,200	$460,167
44	453		PLAINS STATE BANK	HUMBLE	TX	29	$32,845,000	$1,132,586
45			FIRST COLORADO NATIONAL BANK	PAOINIA	CO	44	$32,689,100	$742,934
46	58	49	M&I BANK	MILWAUKEE	WI	211	$32,519,500	$154,121
47	63	65	BREMER BANK	ST. PAUL	MN	99	$31,813,233	$321,346
48	73	150	UNITED WESTERN BANK	DENVER	CO	51	$30,318,500	$594,480
49	74	69	STERLING SAVINGS BANK	SPOKANE	WA	55	$29,908,900	$543,798
50	53	68	SUSQUEHANNA BANK	LITITZ	PA	69	$28,717,400	$416,194

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Sent copy to Myla, FYI.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

MAR 9 2010

March 5, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
Washington, DC 20515

Dear Mr. Chairman:

I realized after the hearing that there may have been some confusion caused by my answer to a question by Congressman Green regarding the Administration's proposal to create a Small Business Lending Fund (SBLF). I wanted to clarify that, although I would support an expansion of guaranteed SBA lending activities by commercial banks, that in no way diminishes my support for the proposed SBLF. Access to credit by small businesses is an important factor in our economic recovery and in lowering the unemployment rate, and the SBLF would help provide credit to this important sector of the economy.

As proposed, the SBLF would support lending by viable community banks with assets under $10 billion. Banks with less than $1 billion in assets would be eligible for investments up to five percent of risk weighted assets, while banks with between $1 billion and $10 billion in assets could receive investments up to three percent of risk weighted assets. As lending to small businesses increased, the dividend rate payable to Treasury would decline. As long as it remains clear that the new loans are intended to be made to creditworthy borrowers, as Treasury has made clear, I think this is a sensible proposal that would create a strong incentive to make new loans to small businesses.

Sincerely,

John C. Dugan
Comptroller of the Currency

2466

Questions for The Honorable Elizabeth Duke, Governor, Board of Governors of the Federal Reserve System, from Chairman Frank:

Many feel that the crisis was caused by financial institutions that became too big and too complex. Now that the crisis is ending the four largest banks are 50% bigger and much more complex than before the crisis. Are you happy with this outcome? If not, what are you prepared to do to reduce their size and complexity?

The recent financial crisis demonstrated the problems posed by financial institutions that are perceived to be "too big to fail." As supervisors we are pursuing a number of initiatives in this area.

First, we are vigorously addressing the weaknesses at major financial institutions with regard to capital adequacy, liquidity management, and risk management. Firms whose failure would pose a systemic risk should receive especially close supervisory oversight and be held to the highest prudential standards. Aside from its direct benefits for the safety and soundness of these large institutions, this approach also should help offset financial firms' incentive to grow until they are perceived to be "too big to fail."

Second, we are paying close attention to compensation practices that can create mismatches between the rewards and risks borne by institutions or their managers. As the Federal Reserve and other banking agencies have noted, poorly designed compensation policies can create perverse incentives that can ultimately jeopardize the health of the banking organization. Management compensation policies should be aligned with the long-term prudential interests of the institution, be tied to the risks being borne by the organization, provide appropriate incentives for safe and sound behavior, and avoid short-term payments for transactions with long-term horizons.

In addition, we and our supervisory colleagues around the world are exploring requiring banking firms to identify obstacles to the sale or liquidation of parts of the firm, areas of unnecessary complexity, and obstacles to an orderly resolution, and to show they can quickly produce the information needed for the supervisor to orchestrate an orderly resolution should the need arise (so called "living wills"). A living will of this type could remove some of the uncertainty around a possible resolution. As part of their ongoing oversight, supervisors could target the areas where a firm's planning falls short of best practices. Focusing on the legal, contractual, and business relationships among the firm's subsidiaries could yield significant benefits for prudential supervision in normal, as well as stressed, times. The various elements of the regulatory system could thus be better integrated by identifying mechanisms and connections for the transmission of risk and liability between affiliates and by identifying relationships that may present an obstacle to the ready sales of businesses, the proceeds from which might allow the firm to avoid failure.

For the two banks that are above the 10 percent cap on deposits, would you approve a new deposit taking branch? Are you intent on flouting the express desire of congress?

You have said that the Bank of America's former thrift deposits don't count toward the market cap. Would you tell the committee how those former thrift customers are treated differently by the bank? Can they use B of A ATM machines? Go to B of A branches? Apply for consumer loans?

The terms of the deposit cap, and the authority of the Federal Reserve to apply that cap, are set by statute and do not cover all manners in which an insured depository institution may expand. Specifically, the deposit cap provision in Section 3(d) of the Bank Holding Company Act (BHC Act) applies only to interstate acquisitions of a bank. See 12 USC 1842(d). By its terms, this limitation does not apply to in-state acquisitions, acquisitions of savings associations, branch openings, or organic growth. If a bank holding company such as B of A proposed to acquire a bank in an interstate transaction, however, the deposits of its subsidiary thrifts and banks alike, together with the deposits of the bank to be acquired, would be included in the bank holding company's amount of total deposits for purposes of evaluating compliance with the 10 percent deposit limit in Section 3(d).

If pending legislative proposals are enacted, the deposit cap limitation would be broadened to include acquisitions of savings associations.

International Council
of Shopping Centers

February 26, 2010

Chairman Barney Frank
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Congressman Spencer Bachus
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Chairwoman Nydia Velazquez
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Congressman Sam Graves
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman/woman and Members of the House Financial Services Committee and House Small Business Committee:

Thank you for conducting today's joint hearing on the Condition of Small Business and Commercial Real Estate Lending in Local Markets. Over the last year, the International Council of Shopping Centers (ICSC) has worked to highlight our significant concerns about the lack of access to capital and credit impacting commercial real estate and retail businesses. ICSC has developed a legislative concept that would create significant investor incentives and help to rebalance the debt/equity equation plaguing the regional and community banking system.

ICSC is the premier global trade association of the shopping center industry. Its nearly 60,000 members include shopping center owners, developers, managers, investors, retailers and brokers, as well as academics and public officials. With this broad reach across the retail real estate industry, we believe that we have a unique perspective into how the current credit crunch is impacting Main Streets across the country.

As we look at the economic indicators on the horizon, we believe that the lack of access to capital or credit for the retail real estate industry will worsen in the coming year. According to the February 11, 2010 report by the Congressional Oversight Panel on the Troubled Asset Relief Program, between 2010 and 2014, about $1.4 trillion in short-term commercial real estate (CRE) loans will expire. Meanwhile, the FDIC is reporting that lending in 2009 by the banking industry fell by $587 billion, or 7.5 percent. Additionally, the secondary market for commercial real estate, the Commercial Mortgage Backed Security market, remains almost entirely frozen.

As we are beginning to see, the credit troubles facing commercial real estate translate into potentially systemic problems for the regional and community bank system. At the end of 2009, the FDIC considered 702 banks to be in danger of failing, and nearly 3,000 banks have excessive concentrations of debt in CRE loans. Furthermore, nearly half of the maturing CRE debt coming due are on properties that are "underwater," meaning that the borrower owes more than the property is currently worth. This poses a significant dilemma for borrowers, lender and regulators.

In response to this growing threat, ICSC has been developing a legislative concept designed to provide temporary tax incentives to attract new equity for existing commercial real estate assets. This new equity would be used to deleverage or pay-down bank held CRE debt and to provide capital investment in the property to create jobs.

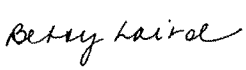
If enacted, this proposal would largely be targeted to assist small and medium private developers that own and operate commercial properties, the largest sector of commercial real estate owners and developers, as well as community and regional banks. Moreover, this is not a "bail-out" for the commercial real estate sector because everyone has to give a little to get a little. There is no direct federal spending, no federal guarantees, and private capital is picking the "winners" and "losers." Ultimately, taxpayers and consumers will benefit by reducing bank failures and limiting losses to the FDIC insurance fund, while creating new jobs.

Our incremental plan to rebalance outstanding CRE loans with an infusion of new equity will bring Loan-to-Value ratios (LTV) and debt service coverage back in line with appropriate underwriting standards. Once these under-capitalized loans are rebalanced, ICSC believes that the banking industry will be in a better position to deal with truly toxic commercial real estate assets and generate better terms for lending across all asset classes.

Something needs to be done to rebalance the debt/equity equation for commercial real estate and the banking industry and to allow for greater lending for Main Street businesses across the country. We believe that we have developed a thoughtful concept that merits immediate consideration by your respective committees.

Thank you again for your attention to this matter and please do not hesitate to contact the ICSC Global Public Policy staff at 202-626-1400 for additional information.

Sincerely,



Betsy Laird

Senior Vice President, Global Public Policy

ICSC Accelerated Depreciation Proposal for Commercial Real Estate

The Problem
There is growing consensus that declining property values in the commercial real estate sector pose the next great economic crisis for the nation. Commercial real estate values are down 30% to 40% (more than even residential real estate) and tens of thousands of commercial properties across the country are "underwater," with the borrower owing more than the property is worth. According to the Congressional Oversight Panel of the Troubled Asset Relief Program, banks hold approximately $1.5 trillion of commercial real estate debt that will come due in the next three years. And the greatest exposure in relation to capital is not with large money center banks but with regional and community banks, which are the primary sources of credit to small business.

Last year, the FDIC shut down 140 commercial banks and hundreds more are expected to fail during the next four years as a result of losses from commercial real estate loans - at a cost of $100 billion to the FDIC. Greater losses in the banking sector ahead will further suppress bank lending, strain the financial system, threaten the ability of the economy to recover and hurt job creation.

As property values fall, and lenders adopt more restrictive lending standards with lower debt ratios, the commercial real estate industry needs to find vast new sources of equity capital to remain afloat. This proposal is designed to attract new equity capital to commercial real estate, with the requirement that the new funds be used to pay down commercial bank loans, reducing the excessive debt ratios that threaten both the commercial real estate and banking sectors, as well as the broader economy.

The Solution
ICSC's concept is designed to provide temporary tax incentives that can produce new equity for existing real estate projects. The incentives are simple: enhanced depreciation on the new investment equity and deduction of losses that are not subject to passive loss limits. A key condition of the proposal is that at least 80% of the invested capital would be directed to reducing the outstanding balance of the commercial mortgage debt with the remainder going to energy efficiency or tenant improvements. The new equity investors would receive a disproportionate share of the depreciation and would be able to take a one-time 50% bonus depreciation the first year or depreciate their share of the investment over 15 years instead of 39 years. The immediate infusion of equity capital earmarked to paying down debt would lower loan-to-value ratios on existing loans and improve debt coverage ratios, easing debt market concerns and favorably impacting the broader economy.

The Success
This proposal would bring new equity to commercial real estate and enable banks to convert troubled loans into performing loans. The number of bank failures would be reduced (at a savings to the FDIC deposit insurance fund), and banks would be in a better position to extend new credit to support the economy. While the new deductions would impose revenue costs on the Federal government, those costs would eventually be reclaimed as future depreciation benefits are reduced and gain is triggered upon taxable sales.

At ICSC, we believe that our plan is the only one aimed at helping the largest sector of commercial real estate owners and developers – small to medium private businesses that own and operate commercial properties. This is not a "bail-out" of the commercial real estate sector by the federal government. Washington does not have to invest or guarantee anything. Ultimately, taxpayers benefit by reducing bank failures, limiting revenue losses from failed banks, shopping centers, and other retail businesses, and avoiding the related loss of jobs.

NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

500 New Jersey Avenue, N.W.

Washington, DC 20001-2020

Vicki Cox Golder
CRB
President

Dale A. Stinton
CAE, CPA, CMA, RCE
Chief Executive Officer

GOVERNMENT AFFAIRS DIVISION
Jerry Giovaniello, Senior Vice President
Gary Weaver, Vice President
Joe Ventrone, Vice President
Jamie Gregory, Deputy Chief Lobbyist

HEARING BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
AND
COMMITTEE ON SMALL BUSINESS

ON THE SUBJECT OF

SMALL BUSINESS AND COMMERCIAL LENDING

WRITTEN STATEMENT OF

THE NATIONAL ASSOCIATION OF REALTORS®

FEBRUARY 26, 2010

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

The National Association of REALTORS® (NAR) is pleased to offer our views on the "Condition of Small Business and Commercial Real Estate Lending in Local Markets". The National Association of REALTORS® represents more than 1.2 million REALTORS® who are involved in commercial and residential real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry.

Having a sound and well-functioning commercial and multifamily real estate sector is critical to our country's economic growth and development, and to millions of U.S. businesses of all sizes that provide local communities with jobs and services. It is estimated that the commercial real estate sector supports more than 9 million jobs and generates billions of dollars in federal, state and local tax revenue. Nonetheless, the overall economic downturn and crisis in the broader financial markets is directly impacting not only the fundamentals of commercial real estate finance, but also the outlook for recovery. And while the commercial and multifamily real estate markets play a vital role in the economy, these markets are now experiencing the worst liquidity challenge since the early 1990s.

Many in the $6.5 trillion commercial real estate industry have been warning for some time that the liquidity crisis facing our industry has the potential to wreak havoc on the broader economy. In fact, an apt description for the situation is that commercial real estate is the "next shoe to drop". The collapse of the nation's housing market had and continues to have a huge impact on the entire global financial system. Likewise, it is important to recognize the economic ramifications of a widespread collapse in the commercial real estate markets.

Just this month, Moody's proposed that "[l]osses on commercial real estate loans could top $150 billion by the end of 2011." In fact, last month more than 6% of commercial mortgages in the U.S. were delinquent and the number continues to rise at an alarming rate, according to the Wall Street Journal. By year end, delinquency rates on loans for commercial properties could rise to between 9% and 14%, according to Jefferies & Co., as consumer spending and confidence continue to be low. Furthermore, commercial property values have fallen 43% across the board from their peak in 2007, according to Moody's. Moody's also estimates that commercial property values could fall between 44% and 55% from 2007 prices. Billions of dollars in U.S. mortgages are now underwater, meaning the loan balance is higher than the value of the underlying asset. Falling real estate values have forced many banks to reduce their commercial real estate loan volumes, which are down 86.5% from 2007.[1]

A crisis is looming in the commercial real estate market due to a confluence of issues that include: (1) economic conditions, especially high unemployment; (2) weakening commercial property fundamentals; (3) declining commercial property sales volume and price; (4) slowing commercial property lending; and (5) increasing commercial loan delinquencies. These circumstances, paired with $1.4 trillion of anticipated commercial mortgages' maturities through 2014, create a challenging commercial real estate finance environment.

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[1] Wei, Lingling. "Another CMBS Bright Spot – J.P. Morgan Expected to Sell $500 Million in Inland Western Debt." *Wall Street Journal* 2 Dec. 2009: C8.

Combating the Crisis

NAR believes that a number of solutions will be needed to lessen this crisis. Since all properties are different, different approaches will be necessary. We see commercial properties as falling into one of three categories: properties that are simply not sustainable; properties that are performing, current, and can support their debt, but may have difficultly refinancing because their values are lower than their debt; and properties that are viable long-term but need immediate help with loan modifications or refinancing assistance. There are a number of solutions that we believe can start to solve the problems in two of these three categories. In the first category are properties that are not viable and cannot be saved. But properties that fall within the other two are viable long-term and can be saved with a variety of tools. It is critical that steps are taken now to prevent a total collapse of commercial markets and a corresponding downturn in our economy.

NAR presents six proposals to improve commercial real estate markets. While none of these can solve the crisis alone, together they can all contribute to a recovery. We urge the Committee to give these proposals strong consideration. The proposals are: incentives for increasing investment in properties; increasing the cap on credit union business lending; a mortgage insurance program for performing commercial loans; additional Federal Reserve and banking agency guidance especially relating to term extensions; an extension of TALF; and improve lending access for small businesses.

Incentives for Increasing Investment Property - Accelerated Depreciation

Improved cash flow for investors/owners of commercial real estate would help to fend off some of the challenges the market faces. The most effective means of improving the cash flow on real property is to provide more generous depreciation allowances. We believe that some combination of accelerated depreciation (or shorter recovery periods) and passive loss relief would be significant investor incentives. Proposals related to depreciation would have the most immediate and beneficial impact on investment incentives and carry great potential for improved cash flow. Improved cash flow can soften some of the coming commercial liquidity crisis, particularly as it affects performing loans that are underwater.

Increasing the Cap on Credit Union Business Lending

The biggest problem in commercial real estate and small business markets is a lack of liquidity. Commercial banks account for $1.5 trillion, or 45 %, of outstanding commercial real estate debt.[2] Due to the slumping economy and falling commercial real estate values, many commercial banks have tightened their credit standards and reduced their loan volumes. For example, lending was down 7.82% among the ten largest U.S. banks in 2009. While large banks, with assets over $10 billion, hold over half of commercial banks' total commercial real estate whole loans, their actual exposure (total commercial real estate loans/total Tier 1

[2] Congressional Oversight Panel, *February Oversight Report: Commercial Real Estate Losses and the Risk to Financial Stability*, (February 10, 2010) (online at http://cop.senate.gov/documents/cop-021110-report.pdf) (hereinafter "Oversight Panel").

capital) is relatively low when compared with small and mid-sized financial institutions.[3] Tier 1 capital is the amount of money banks have on hand to cover any loan losses.

According to the Congressional Oversight Panel (Oversight Panel) report issued this month, banks with assets of $1 billion to $10 billion have the highest commercial real estate exposure, followed by those with assets of $100 million to $1 billion. These two asset groups have an average commercial real estate exposure of 347% and 345% more than their available Tier 1 capital reserves, respectively. Unlike large banking institutions, small and mid-size banks are more vulnerable to commercial real estate trends because they do not have credit card services or investment banking operations to offset significant commercial real estate losses.

The Oversight Panel report also identified smaller regional and community banks with "substantial" commercial real estate exposure account for almost half of the small business loans issued across the country. Of the 8,100 U.S. banks, 2,988 small institutions have "problematic" exposure to commercial real estate loans, according to the Wall Street Journal. In other words, their level of commercial real estate loans is at least 300% of total capital or their construction and land loans exceed 100% of total capital. This exposure amongst small regional and community banks has caused a significant decrease in credit available to the small business community, which has slowed down the national economic recovery. This decrease in small business loans also has the potential to elevate problems within the commercial real estate industry by further reducing cash flows and raising vacancy rates. Additionally, we are concerned that lending will be further constrained as more banks continue to fail, are seized, or taken over by regulators. The Wall Street Journal reports "Since January 2008, 181 banks and savings institutions have been seized by regulators, including 16 so far this year."

During previous crises consumers and businesses have relied on credit unions to fill in the gaps where banks could not serve them. Credit unions have been providing business loans for more than 100 years. Today, however, credit unions are hampered by a business lending cap of 12.25% of total assets. Many commercial REALTORS® have reported having strong, long-lasting relationships with credit unions, which could help them refinance and sustain their properties but find the lending cap presents an obstacle. More than half of the outstanding business loans held by credit unions have been extended by those approaching or at, the cap. That means that credit unions with experience in handling commercial loans are unable to continue to help get us out of this crisis. We are pleased to support H.R. 3380, introduced by Rep. Kanjorski (D-PA) and Rep. Royce (R-CA), that will increase the cap on credit union lending to 25% of total assets.

Mortgage Insurance Program for Performing Commercial Real Estate Loans

Commercial real estate loans are generally short-term - sometimes even less than five years. The problem commercial properties are having is that when they go to refinance an existing loan, there can be a significant difference between the current appraised value of the property and the debt currently serving the property. Even on performing properties, lenders will not refinance at the existing debt level and are instead demanding a new infusion of capital into the project—capital which simply isn't available.

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[3] Oversight Panel

One proposal is to develop a mortgage insurance program for commercial debt. This would not insure the entire value of the loan, but instead would offer insurance on the difference between the current value and the debt service. Such a proposal or even a government guarantee program could bolster commercial markets during this difficult time. The program could be structured to limit eligibility to performing properties that have been evaluated and are income producing, and expected to be viable in the long-term. Banks would pay a guarantee or insurance fee that would help fund the program. The insurance could be short-term and designed to cover the equity gap until the market rebounds.

Additional Guidance Relating to Term Extensions

Another proposal for helping performing properties overcome the equity gap is term extensions. For properties that can support their current debt, a simple loan extension makes perfect sense. As most commercial loans are short term, these loans refinance frequently. If instead of requiring a refinance at the end of a loan term (and having to deal with the equity gap), lenders could be encouraged to extend the term of the current loan.

Currently lenders are not offering extensions because they are wary of oversight and regulatory concerns. Federal guidance encouraging these types of extensions for appropriate properties could be a helpful tool.

Extension of TALF

The commercial mortgage backed securities (CMBS) market, which supports commercial and investment real estate lending, continues to remain tightly constrained. In 2007, the CMBS market provided approximately $240 billion in financing. In contrast, the CMBS market provided less than $13 billion in issuance in 2008, despite strong credit performance and huge demand from borrowers.

With an average of $300 billion in commercial real estate loans maturing each year for the next decade and an extremely limited capacity to refinance, the result could very well be widespread systemic damage. Deutsche Bank's Parkus estimates that more than 65% of loans packaged into CMBS won't qualify for refinancing when they come due. This lack of capacity threatens our economic recovery. This threat is exacerbated by the hundreds of billion in commercial mortgage loans coming due in the next several years. In fact, the inability to secure financing will result in increased loan defaults and foreclosures, and the forced sale of many properties at greatly depressed prices, creating a ripple effect of financial losses and more job layoffs. CMBS delinquencies climbed to about 6.5% this month, an all-time high according to Trepp. Fitch Ratings estimates this number could reach 12% in 2012. Last November, the first CMBS in over 18 months was sold with assistance from TALF. Additional loans are now in the program's pipeline. At the end of 2009, the Federal Reserve reported it had made $7 billion in TALF CMBS loans. The initial success of TALF helped drive two other CMBS refinancing deals that were completed in the fourth quarter of 2009, without help from the program. Nonetheless, these deals were conservative in nature, featuring extremely strict underwriting standards and greater safeguards to investors.

This year, up to $20 billion of commercial mortgage bond issuance is expected, according to Barclays Capital. However, due to the long-term nature and complexity of putting together CMBS deals – often taking between six months and two years to complete – potential investors will be excluded from participation in the

program as a result of the March 31, 2010, and June 30, 2010, sunset dates for legacy and newly issued CMBS, respectively. The Oversight Panel cautions "[t]he withdrawal of Federal Reserve liquidity programs such as TALF (a partially TARP funded program) may result in wider spreads, less readily available capital for commercial real estate, and more difficulty refinancing loans at maturity." Given additional time, we expect TALF to continue to jumpstart the private commercial mortgage markets by restoring investor confidence.

The extension of the TALF program through at least the end of 2010 is the most effective way to immediately address the crisis in the commercial credit market with the least exposure to the taxpayer. TALF should be extended as soon as possible in order to continue to help restore capacity and address the enormous credit shortfall facing commercial real estate.

Improve Lending Access for Small Businesses

In addition to addressing the issues facing the commercial real estate market, improving access to capital for small businesses—widely acknowledged as a critical part of growing the American economy—is also greatly needed. According to recent reports, banks reduced the amount of money extended to small businesses by $15.7 billion between September 2008 and September 2009.[4] As banks continue to pare back small business lending, we believe that the Small Business Administration (SBA) can be a useful tool for facilitating access to the loans small businesses need.

Unfortunately, however, it seems many small businesses are having trouble getting SBA loans to grow and improve their operations. Applications for SBA loans can be as much as 100 pages long; documentation is required that most small businesses don't keep; some lenders are uninformed on who is eligible for the loans; and even after these obstacles are surmounted, SBA lenders are often still reluctant to make the loans.

Like any small business, many real estate brokers and agents struggle to find capital for day-to-day operating expenses, debt service, capital expenditures, and funding for expansion. Unfortunately, our members report that SBA lenders continue to turn them away under the mistaken belief that real estate agents are ineligible for SBA loans despite the SBA's recent clarification that independent contractor sales agents are, in fact, eligible. NAR appreciates the SBA's willingness to provide that clarification and is hopeful that SBA lenders will soon "get the message."

Recently, the President proposed increasing the limits of SBA loans. While we welcome the proposed increases, we are concerned that this will not get at the core issues of an arduous application processes and reticent lenders. NAR has made recommendations to SBA to improve the current situation. In particular, we have suggested in comment letters that the SBA should seek authority to eliminate SBA's 1/4 point guaranty fee for loans with maturities of 12 months or less where the total loan amount is no more than $150,000. A quarter percent on a $150,000 loan is $375 and, to the extent that a $375 fee might affect the SBA's decision to make a loan, the fee should be eliminated.

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[4] Appelbaum, Binyamin and Ylan Mui. "Lack of Customers, Assets Stunting Growth of Small Business." *The Washington Post* 23 February 2010: A12.

NAR has also proposed waiving lender fees, as permitted under the American Recovery and Reinvestment Act (ARRA). This would eliminate fees that impede loan applications and ultimately the loans themselves. Among the SBA's stated reasons for excluding this measure from recent efforts to stimulate lending are the prioritization of borrower relief and a need for appropriations to fund the measures. NAR believes that if the Administration wishes to increase small business lending, it should not matter on which side of a transaction fees occur if the fees continue to prevent loans from being made. We would also urge Congress to provide appropriations for these measures that will match small business demand.

The availability of credit to small businesses has a strong impact on commercial properties. According to the Oversight Panel, large banks with the highest exposure to commercial real estate loans also account for nearly 40% of all small business loans. As small business credit becomes even less available, commercial markets will continue to suffer. Many small businesses take out short term loans to cover inventory or payroll expenses until sales or other revenue is generated. However, many of these borrowers have found themselves unable to obtain credit in the last year. According to the National Federation of Independent Businesses, the percentage of small business owners holding a business loan or credit line each fell almost 20% in the last year. This makes it harder for them to pay rent on their leased space, or causes them to abandon their business, creating high vacancy rates in commercial space, which can decrease the value of the properties, adding to the crisis.

Conclusion

Having a sound and well-functioning commercial and multifamily real estate sector is critical to millions of U.S. businesses of all sizes that provide local communities with jobs and services and, consequently, to our country's overall economic growth and stability.

NAR believes it is critical for Congress to act now. During the previous commercial market collapse in the 1980s, the Oversight Panel states that "roughly 2,300 lending institutions failed and the government was forced to expend $157.5 billion (approximately $280 billion in 2009 dollars) protecting depositors' funds and facilitating the closure or restructuring of these organizations." Given that the same report states projects that losses at banks could range as high as $200-300 billion between now and 2011, something MUST be done.

We thank the Committees for this chance to provide input on the important issues surrounding the commercial real estate crisis. The National Association of REALTORS® looks forward to additional opportunities to work with the Committees and find solutions to recreate healthy markets, communities and our economy.

February 25, 2010

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

RE: Challenges Facing Community Banks

Dear Representative Frank and Representative Bachus:

I have represented community banks on federal and state regulatory matters for over thirty years. I can honestly say that the past two years have been the most trying times the financial industry has ever experienced. Too often the investment banks are being mischaracterized by the media as part of the commercial banking industry; and, due to this mischaracterization, members of the public are led to believe that all banks, in some fashion or form, are paying excessive executive compensation, when in reality most true community banks pay executive salaries that are based on market norms.

The Troubled Asset Relief Program, "TARP," as originally planned, would have allowed banks to sell their loans to the federal government. Unfortunately, the large banks (e.g. Bank of America, J.P. Morgan Chase, CitiGroup, etc.) could not avail the benefit of that program due to the securitization of loans, which would have required security-holders to agree to the discounted values of those loans. Instead, TARP was changed to provide capital to banks. Consequently, the availability of capital that was set aside for the banking industry became a very subjective process and resulted in only a handful of small community banks receiving TARP funding. For the banks who did receive TARP funds, it was clear that the funds were to be used for lending.

Now, federal banking regulators e.g. the Federal Reserve Board, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and the Office of the Comptroller of the Currency (collectively the "Regulators") believe the funds should be used differently then originally intended. The Regulators are viewing the TARP funds as funds that should be used for enhancing reserves and the capital positions of banks and not for lending. The Regulators are requiring banks to substantially use the TARP funding to increase reserves and meet newly created capital requirements, instead of lending money

to the communities which they serve. In fact, in a recent Safety and Soundness Examination of one of our clients, the FDIC Examiner in Charge advised the Board of Directors that the purpose of TARP was for enhancement of loan loss reserves and heightened capital requirements for the banks

What we are seeing today is a self fulfilling prophecy. Regulators are using spot visitations prior to full Safety and Soundness Examinations as a first step in downgrading community banks individual CAMELS ratings and thus, the overall ratings of the bank's themselves. Once highly rated community banks, with Composite ratings of 1's and 2's, are being downgraded in these visitations, only to find their CAMELS and Composite Ratings being subsequently downgraded again during the follow up Safety and Soundness Examination. This results in increased deposit insurance premiums, a decrease in available sources of funding, restrictions on deposit sources, and further scrutiny on deposit rates paid to customers. All in all, the result is increased expense, and decreased earnings for the community banks, which further exacerbates their problems.

As Congressmen Barney Frank and Walt Minnick succinctly stated in their letter of October 29, 2009, to the five federal bank regulators, examinations have become driven by "Asset Quality". When Asset Quality is given a low rating, regulators seize upon the opportunity to reduce other CAMELS ratings. For example, the Asset Quality of virtually all community banks in Florida has suffered from the unprecedented devaluation in real estate values, a condition which was outside of the control the respective management of most community banks. However, where in prior examinations, Management had received a "1" or "2" Management Rating, with examiners' comments lauding the effectiveness and oversight of Management, current examinations are now very critical of that same Management based upon loans that had been approved several years earlier, but have become "Classified" or are "Nonperforming". Mark to market valuations are also having an adverse impact on real estate markets, as recovery is hampered by the valuations of Bank-Owned properties in surrounding areas. Had the TARP Program as initially proposed been put into effect, community banks would have been able to sell their troubled loans to the federal government and would not have been required to mark those assets to-market. The government could have worked with borrowers whose homes or commercial real estate projects, which are now instead being foreclosed on, and continue to clog markets and stymie real estate price recovery. As Congressmen Franks and Minnick pointed out, banks are being forced to "Fire Sale" loans, which they would have normally been able to hold until the markets stabilized. This creates yet another regulatory imposed loss for which Management will be blamed in the examination by the Regulators.

Community banks are the backbones of our communities. Community banks are the banks that are lending to the small businesses and play a vital role in stimulating the

U.S. economy. The big banks are not even lending to small businesses or to community banks with regards to lines of credit that would help them for liquidity purposes.

Furthermore, capital, which is an important component for every financial institution, on the community bank side, is becoming very difficult to come by, due to the "moral hazard" created by the FDIC (i.e., investors are reluctant to invest in banks pre-receivership, when a government guarantee exists after a bank has been taken from the FDIC post-receivership). While the 15 largest banks have relatively few problems raising capital, due in part to their large market caps, access to sophisticated capital markets and discounted share values, the opposite is true at the community bank level. In fact, in today's market it has been very difficult for community banks to raise even $3 million or $4 million in new capital. Part of this problem is that private equity firms are now circling to take advantage of the loss sharing transactions promoted through the FDIC resolution bid process, as opposed to investing in community banks that are being mandated by the Regulators to have super high Tier 1 Leverage and Total Risk Based Capital Ratios. The minimum capital requirements under Part 325 of the Federal Regulations provide that to be "Well Capitalized" a bank must have at least 5% for Tier 1 Leverage Capital and 10% for Total Risk Based Capital. In Florida, community banks are being required to have 8% to 9% Tier 1 Leverage Capital requirements and between 12% and 14% Total Risk Based Capital Requirements. Again, these are all unofficial and totally subjective standards imposed by the Regulators. The capital standards between states are also different. In at least one case, an industrial bank in California is being required to maintain 10% Tier 1 Leverage Capital, while Georgia banks are being required to have 8% Tier Leverage Capital and 10% Total Risk Based Capital. When asked at a recent bankers association forum about the discrepancies in capital requirements, Chairman Sheila Bair stated she was not aware that there were enhanced capital requirements.

Mandating unofficial higher capital ratios takes away the leverage capabilities and the 20% to 25% types of returns on equity numbers that private equity investors or institutional investors seek. The only way they can see those types of investment returns materialize is to be the winning bidder on FDIC assisted transactions, where the FDIC picks up a shared loan loss of anywhere between 80% to 85%. Private equity investors naturally want to be part of that resolution because the government is picking up the majority of the risk and there is a high return on their investment.

While private equity investors deserve to be able to profit from their investments, they should be required to do so through the front door by first having to invest in community banks needing capital, as opposed to the back door investment where private equity essentially has no risk. In other words, private equity should have to acquire an existing stressed bank before being able to benefit from purchase accounting and other accretive benefits that are achieved from the FDIC resolution process.

As far as Safety and Soundness Examinations, there is no consistency. Senior examiners provide some balance, but there are a lot of young examiners who do not have the necessary backgrounds or experience to properly assess risk. Former FDIC Director of Supervision and Resolution, Paul G. Fritts, recently stated that most of the FDIC examination staff today does not have the expertise necessary to properly analyze credit risk. What examiners are now doing, especially federal examiners, is simply requiring the banks to increase their loan loss reserves to mirror the bank's percentage of nonperforming assets. In essence the examiners are simply trying to do a dollar for dollar reserve, as if the banks are going to have a 100% loss on those assets. This is neither proper risk assessment, nor is it realistic.

Concentrations in commercial real estate have also been a significant area of concern for the banking regulators. The Financial Institution Letter ("FIL") 105-2006 and the related Concentrations in Commercial Real Estate ("CRE") Lending, Sound Risk Management Practices (the "Guidance"), were issued by all of the banking regulators, in some form, in late 2006. It was initially feared by many of those who commented on the Guidance, as well as some members of the House Subcommittee on Financial Institutions and Consumer Credit, that examiners might interpret the Guidance as requiring banks to adopt all of the risk management measures referenced in the Guidance, or use the Guidance to set numerical thresholds for CRE concentrations.[1]

After an extensive comment period, the Guidance itself stated that it did "not establish specific CRE lending limits, rather promoted sound risk management practices and appropriate levels of capital that will enable institutions to continue to pursue CRE lending in a safe and sound manner." Guidance, 71 Fed. Reg. at 74,585. The Guidance also indicated that the FDIC was not going to use the levels as a standard, but rather as a preliminary step to assess risk. Finally, the Guidance suggested that portfolio stress testing and other risk management processes were to be appropriate to the "size and nature of the portfolio, as well as the level and nature of concentrations and the associated risk to the institution."

Today, however, Regulators are using CRE concentrations as a yardstick for risks inherent in the portfolio, even if the portfolio is geographically diversified. Federal regulators are also recommending that community banks reduce CRE lending and even sell some existing CRE loans that have been rated "Substandard" or worse. Of course, any loan sales in the current real estate environment yield only a fraction of the value of the loan, causing community banks to take additional losses.

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[1] Letter from Paul Smith, Senior Counsel, Am. Banker's Association, to Robert E. Feldman, Executive Secretary, FDIC, Jennifer J. Johnson, Secretary Board of Governors of the Federal Reserve System, Officer of the Comptroller of the Currency and Office of Thrift Supervision 3 (Mar. 30, 2006).

Problematically, although community banks hold only around 11% of total industry assets, community banks originate 38% of all small business and farm loans. According to the FDIC, banks with less than $1 billion in assets make more than half their loans to small businesses. In such a precarious point in our economic cycle, cutting lending to small businesses and farms could exacerbate existing pressures on the economy, leading to an increased probability of a double-dip recession.

As a result of the current regulatory climate, the number of institutions in Florida whose Composite Rating is "1" has declined dramatically. There are less than six such "highly rated" institutions in Florida now. Banks that have failed in the state have been purchased by much larger, out-of-state banks, which further erodes the purpose and necessity of community banks in their respective communities.

Of the remaining 292 Florida banks, less than six banks have a Composite "1" rating, with about eighteen banks having Composite Ratings of "2" or "3". The remaining banks have either a "4" or "5" Composite Rating. The Florida Office of Financial Regulation ("OFR") has also expressed frustration with what the FDIC is doing. OFR representatives have advised some of our bankers that they believe these examinations by the FDIC are too harsh. As OFR representatives view 2010, they see that banks need to maintain an "Adequately" capitalized status in order to be able to survive until 2011 and beyond. Notwithstanding this assessment, Regulators continue to push artificially high capital requirements coupled with extremely high reserve requirements, applying a forward-working supervisory approach. Traditionally banks' loan loss reserves were required to be 1% to 1.5%, but are now required to maintain 3% to 4.5% reserves. When asked at a recent bankers meeting, FDIC Chairman Bair indicated that she was not aware that the Atlanta Regional Office was mandating higher capital levels.

From an ethics perspective, another issue needs to be addressed. One could reasonably argue that the FDIC has a conflict of interest regarding its ability to use the CAMELS ratings of community banks as a means to replenish the FDIC's Deposit Insurance Fund. Although this issue has been litigated previously to some extent, there is no denying that a lower CAMELS rating for a bank will increase the amount the bank is assessed by the FDIC each year, as base assessment rates are calculated using a combination of financial ratios and CAMELS component ratings. With the FDIC desperately is in need of funds, and having masterfully eliminated the Ombudsman appeal process by issuing formal enforcement orders simultaneously with examination results, the FDIC can effectively ensure higher rates without public comment or formal rulemaking.

I recognize that I have covered a number of topics in this overview, but would ask you to consider this information in discussions that you and members of the House Banking Committee will have on what needs to be done to resume lending in the banking industry. Additional or more stringent regulations for community banks is not the answer. There are over 4,500 pages of federal banking regulations today. As Congress looks to regulating the big banks from a risk factor standpoint, they need to look at ways to help the community banks by alleviating some of the regulatory burdens that they are being placed under and getting the Regulators to work with the community banks who are trying to work with their customers through troubled debt restructuring and modifications. FDIC Chairman Bair recently stated that if banks were having problems with their examiners as far as their being treated unprofessionally or in their examination ratings, they should utilize the Ombudsman appeal process. Having utilized that process on various occasions, we find that the FDIC, by downgrading banks to a "4" Composite Rating, has eliminated most banks from being able to challenge their examinations. Instead of being able to use the Supervisory Appeal Review Committee or the Ombudsman process, community banks are being precluded from that process because of their Composite Ratings, leaving only the more expensive administrative hearing process.

Sincerely,

IGLER & DOUGHERTY, PA

/s/ A. George Igler

A. George Igler

INDEPENDENT SECTOR
A vital voice for us all

House Financial Services Committee and House Small Business Committee

Hearing on the Condition of Small Business and Commercial Real Estate Lending in Local Markets

Statement for the Record
Submitted by
Independent Sector
on
The Need for Bridge Loans to Nonprofits

9:00 a.m., February 26, 2010
2128 Rayburn House Office Building

Thank you for convening the Joint Hearing on "The Condition of Small Business and Commercial Real Estate Lending in Local Markets." The continued difficulty in accessing capital makes this topic critically important and timely. Nonprofit organizations - like small businesses and the commercial real estate market - have been significantly impacted by the financial crisis and have encountered great difficulties in obtaining the capital investments and short-term funding needed to sustain and expand their services in response to the growing needs of communities throughout the nation. Because of the severe budget shortfalls facing a large number of state and local governments, their nonprofit partners are experiencing significant delays in receiving reimbursement payments for contracted services. These nonprofits have already made significant cost reductions and many have exhausted available financial reserves and lines of credit. Without access to short-term funding, these nonprofits, whose work is critical to meeting the needs of the communities they serve, will be forced in the coming months to lay off more staff and close essential facilities, and some may shut down altogether. The Independent Sector appreciates the opportunity to submit a statement for the record on this important issue.

Independent Sector is the nation's leading coalition of charities, foundations, and corporate giving programs. Our approximately 550 member organizations represent a broad cross-section of our nation's nonprofit community, which exists to meet society's needs in diverse areas such as education, human services, community development, health, and more.

The Economic Impact of Nonprofit Organizations

Nonprofit organizations are a significant portion of our nation's economy. There are approximately 1.5 million nonprofit organizations,[1] including hospitals, museums, private schools, religious congregations, orchestras, public television and radio stations, soup kitchens, and foundations, that benefit the broad public interest. In 2008, these organizations were responsible for generating 5.2 percent of our nation's GDP.[2]

Nonprofit organizations are also a considerable source of employment. In 2005, the year for which the most recent statistics are available, nonprofits employed 12.9 million people, nearly 10 percent of America's workforce[3], accounting for 8 percent of wages and salaries paid in the United States.[4] Similar to businesses, most nonprofits are small – 52 percent have fewer than ten employees and 65 percent have fewer than 25 employees.[5]

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[1] CONGRESSIONAL RESEARCH SERVICE, AN OVERVIEW OF THE NONPROFIT AND CHARITABLE SECTOR, R40919 (2009).
[2] *Id.*
[3] KENNARD WING, THOMAS H. POLLAK, & AMY BLACKWOOD, THE NONPROFIT ALMANAC 2008 (The Urban Institute Press 2008).
[4] *Id.*
[5] CONGRESSIONAL RESEARCH SERVICE, *supra* note 1.

Investing in job creation by nonprofit organizations provides a double benefit to our communities because it will not only provide important jobs for Americans, the work those employees carry out improve the quality of life for many others. Nonprofit organizations engaged in delivering human services deliver a range of assistance to over 98.0 million Americans,[6] including 37.3 million individuals at or below the poverty level.[7] These organizations operate most of our nation's homeless shelters and food banks, provide services to people that are elderly and have disabilities, and offer support to families and youth that are at-risk. Their services are integral to the economic health and vitality of communities, particularly during these difficult economic times. These critical functions include providing job skills and training, as well as child care, financial counseling, and other support services many Americans need to find and maintain employment.

Credit Experience of Nonprofits

Nonprofit organizations partner with states and localities by contracting with government to deliver essential services. These organizations increase the impact of government investments by supplementing those dollars with private contributions of financial support, in-kind goods, and volunteer services. Nonprofit organizations whose primary purpose is the delivery of human services rely on this funding for approximately 66 percent of their total support – nearly $85.3 billion annually.[8] The organizations are typically required to provide the services before they are reimbursed and must shoulder those costs until government processes the receipts.

However, because of the severe budget shortfalls facing a large number of state and local governments, nonprofit service partners are now experiencing additional long delays in receiving reimbursements for expenses they have already incurred.[9] It is estimated that at least $15 billion – 18 percent of all government funding to nonprofit human service providers – is currently being held in delayed reimbursements or will be delayed if the problem is not addressed.[10] Moreover, the problem is expected to become more acute in the coming year as American Recovery and Reinvestment Act funding for state and local governments comes to an end. A recent news article reported that much of Illinois' $3.8 billion in unpaid bills is owed to nonprofit groups providing critical services to the state's citizens.[11] Newark, New Jersey cut a $1 million

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[6] WING ET AL., *supra* note 3.
[7] U.S. Census Bureau, Income, Poverty, and Health Insurance Coverage in the United States: 2007 (2007), http://www.census.gov/hhes/www/poverty/poverty.html.
[8] WING ET AL., *supra* note 3.
[9] *See* VARINA WINDER, ALLIANCE FOR CHILDREN AND FAMILIES AND UNITED NEIGHBORHOOD CENTERS OF AMERICA, SOME STATES ARE DELAYING PAYMENTS TO NONPROFITS (Apr. 30, 2009).
[10] Conservative estimate based on anecdotal evidence and preliminary data from the Michigan Nonprofits Association indicating that 50 percent of organizations receiving government funding are experiencing delays in payments.
[11] John Keilman, *Nonprofit Groups Hang by a Thread Waiting for State Funds*, CHICAGO TRIBUNE (Feb. 18, 2010), http://www.chicagotribune.com/news/local/northnorthwest/ct-met-broke-agencies-0218-20100218,0,3897492,full.story.

contract to a nonprofit for job training and other assistance to 400 mentally ill welfare recipients, forcing it to shut down the program and lay off about a dozen people.[12]

In more stable economic times, nonprofits cover the lag between incurring expenses and receiving reimbursements through a combination of lines of credit and private donations. Now, many nonprofits have reported that they have utilized the maximum amounts available under their ongoing lines of credit, banks have shrunk the size of the credit lines available to them, and the cost to access credit lines has become prohibitive.[13] Moreover, the private contributions nonprofit organizations frequently count on to weather long delays are also dwindling.[14] Individual giving has declined, and private foundations that have watched their endowments plummet now have fewer dollars available for new grant funding.[15]

For example, one nonprofit reported that last year, a financial institution dropped the line of credit it has used for a number of years to cover monthly expenses that are incurred and later reimbursed under a government contract. The nonprofit helps developmentally disabled adults find and keep jobs. It has typically borrowed $35,000 - $40,000 a month against expected reimbursements of $40,000-$45,000. When the nonprofit tried to get another line of credit from local banks, they were told they would have to have an individual co-sign the loan. Their board and staff members are not able to take on this level of individual risk. The prospect of laying off employees and cutting services has become more imminent as the nonprofit draws down its savings.[16] Another organization, owed $1.5 million by Illinois, has paid $50,000 in bank borrowing expenses, lost interest income which was used for its budget, and been forced to cut paychecks to its 200 employees.[17]

Adding further pressure on nonprofits is the staggering increase in demand for services. Nonprofit organizations are experiencing an unprecedented increase in the number of individuals and families asking for basic services and financial assistance to survive the nation's current economic crisis. For example:

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[12] Jacqueline Salmon, *Government Cutbacks Leave Faith-Based Services Hurting*, WASHINGTON POST, at A01 (Feb. 20, 2009).
[13] *See* WINDER, *supra* note 9.
[14] *See, e.g.,* Catholic Charities USA, Snapshot Survey: Crisis Exceeds Financial Woes, http://www.catholiccharitiesinfo.org/NetCommunity/Page.aspx?pid=1075.
[15] *See e.g.,* Kristi Heim, *Gates Foundation Endowment Drops $2 Billion*, THE SEATTLE TIMES (June 9, 2009), http://seattletimes.nwsource.com/html/thebusinessofgiving/2009319668_gates_foundation_endowment_dro.html.
[16] Individual Report to Independent Sector.
[17] Marshall Eckblad, *When States Can't Pay, Small Employers Face Cash Drought*, WALL STREET JOURNAL (Feb. 9, 2010), http://online.wsj.com/article/SB10001424052748704820904575055622253997154.html.

- The State of Arizona reported an increase of more than 100 percent in the number of people who sought social services in 2008,[18] and economic conditions have declined significantly in the following year.
- United Way saw a 68 percent increase in the number of calls for basic needs such as securing food, shelter, and warm clothing in 2008, and is receiving 10,000 to 15,000 more calls every month compared to the previous year.[19] Nationally, more than 5,000 requests for services went unmet due to lack of resources. More than 50% of these requests were for some form of housing (either emergency shelter or transitional housing).[20]
- Catholic Charities USA's 2009 Fourth Quarter Snapshot Survey revealed a dramatic increase nationwide in requests for life-sustaining emergency services across the country. Of the 47 agencies responding to the survey, 83% reported an increase in the working poor seeking assistance, 70% reported an increase in families seeking assistance, 57% reported an increase in the homeless seeking assistance, and 51% reported an increase in the middle class seeking assistance. These clients include unemployed parents; two-income families struggling to make ends meet; pregnant women and teens, homeless with nowhere to turn; former donors to Catholic Charities organizations now in need of help; and repeat clients with deeper needs and greater barriers to self-sufficiency.[21]

While nonprofits are working feverishly to meet the increased demand, they are facing severe financial constraints that are threatening their capacity to continue, much less expand, services to accommodate the exponential growth of need.

Organizations are moving as quickly as possible to develop new ways of doing business and collaborating with each other to address this crisis. Some are merging operations with other nonprofits, while others are restructuring their operations – combining service centers, postponing new projects, and developing shared back-office service arrangements with other nonprofits. Many are also looking to inventive new fundraising approaches. However, these measures are very costly and time-consuming and mostly increase the financial burdens of the organizations in the short-term.

Without access to affordable credit and capital investments, nonprofits that provide critical services to meet the needs of their communities that have already been forced to lay off staff and close essential facilities, altogether will need to make further cuts in jobs and services and some may shut down altogether. An estimated 300,000 jobs at nonprofit human services providers – nine percent of the nonprofit workforce – are at risk,[22] endangering services to at least 7.8 million Americans.[23]

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[18] Craig Anderson, *Demand for Assistance Sours as Foreclosures, Layoffs Take Toll*, THE ARIZONA REPUBLIC (Jan. 5, 2009), http://www.azcentral.com/arizonarepublic/business/articles/2008/12/27/20081227biz-nonprofits1227.html.

[19] THE UNITED WAY, REPORT FOR HOUSING AND URBAN DEVELOPMENT ON TRENDS IN HOUSING-RELATED CALLS (2008).

[20] United Way of America, http://www.nnedv.org/census/DVCounts2006/DVCounts06_Appendices.pdf, p.3.

[21] Catholic Charities USA, http://www.catholiccharitiesusa.org/NetCommunity/Page.aspx?pid=1964.

[22] U.S. Census Bureau, *supra* note 7.

The Need for Assistance

The current financial crisis has produced a confluence of circumstances that pose a significant threat to nonprofit organizations and the critical services they provide to our nation's citizens. As the House Financial Services Committee and the House Small Business Committee consider programs to assist small businesses and the commercial real estate market, Independent Sector strongly urges you to consider the credit issues that nonprofits are experiencing and that you work with the nonprofit community to develop solutions that will benefit the sector and the economy.

One possibility is to permit the banks that received TARP funds to fulfill their obligations under the TARP program by making bridge loans to nonprofit organizations. Such an initiative could encourage banks and community development financial institutions (CDFIs) to treat government receivables as collateral for loans. Eligible nonprofits would include those organizations that have clearly documented contracts or grant commitments from government bodies that will be fulfilled within a specified time period. Loans would be repaid when state and local governments are able to resume their normal reimbursement procedures and schedules and, therefore, there would be little or no risk to taxpayers.

Nonprofit organizations, similar to small businesses, are suffering the consequences of lack of access to capital – the real possibility of having to cut jobs, shut down facilities, and curtail services. In order to avoid this outcome, we are requesting that existing programs aimed at capital access incentivize banks to provide short-term bridge loan funding to otherwise healthy, creditworthy nonprofits with quality government receivables so that they are able to survive these difficult times and continue serving those in need. Such an initiative would assist families on Main Street by encouraging banks to provide low-cost loans to the nonprofits that provide vital services to our nation's citizens.

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[23] *See* CATHOLIC CHARITIES USA, 2007 ANNUAL SURVEY. Estimate of individuals served by 300,000 human services employees at a rate of 25.9 per employee.

February 25, 2010

RE: LOAN #62-5029571
HIGHWAY 751 PARTNERS, LLC

Chairman Frank and Members of the House Committee on Financial Services,

I am seeking some immediate relief for a perhaps unintended but egregious action. A couple of years ago, I obtained a $27mm acquisition development loan to acquire the land and build 300 multifamily units on Mallard Creek Road in Charlotte, NC (Exhibit A)

With the sale of Washington Mutual to **JP Morgan Chase** ("**Chase**") in September 2008, we were informed that this loan was no longer possible and we needed to immediately pay off the $2.8mm loan balance used to acquire the loan. (Exhibit B) We spent approximately $2mm of additional equity in anticipation of this development. We made several attempts to resolve the issue with **Chase**, who is represented by Mr. Gordon Kovacs in Houston, a recent ex-Washington Mutual employee. We informed Mr. Kovacs that we would obtain a new loan through HUD utilizing the 221-D4 program which we have diligently pursued. We have expended a year and several hundred thousand more dollars in processing the HUD loan. (Exhibit C)

We were informed that through "due process", **Chase** has obtained our loan at less than $19,000.00! Many attempts by Mr. Kovacs and the law firm of Carruthers & Roth have been made to thwart our progress to obtain resolution including the making of false statements to the court that we were not diligently pursuing financing. We have furnished substantial proof of our attempts to the contrary. (Exhibit D) The turmoil of the market has also not helped and we have even had to deal with our original HUD loan underwriter, **Capmark's**, failure (Exhibit E). In spite of these obstacles and the constant barrage of legal assaults by **Chase**'s attorneys, we have continued forward. **Chase**'s efforts continue to hamper as they bleed precious resources and distract in their suits against me personally and undermine our efforts with HUD. It seems patently inequitable that a $3mm loan procured for one percent of its face value, with the help of me as a taxpayer through the FDIC, is contributing to my own destruction even as I attempt to reward **Chase** with a sixteen thousand percent (16,000%) return on the note (Exhibit F).

We have offered to bring in a note buyer to purchase the note, restructure the loan and a host of other viable options, all refused in the steady march of **Chase's** foreclosure and liquidation of this loan. Chase has already started down the path of getting a judgment against my personal guaranty as a result of deficiency before the foreclosure is complete. No reasonable option has been accepted by **Chase** and we are quickly arriving at the end of solutions. This project adds several hundred much needed jobs to the economy and preserves this firm and its existing employee base. As one who has been appointed by the Speaker of the House and the Governor of the state of Florida, to address the economic challenges of our state (Exhibit G), I find this a perfect example of narrow decision making chipping away at the very timber of our economic recovery efforts. A foreclosure sale was held on Monday, February 22, 2010, whereby **Chase** bid in at $2,330,316.00.

As I write this letter, I have been informed that in a valiant effort to help, the Greensboro HUD field office has agreed to finance the project! (Exhibit H) I have been told by numerous **Chase** officials that since it is in litigation, they cannot address the matter while it is they who sued me for foreclosure. I have attempted to personally contact the Chairman of **Chase,** Jamie Dimon, through letters and the attached video, to no avail.

To what purpose have I and the citizens of this country rushed to assist major financial institutions in this country? To not make the development loan is bad enough. But to use their might and power to crush those that can provide resolution is beyond belief. This is a tragic commentary on our good intentions.

Respectfully submitted

Donald E. Phillips
(and 300 hungry, anxious Americans)

Washington Mutual
Commercial Real Estate Lending

Kurt E. Schwarz
Director, Relationship Mgr
555 North Point Center East
Fourth Floor
Alpharetta, Georgia 30022

February 9, 2007

Donald E. Phillips
Brad Minsley
Phillips Development & Realty
2080 Brentmoor Road
Raleigh, NC 27604

Re: Construction financing for a planned 328-unit multi-family apartment project to be built on 30.2 acres on Mallard Creek Church Road in Charlotte, NC.

Dear Donald and Brad:

On behalf of Washington Mutual Bank ("WaMu"), we are pleased to provide the following term sheet for your consideration for the proposed construction loan to provide financing for the above referenced property. This term sheet is not a commitment, rather an expression of WaMu's interest to facilitate financing.

Borrower:	A to-be-identified single asset entity that owns the subject land, controlled by Donald Phillips.
Loan Amount:	The lesser of [i] $28,390,000, [ii] 80% of loan-to-cost based upon approved project budget, or [iii] 75% loan-to-value based upon the "as-stabilized" value from a WaMu ordered and reviewed MAI third-party appraisal. The stabilized NOI, as indicated by the appraiser, must be sufficient to cover debt service on the loan amount at least 1.15x using assumed 6.5%/30-year amortization (constant = .0758).
Pricing:	1-month LIBOR + 165 bps, floating. There will be an origination fee of 62.5 bps paid at closing.
Personal Guaranty:	Donald E. Phillips will provide a 100% guaranty of completion, principal, interest and fees. The repayment guaranty will reduce to 50% of the principal amount upon completion (issuance of final certificate of occupancy for all buildings). The repayment guaranty will reduce further to 25% of the commitment amount once the property generates an NOI capable of covering hypothetical debt service 1.15x. To determine NOI, three consecutive months of rental revenue in place will be annualized and decreased by the greater of [1] actual operating expenses for the previous twelve months decreased by adequate replacement reserves or [2] proforma operating expenses. Hypothetical debt service will be based upon an interest rate at the greater of [a] contract pay rate, [b] 6.5%, or [c] 10-year Treasury + 150 bps, with an amortization of 30 years.
Term:	36 months.
Extension Option:	A single 12-month extension option contingent upon [i] no existing uncured defaults, [ii] property NOI covering hypothetical debt service 1.15x. To determine NOI, three consecutive months of rental revenue in place previous to the maturity date will be annualized and decreased by the greater of [1] actual operating expenses for the previous twelve months decreased by adequate replacement reserves or [2] proforma operating expenses. Hypothetical debt service will be based upon an interest rate at the greater of [a] contract pay rate, [b] 6.5%, or [c] 10-year Treasury + 150 bps, with an amortization of 30 years, and [iii] payment of a 20 bp extension fee.
Repayment:	Interest-only during initial term of loan. If extension option is requested and granted, loan will amortize on a 30-year schedule during extension option term.

Washington Mutual
Commercial Real Estate Lending

Security:	WaMu will be secured by a first lien mortgage/deed of trust on the borrower's fee simple interest in the subject 30.2 acre parcel of land to be improved with 328 rental multi-family units totaling approximately 328,924 square feet, located at Mallard Creek Church Road and Westbend Drive in Charlotte, NC. WaMu will require the assignment of all leases, rents, plans and specs, as well as all contracts associated with the project, including, but not limited to, the construction contract, architect's contract, engineer's contract, and management contract.
Contractor:	Bank will require a fixed price Gross Maximum Price Contract (GMP) from an acceptable general contractor, and will require the general contractor to be bonded.
Developer Fee:	The developer fee of $1,774,369, due to Phillips Development & Realty, will be funded as follows: [i] $1,064,621 (60% of the total development fee) will be funded on a percentage of completion basis as certified by Bank Construction Consultant, and [ii] the remaining $709,748 (40% of total development fee) will be funded once the property generates an NOI capable of covering hypothetical debt service 1.15x. NOI and hypothetical debt service definition will be consistent with that identified in the Personal Guaranty section above.
Financing Fee:	The financing fee of $354,874, due to Phillips Development & Realty, will be held back from funding until the property generates an NOI capable of covering hypothetical debt service 1.15x. NOI and hypothetical debt service definition will be consistent with that identified in the Personal Guaranty section above.
Deposits:	WaMu will require that the Borrower keep its operating account for the project with WaMu while loan funds are outstanding.
Loan Documentation:	The Borrower will be responsible for all reasonable costs of closing, including legal, title, appraisal, environmental, survey, structural, and any other report or information required by WaMu.
Covenants:	WaMu will require Donald Phillips to maintain at all times a minimum of at least $2,000,000 of unrestricted liquidity and a minimum net worth of at least $30,000,000 while loan funds are outstanding.
Closing:	Loan closing must occur on or before June 30, 2007.
Confidentiality:	The subject term sheet is provided to you on a confidential basis. This term sheet, in whole or its individual terms within, are not to be shared with any person or entity outside of the direct parties to the subject transaction.

Washington Mutual is pleased to offer these terms for your consideration. Please call me to discuss this Term Sheet at 678.366.4544 at your earliest convenience. I look forward to hearing from you.

Sincerely,

Kurt E. Schwarz
Director

Accepted (with cash deposit of $25,000):

Name 2/12/07 Date

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Commercial Real Estate Lending

SOURCES & USES OF FUNDS

Project:	Mallard Creek Church Road Apts						
Location:	Charlotte, North Carolina	NRSF	Units				
Loan Amount:	28,390,000	328,924	328	Uses	Sources		
Category		Per SF	Per Unit	Total Cost	Funded by Loan	Upfront Equity	Deferred Equity
Land		11.37	11,402	3,740,000		3,740,000	
Site Improvements		.00					
	Subtotal Land	**11.37**	**11,402**	**3,740,000**		**3,740,000**	
Contract Amount (includes site work)		70.11	70,308	23,061,142	19,703,754	3,357,388	
Community House		.					
Garages		.					
Furniture, Fixtures and Equipment		.					
Sewer/Water Taps		.					
	Subtotal Improvements	**70.11**	**70,308**	**23,061,142**	**19,703,754**	**3,357,388**	
Architect & Engineer's Fees		1.76	1,765	579,000	579,000		
Surveys/Wetlands Delinlation		.05	49	16,000	16,000		
Legal Fees/Title/Lender Inspection Fees		.68	686	225,000	225,000		
Construction Management		.3	305	100,000	100,000		
Insurance: Owner General Liability		.12	122	40,000	40,000		
Real Estate Taxes During Construction		.3	305	100,000	100,000		
Appraisal/Market Study/Environmental/Testing		.07	70	23,000	23,000		
Performance Bond Premium		.85	852	279,582	279,582		
Building Permits/Connection Fees		.36	363	119,064	119,064		
Other (Prelim Site Design/Other Financing/Preconstruction Costs)		1.25	1,250	410,000	410,000		
	Subtotal Soft Costs	**5.76**	**5,767**	**1,891,646**	**1,891,646**		
Permanent Loan Fee		.					
Financing Fee (not third-party-will be funded w/performance)		1.08	1,082	354,874	354,874		
WaMu Loan Fee		.67	676	221,796	221,796		
Construction Loan Interest (2)		8.01	8,033	2,634,939	2,634,939		
Operating Deficit Reserve		.					
Lease Concessions		.					
	Subtotal Financing/Carry	**9.76**	**9,791**	**3,211,609**	**3,211,609**		
Contingency (1)	5%	3.24	3,246	1,064,622	1,064,622		
Developer's Fee	5%	5.39	5,410	1,774,369	1,774,369		
Overhead		.					
Lease Commissions		.					
Marketing		2.26	2,268	744,000	744,000		
Misc/Other (consulting, testing, etc.)							
	Subtotal Miscellaneous	**10.89**	**10,924**	**3,582,991**	**3,582,991**		
					80%	20%	0%
TOTAL		**107.89**	**108,193**	**35,487,388**	**28,390,000**	**7,097,388**	

Washington Mutual
Commercial Real Estate Lending

Kurt E. Schwarz
Director, Relationship Mgr
555 North Point Center East
Fourth Floor
Alpharetta, Georgia 30022

February 9, 2007

Donald E. Phillips
Brad Minsley
Phillips Development & Realty
2080 Brentmoor Road
Raleigh, NC 27604

Re: Refinance of land loan secured by 30.2 acres on Mallard Creek Church Road in Charlotte, NC.

Dear Donald and Brad:

Attached under separate cover, please find a non-binding term sheet to provide construction financing for the above referenced project. Below are terms to refinance an existing land loan from Paragon Commercial Bank secured by the above referenced land. The two loan proposals are joined. WaMu does not wish to seek approval for the subject land loan without acceptance of terms by the borrower for the construction financing of the proposed project. On behalf of Washington Mutual Bank ("WaMu"), we are pleased to provide the following term sheet for your consideration for the proposed land loan to provide financing for the above referenced property. This term sheet is not a commitment, rather an expression of WaMu's interest to facilitate financing.

Borrower:	A to-be-identified single asset entity that owns the subject land, controlled by Donald Phillips.
Loan Amount:	The lesser of [i] $3,040,000, [ii] 80% loan-to-cost based upon purchase price, or [iii] 80% loan-to-value based upon the "as-is" value from a WaMu reviewed MAI third-party appraisal. An appraisal report prepared by Fred H. Beck & Associates, LLC, dated August 19, 2006 is currently being reviewed to determine if it complies with bank standards. If this appraisal is not acceptable, a new appraisal for the full construction loan, to include both an "As-is" value of the land, as well as "As-Complete" and "As-Stabilized" values of the proposed 328-unit multi-family project, will be ordered by WaMu at the borrower's cost.
Pricing:	1-month LIBOR + 225 bps, floating. There will be an origination fee of 50 bps of the commitment amount paid at closing. Interest-payments during term, full repayment at maturity.
Guaranty:	Donald E. Phillips will provide a 100% guaranty of principal, interest and fees.
Term:	6 months.
Interest Reserve:	Interest on the loan will be paid from an interest reserve in the amount of $125,000 that will be held back from initial funding, and funded over time by WaMu as interest is billed.
Exit Fee:	If the borrower accepts the subject land loan, and utilizes construction financing from a financial institution other than WaMu, the borrower will pay to WaMu and exit fee for the subject land loan of $100,000.
Security:	WaMu will be secured by a first lien mortgage/deed of trust on the borrower's fee simple interest in the subject 30.2 acre parcel of land located at Mallard Creek Church Road and Westbend Drive in Charlotte, NC.

Sincerely,

Kurt E. Schwarz
Director

Accept terms for land loan by executing on page 2 of construction loan term sheet attached.

3800 Buffalo Speedway #200
Houston, Texas 77098

Gordon Kovacs
Direct Line 713/354/6821
Facsimile 713/354/6830

Washington Mutual

October 23, 2008

Sent wrong to old address

Highway 751 Partners LLC
1510 West Cleveland Street
Tampa, Florida 33606

VIA CERTIFIED MAIL 7160 3901 9846 2678 1462
RETURN RECEIPT REQUESTED
AND U.S. MAIL

Re: LOAN NO. 62-5029571 to Highway 751 Partners, LLC ("Subject Loan")

Dear Borrower:

JPMorgan Chase, through its ownership of a loan made by **Washington Mutual Bank, FA,** (the "Bank") is the owner and holder of the note, commercial security agreement and all other documents evidencing, securing, governing or pertaining to the indebtedness evidenced by the note.

The Bank has previously informed you that he Subject Loan matured on October 1, 2008. This is an Event of Default. To avoid collection action being commenced by the Bank, demand is hereby made for payment of the entire debt of $2,864,999.85, plus accrued interest and late charges or before November 6, 2008. If payment is not received in full by said date, the Bank will proceed with moving the debt to the Default Rate defined in the Promissory Note, and exercise all of its legal rights and remedies available under the loan documents and applicable law, all of which such rights and remedies are reserved hereby. Such remedies may include but are not limited to, foreclosure of the collateral pledged under the commercial security agreement and all other security instruments.

If made by regular mail:
Washington Mutual Bank
P. O. Box 650528
Dallas, Texas 75265-0528

If made by overnight delivery:
Washington Mutual Bank
1100 E. Arbrook Boulevard
Arlington, Texas 76014

The Bank reserves its rights to utilize any and all remedies available against all parties obligated under the Subject Loan, if all amounts owing are not received by said date.

Any costs incurred by Bank in relation to your default are your responsibility to the extent provided in your loan documents and/or by applicable law.

Should you have any questions, please contact the writer at **713-354-6821.**

Sincerely,

WASHINGTON MUTUAL BANK
a division of JPMorgan Chase Bank,
National Association

By: _____
Name: Gordon Kovacs
Title: First Vice President

GAK:LLF

c: Highway 751 Partners, LLC
P. O. Box 458
Tampa, Florida 33601

Mr. Donald E. Phillips
823 Seddon Cove
Tampa, Florida 33602

HIGHWAY 751 PARTNERS, LLC

February 24, 2009
VIA EMAIL: Gordon.kovacs@wamu.net

Mr. Gordon Kovacs
Washington Mutual Bank
3800 Buffalo Speedway #200
Houston, TX 77098

Re: $3,040,000.00 Loan From Washington Mutual Bank, F.A. ("Lender") to Highway 751 Partners, LLC ("Borrower") Dated March 15, 2007 (the "Loan") Secured by Approximately 30 acres, Mallard Creek Church Road, Charlotte, North Carolina (the "Property"); FOR SETTLEMENT NEGOTIATION PURPOSES ONLY

Dear Mr. Kovacs:

The purpose of this letter is to set forth the Borrower's proposal to extend and/or purchase the Loan. This letter is for settlement negotiation purposes only and may not be construed as an admission of default or liability by either the Borrower or the Guarantor.

The Loan is evidenced by, among other things, (i) that certain Loan Agreement between Borrower and Lender dated March 15, 2007 (the "Loan Agreement"), (ii) that certain Promissory Note in the principal amount of $3,040,000.00 from Borrower payable to Lender dated March 15, 2007 (the "Note"), (iii) that certain Guaranty from Guarantor to Lender dated March 15, 2007 (the "Guaranty"), and (iv) that certain Deed of Trust, Security Agreement, Assignment of Leases and Rents and Fixture Filing from Borrower to Metro Title Company, LLC, Trustee for the benefit of Lender dated March 15, 2007 (the "Deed of Trust"). The Loan Agreement, Note, Guaranty, Deed of Trust and all other documents evidencing and securing the Loan shall be referred to collectively herein as the "Loan Documents". Certain defined terms used herein that are not otherwise defined shall have the meanings ascribed to them in the Loan Documents.

1. Status of Loan. As of the date of this letter, the principal balance due under the Loan is approximately **$2,865,000.00**, plus accrued interest and late charges. The Loan matured on October 1, 2008 (the "Maturity Date").

Mr. Gordon Kovacs
February 24, 2009
Page 2

2. Refinance Application; Short Term Loan Extension. The Borrower has made application to HUD for a loan to be secured by the Property which will provide for the repayment of the Loan (the "HUD Application"). The Borrower proposes to extend the Loan until May 31, 2009 (the "New Maturity Date") for purposes of completing the HUD Application process and review and determining whether the HUD Application will be accepted. In consideration of Lender's agreement to extend the Loan as provided herein, Borrower shall make interest payments to Lender in the amount of $5,000.00 on each of March 31, 2009, April 30, 2009 and May 31, 2009. Lender shall waive any and all late charges, penalties, collection costs and additional interest accruing and due under the Loan between the Maturity Date and the New Maturity Date. These terms and conditions (and the other terms of this letter) will be evidenced by a formal Loan Modification Agreement to be executed by the parties on or before March 6, 2009.

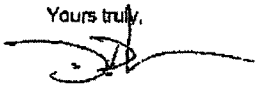
3. Acceptance of HUD Application. In the event the HUD Application is accepted by the New Maturity Date, the Loan will be further extended for a period of up to six (6) months to allow for the closing of the HUD loan. During this period, Borrower shall continue to make interest payments to Lender in the amount of $5,000.00 on the last business day of each month, which will be accepted by Lender as payment in full of all interest accruing and due during such period.

4. Rejection of HUD Application. In the event the HUD Application is not accepted by the New Maturity Date, Lender will agree to sell the Note to Borrower or any affiliate of Borrower or Guarantor for the sum of $1,500,000.00 (the "Note Sale"). The Note Sale shall occur within sixty (60) days following the New Maturity Date (the "Hold Period"). During the Hold Period, the Lender shall take no action to enforce its rights under any of the Loan Documents and will not sell or assign the Note or enter into any agreements to sell or assign the Note. Upon completion of the Note Sale, Lender shall not provide any negative information regarding Borrower or Guarantor to any of the credit reporting agencies, and shall not issue an IRS Form 1099 to either Borrower or Guarantor reflecting any "income" from the Note Sale.

5. Confidentiality. The terms of this letter and any subsequent settlement between the parties shall remain confidential among the parties and their counsel.

We appreciate your consideration of this proposal and believe that it is in the best interests of all parties to move forward in a non-confrontational manner. Our clients are prepared to memorialize the terms of this letter in a mutually agreeable Loan Modification Agreement as soon as possible following the Lender's acceptance thereof. Please feel free to contact me with any questions regarding this matter.

Yours truly,



Donald E. Phillips

Enclosure
c: William H. Weatherspoon

Donald Phillips

From: Kovacs, Gordon A. [gordon.kovacs@wamu.net]
Sent: Wednesday, February 25, 2009 12:14 PM
To: Donald Phillips
Cc: Brad Minsley
Subject: RE: WAMU loan to Highway 751

Dear Don: This proposal is not even close to being remotely acceptable. My first reaction was "this is ludicrous". You are behind well over $100,000 in payments. I am planning to contact my NC attorneys today. A foreclosure in NC takes enough time for you to have answer from HUD, if you wish to continue along that route. If you wish to get serious about negotiations, my phone number is 713 216-1346.

Yours truly,
Gordon

From: Cathy Miller - Donald Phillips' Executive Assistant [mailto:Cathy@pdrllc.com]
Sent: Tuesday, February 24, 2009 4:55 PM
To: Kovacs, Gordon A.
Cc: Brad Minsley; Donald Phillips
Subject: WAMU loan to Highway 751

Mr. Kovacs – Per our previous conversation, attached is letter dated today from Mr. Phillips.

CATHY MILLER
Executive Assistant to Donald Phillips

PHILLIPS DEVELOPMENT & REALTY
142 W. Platt Street
Tampa, Florida 33606
(813) 868-3100 x113
(813) 868-3102 (fax)

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Please consider the environment before printing this email

CAPMARK

December 11, 2008

Mr. Brad Minsley, Principal
Phillips Development & Realty
142 W. Platt Street
Tampa, FL 33606

Subject
Project Name: Willow Run
Location: 628 West Mallard Creek Church Rd.
Charlotte, NC
Number of Units 328
Loan Amount Requested: $28,758,700

Dear Brad:

Upon your execution and return in accordance with its terms, this Engagement Letter Agreement and all its attachments ("Agreement") shall constitute the loan application of PDRH, LLC ("Applicant") for a Commitment from Capmark Finance Inc. ("Capmark") to make a mortgage loan ("Loan") for the above referenced Project ("Project"). The Loan will be insured by the Department of Housing and Urban Development ("HUD") under the provisions of Section 221d4 pursuant to the National Housing Act as amended and the Regulations now in effect ("Insured Loan").

By signing this Agreement, Applicant agrees to the provisions as defined in Exhibit A, (General Terms and Conditions) attached and incorporated herein, which shall apply to the proposed Loan and agrees to pay to Capmark the fees and charges itemized in this Agreement.

The services Capmark will provide, pursuant to this Agreement, with respect to the HUD submission, shall include but are not limited to the following:

- Complete an initial underwriting and analysis of the Project and provide recommendations regarding the proposal to be submitted to HUD.
- Prepare and submit the necessary forms, exhibits and application(s) ("Application") for a Commitment for Mortgage Insurance for the above captioned project.
- Interact with all Principals and third party professionals regarding any requirements that are necessary for mortgage underwriting relative to the submission of the Application.
- Monitor your Application during the processing and underwriting period.
- Determine the most appropriate method of processing the Application either under Multifamily Accelerated Processing ("MAP") or traditional processing ("TAP").
- Serve as your advocate with HUD during all phases of the Application processing.
- Provide advice, guidance and assistance regarding the terms and conditions of the HUD Firm Commitment, and strategy to appeal any unacceptable underwriting or closing requirements.
- Facilitate in the placement of the construction and/or permanent funding of the Insured Loan with an investor whose terms and conditions are acceptable to the Applicant.

- Assist in the preparation and submission of the Insured Loan's initial/final endorsement ("Closing") documents.
- Close and service your loan.

The Loan will be funded by Capmark through the sale and delivery of Government National Mortgage Association ("GNMA") Mortgage Backed Securities or loan participation to an institutional investor ("Investor"). Any discount, placement fees or additional escrow deposits required for the placement of the loan at the underwritten rate will be determined after the issuance by HUD of the Firm Commitment for mortgage insurance.

Upon your execution and return of this Agreement in accordance with its terms, Capmark shall begin processing the Application and initiate the registration with the appropriate HUD office. Applicant agrees to cooperate and provide Capmark with all the necessary information for loan underwriting on a timely basis, as required by Capmark and HUD. Applicant agrees to provide to Capmark the sources and uses for any equity financing to be provided for this transaction prior to the submission of the initial application ("Application") to HUD. By accepting this Agreement, Applicant grants permission for any Capmark or HUD employee or their agents, to visit and inspect the property and the permission to disclose all information provided to them regarding the proposal, the management of the property, the Borrower and its Principals.

In consideration of the time and resources Capmark will devote on behalf of the Applicant, the Applicant grants Capmark the exclusive right to financially represent and be the Lender to negotiate with HUD. Applicant represents and warrants that upon execution of this Agreement, it will not execute another application to finance the project with any other lender or lender's agent until the termination of this Agreement with Capmark. Further, the Applicant hereby grants to Capmark the exclusive right to arrange for placement of the Insured Loan, which placement shall be subject to the terms and conditions of a separate Financing Commitment between the parties.

Both Capmark and the Applicant warrant and represent that this Agreement is the entire Agreement with respect to the payment of fees and expenses, and no other representation, written or oral, or prior written agreement is in any manner binding. No amendment or modification of this Agreement shall be valid unless in writing and signed by all parties.

The following Loan Terms are Capmark's initial estimates based on the preliminary analysis of the Project data, attached hereto as Exhibit "C", and are based on the information given Capmark by the Applicant. These terms are subject to adjustment and are not to be construed as a Commitment to make a loan.

Projected Loan Amount	$28,758,700
Loan Term/Amortization	40
Estimated Interest Rate	6.75% determined at time of rate lock.
Capmark Processing Fee	Waived
Third Party Reports	$ 9,200 Appraisals (Limited & Final) $ 6,000 Market Study $ 2,700 Environmental Report & 4128 $ 7,500 Architectural & Costs Reviews $_____ Inspection & Reserve Analysis $_____ Any special reports or reviews

HUD Application Fee	$ 86,278	(0.30% of the Loan Amount)
Financing Fee	$287,587	(1.00% of the Loan Amount)
Placement Fee	$ N/A	(0.00% of the Loan Amount)

If these terms are acceptable to you, please sign and return one original copy of this Agreement (including all Exhibits), together with a check in the amount of $25,400 representing the Processing Fee ($waived) and Third Party Report Deposit ($25,400). This Agreement will become effective only upon acceptance by the Applicant and receipt by Capmark within ten (10) business days following the date hereof.

We appreciate the opportunity to provide you with your financing needs and look forward to working with you on this transaction.

Yours truly,

By: Steve R. Brady VP.
Capmark Finance Inc.
Steve R. Brady,
Vice President

AUTHORIZED AND ACCEPTED THIS 18 DAY OF December, 2008:

Brad Minsley, Principal

By: _____
Name: Donald Phillips
Title: Managing Director

Attachments:

Exhibit A – General Terms and Conditions
Exhibit B – Partial List of Required Exhibits
Exhibit C – Preliminary Loan Analysis

EXHIBIT A

GENERAL TERMS AND CONDITIONS

The following General Terms and Conditions supplement the information in the Agreement Letter:

1. Under this Agreement, the definition of the Applicant shall include the legal single purpose entity which is intended to be the borrowing entity, if or when formed. The Principals or Sponsors of such entity shall include all the General Partners, all Limited Partners with 25% or more interest, the operating officers, all directors, and all shareholders with more than 10% interest; all Managing Members and Members with 10% or more interest, and any agents or assigns thereof. By signing this Agreement, the Applicant is indicating that it is the Owner of the Project, or the Owner's agent, or contractually in control of the Project by way of a valid, existing contract, and is duly authorized to execute this Agreement for the purpose of obtaining financing for the ownership entity identified herein.

2. Applicant hereby certifies that there is no financial or family relationship between any officer, director, stockholder, partner, or affiliate of Capmark, its principal staff or contract employees working on this transaction and any officer, director, stockholder, partner, affiliate or subsidiary of the Applicant, Borrowing Entity, it's Principals or Sponsors, the General Contractor, or the seller of the land or property. Applicant acknowledges that the MAP Program prohibits any identity of interest as described in this paragraph, and that traditional processing (TAP) requires prior written approval of any such identity of interest. Accordingly, Applicant agrees to notify Capmark immediately should any such identity of interest become known it.

3. The Processing Fee shall be used to offset Capmark's costs of travel, credit reports, and other reasonable expenses of Capmark in connection with the processing of the Application, to bring about the issuance of a Firm Commitment. The Processing Fee is in addition to any other fees or deposits collected for third party reports or HUD's Application Fee. If so desired, Applicant shall notify Capmark in writing that Applicant requests the option of authorizing any travel expenses prior to travel occurring. If expenses incurred by Capmark exceed the amount deposited by the Applicant, then the Applicant shall promptly reimburse such expenses upon demand by Capmark. The Applicant shall reimburse Capmark for expenses regardless of whether or not a Firm Commitment is issued or Closing is achieved.

   Applicant hereby agrees that if at any time during processing of the Application, the Applicant elects to cancel, withdraw or otherwise not to proceed with the Application, or intentionally fails to furnish Capmark with that which is necessary to complete processing of the Application, any funds continuing to be held by Capmark, after payment of all costs and expenses incurred to date by Capmark, shall be returned to Applicant. Applicant agrees to pay all costs, fees, and expenses incurred in connection with the preparation, processing, review, and submission of the Application. These charges include but are not limited to: the HUD Application Fee (0.30% of the Insured Loan Amount), costs of preparation and review of all exhibits to the Application (including any third party reports and technical reviews), surveys, title reports, attorney fees, and any other expenses necessary for the processing of the Application through the issuance of the Firm Commitment.

4. Applicant will pay to Capmark a Financing Fee of one percent (1.00%) of the Insured Loan amount stated in the Firm Commitment for processing the Application and obtaining a Firm Commitment from HUD. Upon issuance of the Firm Commitment, substantially in conformity with the material terms of the Application, or such other form and amount as shall be reasonably acceptable to the Applicant or its Principal (s) or Sponsor (s), the Financing Fee shall be considered earned, due and payable. Payment of the Financing Fee shall occur at the earlier of the Closing of the Insured Loan or the expiration of the Firm Commitment.

   Applicant agrees that there is no individual or group that has provided consultant services to Capmark or is due a fee from Capmark in connection with this transaction. Applicant agrees that Capmark has no responsibility for payment of any consultant fees relating to this transaction. Applicant agrees to indemnify Capmark from any and all claims, demands and liability for consultant commissions, assignment fees, finders or other compensation arising from the issuance of this Agreement by Capmark or the making of this Insured Loan.

5. Applicant will also pay to Capmark a Permanent Placement fee of N/A of the Insured Loan amount. The Permanent Placement Fee represents compensation for arranging the financing for the Insured Loan (including construction financing, if applicable). The Permanent Placement Fee will be considered earned, due and payable at the time of the Insured Loan is placed with an investor upon terms and conditions acceptable to the Applicant. The Permanent Placement Fee shall also be paid not later than Closing of the Insured Loan.

   The Financing Fee and Permanent Placement Fee outlined above are exclusive of any Insured Loan discounts, extension fees, bond issuance costs, and any HUD fees, or any other fees due any other parties not identified herein, all of which are to be paid by Applicant. In the event the Insured Loan will provide funds for construction or substantial rehabilitation, Principals or other acceptable guarantors will be called upon to guarantee payment of extension fees which may result from delays in achieving final loan closing.

6. Applicant acknowledges that: (a) Capmark's due diligence investigation and analysis of Applicant, its Principals or Sponsors, the Project and its operations, including all appraisals, market studies, engineering reports and other investigations shall be done or have been done for the sole benefit of Capmark in its preparation of the Application; (b) such analyses may not be relied upon for any other purpose whatsoever by the Applicant or any other party other than Capmark and HUD; and, (c) the analyses, appraisals, market studies, engineering reports and other investigations and reports are the property of Capmark solely for the use and benefit of Capmark, its affiliates and their respective assignees, and will be held in confidence and not released to others without the prior written consent of Capmark. Upon Applicant's request and execution of a Report Release Agreement acceptable to Capmark, Capmark may provide a copy of any appraisal, market study and/or engineering report to Applicant for informational purposes only. Applicant agrees to permit access to the Project for such investigations and provide all necessary credit search authorizations. No due diligence consultant engaged by Capmark is or shall be deemed an agent of Capmark or its affiliates.

7. Applicant acknowledges that, while Capmark will attempt to negotiate and obtain the Firm Commitment in general conformity with the terms in this Agreement and the Application, Capmark has made no representations or promises that HUD will issue such a Firm Commitment, and Capmark will not be responsible or liable to Applicant if such a Firm Commitment is not issued, or is issued on terms and conditions other than those contemplated by this application, or should the Insured Loan not reach Closing in a manner or within the time desired. Further, appropriation of credit subsidy, if applicable, for the Firm Commitment shall be the sole responsibility of HUD, and Capmark will not be held liable for lack thereof.

8. Neither this agreement nor any statements contained herein or in the Application shall be deemed to obligate Capmark directly or indirectly to make a Loan to the Applicant, or to otherwise render services to the Applicant in connection with the making of a Loan. Any such commitment to make a Loan shall be only upon terms and conditions agreed to by the parties in their sole discretion, and set forth in writing in a separate agreement between the parties. This separate agreement shall stipulate the financing terms and conditions for which the loan will be funded and shall not be enforceable against Capmark unless and until HUD has provided sufficient amounts of credit subsidy for this Insured Loan (if applicable), which shall be evidenced by written confirmation from HUD. Capmark may elect to fund the loan through its affiliate Capmark Bank, in which case Applicant agrees that all of Capmark's rights under the Firm Commitment will be assigned to Capmark Bank.

   To help the government fight the funding of terrorism and money laundering activities, Federal law requires that financial institutions implement a customer identification program for the purpose of obtaining, verifying and recording information regarding the identity of their customers. When you apply for a loan with Capmark that may be funded by Capmark Bank, you will be asked to provide the name, tax identification number, residence or principal place of business, organizational documents and other information that may be required to confirm the identity of the Applicant, the Mortgagor and each Principal or Sponsor of the Mortgagor as we deem necessary.

9. Applicant also acknowledges that Capmark is relying upon data and information provided by the Applicant in preparing the Application presentations and submissions. Applicant agrees to defend, indemnify and hold Capmark and its employees and agents forever harmless of and for all losses, costs or damages (including the costs and legal fees of attorneys selected by Capmark) incurred by Capmark as the result of any disputes between Applicant, HUD and other related parties in the transaction over the accuracy of the data, representations or information provided by the Applicant.

10. This Agreement may not be assigned by the Applicant or assumed by any other person or entity without the prior written consent of Capmark.

11. The scope of Capmark's services hereunder is wholly and expressly limited to comply with conditions, requirements or procedures imposed by HUD in connection with the Application and the issuance of the Firm Commitment. Capmark shall not be obligated to engage in any activity which would be considered to be "lobbying" pursuant to 24 CFR Part 86 or 87.

12. Capmark has the right to publicize the financing of this Insured Loan after Closing at its own expense.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Greensboro Field Office
Office of Multifamily Housing
1500 Pinecroft Road, Suite 401, Asheville Building
Greensboro, North Carolina 27407-3838
336-547-4000
www.hud.gov • espanol.hud.gov

NOV 18 2009

Phillips Mallard Creek, LLC
ATTN: Donald E. Phillips
142 West Platt Street
Tampa, FL 33606

Dear Mr. Phillips:

SUBJECT: Mallard Creek Apartments
Charlotte, North Carolina

This letter is to advise you that we have received the subject SAMA (Site Appraisal/Market Analysis) application proposing new construction of 300 units to be located on Mallard Creek Church Road in Charlotte, North Carolina.

If you have any questions, please contact Brenda Ward, Project Manager, at (336) 547-4000, extension 2125.

Sincerely,

Daniel A. McCanless, Jr.
Director
Greensboro Multifamily Hub

cc: Mr. Brad Minsley

Bloomberg.com

Capmark Files for Bankruptcy With $21 Billion in Debt (Update3)

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By Dawn McCarty

Oct. 26 (Bloomberg) -- Capmark Financial Group Inc., the lender owned by companies including **Goldman Sachs Group Inc.** and **KKR & Co.**, filed for bankruptcy protection after posting a second-quarter loss of about $1.6 billion.

The company listed consolidated debt of $21 billion and consolidated assets of $20.1 billion as of June 30, according to Chapter 11 documents filed yesterday in U.S. Bankruptcy Court in Wilmington, Delaware. Forty-three affiliates also sought protection.

Capmark, based in Horsham, Pennsylvania, is one of the largest U.S. commercial real estate finance companies, with more than $10 billion in originations, according to Moody's Investors Service. The company, formerly known as GMAC Commercial Holding Corp., services more than $360 billion of debt. It has struggled as the default rate on commercial mortgages held by U.S. banks more than doubled to the highest since 1994.

"The Capmark bankruptcy reinforces that, in the case of institutions with large concentrations in commercial real estate, current disruptions to the market have the potential to impact their viability," said **Sam Chandan**, president and chief economist of Real Estate Econometrics LLC, a commercial real estate consulting firm in Manhattan.

Capmark asked a bankruptcy judge to approve the sale of its loan-servicing and mortgage business to **Warren Buffett's** Berkshire Hathaway Inc. and **Leucadia National Corp.** for as much as $490 million. Higher bids would be sought at an auction. The deal was announced Sept. 2, the same day Capmark said it might file for bankruptcy.

'Saved or Sold'

"All the businesses will be saved and continue with Capmark or will be sold as going concerns for full value," attorney **Martin Bienenstock**, a partner at Dewey & LeBoeuf LLC in New York, which is handling the bankruptcy case, said in an e- mail.

Capmark provides mortgage financing and portfolio management services for investors in apartment buildings, offices, industrial property, shopping centers and malls. Unlike real estate investment trusts, Capmark's core business isn't holding property, according to its Web site.

Capmark and its units owe $7.1 billion to the 30 largest creditors without collateral backing their claims, according to court documents.

The three biggest are Citibank NA, as administrative agent under the $5.5 billion credit agreement, with a claim of $4.6 billion; Deutsche Bank Trust Co. Americas, as trustee for the 5.875 percent senior notes and the floating senior notes due 2010, with claims of $1.2 billion and $637.5 million, respectively; and Wilmington Trust FSB, as successor trustee for the 6.3 percent senior notes due 2017, with a claim of $500 million, according to court papers.

Late Payments

Capmark filed for bankruptcy following a drop in revenue from loan origination, servicing and its portfolio, said Chandan, who is also an adjunct professor at the Wharton School at the University of Pennsylvania in Philadelphia.

As of June 30, $4 billion in loans were late by 60 days or more, out of a total portfolio of $24.1 billion in securitized or owned mortgages, according to Capmark's most recent quarterly report. That was up from late payments on $1.52 billion in loans out of a $26.9 billion portfolio as of Dec. 31.

Commercial property values in the U.S. have plunged since 2007 as employers cut jobs and the recession reduced demand for offices, retail space and rental apartments. The Moody's/REAL Commercial Property Price **Indices** fell 3 percent in August from July, bringing the decline to almost 41 percent since October 2007, Moody's Investors Service said Oct. 19.

Unleased Space

U.S. office vacancies are at a five-year high, apartment vacancies are at a 23-year record, and retail centers are showing the greatest share of empty store-fronts since 1992, according to real estate research firm Reis Inc. All that unleased space makes it harder for landlords to pay their mortgages to lenders such as Capmark.

Property investors including New York developer **Harry Macklowe**, whose trophies included Manhattan's General Motors Building, and Tishman Speyer Properties LP, which controls the Chrysler Building and Rockefeller Center, are being affected by plunging values and a dearth of credit.

Losses from commercial real-estate lending pose the biggest threat to U.S. banks as the loans deteriorate, leaders of Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and Office of Thrift Supervision told the Senate Banking Committee earlier this month.

Capmark had its senior unsecured ratings lowered to C from Caa1 by Moody's Investors Service Inc. after the announcement of the potential sale, release of the operating results and restructuring efforts, according to a Sept. 9 credit opinion published by Moody's.

'Substantial Losses'

"Unsecured lenders and bondholders, either in a default or restructuring scenario, would experience substantial losses," Moody's said.

KKR, the New York-based private-equity company run by **Henry Kravis** and **George Roberts**, wrote the investment in Capmark down to zero as of March 31 of this year, according to data provided by KKR's publicly traded investment vehicle.

Andrea Raphael, a spokeswoman for Goldman Sachs, declined to comment on the status of her firm's investment in Capmark.

The case is In re Capmark Financial Group Inc., 09-13684, U.S. Bankruptcy Court, District of Delaware (Wilmington).

To contact the reporter on this story: **Dawn McCarty** in Wilmington, Delaware, at **dmccarty@bloomberg.net**.

Last Updated: October 26, 2009 17:39 EDT

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NORTH CAROLINA

WAKE COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
09 CVS 0566

JPMORGAN CHASE BANK, N.A.	)	
	)	
Plaintiff,	)	
	)	
V.	)	
	)	AFFIDAVIT
	)	
HIGHWAY 751 PARTNERS,	)	
And DONALD E. PHILLIPS	)	
	)	
Defendants.	)	

My name is Brenda Mulder. I am a citizen and resident of Hillsborough County, Florida.

Being duly sworn, I state:

1. I am an economist employed by the firm Mulder and Eastridge, Economists. I have been doing private consulting work for over twenty-six years. I have worked on several thousand legal cases in my career.

2. I have a Bachelor's degree in Education which I obtained in 1972 from the University of Florida. In addition, I have a Master's degree in Business Administration with a concentration in the area of finance and economics. My Master's degree was earned from the University of South Florida in 1985.

3. In addition to my educational background and studies, much of my professional time has been in the area of economics and financial research and analysis. I do consulting work for businesses, most of which is litigation related. I've been employed by the Center for Economic and Management Research at the University of Florida. I've done work for the United State Justice Department and I have worked with the Equal Employment Opportunity Commission determining economic losses. I've travel to South America to do research on economic conditions in Guyana. I've worked as a consultant doing studies to determine the economic impact of the phosphate industry in Hillsborough County. And I have taught classes at Hillsborough Community College as an adjunct instructor in Macroeconomics.

4. I have been qualified as an economic expert and offered testimony in both state and federal court hundreds of times.

5. My professional resume is attached as Exhibit A. I have been retained by Defendants and hereby offer the following calculations regarding this case.

6. Through information publically available, I became aware that on September 25, 2008, the United States Office of Thrift Supervision (OTS) seized Washington Mutual Bank from Washington Mutual, Inc. and placed it into the receivership of the Federal Deposit Insurance Corporation (FDIC). According to the OTS Fact Sheet, 9/25/08, Washington Mutual Bank had total assets as of June 20, 2008 of over $307 billion ($307,020,000,000.00). *See* Exhibit B (9/25/08 Press Release, OTS 08-046 – "Washington Mutual Acquired by JP Morgan Chase"); *See* Exhibit C (9/25/08 Press Release, FDIC – "JPMorgan Chase Acquires Banking Operations of Washington Mutual").

8. In September 26, 2008, JP Morgan Chase & Co., acquired Washington Mutual's banking operations from the FDIC for $1.9 billion dollars ($1,900,000,000.00). *See* Exhibit D (The Wall Street Journal, 9/26/08, "WaMu is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History").

9. Applying the above numbers obtained from public records, JP Morgan Chase & Co., acquired the assets from Washington Mutual Bank at 0.006 of their face value (0.6% or 6/10th of a cent on the dollar).

10. The face value of the loan between Highway 751 Partners and Washington Mutual is over 3 million dollars ($3,040,000.00).

11. Thus JP Morgan Chase & Co. would have paid slightly over 18 thousand dollars ($18,240.00) to acquire the Highway 751 Partners 3 million dollar loan from Washington Mutual.

12. If JP Morgan were able to collect the face value of this loan, it would result in a 3,021,760.00 increase above and beyond what they would have paid for this loan.

13. In my opinion, this would result in a 16,567% gross profit on this transaction as it relates to these parties.

Brenda Mulder
Mulder and Eastridge, Economists

STATE OF FLORIDA
COUNTY OF HILLSBOROUGH

I Norma L. Ray, Notary Public in and for said County and State, do hereby certify that Brenda Mulder personally appeared before me this day and acknowledged the due execution of the foregoing instrument.

WITNESS my hand and official stamp or seal this 22 day of July, 2009.

Notary Public
Commission Expires: 11/13/2011

NORMA L. RAY
Comm# DD0734024
Expires 11/13/2011
Florida Notary Assn., Inc

A

PROFESSIONAL RESUME

NAME : **BRENDA B. MULDER**

ADDRESS : 4613 W. North A Street, Tampa, FL 33609

TELEPHONE : (813) 286-1997

DEGREES : B.A., University of South Florida (Education), 1972
M.B.A., University of South Florida (Finance & Economics), 1985

QUALIFIED AS AN ECONOMIC EXPERT WITNESS IN THE FOLLOWING JURISDICTIONS:

- United States District Court, Middle District of Florida, Tampa Division
- United States District Court, Middle District of Florida, Ocala Division
- United States District Court, Middle District of Florida, Admiralty Division
- United States District Court, Middle District of Florida, Fort Myers Division
- United States District Court, Northern District of Florida, Gainesville Division
- United States District Court, Northern District of Florida, Tallahassee Division
- United States District Court, Southern District of Florida, Key West Division
- United States District Court, Southern District of Florida, Miami Division
- United States District Court, Southern District of Florida, Ft. Lauderdale Division
- Circuit Court of the Second Judicial Circuit of the State of Florida, in and for Leon County
- Circuit Court of the Fourth Judicial Circuit in and for Duval County, Florida, Civil Division
- Circuit Court of the Fifth Judicial Circuit in and for Marion County, Florida, Civil Division and Family Division
- Circuit Court of the Fifth Judicial Circuit in and for Citrus County, Florida
- Circuit Court of the Fifth Judicial Circuit in and for Hernando County, Florida

QUALIFIED AS AN ECONOMIC EXPERT WITNESS IN THE FOLLOWING JURISDICTIONS CONTINUED:

- Circuit Court of the Sixth Judicial Circuit in and for Pinellas County, Florida, Civil Division
- Circuit Court of the Sixth Judicial Circuit in and for Pasco County, Florida, Civil Division
- Circuit Court of the Eighth Judicial Circuit in and for Alachua County, Civil Division
- Circuit Court of the Eighth Judicial Circuit in and for Bradford County, Civil Division
- Circuit Court of the Ninth Judicial Circuit in and for Orange County, Florida, Civil Division
- Circuit Court of the Ninth Judicial Circuit in and for Osceola County, Florida, Civil Division
- Circuit Court of the Tenth Judicial Circuit in and for Highlands County, Florida, Civil Division
- Circuit Court of the Tenth Judicial Circuit in and for Polk County, Florida, Civil Division
- Circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida, General Jurisdiction
- Circuit Court of the Twelfth Judicial Circuit in and for Sarasota County, Florida, Civil Division
- Circuit Court of the Twelfth Judicial Circuit in and for Manatee County, Florida
- Circuit Court of the Thirteenth Judicial Circuit in and for Hillsborough County, Florida, Civil Division and Family Division
- Circuit Court of the Fourteenth Judicial Circuit in and for Bay County, Florida
- Circuit Court of the Fourteenth Judicial Circuit in and for Gulf County, Florida
- Circuit Court of the Sixteenth Judicial Circuit in and for Monroe County, Florida
- Circuit Court of the Eighteenth Judicial Circuit in and for Brevard County, Florida
- Circuit Court of the Twentieth Judicial Circuit in and for Lee County, Florida, Civil Division
- Circuit Court of the Twentieth Judicial Circuit in and for Charlotte County, Florida, Civil Division
- Circuit Court of the Twentieth Judicial Circuit in and for Collier County
- Circuit Court of the Twentieth Judicial Circuit in and for Hendry County, Florida, Civil Division
- Proceeding Before the National Association of Securities Dealers
- American Arbitration Association

CURRENT POSITION

MULDER & EASTRIDGE, ECONOMISTS, INC.

Appraisal of economic and financial losses associated with persons' loss of life and/or reduced capacity.

Business valuation to assist in the following: distribution of marital assets, value of leasehold interest, allocation of debt and equity positions, and appraisal of lost business profit/opportunity.

Evaluation of present value of benefits obtained in Workers' Compensation actions for purposes of attorney fee determination and claimants' settlement efforts.

Evaluation of employee wage and fringe benefit compensation packages.

Interpretation of regional, national, and international economic data for purposes of evaluating conditions effecting business, marketing and financial decisions.

Hillsborough Community College Adjunct Instructor of Economics 1997-Present.

Paradox Learning Systems, Inc.- serve on Board of Directors.

ACADEMIC EXPERIENCE

University of South Florida, College of Business Administration
Center for Economic and Management Research
Graduate Assistant, 1982-1983: Researched, obtained funding, published and marketed The Industrial Park and Site Guide
for Dade County, Broward County, and Palm Beach County

Auburn University, College of Business of Administration
Graduate Assistant; Professional Development, 1981-1982

PREVIOUS PROFESSIONAL EXPERIENCE

Mellish, Mulder and Eastridge, Economists (1983 to 1992) Consulting in areas related to current position.

Cobb County Board of Education, Educator (1972-1979) Marietta, Georgia.

HONORS AND AWARDS

Graduate Registration Fellowship 1982 (University of South Florida)
Dean's List of Scholar's

PROFESSIONAL PRESENTATIONS

"Economic Damages in Age Discrimination", presented at the Equal Employment Opportunity Practice 1987 conference, February 1987.

"1994 Advanced Current Labor Topics" The Florida Bar Continuing Legal Education Committee and The Labor & Employment Law Section, April 1994.

University of South Florida, Gus A. Stavros Center for Free Enterprise & Economic Education and the National Center for Middle School Education
Tampa, Florida, 1995.

Econ USA+ "Scarcity", Presentation for Educational Television Programing, University of South Florida, Gus A. Stavros Center for Free Enterprise Education.

"Economic Damages in Employment Cases" presented by Lorimar Productions for continuing legal education credits for Florida lawyers, January 1997.

Allgood-Altman American Inn of Court, Pasco County.
Panel Presentation. November 1998.

Trial Practice Section of the St. Petersburg Bar Association- Guest Speaker, April 2002.

Trial Practice Section of the St. Petersburg Bar Association- Guest Speaker, Economic Damages in Medical Malpractice, February 20, 2003.

PROFESSIONAL MEMBERSHIPS

Financial Management Association
National Association of Forensic Economics
Midwest Finance Association
Thirteenth Circuit Unlicenced Practice of Law Committee of the Florida Bar (formerly)

B

Press Releases

JPMorgan Chase Acquires Banking Operations of Washington Mutual

FDIC Facilitates Transaction that Protects All Depositors and Comes at No Cost to the Deposit Insurance Fund

FOR IMMEDIATE RELEASE
September 25, 2008

Media Contact:
Andrew Gray (202) 898-7192
angray@fdic.gov

JPMorgan Chase acquired the banking operations of Washington Mutual Bank in a transaction facilitated by the Federal Deposit Insurance Corporation. All depositors are fully protected and there will be no cost to the Deposit Insurance Fund.

"For all depositors and other customers of Washington Mutual Bank, this is simply a combination of two banks," said FDIC Chairman Sheila C. Bair. "For bank customers, it will be a seamless transition. There will be no interruption in services and bank customers should expect business as usual come Friday morning."

JPMorgan Chase acquired the assets, assumed the qualified financial contracts and made a payment of $1.9 billion. Claims by equity, subordinated and senior debt holders were not acquired.

"WaMu's balance sheet and the payment paid by JPMorgan Chase allowed a transaction in which neither the uninsured depositors nor the insurance fund absorbed any losses," Bair said.

Washington Mutual Bank also has a subsidiary, Washington Mutual FSB, Park City, Utah. They have combined assets of $307 billion and total deposits of $188 billion.

Thursday evening, Washington Mutual was closed by the Office of Thrift Supervision and the FDIC named receiver. WaMu customers with questions should call their normal banking representative, service center, 1-800-788-7000 or visit www.WaMU.com. The FDIC's consumer hotline is 1-877-ASK-FDIC (1-877-275-3342) or visit www.fdic.gov.

Additional Notices

- JP Morgan Acquires All Qualified Financial Contracts as Part of Washington Mutual Acquisition
- Washington Mutual Bank Investors – Additional Information
- Continuation of Contracts Transferred From Washington Mutual Bank

###

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. The FDIC insures deposits at the nation's 8,451 banks and savings associations and it promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars – insured financial institutions fund its operations.

FDIC press releases and other information are available on the Internet at www.fdic.gov, by subscription electronically (go to www.fdic.gov/about/subscriptions/index.html) and may also be obtained through the FDIC's Public Information Center (877-275-3342 or 703-562-2200). **PR-85-2008**

Last Updated 9/26/2008 communications@fdic.gov

C

Press Releases

September 25, 2008

OTS 08-046 - Washington Mutual Acquired by JPMorgan Chase

FOR RELEASE:
Thursday, Sept. 25, 2008

CONTACT: William Ruberry
(202) 906-6677
Cell - (202) 368-7727

Recent Upd
Press Relea
Events
Speeches
Testimony
Website Su

Washington, DC — Washington Mutual Bank, the $307 billion thrift institution headquartered in Seattle, was acquired today by JPMorgan Chase, the Office of Thrift Supervision (OTS) announced.

The change will have no impact on the bank's depositors or other customers. Business will proceed uninterrupted and bank branches will open on Friday morning as usual.

Washington Mutual, or WaMu, specialized in providing home mortgages, credit cards and other retail lending products and services. WaMu became an OTS-regulated institution on December 27, 1988 and grew through acquisitions between 1996 and 2002 to become the largest savings association supervised by the agency. As of June 30, 2008, WaMu had more than 43,000 employees, more than 2,200 branch offices in 15 states and $188.3 billion in deposits.

"The housing market downturn had a significant impact on the performance of WaMu's mortgage portfolio and led to three straight quarters of losses totaling $6.1 billion," noted OTS Director John Reich.

Pressure on WaMu intensified in the last three months as market conditions worsened. An outflow of deposits began on September 15, 2008, totaling $16.7 billion. With insufficient liquidity to meet its obligations, WaMu was in an unsafe and unsound condition to transact business. The OTS closed the institution and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. The FDIC held the bidding process that resulted in the acquisition by JPMorgan Chase.

Customer questions regarding the institution, including questions about federal deposit insurance coverage, should be directed to the FDIC at 1-877-ASK-FDIC. WaMu customers with questions can also call the bank's service center at 1-800-788-7000.

Office of Thrift Supervision

FACT SHEET

1700 G Street, N.W., Washington, D.C. 20552 • Telephone (202) 906-6677 • www.ots.treas.gov

FOR RELEASE:
Thursday, September 25, 2008
OTS 08-046A

CONTACT:
William Ruberry
(202) 906-6677
Cell – (202) 368-7727

OTS Fact Sheet on Washington Mutual Bank

Institution Profile

- Total assets as of June 30, 2008: $307.02 billion
- Primary executive and business segment headquarters are located in Seattle, Washington.
- Branches: 2,239 retail branch offices operating in 15 states
- 4,932 owned and branded ATMs
- Employees: 43,198 at June 30, 2008

Recent Deposit Flows

- Because of adverse events in the financial markets, material outflows began on September 15, 2008. Coupled with further rating agency downgrades of Washington Mutual Inc. (WMI, the top-tier holding company) and Washington Mutual Bank (WMB or the Bank), the Bank experienced a net deposit loss of $16.7 billion through September 24, 2008.

Other Financial Details (as of June 30, 2008)

- Total deposits: $188.3 billion
- Brokered deposits: $34.04 billion
- Total borrowings: $82.9 billion primarily comprising Federal Home Loan Bank advances of $58.4 billion and $7.8 billion of subordinated debt
- Loans held: $118.9 billion in single-family loans held for investment - this includes $52.9 billion in payment option ARMs and $16.05 billion in subprime mortgage loans
- Home Equity Lines of Credit (HELOCs): $53.4 billion
- Credit Card Receivables: $10.6 billion

- Total loan servicing: $689.7 billion total loans serviced, including $442.7 billion in loans serviced for others and $26.3 billion of subprime mortgage loans
- Non-performing assets: $11.6 billion, including $3.23 billion payment option ARMs and $3.0 billion subprime mortgage loans

Institution History

- WMI is the top-tier savings and loan holding company and owns two banking subsidiaries, WMB and Washington Mutual Bank, fsb (WMBfsb), as well as nonbank subsidiaries.
- Since the early 1990s, WMI expanded its retail banking and lending operations organically and through a series of key acquisitions of retail banks and mortgage companies. The majority of growth resulted from acquisitions between 1996 and 2002. On October 1, 2005, the Bank entered the credit card lending business by acquiring Providian Financial Corporation. These acquisitions enabled WMB to expand across the country, build its customer base, and become the largest savings and loan association in the country.
- The Bank had four business segments: the Retail Banking Group, the Card Services Group, the Commercial Group and the Home Loans Group. WMB is a leading originator and servicer of both single- and multi-family mortgages and a major issuer of credit cards.

Recent Events

- *Changes in Business Strategy* - Beginning in late 2006 through today, WMB was proactively changing its business strategy to respond to declining housing and market conditions. Changes included tightening credit standards, eliminating purchasing and originating subprime mortgage loans, and discontinuing underwriting option ARM and stated income loans. Management reduced loans originated for sale and transferred held for sale loans to the held for investment portfolio. WMB was focusing on shrinking its balance sheet and developing a retail strategy through its branch operations.

- *Reduction of Overhead Expenses* - In December 2007, WMB announced the resizing of its Home Loans business including the elimination of approximately 2,600 employee positions, closure of approximately 190 home loan centers and sales offices, and closure of nine loan processing and call centers.

- *Maintaining Capital* - In late 2006 and 2007, WMB began to build its capital level through asset shrinkage and the sale of lower-yielding assets. In April 2008, WMI received $7.0 billion of new capital from the issuance of common stock. Since December 2007, WMI infused $6.5 billion into WMB. WMB met the well-capitalized standards through the date of receivership.

- *Operating Losses* - WMB recorded a net loss of $6.1 billion for the three quarters ended June 30, 2008. In the second quarter of 2008, WMB management disclosed that the Bank's credit quality had deteriorated and it might incur up to $19 billion in losses on its single-family residential mortgage portfolio. WMB increased its loan loss provisioning in response to the deteriorating housing market. Loan loss provisions increased from $1.6 billion in the fourth quarter of 2007, to $3.6 billion in the first quarter of 2008 and $6.0 billion in the second quarter of 2008.

- *Deposit Outflows* – Since July 2008, the pressure on WMB increased as market conditions continued to worsen. Significant deposit outflows began on September 15, 2008. During the next eight business days, WMB deposit outflows totaled $16.7 billion, shortening the time available to augment capital, improve liquidity, or find an equity partner. Given the Bank's limited sources of funds and significant deposit outflows, it was highly likely to be unable to pay its obligations and meet its operating liquidity needs.

- *Receivership* - With insufficient liquidity to meet its obligations, WMB was in an unsafe and unsound condition to transact business. OTS placed WMB into receivership on September 25, 2008. WMB was acquired today by JPMorgan Chase. The change will have no impact on the bank's depositors or other customers. Business will proceed uninterrupted and bank branches will open on Friday morning as usual.

OTS Enforcement Actions

- October 17, 2007 – Issued a Cease and Desist Order related to deficiencies in Bank Secrecy Act/Anti-Money Laundering (BSA/AML) programs
- October 17, 2007 – Assessed Civil Money Penalties (CMPs) related to violation of flood insurance regulations
- November 14, 2007 – Initiated a formal examination of the appraisal process to assess the validity of a complaint filed by the New York Attorney General's (NYAG) Office
- February 27, 2008 – Issued overall composite ratings downgrade and received a Board resolution in response to the supervisory action
- June 30, 2008 – Initiated discussions about Memorandums of Understanding with WMI and WMB
- September 7, 2008 - Issued Memorandums of Understanding to WMI and WMB
- September 18, 2008 – Issued overall composite ratings downgrade

OTS Profile
Established - 1989
Thrift institutions supervised as of June 30, 2008 - 829
Thrift industry assets supervised as of June 30, 2008 - $1.51 trillion
OTS employees - 1,055
Washington Mutual Bank assessment revenue – 12.2 percent of 2008 OTS budget

D

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THE WALL STREET JOURNAL.
WSJ.com

SEPTEMBER 26, 2008

WaMu Is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History

By ROBIN SIDEL, DAVID ENRICH and DAN FITZPATRICK

In what is by far the largest bank failure in U.S. history, federal regulators seized Washington Mutual Inc. and struck a deal to sell the bulk of its operations to J.P. Morgan Chase & Co.

The collapse of the Seattle thrift, which was triggered by a wave of deposit withdrawals, marks a new low point in the country's financial crisis. But the deal, as constructed by the Federal Deposit Insurance Corp., could hold some glimmers of hope for the beleaguered banking system because it averts any hit to the bank-insurance fund.

Instead, J.P. Morgan agreed to pay $1.9 billion to the government for WaMu's banking operations and will assume the loan portfolio of the thrift, which has $307 billion in assets. The full cost to J.P. Morgan will be much higher, because it plans to write down about $31 billion of the bad loans and raise $8 billion in new capital. All WaMu depositors will have access to their cash, but holders of more than $30 billion in debt and preferred stock will likely see little if any recovery.

The deal will vault J.P. Morgan into first place in nationwide deposits and greatly expand its franchise.

The seizure was another watershed event in a frenetic period for the U.S. banking system, and came while members of Congress wrangled over the Bush administration's proposed $700 billion bailout package. The tally of U.S. financial giants that have either been seized by the government or sold themselves off to stronger firms in recent weeks includes mortgage titans Fannie Mae and Freddie Mac, insurer American International Group Inc., and Wall Street firms Lehman Brothers Holdings Inc. and Merrill Lynch & Co.

The failure of WaMu eclipsed what had long been America's largest bank bust on record, the 1984 collapse of Continental Illinois, which had $40 billion in assets.

The fact that no bank was willing to buy WaMu until it failed shows how badly confidence has eroded in a banking system awash with record profits just a few years ago. Faced with deepening losses on mortgages, credit cards and other loans, big and small banks across the country are struggling with what many bank executives say is a crisis far deeper than the savings-and-loan debacle.

The seizure of Washington Mutual is likely to send tremors through the thrift industry. Many of WaMu's smaller brethren are also struggling with a wave of bad loans and some have already been ordered by regulators to raise capital and stop growing. Many community and regional financial institutions are also slashing dividends, selling branches and reining in lending in order to preserve capital.

WaMu has suffered huge losses but still boasts a strong deposit base and a network of 2,239 branches that bigger banks would have paid dearly for when times were good. In March, with the credit crisis in full bloom, J.P. Morgan offered to acquire WaMu but was spurned in favor of a $7 billion infusion led by the private-equity firm TPG, considered one of the savviest buyout firms. TPG, led by investor David Bonderman, said it will lose $1.35 billion, wiping out its investment.

This is the second time that J.P. Morgan, the second-largest U.S. bank in stock-market value, has been a buyer of last resort. In March, the New York company agreed to purchase Bear Stearns Cos., getting a $29 billion backstop from the federal government.

FDIC Chairman Sheila Bair said that WaMu's downward spiral "could have posed significant challenges without a ready buyer." Referring to J.P. Morgan's willingness to buy WaMu and absorb its shaky loans amid continuing debate over the $700 billion bailout package, she added: "Some are coming to Washington for help, others are coming to Washington to help."

While WaMu has been struggling since last year, its demise occurred with breathtaking speed.

Starting Sept. 15, the day that Lehman filed for bankruptcy protection, WaMu's customers began heading for the exits. Over the next 10 days, they yanked a total of $16.7 billion in deposits, according to the Office of Thrift Supervision. That was about 9% of the thrift's deposits as of June 30. WaMu declined to comment.

Melody Williams, 50 years old, said in the past 30 days she has moved about $25,000 out of Washington Mutual, spreading it to other financial institutions she thought were stronger, including Wells Fargo & Co. Ms. Williams, the controller for an architecture firm, said she thought that Washington Mutual had gotten "too big for their britches" with too many deals over the years.

Accelerated Shutdown

Regulators also hustled to shut down WaMu faster than they have with other failing banks this year. Normally, when the FDIC and another regulatory agency are preparing to take over a bank, the FDIC will solicit bids for the bank on Tuesday or Wednesday and then seize it on Friday evening, after the bank's branches have closed for the weekend. Sometimes the FDIC will even wait another week to step in. Every bank to fail this year has been shut down on a Friday. The FDIC steps in on Fridays to ensure a smooth transition so that customers hardly notice the handover.

In WaMu's case, the FDIC set a Wednesday evening deadline for interested parties to submit their offers for various parts of WaMu. Twenty-four hours later, they were already preparing to seize the bank. Earlier this month, Treasury Secretary Henry Paulson made it clear to WaMu that the company should have accepted the takeover deal J.P. Morgan had offered earlier this year, according to a person close to WaMu.

As pressure mounted on WaMu over the past two and a half weeks, regulators sparred over how to handle the situation, according to people familiar with the matter. Last week WaMu met in Washington, D.C., with the FDIC and OTS, WaMu's chief regulator. WaMu, according to a person familiar with the situation, asked for the meeting because it had received conflicting information from the two agencies. The tension between the two groups was palpable, this person said. The FDIC, this person said, was more aggressive in describing the information it wanted from the thrift.

Federal regulators said the exodus of deposits left WaMu "with insufficient liquidity to meet its obligations." As a result, WaMu was in "an unsafe and unsound condition to transact business," according to the OTS.

The OTS closed WaMu on Thursday and appointed the FDIC as receiver. The FDIC ran the bidding process that resulted in the decision to sell WaMu's banking operations to J.P. Morgan.

The change, according to OTS, "will have no impact on the bank's depositors or other customers." WaMu's bank

branches will open on Friday morning as usual and business will "proceed uninterrupted."

As of June 30, WaMu had more than 43,000 employees, more than 2,200 branch offices in 15 states and $188.3 billion in deposits, according to the OTS.

"The housing market downturn had a significant impact on the performance of WaMu's mortgage portfolio," said OTS director John Reich.

With mortgage losses mounting and its stock price plunging, WaMu has been scrambling over the past month to find a solution. Last week, it put itself on the auction block. A number of banks -- including Citigroup Inc., Wells Fargo and Banco Santander SA -- pored over WaMu's books, but the bank didn't receive any offers. This week, WaMu's outside bankers approached a group of private-equity funds to gauge their interest in a deal. Those talks were viewed as a last-ditch effort.

Also this week, the FDIC took the step of reaching out to banks, asking them to express interest in taking over some or all of WaMu, according to people familiar with the matter. Those bids were due at 6 p.m. Wednesday.

J.P. Morgan's takeover of WaMu's deposits represents a huge blow for private-equity firm TPG, which led a deal to inject $7 billion into the thrift this spring.

"Obviously, we are dissatisfied with the loss to our partners from our investment in Washington Mutual," said a TPG spokesman. "The unprecedented turmoil in global financial markets and resulting macro crisis of confidence has radically changed the dynamics for all financial institutions, and led to widespread losses among investors throughout the sector." TPG said its losses are about $1.35 billion, wiping out its investment.

Before the deal, J.P. Morgan ranked as the fourth-largest bank as measured by branches, ranking below Bank of America Corp., Wachovia Corp. and Wells Fargo. Its network of more than 3,100 branches stretches across 17 states with deep penetration in New York, Illinois, Texas, Michigan and Ohio.

Instant Presence

The deal will expand J.P. Morgan's footprint westward and into the South. Most importantly, it will give J.P. Morgan an instant presence in two states where it is now virtually non-existent: California and Florida. Although both states have been battered by the housing market collapse, they still offer significant potential for J.P. Morgan, which can pitch a slew of financial services that weren't big business for WaMu, such as wealth management and commercial banking. WaMu has nearly 700 branches in California and operates more than 250 branches in Florida.

James Dimon, J.P. Morgan's chairman and chief executive, has long coveted Florida -- as have his customers. Although WaMu is dominated in Florida by Bank of America and Wachovia, J.P. Morgan is likely to boost WaMu's 3% market share in the state by tapping into its base of New York customers who spend the winter months in Florida.

Last year, one of those New York customers expressed frustration at J.P. Morgan's annual meeting, telling Mr. Dimon "it galls me" that the bank didn't have a presence there.

"It p- me off too," Mr. Dimon said, drawing laughter from the audience. "Believe me, we would love to be much bigger in Florida and we'll find some way to do it. You will see us there."

The job of integrating WaMu's branches into J.P. Morgan's vast network will fall to Charles Scharf, a longtime ally of Mr. Dimon who followed him from Citigroup to Bank One Corp. in 2000. Mr. Scharf, 43, now runs J.P. Morgan's retail operations, which include branch-banking, mortgages and home-equity loans.

Over the past few years, Mr. Scharf has overseen the overhaul of J.P. Morgan's hodgepodge of retail branches that had

fallen into disrepair after a slew of big mergers. J.P. Morgan has poured millions of dollars into its tired branches that sometimes featured outdated logos and chipped wood paneling.

Taking a cue, in part, from the fresh looks flaunted by rivals like WaMu, Commerce Bancorp., and Bank of America, J.P. Morgan added brighter lights and carpeting. The bank also hired Lands End to design outfits for branch employees so they had an easily recognizable and uniform appearance.

Along with the new looks, J.P. Morgan launched a technology overhaul of its branch network so that customers who open an account in Texas could make deposits from a branch in New York. That type of integration has been missing from many banks that went through big mergers over the past decade.

J.P. Morgan's branch strategy got another push in 2006, when the bank solidified its hold on New York by acquiring 300 branches from Bank of New York Corp.

The deal is a bold move for Mr. Dimon, 52, who has emerged as one of the banking industry's most powerful executives during the current credit crisis. Just six months ago, J.P. Morgan swept in to acquire Bear Stearns as the brokerage firm was collapsing and heading for bankruptcy. Although J.P. Morgan has also been hurt by the credit crisis, it has one of the strongest balance sheets in the industry despite exposure to many of the banking businesses that are feeling pain.

Since taking the reins of J.P. Morgan nearly three years ago, Mr. Dimon has transformed the bank. Much of those efforts came during a period of prosperity for the banking industry, giving him time to upend the bank's culture and computer systems. Along the way, he has emphasized the need to create a "fortress balance sheet" that can withstand a weak economy.

Still, J.P. Morgan isn't immune to the troubles afflicting thousands of other banks. Its investment-bank unit is expected to take a big hit in the third quarter due to the widespread turmoil in capital markets. The bank has been hit badly by home-equity losses and its massive credit-card business is being hurt by rising delinquencies and defaults.

A former protégé of Citigroup's Sanford Weill, Mr. Dimon was once viewed as his heir-apparent at Citigroup. But the two had a falling out in 1998 that led to Mr. Dimon's ouster. In a move that startled the New York banking industry, Mr. Dimon headed west to take the top job at Bank One, a regional Chicago bank that had stumbled after a string of acquisitions.

Mr. Dimon's return to New York came in 2004, when J.P. Morgan acquired Bank One for $58 billion. That deal put Mr. Dimon into the upper ranks of J.P. Morgan's management and paved the way for him to take over as chairman and chief executive officer.

String of Mergers

WaMu, founded in 1889, became a national mortgage- and consumer-lending giant via a string of mergers in the 1990s led by Chief Executive Officer Kerry Killinger. But Mr. Killinger made several missteps. He pursued an aggressive retail expansion marred by poor locations in too many markets. He steered WaMu into subprime mortgages, only to discover too late that the thrift was lending to many unqualified borrowers.

This year the company laid off employees, closed mortgage centers and cut its dividend.

But it still posted a $3.3 billion second-quarter loss and said it expected to lose $19 billion on its mortgage portfolio over the next two and a half years. WaMu's biggest predicament was that it held large amounts of mortgages made in U.S. regions where housing prices have fallen sharply, such as California. WaMu has $53 billion in option adjustable-rate mortgages, a type of loan particularly vulnerable to default, as well as $16.1 billion in loans made to subprime borrowers.

The board, responding to investor discontent, stripped Mr. Killinger of his chairman's title and then ousted him Sept. 7, installing Brooklyn banker Alan Fishman in his place. Messrs. Killinger and Fishman couldn't be reached for comment Thursday night.

Short Tenure

Upon taking WaMu's helm, Mr. Fishman, who had run Independence Community Bank in Brooklyn, N.Y., before selling it to Sovereign Bancorp Inc. in 2005, declared his intention to keep WaMu independent. As rumors swirled about the company's financial troubles, he tried to reassure investors and depositors by releasing more details about the company's financial health.

But Mr. Fishman seemed to realize that WaMu's problems were intractable. Last week, he asked Goldman Sachs Group Inc. investment bankers, hired by WaMu earlier in the year as it sought additional capital, to put the thrift up for sale.

In a year in which a number of financial-services CEOs have had remarkably short tenures -- notably Merrill Lynch's John Thain and AIG's Robert Willumstad -- Mr. Fishman stands out. While it's not clear what role, if any, he will play following the J.P. Morgan transaction, he has been on the job for a mere 16 days.

WaMu's deal team, including Mr. Fishman, left New York on Thursday night and caught a plane back to Seattle, not knowing that the company was about to be taken over by the OTS and sold to J.P. Morgan.

—Damian Paletta and Peter Lattman contributed to this article.

Write to Robin Sidel at robin.sidel@wsj.com, David Enrich at david.enrich@wsj.com and Dan Fitzpatrick at dan.fitzpatrick@wsj.com

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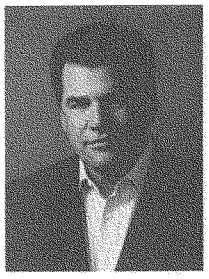

Donald E. Phillips
Managing Director

Donald Phillips, managing director of Phillips Development & Realty, LLC (PDR), has been in the real estate industry since the early age of 19. As one who considers family a huge driving force in his life, it is only fitting that Phillips began his career conducting his first real estate transaction with none other than his mother. With the property he purchased, costing only $18,000, he made a 40 percent return in just seven months.

This initial achievement – along with the inspiration he obtained while observing his father's successes in the business so many years prior – confirmed for Phillips his desire to work in real estate and development also. Following in the footsteps of his father, who died in an airplane crash when Phillips was 14, he entered into the business in 1986 and received his North Carolina broker's license two years later. In 1990, he joined Hock Development, Inc. where he structured development programs for medical office buildings throughout the Southeast. The company's position in the marketplace increased remarkably with his leadership.

It was at Hock Development, Inc., under the tutelage of his mentor and the principal, Gary Hock, that he learned the inner workings of corporate real estate structure. Following his departure from Hock Development, Inc. in 1994, his first transaction was the Triangle SportsPlex, an 82,000 square foot facility combining an Olympic-size aquatic center, hockey rink and public concession area. The transaction, which occurred in North Carolina, was an IRS 63-20 bond (a nonprofit, single purpose entity issuing a non-rated, tax exempt bond through private placement) offering for $10.6 million.

Phillips began his move from operator to operation with the formation of PDR in 1999. He formally organized PDR as an entity which focused exclusively on the multi-family rental business. While he remains committed to this centralized multi-family niche, his broad real estate portfolio spans work in office, institutional, recreational, and industrial applications.

Phillips has been the driving force behind the upscale residential and mixed-use developments of PDR. Most recently, he has been recognized for work done with the *Phillips University Center* in Charlotte, N.C., *Phillips International* in Tampa, Fla., *Phillips at McKinney Ranch* in Texas and the one-million-square foot mixed-use project in Houston known as *Mosaic*.

In 2003, Phillips relocated the PDR headquarters from Raleigh to Tampa, Fla. Since then, he has continued to build a legacy representing quality and integrity in the industry, and his work has captured the attention of leaders throughout the state. To date, Phillips has received three gubernatorial appointments and serves on multiple influential legislative policy committees. He was appointed twice by Governor Crist to the Tampa-Hillsborough County Expressway Authority (THEA) board, and currently serves as the Vice Chairman. His experience and familiarity with the surrounding communities made him the best choice for the $40-million-a-year THEA, which owns and operates the Selmon Crosstown Expressway.

Additionally, Phillips was appointed board member to Enterprise Florida (e-Florida) by Speaker of the Florida House of Representatives, Larry Cretul. In June 2009, he was reappointed to the board by Governor Crist and asked to serve on the Legislative Policy Commission, a liaison group which collaborates with the state legislature and cabinets to review and promote initiatives fostering both competitiveness and effectiveness. He works closely with this board in the continued pursuit of international trade, visiting regularly with his counterparts in Costa Rica and Panama, among others, to source and promote opportunities for the small businesses of the State of Florida.

Most recently, he was appointed one of five board members for the Transportation and Expressway Authority Membership of Florida (TEAMFL), an association representing the five expressway authorities of Florida. At this post, he will continue to share innovative ideas for toll road operations, including acquisition, financing, and marketing.

With more than 25 years of industry experience, Phillips has developed over 3,000 multi-family residential units, office/retail spaces, medical and municipal facilities - totaling more than $500 million. Today, he remains committed to selecting promising locations and projects in the best interests of communities, investors, and the environment. Phillips leads the industry with new business practices and environmentally-conscious initiatives which are models for the real estate industry.

Personally, he is an avid sportsman, conservationist, adventurer, and traveler, combining his appreciation for the scenic wonders of South America, Africa, and Europe with his passion for angling, wing shooting, and big game hunting. Phillips' enjoyment of aviation started as a boy, flying frequently with his father, and continues as he now shares this joy with his sons in their Mooney Ovation. His beloved family consists of his wife Erin and their children Brenden (7 years), Collin (5 years), Cooper (4 years) and Kodee (16 months).

Contact Info:
Email Don@pdrllc.com
Office (813) 868-3100
Cell (813) 846-2669
Fax (813) 868-3102

Phillips Development & Realty, LLC
142 W. Platt Street
Tampa, Florida 33606
www.PHILLIPSDEVELOPMENT.COM

COMMERCIAL REAL ESTATE SERVICES

CBRE
CB RICHARD ELLIS

Monica Newman
First Vice President

CBRE HMF, Inc.
FHA / HUD

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Sales • Finance • Investment Banking

1225 17th Street
Suite 2950
Denver, CO 80202

303 628 1703 Tel
303 628 1751 Fax
303 881 3246 Cell

monica.newman@cbre.com
www.cbre.com/capitalmarkets

February 25, 2010

Phillips Development & Realty
142 W. Platt Street
Tampa, FL 33606
Attn Kevin Johnston

Re: Phillip Mallard Creek
Charlotte, North Carolina

Dear Mr. Johnston,

CBRE HMF, inc. is pleased to announce that the TAP Site Analysis Market Appraisal (SAMA) application submitted to the HUD North Carolina Field Office ("HUD") has been accepted by HUD as of Tuesday, February 23, 2010. HUD indicated that this project is located in one of the most viable markets in Charlotte and based on this analysis they will be issuing a SAMA approval in the near future.

Additionally, during our conversations we discussed converting this application from a TAP SAMA to a MAP application as well as transferring the application fee paid with the SAMA to the MAP application. This request has been provisionally approved, subject to a written request from CBRE HMF, Inc. following receipt of the SAMA approval letter.

We also discussed the credit issues surrounding the bankruptcy with this project. HUD is currently reviewing the process they wish to employ and will outline the same to us shortly. It will be the same process currently to be used with the other under HUD's review known as Phillips Mallard Swift. We recognize you are in the midst of completing this process with that application and it will be a relatively easy task of duplicating the effort and applying it specifically to this project.

We look forward to moving forward with the final underwriting of this project loan with a loan closing following thereafter. HUD advised that the closing may occur as quickly as we and the borrower are able to complete the due diligence package and submit to them so that they may complete their review. Please call me with any questions.

Sincerely,

Monica L. Newman

February 24, 2010

Via Email @ mfairchildhunter@gmail.com
ATTN: Matthew F. Hunter

Dear Mr. Hunter,

Sir, I am the Chief Operating Officer for our company. I am also a retired Colonel from the United States Air Force. I am a career leader and program manager...in short I am a problem solver and I get results. I manage all of our company's efforts associated with execution of five multi-family projects utilizing the Department of Housing & Urban Development (HUD) Section 221(d)(4) FHA financing program. One of these five projects is our Mallard Creek Project in Charlotte, NC which will consist of 300 units at the Gates of the University of North Carolina, Charlotte. This program will provide funds for the land payoff owed to JP Morgan and construction of 300 Class A apartments.

As you know, the 221(d)(4) program is structured into two steps. Step 1 is pre-application and step 2 is firm commitment which leads to loan closing. In a perfect world on average this entire process is 12-14 months to get to loan closing. We have been diligently working the Mallard Creek project since Dec 2008 and we are nearing the goal line to close.

We have overcome many uncontrollable variables along the way including the financial failure of our initial FHA lender CAPMARK Finance Inc. This set back alone cost us months and required us to re-assign the loan to CBRE (see attached) which is why we are in month 14. Nevertheless, our team has pulled through and we are on the 2 yard line as we expect a Firm Commitment from HUD any day now (see attached email from CBRE). We are poised to submit our Firm Commitment package now which will lead us to closing in the next 4 months. Our near term schedule is outlined below:

ITEM	DUE DATE	STATUS
Complete Civil, Arch Plans Specs	6 Jan 10	Complete. Land Design and Preston locked and loaded
GC Selection and draft construction contract	31 Dec 09	Complete. McShane Construction selected based on competitive acquisition process
Finalize 2328s (Hard Costs)	11 Jan 09	McShane Draft Complete
HUD AE Review Plans & Specs	15 Mar 10	Ray Ruff to be used same as Swift Creek. Transition to MAP
Firm Application complete	30 Apr 10	PDR in process in advance of LOI from HUD
Close and construction begins	1 Jun 10	Will need to pull permits already funded

As you can see we are swiftly proceeding to closing. What is not shown on the above schedule is the 12 months of work we have accomplished to get to this point. We are persistent and have a highly capable team. We have all confidence this project will close in the next several months.

PHILLIPS DEVELOPMENT & REALTY, LLC

I can be reached on 813-868-3100 x 136 or kevin@pdrllc.com.

Very Respectfully,

Johnny K. Johnston, Chief Operating Officer
Phillips Development & Realty

CHARLIE CRIST
GOVERNOR

November 12, 2008

To Whom It May Concern:

We are fortunate to have business and civic leaders like Donald Phillips in the great State of Florida.

Since moving his company, Phillips Development & Realty LLC, to the Sunshine State over 5 years ago, Donald continues to be influential in the real estate industry, building upscale multi-family and mixed use developments throughout the southern United States. Over the years, Donald has built more than 2,000 multi-family units in addition to municipal and commercial projects. During his time in Florida Donald has actively serving his local community by supporting the Ryan Neece Foundation, the Florida Sheriffs Association, and Voices for Children. In 2007, I appointed Donald to the Tampa-Hillsborough County Expressway Authority, a position I reappointed him to earlier this year.

I appreciate Donald's commitment and service to the great State of Florida!

Sincerely,

Charlie Crist

THE CAPITOL
TALLAHASSEE, FLORIDA 32399 • (850) 488-2272 • FAX (850) 922-4292

SENATOR VICTOR D. CRIST

August 28, 2009

Don Phillips
Phillips Development & Realty LLC
Parkside of One Bayshore
142 West Platt Street
Tampa, FL 33606

Dear Don:

Thank you for meeting with me on Wednesday and your willingness to give me your time. I really enjoyed our conversation. I look forward to meeting with you again to see your good work and to explore opportunities for community improvement.

Please remember that my door is always open. If there is ever an issue that my staff or I can assist you with, please feel free to call on me.

Sincerely,

Victor

Senator Victor D. Crist

POST OFFICE BOX 47058 • TAMPA, FL 33646

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August 21, 2009

Mr. Donald E. Phillips
Managing Director
Phillips Development & Realty, LLC
142 West Platt Street
Tampa, FL 33606

Re: Mr. Donald Phillips, Phillips Development & Realty

To Whom It May Concern:

I am pleased to offer this letter of recommendation for Don Phillips, as well as for his company, Phillips Development and Realty (PDR). We began our relationship with PDR back in 2003 and have had the privilege of providing architectural services on no fewer than 18 of their projects these past six years. During that time, Don put together an expert team and provided the leadership that now ranks PDR as one of our most reputable and successful clients. Their considerable depth in talent is coupled with an ability to execute on projects that makes them the envy of many of their peers.

I have also enjoyed a personal friendship with Don, which has flourished these past six years. I have come to know him as a man of honesty, integrity and fairness. He has a strong entrepreneurial spirit about him which gives energy to just about anything he does. Additionally, I think he has a great strength in being positive, humorous and enthusiastic, especially at times which are often most demanding of him.

We hope to continue doing business with Don and PDR as long as they will allow us to service their architectural needs. I can unequivocally recommend both of them and I hope you will not hesitate to call me should greater insight be needed.

Sincerely,

Robert N. Preston, AIA
Managing Principal
The Preston Partnership, LLC

X:\1Preston\1Bob\Correspondence\LET_PDR_Rec_09_08 19.doc

JOHN McCAIN
UNITED STATES SENATOR

March 6, 2009

Mr. Don Phillips
Phillps Development & Realty
PO Box 458
Tampa, FL 33601

Dear Don,

Cindy and I cannot begin to express our sincere appreciation and gratitude for your friendship. Our campaign for the presidency was and will remain the great honor of my life.

Through it all, your tireless dedication, generosity and support never wavered. And for that, Cindy and I will always be grateful.

The journey we have been through together was a long one, and recently Cindy and I have had time to reflect on what our campaign accomplished. It was an historic campaign inspiring millions of Americans across the political spectrum and we hope you stand proud of all that we accomplished.

Our campaign was about building the foundations for a stable and enduring peace, setting new standards for accountability and transparency in Washington by changing the way government does business, and getting our nation back on the road to prosperity.

As I have done for over fifty years, I will continue to serve and stand up for what I believe. These are difficult times for our nation and the world, and our cause remains. I will continue on this journey fighting for what is right for our country.

I remain a humbled servant to a country that I love and hold dear. I will always be appreciative of your confidence in me and for your friendship throughout our journey.

It has been, and continues to be, a privilege and an honor.

Sincerely,

John

John McCain

Paid for by the McCain-Palin Compliance Fund
1235 South Clark Street, Suite 1206, Arlington, Virginia 22202

The Florida House of Representatives

Office of the Speaker

Larry Cretul
Speaker

March 4, 2009

Mr. Donald Phillips
Phillips Development and Realty
142 West Platt Street
Tampa, FL 33606

Dear Mr. Phillips:

It is my pleasure to appoint you to Enterprise Florida, Inc. Board of Directors to complete the remainder of the term vacated by the resignation of Mr. James Holton. Your term is effective immediately and will end on August 12, 2009.

By copy of this letter, I am notifying John Adams, President and Chief Executive Officer of Enterprise Florida, of your appointment. Any questions you may have may be directed to Mr. Adams at 407-956-5600.

Thank you for giving of your time to serve.

Sincerely,

Larry Cretul
Speaker

cc: The Honorable Charlie Crist, Governor
The Honorable Jeff Atwater, Senate President
Mr. John Adams, Enterprise Florida

420 The Capitol, 402 South Monroe Street, Tallahassee, Florida 32399-1300
(850) 488-1450

FOWLER WHITE BOGGS
Attorneys at Law Est. 1943

August 3, 2009

SUBJECT: Mr. Donald Phillips
Managing Director
Phillips Development & Realty, LLC
Parkside at One Bayshore
142 Platt Street
Tampa, Florida 33606

To Whom It May Concern:

It is my pleasure to transmit this letter of recommendation for Donald Phillips. Don is a capable and committed businessman who has made it his mission to support the communities of Tampa Bay and to make a significant difference for those who live here. With over 20 years in the real estate industry, he founded Phillips Development & Realty, LLC in 2001. He has successfully led the company to achieve significant notoriety for his upscale residential and mixed-use developments.

As a result of Don's success in the business community as well as his wealth of experience and knowledge, he was appointed by Governor Charlie Crist to serve on the Tampa-Hillsborough County Expressway Authority (THEA) – a user-financed public agency tasked with developing and owning toll highways. Don's contribution on the THEA Board has led to new and exciting proposals to meet the significant transportation needs of the community.

Finally, Don has put his considerable capacity to good use in helping to mentor others in successful business initiatives. I have the deepest respect for Don and am happy to provide this recommendation for your consideration.

Sincerely yours,

Rhea F. Law
CEO and Chair of the Board

RFL:cdf

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501 EAST KENNEDY BLVD., SUITE 1700 • TAMPA, FLORIDA 33602 • P.O. BOX 1438 • TAMPA, FL 33601
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Florida House of Representatives
Representative Darryl E. Rouson

Darryl.Rouson@myfloridahouse.gov

District 55
District Office:
1198 62nd Avenue South
St Petersburg, FL 33705
(727) 552-1370
(727) 552-1372 (fax)

Tallahassee Office:
210House Office Building
420 South Monroe Street
Tallahassee, FL 32399
(850) 488-0925

November 3, 2008

To Whom It May Concern,

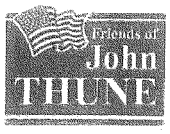
Donald Phillips is a model for community leadership in the Tampa Bay area. Not only does Don provide quality building product and design, but he is constantly improving the community in which he does business. Don's success and reputation is directly attributed to his community activism and benvolent giving.

The Tampa community is grateful for Don's involvement in many non-profit organizations including the H. Lee Moffit Cancer Center, Children's Dream Fund, American Cancer Society, Ryan Nece Foundation, Project Uplift, and One Breath at a Time, Inc.

It is truly a gift to have Don Phillips working within our community.

Regards,

Representative Darryl E. Rouson



PO Box 841 • Sioux Falls, SD 57101 • Phone (605) 221-1010 • Fax (605) 221-1021 • www.johnthune.com

September 16, 2008

Donald Phillips
PO Box 458
Tampa, FL 33601-0458

Dear Don,

Thank you for your generous contribution of $1,500.00 to my reelection campaign.

Your contribution has helped me to get a serious head start on my opponents so they can't use the same tactics against me that they're using now against our friends nationwide during this election.

Don, thank you again for your ongoing friendship and support. Please enjoy the rest of your summer spending time with family and friends.

Sincerely,

John Thune
United States Senator

Don, as always, it's an honor to receive your friendship and special prayers and support. Thank you. It was great being with you in Minneapolis. We appreciate and need your support. Enjoy the rest of your summer.

Paid for and authorized by Friends of John Thune

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JE DUNN®
CONSTRUCTION

July 23, 2009

Donald Phillips
Phillips Development
142 West Platt Street
Tampa, FL 33606

Dear Donald,

In response to your request for a letter of reference, I am very pleased to have the opportunity to state the following:

I have worked closely with Don Phillips over a recent four-year period. At the time, I was serving as Chairman/CEO of JE Dunn South Central and our firm was engaged as the Builder for the construction of two, 400-unit, 23-story residential towers.

During that period of time I was very involved in both the preconstruction and construction phases of the project and interfaced with Don on a frequent basis. I found Don Phillips to be a person of high intellect, high integrity and a person who was always good for his word.

I have worked with many Owners/Developers over my 45-year career in the building industry and would place Don Phillips at the top of my list of Owner/Developers with whom I would want to have a repeat relationship.

Regards,

Peter G. Doyle, FAIA, LEED AP

ATLANTA
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901 S. Mopac Expressway, Suite 200, Austin, TX 78746 | TEL > 512.329.9618 | FAX > 512.306.1255 | WWW.JEDUNN.COM

CITY OF TAMPA

Pam Iorio, Mayor

November 17, 2008

RE: Donald Phillips
Managing Director
Phillips Development & Realty, LLC
Parkside at One Bayshore
142 Platt Street
Tampa, FL 33606

To Whom It May Concern:

It is a pleasure to send this letter of recommendation on behalf of Donald Phillips, a person I have come to know well over the last several years. Don is a very successful businessman in our community. He has a positive can-do attitude that has contributed greatly to our county.

His commitment to our community is well-known and is particularly evident in both his professional life and in the many political, civic and philanthropic causes he is devoted to. Our city is successful in large part because of citizens such as Don and his efforts have been instrumental in improving the quality of life for Tampa's citizens.

It is always good to see someone who is sincere in their desire to help make life better for others. Don has a very positive reputation in our community is respected immensely. Please feel free to contact me if I can provide further information.

Sincerely

Pam Iorio

Compass Bank

24 Greenway Plaza
P.O. Box 4444
Houston, Texas 77210-4444
713-499-8625
Fax 713-499-8675

George M. Bolwood
Senior Executive Vice President

October 17, 2008

RE: Donald E. Phillips, Phillips Development & Realty, LLC

To Whom This May Concern:

On behalf of Compass Bank, I am happy to recommend Donald E. Phillips and Phillips Development & Realty, LLC as a prospective client to you.

Beginning in 2001, Compass Bank began its relationship with Phillips Development and Don Phillips by serving as the lead bank on the 396-unit Mosaic Phase I high-rise apartment tower built in Houston, Texas. Mosaic Phase I is now complete and has successfully converted into a condominium tower with over 200 units under contract or sold.

Since the inception of this relationship, Compass Bank has financed an additional four multi-family projects with total commitments exceeding $72,000,000. These projects are located in three different states, Texas (commitment of $17.4 million), North Carolina (commitments of $5.9 million and $30.3 million), and Florida (commitment of $15.5 million). Compass has also extended a personal line of credit to Mr. Phillips in the amount of $4 million for working capital purposes.

In addition, Mr. Phillips has a wealth management account with Compass and utilizes Compass' financial risk management products and insurance products. Over the last several years and throughout the process of closing, constructing, and completing these projects, Phillips Development & Realty and Don Phillips have performed as agreed. Mr. Phillips' team of executives and staff have been extremely involved, highly motivated, and very responsive throughout each step.

Compass Bank is pleased to consider Mr. Phillips and Phillips Development & Realty one of our top Commercial Real Estate clients.

Sincerely,

GMB/tyb

CLINTON GROUP

October 1, 2008

David M."Tanker" Snyder
Clinton Group
3507 Bayshore Blvd, Suite 1501
Tampa, FL 33629
(813) 412-8131 Direct

In reference to:
Donald Phillips
Managing Director
Phillips Development & Realty, LLC
Parkside at One Bayshore
142 Platt Street
Tampa, FL 33606

Dear Business and Civic Leader:

It is with great pleasure that I recommend Donald Phillips. Since arriving over five years ago in Tampa, when I was serving as the MacDill Air Force Base installation commander, Don has become a highly admired business and community leader. I was fortunate to get to know Don through mutual civic activities. When I retired from the Air Force to join the Clinton Group, a New York based hedge fund, Don was a mentor who assisted me with several business ventures.

Not only does Don have outstanding business insights, but he has always displayed a high degree of integrity, honesty, and civic responsibility. Although Don is based here in Tampa, he is a positive force in multiple communities throughout the southeast all the way from Iowa to Texas. His impact on the Tampa Bay community has been immense. Don has built a first-rate company developing quality projects, but more importantly, he invests his time and leadership giving back to the community on important political issues, civic events, and philanthropic causes.

Don Phillips' business acumen is what has earned him such an outstanding reputation, but it is his dependability and team play which make him an outstanding leader. Don Phillips is a friend and colleague whom I respect immensely. I am proud to give him my wholehearted endorsement.

Sincerely,

David M. "Tanker" Snyder

David M. "Tanker" Snyder
Brigadier General, USAF, Retired
Senior Managing Director, Clinton Group

LINDELL PROPERTIES

To Whom it May Concern:

Don Phillips has been a great friend not only to me but a great citizen to the City of Tampa. He's also one of the most profitable and highly regarded developers in our region. Don and i both serve the community in many ways.

The governor has appointed Don to serve on the Tampa Expressway Authority while I serve as a Port Director. Don has been active politically and charitably in almost every event I have attended. He sees the big picture and is a man with solutions to problems—not just complaints (as we too often hear). He would be a great man to have on any team.

Sincerely

Carl Lindell Jr.

Commercial ▪ Office ▪ Industrial ▪ Single & Multi Family ▪ Investments & Development
One Urban Centre ▪ 4830 W. Kennedy Blvd. Ste 250 ▪ Tampa, Florida 33609
PH: (813) 286-3800 ▪ FAX: (813) 286-3820
www.lindellproperties.com

KeyBank
Real Estate Capital

4200 W. Cypress Street, Suite 490
Tampa, FL 33607
Phone: 813-313-5506
Fax: 813-313-5556
Email: lisa_resnick@keybank.com

March 12, 2007

Mr. Donald Phillips
Phillips Development
1510 West Cleveland Street
Tampa, FL 33606

Re: References

Dear Don:

It's been a pleasure to work with you and your team over the last few years. All projects have been handled in a professional and timely manner, and have worked out well from both a lender and borrower prospective. Our loans have included the following:

- $38,650,000 apartment construction loan for Tuscano at Suncoast Crossing, repaid in March 2006 via sale of the property.
- $9,926,000 land acquisition loan for a 48 acre site in Houston, to be repaid in April 2007 via sale of the property.
- $9,200,000 land acquisition loan for a 41 acre site in Charlotte. We hope to provide funding for the proposed apartments at this site later in 2007.

I look forward to working on many future deals together!

Sincerely,

Lisa Resnick
Vice President

OFFICE OF THE MAYOR

TOWN of CARY
PO Box 8005
316 North Academy Street
Cary, NC 27512-8005
tel 919-469-4011
fax 919-460-4910
www.townofcary.org

October 20th, 2003

To Whom It May Concern:

I have worked closely with Donald Phillips for the last year. I have found Mr. Phillips to be a man of integrity whose word is his bond. I have observed other qualities in Mr. Phillips as well of which I now write.

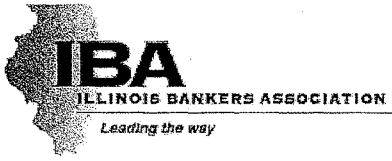
Mr. Phillips has an ability to grasp complex business issues. He takes the time to understand the all sides of and issue before formulating a strategy. He then creates "win-win" scenarios to the greatest extent possible for all involved.

Mr. Phillips and I do differ with regard to political philosophy and policies surrounding development in some cases, but he has helped me to gain understanding of the affect on development of our policies. I have found his opinions informed and insightful and he has a willingness to strike a balance point on most issues that I find refreshing in comparison to many in his industry. I have encountered many folks who have worked with Mr. Phillips and have yet to have any person tell me he has been unfair or dishonest in any of their dealings with him.

I unequivocally give my highest recommendation to Mr. Phillips with regard to his integrity, his honesty and his commitment to fairness. Please feel free to contact me t discuss.

Sincerely,

Glen D Lang
Mayor of Cary
919-291-7936



Examples of Exam Issues Due to Regulatory Accounting Interpretations

- "We were required to reserve 3% on all of our FULLY PERFORMING construction loans, land loans, and land development loans. This has significantly impaired our capital ratios, resulting in our becoming just barely "adequately capitalized." In turn, this resulted in our being told to withdraw our application for TARP funds. Had we received TARP funds, we would now be "well capitalized" and not in danger of becoming undercapitalized, with all of the ramifications that entails."

- "We encountered an issue during our last exam regarding an unsecured loan that had always been and continues to remain current on its payments. Due to the lack of collateral and the borrower's tight cash flow, we had fully reserved for the loan. Thanks to our being so prudent, the examiners made us charge the loan off as a complete loss, 'because it was fully reserved, so why not?' Keep in mind – we are still receiving timely payments. But now we can't return the reserves to capital as payments are received for the loan; we have to wait until the full loan is paid off."

- "Our examiners have made us charge off percentages of principal on loans that are current and that have always been performing simply because the loan collateral is real estate. In some cases, the appraisals are coming in at "fire sale" values (50-60% discounted). In other cases, particularly with respect to vacant properties, the appraisers are telling us that there are no comparables and no current market (thus 100% discounted). Obviously, appraised values are going to be depressed in the current economic environment, but we are talking about properties where the borrowers have absolutely no intention to sell until the market comes back, and meanwhile, they are completely current on their loan repayments. This is creating huge write-downs for our bank and putting major stress on our capital levels."

- "We have a large loan secured by farmland that requires the borrower to prepay interest 3 months in advance into an escrow account. We are collecting this interest in advance and have had no problems with this loan, and yet the examiners have forced us to put this loan on a nonaccrual basis. Why? How are we expected to make more farm loans under these conditions?"

- "In our recent exam, we had a sampling of 40 small commercial loans that were looked at (all had some reserves set aside), and we had to defend each and every one of them from being classified as substandard. Some battles were won and some were lost. As a result, however, we now have little appetite to extend credit to small businesses out of a fear that the loan will be classified as substandard in our next examination. When examiners are focusing on bank-classified assets and punishing those who reserve prudently, why should we take chances making small business loans when the likelihood of an examiner-imposed substandard classification is so high?"

- "We have commercial development loans that are current according to their loan terms, that have well-documented positive cash flow, and that are solidly collateralized based on current appraisals, which the examiners have nonetheless classified as substandard because they were not fully amortized over a 5 to 7 year period. How can one reasonably expect borrowers in the building trade to amortize all of their debt over a 5 to 7 year period in this environment? What do you think this is going to do to credit availability for the building trade in our community?"

- "Our third-party, independent loan review had just determined that our loan loss reserves were adequate and had agreed with our methodologies when we entered our latest safety and soundness exam. In our exam, the Examiner in Charge informed us that our reserves were not equal to our peer group and consequently that we had to increase our reserves to an amount that made us equal to our peer group. To justify this increase, we were told to put ALL of our classified credits into the FAS 114 reserve bucket, EVEN IF THEY WERE CURRENT. We were then instructed to backdate the reserve adjustment and refile our call report. My question is this: If the regulators want the industry to be at a certain reserve percentage, irrespective of the facts pertaining to specific loans, why not just tell us that and save everyone the fight?"

- "We recently went through an exam. We had two participation loans with another bank, both of which had recent appraisals that still justified our loan-to-value positions. We were not told to charge either loan down. Having said that, while our lead field examiner recommended a top rating for us, she was overruled by her supervisor because of these two loans. We had no charge-offs and no write-downs at all in this exam. We had comparable capital, better liquidity, better risk management and better income ratios than our peers. We were criticized for having increased commercial loans over the past FIVE years (mainly due to these two loans), but even accepting this 20-20 hindsight, WE ARE STILL WAY BELOW OUR PEER GROUP. Nonetheless, our composite CAMELS rating was dropped due to these two loans, the only result being that now we have to pay more in FDIC assessment fees. It is the belief of our entire organization that the exam result was manipulated by a supervisor who had an apparent agenda. It is inexplicable to us."

- "Our examiners told us that we could not assist our commercial customers by offering them to provide additional "interest reserves" supported by additional collateral, which would have afforded them a greater chance to survive in the present economy. (An "interest reserve account" is a separate account created to ensure payment of interest costs accrued from a long-term debt obligation.) Instead, the examiners insisted that we ask for a secondary source of repayment other than collateral. What business customer has an alternative source of repayment when their business is suffering, other than additional collateral? As a result, a number of entire loan relationships were downgraded to "substandard," despite being current on payments and having low loan-to-value financings (even when based on new appraisals). Additionally, we were warned that it would be imprudent for us to ever do what we had proposed, or else our management rating would be downgraded. The threat was very real and very disturbing."

- "We just experienced a situation where the FDIC, as receiver, sold the servicing rights to a loan participation that we are in to a non-bank and non-loan participant. This firm is charging about 5 to 10 times than what they should be for servicing this loan. Furthermore, the sale of the servicing rights to a non-participant is in direct contradiction to the participation agreement. We were not given the opportunity to bid on the servicing rights, or even given the names of the bidders for these rights so that a new servicer could be elected by the loan participants. Why are we, the loan participants, being given so little consideration by the FDIC?"

- ***Please Note:*** We understand the following example is too long for use in the Committee hearing, but we think it is an excellent illustration of the current examination climate and are hopeful that you will have the time to read it:

"I would need several hours to compose an e-mail that addresses all of the problems we have experienced with our examiners during the past several years. However, I would like to express some initial thoughts.

Our bank is regulated by the Office of the Comptroller of the Currency. I worked for the OCC for 10 years, and since then, I have had 20 years of experience as President & CEO of this bank. When I left the OCC to take my current position, I was a seasoned field examiner who was involved with the oversight of many problem banks during the 1980's.

In addition to my oversight of problem financial institutions, I was involved with many special assignments to help provide oversight and direction of bank supervision. I also served as a training team leader for several groups of young or new examiners hired by the agency. I also was involved in the development of loans used in the test for commissioned national bank examiners. During my tenure with the OCC, I was considered by many personnel in our field and district offices as a major resource person with expertise in the fields of funds management and interest rate risk, investments, loan portfolio management, and taxes. I truly believe that my skills in these areas have been enhanced while serving in my present capacity as President/CEO of the bank.

I bring your attention to my background so that you may have some insight into my insights. My point is that in all my years of working in the banking industry, I have never felt more insulted, belittled and ridiculed by any one examiner or group of examiners, all with much less experience than me. Realistically, I have given up on having any form of meaningful discussions with the examiners on various banking-related issues that pertain to our bank. My background and experience means very little to them and even possibly threatens them. We have held what I considered civil discussions, exit meetings, etc. when meeting "face to face," only to receive a written report of examination or letter that criticized me personally for lack of objectivity and challenged my integrity. Overall, I am "old school" when it comes to criticism and can handle it well. However, in this environment, it has become more personal.

To give you a specific example, I will discuss the issue of Other Than Temporary Impairment (OTTI) as it pertains to the bank's investment portfolio. Last fall, I spent countless hours studying the matter and consulted with various experts in the field. At the time, we owned a large volume of whole loan CMOs, so this was critical to the bank. Our initial due diligence and supporting documentation that went into the purchase of each of these investments was significant and initially provided critical support for our investment decisions. All of our bank's purchases were of high-end tranches. However, credit quality in some of the issues had deteriorated, therefore requiring an OTTI analysis.

The examiners and I held several discussions on how each OTTI analysis should be performed for each security impacted. During our conversations, the examiners specifically stated that they had a lack of direction from their superiors on this matter. In the meantime, I was working on my OTTI analysis of each bond that potentially could be impacted. I want to specifically mention that an OTTI analysis is an estimate of potential loss at some future date based on the facts and circumstances available at the time. It is a tool used to predict a potential loss. It does not mean the loss will actually occur, but that it could occur based on the current information available combined with present expectations. This leaves a lot of room for subjectivity. If an OTTI analysis is performed only once, it would require significantly more accuracy. However, the estimate is performed quarterly as new facts present themselves.

I believe the OCC examiners wanted us to be 100% accurate "out of the box" on the first OTTI analysis, yet neither they nor we (nor the industry) had any guidance or experience on how to do so. On the other hand, my approach was to analyze each bond with respect to its overall performance and develop 3 scenarios for each: best case, worse case, and most likely. Basically, CMOs can be analyzed based on 3 performance criteria: prepayment speeds (e.g. CPR), loss rates (CDR), and loss severity (dollar percentage of loss when the asset or property is sold).

The factors that pertain to each of these criteria as applied to each security, and their impact on each security, will be unique for a multitude of reasons. They cannot and should not be

standardized. However, that is exactly what the examiners wanted us to use – one single, homogenous standard. They had no interest in the most likely or best case scenarios, despite any meaningful rationale that we discussed. Their interest was only in the worse case scenario for each bond. In addition, if the worse case scenario did not produce the results they wanted to see – in other words, a loss – the examiners wanted us to run even more severe rates until a loss was produced. The worse case scenarios that we were required to run in our models included the lowest CPR rates experienced in the prior 3 to 6 months, combined with the highest CDR and loss severity rates in the prior 3 to 6 months. I tried to explain to the examiners how this would not realistically be possible. High CDR and loss severity rates will produce high CPR rates as well. However, they did not understand and expressed no interest in this rationale. (Hence their criticism for our lack of objectivity.)

It is important to note that we have taken a little over $400,000 in OTTI charges in 2009. HOWEVER, WE HAVE YET TO EXPERIENCE ANY ACTUAL LOSSES. We began 2008 with $38.3 million (gross invested value) in our investment portfolio. As of September 30, 2009, our gross invested value will be roughly $18.3 million, representing a net reduction of $20 million, or 52%. This reduction has occurred through a combination of payments received on CMOs, calls, maturities or sales. Overall, we have not experienced any loss from this activity. In fact, we have recognized roughly $140,000 more in income through $90,000 in security gains and $50,000 in additional accretion income. In addition, our current payment stream on the bonds has not been disrupted. Still, we are being required to run exclusively worse case scenarios on our remaining investment portfolio and to take OTTI losses when these forced scenarios necessarily exhibit them.

This is just one of many frustrating examples that we are currently experiencing in this environment. However, it may be the most compelling. Thank you for your time."

September 23, 2009
Illinois Bankers Association

Desert Hills Capital Corp

VIA E-MAIL Nicole.austin@mail.house.gov

February 3, 2010

Congresswoman Judy Biggert
Committee on Financial Services and
Small Business Committee
U.S. House of Representatives

Re: Condition of Small Business and Commercial Real Estate Lending in Local Markets

Dear Congresswoman Biggert:

In response to the above-referenced matter, the initial cause for the reduction in lending started with the misguided and mishandled utilization of TARP. The Federal Government decided to pick "losers and winners" based on some misguided "systemic risk" fallacy. The very backbone, of lending to Small Business (Community banks) were "redlined" from the process by the Banking Regulators, thru some secret process. These very large banks that were deemed to big to fail are the very institutions that caused the problems, not the Community banks, yet today it is the Community banks that are being subjected to punitive actions by the Banking Regulators..

The end result (of TARP) is that these banks that are now considered too big, and present too great a risk to our economy are even bigger and they have not ever utilized TARP proceeds to increase lending activities. Since then, overzealous Regulators have swung the pendulum too far toward Regulatory overkill, compounding the lack of available credit that otherwise would be available to the public. The Bank Regulators are forcing arbitrary write downs on performing loans, excessively high Loan Loss Reserve, Capital and Liquidity requirements. All of these actions reduce the amount of available credit that otherwise might be available. Everyday Bankers are being told (by their Regulators) to NOT make loans and in fact reduce their existing loan portfolios. The only viable and practical way to increase Bank lending activities is to get the Regulators back to a common sense and realistic approach in their examinations and treatment of banks.

Sincerely,

Robert K. Buhrke,
Chairman Emeritus

Office: 602-324-6707 • Fax: 602-218-7175 • 3001 East Camelback Road • Phoenix, Arizona 85016

Joint Hearing: Committee on Financial Services and Small Business Committee, U.S. House of Representatives

Date: Thursday, February 11, 2010

Title: "Condition of Small Business and Commercial Real Estate Lending in Local Markets"

Response:

There are a number of factors that have led banks, particularly smaller community banks, to reduce lending to small businesses resulting in fewer jobs as well as having additional economic consequences.

1. One of the primary inhibitors is the disconnect between the President's message and the actions of regulatory agencies. President Obama challenges banks to begin lending again with his plan to recycle $30 billion of the remaining TARP funds into a new government lending program offering low-priced capital to community banks that boost their small business lending this year. The hope is that this increase in small business lending could help to restart some segments of the economy.

   Helping small businesses grow and expand can help to create new jobs, and many small businesses (those with under $10 million in sales) prefer to bank with small banks (under $1 billion in size). Over half of the loans under $100,000 made to small businesses are done by these smaller banks. Small banks are designed to lend money as their business models are not structured to borrow money from the Fed and buy treasuries. Instead, the focus is on offering streamlined products to raise deposits and make loans. Comparatively, larger banks are not incentivized to lend to small businesses as they make more profit through trade.

   However, constricted regulatory requirements for reporting have made banking and lending more difficult as banks try to overcome even more red tape. While both large and small institutions recognize that they are in a regulated business with inherent risks, small banks have different challenges than larger ones. Small banks are, in effect, small businesses with limited staff and a lot to accomplish. If they have to spend an abundance of time dealing with regulatory constraints, they are left with inadequate time and resources to bring in new business.

   The challenge is finding a balance, and the message must be consistent and achievable. For community banks to lend more, the regulatory agencies need to find a way to lean on banks less without allowing them to expose themselves to risks and losses which they can't absorb. The agencies should recognize, as President Obama has, that community bankers typically did not engage in much of the risky activities that helped precipitate the financial crisis in the first place. In turn, small banks must be required to know their communities and customers before taking calculated risks. With the right risk management and internal controls in place, banks should be able to operate as for-profit institutions that can do as the President has asked and begin to lend money once again without fear of regulatory consequences.

2. Another inconsistency is between the regulatory definition of well-capitalized ratios and actual practice. Although the regulators have published official numbers (5% for well-capitalized), they now informally encourage much higher standards (8-9%).

   To address this, small banks have needed to develop new capital plans to manage the increased scrutiny. The vast majority of institutions strive to be well capitalized, and many greatly exceed the minimum requirements for a well-capitalized institution. Even slipping to adequately capitalized is something that institutions try very hard to avoid.

   These discrepancies create confusion about what capital standards banks are supposed to be operating under. An unintended side-effect is that bank credit becomes more expensive for small businesses. The new suggested standards have caused banks to raise floors and pricing, adversely affecting potential borrowers.

   Regulators should either stick to existing capital standards or set new ones. If the goal is for banks to lend more, there needs to be clarification as to the rules they should be operating under.

3. The media has also contributed to a negative sentiment towards banks in general, including small community banks. Damaging news coverage has unfairly lumped small banks in with larger ones, and the banking industry as a whole has been blamed for the financial crisis. This is despite the fact that community banks are still healthy and were not involved in most of the risky activities and subprime lending.

   Unfortunately, the word "bank" appears in the names of both small and large banks, and news coverage has not distinguished among them or mentioned the non-bank lenders that played a significant role in the crisis. This causes small businesses and communities to remain fearful of banks in general causing them to resist seeking credit for expansion.

4. Another issue affecting small business lending is the gridlock in Washington. It is difficult to get a timely decision out of any of the regulating agencies (OCC, FDIC, OTS) as situations are passed along from local to regional and finally to Washington. Because there is not a clear picture of what the resulting regulatory environment will look like, the consequence is inaction by both the regulating agency and then by the bank.

Thank you for the opportunity to submit these comments anonymously.

STATEMENT SUBMITTED BY THE

THE NATIONAL MULTI HOUSING COUNCIL
AND THE NATIONAL APARTMENT ASSOCIATION

FOR THE
HOUSE FINANCIAL SERVICES COMMITTEE
AND THE
SMALL BUSINESS COMMITTEE

JOINT HEARING ON

"CONDITION OF SMALL BUSINESS AND COMMERCIAL REAL ESTATE LENDING IN LOCAL MARKETS"

FEBRUARY 26, 2010

*The attached statement is from the Congressional Oversight Panel hearing on January 27, 2010 regarding commercial real estate lending.

1850 M Street, NW, Suite 540 ▪ Washington, DC 20036 ▪ 202.974.2300 ▪ FAX 202.775.0112 ▪ www.nmhc.org ▪ info@nmhc.org

STATEMENT BY

DAVID STOCKERT

PRESIDENT AND CHIEF EXECUTIVE OFFICER

POST PROPERTIES

ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND THE

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ATLANTA, GA

JANUARY 27, 2010

1850 M Street, NW, Suite 540 ▪ Washington, DC 20036 ▪ 202.974.2300 ▪ FAX 202.775.0112 ▪ www.nmhc.org ▪ info@nmhc.org

Chairman Warren and distinguished Members of the Oversight Panel, I am David Stockert, the President and Chief Executive Officer of Post Properties. With a total market capitalization of roughly two billion dollars, Post Properties operates as a real estate investment trust whose primary business is developing and managing apartment communities.

We were founded nearly 40 years ago, and we are one of the largest developers and operators of multifamily communities in the United States. Post Properties is headquartered in Atlanta, Georgia and has operations in nine markets across the country. We currently own and operate approximately 20,000 apartment units in 55 communities.

I am a witness today on behalf of the National Multi Housing Council (NMHC) and the National Apartment Association (NAA).

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is a federation of 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes. One-third of Americans rent their housing, and over 14 percent of all U.S. households live in a rental apartment.

Your interest in the current economic circumstances and liquidity issues affecting the commercial real estate industry is prudent and appropriate. As a developer and owner of income properties, I can share with you our experience and offer you suggestions regarding strengthening the financial system and improving the business climate for commercial real estate.

Post Properties and the entire membership of NMHC/NAA feel acutely the stress on the multifamily housing sector resulting from our nation's economic situation. We fully support federal efforts to help preserve the nation's supply of safe, decent and affordable housing and to provide liquidity to the apartment sector. While there is a perception that the apartment sector has not suffered to the same degree as the single-family sector, we are nonetheless collaterally impacted by the bursting of the housing bubble and the ensuing economic and financial meltdown.

Because of the nearly complete freeze in the capital markets, much of the new development activity in our sector has come to a standstill. The real estate value of our communities has been substantially diminished. Net operating income has declined. In addition, our industry faces an estimated $50-60 billion in loans that are maturing in 2010-2011 and will need to be refinanced.

Because of the frozen capital markets, sales of apartment properties have plummeted. Construction financing has all but disappeared, and with it, much of our sector's capacity to develop new apartments once market conditions improve. This comes at a time when the single-family foreclosure crisis has increased the demand for affordable rental housing. Without a fully functioning capital market to support the development of new rental housing, the nation will face a shortage of apartments beginning as early as 2011.

We are optimistic that, by the end of 2010, much of the decline will be behind us, but recognize that we are likely facing a slow return to a stabilized or growth environment.

The State of the Multifamily Industry

Job growth is one of the most important drivers of demand for apartments. Due to the dramatic loss of jobs in the U.S., 2009 was one of the most challenging years in memory for the apartment industry. U.S. apartment vacancy hit eight percent in the fourth quarter, an almost 30-year high. There are more than 4.5 million vacant rental units; as much as 1.5 million more than in a normal market. 2009's 2.3% drop in rents nationally was the largest in at least 30 years.

Without a fully functioning credit market, transaction volume plummeted; falling from $100 billion to around $14 billion in just two years.

Many in our industry believe that 2010 will likely mark the bottom in terms of declining occupancies and net operating income in most markets. While there may be some sub-markets that will continue to weaken, overall the industry expects it will begin to see a modest recovery commence by the end of 2010.

Despite this generally more optimistic consensus, the headwinds are still very strong. Most of 2010 is expected to be a challenging year for the apartment sector. Even though GDP is expected to recover in 2010, there won't be significant job growth until 2011. Employment growth is essential for apartment demand, and the loss of over eight million jobs during the recession is a severe blow to our industry.

In addition, a "flight to quality" will create a greater separation between different markets and different classes of properties. Class A properties in primary markets will benefit, while older properties with weaker sponsorship and secondary markets will continue to find it difficult to access capital, even as investors return to the market.

Post Properties is known for the quality of our communities and a high level of customer service. Although we focus on "luxury" apartments, the truth is that we provide affordable housing alternatives for residents who wish to live near major employment centers but could not afford similarly located single-family housing. While fewer of our customers leave to buy houses or condominiums today, many more are moving in with friends, roommates or family as a result of job loss.

Rents today at many of our communities are less than they were ten years ago; expenses, however, continued to escalate over that time period at roughly the rate of inflation.

A. Multifamily Vacancy

The U.S. Census Bureau vacancy rate for all rental apartments (in buildings with 5 or more units) rose to 13.1 percent, the highest figure since the inception of the series in 1968. The MPF Research national vacancy rate for investment-grade apartments declined slightly to 7.9 percent from last quarter but is still 1.7 percent higher than a year ago. The vacancy rate remained the same in the Midwest (7.8 percent) and the South (a record high of 9.2 percent), but edged down 10 bps in the Northeast (to 5.9 percent). The vacancy rate fell 50 bps in the West, to 7.1 percent.

Table 1
U.S. Multifamily Vacancy Rate Information

Multifamily % Vacant	**3Q 09**	2Q 09	Change Last Qtr	3Q 08	Change Yr Ago
U.S. – Census	**13.1**	12.1	1.0	10.7	2.4
U.S. – MPF	**7.9**	8.1	-0.2	6.2	1.7

B. Multifamily Construction Activity

According to NMHC analysis, multifamily permits and starts continued their steep downturn; completions also declined this quarter.

Permits (5+ units in structure) decreased sharply to a seasonally adjusted annual rate (SAAR) of 94,700, down 8.4 percent from last quarter and a large 65.6 percent drop from a year earlier. This is the lowest level on record (since 1959).

Starts dropped even more precipitously to a SAAR of 84,000, down 19.7 percent from last quarter and 67 percent from a year ago. This is also the lowest level on record.

Completions decreased to a SAAR of 247,000, down 15.6 percent from the previous quarter and 10 percent from a year ago. The declines in starts and permits will mean larger drops in completions in the coming quarters.

Table 2
New Construction Permit Activity

Permits (2+ units, unadjusted)	**3Q 09**	2Q 09	Change Last Qtr	3Q 08	Change Year Ago
Northeast	4,600	4,700	-100	9,100	-4,500
Midwest	6,500	4,500	2,000	13,900	-7,400
South	12,500	16,600	-4,100	42,700	-30,200
West	6,500	6,000	500	17,500	-11,000
U.S.	30,100	31,800	-1,700	83,200	-53,100

C. Rents and Transaction Activity

Apartment rents measured by public and private data sources diverged. Same store rents for professionally managed apartments tracked by MPF Research declined 4.6 percent this quarter, surpassing last quarter's record decline of 3.4 percent. Rents continued to decline in all four regions for a fourth straight quarter. The West had the largest decline at -7.7 percent, while the Northeast (-2.6 percent), the Midwest (-2.8 percent) and the South (-3.3 percent) experienced smaller declines. Regional rent growth declines set records, except in the Northeast.

By contrast, the CPI rent index, which covers all rental housing, rose 2.0 percent, still positive but the lowest rate of annual growth since 1968. With overall inflation negative, real rent grew by a larger amount, namely 3.6 percent.

Table 3
Same Store Rent Change

MPF "same store" rent (annual change %)	3Q 09	2Q 09	1Q 09	4Q 08	3Q 08
Northeast	**-2.6**	-2.1	-1.3	-5.4	2.3
Midwest	**-2.8**	-1.8	-0.7	1.6	2.4
South	**-3.3**	-2.0	-0.6	-0.7	1.6
West	**-7.7**	-6.5	-3.8	-1.7	1.3
U.S.	**-4.6**	-3.4	-1.7	-1.7	1.7

Looking at apartment transactions, volume rose slightly in the third quarter to $3.6 billion, up 12.1 percent from the prior quarter but still down an exceptional 64.2 percent from last year's level, and still far below mid-decade levels. Apartment prices fell further. The average price for properties sold in the third quarter of 2009 was $78,709 per unit, down 9.7 percent from the previous quarter and down more than 30 percent from 2008. This was the fifth straight quarter of decline and the lowest average price since the second quarter of 2004. The market value of investment-grade apartments in the National Council of Real Estate Investment Fiduciaries' (NCREIF) database also continued to decline in the third quarter, falling 4.3 percent from the previous quarter and 27.0 percent from last year. The capitalization rate increased to 7.1 percent.

D. New Apartment Absorption

Absorption rates for newly completed apartments have dropped to the lowest levels since data started being collected in 1989. Census Bureau data show that looking at the trailing 12-month average, using not seasonally adjusted data, only 50 percent of 2009Q1 new apartments were leased, the same as the previous quarter and a record low. The historical average for the series is a 67 percent lease-up rate.

Similarly, the 6-month absorption rate (also on a trailing 12-month average basis) was 68 percent, also a record low and well below the series average of 84 percent. After fairly steady absorption rates in the 1990s, lease-up rates have fallen for most of the decade, interrupted only by a partial rebound from 2003-05.

Debt Financing and Liquidity

The commercial real estate markets have had great difficulty accessing capital since 2007's collapse of the commercial mortgage-backed securities (CMBS) markets. Institutional investors such as pension funds, insurance and other equity sources exited the commercial and multifamily real estate markets and did not participate in the private real estate markets in 2009.

Historically, multifamily has typically enjoyed good access to debt for decades, even during difficult economic periods and weak market conditions. When one supplier of credit to apartment properties or multifamily developers was under stress, another would step in to take its place.

For example, when the savings and loans crisis occurred in the late 1980s, commercial banks expanded their market shares. When the FHA temporarily exited the market in the wake of the failure of the co-insurance program, the GSEs, banks, and others helped to ensure a flow of

credit. When Freddie Mac's portfolio of multifamily mortgages was under stress in the late 1980s from loans written in distressed markets, Fannie Mae and other lenders gained share.

In this economic crisis, the GSEs have stepped in to fill the gap, and the FHA multifamily mortgage insurance program has served as a partial replacement for construction financing. These two capital sources—the GSEs' multifamily loan purchase programs and the FHA/Ginnie Mae multifamily insurance program—accounted for 90-95 percent of all the multifamily debt issued in 2009.

Table 4
Outstanding Mortgage Debt by Source

	2000 Second Qtr.		2008 Fourth Qtr.		Change '00-'08	
Institution	**Billions**	**Percent**	**Billions**	**Percent**	**Billions**	**Percent**
Commercial Banks	$78	19%	$217	24%	$139	179%
Savings Institutions	$61	15%	$64	7%	$3	5%
Life Insurance Companies	$34	8%	$50	6%	$16	49%
Farmers Home	$12	3%	$11	1%	-$1	-6%
FHA/GNMA	$21	5%	$45	5%	$24	113%
Fannie Mae & Freddie Mac	**$72**	**18%**	**$318**	**35%**	**$246**	**343%**
Conduits	$47	12%	$110	12%	$63	135%
Individuals/Others*	$79	20%	$96	11%	$17	22%
Total	**$404**	**100%**	**$911**	**100%**	**$507**	**126%**

Table Notes:

- ** The Individuals/Others category includes REITs, insured pension funds, non-insured pension funds, mortgage companies, state and local credit agencies, state and local pension funds, credit companies and finance companies.*
- *Source: Federal Reserve Board Statistical Supplement, Report 1.54 - Outstanding Mortgage Debt, 2001 and 2008 fourth quarter reports.*
- *Data includes outstanding balance on issued and insured mortgage securities.*

But it has not been all good news for the multifamily sector of commercial real estate. As fundamentals weakened, debt providers significantly tightened their underwriting requirements. This has meant that apartment firms had to provide additional equity to finance a purchase transaction, refinance a maturing loan or renovate or develop new rental housing. FHA has also indicated that it will tighten its underwriting and loan requirements. With most equity sources on the sidelines, this has meant a capital crisis for the apartment sector even with the backstop provided by the GSEs and FHA. In other words, the GSEs are necessary, but not sufficient to meet the industry's capital needs.

Multifamily Loan Performance

There has been widespread media coverage of a March 3, 2009 report by Deutsche Bank declaring that multifamily CMBS are experiencing the worst deterioration of all the CMBS thus far, and that the deterioration is worsening. While the multifamily CMBS market is indeed suffering, it is important to keep this in perspective. Many observers have misunderstood the Deutsche Bank report to mean that ALL multifamily mortgages are experiencing high default rates.

This is untrue. The CMBS multifamily rates, while high, are only a portion of the debt outstanding. CMBS represents just 12 percent of the more than $900 billion of multifamily loans

outstanding. The vast majority of multifamily mortgages are held by commercial banks (24%) and the GSEs Fannie Mae and Freddie Mac (35%). Banks and Thrifts account for just under a third of multifamily mortgage debt outstanding (31%), life insurance companies (6%) and FHA/Ginnie Mae (5%).

When loans held by those entities are examined, it is clear that multifamily default rates remain, in fact, quite low and much lower than in the single-family sector. Delinquencies for loans issued by insurance companies and the GSEs remain well below one percent, and the GSEs are underwriting new multifamily loans with good coverage ratios and relatively moderate loan-to-value levels.

Nonetheless, the agencies are anticipating increased loan defaults both in their portfolios of multifamily mortgage loans and guaranteed mortgage securities. Reports indicate that Fannie Mae will increase its loan loss reserve capital by $1 billion; Freddie Mac is also expected to increase its capital reserves to compensate for potential losses in its multifamily mortgages.

Secondary Market Concerns and Future

As you know, Congress is beginning to develop plans to restructure Fannie Mae and Freddie Mac. What that new structure will look like and how we transition to it will be debated for months, and maybe years, to come.

In the short term, the industry is reassured by the December 24 announcement by the Treasury Department confirming its unlimited support for Fannie Mae and Freddie Mac through 2012 and easing the portfolio limits on the mortgage giants. Before the announcement, the retained portfolio of each firm was capped at $800 billion and each was required to reduce their portfolios by 10 percent a year beginning in 2010. Now, the portfolio reduction requirement applies to the portfolio caps ($900 billion) and not the actual size of the portfolio at the end of 2009 ($771.5 billion for Fannie Mae and $761.8 billion for Freddie Mac).

This means the companies will not have to take immediate steps to reduce their portfolios and could even expand them. In addition, Treasury announced that it was committed to providing the GSEs with unlimited financial support through 2012, removing a prior limit of $200 billion per company.

The announcement makes it clear that the federal government intends to back the GSEs in whatever capacity is necessary to maintain their housing finance activities.

In the long term, however, the multifamily industry is greatly concerned about the future of the GSEs, given their critical role as a liquidity backstop. As the Administration and Congress begin the process of establishing a new secondary mortgage market system and regulatory oversight for the GSEs, lawmakers should understand the unique needs of the multifamily sector and take steps to ensure that they do not restrict the supply of multifamily capital as they reform the single-family financing process.

Among other things, the GSEs must:

- Continue to serve the entire multifamily market to provide liquidity. This will allow banks and other construction capital sources to have a steady and reliable source for perma-

nent debt. It also provides for needed loan diversity to support loans for affordable and workforce housing that have greater credit risk profiles due to the need for higher loan proceeds and limited income stream to support debt coverage.

- Continue to be available to the market regardless of market conditions. Fannie Mae and Freddie Mac serve not only as a mortgage capital source, but serve as a standard in multifamily lending in all markets, both large and small, and in urban and rural areas.
- Continue to create and support opportunities for mixed-income and mixed-use development that improves economic development and accessibility to jobs.

Commercial Mortgage-Backed Securities (CMBS)

Reestablishing a viable commercial mortgage-backed securities market is also critical to meet the variety of financing needs. Reforming the regulatory oversight of Wall Street and improving transparency and rating agency performance are important to bringing back the CMBS market. Reform measures and efforts by the Federal Reserve and Treasury through the Term Asset-Backed Loan Facility (TALF) program are important. As such, the government should not terminate its efforts, and should continue to extend the TALF program, at a minimum through 2010. This is important to build additional confidence among investors. With greater investment anticipated during 2010, programs such as TALF are important to stimulate the markets.

Troubled Asset Relief Program (TARP)

I have been asked to address the use of TARP funds to support our sector. Last year, legislation was introduced that would have recycled TARP funds to support distressed multifamily properties. While we are not actively seeking such funds, should they be made available, we would recommend that they not be used to transfer properties to new owners, but rather that they support existing owners and lenders.

We would support two key uses of TARP funds:

1. Provide insurance to lenders who extend current loans for periods of 24-36 months.
2. Provide gap financing on newly refinanced loans through subordinated debt, cash-flow mortgages or, when appropriate, grants.

Any TARP program should not create uncertainty in the capital markets about potential future government intervention in the contractual and legal chain of ownership, and should carefully define when such funds are used.

National Policy Change to Meet Our Housing Needs

For decades, the federal government has pursued a "homeownership at any cost" housing policy, ignoring the growing disconnect between the country's housing needs and its housing policy. In the process, many people were enticed into houses they could not afford, which in turn helped fuel a housing bubble that ultimately burst, catalyzing a global economic crisis.

The nation is now paying the price for that misguided policy and learning firsthand that there is such a thing as too much homeownership; that aggressively pushing homeownership was not only disastrous for the hardworking families lured into unsustainable homeownership, but also for our local communities and our national economy.

If there is a silver lining in this situation, it is the opportunity we now have to learn from our mistakes and rethink our housing policy. Housing our diverse nation means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn't measure success solely by the level of homeownership.

For many of America's most pressing challenges, from suburban sprawl to affordable housing, apartments are the preferred solution. Apartments help create stronger and healthier communities by offering enough well-located housing for the workers that businesses need, by reducing the cost of providing public services like water, sewer and roads, leveraging existing infrastructure, and by creating vibrant live/work/play neighborhoods.

Apartments offer a flexible and convenient lifestyle and will help us house our booming population without giving up all our green space and adding to pollution and traffic congestion. And they will help us reduce our greenhouse gas emissions by creating more compact communities that enable us to spend less time in our cars.

Elements of a Balanced Housing Policy

NMHC and NAA have joined together to advocate for a more balanced housing policy, one that respects the rights of individuals to choose housing that best meets their financial and lifestyle needs. We urge policymakers at all levels of government to work with the apartment industry to craft a smarter housing policy that:

- Assures that everyone has access to decent and affordable housing, regardless of his or her housing choice;
- Respects the rights of individuals to choose the housing that best meets their financial and lifestyle needs without disadvantaging, financially or otherwise, those who choose apartment living;
- Promotes healthy and livable communities by encouraging responsible land use and promoting the production of all types of housing;
- Recognizes that all decent housing, including apartments, and all citizens, including renters, make positive economic, political and social contributions to their communities; and
- Balances the expected benefits of regulations with their costs to minimize the impact on housing affordability.

Attachments:

NMHC Research Notes Series 2009
NMHC Market Trends Series 2009

NMHC

Research NOTES

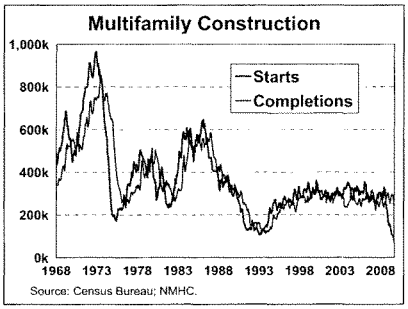
October 30, 2009

IS A SUPPLY SHORTAGE LOOMING?

The apartment industry is facing arguably the most difficult operating environment in the postwar era. Renter vacancy rates are at record levels whether measured across all apartments (5+ units) or only investment-grade, and whether the data comes from government sources or private data providers. Yet there is a broad consensus that as early as 2011 today's insufficient demand will be replaced by a supply shortage. Construction of market-rate apartments has all but shut down because of scarce construction financing and the current oversupply. Once job growth returns, demographic and household formation trends will kick in. But is the existing oversupply too large for demographic demand to work off quickly? This issue of *Research Notes* looks at current supply conditions to help gauge whether we might see a shortage in the coming years.

New Construction Trends

The data on apartment construction underscore the decline in new supply; starts have dropped dramatically. Although multifamily completions (5+) have thus far remained close to the 1990s levels, they typically lag the starts data by about nine months and are expected to drop in the near future.



For the most recent month, starts have fallen to a seasonally adjusted annual rate of only 84,000. (Note: This is measured as a 3-month moving average to offset the fact that multifamily construction varies greatly from month to month for reasons that may have nothing to do with underlying trends.)

We need to net condos out of these figures, however. The condo share of construction has decreased considerably—from a high of 47 percent at the height of the boom in mid-2005 to around 15 percent in the first half of 2009. Taking account of condos and a small number of other non-apartment units, we're currently on an annual pace to produce fewer than 90,000 apartments, including tax credit/subsidized units. Unfortunately, there are no current data on the share of subsidized construction, but anecdotal reports suggest it might be a bit higher than in the last year or so—perhaps one-third. That takes market-rate construction to an annual rate of about 60,000.

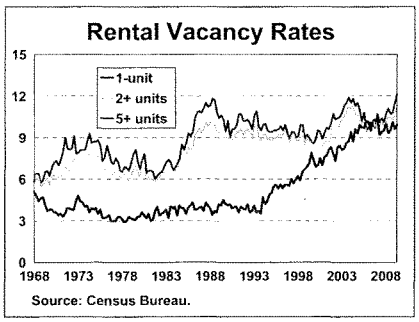
That is a little less than replacement need. Applying an estimated annual loss rate of 0.7 percent (the average for the last 10 years) to a conservatively estimated 10 million (likely more) market-rate apartments shows annual losses to the stock of 70,000. So at current production levels, the number of market-rate apartments in the U.S. is actually declining.

The Current Oversupply

As a result of the steepest drop in employment of the postwar era plus the spillover of bubble-induced excess construction in the for-sale market, the Census Bureau reported that the number of for-rent vacant residences of all types reached a record 4.4 million in the second quarter. Of these, 1.4 million were vacant single-family units for rent. We estimate 800,000 were in buildings with 2-4 units, and 2.2 million were in 5+ multifamily buildings.

Of course, some vacancies are normal and necessary; only the number of units over and above the normal level should be considered excess inventory. Using the 1990s average vacancy rate of 7.7 percent as the norm suggests that the rental oversupply (of all types of units) is currently 1.3 million units overall, also a record. (Note that if we used a lower vacancy rate as the norm, the estimated oversupply would be larger.)

Gauging how many excess vacant units are apartments rather than single-family or small multifamily is somewhat more difficult. In particular, it is hard to know what the normal vacancy rate should be for the single-family rental sector. For 25 years, the single-family vacancy rate was far more stable than the multifamily (measured as either the 2+ or 5+ sector) rate, and about half as large. But beginning in 1994, there has been a steady rise in the former rate until it essentially converged with the multifamily vacancy rates in the middle of the current decade.



So is the former 3-5 percent single-family vacancy range the norm or is the current 9-10 percent range? For present purposes, we'll assume the recent range is the more likely one. If we assume that in the future the vacancy rate on rental units should be the same regardless of structure, then the excess supply would shake out as shown in the table below.

Excess For-Rent Inventory

	Total Vacant	*Excess Vacant*
Single-family	1,428,000	410,000
2-4 units	800,000	230,000
5+ units	2,179,000	856,000
Total	4,407,000	1,266,000

Source: Census Bureau; NMHC.

This estimate is sensitive to a number of assumptions. In particular, if the normal vacancy rate for single-family rentals is actually more like its 1990s average of around 5 percent, then the number of normal vacancies in the

single-family sector would be smaller. In turn, this implies that a higher share, and number, of the single-family vacant units represent excess inventory. Since the estimate for the total excess for-rent inventory is fixed, that would mean that the number (and share) of apartment units that represent excess inventory is actually smaller.

Working in the other direction, some vacant units in the rental universe have been excluded, such as units that have been rented but not yet occupied and units that are being held off the market for various reasons. It is not clear whether or not these categories should be included. In any case, the Census Bureau does not provide any information on how many such units should be part of the for-rent, vs. for-sale, housing stock, so there is no practical way to include them.

How Fast Can the Excess Inventory Be Used Up?

The past may not offer much insight into how rapidly this excess can be worked off. In four decades of data, the steepest one-year decline in vacant, for-rent units was only 320,000, and that was for the entire rental stock, including single-family and small multifamily buildings. However, production of new, for-rent residences over the same time frame has never been as low as it is today.

By contrast, the greatest one-year net absorption (net increase in the number of renters overall) was 1.5 million. If repeated over the next 12 months, that might eliminate the entire excess rental stock. (This assumes that the rental units in the categories mentioned above, for which we don't have enough information to include, such as units held off the market, do not flood back into the market.) Although this record occurred recently (2007), throughout the 1970s and 1980s, the two-year increase in renters averaged 1.1 million and was frequently above 2.0 million. It is encouraging that the demographics now are similar in many ways to the era when the baby boomers moved into the housing market. Unfortunately, the Census data do not break down the change in renters by type of rental unit, so we can't examine the impact on apartments separate from other rental units.

It seems likely that the excess inventory could be worked off quickly: economic recovery, demographic trends and the lack of new supply will combine to reverse the current supply-demand imbalance. But the timing is hard to gauge. If the recovery is slow and halting, it is likely to postpone—but not cancel—the positive demographics. A subpar recovery is not likely to cause a supply surge, however, so demand is still likely to outstrip supply at some point in the next few years.

Questions or comments on Research Notes should be directed to Mark Obrinsky, NMHC's Vice President of Research and Chief Economist, at mobrinsky@nmhc.org or 202/974-2329.

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NMHC

Research NOTES

July 2009

WHO'S MOVING INTO APARTMENTS?

The U.S. has always been a country on the move. On average, one in six households lived somewhere else a year ago. While the economic downturn has postponed many planned relocations, they are likely to rebound when the economy begins to improve.

It is well known that renters move more often than homeowners. Less well known is the fact that there is considerable tenure switching—from owner-to-renter or renter-to-owner. Even less well known is that more tenure-switching movers are owners becoming renters than vice versa.

This issue of *Research Notes* examines which households are most likely to move from owners to renters and which households are most likely to move into apartments specifically. It finds that younger households have a high net switch rate into apartments. But there is one age group that is even more likely to switch to apartments: seniors.

Among household types, singles are the most likely to switch into apartments; single parents also have a decided net switch rate to apartments.

Households on the Move

In 2007 (the latest year for which we have data), 16 percent of households had moved within the previous 12 months. There has been little variation in this figure since 1997—the high was 17.8 percent during the peak of the housing boom in 2005, while the low was 15.6 percent in the recession year 2001.

Of those households who moved, 52 percent had been and remained renters—virtually the same as the average of 51 percent since 1997. Another 18 percent had been and remained homeowners. That means 30 percent of movers switched tenure.

In 2007, more owners became renters (17 percent) than renters became owners (13 percent). To a smaller degree, this has been true over the last decade as well. The 10-year average shows 16 percent of movers switched from owner to renter, and 15 percent made the renter-to-owner switch.

Note the data source, the American Housing Survey (AHS), only has the prior tenure information for 93 percent of households who moved. The other 7 percent either split off from previously existing households (e.g., children leaving their parents' homes or a roommate leaving to get married), were recent immigrants to the U.S., or did not answer the question. So, although more movers switched from owner to renter than from renter to owner, the homeownership rate didn't necessarily decline.

Even so, the fact that a large number of owners become renters every year is not widely known, so it merits some investigation. To do this, we need to analyze the data in the "recent mover" file.

Recent Movers

Recent movers are defined as households who have moved within the prior two years (rather than just last year). The AHS captures key demographic, housing, and income data about them. Below are tenure data about recent movers by age group.

Tenure of Recent Movers by Age Group

	Used to rent	*Currently rent*
All movers	61%	63%
Under 30	71%	76%
30-44	63%	58%
45-64	50%	53%
65 and over	36%	52%

Source: NMHC tabulations of the American Housing Survey recent movers, 2007.

Among all households who moved in the previous two years, 61 percent had been renters, but 63 percent are now renters. Not surprisingly, youngest households were the most likely to be renters—both before (71 percent), and after (76 percent), the move. Households in the 30-44 year age group were the only group less likely to rent after the move than before—many probably became first-time homeowners.

What may be a surprise is that the age group that increased its rentership the most is the oldest age group. Fully 52 percent of recent movers who are 65 or more years old are now renters, though only 36 percent had been renters before moving—a net increase of 16 percentage points. The economic recovery might lower this figure somewhat, although it will likely remain high. While seniors move the least, they are nonetheless expected to be the fastest-growing age group over the next 15 years, making this potentially a very important market for the apartment industry.

The types of households most likely to rent—singles, single parents, and "others" (i.e., not a married couple,but also neither a single-person nor single-parent household)—are also the households that increase their rentership the most when moving. Among single-person household movers, 61 percent rented before moving, while 73 percent rent after moving. Among single-parent households, rentership increases from 69 percent before the move to 76 percent after. "Other" households changed less—from 70 percent renters before moving to 74 percent after.

By contrast, married couples were considerably less likely to rent after moving than before; among those without children, 49 percent were renters before moving but only 40 percent after; for those with children rentership fell from 54 percent to 42 percent.

There is a similar story when we look at whether movers live in single-family or multifamily (rental or for sale) housing. (Note that due to data limitations, the term "multifamily" in these analyses means units in buildings with at least two—not five—units in them.)

Housing Type of Recent Movers by Age Group

	Formerly Multifamily	*Currently Multifamily*
All movers	36%	43%
Under 30	43%	56%
30-44	37%	37%
45-64	29%	35%
65 and over	23%	42%

Source: NMHC tabulations of the American Housing Survey recent movers, 2007.

Recent movers are more likely to live in multifamily housing (whether for-sale or rental) after moving than they were before. Interestingly, this is true of all age groups (except among 30-44 year-olds, who are equally likely to be in multifamily housing after the move as before). But younger (under 30) and older (65 and over) households are the most likely to switch into multifamily housing.

Singles were also the household type most likely to switch into multifamily housing. Before moving, 39 percent of single-person households lived in multifamily residences; after moving, the figure was 61 percent. Single parents also chose multifamily more often after moving (47 percent) than before (38 percent). Among "other" households, 41 percent lived in multifamily buildings before moving, but 48 percent did after moving. Only 20 percent of married couples with children live in multifamily properties after moving, the smallest figure for any type of household.

We can combine these analyses and examine which households are most likely to switch into apartments.

Recent Movers Switching to Apartments

	Former Apt Resident	*Current Apt Resident*
All movers	35%	40%
Under 30	43%	53%
30-44	35%	34%
45-64	28%	32%
65 and over	21%	37%
Singles	37%	57%
Single parents	37%	46%
Married with kids	31%	25%
Married, no kids	27%	19%
Other	40%	45%

Source: NMHC tabulations of the American Housing Survey recent movers, 2007.

Care must be taken here, as the cross tabulations run into the limits of the sample size. Still, a number of points stand out. Among households who move, seniors and singles show the biggest increase in apartment residence among all households. Younger (under 30) households and single parents also substantially increase their likelihood of renting an apartment when they move. Even households headed by a 45-64 year-old mover increase their likelihood of living in an apartment. That means only 30-44 year-olds—along with married couples—as less likely to be in an apartment.

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Research NOTES

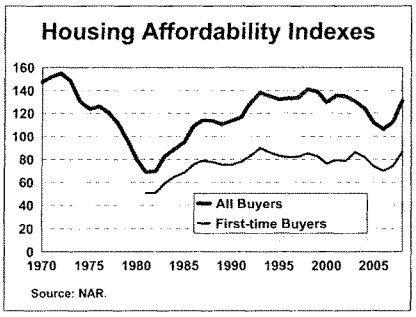
April 29, 2009

MORE COMPETITION FROM HOMEOWNERSHIP?

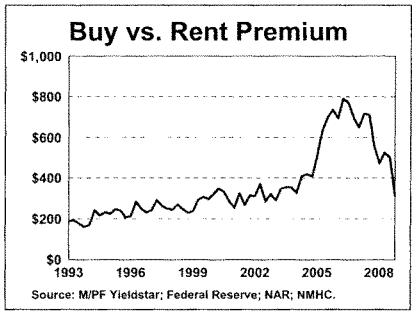
The sharp drop in house prices over the last two to three years has helped cause a surge in popular measures of homeownership affordability. The implications of that increase are unclear however. Will buyers start to return to the single-family and condo markets? Will this mean increased competition from the for-sale market, with apartment renters moving out in greater numbers again? While this trend bears watching, the view here is that the housing downturn still has a way to go. And that the economy is still a far greater problem for apartment owners than homeownership.

Measuring Affordability

The most widely cited measure of affordability is the National Association of Realtors' Housing Affordability Index (HAI). It is calculated as the ratio of median family income to the principal and interest (P&I) payment on a median-priced house—with a downpayment of 20 percent and a maximum of 25 percent of income devoted to the P&I payment.



In the first two months of this year, the HAI for all buyers reached an all-time high of 173. Clearly, by this measure, affordability has improved greatly. But it is not at all clear what, if anything, that implies for apartment owners. After all, the big run-up in homeownership rates took place from 1995-2005. Yet over that period, the HAI—for both first-time buyers and for all buyers—was flat or falling. The limitations of the HAI are that it leaves the mortgage market out of the picture; it assumes no change in would-be buyers' ability to make a downpayment; and it ignores the cost of the other tenure choice, namely renting.



The latter drawback can be remedied simply enough. The buy vs. rent premium is the amount by which the monthly payment on a median-priced house nationally (including property taxes and insurance) exceeds the median national rent for professionally managed apartments.

The trend in this chart is somewhat similar to the first: the sharp run-up of recent years has been largely unwound, with the premium now down to the 2001 level. Nevertheless, it still cost, on average, $313 more to buy than rent in the fourth quarter of 2008, well above the $271 average for 1995-2000 when the for-rent *and* for-sale markets were doing well.

It is more difficult to determine how changes in mortgage underwriting are affecting the for-sale market. Looser credit requirements had a lot to do with the housing boom, and the return to more traditional underwriting should reduce mortgage borrowing (for a given affordability level or buy-rent premium). We also know that downpayment requirements were greatly loosened during the housing bubble, but that they are back. To gauge how much that affects home buyer demand we need to know a great deal about the over-

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all wealth (both assets and liabilities) of potential buyers. While there is no time series with such data, the Census Bureau produces periodic analyses estimating overall affordability that takes into account the buyer's ability to make a downpayment.

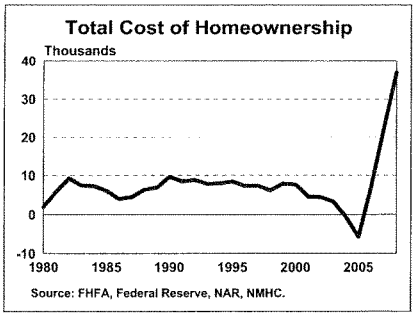
The conclusion of the most recent report (covering 2002) is that the ability to make the monthly payments plays a very small part in affordability. Only 19 percent of those who could not afford a median-priced house had sufficient funds for downpayment, but not enough income for the monthly payments.

By contrast, 23 percent could afford the monthly payments, but either lacked a downpayment or had too much debt. The majority (58 percent) of would-be buyers priced out of the market had more than one problem—that is, they could not afford the monthly payment and had either too much debt or insufficient cash for a downpayment.

The figures are even starker for renters: only two percent were unable to afford to buy solely because they could not afford the monthly payments. In other words, measures of home buying affordability that only look at the monthly payments are missing the main problem, and consequently provide only limited information.

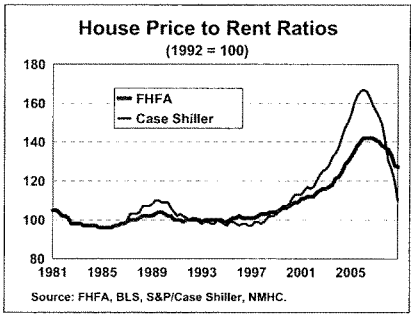
The House Price Effect

House prices also affect the cost of owning, mainly through future appreciation. If house prices are rising, the cost of owning is lower; if they are falling, the cost of owning goes up. Since we don't know actual appreciation in advance we must estimate it, for example, by using either the most recent year's appreciation rate or the long-run average (around four percent).



The chart above offers a comprehensive measure that includes the cost of debt and equity, as well as property taxes, maintenance and depreciation, house (or, really, land) price appreciation and tax savings. (Economists refer to this as the "user cost" of ownership. For more on this concept, see the March 14, 2003 *Research Notes*.) Using the assumption that this year's appreciation will equal last year's, the user cost clearly fell below the bottom of its usual range and was actually negative in 2004 and 2005. That surely helps explain the continued surge in demand despite the increasing cost, at least as shown by some affordability measures.

This also helps explain the stunning drop in current homeownership demand: although prospective monthly payments have fallen, as has the premium over renting, the user cost has shot up to unheard-of levels because of negative appreciation. Indeed, the 2008 figure of $36,976 is almost four times as high as the pre-2005 peak ($9,628).



If would-be home buyers continue to expect the near future to resemble the recent past, the user cost of homeownership may remain elevated for a while. The house price-to-rent ratio is a simple gauge of how prices compare to rents. Both measures shown above—based on the more volatile Case Shiller, and the more stable FHFA (formerly OFHEO) home price indexes—suggest that prices are still too high relative to rents, by anywhere from 10-27 percent. But prices could fall more than that. Not only is it possible they will "overshoot," but also with rents falling, the equilibrium price is a (downward-) moving target.

Put differently, as long as prospective home buyers expect house prices to continue to fall—or even remain flat—they will rightly see the homeownership cost as historically high, and probably further delay buying.

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Research NOTES

February 3, 2009

THE GSEs' ROLE IN MULTIFAMILY FINANCE

The credit crisis that began in August 2007 and the ensuing financial sector collapse have affected virtually all industries. For the apartment sector, it has meant a near halt in construction lending and more expensive and more restrictive acquisition finance. But our industry has one big advantage over the other commercial real estate sectors: Fannie Mae and Freddie Mac. Barred by charter from the commercial mortgage market, the firms have served as a critical liquidity backstop for the apartment market.

It is unclear, however, whether they will be able to supply the same degree of liquidity next year because of regulatory mandates that they begin to reduce the size of their portfolios in 2010. This issue of *Research Notes* looks back at the role they have played in multifamily finance.

Background

Fannie Mae was established as a federal agency in 1938 and then privatized in 1968 to become a government-sponsored enterprise (GSE) with private shareholders but a public purpose and responsibilities. Freddie Mac was chartered two years later. Although conventional wisdom holds that the GSEs were created to make homeownership more affordable, that is not actually listed in their charters. Their primary purpose has always been to provide liquidity to the mortgage markets—in fact, three of the four purposes listed in their charters concern liquidity.

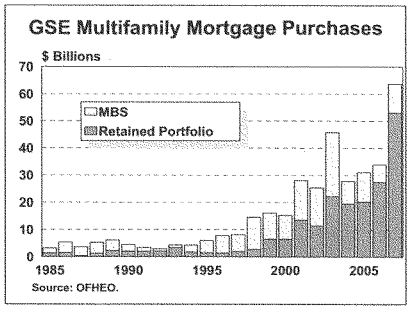
Both firms began buying multifamily mortgages essentially since the beginning, but in contrast to their single-family mortgages, which were largely securitized, both tended to hold the majority of their multifamily mortgages in their retained portfolios.

For Fannie Mae, the multifamily share of their portfolio has risen and fallen in long cycles, never going below 5 percent, and reaching a high of 28 percent in the third quarter of 2008 (latest data available). Freddie Mac's multifamily portfolio has also cycled higher and lower over the years. Currently, more than two-thirds of Freddie's mortgage portfolio is in multifamily.

Both companies do securitize some of their multifamily mortgages; however, the multifamily share of their mortgage-backed securities (MBS) is much smaller than the multifamily share of their portfolios. Currently, only 4 percent of Fannie's MBS outstanding are multifamily, while for Freddie the share is less than one percent.

Thus, for Fannie Mae, 53 percent of their multifamily total is held in their portfolio; for Freddie Mac, 86 percent of their multifamily total is retained mortgages.

Combined, 62 percent of the GSEs' multifamily business is retained in their portfolio (vs. 38 percent securitized). By contrast, only 7 percent of single-family loans are in portfolio (93 percent are securitized).



The chart above shows annual combined multifamily mortgage purchases by Freddie Mac and Fannie Mae through 2007. Clearly, GSE activity slowed in the middle of the current decade, even as transaction activity reached new highs and the CMBS market boomed. Arguably, that is just what policymakers would want: the firms step up when needed, but step back when not.

The GSEs and Liquidity

It is worth looking closer to see whether the GSEs have provided liquidity when it was needed most. Unfortunately, there is no reliable data series on multifamily loan originations, so it is not possible to measure lender shares against the GSE share. The Federal Reserve data on mortgage debt outstanding (MDO) does, however, fill the gap and it confirms the important liquidity role of Fannie and Freddie.

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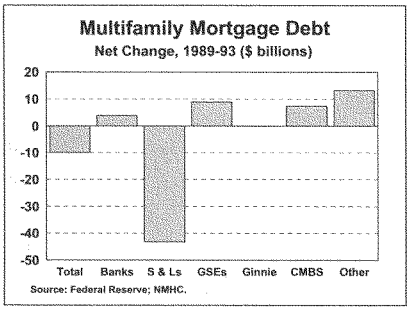
There are a number of examples that illustrate this point, but two will suffice for present purposes. The first example is the "credit crunch" of two decades ago, brought on by a combination of overbuilding, revised tax laws, the resolution of the savings and loan crisis, tightened regulation of banks and a moderate recession.

Over the five years from 1989 through 1993, net multifamily mortgage debt actually declined by $10 billion. As the chart below shows, this was mainly due to the net disinvestment from thrifts (-$43 billion). Some of those loans went into the portfolios of banks who took over S&Ls and some were packaged into securities by the Resolution Trust Corporation (RTC).

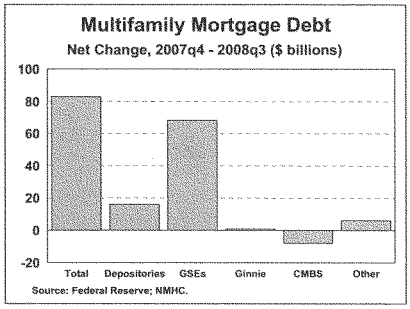
In order to dispose of the assets of failed S&Ls, the RTC packaged commercial mortgages into mortgage-backed securities, thus becoming an important pioneer in the CMBS market and accounting for the $7.4 billion figure for CMBS shown below. Ginnie Mae MBS volume was essentially flat, while life insurance companies added about $3 billion (lumped into the "Other" category below).

Fannie Mae and Freddie Mac, meanwhile, provided a net multifamily investment of $9 billion, making them essential players in this market. In other words, when the multifamily mortgage market was under great stress, the GSEs increased their multifamily activity just as they were designed to do.



The second example of how the GSEs provided crucial liquidity to the apartment industry is the current one. This time the implosion of the single-family mortgage market—brought on by the combination of a bursting housing bubble and lax (at best) underwriting—combined with a highly leveraged global economy has brought the financial system to a state of near-collapse.

For the multifamily mortgage market, this has meant the drying up of almost all sources of debt finance, with the exception of Fannie and Freddie. In this respect, the apartment industry has a big advantage over the other commercial real estate asset types, as participants in these markets will readily admit.



The chart above makes the point rather starkly. In the 12 months from October 2007 through September 2008, multifamily mortgage debt outstanding grew by $83 billion. Of that amount, a staggering $68 billion (82 percent) was provided by the GSEs.

Ginnie Mae provided less than $1 billion, the life insurance companies less than $4 billion (again included in "Other"), and the CMBS market went into reverse, as multifamily CMBS outstanding fell by $8 billion. Clearly, without Fannie and Freddie, the apartment industry would have been virtually unable to obtain acquisition financing or to refinance existing debt.

Unfortunately, the Fed data do not break out construction financing from permanent financing. As a result, the GSEs' role may be even greater than shown in the chart. Depository institutions provided just under $16 billion in funding over this time frame, but this is widely believed to be primarily construction finance. If it were entirely construction lending, it would mean the GSEs were responsible for **all** permanent financing. If only half of depository lending consisted of construction loans, the GSEs' share of permanent lending would be 91 percent.

This is exactly what the market needed, and exactly what Fannie and Freddie were created to do: provide a liquidity backstop when the private market either cannot or will not. While there may well be other ways to accomplish this, surely the starting point for any rethinking of the GSEs' role ought to be: first, do no harm.

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MARKET TRENDS

November 2009

Apartment vacancy rates diverged this third quarter. The U.S. Census Bureau vacancy rate for all rental apartments (in buildings with 5 or more units) rose to 13.1 percent, the highest figure since the inception of the series in 1968. The MPF Research national vacancy rate for investment-grade apartments declined slightly to 7.9 percent from last quarter but is still 1.7 percent higher than a year ago. The vacancy rate remained the same in the Midwest (7.8 percent) and South (a record high of 9.2 percent), but edged down 10 bps in the Northeast (to 5.9 percent). The vacancy rate fell 50 bps in the West, to 7.1 percent, a considerable decline from the recent high of 8.1 percent in 2008Q4.

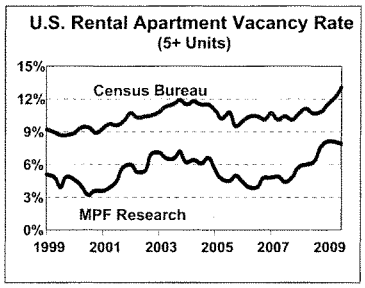
Multifamily % Vacant	3Q 09	2Q 09	Change Last Qtr	3Q 08	Change Yr Ago
U.S. – Census	**13.1**	12.1	1.0	10.7	2.4
U.S. – MPF	**7.9**	8.1	-0.2	6.2	1.7

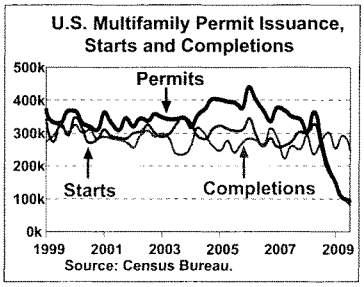
Multifamily permits and **starts continued their steep downturn; completions also declined** this quarter. **Permits** (5+ units in structure) decreased sharply to a seasonally adjusted annual rate (SAAR) of 94,700, down 8.4 percent from last quarter and a large 65.6 percent drop from a year earlier. This is the lowest level on record (since 1959). **Starts** dropped even more precipitously to a SAAR of 84,000, down 19.7 percent from last quarter and 67.0 percent from a year ago. This is also the lowest level on record. And **completions** decreased to a SAAR of 247,000, down 15.6 percent from the previous quarter and 10 percent from a year ago. The declines in starts and permits will likely mean larger drops in completions in the coming quarters.

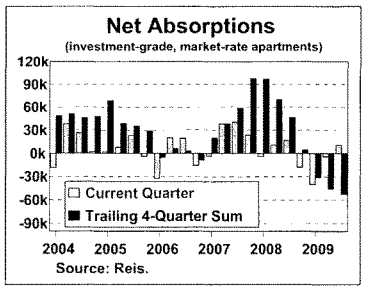
Permits (2+ units, unadj.)	3Q 09	2Q 09	Change Last Qtr	3Q 08	Change Year Ago
Northeast	4,600	4,700	-100	9,100	-4,500
Midwest	6,500	4,500	2,000	13,900	-7,400
South	12,500	16,600	-4,100	42,700	-30,200
West	6,500	6,000	500	17,500	-11,000
U.S.	30,100	31,800	-1,700	83,200	-53,100

Multifamily net absorptions of investment-grade apartments tracked by Reis were 10,397 units, up 14,767 from the previous quarter, but down 6,054 from a year ago. This is the first positive level of absorptions in four quarters. Still, the four-quarter trailing net absorptions figure of -52,257 is at its lowest level since the second quarter of 2002.

Multifamily completions in the investment-grade market also declined to 21,122 units, down 5,987 from last quarter and 5,984 from a year ago. For now, completions remain much higher than absorptions, which is reflected in higher vacancy rates.







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Apartment rents measured by public and private data sources diverged. Same store rents for professionally managed apartments tracked by MPF Research declined 4.6 percent this quarter, surpassing last quarter's record decline of 3.4 percent. Rents continued to decline in all four regions for a fourth straight quarter. The West had the largest decline at -7 percent, while the Northeast (-2.6 percent), the Midwest (-2.8 percent) and the South (-3.3 percent) experienced smaller declines. Regional rent growth declines set records except in the Northeast. By contrast, the CPI rent index, which covers all rental housing, rose 2.0 percent, still positive but the lowest rate of annual growth since 1968. With overall inflation negative, real rent grew by a larger amount, namely 3.6 percent.

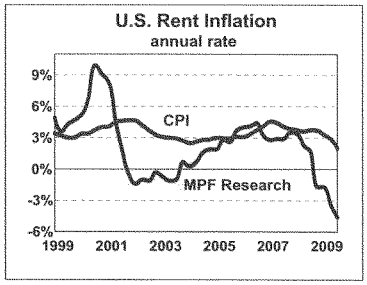
MPF "same store" rent (ann. chg., %)	3Q 09	2Q 09	1Q 09	4Q 08	3Q 08
Northeast	**-2.6**	-2.1	-1.3	-5.4	2.3
Midwest	**-2.8**	-1.8	-0.7	1.6	2.4
South	**-3.3**	-2.0	-0.6	-0.7	1.6
West	**-7.7**	-6.5	-3.8	-1.7	1.3
U.S.	**-4.6**	-3.4	-1.7	-1.7	1.7

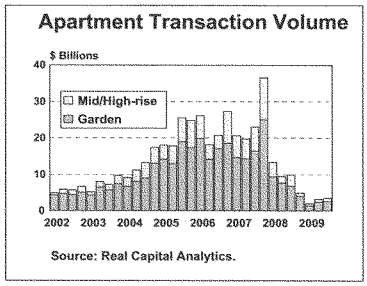
In the apartment transaction market, **volume rose slightly** in the third quarter to $3.6 billion, up 12.1 percent from the prior quarter but still down 64.2 percent from last year's level, and still far below mid-decade levels. **Apartment prices fell further.** The average price for properties sold in the third quarter of 2009 (tracked by Real Capital Analytics) was **$78,709 per unit,** down 9.7 percent from the previous quarter and a striking 30.5 percent drop from last year. This was the fifth straight quarter of decline and the lowest average price since the second quarter of 2004. The market value of investment-grade apartments in the National Council of Real Estate Investment Fiduciaries' (NCREIF) database also continued to decline in the third quarter, falling 4.3 percent from the previous quarter and 27.0 percent from last year. The **cap rate** increased to 7.1 percent.

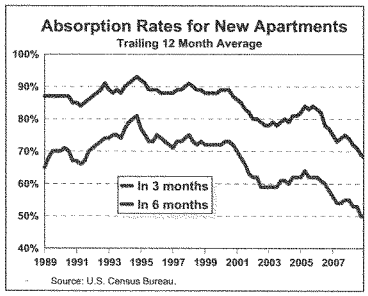
New Apartment Absorptions

Absorption rates for newly completed apartments have dropped to the lowest levels since data started being collected in 1989. Census Bureau data show that in the first quarter of 2009 (latest data available), only 52 percent of newly completed apartments were leased up. Although this was an improvement from the 45 percent figure of the previous quarter, the series is generally too volatile to read much into quarter-to-quarter changes.

For that reason, it's helpful to look at the trailing 12-month average (using not seasonally adjusted data). By that measure, 50 percent of 2009Q1 new apartments were leased, the same as the previous quarter and a record low. The historical average for the series is a 67 percent lease-up rate. Similarly, the 6-month absorption rate (also on a trailing 12-month average basis) was 68 percent, also a record low and well below the series average of 84 percent. The Absorption chart shows just how challenging the current decade has been for new apartment lease-ups. After fairly steady absorption rates in the 1990s, lease-up rates have fallen for most of the decade, interrupted only by a partial rebound from 2003-05.







Questions or comments on *Market Trends* should be directed to Dr. Mark Obrinsky, NMHC's Vice President of Research and Chief Economist, at mobrinsky@nmhc.org. Web sites of organizations providing data used in this issue are: www.mpfresearch.com (MPF Research); www.reis.com (Reis); global.rcanalytics.com (Real Capital Analytics); www.ncreif.org (NCREIF); www.census.gov (U.S. Census Bureau); and www.bls.gov (U.S. Bureau of Labor Statistics). Some data providers revise prior figures on an ongoing basis; as such, figures and percentage changes reported may be inconsistent across newsletters.

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MARKET TRENDS

August 2009

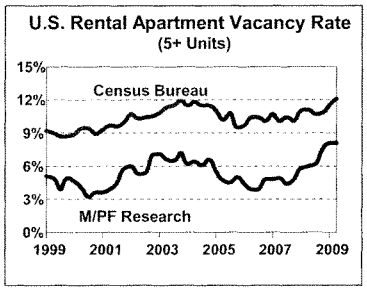
Apartment vacancy rates were at record levels in the second quarter. The U.S. Census Bureau vacancy rate for all rental apartments (in buildings with 5 or more units) rose to 12.2 percent, the highest on record (going back to 1968). The M/PF Research national vacancy rate for investment-grade apartments was 8.1 percent, the same as the revised first quarter figure and also an all-time high (though this series only goes back to 1993). The vacancy rose slightly in the South to 9.2 percent, remained steady in the West at 7.7 percent, and declined slightly in the Northeast to 6.0 percent and in the Midwest to 7.8 percent. The figure for the South was a record; it was also the 10th straight quarter in which the highest regional vacancy rate was in the South.

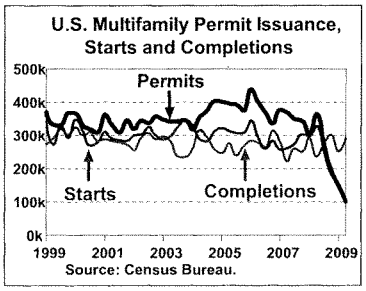
Multifamily % Vacant	2Q 09	1Q 09	Change Last Qtr	2Q 08	Change Yr Ago
U.S. – Census	**12.2**	11.5	0.7	11.7	0.5
U.S. – M/PF	**8.1**	8.1	0.0	6.0	2.1

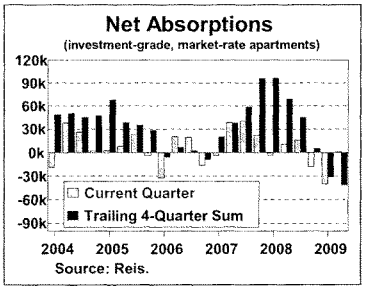
Multifamily **permits** and **starts continued their steep decline** while **completions increased** this quarter. **Permits** (5+ units in structure) decreased sharply to a seasonally adjusted annual rate (SAAR) of 101,700, down by 32.1 percent from last quarter and by 72.1 percent from a year earlier. Having dropped for nine consecutive quarters, this is the lowest level of permitting on record (since 1959). **Starts** declined nearly as dramatically to a SAAR of 108,000, down by 28.2 percent from last quarter and by 67.1 percent from a year ago. This was the second lowest figure on record. In contrast, **completions** increased to a SAAR of 293,000, up by 16.0 percent from the previous quarter and 24 percent from a year ago. Completions have yet to reflect the downturn in permits and starts.

Permits (2+ units, unadj.)	2Q 09	1Q 09	Change Last Qtr	2Q 08	Change Year Ago
Northeast	4,700	4,500	200	35,600	-30,900
Midwest	4,500	5,100	-600	12,100	-7,600
South	16,400	18,700	-2,300	37,500	-21,100
West	5,600	9,600	-4,000	24,500	-18,900
U.S.	31,200	37,900	-6,700	109,700	-78,500

Multifamily net absorptions of investment-grade apartments tracked by Reis were 888, up 40,786 from the previous quarter, but down by 9,959 from a year ago. Since the bulk of new leasing activity occurs during the second and third quarters, such a slim net absorption is a sign of real weakness in apartment demand. The four-quarter trailing net absorptions figure of 41,118 is at its lowest level since the 3rd quarter of 2002. **Multifamily completions** in the investment-grade market also declined slightly to 22,696, down 1,973 from last quarter and 5,858 from a year ago. However, completions have not declined nearly as rapidly as net absorptions.







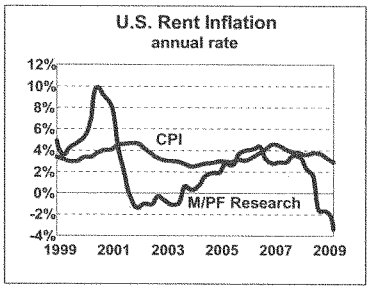
Apartment rents measured by public and private data sources continued to diverge widely. Same store rents for professionally managed apartments tracked by M/PF Research declined by 3.4 percent, the biggest decline on record. Rents continued to decline in all four regions for a second straight quarter. (Note that since overall inflation was negative in the quarter, the "real" rent decline was smaller at -2.2 percent.) The West had by far the largest decline at -6.5 percent, while smaller declines were posted in the Northeast (-2.1 percent), the Midwest (-1.8 percent), and the South (-2.0 percent). In contrast, the CPI rent index, which covers all rental housing, not just apartments, rose by 2.9 percent in the second quarter. This was the lowest such increase in over four years. Coupled with the negative inflation of the quarter, however, "real" rent actually rose by a startling 4.1 percent, the highest in 55 years.

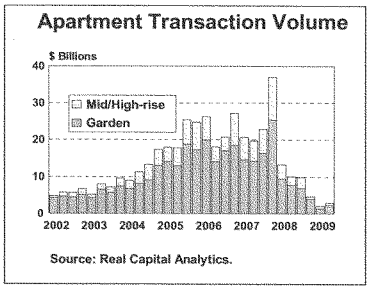
M/PF "same store" rent (ann. chg., %)	2Q 09	1Q 09	4Q 08	3Q 08	2Q 08
Northeast	**-2.1**	-1.3	-5.4	2.3	2.3
Midwest	**-1.8**	-0.7	1.6	2.4	2.1
South	**-2.0**	-0.6	-0.7	1.6	2.1
West	**-6.5**	-3.8	-1.7	1.3	2.7
U.S.	**-3.4**	-1.7	-1.7	1.7	2.3

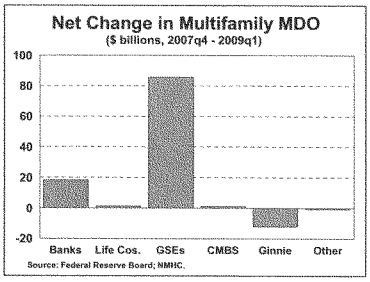
In the apartment market, **transaction volume rose slightly** in the second quarter to $2.8 billion, up by 42.5 percent from the prior quarter but still down 71.9 percent from a year ago and near the record low. **Apartment prices fell further.** The average price for properties sold in the second quarter of 2009 (tracked by Real Capital Analytics) was **$85,407 per apartment unit,** down by 3.1 percent from the previous quarter and by 8.2 percent from last year. This was the fifth straight quarter of decline and the lowest average price since the 2nd quarter of 2004. The market value of investment-grade apartments in the National Council of Real Estate Investment Fiduciaries' (NCREIF) database continued to decline in the second quarter, falling by 6.4 percent from the previous quarter and by 24.8 percent from last year. The **cap rate** remained at 6.8 percent.

Multifamily Mortgage Debt

Multifamily mortgage debt grew by only $6.1 billion in the first quarter of 2009, a drop of almost 60 percent from the year-earlier level and the lowest such figure in more than 11 years. Over the most recent four quarters, mortgage credit increased by $46.4 billion, a moderation after the run-up to an all-time record of $98.9 billion just five quarters ago. While the decline mainly reflects the sharp drop in transactions activity, the changed landscape of mortgage lending has also played a role. In particular, the CMBS market remains dormant, and portfolio lenders are generally providing limited credit. As a result, Fannie Mae and Freddie Mac—which have continued to lend—have become the key pillars in multifamily mortgage credit. From the fourth quarter of 2007 through the first quarter of this year (latest data available), the GSEs were responsible for 92 percent of the net increase in mortgage credit to the apartment industry. (Note: On the accompanying chart, "banks" refers to thrifts as well as commercial banks.)







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NMHC

MARKET TRENDS

May 2009

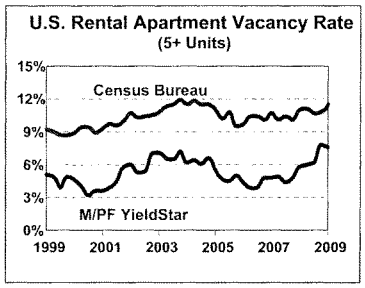
In the first quarter of 2009, **apartment vacancy rates did not trend consistently.** The U.S. Census Bureau vacancy rate for all rental apartments (in buildings with 5 or more units) rose to 11.5 percent, the highest vacancy rate since the 4th quarter of 2004. The M/PF YieldStar national vacancy rate for investment-grade apartments decreased slightly this quarter to 7.6 percent. While the vacancy rates rose in the South to 9.1 percent, the highest in nearly a decade, and in the West to 7.7 percent, these increases were more than offset by declines in the Midwest (to 7.9 percent) and the Northeast (to 5.0 percent).

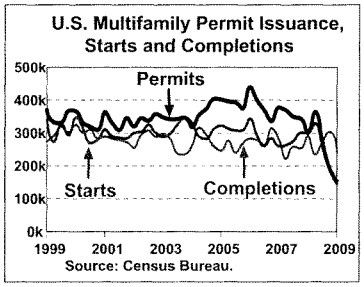
Multifamily % Vacant	1Q 09	4Q 08	Change Last Qtr	1Q 08	Change Yr Ago
U.S. – Census	**11.5**	10.8	0.7	11.0	0.5
U.S. – M/PF	**7.6**	7.8	-0.2	5.8	1.8

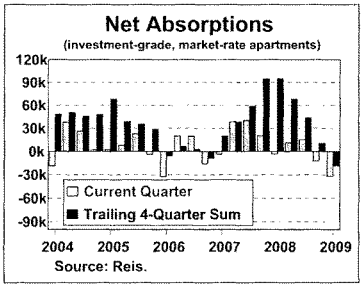
Multifamily **permits, starts,** and **completions** all declined this quarter. **Permits** (5+ units in structure) decreased to a seasonally adjusted annual rate (SAAR) of 153,700, down by 20.1 percent from last quarter and by 48.9 percent from last year. This is the lowest level since the second quarter of 1993, and reflects declining activity in all regions of the country. **Starts** declined for a third straight quarter to a SAAR of 145,700, down by 21.5 percent from last quarter and by an even larger 51.7 percent from a year ago. **Completions** declined to a SAAR of 241,700, down 20.4 percent from the previous quarter and 17.1 percent from a year ago. Since completions lag starts by several quarters, they have not yet shown the steep drop seen in permits and starts, but surely will do so soon.

Permits (2+ units, unadj.)	1Q 09	4Q 08	Change Last Qtr	1Q 08	Change Year Ago
Northeast	**4,500**	6,200	-1,700	10,100	-5,600
Midwest	**5,100**	8,300	-3,200	9,200	-4,100
South	**18,700**	23,100	-4,400	39,600	-20,900
West	**9,600**	14,200	-4,600	19,200	-9,600
U.S.	**37,900**	51,800	-13,900	78,100	-40,200

Multifamily net absorptions of investment-grade apartments tracked by Reis were -32,095 in the first quarter, a further erosion of 19,558 from the previous quarter, and a drop of 28,700 from a year ago. This is the lowest level of net absorptions in three years. The trailing four-quarter sum showed net absorptions of -18,270, the lowest figure since the third quarter of 2002. **Multifamily completions** in the investment-grade market also declined to 22,833, down 7,938 from last quarter but just 122 lower than a year ago. The trailing four-quarter sum was essentially unchanged from last quarter and does not yet reflect the slowdown in new construction permits and starts.







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Apartment rents measured by public and private data sources diverged widely. Same store rents for professionally managed apartments tracked by M/PF YieldStar declined by 2.8 percent, the biggest decline in at least 15 years. For the first time since the third quarter of 2003, rents declined in all four regions. The Northeast and West had the largest declines (-6.1 percent and -3.8 percent, respectively), while declines in the Midwest and South were more modest (-0.7 percent and -0.6 percent, respectively). In contrast, the CPI rent index, which covers all rental housing, not just apartments, increased in the fourth quarter by 3.3 percent, the lowest in three years.

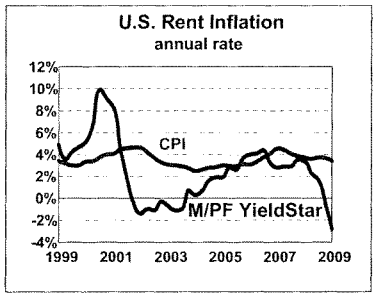
M/PF "same store" rent (ann. chg., %)	1Q 09	4Q 08	3Q 08	2Q 08	1Q 08
Northeast	-6.1	-0.1	2.3	2.3	4.1
Midwest	-0.7	1.1	2.4	2.1	3.3
South	-0.6	0.2	1.6	2.1	2.5
West	-3.8	-1.7	1.3	2.7	4.4
U.S.	-2.8	-0.3	1.7	2.3	3.4

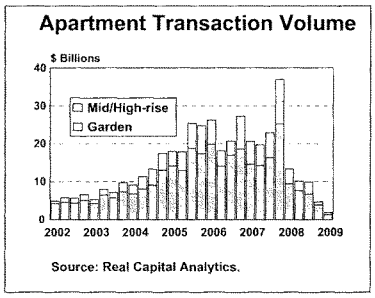
In the apartment market, **transaction volume continued to plummet** in the first quarter to an anemic $1.8 billion, down 61 percent from the prior quarter and 86 percent from a year ago. This is the lowest level of transaction volume since at least 2001. **Apartment prices rose slightly but remain below last year's levels.** The average price for properties sold in the first quarter 2009 (tracked by Real Capital Analytics) was $89,250 **per apartment unit,** up 2.1 percent from the previous quarter but down 8.9 percent from a year ago. The market value of investment-grade apartments in the National Council of Real Estate Investment Fiduciaries' (NCREIF) database continued to decline in the first quarter, falling 9.9 percent from the previous quarter and 11.4 percent from last year. These were each record-setting declines. The **cap rate** remained at 6.8 percent.

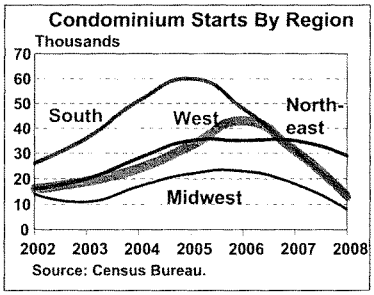
Condo Construction

In 2008, multifamily (2+) condo starts and completions both continued their decline. Nationwide, starts were down 43 percent from 2007 and 57 percent from their peak in 2006. The West, Midwest and South all recorded more than 50 percent drops. The Northeast led the regions with 29,000 units started; the Midwest recorded the lowest level at 8,000 units.

Completions, on the other hand, were down just 13 percent from 2007 totals, but at 101,000 units they were not notably lower than their five-year average of 103,000 units. Having recorded a high level of starts earlier in the decade, the South led the other regions in 2008 annual completions at 36,000. However, that was a 38 percent drop from its 2006 peak. The West overtook the Northeast in condo completions for the second year in a row, while completions in the Midwest remained slightly above their five-year average at 17,000 units.







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MARKET TRENDS

February 2009

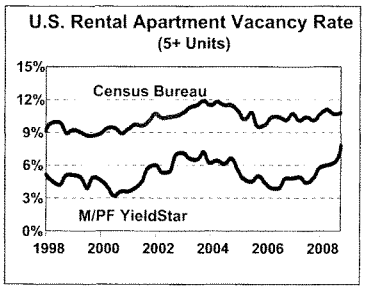
In the fourth quarter of 2008, **apartment vacancy rates increased.** The U.S. Census Bureau vacancy rate for all rental apartments (in buildings with 5 or more units) rose to 10.8 percent. This is also the average vacancy rate for the year and the highest average vacancy rate since 2004. The M/PF YieldStar national vacancy rate for investment-grade apartments increased sharply to 7.8 percent, the second highest vacancy rate since 1993. Mirroring the national vacancy rate, the M/PF YieldStar regional vacancy rates rose too. The highest vacancy rate was in the South (8.5 percent), followed by the Midwest (8.0 percent), the West (7.3 percent), and the Northeast (6.2 percent).

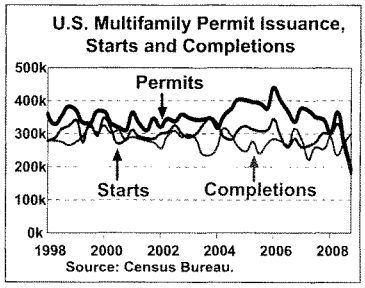
Multifamily % Vacant	4Q 08	3Q 08	Change Last Qtr	4Q 07	Change Yr Ago
U.S. – Census	**10.8**	10.7	0.1	10.1	0.7
U.S. – M/PF	**7.8**	6.2	1.6	4.8	3.0

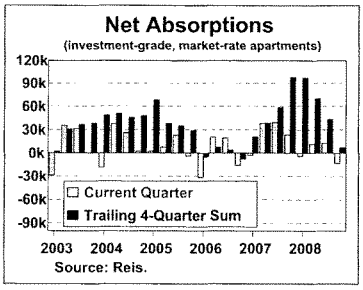
Continuing the previous quarter's trend, **multifamily permits and starts decreased while multifamily completions increased in the fourth quarter. Permits** (5+ units in structure) decreased to a seasonally adjusted annual rate (SAAR) of 192,300, the lowest quarterly permitting level in nearly 16 years. For 2008, permits totaled 290,300, the lowest since 1996. **Starts** declined sharply for a second straight quarter to a SAAR of 180,300, down by 29.6 percent from last quarter. For the year, starts slipped to their smallest level since 1995. **Completions** increased to a SAAR of 299,700, up by 9.8 percent from the previous quarter. This is the first quarter since 1991 that the level of completions has exceeded that of starts and permits. For the year, completions reached 275,000, an 8.3 percent increase over 2007, but just under the average for the past 10 years.

Permits (2+ units, unadj.)	4Q 08	3Q 08	Change Last Qtr	4Q 07	Change Year Ago
Northeast	**6,200**	9,300	-3,100	16,200	-10,000
Midwest	**8,300**	12,900	-4,600	12,700	-4,400
South	**23,100**	39,200	-16,100	40,800	-17,700
West	**14,200**	17,000	-2,800	25,400	-11,200
U.S.	**51,800**	78,400	-26,600	95,100	-43,300

Multifamily net absorptions of investment-grade apartments tracked by Reis were -13,160 in the fourth quarter, a further sign that the sharp drop in employment in the late fall and winter has begun reverberating throughout the apartment industry. That brought absorptions for the year down to 7,011; although positive, this was well below the previous year's figure of 98,203. **Multifamily completions** in the investment-grade market rose slightly to 24,226; that's up 1,583 from the previous quarter but down 6,480 from a year ago. For the year, completions reached 96,796, not much changed from the level of the prior four years.







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Apartment rents measured by both public and private data sources did not trend consistently. Same store rents for professionally managed apartments tracked by M/PF YieldStar declined by -0.3 percent, the first decline since the third quarter of 2003. This slight national decline reflected the effect of negative rent growth in the West (-1.7 percent) and Northeast (-0.1 percent), while rents increased in the Midwest (1.1 percent) and South (0.2 percent). Still, inflation-adjusted rent growth was negative in all four regions. The CPI rent index, which covers all rental housing, not just apartments, increased in the fourth quarter by 3.7 percent.

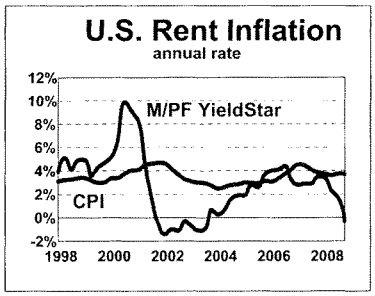
M/PF "same store" rent (ann. Chg., %)	4Q 08	3Q 08	2Q 08	1Q 08	4Q 07
Northeast	**-0.1**	2.3	2.3	4.1	3.4
Midwest	**1.1**	2.4	2.1	3.3	2.8
South	**0.2**	1.6	2.1	2.5	2.6
West	**-1.7**	1.3	2.7	4.4	4.9
U.S.	**-0.3**	1.7	2.3	3.4	3.5

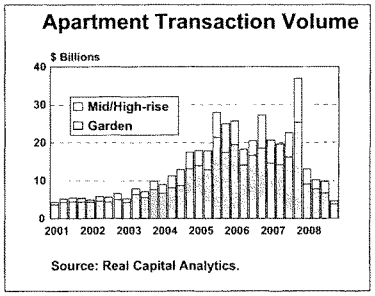
In the apartment market, **transaction volume continued to decline** in the fourth quarter to $4.6 billion, down by 53.3 percent from the third quarter. For the year, total volume decreased to $37.6 billion, off by 61.7 percent from 2007 and the lowest since 2004. **Apartment prices fell for the third straight quarter.** The market value of investment-grade apartments in the National Council of Real Estate Investment Fiduciaries' (NCREIF) database declined in the fourth quarter by 9.5 percent from the previous quarter and by 11.4 percent from last year. These were each record-setting declines. Among apartment transactions monitored by Real Capital Analytics, the average price for properties sold in the fourth quarter 2008 was $87,164 **per apartment unit,** down 23 percent for the quarter and 13.8 percent from last year. At 6.8 percent, the average **cap rate** rose by 30 basis points from the previous quarter to the highest level since 2004.

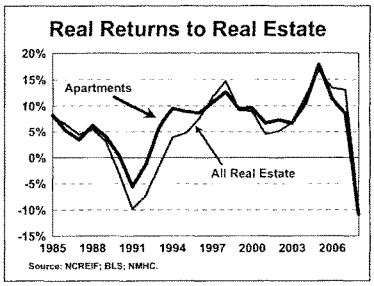
Apartment Investment Returns

Not surprisingly, the economic downturn has taken a toll on apartment investment returns. According to the National Council of Real Estate Investment Fiduciaries, total unlevered returns on privately held apartments were -7.0 percent in 2008, the worst performance in the 20-year history of the NCREIF apartment index. Adjusted for inflation, the total return to apartments was -10.8 percent, also the worst on record. Returns to all real estate asset types were not much better at -6.5 percent. No asset type registered positive returns: hotels turned in the worst performance at -9.4 percent, while retail performed the best at -4.1 percent.

In the public markets, however, apartment REITs outperformed the other REIT asset classes. Last year, the total return to apartment REITs was -25 percent, compared to -41 percent for office REITs, -48 percent for retail REITs, -60 percent for lodging REITs and -67 percent for industrial REITs. Apartments were the only real estate asset class to outperform the overall stock market: as measured by the S&P 500, the total return to stocks was -38 percent.







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February 24, 2010

Chairman Barney Frank
U.S. House of Representatives
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

Chairwoman Nydia Velazquez
U.S. House of Representatives
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Frank and Congresswoman Velazquez:

As the president and owner of Southaven Pontiac Buick GMC in Southaven, Mississippi and the president of the General Motors Minority Dealers Association (GMMDA) in Southfield, Michigan, I would like to present some very critical issues to you as it relates to the survival of auto dealers, our continuing fight to secure loans needed to operate our dealerships and the dismal state of affairs of the minority dealer body in America.

As you are well aware, owners and operators of automotive dealerships, like the manufacturers, have fallen victim to the devastating effects of last year's worldwide financial crisis and distressed credit markets. The disappearance of liquidity in credit markets has continued to cripple numerous dealerships nationwide and threatens to further weaken even more communities where we operate. As noted by the Michigan Congressional delegation, "there is no single segment of America's economy that is more critical to the financial well-being of millions of Americans than the automotive industry." With the continued depressed credit markets, financing continues to be extremely limited for dealers, even today, to purchase inventory and pay employees. Without moves to assist distressed dealerships, these conditions will continue to dramatically weaken vehicle sales and add greater risk not only for auto manufacturers, but the broader network of dealers, suppliers, vendors, and other peripheral businesses that provide goods and services to America.

Despite the enormous governmental support provided to banks and financial institutions and the expansion of the size standards and guarantees under the SBA 7(a) loan program, countless dealers, including myself, have yet to secure a single loan to help us keep our dealerships open. Personally, I have been turned down by a total of ten (10) banks and financial institutions despite my stellar 10+ year career as a GM dealer and recognition as one of the top certified-used vehicle GM dealerships in the country. My challenge is not finding a program that my dealership qualities for, like the SBA 7(a) loan program, the problem lies with the unwillingness of the SBA approved lenders to agree to underwrite a loan for my dealership. Many of the banks that turned down my request for a loan are the very same banks that received financial support from the government under the federal stabilization program. While there is no question that the American auto industry has been tainted by the historic auto manufacturer bankruptcy filings, negative reports of financial mismanagement and continual financial losses, the true victims are the auto dealers who have no access to secure the desperately needed loans and other financial support to sustain their dealerships.

It is true that Congress provided the Treasury and the Federal Reserve with an array of important powers and authority to be used to stabilize financial and capital markets and restore equilibrium to the nation's economy. Although understanding the intent behind this action, the reality is that very few dealers have yet to benefit from this activity. The same financial and credit markets crisis that caused Chrysler, Chrysler Financial, General Motors and GMAC to seek and receive billions of dollars from the U.S. government has led to significant deterioration in the financial health of dealerships. Unfortunately, many of the nation's auto dealers have impaired cash positions and weak balance sheets which have resulted in negative decisions being made by GMAC and other banks and financial institutions not to provide the requested loan assistance. This continued action will force even more auto dealers out of business since floor plan loans and working capital loans are **essential** for a dealers' survival.

Our association's leadership has worked collectively with leaders from other dealer associations across the country in an effort to obtain the appropriate financial and equitable relief needed to assist dealers over the past 18 months. From participating in a meeting with President Obama and the top White House Administration representatives in June 2009, a meeting with SBA executives in May 2009, a meeting with senior level GM executives and a representative from the U.S. Treasury Department in July 2009 and countless congressional hearings and meetings where representatives and dealers provided testimony about the dire situation for dealers, we have yet to receive the desperately needed and requested relief. Accordingly, we are left to believe that we have exhausted all possible avenues for securing the support needed to keep our dealerships alive. Thus, we are appealing to you for your immediate intervention and help.

FACT: GMAC IS THE PRIMARY FINANCIAL RESOURCE FOR APPROXIMATELY 80% OF THE GM MINORITY DEALERS.

As it relates to the subject of minority auto dealers, while General Motors and Chrysler have received enormous financial assistance from the government, most if not all, minority-owned dealerships lack the legacy wealth and financial stability to secure financial assistance to sustain their businesses. As a result, many of them are forced to close their dealerships at alarming rates. Additionally, the rejected and terminated minority dealers have been deprived of their franchise agreements without fair compensation and due process. As you know, many dealers were forced to sign onerous and oppressive documents giving up their franchise rights and privileges that they are rightfully entitled to. The end result will be an extremely small number of minority dealerships that will be afforded the opportunity to continue on with the new GM and Chrysler companies; thus, ending 30+ years of advocacy efforts to ensure that ethnic minorities are given a fair and equitable opportunity to own dealerships.

While the auto manufacturers have made efforts to increase the number of ethnic minority owned dealerships over the years, the grim reality is that ethnic minority dealer ownership represents less than 3% of the entire dealership base in the United States. Currently, GM's minority dealers make up less than 4% of the entire GM dealer network, however, 19% of the minority dealers were recently terminated by General Motors in their effort to "right size" and restructure the company. Chrysler had minority dealer representation of less than 5%, but rejected 20% of their minority dealers. These rejected and terminated minority dealers serve as tremendous assets to their communities through skilled professional employment opportunities, substantial tax base for their local municipalities and ongoing financial support to community-based organization and groups.

During a hearing on November 19, 2008 before the United States Financial Services Committee entitled "Stabilizing the Financial Condition of the American Automotive Industry", Congressman David Scott presented a direct question to all the presidents of the automotive manufacturers, *"We need to make sure that if we give you this money that you would ask either the president or SBA director would declare ethnic minority disaster loans under the current SBA authority. If we do those things, we would be helping more directly, not only the overall industry, but I would like to ask that if each of you would just simply nod your head and say yes that you would support getting capitalization and available capital to dealers?"* In reply, all of the manufacturer

representatives on the panel, G. Richard Wagoner, Alan Mullaly and Robert Nardelli, replied *"yes"*. Nevertheless, no action whatsoever was taken by either of these individuals on behalf of the auto dealers as noted in their recorded testimony.

While the following list is not exhaustive, I would recommend that Congress consider these recommendations to help preserve and maintain American auto dealers and the communities that we serve:

1. Take immediate action to require that GMAC, and any bank or financial institution that received government funding under the TARP program or other federal stabilization program last year be required to approve a reasonable number of working capital and floor plan loans for auto dealers;

2. Request that the Treasury Department implementation the creation of a new, limited Commercial Paper Funding Facility (CPFF) to complement the Federal Reserve's existing credit facilities to help provide liquidity directly to distressed automotive dealership owners and operators;

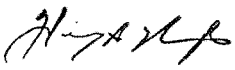
3. Establish a comprehensive automotive industry restoration package that will also provide distressed automotive dealership owners and operators access to direct funding that would accommodate their credit needs;

4. Request that President Obama sign an Executive Order to implement a direct loan program under the SBA, premised on the Emergency Dealer Assistance Program that President Jimmy Carter enacted in 1980 to assist auto dealers with securing loans without having to rely upon the approval of banks and financial institutions;

At a minimum, the implementation of these recommendations above would ensure that the United States continues to safeguard the economic rights of manufacturers, dealers, and consumers. Additionally, these recommendations would assist in facilitating the revitalization of American economic prowess and the sustainability of our country as we move forward into the bright future that lies ahead. I welcome the opportunity to join together with you and other members of Congress in developing an urgent plan to assist the auto dealers in America. Lastly, I trust that you and your fellow members of Congress will give immediate care and attention to the traumatic plight of the auto dealers and dealerships who sit at the foundation of this industry.

Thank you in advance for your time, attention and consideration. Please feel free to contact me directly at: (901) 553-3084 or via email at: soupont@aol.com

Sincerely,



Henry A. Ware
President
Southaven Pontiac Buick GMC
GM Minority Dealers Association

Enclosure: *Summary of Testimony from Congressman David Scott dated 11/19/08*

cc: Rep. Travis Childers

March 22, 2010

Rep. Scott Garrett, New Jersey
137 Cannon House Office Bldg.
Washington, D.C. 20515

Dear Rep. Scott Garrett:

Job creation is priority No.1 to restoring the American economy. Everyone from the President, to Congress to the man and woman on Main Street understands that the health of the nation's economy hinges on creating a business environment that grows jobs.

From my vantage point the biggest impediment to job growth is the credit crunch. Last year lending across the U.S. economy contracted 7.4 percent, the biggest such drop since 1942, according to the FDIC. The Treasury Department estimates that $1.5 trillion in lending evaporated last year.

As one business owner put it; "capital is the oxygen we need to survive and thrive, but the air out here is pretty thin at the moment."

In order to breathe life into the economy ways must be found to boost lending to businesses of all sizes now.

My company, Metro Funding Corp., a private commercial real estate lender headquartered in New Jersey, is very much "in the lending business". We specialize in immediate and creative financing solutions and have already lent $75 million nationwide. Many of our loans went to business owners who were unable to receive funding elsewhere.

For example, we recently provided a York, PA businessman with a $1.4 million loan on land for a construction project. The property was approved by HUD for 308 low-income residential units for seniors, yet, no one else would give the borrower, who has a excellent track record of constructing and renovating residential units, an acquisition loan.

In another instance, we loaned $1.25 million to help a family-run fabric dyeing plant in New Jersey expand. The company, with more than 20 years of experience had secured several contracts for new business, including the production of American flags and needed additional operating capital. Metro Funding Corp. stepped up to the plate to help this borrower when several larger lenders passed.

ONE KALISA WAY • SUITE 310 • PARAMUS, NEW JERSEY 07652
TEL: (201) 262-6360 • FAX: (201) 262-6910 • www.metrofundingcorp.com

Despite urging by President Obama the executives of the nation's biggest banks have been slow to free up credit. Nationally, only 40 percent of businesses received their entire loan request granted in 2009, according to a recent study by the National Federation of Independent Business.

In 2006, that number was 90 percent.

At a time when larger banks are seeking profits by providing fewer loans for larger amounts to larger companies rather than more loans for less money to medium and smaller businesses, we must make it easier for business owners to turn to smaller lenders to meet their needs.

Karen Mills, head of the Small Business Administration was recently quoted as saying: "There's a big gap in access to credit for small firms now, and it's a huge problem...We have a sense that the banks are not back to lending the way that they need to be, going forward."

However, asset-based lenders like Metro Funding Corp. are making loans to businesses of all sizes, particularly to companies that don't have the credit ratings, track record or frankly, the luxury of time to pursue capital from traditional large lenders.

At Metro Funding we recognize the fact that each loan presents unique circumstances and therefore we place emphasis on innovation and efficiency, while working closely with clients to ensure project funding.

Because asset-based lenders focus on collateral, rather than credit-worthiness, we do deals that more traditional lenders shy away from.

In 2008 asset-based lending, excluding mortgages, grew by 8.3% to almost $600 billion, according to the Commercial Finance Association, an industry trade group. The numbers are not yet in for 2009, but preliminary surveys undertaken by CFA show double-digit percent increases in lending. In comparison, conventional lending in 2009 dipped by nearly 40 percent.

At Metro Funding Corp., we are now finding ourselves servicing clients that we traditionally had not seen before. These clients have solid track records with extensive business experience and present very low risk to a lender. In a normal business climate these business owners would turn to their traditional local lenders for financing, but local banks just aren't lending.

I believe that it is critical to ensure that small banks and commercial lenders who are actually making loans to businesses can more readily access capital. Commercial lenders, such as Metro Funding Corp., want to make business loans but don't have the access to capital at the moment. With adequate access to capital we can speed up and expand our lending to large, medium and small businesses and do our part to help put the U.S. firmly on the road to economic recovery.

Giving lenders who lend, such as ourselves, direct access to much needed capital is the only way to revive the lending market and is critical to the successes of the Administration's efforts to solve our current economic crisis.

ONE KALISA WAY • SUITE 310 • PARAMUS, NEW JERSEY 07652
TEL: (201) 262-6360 • FAX: (201) 262-6910 • www.metrofundingcorp.com

It is my sincere hope that a way is found to free up capital for small banks and commercial lenders as soon as possible.

Sincerely,

David Hecht, President
Metro Funding Corporation

ONE KALISA WAY • SUITE 310 • PARAMUS, NEW JERSEY 07652
TEL: (201) 262-6360 • FAX: (201) 262-6910 • www.metrofundingcorp.com

Dear Sir,

My name is Paul Floyd Jr, of San Benito, Texas, I farm in the Rio Grande Valley and I am very concerned about my farming operation, Banks are not wanting to make any farm loans. I have tried several banks and loan institutions and have been turned down. Some will not even offer a loan application once they know that want a farm loan. Planting time is almost here and no fertilizer has been put down yet because there is no money to carry on with business. Sir, if there \are any suggestions, or any help please let me know. I have several friends who farm in the Valley and are in the same position. Thank you.

Paul Floyd Jr.
San Benito, Tx
Farming since 1976
Age 50
January 28, 2010

1310 Kilgore Rd.
San Benito, TX 78586

Sonia Anciso
4426 S. McColl Rd. Suite 1
Edinburg, TX 78539

January 2, 2010

Representative Ruben Hinojosa
2864 W. Trenton Rd.
Edinburg, TX 78539

Dear Congressman Hinojosa,

My name is Sonia Anciso, for many years now I have done business in the Rio Grande Valley as a small business owner. My latest business ventures to assist the elderly community have been True Life Home Health and Ergo Mediq, Ltd.

I am writing to ask your assistance to deal with a problem relating the difficulty to secure small business loans. I've talked to small business owners across Hidalgo County who want to grow and add jobs but cannot because they do not have access to loans at reasonable terms. Providing small businesses with access to secure loans is the key to creating more jobs. Supporting small businesses and reducing the national debt should be the top priorities right now.

Please contact me if you require further information. I hope you will see fit to devote some time to this matter, and that something can be done to assist small business owners. If you have questions, you can reach me at (956)-212-8005.

I thank you for your time and your attention.

Regards,

Sonia Anciso
Local Small Business Owner
True Life Home Health/Ergo Mediq

From: REY CONTRERAS (butch@sejainc.com)
To: adriandelossantos@sbcglobal.net
Date: Tue, February 2, 2010 12:07:16 PM
Subject: Hardship Letter

Rey Contreras
801 N. 11th St.
Donna, Texas 78537

This letter is to convey the situation that I am personally in economically due to the economic downturn. As a result of the extended economic situation my farming and distribution business has taken a downturn financially.

With the situation at hand it has become a hardship to the family, the farming operation as well as our distribution business. Financing has become very difficult to non-exsistent due to this economy. At the moment I need to re-structure my financial obligations to be able to meet my monthly payments. At the moment, that doesn't seem to be a possible, or something that could happen soon enough to keep me from the possibility of having to claim bankruptcy, as an option that I would rather not go into unless there is no other option available to me.

I hope that there is another option and that there is a real option available to me and others that find themselves in the same financial crunch. If there is an opportunity to offer some releif on this matter I can only hope that it does come soon enough. Thank you for the opprtunity to express my personal situation that I find my self in economically.

Respectfully yours,
Rey Contreras

Feb-03-10 03:00pm From- T-171 P.010/010 F-587

To Honorable Ruben Hinojosa

I Farm Here in the Valley and the troubles we have Had the Last Few years Has made Financing Difficult. The Banks we Have In The Valley Don't want to Deal with Agriculture or Agriculture Type Loans. I would Appreciate Any Help In this area of Financial Institutions, Thank You For Your Time and Any Help You can Give

Tim McDaniel
Tim McDaniel
37 A
La Casa Gardens
Mercedes, Texas 78570

Feb-08-10 03:37pm From- T-185 P.003/005 F-621

The Honorable Ruben Hinojosa,

2864 W. Trenton Rd.
Edinburg, TX 78539

Dear Congressman,

I am writing you on behalf of small businessmen & businesswomen involved in the construction business throughout the Rio Grande Valley seeking assistance to small business owners. While most in the media indicate our region is economically better off than other parts of our country, it's still a daily struggle for small business, especially us in the construction sector.

As you are aware, the residential construction came to a halt in the late 2008 and in 2009 the commercial building slowed down drastically due to the tightening of the credit markets. Commercial projects were delayed or eliminated as the owners struggled for to find the necessary investment capital. Therefore, the lack of business has forced a highly competitive market and has reduced the profit margins on all businesses.

As entrepreneurs we have learned to do whatever it takes to keep our business operating, but a second blow affecting small business is the ability to collect our accounts payables, because our customers are in the same boat we are. A final blow is the lack for financial assistance from lending institutions, including the SBA. The majority of small business owners are first generation entrepreneurs and have yet acquired the necessary assets to weather out the storm.

We hear about the "stimulus money" being allocated, but we have only heard of one major construction company in our area that has actually been awarded stimulus projects.

Congressman Hinojosa, your record on helping small business and bringing construction projects through the region is impeccable. In times like these we need for you to continue to talk to those in government who can provide true assistance to the small entrepreneur. Thank you in advance for your help and support.

Sincerely yours,

Osvaldo Garcia Jr.

President

Garcia Equipment Enterprises, LLC
1[illegible] W. Expressway 83
Pharr, TX 78577

Business
(956) 464-1100

Interior
(956) 464-1193

FEB-03-2010 09:55 From: To:19566182834 Page:2/2

Feb-03-10 03:49pm From- T-171 P.002/010 F-587

Dear Congressman 2/1/2010

My name is Adrian De los Santos I'm a retired USDA FSA employee. I have dedicated my career for the past 30 years to helping farmers. I being as a young man at age 21 with what is now NRCS and retired as a loan officer for FSA in 2006.
My life's work has been in public service and I still provide assistance to small farmers and ranchers as well as large producers. I provide my services as a liaison for USDA programs though the Texas Mexico Border Coalition and assist small farms to grow crops for farmers markets through assistance with University of Texas at Pan Am.
I help farmers with loan package assistance and financial advice plus record keeping training.
Lately my job has been near to impossible to help producers. The small farmers because they are too small and don't have enough collateral and the large producer because they don't have sufficient income to show a profit. There is always an excuse not to finance these producers. I work on their loan application as a retired loan officer with FSA I work their loan application and more then 95 percent of this loans are feasible and should be eligible. When you go through two major disasters like our farmers have gone through in the past two years, it takes a toll on their operations. Last year I worked on 26 loans of which 24 were approved. Only 3 were approved by a bank and the rest were approved by FSA. In order for FSA to approve a loan it has to be denied by at least 2 lenders. That means that 48 loans were denied by banks. This year there will be more denials.
FSA helps lots of farmers but needs improvements. The processing of loans requires a minimum of 30 days to complete an application, rarely does any loan gets approved complete in less time. Once complete it requires or it usually takes about another 30 days to possibly 60 days for approval determination. We are looking at possibly 90 day for a loan approval if denied a producer has an option to request reconsideration. The chances for approval are slim to none. The farmer has no way of knowing how to prepare a loan or what needs could be done to change his situation. The loan officer says you're not eligible and the applicant has no other option.
If a producer receives his loans late in the season the possibly to producer a good crop or yield is next to impossible. These produce bad producers and are ear marked by lenders as not good farmers because they can't make the yields. A disaster on top of the situation just makes matter worst.
I know lenders have problems but things can only get worst if they don't help the farmers who generate jobs and makes the economy move. A guarantee program for lenders is a good program and should be used to help farmers with out stretching their necks out with assistance form the USDA. FSA needs to assure lenders more assistance with out harsh punishments for not compliance with the program. I have been to workshops they are not the solution to helping the lenders they need trained individuals to help them with the programs. This allows the lenders to make more loans. I want to thank you for allowing me to speak my mine and hope you can help our farmers.

Sincerely

Adrian De los Santos

17256 Jimenez Rd.
San Benito, Texas 78586

To: Senator Hinojosa

From: Bruce Gamble

Re: Current banking problems face by farmers

I am a degreed mechanical engineer from Texas A& M University and I have been farming for eighteen years. I raise 1700 acres of cotton, corn, milo, soybeans, and sugarcane as well as 700 acres of fresh market vegetables. All of our vegetables are hand harvested.

I employ four full time laborers as well as many part time harvesters employed by the packing shed. We produce a healthy, safe food supply for the citizens of our country; however we are currently having financial difficulties because the banks are not able to provide us with operating loans even though our asset to liability ratio is 3.36:1. The banks say that they would like to deal with us but that the Federal auditors will not allow them to.

In the past I have read that for every dollar that a farmer spends it becomes nine dollars in the local economy. If that number is accurate we farmers could greatly help the economy if we were provided with our operating loans. The government has provided a revenue assistance program for 2008 because of the hurricane however we have yet to see any of that money. The Secretary of Agriculture has the ability to advance farmers their direct payments for 2010 which he is currently doing but it is only twenty two percent of the amount due. The balance of these monies will not be paid until October. If the remaining seventy eight percent could be advanced now it would greatly help many farmers and the economy.

Bruce Gamble
10539 Mile 8 Rd.
La Feria, Texas 78559

February 3, 2010

Dear Congressman Ruben Hinojosa;

My name is Servando Pruneda I am the co- owner of a company named Temps Plus. Temps Plus is a partnership that was created to help the unemployed citizens of the Lower Rio Grande Valley Area find employment. Despite of our current 8.3 % unemployment rate, our corporation has succeeded in placing an average of 25 people to work per week since we opened on October 12, 2009. We specialize in placing employees in construction, light industrial, skilled and semi-skilled positions.

Given the current recession and decline in those jobs we have also diversified into the clerical and administrative fields. Although our resources are limited to what we have invested we have been able to provide a service to our community. We feel that if we had the proper funding for our organization we can help more people.

We have been unsuccessful securing our financial needs despite of our decent credit history and numerous years of experience in this field. All attempts to acquire funding from local and out of town banks have been unsuccessful. Since we serve as the employer of record we have to cover the employees' salaries until our clients compensate us. The monies invested in this organization have been out of pocket from its owners and are limited. If we had success in obtaining a loan we are confident that we can help more people feed and clothe their families.

We appreciate your time and considerations in these matters and hope that you may be able to help

Sincerely

Servando Pruneda

Servando Pruneda
Temps Plus LLC
3323 N Ware Rd
McAllen Texas 78501

THE HONORABLE RUBEN HINOJOSA
UNITED STATES HOUSE OF REPRESENTATIVES
4263 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-4315

JANUARY 31, 2010

DEAR REPRESENTATIVE HINOJOSA,

I AM WRITING TO INFORM YOU AS TO JUST HOW DIFFICULT IT IS FOR MANY FARMERS (INCLUDING MYSELF) IN SOUTH TEXAS TO OBTAIN OR RENEW AGRICULTURAL LOANS NEEDED FOR FARMING PURPOSES.

AS YOU KNOW, TIMING IN AGRICULTURE IS EXTREMELY IMPORTANT. FOR THE PAST THREE YEARS MY LENDING AGENCY, AG CREDIT OF SOUTH TEXAS, HAD LITERALLY "PUT ME BEHIND THE EIGHT BALL" BY NOT PROVIDING MY FINANCING IN A TIMELY MANNER. THREE TO SIX MONTHS LATE WITH FINANCES DOES NOT ALLOW TIME TO MAKE A CROP. – IN 2008, I STILL HAD APPROXIMATELY 90% OF MY CROPS YET TO BE HARVESTED WHEN HURRICANE DOLLY HIT THE RIO GRANDE VALLEY. THIS WAS CAUSED BY LATE FINANCING.

MANY BANKS IN THE RIO GRANDE VALLEY DO NOT PROVIDE AGRICULTURAL LOANS. FOR THE 2010 CROP YEAR, I WAS FINALLY ABLE TO RECEIVE A LOAN FROM FSA-USDA IN A MORE TIMELY MANNER, BUT EVEN THEN IT IS A RATHER DIFFICULT MATTER.

SINCE HURRICANE DOLLY, I HAVE HEARD MANY RUMORS OF FARMERS WHO HAVE STRUGGLED TO PAY DOWN OR PAY OFF THEIR LOANS AND THEN WERE TOLD THAT THEY COULD NOT HAVE A NEW LOAN TO CONTINUE FARMING.

I FEEL THAT AGRICULTURE IS STILL THE "BACKBONE" OF THE RIO GRANDE VALLEY, AND THAT SOMETHING SHOULD BE DONE TO ENCOURAGE THE BANKS OR LENDING AGENTS SUCH AS AG CREDIT TO PROCESS AGRICULTURAL LOANS IN A MORE TIMELY MANNER.

YOUR ASSISTANCE IN CORRECTING THE SITUATION WOULD BE GREATLY APPRECIATED.

YOURS TRULY,

Edward Ostrowski Jr.

EDWARD OSTROWSKI, JR.
22435 N. Kansas City Road
Santa Rosa, Texas 78593

1-29-10

To whom it may concern,

My name is Juan Garcia. I'm a cotton, grain sorghum, corn and sugarcane farmer in San Benito, Texas in the county of Cameron. I have been in the farming industry since 1976, which was the year I graduated high school. I first started with my Dad and then continued on my own in 1977.

I have been borrowing money to operate since 1977. There has been some years I have been able to finance part of my operation myself and borrow enough to finish the crops. In other years I have to finance the whole operation.

In 2007 we had a year that was expensive, and crops were average to the point that I had a loss on the farm. In 2008, we had a good crop, good prices, but with diesel, fertilizer, seed and supplies at the highest in history and hurricane dolly came and hurt our crop. Unfortunately the farm lost money again.

In 2009, Yields were low due to the excessive heat, even though I have irrigation the overall yields on grain sorghum and corn were down about 1200 pounds to the acre, Price was about a third less than 2008, but the cost was as high. The expense did not drop.

In September of 2009, I applied at a financial institution for my operating loan for the 2010 crop year. I have done business with them since 2002. I waited for a response from them till the second week in January of 2010. At that time I was told that they would not finance me for 2010. My loan for 2009 had been payed in full. They claimed the numbers didn't meet their criteria for the last three years due to the losses. I was told that according to my history I would not be able to pay my 2010 loan back.

Due to the delay, they have put my business in jeopardy. I have applied with Farm Service Agency for my loan and hope I get it.

Agriculture lending is in jeopardy and something needs to be done. Agriculture is a very important part of the Rio Grande valley and needs to be addressed.

Thanks

Juan Garcia

P.O. Box 115
San Benito, Texas 78586

3813 Pelican Avenue
McAllen, TX. 78504
02/01/2010

Dear Congressman Hinojosa,

My name is Vidal H. Saenz, and I work for the Cooperative Extension Program at Prairie View A&M University and I am an Extension Agent stationed in Hidalgo County. My job as an Extension Agent is to administer the Small Farm Outreach Training and Technical Assistance Program (SFOTTAP) for the agricultural producers of the Rio Grande Valley. The main purpose of the SFOTTAP is to remove all of the obstacles that impede local farmers and ranchers from applying for USDA-Farm Service Agency loan programs. The counties that I cover are Hidalgo, Starr, Cameron and Willacy. In 2009, the SFOTTAP provided technical assistance for 55 farm families and their total loan requests amounted to $6,666,270. In 2009, we served more ag producers than usual in applying for USDA-FSA loan programs because local lenders have been denying farm operating loans to local producers.

I was told this morning by a friend, Adrian de los Santos, who is also a loan packager that helps ag producers in filling out loan requests, to call as many farmers and ranchers that I can to send you letters that portray their situations with the local lenders. With this short notice and the fact that I will be assisting a producer with his loan application today, I do not have the time to call on anybody. However, I can speak for every one of them by saying that for them to apply with USDA-FSA, they must be turned down by two different lenders. Take the 55 applicants assisted in 2009 and multiply by two and you have 110 denials from local lenders. This amount of denials suggests that the local lenders do not have faith in lending for agriculture.

Aside from being an Extension Agent, I also own a small feedyard in Starr county and farm 600 acres of irrigated land in Hidalgo county. My lender for the cattle was Ag Credit of South Texas and had been for 12 years. In 2009, they made me obtain a guarantee from USDA-FSA in order for them to keep my 5-year revolving line-of-credit going. I did what they wanted and the guarantee cost me $6,000. In late 2009, I was notified that Ag Credit of South Texas was no longer going to finance my revolving line-of-credit and wants me to pay down the note and shut down my operation. This has put a hardship on me and my family because we were left with 900 head of feeder cattle and no loan to keep the operation going. My farm loan for the 600 irrigated acres was financed in 2009 through USDA-FSA. I re-applied for a 2010 farm operating loan in August 2009 and still have not received an answer. It has been over 150 days and I am still

waiting. I started planting corn and the seed and fertilizer dealers will allow a grace period of one month for us to pay them, but I don't know what to do if my loan does not come through.

Congressman Hinojosa, I ask you to look into the financing needs of the ag producers in the Rio Grande Valley and help out the situation. I know that every farmer and rancher has different financing needs and that everyone's financial situation is different, but financing for ag has become increasingly difficult lately and we need your help!

Sincerely,

Vidal H. Saenz
Extension Agent-CEP
(Farm Advisor)

LYNN JENKINS, CPA
2ND DISTRICT, KANSAS

ASSISTANT WHIP

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

Congress of the United States
House of Representatives
Washington, DC 20515–1602

130 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-6601

3550 SW 5TH STREET
TOPEKA, KS 66601
(785) 234-5966

701 N. BROADWAY STREET
PITTSBURG, KS 66762
(620) 231-5966

HTTP://LYNNJENKINS.HOUSE.GOV

Joint Hearing
House Financial Services Committee
House Small Business Committee
Friday, February 26, 2010

I am home every weekend, traveling the district and meeting with constituents. As I talk to small business owners, there is a near-constant message they are trying to send those of us in this room – and that is a lack of credit which is hampering economic recovery. Even businesses with long track records of sound payment history are experiencing difficulties.

The numerous small, community financial institutions which by-and-large serve my district and the state of Kansas did not contribute to the financial meltdown. However, as you will see from the enclosed letters, we need to get our foot on the gas pedal and the regulators off the brake pedal.

Even more pointedly, one banker states it simply: "They are fearful of the government's anti-business stance."

These circumstances appear to be leading down a road toward a "perfect storm" which could cause a second crisis – businesses can't grow and when those which want to grow lack credit, we will never get this nation out of the economic downturn and back onto the road to prosperity.

The enclosed letters from businesses and financial institutions across my state reinforce that there are businesses that want to and need to grow. Institutions are trying to lend but are facing increased restraints.

We must focus on doing what is necessary to ensure that those who have made financially sound decisions have the ability to lend or access to the capital they need.

I thank Chairman Frank for allowing Members to submit letters from constituents. I am eager to hear from today's witnesses so that we can work toward effective solutions.

Lynn Jenkins, CPA

Lynn Jenkins

PRINTED ON RECYCLED PAPER

January 28, 2010

Jean Carroll
U.S. House of Representatives
Committee on Financial Services
2120 Rayburn House Office Building
Washington, DC 20515

RE: Testimony for Bank Lending Hearing

First and foremost, we thank you for the opportunity to tell our story and the chance to make lawmakers fully aware of the impact their changes, both enacted and proposed, have had or will have when they're played out in middle America where we reside.

A brief overview of Kan Build's history is relevant to help set the stage for understanding the numerous difficulties we have already endured prior to the banking meltdown of the past two years. Our company/facility was founded in 1984 by way of a joint venture between two large companies, Marley Continential Homes and J. C. Nichols. Opening in 1985 the organization operated four short years before closing. In 1989 John Samples, a local man who had previously acted as the General Manager of the facility, in conjunction with the employees and local businesses, pooled resources and reopened the facility as Kan Build, Inc.

Though the company struggled substantially in the beginning, through tenacity, hard work, and dogged determination, the company began to grow and eventually included three plant locations, 500 employees, and annual sales of $30 Million dollars by 2001. In 2001 facing overwhelming competition by better financed, publicly traded companies, Kan Build sold to Coachmen Industries, a company then traded under the stock symbol COA.

In a manner similar to the facility's first inception in 1985, Coachmen systematically modified a previously successful business model and instilled big company values and systems in the Osage City facility. Within five years, Coachmen Industries had announced its intention to close the facility in Osage City Kansas putting over 115 family's financial future in jeopardy. Once again Mr. Samples and a partner, Quintin Robert, stepped in to rescue the failing company that they had worked so hard to build previously. On January 1, 2006 Kan Build was reformed, the jobs were saved, and the second journey of Kan Build, Inc. began to unfold.

Confident that their previous success with the company and their decades of industry experience would help them to navigate the business environment even more quickly than the first time, commitments were made by Mr. Samples and Mr. Robert and the journey began. Relationships were re-established with employees, municipalities, lenders, governmental agencies, vendors, and customers. A renewed sense of purpose prevailed and hope returned to the small communities that had come to rely on the millions of dollars of wages that come to them annually as a result of the jobs Kan Build creates.

Obviously now, in retrospect, the housing economy was cooling from nearly the outset of the journey. Undaunted, Kan Build pressed on with the goal of rebuilding the company to the level of strength previously enjoyed. Amongst the challenges were non-competes precluding entry to certain markets, the reestablishment of trade relationships, the repair of relationships damaged by the former company, a cooling housing economy, and the restoration of trust between the company and the workforce. In spite of these challenges, Kan Build continued to make progress towards rebuilding and restoring the company. Then in mid-2008 the banking environment began to change in earnest. Kan Build, like many other small companies began to lose credit instruments including a $2 Million operating line of credit. The explanation we received was that the bank examiners had concerns over our credit worthiness.

To be clear, we defaulted on no bank payments, made no bank payments late, we paid on time and in no way, shape, or form, violated any loan covenant in place. We were current with 100% of our creditors. We asked out loud, how can it be that we have performed flawlessly on these obligations and yet are being punished in this way? We were told that it was due to changes in the approaches taken by bank regulators. Although we clearly have struggled like other housing companies these past three years, Kan Build was on time and one of the very few housing companies that actually made money in 2008, the same year that we lost our credit lines.

In 2008 and 2009 we spoke to over ten banks regarding our debt and repeatedly we were told that normally they'd have an interest in this, but "with the examiners the way they are right now, we just can't do it". So we pressed on through 2009. Without adequate credit lines and with an increasingly brutal housing market, we pressed on and suffered substantial losses. Now the bleak forecast for our business given by the bankers 18 months ago has nearly become a self-fulfilling prophecy. Not because of our lack of faith, but because of our lack of adequate credit resources. Cash strapped producers tend to lose leverage with their consumers and perhaps make deals that one wouldn't if it didn't seem absolutely necessary. Without adequate credit lines, we have also been unable to take advantage of special incentive prices on materials that come along and so on.

Through this all, Kan Build has not paid any creditor late and the employees have also never been paid late, but these accomplishments have come at a substantial cost to Kan Build's liquidity. Like many folks, we can't comprehend the dollars we hear batted around in the media for bailouts and stimulus programs. Since the mid 1980's, the people of this plant (at one point nearly 275 in number) have gotten up, put their boots on and went to work. As a company, we've given generously to local organizations ranging from the 4-H to Churches and from the Boy Scouts to the Fair boards. We've donated as small as $50 and as large as an entire building through the years. We've received awards ranging from the Kansas Calvary award from Governor Graves to the Ernst and Young Entrepreneurs of the Year Award.

In short, we've done what we should, paid what was owed, donated when times were good, and generally tried to build the kind of Company that is indicative of the Kansas work ethic. But at this point, we're riding straight into the wind and we need your immediate help. We have got to have a more reasonable, less punitive approach to bank regulation. At the end of the day, it likely wasn't the small rural banks that got us into the banking mess we suffered through as a nation. However, it is those small rural banks that had previously worked with us to create and maintain the rural jobs so vital to our local economy. Those same banks have been restricted from making the loans so desperately needed to help restore the local economy we share. That has got to change if we are to have any hope of an economic recovery.

We understand that our story is not unique. We've talked to other small businesses that have been derailed by similar means during the banking regulation aftermath. Sadly, many businesses that have survived through this economy without the needed credit lines, now look so ugly on paper that they couldn't qualify for help even if saner banking days return. We tell our story mostly now for cathartic reasons and with the continued hope that, perhaps, new home buyers will once again be afforded the credit needed, if deserved, to purchase a new home and help us to restore our businesses' health on our own, in spite of the banking environment.

We thank you for your time and your thoughtful consideration to what we have shared.

Respectfully,

John Samples

John Samples
CEO, Kan Build, Inc.

Quintin Robert

Quintin Robert
President, Kan Build, Inc.

121 SOUTH MAIN STREET
POST OFFICE BOX 187
TROY, KANSAS 66087
PHONE 913/985-3511
FAX 913/985-3514

Dear Chairman Frank and Committee Members,

My name is Thad Geiger and I am the Executive Vice President of The Troy State Bank in Troy, Kansas. I share my name and my bank because I am proud of the job I do and the community I serve without fear of retribution from any regulator. I have been with the Troy State Bank since 1983 so I have witnessed many economies as I have grown long in the tooth and grey in the mane.

I write to you today to tell you that lending is alive and well in the community banks of the heartland of America. Yes we have had many barriers this past year. Liquidity has been challenged by increased FDIC assessments, assessments paid because of the sins of our "big brother financial institutions". Regulations, especially cumbersome changes to real estate lending, have made making loans more of a challenge. Small banks with limited staffs are now being asked to take on more responsibility such as escrowing taxes and insurances which in of itself opens a whole Pandora's Box of new requirements for banks. Finally the general economy itself with job losses, depreciation of home values, and ever increasing expenses (the least of which is health insurance premiums) has created unprecedented hurdles for community banks to deal with.

Despite all these obstacles, community banks have continued to do what they have done in every other economic downturn, serve their community. Troy State Bank realized a long time ago you do not improve an economy by choking off your community's ability to borrow. During the great agricultural crisis of the eighties it would have been very easy to quit making farm loans. Instead we made more loans and we made them better loans with more discipline and better underwriting. And yes we did it in an environment of increased assessments and highly scrutinized regulation without any stimulus or outside help.

The Troy State Bank has a loan to deposit ratio of 64% today and I expect it to grow to over 75% as we finance agricultural operations this spring. This past week I made a loan to a construction worker for $700 until the weather breaks and he can get back to work. I also set up a line of credit to a large grain farmer for $600,000. I am currently making real estate loans to two young families. One is a $32,000 loan for an older starter home, the other a $140,000 loan for a major refinance and home improvement. We make our loans, we service our loans and we put the profit back to bank capital and into our community. And yes we are looking for more good loans to make. Thank you for letting me share this with you and God Bless in your tasks.

Sincerely,

Thad Geiger, EVP
The Troy State Bank

ROGER F. BROWN ..... PRESIDENT
JOHN F. MIES ..... EXECUTIVE VICE PRESIDENT
JACK CROSSMAN ..... VICE PRESIDENT
DENISE MASTERSON ..... CASHIER/COMPLIANCE OFFICER
TAMMIE HOPPER ..... ASSISTANT CASHIER
DONNA RAUSCH ..... IT/LOAN OFFICER
DANIELLE YOUNG ..... LOAN OFFICER

January 29, 2010

To: Committee on Financial Services
JeanCarroll@mail.house.gov

Dear Members:

Our lending demand at our bank has been stagnant. Our reasons are as follows:

1. Many borrowers are reluctant to gamble on going into further debt in this economy
2. We have had to raise our lending requirements to satisfy our board and regulators. We are not making the loans that are on the bubble.
3. Regulations on owner occupied home loans has been difficult in the past, but it is almost impossible to do correctly now. Compliance to a small bank has been a problem before and is worse than ever now. We have spent a great amount of time and money on seminars and training.

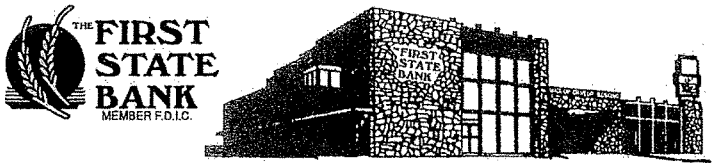
As you can see, we are concentrating on making loans of better quality and not trying to necessarily stimulate the economy. We are rewriting and re-amortizing existing customers loans to help those in financial difficulty.

Yours truly,

Roger Brown

Roger Brown
President

306 N. MAIN • P.O. BOX 509 • CHENEY, KANSAS 67025 • (316) 542-3142 • FAX (316) 542-9822
MEMBER FDIC



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Vice President
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Vice President & T.O.
Michael Haresnape
Vice President

P.O. BOX 560 • NORTON, KANSAS 67654-0560 • 785-877-3341

January 26, 2010

Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Chairman Barney Frank:

Thank you for the opportunity to submit comments for the lack of lending our nation is currently experiencing.

I am the president of a community bank located in Kansas. Our economy, although strongly agricultural oriented, is unique due to a strong wage earner base associated with local manufacturing firms and service industry. Our bank is approximately $270 million in assets and we maintain four locations in four different communities throughout northwest Kansas. Like many community banks, our local economy has been adversely affected by the financial crisis. Our manufacturing and service industry reduced their employment base and have yet to return to full staff. Other businesses have also closed in this timeframe.

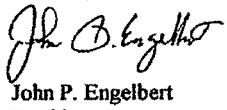
We have all read that loan volume is down due to over zealous examiners. It is true that examiners are 'looking closer', but in our opinion their actions have had little impact on our loan volume. First and foremost, there is a lack of demand for new loans. We have denied very few applicants, but rather businesses are fearful of taking on additional debt. Our bank wants to make new loans, there is simply minimal demand.

Businesses are concerned with the excessive federal deficit, the impending health care debate, and the related threat of new taxes. Business owners view the government expenditures as 'out of control' and know this will ultimately lead to new and increased taxes on the small business owners. They are also concerned about the proposed health care bill. They are fearful of hiring new employees due to the new costs and penalties associated with this bill. Finally, they are fearful of the government's anti-business stance.

In summary, the lack of lending is very simple. Small businesses want the government to take a reduced role in managing their business. They do not want new stimulus funds or new sources of borrowings, they want less government. Remove the threat of new taxes, fees, and penalties and they will start to borrow again. The only way to accomplish this is for the government to take less of a role, not add to the pain by burdening them with a new health care bill and new taxes associated with paying for the ever growing deficit.

Thank you for this opportunity to share our thoughts on this very important issue.

Sincerely,



John P. Engelbert
President

2808 SW Arrowhead Road
Topeka, Kansas 66614-2476
785.271.6900
www.educationalcu.org

February 1, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

Educational Credit Union has been offering business services to our members for several years. We had a significant demand to offer these products and services by our existing members because they were growing increasingly tired of rising fees and loan rates on business accounts offered by national and even local community banks, not to mention the tightening of their loan portfolios. Since inception of our business services program, our niche market has been small locally owned businesses such as salons, heating, cooling and plumbing operations, and doctor's offices.

In fact, most of our loans have been for under $30,000, a loan amount many banks aren't interested in even considering. Consider the following examples:

We recently assisted a local salon in remodeling the interior of their thirty year old salon. ECU was able to give the small business owner the funding she needed with a low rate and terms that met her expectations. The owner had been doing business with a local bank for a number of years and found that they were not interested in assisting her due to the size of the loan. This was despite the fact that she was an existing longtime customer with excellent borrowing history.

ECU also assisted the start-up of a plumbing, heating & cooling business. An existing consumer approached our business services department and shared the fact that he and all co-workers were being laid off by the end of the week due to a business closure. Our member had over twenty five years of experience as a project manager with this company, and showed interest in starting his own business of a similar nature. We were able to assist with a plan to get his business up and running within a week by setting up the following services for his company:

- Interest bearing checking account
- Revolving line of credit
- Term loan for small fleet of service vans
- Low fixed rate business credit card for expenses

Educational Credit Union is providing our local community financial solutions through lower business loan rates and closing costs while paying higher interest rates on business checking accounts. As a member owned financial cooperative with the sole mission of serving our membership, we look forward to expanding our business services portfolio and using "the credit union difference" to help more local businesses to grow and prosper.

Sincerely,

Greg A. Winkler
President/CEO

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

My name is Stephen Smith and I was a project manager for Young's Inc when we were given a one week notice that they were going out of business. I knew that there were still customers who needed service and there were good technicians who would need a job. So I spoke to a few of the best technicians, and instead of taking our place in the unemployment line, our families decided to take a risk and open a new company. Since we have had our personal accounts with Educational Credit Union for over 12 years it was naturally our first choice to open our business accounts. We were directed to Jennifer Kirmse who immediately helped us open our interest bearing checking account and approved us for a revolving line of credit, a loan to purchase work vans and a business credit card. The process was completely hassle-free, Jennifer took care of everything. So with the help of ECU one week after being told we would no longer have a job we opened Wheeler's Plumbing, Heating and Cooling LLC. The rates on our loans were much lower in comparison to the area banks.

Sincerely,

Stephen Smith
Wheeler's Plumbing, Heating & Cooling LLC

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

I am a small business owner in the hair salon industry. Recently I needed to replace hair equipment at my salon. I've banked at Citizens bank in Topeka, KS for 25 years. Naturally, I applied for a loan there as well as Bank of America and US Bank. Both bank's loan rate were too high and my personal bank, Citizens, had too much complicated paperwork to take out a loan. I've taken out two loans before from Educational Credit Union and completely repaid them ahead of schedule. I received amazing customer service and support from their associates. I'll gladly refer others to Educational Credit Union for any type of personal loan, business loan, or account.

Sincerely,

Darlene A. Perez
Hair Expressions, INC
3074 SW 29th
Topeka, KS 66614

From: Greg Carr
Sent: Thursday, February 04, 2010 12:09 PM
To: [redacted]
Cc: Haley DaVee
Subject: Business Lending Letters

Summer 2009 I received a call from Derek Sharp, owner of Supersonic Music here in Topeka Kansas. Supersonic Music is a locally owned store providing all types of drum sets and guitars to the community. Derek was interested in possibly refinancing his business loans and getting away from a large commercial bank.

Derek had a commercial real estate loan, equipment loan, and small line of credit. He also needed a short term loan to put a new roof on the building. The large commercial bank was dragging their feet on this request which in turn made him look elsewhere. He had been a customer with this bank for 10 years when he bought the business.

Credit Union 1 of Kansas refinanced each loan at a lower fixed rate and approved his request for a new roof. Derek had the appraiser come out after the new roof to readjust the appraised value for himself and the credit union. The new value increased $27,000 and dropped out LTV from 74% to 60%. That makes all around good business sense.

In bringing over his business checking account, Supersonic Music no longer has to pay per item transaction fees as he did at his former bank. This savings creates a large increase in cash flow and bottom line income Derek can use in his business.

Needless to say Derek is a huge fan of credit unions. When I went to his shop to deliver Christmas cookies he introduced me to everyone in the store as his new "banker". He vowed to share the "credit union movement" to everyone he knows.

Greg Carr
Vice President Lending
Credit Union 1 of Kansas
PO Box 1128
610 SW 10th St
Topeka KS 66601-1128
785.233.5556
785.233.4850 Fax
800.432.2470
www.cu1ks.org

February 2, 2010

Congressman Paul E. Kanjorski
2188 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Kanjorski,

The Ertley Dealerships has been in the retail automobile and related insurance and warranty business for 73 years. During this period of time we have had lines of credit with banks in excess of 60 million dollars, being used for working capital and floor plans for automobiles. Our company has never had a default or a negative credit issue with any of the lending institutions.

In the summer of 2009, Chrysler Financial was our supplier of credit for our inventory of automobile products. At that time they informed us that because of the Chrysler bankruptcy they would be going out of the dealer finance business, and thus, would no longer be extending credit to us. This was the beginning of our problems along with hundreds of other automobile dealerships.

We went searching for new floor plan credit lines in the amount of 2 [two] million dollars for our existing business needs. We contacted the credit officers of the following banks; PNC Bank, Old Forge Bank, Penn Security, First National Community Bank, Luzerne Bank, Landmark Bank, Honesdale Bank, M&T Bank, and the Franklin Security Bank. The story was always the same, the bank examiners said that the

ERTLEY Chrysler, Jeep, Dodge, Kia, Pre-Owned
4250 Birney Avenue
Moosic, PA 18507
Phone: 570-457-6600
Fax: 570-457-6700
info@ertley.com

ERTLEY Pre-Owned in Trucksville
161 S. Memorial Highway
(Next to Sheetz)
Trucksville, PA 18708
Phone: 570.696.2900
Fax: 570-696-2920

www.ertley.com

automobile business was a poor risk, and that the examiners were requiring the banks to immediately write down these types of loans.

Some of the banks stated that they might consider the loan if we pledged CD's in the amount equal to the loan, in addition to the titles to the cars. However, if we were able to meet that requirement, then we wouldn't need the loan.

In December 2008, Congressman Kanjorski met with a group of local dealers who were unable to obtain bank financing. In that meeting the Congressman suggested Credit Unions as a possible source for our funding needs.

We contacted the Cross Valley Federal Credit Union by early 2009 and was able to secure the working capital funds that the banks were unwilling to lend. Subsequently, the SBA program became available to car dealerships last fall, and we revisited these same banks with the expectation that they would now have the comfort of the Federal Government guaranty. But with the exception of PNC Bank, all of the other banks declined to become involved with the SBA dealer program. PNC Bank would work with the SBA, but our request was too small for them to consider.

In September of 2009, still without floor plan credit, the ability of our company to survive was very doubtful. Knowing that the Cross Valley Federal Credit Union did not provide floor plan loans, we contacted them for help in finding a floor plan source. Cross Valley looked at our financial statements and they offered to fund our floor plan themselves, under the guaranteed program offered by the SBA. With the help of Congressman Kanjorski, the SBA approved the Cross Valley Federal Credit Union as a first time floor plan provider. The Credit Union spent the time and money to train their

personnel and to add the necessary equipment to support the floor plan program for us.

We are sincerely grateful to Congressman Kanjorski, the SBA and the Cross Valley Federal Credit Union for their confidence and support for the continuation of our company and its' 24 employees. This will give us the ability to once again grow our company and add another 15 or more employees to our staff in the very near future.

We count ourselves among the very fortunate who have found financing, and feel extremely sympathetic to those many worthy businesses that cannot find a lending institution willing to meet their needs.

Sincerely,

Ronald D. Ertley
President

enclosures

Chrysler Group [illegible] NCO LIFO bills, inventory levels in Camp Hill, Pa.

Dealer makes the cut with Chrysler, but credit remains a pain

Bradford Wernle
bwernle@crain.com

Iversen Motors in Santa Maria, Calif., made the cut last May when Chrysler dropped 789 dealerships. But co-owner Alan Claycamp sometimes thinks it might have been better if his store had been cut, too.

Claycamp has only one new car on his lot: a red 2009 Chrysler 300C demonstrator. He can't buy new cars because GMAC Financial Services rejected his application for floorplan financing last July, but he acknowledges that he was in financial trouble before the GMAC rejection. About a dozen other banks have since declined to extend him credit.

While Claycamp's financing problems are unusual, his situation does illustrate a significant headache for Chrysler Group: inadequate credit dogs Chrysler dealerships in some markets, even though GMAC has approved about 84 percent of the 1,474 Chrysler dealerships formerly floorplanned by Chrysler Financial.

The problem is particularly acute along the central coast of California, a region stretching north from the western suburbs of Los Angeles almost to San Jose — an area that includes Claycamp's store.

Trouble in California

Says Brian Maas, director of government affairs for the California New Car Dealers Association in Sacramento: "When the whole bankruptcy thing happened, Chrysler Financial pulled out and GMAC was supposed to step in, and they've been slow to do that. A lot of these guys are scrambling for financing, and banks aren't willing to do that.

"Unless you're dualed or have another line willing to floor your Chrysler vehicles, you're going to be scrambling. If you don't have access to capital, you can't buy the inventory. And the customer goes in and says you just don't have the choice of vehicles that competing dealers at another line might have."

Alan Claycamp, of Iversen Motors in Santa Maria, Calif., has only one new car on his lot: a 2009 Chrysler 300C demonstrator. He says: "The service department is what's keeping us going."

Chrysler Group had a 5.4 percent market share in California for 2009, according to the dealers association. That compares with 6.5 percent for 2008 nationally. In 2005, Chrysler held a 7.5 percent share of the California market.

Chrysler Group spokeswoman Kathy Graham acknowledges that California is a tough market for the automaker.

"The market share speaks for itself," Graham says. "It's not a market we've given up on. As

see CLAYCAMP, Page 17

CLAYCAMP
Credit still a hurdle for Chrysler dealers

continued from Page A

the company moves forward, we're going to try to continue to increase market share and sales."

Chrysler Group CEO Sergio Marchionne has praised GMAC for working quickly to get many former Chrysler Financial dealerships floorplanned.

As Chrysler entered a government-sponsored bankruptcy last spring, the federal government appointed GMAC Financial Services as Chrysler's finance company. That forced Chrysler dealerships to negotiate new terms with GMAC.

Some dealers who owed large amounts to Chrysler Financial have had trouble getting GMAC to approve them for floorplan lines, so they have had to seek other lenders at a time when credit is tight.

The U.S. Department of Treasury holds a 58 percent stake in GMAC, up from 35.4 percent before a recent infusion of aid.

GMAC declined to speak about the situations of individual dealers.

"We approved the vast majority of Chrysler dealers who applied for wholesale credit lines and are continuing to work with the few remaining dealers who have conditional credit approval," GMAC President Bill Muir said this month.

Scott Reneau, dealer principal of Reneau Chrysler-Dodge in Paso Robles, Calif., can't buy new cars, either. Last week he had four new cars on his lot, all 2009 models. He says talks continue with banks, and he has some hope of success.

Reneau says he is able to order some cars from another dealer and pay cash for them. He says GMAC told him he is undercapitalized. Reneau says he's willing to take a smaller floorplan line but has found GMAC and other banks unreceptive.

"They think of it as more of a cost. They don't want to do [a credit line of] $1 million or $2 million," says Reneau, who used to sell 35 to 45 cars a month.

Reneau is frustrated: "You ask for help, and you're treated like a leper out here. You call banks, and they don't return phone calls."

Seeking another franchise

Claycamp is working hard to get as much revenue as possible from the Iversen Motors service department and boost his store's bottom line so he can make a run at another franchise.

"The service department is what's keeping us going," he says. "I have not heard from Chrysler motors at all. They're not pushing the issue that I'm not buying cars. I'm one of the only guys who can take care of customers for as the company work."

> **"You ask for help, and you're treated like a leper out here. You call banks, and they don't return phone calls."**
>
> **SCOTT RENEAU**
> *Reneau Chrysler-Dodge*

Iversen Motors got into trouble when the economy went downhill in late 2007 and early 2008, Claycamp says his dealership kept buying cars whenever Chrysler asked, and the cars kept piling up as the economy deteriorated.

Iversen had about 200 new cars on the ground when Chrysler Financial suspended the dealership's floorplan line in February 2008.

Although Iversen was on floorplan hold, Chrysler didn't reject the dealership during the automaker's bankruptcy. Claycamp says a GMAC official told the dealer that Claycamp couldn't get the $6 million line he was seeking even if he put up $3 million himself.

"It's our belief that GMAC got Chrysler dealers crammed down their throats, and they were going to be very selective," says Claycamp, who does not own his dealership's property. "If you didn't own your own property and have equity and all the collateral they were looking for, you were wasting ink."

Can't get floorplanning

Saleen Amsoun owns Simi Valley Chrysler-Jeep-Dodge, situated in a community of about 110,000 on the western edge of metropolitan Los Angeles. He says he can't get floorplanning even though he tried to take advantage of a U.S. Small Business Administration program that would have guaranteed 75 percent of the loan.

"Nobody wants to do Chrysler dealers," Amsoun says.

Jim Crook, owner of Santa Barbara Chrysler-Dodge-Jeep, is more optimistic, although he still doesn't have a floorplan line because he is undercapitalized.

Crook had a $5 million flooring line with Chrysler Financial. He says he now would be willing to have a substantially smaller line, more in line with market realities for Chrysler in California.

Crook bought the dealership in this upscale community three years ago. A month later he learned Daimler-Chrysler AG was putting Chrysler up for sale.

"There are a lot of positive things going on," Crook says. "I was a big boy. I was the one who got involved. Somehow this thing will come out. Sergio [Marchionne] has some great ideas."

February 22, 2010

Dear Congressman Kanjorski:

Luzerne Bank is a seven office community bank completely within the district of Rep. Kanjorski. Like many community banks, we had a robust year in terms of growth. If you check on our safety and soundness, you will see, we are one of the safest. We never lowered our credit standards, and therefore did not contribute to the debacle that faces our economy today. We continue to lend quite vigorously and have the reputation of one of the best in our market at providing for local needs. In fact, our outstanding loan balances increased 11.7% this past year. Our delinquencies remain very low, we own no real estate from foreclosure and have relatively few non performing assets. Yet, we continue to be painted by the same broad brush stroke as the Wall Street Banks and will suffer from any and all mandates leveled upon our industry as a whole. Our FDIC premiums increased 246.7% last year as a result of the problems our country faces. We did not create a problem but, as always, have become part of the solution.

The Administration wants to make financing easier, yet the regulators urge caution. Considering the current mess, I would side with the regulators. Please understand, there is no shortgage of credit available on main street America, especially by banks in our area. It is the very largest institutions that have tightened credit. Our bank continues to gain from their tightening. So instead of looking at financial institutions as an entire industry, please understand that community banks are the real backbone of main street. Community banks did not cause today's problems. Please do not put undue restrictions upon us. We had MCI and Enron, so an entire nation ended up with Sarbaines-Oxley. Let's not let that happen again. I fear for the future of community banking. Every new regulation hurts the little guys not the huge banks with their armys of lawyers and compliance experts. The cost of compliance is steep and becoming overwhelming for the community banks. Please go after those causing the problems, not those of us standing tall in our communities.

Thank you.

Robert C. Snyder
President and CEO
Luzerne Bank
118 Main Street
Luzerne, PA 18709
(570) 288-5821

February 8, 2010

United States Representative Paul Kanjorski
2188 Rayburn House Office Building
Washington, D.C. 20515-3811

Dear Congressman Kanjorski,

After having read the article in the Citizens Voice calling for requests for input on the absence of lending to small businesses, I would like to offer my story.

Signature Building Systems was started in 1993, around the time of the end of the last slowdown in the housing industry. From 1993 through about 2006, our company saw steady growth in the number of people employed, housing units built, revenues and profits. We were able to start a satellite operation in St George, South Carolina, acquire controlling interest in another modular home manufacturing facility in Bloomsburg, trading as Design Homes. In addition, we were able to design, build and invest in a new $5,000,000, 80,000 square foot, production facility in Moosic, Pa. In 2006 our revenues were in excess of $ 31,500,000, employing 360 people throughout all three facilities. Keep in mind that we started our company in 1993 with 7 employees and 0 dollars in revenue. I think that I should also mention that I am a 36 year veteran of the housing industry; having served in various capacities in the housing business until I choose to start this company in 1993.

During the good times in our industry, we acted on what we thought was the right decision and paid off all of our machinery and equipment loans, thereby increasing our equity in the company and eliminating our debt. Equity should be a good thing, but it turned out to have little or no value in today's lending climate.

Our company has seen the same declines in housing that the industry has seen as a whole. Revenues have dropped by better than 60 percent in the last 3 years since the decline started in 2007. We have been fortunate to have a hard working staff that has sacrificed and made cuts in all departments. We have been forced to let go or layoff 160 people over the past 3 years, bringing our employee level to 200.

1004 Springbrook Avenue – Moosic Pennsylvania – 18507
Ph: 800-231-8713 Fax: 570-774-1010
www.signaturebuildingsystems.com

We have approached at least 20 banks, including the one we do business with right now, with loan requests to convert our equity into cash that would be used to help our company survive this downturn. Each and every request has been met with the same answer, "we are not making loans to companies in the building business unless they are profitable." We have suggested the possibility of an SBA backed loan that is intended for precisely this purpose, but to no avail. As you know, it is difficult to find a company running profitably at this time.

The housing industry has lost a countless amount of jobs and businesses during the past 3 years. I am certain that there are many companies like our own, that have done their best to this point to survive, but need help converting the equity they have into much needed cash to sustain their businesses through these difficult and uncertain times.

I appreciate the fact that you have asked us to share our story. When I read the stories about the TARP funds and their intended purpose I was somewhat optimistic that these funds would have been used to shore up balance sheets and encourage lenders to go out and make loans to put our economy on track. But in this case the good intentions of this fund were not matched by the reality of the situation. Small businesses are the core of job growth. If we don't survive, putting people back to work and creating jobs will not happen.

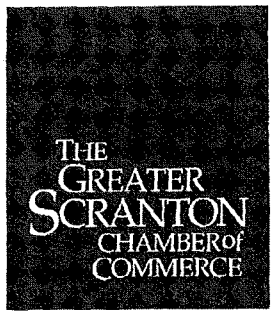
I am convinced that if businesses like mine get the needed funding, we will once again begin to grow and prosper, but most importantly create new jobs for the economy.

Thank you for hearing my story. I hope this is of some help in understanding that there are plenty of small businesses out there that need and deserve funding to survive.

Sincerely yours.

Victor A. DePhillips
President /C.E.O.
Signature Building Systems of Pa LLC

1004 Springbrook Avenue – Moosic Pennsylvania – 18507
Ph: 800-231-8713 Fax: 570-774-1010
www.signaturebuildingsystems.com



February 9, 2010

Congressman Paul Kanjorski
2188 Rayburn House Office Bldg.
Washington, DC 20515

Dear Congressman Kanjorski:

As President of the Greater Scranton Chamber of Commerce, I am all too aware of the effects the tightening credit market has had on our 2000 members.

In conversations with our members, difficulty in accessing working capital is a common theme. The credit crunch has impacted nearly every business sector leaving manufacturers with the inability to access materials for production, retailers with the inability to purchase inventory and leaving all with shrinking employment rosters.

The wheels of our economic engine are in many cases "spinning" but not "turning." Key businesses in our community are surviving and thriving despite our longitudinal economic downtown, but this is not a commonality. Our members need access to dollars. In some cases, the dollars will help bridge the gap created by the recession, saving jobs while businesses create and retain customers. In other cases, dollars are needed for larger capital expenses. Traditional lending institutions may not be interested in exposing themselves to the additional risks that were created by worsening credit through our unstable economic conditions.

Access to working capital is a barrier for our businesses. A major modular home construction company in Scranton noted that their sales have fallen substantially over the past three years, which has forced their business to operate on alternating weeks. This business is having a difficult time securing funding from various banks to "weather the storm." Manufacturing is a key industry to our community, and limited working capital may put this company in jeopardy.

Another local metal manufacturer has noted a similar problem, which has caused problems accessing materials for production. A lack of customers is not the problem, but

222 Mulberry Street / P.O. Box 431 / Scranton, Pennsylvania 18501-0431 / (570) 342-7711 / FAX: (570) 347-6262
www.scrantonchamber.com

the ability to purchase materials to serve customers is the problem. Once again, more dollars are needed, but access to these valuable resources appears to be limited.

In addition, MetroAction, Inc., an affiliate of our organization, is a Community Development Financial Institution. The organization was established 12 years ago to provide an alternative financing mechanism for small businesses and entrepreneurs that could not secure financing through a traditional lending institution.

Prior to last year, the borrowers' for this loan product were typically under collateralized, under capitalized or had credit scores that ranged between 550 and 650. However, that has all changed. Within the last 12 months, we have seen a sharp increase in applications from larger, established businesses needing working capital to keep their doors open. The owners of the businesses have good credit, but are unable to find a bank that is willing to take a risk on their business.

In a recent outreach meeting, an employee of a national bank indicated, "we are training our staff on how to say no to our customers." Instead they are encouraging their employees to focus on opening new accounts and maintaining existing accounts rather than promoting lending activities.

As a result, the number of applications for financing received by our organization has increased 243% over the previous year. The growth of our program is primarily driven by businesses that previously would have received bank financing that are now seeking alternative avenues to finance their business activities.

We thank you for your continued advocacy for the growth of small business in northeastern Pennsylvania.

Sincerely,

Austin J. Burke
President

Page 2 of 2 Pages

February 10, 2010

TO: U.S. Rep. Paul E. Kanjorski
Washington Office

FROM: Vincent Bryk
Co-Owner/Partner
Dupont Tool & Machine Company
Dupont, Pa.

Mr. Kanjorski,

I am responding to the request for comments from Small Businesses pertaining to an article in a local newspaper, The Citizens Voice, (Wilkes-Barre, Pa., on 2/06/2010) for input pertaining to Small Businesses, finding it hard to secure Financing from Banks for Business Expansion & Job Creation.

Perhaps it's not hard for them to secure additional financing because of the financial debt they are already in. Its probably because they refuse to go to the banks to secure (loan) more money because of their high interest rates the banks are charging.

What good financially is it to Small Business if Washington allocates large sums of money to Banks to Loan to Small Businesses if they in turn charge high interest rates? The only one that is profiting are the Banks.

I don't believe this an enticement for Small Business to seek additional financial help especially if they (small business) are currently obligated to the banks and paying high interest rates.

What is needed is a Stimulus Program that would help Small Business (not banks) in form of much lower interst rates or a flat fee reasonable that banks would charge small business for/from the stimulus monies they receive from Washington, to encourage Small Business to expand, hire additional help, purchase new equipment and more importantly so, either to help pay existing debt Small Business have acquired because of them being victimized by others filing Chapter 11 protection. We have become a financial victim, as in our case, manufacturing parts for other Businesses. It is almost impossible to re-coup the loss. You can hire a Lawyer to try to re-coup the loss of income only to find out that after several months and through the law firm that they have filed Chapter 11. Bankruptcy, with any additional bill that one must pay of several thousand dollars for Lawyer Fees.

My recommendation is to consider and help those Small Businesses, through some type of Financial Stimulus Program who have been victimized because of Chapter Eleven Bankruptcies and other wrong-doing activity that have placed a financial burden on Small Businesses, restricitng them to continue to grow.

Respectfully Yours,
Vincent Bryk
VINCENT BRYK
Co-Owner/Partner
DTM

F. J. GAWAT Insurance Agency (570) 779-9555
405 W. Main Street, Plymouth, PA 18651 FAX (570) 779-9630

February 9, 2010

To: The Honorable Paul E. Kanjorski
1 page
From: Rosemary A. Gawat, T/A F.J. Gawat Insurance Agency

I am a small business owner operating an insurance agency successfully for the last 38 years due to becoming widowed in 1971.

Because of the present economic conditions in the country my business has suffered. In addition to the insurance business I own and reside in a small commercial rental property and economic conditions caused two tenants not to be able to pay the rental fees and vacate the premises.

This hardship adversely affected my business working capital. Current conditions in the financial industry made it impossible to obtain any financing for cash flow. In this situation my business is now in jeopardy. It is disappointing for business owners to watch government spending increasing and very little being done for small business.

Sincerely,

Rosemary A. Gawat

Rosemary A. Gawat

E-Mail Viewer

Message | Details | Attachments | Headers | Source

HTML

From: "Peter and Carol Kern" <cpkern@ptd.net>
Date: 1/29/2010 9:44:38 PM
To: "paul.kanjorski@mail.house.gov" <paul.kanjorski@mail.house.gov>
Cc:
Subject: Your Hearing on Bank Lending Practices

January 29, 2010
Dear Representative Kanjorski:

Thank you for your email of January 29th on the upcoming Congressional hearing to examine why banks are not lending. Although your emphasis appears to focus on the unwillingness of banks to lend to qualified small businesses, that same unwillingness exists in the home mortgage market.

Last April, in the depths of our economic crisis, Bank of America was pleading with home owners to refinance their mortgages to take advantage of historically low interest rates. My family's personal experience with their "bait and switch" tactics has left me with the conviction that our representatives in Washington were gulled into believing that TARP money would filter down to homeowners to enable them to refinance and reduce their interest payments. It is clearly not the case! Bank of America have strung out the process with more and more trivial requests because it is clear that they are not interested in refinancing any mortgage that they believe is "safe". They took the commitment money and held it for a very frustrating nine months until we gave up. Are we an isolated case? I doubt it. There are probably thousands more just like us.

Too big to fail?? Rubbish! You should have let them fail! The government and the people would have been better served if the money had been put into community banks!

Thank you for allowing me the opportunity to share this with you.

Sincerely,
Peter L. Kern
President
Palmerton Area Chamber of Commerce

Close

Hello Paul,

My name is George Tassone and I am an American swimming pool manufacture as my father was before me.

I was born and raised in Brooklyn, N. Y. and my company, The Pool Factory, Inc, is presently located in Wilkes-Barre, PA.

I am responding to your request for input with regards to how the government can help small businesses while also creating a significant amount of new jobs.

Our family business has been experiencing a steady major loss in sales since 9/11/2001 .Our employees have reduced from over 200 to less than 10.

Just like 4,000,000 other American manufacturing jobs in the past four years and the also thousands of American manufacturing companies we were on our way out of business.

I believe one of the major reasons for our loss of sales is inexpensive and inferior foreign imports but that's another story.

As it turns out due to our ingenuity, optimism, hard work and a lot of prayers we were able to survive long enough to put our expertise to good use.

About a year ago we had invented a new and revolutionary swimming pool design called EZ Panel Pool.

As you know over the past two years banks would not fund businesses or individuals unless they were AAA rated and with collateral. So I had no choice but to sell this superior design to our stronger competitor.

I personally am going to be fine as I will receive a royalty on this new item which is quickly becoming a leading industry seller. However this provides no help for our worker's and their jobs.

It's a shame that I was unable to get a loan at that time which would have enabled me to save old and create new manufacturing jobs in Pennsylvania.

But this is not a letter about a businesses failure and it's not about a personal success. It's a letter with recommendations and maybe solutions.

Both President Obama and Congressman Kanjorski are asking for suggestions, so here goes;

LEND BABY LEND!!

We all know small business has been the engine that drives this great country and the banks lending standards now only favor the rich or a risk free investment.

The proposal below is totally based on incentives for the average American to own their own business and works as follows;

1) Set up 52 government direct lending centers (one in every state).You will not be hurting banks as they do not lend to this type of clientele anyway.
2) Lend $500,000,000 to $1,000,000,000 through each satellite station or lending center in a one year time frame (so about $100,000,000 per month, per state).
3) Change the lending standards.
4) Lending should be ***based on experience, references and a good plan*** (not as the banks do, based on collateral and AAA ratings). Example; an experienced chef, mechanic, engineer or salesperson knows their particular industry as it's already their life's commitment. They have already proven that they are reliable, dependable and professional through working in their trade for many years and therefore these are the most likely candidates to succeed in that industry.
5) Lend on a 50% government partnership position with simple interest on the loan.
6) Then allow (per contract)the 50% private owner/partner to buy out the 50% government's partnership position over a 3 or 5 year period (or sooner) on a sort of sliding scale or phasing out basis. Everyone wants to make money and own their own business and now the government can help make this American dream come true. The government will be praised for believing in the American people and proving it with this optimistic and aggressive partnership/lending program.
7) Of coarse their will be some failed businesses. But these loans will create a steady and strong cash flow of revenue for the economy, American businesses and American jobs. With a little luck, hard work and some smart ideas the governments profit from the 50% partnership plus the interest earned should out way the losses from any failing businesses. This plan should help jump start our country almost immediately. Everyone wants their own business so the borrowers will give all the effort they have to eliminate the government's partnership position.
8) Bank will not lend to borrowers based on the above eligibility requirements.
9) Politicians may steer the money towards nepotism which will also be a problem.
10) So set up a new accountable committee that would overlook these businesses and loans.

From: 02/09/2010 14:28 #034 P.006/008

FEB-10-2010 12:53 AM C&D.CONTRACTOR&SONS 6108659880 P.01

February 9, 20010

Dear Sir,

I saw on TV that you would like to hear from the little businesses. Well I guess we qualify for that. We have been in business for about 28 years. We are a small family business + it has been a real struggle to keep going for the past two years - not only for us but my two son's + their families.

We started building homes about 28 years ago. We all worked hard on the houses + our Customers were very pleased with our work. We never had to advertise our homes they were sold by word of mouth. We took pride in our work + so did our men. Our men did a lot of work in our homes. We built custom homes only. In the winter we built homes + thru the summer we would do Concrete work. We built 75 homes + the last two we were lucky to sell cause the Economy went bad. We lost money on the last two homes + we were going into the winter, can't pour Concrete in the winter, so I had to put the guys on unemployment. Our business was homes + concrete work, curb + side-walks + floors.

Now the spring is ahead of us, we have to have money for payroll, + medical benifits + workers Compensation. So we had to borrow funds to get started.

(2)

We had the East Stroudsburg University job, which was a 2 year job, that helped keep us a float. ESU was pleased with our work & we did some of the Boro of East Stroudsburg's work.

We have bid on so many jobs this year, & gone down on our prices & you can't bid on a job & loose money. Every job has loads of bidder's. The goverment wants little businesses to hire more people. We would be glad to if we had a lot of work. We have some jobs lined up for Spring, but there is nothing real big.

I wish Pennsylvania would pass a law that all contractors have to pay there subs. So many little businesses are getting hurt because they do a job for them & they don't get paid. We did a job for a twsp one time & it was a prevailing rate job. We weren't getting paid, so I called the State & asked them what I could do. They asked if I was an employee & I said no - I was an employer, & they said there was nothing they could do. Why can't we get some kind of help? Plus we just recently did a county job where we weren't paid completely. There's still 1,000 of dollars owed to us. It was a prevailing rate job & we paid all our labor. What can we do there is no money to sue.

Our business has never been hurting so bad. I am a woman & I have ran this business by myself & my husband

(over)

(3)

& two boys. I know the economy, banks & health care is a big part of it. We carried health care for our guys all along. Just last year we made our business women owned. I have 51 per cent of the business.

We moved from Bethlehem to Stroudsburg 3 years ago. We still have a very good name. I hope the spring will pick up. I have talked to a lot of small business owners & they are all in the same boat.

I'll be 70 years old & my boys & grand children hope to stay in the business. I hope the economy picks up & things turn around for my children & grandchildren & my men. I don't want to lose everything we all worked so hard for.

Sincerely,
Carol J. Brown, President
owner of C. & D. Contractor & Sons Inc.

C & D Contractor & Sons Inc.
RR 1 Box 1487
Stroudsburg, PA 18360
570-992-7076

Allen

From: "Allen" <Aconklin@ptd.net>
To: "http://kanjorski.house.gov"
Cc: "REP. PAUL kANJORSKI" <PAUL KANJORSKI@MAIL HOUSE GOV>
Sent: Tuesday, January 05, 2010 5:41 PM
Subject: Small business help

Dear Rep. Kanjorski
My name is Allen Conklin and I am the owner of Effort Woodcraft Inc. We are a small manufacturer of kitchen cabinets and assorted other cabinets and wood products.
I started this business in 1952 and it has grown to where we employed 27 workers.
this is a family business and my wife and son Thomas are also involved in the business.
Since the recession hit about two years ago, we have had to lay off people, and little by little we are now down to only 8 employes.
A business the size of ours cannot function with only 8 employes, despite trying to cut expences, our overhead is too high.
We are having trouble paying our bills, bank payments Etc.
With some help from the Gov., we could get more work and start bringing our laid off people back to work.
Small business is the backbone of America and employes more people then big business.
the Government has put alot of our tax dollars in big business and has not gotten a lot of return in the economy,
I beleive if the Government woul put money in small business, there would be a much faster return and unemplo9yment would drop faster.
It would also save small businesses that are sure to fail without help.
We as one business are nearing the end without help, and i think it is sad for all the hard work and years put in our business , and there are many more just like us.
I have a great deal of respect for you, and I hope there is something you can do for small business
Respectfully yours
Allen Conklin
Pres. Effort Woodcraft Inc.
Allen Conklin

If you have any Suggestions Please let me Know.

FEB 24 2010

@ P.O. Box 590
Effort, Pa 18330

FEB-9-2010 13:46 FROM:E.SHAMANY PAINTING I 5704542629 TO:12022250764 P.1/2

02/09/10

Attn: Congressman Paul Kanjorski

RE: Secure financing during tough times

We tried to secure a loan with two different banks and were informed a small business would have to show a good financial statement for a period of two years. We are not able to do that due to business being so slow and the bad economy. We are trying to apply for a new program called America's Recovery Capital (ARC loans) which the Small Business Administration began accepting loans as of 06/15/09.

ARC loans available for small businesses

On June 15, the Small Business Administration began accepting loans for a temporary new program called America's Recovery Capital.

"ARC" loans of up to $35,000 are designed to provide a "bridge" for viable small businesses with immediate financial hardship – to keep their doors open until they get back on track.

ARC loans are deferred-payment loans of up to $35,000, available to established, viable, for-profit small businesses that need short-term help to make their principal and interest payments on existing and qualifying business debt. ARC loans are 100 percent guaranteed by the SBA and have no SBA fees associated with them.

ARC loans will be disbursed over a period of up to six months and will provide funds to be used for payments of principal and interest for existing, qualifying small business debt including mortgages, term and revolving lines of credit, capital leases, credit card obligations and notes payable to vendors, suppliers and utilities. SBA will pay the interest on ARC loans to the lenders at the variable rate of Prime plus two percent.

Repayment will not begin until 12 months after the final disbursement. After the 12-month deferral period, borrowers will pay back the loan principal over a period of five years.

For more information about all of the SBA's programs for small businesses, call the SBA Answer Desk at 1-800 U-ASK-SBA or visit the SBA's Web site at www.sba.gov

Maron Products, Inc.

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, D.C.

February 1, 2010

Chairman Frank,

My name is Paul McMahon and I am President of Maron Products Inc. Maron is a small metal fabrication company in Mishawaka, Indiana. We have been in business for 51 years. I currently employ 96 people. My business currently banks with National City (now PNC Bank). We have been with this bank or its predecessors for the last 18 years (with the exception of a 3 year period with another bank).

In November of 2009, one of our customers contacted me regarding a large project, with an extremely aggressive time frame they were quoting for the U.S. military. It was a job to revamp the suspensions on military trucks being moved from Iraq to be placed into service in Afghanistan. Because of the downturn in the economy, I had the production capacity with the exception of an additional laser cutting machine and 18 welding machines. Total cost of this equipment was approximately $300,000. Beside the compressed timeline, the issue that concerned me was cash flow. My sales were down approximately 45% in 2009 from 2008. With the reduction of business, my inventory and accounts receivables were down, which decreases the availability of my revolving line of credit (my total amount of line is determined by the value of my inventory and receivables). With cash being a concern, I decided to ask for a short term loan from NatCity for the $300,000 for the equipment purchase, figuring it would be a quick and easy request with the proceeds being used to purchase hard assets. Unfortunately it didn't turn out that way.

I contacted my lender at NatCity Bank in mid December to give him a heads up. I followed up with a profit and cash flow projection of this project on December 30. I asked if they were interested in the loan and if they could do it in a hurry, since I had to have this equipment up and running by February 1, 2010 to meet the U.S. military timeline. On January 5, 2010, I received an e-mail from my banker informing me that he could not meet for the next couple of weeks to discuss. Given the tight timeframe to purchase the equipment, move it, set it up, and get it into production, I couldn't afford to wait for him to set up an appointment!

Fortunately for me, I have my real estate loans with Teachers Credit Union in South Bend, Indiana. My loan officer at TCU, Mark Noeldner, was aware of the program (I touch base with him often). As a backup plan, I had sent Mark a copy of the projections on December 30th as well. When I received the e-mail from NatCity January 5th, I called Mark immediately and asked if he was interested. Given his knowledge of the situation and the loans and assets already in place, Mark was able to quickly give me a line of credit for $250,000 in 3 days! (Eventually, I only needed $250,000.) I was able to purchase the equipment I needed and as of today, with the help of TCU and all my employees I am lucky enough to work with at my company, we are actually a little ahead of schedule on this project.

By the way, when I met with NatCity on January 19, they did not seem upset that I had found a Credit Union source for this funding. Hopefully, with increased lending capacity, I can do all of my future borrowing with Teachers Credit Union.

Please feel free to contact me at 574-259-1971 ext. 212. Thank you for your time.

Sincerely

Paul A. McMahon
President

1301 Industrial Drive ● Mishawaka, IN 46544-5799 ● Fax (574) 259-1978 ● Telephone (574) 259-1971

September 8, 2009

The Honorable Charles Schumer
313 Hart Senate Office Building
Washington, D.C. 20510
Fax Number: (202) 228-3027

Dear Senator Schumer:

My name is Joe Mastrocovi and I am the owner of Moderne Communications, Inc. in Rockville Centre, New York. I was pleased to hear of your intention to introduce a bill that would allow credit unions to offer more business loans.

I am a member of Sperry Federal Credit Union (Garden City Park, New York), and they provided me with a member business loan.

When the going got tough and I tried everything not to lay off my employees, Bank of America (20 years my bank) and American Express(20 years never a late payment) ran for the hills and removed previously unused lines of credit. Sperry saved my people.

As you know, credit unions are 'capped' on how many business loans they can offer. Since many banks are pulling back on credit to small businesses, we need *more* access to credit, not less. By introducing legislation that would raise or eliminate the cap on credit union member business loans, you will provide a critical funding option to numerous New York small business owners like me.

Senator, I want to thank you in advance for your consideration and your commitment to lifting the member business loan cap for credit unions. Along with business owners across the state, I am counting on your continued support for this issue.

Sincerely,

Joe Mastrocovi
President

cc: Andrew Kernan
Business Services Manager
Sperry Federal Credit Union
2400 Jericho Turnpike
Garden City Park, NY 11040

operation. They observed, asked intelligent questions about the business operation, considered my proposal and made a loan proposal that met my needs. They obviously knew what customer service meant. The fact that they made an on-site visit to my business convinced me that they cared about my business success. The commercial bankers had responded only by phone. What a difference!

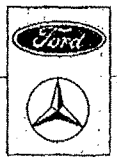
Once we arrived at the details of the loan, the Credit Union people were especially helpful in providing guidance for preparing the necessary financial statements and business forms that were necessary to complete the loan. They were efficient, prompt and helpful throughout the process. All the details were completed in a very timely and professional manner.

In summary, my experience with the Credit Union personnel was outstanding. They were responsible, helpful and prompt in completing all the necessary paper work to expedite the loan and meet my time-line. I was very pleased with the service that I received from them. I continue to be pleased with the way they handle the day to day transactions that we have with them with my checking account. They are prompt, professional and courteous in all our transactions. I am extremely pleased with my decision to switch my accounts to the Credit Union.

Sincerely,

Paul J. Wright

President



FRED MARTIN FORD, INC.
MERCEDES-BENZ
4701 Mahoning Avenue
Youngstown, Ohio 44515-1686

WWW.FREDMARTINFORD.COM
330.793.2444 Telephone
330.793.0819 Facsimile

February 4, 2010

The Honorable Barney Frank, Chairman
House Financial Services Committee
Washington, DC

Dear Congressman Frank:

I am a Ford Dealer in Youngstown Ohio and have been in business for 37 years. As you know, banks have been bought and sold, and through the years we have been with several banks, the most recent being Huntington National Bank. After 10 years of doing business with the, they came to me, **without notice**, and said that Huntington National Bank would no longer support car dealers and that I would have to take my business elsewhere, and that I had 90 days to find a new mortgage company. I was bewildered due to the fact that our standings were always considered excellent.

I immediately pursued 2 banks and a local credit union by the name of Sevenseventeen Credit Union. I needed a new mortgage of $800,000.00 immediately. One bank never responded to my request! If it were not for the Credit Union, I may have had to close my doors and nearly 40 employees that work here would have been without a job.

Thank you for taking the time to read my letter in support of Credit Unions.

Sincerely,

FRED MARTIN FORD INC

Fred Martin
President

West Knox Upper Cervical Care, P.C.
Jesse L. Angle II, DC
Margaret E. Shreve-Angle, DC
1508 Coleman Road, Suite 107
Knoxville, TN 37909-3808

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

February 2, 2010

Dear Sir:

It is our distinct pleasure to do business with our lending credit union.

We personally contacted over twenty banking institutions to apply for an SBA start-up loan beginning in December of 2008. The following is a list of the rejection reasons we received:

- chosen profession
- requested loan amount less that $250,000.00
- SBA denial
- no start-up loans offered
- student loan obligation from doctorate program
- lack of assets and collateral

When we submitted our business plan to our lending credit union, the communication was open and we were confident they were actually processing our application. Upon deciding to fund a start-up loan for our business, our lender made the committment to dedicate themselves and their time to the lengthy process. All requirements were fulfilled in a satisfactory manner according to SBA rules and regulations, and we were approved by SBA upon initial submission.

Our lending credit union provided us with a SBA loan and helped to provide the communites of Eastern Tennessee with a state-of-the-art Upper Cervical Chiropractic office, the only one in the area. We have state-of-the-art x-ray on site, cutting edge analysis and treatment equiptment, cutting edge software and marketing, as well as, a comfortable post-treatment facility - all made possible by our credit union.

Without our lending credit union, we would be working as associate doctors rather than providing a service to new communities, as well as, stimulating the economy on a much larger scale. Our vendors come from our local town, the west coast, the midwest and the east coast.

Thank you for the opportunity to promote credit unions and possibly open doors for more small business and entrepreneurs like ourselves.

Sincerely,

Drs. Lee + Margaret Angle

Drs. Lee and Margaret Angle
West Knox Upper Cervical Care, P.C.
1508 Coleman Road, Suite 107
Knoxville, TN 37909-3808
(865) 249-7276 O
(865) 247-8423 F
westknoxuc@gmail.com
www.uppercervicalcare.com

Village Trophy Co.
1217 W. Third Ave.
Columbus, Oh 43212

614-299-7570

To: Whom it may concern

From: Paul J. Wright
President

Date: February 3, 2010

Re: Banking experience

Having been asked to respond to my recent banking experience to re-finance my business building mortgage I offer the following summary and observations.

First, a brief summary of my business seems appropriate. I started the business in 1975 as a one man part-time venture to provide trophies and plaques for several sporting events that I helped organize and run. Over the next 33 years it has grown to employ five full-time workers and approximately fifteen other employees on a seasonal basis. We now ship awards throughout the entire United States for various events. My payroll last year exceeded 260,000.

It was in the fall of 2008 that I had the necessity to re-finance my business building mortgage which had a balloon payment due. The timing of this re-finance could not have been worse because it came just as the banking crisis of fall 2008 began to unfold. I decided that the best approach was to offer my financial plan to the two commercial banks where I had current accounts and also to the Members First Credit Union which I had seen advertised in the local Chamber of Commerce directory. I received three completely different responses from the three companies.

The first bank responded to my proposal in a very short time with a simple denial. "We would not be interested in doing this deal at this time." This was the response from a bank that I had accounts with over a 40 year period. This bank had loaned me the money to start my business in the first place. Needless to say, I was surprised and a bit discouraged.

The second bank responded to my proposal in a more positive way, however they were only willing to loan me an amount of 70% of the appraised value. My proposal was for 80% of the value. This bank held the current mortgage on the building, so they had a vested interest in completing the re-finance.

Both of these banks responded simply with a phone call. However, I received a completely different response from the Credit Union personnel. Upon making my initial phone call, I was asked to make an appointment with the Credit Union representatives so they could visit my business. They made themselves available and spent several hours observing my business in

203 S. Main St
Suite 6
Goshen, IN 46528
P: 5749714267
www.techknowledgeyinc.com

February 3, 2010

The Honorable Barney Frank
Chairman, House Financial Services Committee
Washington, D.C.

I opened TechKnowledgey, Inc in January 2007. My business offers Information Technology services to the small and medium business marketplace as well as the sale of Xerox Copiers, Printers, and MFP's.

I initially funded my business with what I thought was a local bank. Later I found out that the bank was not a local bank, but that it was owned by a regional bank. The regional bank started to get into trouble since many of its customers were in Michigan and Indiana.

I never missed a payment to my bank. I was not maxed out on my line of Credit and I was within any agreements that I had made with them. In addition to this I personally guaranteed my business loans and I have impeccable personal as well as business credit. I would have thought that all of this would have made me a good customer, but I guess that I was wrong.

My bank began to panic. They started to service me poorly and when my line of credit came up for renewal they made increasingly unreasonable demands. They were scared of a startup business even though I had always held up my end of the deal as a customer.

I shopped my business elsewhere. Within a week I got two offers for my business lending and deposit needs. Both were from locally owned institutions that were able to take into account my business and my personal track record, as well as having a vision for what I could do in the future.

Interra Credit Union by far had the best offer. They offered me lower interest rates and a larger operating line of credit than I had with the bank. This was all done without SBA or other government assistance between local people doing good business.

If you would lift the limits on Credit Union Business Lending it could help the economy heal itself without taxpayer money. With the help of my Credit Union funding, since 2007, my business added direct benefits 4 good paying jobs and over $750,000 new dollars to the local economy. This does not even count the indirect benefits of our charitable contributions and adding to the work of many other businesses which we purchase goods and services from.

Please let the people care for themselves.

Sincerely,

Boyd Smith, President
TechKnowledgey, inc

Melanie Radabaugh
4144 Leith Street
Burton, MI 48509

January 29, 2010

Chairman Barney Frank
House Financial Services Committee
Washington, DC

Dear Chairman Frank:

I am a new, small business owner in Michigan. I am a female owned, garbage/recycling company and I can tell you that when my business grew overnight (which it almost did in 6 short months) I needed credit right away to purchase equipment to fulfill my new service contracts. Chase said "no" and I went to ELGA Credit Union in Burton, MI with whom all of my personal accounts/mortgage are through. They worked with me step by step and made sure that everything was in order to get the deal done. It was a long process, but well thought out and the lenders there were extremely helpful in getting my loans procured....much different than my experience with Chase. Without their support, I would not have been able to fulfill a new $300k plus, 5-year contract and my reputation would have been ruined before I ever started. I fully support this initiative to allow credit unions a higher lending cap so that I may continue to do all of my banking with them!

Sincerely,

Small business owner in MI

JONES REALTY GROUP, LLC
Real Estate Investors • Property Management

February 1, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

As a small business owner, I am writing to urge you to support H.R. 3380. Please support the Credit Unions in our communities as they provide services to their small business members, who are so vital to job creation.

I have been a business owner for over 40 years and have always maintained a strong relationship with my banker. I recently found myself, along with many other small business owners, struggling with the restrictions my current financial institutions was placing on me, in a time when things were already very uncertain. I have always handled my banking well and never been late or overdrawn. My credit score is in the high 700's. However, in 2009, getting loans on our rental properties had become extremely difficult, despite a long relationship with my commercial bank. .

I sought financing elsewhere. My credit union came through for me. They did the loan with better terms and lower closing costs than I had been getting in the past. I had never gone to any credit union before, and was pleased to find that they offered a full range of services for my business. However, I was surprised to learn that my credit union has a very low lending cap and is unable to make loans now, despite having ample funds available to do so. At a time when we are hearing so much talk about helping small business get justifiable loans, so they can create jobs, I find this situation extremely surprising.

Please consider supporting this legislative change in the lending cap for federally and state insured credit unions. Help credit unions help our small businesses in our communities and our economy in the best way they can… Serving!

Respectfully,

Very truly yours,
Jones Realty Group, LLC.

Hal Jones
Owner

P. O. Box 3506, Suwanee, GA 30024 • Tel (678) 596-2100 • Fax: Request Line • hsjones@mindspring.com

The Honorable Barney Frank, Chairman
House Financial Services Committee
Washington, DC 20515

Dear Mr. Frank:

I am a small business owner in Milton, Florida. I have owned the local Krystal restaurant since 1996. When I purchased the building we are in, it was a drive through location only.

In 2009, I decided it would be in my best interest to expand my building to include a seating area. This would allow me to increase my sales. With the increase in sales I would have to hire several more employees.

I approached the local community bank that had my loan at the time. They told me they could not loan the money at this time due to the economic situation. I then approached several more banks to look for my financing. I was rejected by each one.

I found out during my search for funds that Pen Air Federal Credit Union, I was a personal member at the time, was doing loans for small businesses. I then approached the Business Lending department about a loan for the construction. I was approved within days and closed the loan within weeks.

My credit union was there for me when none of the banks were. I just want to say thank you to Pen Air and all the people I have dealt with. We are now open with the new dining area and business is doing great.

Sincerely,

Robyn Baker

Owner / Krystal- Milton

February 2, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Mr. Frank,

Last year, our company was in the process of purchasing and renovating the historic downtown Macy's building in Atlanta, Georgia. Our plan was to convert the building into a mixed-use retail, special event and conference center. We needed funds to payoff the current acquisition/bridge loan of $ 7,000,000 and a disbursement of $3,000,000 to complete the property renovations and obtain a certificate of occupancy.

We were not able to acquire the funding we needed through the banking system.

Instead, we turned to a credit union. Credit Union Business Services worked on our behalf to fund the loan with other credit unions. Their commercial mortgage expertise and their willingness to coordinate with other credit unions was essential to our success.

We would like to be able to borrow money from our credit union again in the future to fund additional projects. My understanding is that our credit union may not be able to provide additional funds due to a cap on business lending of 12.25% of assets.

The business lending limitations currently in place for credit unions should be lifted so that we can continue to borrow money from our credit union and acquire the funding we need to expand my business.

Sincerely,

Robert Patterson, President
180 Peachtree Retail, LLC
191 Peachtree Street, Suite 3300
Atlanta, Georgia 30303

Senators and Members of Congress:

As a small business owner in Tucson, Arizona I am on the front line of what is and is NOT working in our country.

I own a chain of haircut stores (www.SportsBuzzHaircuts.com) and independent trash hauling firm (www.88trash.com). I manage a medical practice and medical lab and I host a morning radio show in our local market (www.WakeUpTucson.net).

Our show covers issues important to our community with a slant towards the role of small business in local **JOB CREATION.** I employ and am responsible every day for over 100 people and families in southern Arizona. I serve on non-profit boards and political commissions in our region.

I take all these roles very personal and work long days making sure we stay ahead of competition and prepared for whatever Washington may throw at us. This past year has been a complete whirlwind for our operations.

In the 12 years of start up and growth I've filled out **DOZENS** and **DOZENS** of loan application with local and regional banks. I have been told NO so many times that I all but gave up. We resorted to credit cards, using credit terms with our vendors to the max and always doing without to growth our businesses.

It wasn't until we began working with our local credit union, Vantage West (DM Federal at the time) that we found capital to expand our businesses. Our local credit union is the only lending institution that actually took the time to bet on me and my track record. We had sound financials and a clear plan of action but didn't fit the typical large banks lending box.

Gone are the days of personal relationship in the big banking system. The credit unions work and they have my business.

I encourage you to look long and hard at the role of credit unions like Vantage West in getting our country moving and back to work.

Joe Higgins
joe@joehigginsinc.com
520-631-7400

ViewPlus Technologies, Inc.
1853 SW Airport Avenue
Corvallis Oregon 97333 U.S.A.
phone: 541.754.4002 fax: 541.738.6505

Rick Hein
CEO OSU Federal Credit Union
1980 NW 9'th Street
POBox 306
Corvallis 97339-0306

Dear Mr. Hein:

I know that there is discussion in Congress about banks and credit unions and their interactions with small business. From ViewPlus' point of view, large banks have been totally uninterested in our business, and local banks have been only marginally more interested. ViewPlus would probably not have survived without our excellent support from the OSU Federal Credit Union.

In our early years, beginning in 1999, we had to deal with banks because credit unions were not allowed to offer much service to companies. Only one local bank was even willing to consider giving us a credit line, even though my wife and I were willing to back it. [As you know our net worth is approximately $2M and our credit rating is perfect.] Linn-Benton Bank finally gave us a $75,000 credit line, which was extremely helpful. Unfortunately when they were bought by the regional Umqua Bank, that credit line was cancelled for no reason other than that we didn't fit the profile of firms that they wanted to do business with.

Cancellation of our credit line would have been a disaster if the law had not been changed, allowing OSU Federal Credit Union to offer us a credit line and other services such as company credit cards and merchant credit card accounts. You not only gave us a credit line but gave us $200,000, which has recently been increased to $400,000 at our request. You have done many other things for us too such as finding ways for us to do payroll, to handle foreign money transfers easily, and even to change your internal procedures to make life more comfortable for us.

Thanks for being such a great partner. Today ViewPlus is a profitable international company with sales approaching $3M/year. We certainly wouldn't be there without you.

John A. Gardner
President

CRL Contracting, Inc.
3475 Mill Valley Drive
Dacula, Georgia 30019
(770) 995-4448
www.crlcontracting.com

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

February 1, 2010

Dear Mr. Frank:

For eleven years I worked in the commercial construction business for my father-in-law's company. Things were going well and I enjoyed the work, but suddenly he became ill and we were at risk of losing the company or closing it down. We discussed our options and I talked with him about buying his business, but when I looked at the finances I became very concerned. Then the bank cancelled our line-of-credit and would not extend any more funds. Things did not look good. I needed to find a way to keep the company going without putting my future at risk.

Fortunately, we were long term members of a credit union and I spoke with them about our situation. The president of the credit union was very experienced in business lending and had started a credit union service organization to assist credit unions throughout the state in making business loans. He took time to sit down and talk with me about the steps I could take to help reduce our monthly expenses and provide some relief on our commercial loan. The credit union provided an interim loan that kept us in business and then assisted us in acquiring an SBA loan that we used to pay-off the bank.

Before working with Credit Union Business Services, we were not aware that credit unions could work together and use their combined resources to loan money more efficiently. We worked with a commercial loan officer on site and they coordinated with other credit unions and the small business administration on our behalf. The entire process was handled locally and very professionally.

By moving our commercial mortgage to Credit Union Business Services and acquiring an SBA loan we were able to reduce our monthly expenses, which for a business our size made a significant impact. We have since expanded and hired several new employees. We would like to continue utilizing credit union loans and services whenever possible to assist in our growth. Without them, or by limiting their ability to provide us with a loan, we may have been forced to take other steps that would have been detrimental to our business and to our community.

The business lending limitations currently in place in regards to credit unions should be lifted so my credit union can continue to lend money to my business and we can continue to grow.

Sincerely,

Sean Roach
President/Owner
CRL Contracting
Dacula, GA

SHELBY RESCUE SQUAD, INC.
627 W. MARION STREET • P.O. BOX 777
SHELBY, N.C. 28150
PHONE 482-3335

January 29, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee

Dear Chairman Frank,

My name is Keith Strickland; I am the Chief Director of Operations for Shelby Rescue Squad Inc. in Shelby, NC. Shelby Rescue is a small business that provides EMS and Rescue services to Cleveland County. We have been in operation since March, 1959. At the present time we have 6 ambulances, 1 Heavy Duty Rescue Truck. We run 24 hrs. A day, 7 days a week, 365 days a year. Shelby Rescue has a total of 35 full time and part time employees.

A few years back Shelby Rescue needed to update their ambulances due to being several years old and having a lot of miles on them and cost of repairs. We went to our hometown bank to try and get another loan for a new ambulance but the payment and interest plan was too high for us to try and pay 2 loans each month.

Shelby Rescue shopped around to try and find a solution and finally found it. The Local Government Federal Credit Union! Not only did they give us a loan, but LGFCU refinanced one ambulance for us. They lowered our interest rate on both loans plus saved us hundreds of dollars each month on payments. If LGFCU had not stepped up and agreed to help us when we needed it we would still be driving out dated and run down equipment.

Chairman Frank, thank you for standing up for our Small Business in Washington, DC.

In this day and time small business need more options, not fewer ones. In my opinion it is the small business owners and employees that keep this great country of ours going. By passing HR3380 this will give small business's a chance to stay alive and create jobs. Not everyone can do the job that we do here at Shelby Rescue. If this bill passes it will give

us the best chance to have state of the art equipment and the best trained personnel to keep our community safe. To me it's a win win situation for all small business's to be able to get the best service to meet their needs.

Sincerely,
Keith Strickland

Keith Strickland
Director of Operations, Shelby Rescue Squad Inc.

Condition of Small Business and Commercial Real Estate Lending in Local Markets

9:00 a.m., February 26, 2010, 2128 Rayburn House Office Building
Joint Hearing: Full Committee & Committee on Small Business

Congressman Klein submission for the record

Submitted By: Ted Bohne
Business Name: Pino Tile and Carpet
Contact information: ted@pinotile.com, (954) 971-9704

Dear Congressman Klein,

My name is Ted Bohne and I am a local business man in the flooring business.
I was the owner of Pino Tile and Carpet, a provider of flooring to middle class Floridians in 13 locations throughout Central, South and West Florida. We catered to average, hard working, retail customers that were remodeling their homes. Our customers were looking for a way to improve their home with someone they could trust without breaking the bank. We did not cater to the construction industry or new construction.
The primary reason I purchased this family owned and run business in 2001 was because I felt it to be recession resistant. I felt that regardless of how bad the a local economy would get, we were spread out enough and healthy enough that we would weather the fluctuations in the market.
Pino Tile employed over 70 fantastic people and had over 60 subcontractor installation companies that completely relied on Pino Tile for their business. All totaled, we put dinner on the tables for well over 300 families.
We paid our bills, we paid our taxes, and ran a very reputable business were our reputation came before making a profit. We started a charity called Pino Tile Children's Charities which has raised almost $100,000 for local children in need.
From mid 2006 to mid 2008 our sales revenues decreased by over 40% to a level we had not seen in 10 years. On the Friday before Labor day weekend, my bank informed me that they were going to call our line of credit rather than assist us as we had asked. Having shopped every bank I could find for over 6 months , unsuccessfully, I knew this was our kiss of death.
Pino Tile throughout the whole decline, never lost money, yet the banks would not assist us to weather the storm.
Pino Tile and Carpet closed its doors for the final time on November 15th 2008.

Why did it die?

1.) Local Taxes!
The cities and counties did not get their budgets in line and save their surplus when the times were good and kept raising our millage rates to a point that it was impossible to move out of your house. Taxes killed the housing boom.

When a family sells their house and buys another one, the economy is stimulated. The family pays the brokers, the mortgage broker and the appraiser. The bank gets the mortgage points and fees. The family then buys new paint, furniture, FLOORING, landscaping, ceiling fans, kitchen cabinets, (did I mention FLOORING), etc. The economy is stimulated!

2.) Homeowners Insurance
After the average guy was complaining about his taxes, he then got his homeowner insurance bill and realized he can't afford the home he is in, much less moving. The newspapers found something new to scare everyone in Florida with. This gave everyone another reason not to buy anything (because they were BROKE).

3.) Banks
The banks put the final nail in the coffin! The banks wrote so many loans without doing their due diligence to determine what they were buying. I choose the word buying because it is in fact what they did. With the highest foreclosure rate in recent history, the banks have effectively bought these homes for what they loaned on.

The banks are a victim of their own greed. They wrote these loans. They didn't use common sense to keep a balanced portfolio and risk pool. They just kept approving loans.

They never deserved a bail out. Nobody is bailing out John Q Public. Nobody bailed out Pino Tile and nobody bailed out the 300 families that fell victim to this historic economic crisis.

I am not an economist, but I can assure you these are the reasons that the Florida economy fell to such a horrific depth.

The banks, landlords and vendors that were not able to be paid did what they needed to do and I, like so many other businessmen, lost everything. I am losing my home, sold (or turned over) most of my possessions , and am in process of personal bankruptcy.

I spent the first four months trying to find any type of job that would support my family and kids. This was a lesson in futility.

Well the story is now taking a better turn.

In April Of 2009, my girlfriend of eight years (and daughter of the original Pino) and I took a big risk. We invested her life savings into resurrecting Pino Tile. We convinced a location owner to give us a chance, begged a few suppliers to buy product (C.O.D.). We told them we would never be able to repay what was lost, but would work to earn back what was lost.

We do things the old school way now. We work the front end of the business 6 days a week and the back end of the business each night. My mother came out of retirement to volunteer 5-6 days a week in sales. We hired one sales person from the old Pino Tile to start. After about 6 months we were able to hire a warehouse man. In January we were able to hire another of our previous sales people.

We have not borrowed a dime. We take just enough salary to live and put everything we can back into building the business.

Our greatest reward is the customers and vendors that support us. Every day we hear customers tell us "Thank god you are back". The encouragement from everyone wanting to see us succeed is unbelievable. We thought we were just trying to make a living. We didn't realize that we are actually trying to keep a thirty year reputation alive and prove that this economy is not going to take all that is good down.

If the government and the banks had to fight and survive the way the local business man and family has had to.....I wonder where we would be today?
Sincerely,

Edward J (Ted) Bohne III
Manager
Pino Tile & Marble, Inc

2.

Submitted By: Andy Cagnetta .
Business Name: Transworld Business Brokers
Contact information: ac@tworld.com, 954-478-4308

Dear Congressman Klein (Ron),

Being a leader in the business brokerage industry has allowed me to see what the lack of capital has done to our small business community.

Basically it has brought growth and expansion to a standstill. Business owners who want to expand or help keep their companies open are unable to do so.

Entrepreneurs understand that the economy has cycles. And they understand risk, and are willing to undertake that risk and lose in the short term. They know that every year isn't a winner. And that sometimes you have to invest money in staff, technology, equipment and facilities to eventually make money.

How do they do this? SBA financing, credit lines, or other sources of capital. What happens when you cant find financing? We lose companies, jobs, and other resources in the community.

For example, take my company Transworld. In 1999 we were awarded CAPCO money from the state to grow. $3.5 million dollars was invested in Transworld. We used only 15% or about $500K of it to open new offices, hire new brokers, advertise, and grow.

We grew from 7 brokers to now over 80 brokers. 1 employee to 7. 1 office to 8 offices state wide.

In 2003 (5 years later!) we paid the money back, with interest!

We also in that time have help over 1,000 businesses change hands. That's 1,000 new buyers with new businesses investing in employees, inventory, and infrastructure to pursue their American Dream.

I am passionate about entrepreneurialism, and I know many business owners want to either expand, save their current one or start new companies. But they all the lack the capital to do so. In fact I know several companies that have closed their doors due to lack of financing. (80 jobs in one company alone).

Lost opportunity, lost infrastructure, lost hope.

What do we need? SBA or alternative financing that works for both the banks and the business owner! Think about the SBA financing after hurricanes (the business owner).

Or how about helping the banks be more profitable with the 7A program. Increase the cap to 5 million, with 4.5 points over prime, and a guarantee that is clear and reliable.

I can speak to this subject all day. I truly believe that many business owners are willing to borrow capital, invest in their businesses, even if they lose in the short term, and pay the loans in full in the near term once the positive cycle has returned.

Please call me if I can assist you in anyway.

God Bless America and our Small Business Owners,

Andy Cagnetta
CEO
Transworld Business Brokers

PISARKIEWICZ MAZUR & CO INC
307 West 38th St NYC 10018
T 212 714 1700
F 212 714 1498

Brand Development
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PM & CO

January 30, 2010

Congresswoman Carolyn Maloney

Re Lending situation with small businesses and banks

Dear Congresswoman Maloney,

My business, a marketing communications and brand design firm, was established in 1979, incorporated in 1981. We are also a certified Woman-Owned Business by WBENC, the state and city of NY. Over the past 30 years, we have been able to obtain financing as necessary. We were also located at One Wall Street Court when the 9/11 terrorist attacks occurred, which of course affected our business greatly.

At the time after 9/11, we were able to obtain various grants as well as a $156,100.00 SBA loan which now has a balance of about 85,000.00, and a $50,000.00 World Trade Center Loan. So naturally this economic recession, coming on the heels of 9/11 has been a terrible financial strain.

We do business with 4 different banks - HSBC, Sovereign, Bank of America, and TD Bank. We have been to all of them for help with financing and NONE of them have come back with any sort of loan offer. We also went to Chase, Wachovia, and Signature. Again, they are not lending any money to small businesses.

Then the ARC program came out. We figured we would be perfect for it with our SBA and small WTC loan. After reviewing our application, they determined that we were NOT NEEDY ENOUGH!!!

We have had to essentially use all of our personal savings, borrow from some family members, laid 2 people off, cut back everyone else's hours and salary (5 people), sublet some space and work with free student interns (earning a $16.00 a day stipend) in order to survive. Our son sat out one year from the University of Rochester and worked at Whole Foods. He is now going back to the City College of New York as we used his U of R tuition money to keep the business afloat. We don't go out, we eat every meal in and take our lunches to work everyday. We work every single day and I'm pleased to say we do have 6 new clients - 2 quite large and one retainer. It seems we will make it - it has not been easy.

When 9/11 happened, as much as I disliked nearly all of the Bush policies and practices, I can say that help, programs and financing were made immediately available to small businesses, so much so, that I remember saying, "What a great country we lived in!"

No more!

After personally campaigning for Obama, making hundreds of telephone calls all over the country through the Move-On organization to get him elected, it is so disappointing to realize that no one is paying attention to us. Yet we are historically the ones who can kick-start the economy with swift hiring, (if we have financing), as we have accounted for 60 - 80% of the job growth in the last decade. We already employ more than 50% of the workforce. But, everyone thinks that we are fungible.

Besides making financing available, why couldn't you put a freeze on payroll taxes for a period (as that happened after 9/11) or suspend all loan payments (to SBA or WTC) for 6 months and have the time of the loan extended on the other end? Or create a fund out of the repaid TARP money to provide financing directly to small business, not through the banks just as you lent them the TARP money. You should also be providing grants.

I think what we need to understand is that big banks today are NOT in the traditional banking business as we once knew it - of keeping clients' money safe and lending them money. They are now in the business of making money from taking companies public, representing them in mergers and acquisitions and investing that money made in terribly risky imaginary funds that eventually got caught in their imaginary play land and brought the whole economy down along with the ordinary public's money. These businesses need to be separated. New investment instruments should to be vetted and approved by some intelligent committee. Things have got to change so that there are no more intricate algorithm made-up financial instruments created by financial engineers who don't really understand the total real world impact they could have, they are just looking at the mathematical what-if upside only.

I have written this same information to Obama via the White House web site - did that one year ago. I guess my letter didn't get read.

As our representative, please do some things quickly to help us!!!

Thank you,

Mary F. Pisarkiewicz
Founder/Chief Creative Officer

Honorable Representative Barney Frank
Chairman, House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

RE: Condition of Small Business and Commercial Real Estate Lending in Local Markets

Honorable Congressman Frank:

Thank you for supporting and permitting public comments to be inserted into the hearing of the House Financial Services Committee. Please accept this brief correspondence as a public comment regarding the above referenced hearing on February 26, 2010.

Let me provide a brief introduction to the organization that I represent. AltaOne Federal Credit Union is a community chartered federal credit union serving the residents of the California Counties of Kern, Inyo, and Mono. AltaOne provides competitive financial services to our membership in both consumer and small business sectors. In our small business lending services, this credit union provides loans for purchase of commercial property as well as business inventory and secured/unsecured lines of credit. AltaOne is also an approved Small Business Administration lender by the SBA. AltaOne has been engaged in making loans to small businesses for over a decade now.

It is clear during these economically challenging times that America needs to put Americans back to work in gainful employment. It is an accepted statement today that small businesses are the backbone of our American talented workforce and a key economic driver to hiring and employing more Americans. Small businesses are also more flexible to adapting to an economic recovery and willing to pursue new workforce talents. Many small businesses are dynamically owned by sole proprietors and require more capital to operate and sustain growth for future employment hiring.

In order to sustain small businesses and support their needs to purchase and retain commercial real estate holdings in their local markets, it is necessary for many small businesses to borrow the required funds. In the communities within the economically stricken California Counties AltaOne serves we see many solid opportunities to financially help and support small businesses recover and return to healthy growth again. This recovery requires infused funds in the form of sound small business lending.

AltaOne believes it is critical that credit unions of this nation be allowed to expand further their member small business lending by raising the legislatively capped capital limit from 12.25% to 25% for all credit unions. AltaOne urges you to support this expanding business lending authority for credit unions within the hearings of the House Financial Services Committee to now help put Americans back to full work.

Thank you for conducting hearings which allow for comments from small business lenders especially in commercial real estate lending to our local markets.

Respectfully yours,

Robert M. Boland
President /Chief Executive Officer

NCUA
Federally Insured by NCUA
701 South China Lake Boulevard, P.O. Box 1209, Ridgecrest, California 93556-1209
(760) 371-7000 • (800) 432-9723 • (760) 371-2304 FAX
www.AltaOne.org
EQUAL HOUSING LENDER

NORTH CAROLINA HOME BUILDERS ASSOCIATION
P.O. BOX 99090 RALEIGH, N.C. 27624-9090
PHONE (919) 676-9090 TOLL FREE 1-800-662-7129 FAX (919) 676-0402
www.nchba.com www.21buildingexpo.com

2010 NCHBA OFFICERS

President
LYLE DARNER
Raleigh
(919) 846-2041

President-Elect
BILL DALEURE
Charlotte
(704) 521-5318

First Vice President
ERIC ANDERSON
Winston-Salem
(336) 722-4816

Vice President, Region I
PATRICK MANN
Morehead City
(252) 726-1099

Vice President, Region II
GLENN MORRISON
Greenville
(252) 321-1813

Vice President, Region III
CHAD RAY
Zebulon
(919) 269-4555

Vice President, Region IV
RALPH DOGGETT
Burlington
(336) 570-9142

Vice President, Region V
JACKIE TRINCHITELLA
Fayetteville
(910) 864-4073

Vice President, Region VI
BRIAN PACE
Charlotte
(704) 365-1208

Vice President, Region VII
MARTY NEEDHAM
Pilot Mountain
(336) 368-1454

Vice President, Region VIII
BRIAN ROBINETT
Denver
(704) 201-9172

Vice President, Region IX
KEVIN ANNAS
Granite Falls
(828) 396-6878

Vice President, Region X
ZAC KOENIG
Highlands
(828) 526-4953

Secretary/Treasurer
BARRY TUTOR
Fuquay-Varina
(919) 552-1367

Immediate Past President & NAHB Executive Committee State Rep.
FRANK WEBNER
Durham
(919) 490-7400

NAHB Executive Committee
BUDDY HUGHES
Lexington
(336) 787-3520

Executive Vice President
MIKE CARPENTER

February 5, 2010

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

Dear Congressman Miller,

Thank you again for the giving our members the opportunity to share their recent experiences with lenders. I received the following correspondence from Michael "Buddy" Smith, a builder member from Jackson County. I hope that this helps to further illustrate the frustration our builders have with their lenders.

> *The discussions of how banks are not working lending money to our industry was sad and concerning. For as I stated then, I've been the victim of being turned down by three banks and one of those twice solely because I am in the construction and related businesses. The assets were there as well as a long track record of being in construction (almost 50 years). I was asking for only 50% of value on property and for a line of credit with 100% collateral. "No" was the answer and we spent hours meeting and a lot of money to prepare the necessary papers to apply with them knowing what I do for a living. It wasn't much comfort to hear that there were others throughout our state that has the exact problem. Some couldn't even get a loan for a vehicle due to being in construction. I could go on, but you get the idea - our banks are putting us out of business.*
>
> *Thanks for being interested and I hope this will help someone see what really happens.*
>
> *Sincerely,*
>
> *Michael "Buddy" Smith*
> *PO Box 2626*
> *Cashiers, NC*
> *828-743-6888*

Please let me know if I can be of further assistance. Again, thank you for your time and attention to these very important lender issues.

Sincerely,

Lisa D. Martin
Director of Government Affairs

To Rep. Barney Frank

As President of Carpet One Floor & Home of Roxboro, NC, I am asking support of the Credit Union lending raising the level to 25% for small businesses.

Small businesses are finding it increasingly difficult to secure credit from banks and other institutions. These small businesses are the engine of the American economy and are uniquely positioned to create new jobs. Credit unions are ready and willing to lend to such businesses but many are currently restricted by a statutory cap on the volume of business loans they can hold.

That is why I am asking you to support inclusion of a provision would raise the credit union member business lending cap from 12.25% of assets to 25% of assets and give credit unions the opportunity to help small businesses in any legislation aimed at creating jobs. If the business lending cap were lifted, credit unions could provide up to $10 billion of stimulus to America's small businesses in the first year alone and create 108,00 new jobs at no cost to the taxpayer.

Credit unions continue to lend, even in these difficult times. In fact, the fastest growing type of credit union lending is business lending. Raising the cap will not lead to unlimited business lending by credit unions. Credit unions are well regulated by the National Credit Union Administration which ensures that credit union loans are in the best interest of members. This conservative approach to lending is what helped credit unions largely stay out of the current crisis, and it is what makes business loans among the safest loans credit unions make today.

Please give credit unions the opportunity to help small businesses create jobs by lifting the credit union business lending cap - in job creation legislation.

WE are working hard everyday to keep our store open and prosperous so that they can retain and grow employment I thank you for your consideration.

Sheila Clayton

Carpet One Floor & Home
Sheila Clayton - President
500 A Old Durham Road
Roxboro, NC 27573

Commercial Development Group
Burlington, NC

1/13/10

State Representative Nelson Cole
N.C. House of Representatives
16 W. Jones St., Rm. 1218
Raleigh, N.C. 27601-1096

Dear Representative Cole:

As a Developer, I would like to ask a few questions and solicit your help or at least an explanation as to what is the problem with the banking industry at this time. Several Developers here in the Piedmont Triad of N.C. are finding it extremely difficult to renew loans on Shopping Centers, Apartment Complexes, and Retail Space. In some cases the banks are just denying the loans regardless of the credit strength of the borrower. We are being told by the banks that the Government is telling them to get out of the business of renewing loans of this type and putting strict regulations on them. We cannot understand this reasoning. Without units to rent, how can anyone become an entrepreneur and how will the economy be stimulated without businesses?

This is not a solicitation for sympathy, this is a cry for help in resolving the issues with the banks. I personally have never been late with a payment and I carry a credit score of 785. I own at least 20 shopping centers across North Carolina. My main business has been to go into impoverished areas and refurbish old shopping centers and bring in new business. I can tell you that my success rate is better than most. We have very few vacancies. With this kind of history, it is extremely difficult to accept the kind of treatment we are getting from the banks. It is not just one, but all the banks.

With all this being said, what is the resolution to this problem? What is the government's position? What are these strict regulations the banks refer to? Will there be intervention? What is our recourse?

Please respond as this stranglehold is going to cause a domino effect. We appreciate all that you do for the citizens of North Carolina and in that spirit we know you support the small businessman and will give us an ear. We would love to have the opportunity to sit down with you and discuss some of these issues. I would be more than happy to provide

a forum for this type of meeting. We have considered a press conference to lay before the public the problems we are encountering. Let's work together to make N.C. a strong and resilient State. We need your help, please do what you can to assist us in this matter. We look forward to hearing from you. If I can provide any further information by phone, please call me at 336 214 4256.

Sincerely,

David M. Morton or dmmorton@gmail.com
Morton & Sharpe Commercial Development Group
1648 Memorial Drive
Burlington, N.C. 27215

Bill Clark Homes

Building the Tradition

February 2, 2010

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

Dear Congressman Miller,

It is near impossible to obtain development money from the banks even if we need lots to build on in areas where we can sell homes. This is going to put private builders at a huge disadvantage against the public builders because they have more access to funds. Unless something changes soon the home building industry will be dominated by the publics. This will not fare well for the country and will certainly cause more job loss.

Sincerely,

Bill Clark

200 East Arlington Blvd., Suite A • Greenville, North Carolina 27858
Office 252-355-5805 • Fax 252-355-2806 or 252-317-0950
www.billclarkhomes.com

The Honorable Brad Miller
US House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

I'm a 55 year old Vietnam vet who happens to be a General Contractor. We are a family operated business grossing 1 to 1.5 mil a year, when the boom was on we averaged 2 to 2.5 mil a year. We primarily build custom homes so we did not get caught up in the speculative market. We built our personal home in 2008 and so did our son. We are looking under every rock and knocking on every door to get work. We are blessed to have a new home to build this year and finishing one from last year, however we are faced with extreme financial difficulties, since our gross is about one third to one half, our bills are not. We are registered for govt. work through the SBA, CCR, ORCA, and should have our HubZone soon (although this doesn't guarantee any work at least we are not giving up). We need a small business loan, but none of our banks seem to be lending. In fact the only business line of credit we have is due in April and the community bank told us do to new regulations that they will not be able to renew our line of credit. We have always maintained excellent credit and we are never late on any of our payments. If we are not able to restructure our finances, then we will be out of business and my son's family and our three grandchildren will probably lose their home as well. My two granddaughters have special needs and this would be devastating to say the least. What can you do for small businesses and what can you do to help stimulate housing? We need your help and there are many others like us.

Sincerely,

Jeff Howard
828-837-9563

2685 Cook Bridge Rd.
Murphy, NC 28906

Phone: 828-837-9563

Email: info@hciwnc.com

www.hciwnc.com

CUSTOMS ~ REMODELS ~ ADDITIONS ~ DECKS.~

LEVEL BEST BUILDERS INC.

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

Dear Congressman Miller:

I am writing to you to bring to your attention a new practice that is apparently taking hold in the building industry: lenders are now requiring builders to submit financial documentation and credit status reports, even if they are not the person applying for the loan. For example, I have spoken to several lenders with whom I work, and they have told me that they know of many instances in which Wells Fargo has denied a loan based on the builder's credit score, even though the builder was not the person applying for the loan. This would be the final nail in the coffin for many area builders, who have experienced hits on their credit due to the market conditions of the past few years. The client would not be able to obtain a loan unless they chose another builder, effectively putting any builders with low credit scores or past/current bankruptcies out of business. These lenders also told me that other banks are discussing implementing these guidelines shortly. It is my understanding that First Federal has also implemented this procedure, and it is only a matter of time before other banks follow suit.

I also spoke with a bankruptcy attorney with whom I do business, and asked his thoughts on this. He stated that he felt that it was "crazy that the banks would want to do a credit check on the builder. There are ways to protect the bank and the homeowner if a builder files bankruptcy or has credit issues, through the builder's contract and through controls over the funds."

Attached please find the 2-page document that Wells Fargo is asking a builder to fill out, even though the builder is not the one applying for the construction loan (i.e., when a client applies for a construction loan with Wells Fargo, they are asked to get these documents filled out by their builder). Note on page 2 where it states that they can ask for/obtain personal credit reports, tax returns, etc. They are now also asking if the organization or any of its principals has ever filed bankruptcy (Item 14).

Please let me know if there is anything more I can do to help. I feel very strongly about this issue and am hoping that we can stop this before it becomes a widespread change.

Sincerely,

Paul Devereaux

Level Best Builders Inc.
P O Box 2232
Carolina Beach NC
28428
PHONE (910) 617-0692
FAX (866) 542-7971
E-MAIL pdev@charter.net

Wells Fargo **Builder Validation Statement**

Business Banking Services, Real Estate Resource Center (Fax 866-494-1628)

Legal Name of Business Website address, if applicable: www.	Phone Number ( ) -	Type of business Corporation ☐ Partnership - General ☐ - Limited ☐
Mailing address	Fax Number ( ) -	
City, State, Zip Code		Sole Proprietorship ☐ LLC ☐

1. Organization has been in business as a general contractor for years.

Type of license or "NONE REQUIRED"	License number	Tax ID# (Required)

2. Organization has been in business under its present name for years.
   Previous Business Name(s) (if any)
3. If organization is a corporation or LLC, complete this section.

Date of Incorporation	☐ "C" corp or ☐ "S" corp ☐ LLC	State of Incorporation

4. Name, Title, SSN and Ownership % of each partner, shareholder or member

Name	Title	Social Security Number	Ownership %
		- -	
		- -	
		- -	
		- -	

5. Number of homes/dollar amounts/the lenders and locations the organization has in process on this date.

Number of Homes	Dollar Amount	Interim Lender	Location

6. Number of homes constructed, the total dollar amount and price range the organization has completed in the past five years.

Number of Homes	Total Dollar Amount	Price Range

7. List your most recently completed home construction projects, and at least four homeowners whom we may call as references.

Number of Homes	Approximate Dollar Amount	Homeowner(s)	Phone Number	Year Completed

8. Subcontractor References. Please list your most commonly used subcontractors and their phone numbers.

	Name	City, State	Phone # and Fax #r
Lumber			
Concrete			
Electric			
Plumbing			
Other			
Other			
Other			

Builder Validation Statement (p.2)

9. Construction experience of the principal individuals of the organization

Name	Experience

10. Trade organization affiliation/trade references

Name	Address	Phone #

11. Bank references

Name	Address	Phone #	Account Number

12. Title Company References

Name	Address	Phone #	

13. Insurance coverage

Liability Insurance	Agent	Phone #
$		( ) -

Workers Compensation	Agent	Phone #
$		( ) -

☐ If checked, I certify that my organization does not carry workers compensation insurance, because my organization does not have any field employees (other than myself), and all hired subcontractors are required to carry their own workers compensation insurance.

14. Has the organization or any of its principals ever filed bankruptcy? ☐ Yes ☐ No

If yes, give date and attach explanation

15. I/We the undersigned certify that the statements and representations made herein are true and complete to the best of our knowledge. Should there be any personal or corporate changes within the company, I/we agree to notify lender of same within thirty (30) days thereof. I/We hereby authorize any Wells Fargo Bank affiliate ("WFB") or Wells Fargo Home Mortgage ("WFHM") to obtain business and/or personal credit reports, and verify the information represented herein with employees, financial institutions, trade and customer references, and other as it may deem necessary or appropriate in its sole discretion. CERTAIN CREDIT AND PROPRIETARY INFORMATION OF BUILDER SUPPLIED TO WFB OR WFHM MAY BE NEEDED BY WFB OR WFHM IN CONNECTION WITH THE PROCESSING AND UNDERWRITING OF LOANS OR PROJECTS INVOLVING THE UNDERSIGNED BUILDER. BUILDER HEREBY CONSENTS TO WFB, WFHM, AND ANY OTHER WELLS FARGO AFFILIATE SHARING SUCH INFORMATION, INCLUDING BUSINESS AND PERSONAL CREDIT REPORTS, FORMS 1003 & 1008, TAX RETURNS, FINANCIAL STATEMENTS, ACCOUNT AND OTHER FINANCIAL INFORMATION, PRIOR EXPERIENCE, CONSTRUCTION INDUSTRY REPORTS AND REFERENCES, AND OTHER BUILDER INFORMATION, REGARDLESS OF WHETHER SUCH INFORMATION WAS FIRST FURNISHED TO OR OBTAINED BY WFB, WFHM, OR OTHER WELLS FARGO AFFILIATE.

Owner/Partner/Member	Title	Date
Owner/Partner/Member	Title	Date
Owner/Partner/Member	Title	Date

(To be processed, all Owners/Partners/Members must sign above.)

29 January 2010

PO Box 2915
Durham NC 27715

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

Dear Mr. Miller,

Please present this letter to the Financial Services and Small Business Committee during the February 5th 2010 joint hearing on small business lending as my Letter of Record. Briefly, I wish to describe the circumstances of our credit-worthy business that cannot get new loans or extend existing loans.

In October of 2008 (on the day the stock market "crashed"), I had made the decision to list my complete home inventory for the dollar amount I owed on them. To walk away owing nothing but yet earning nothing was the goal. Survival; to live; to have another chance another day. It was this day in October, I had scheduled an auction of two of my homes – not because I was behind on my payments or that I could not continue the interest payments- but because I wanted to be proactive and move product in the high perception of getting a deal that the term auction evokes.

Fast forward a few months and my inventory is moving. I have relationships with most regional banks and was seemingly in daily conversations about "what's going on in the world and what are we going to do"? I felt threatened by the Bank Representatives who, for the most part, I have known for over 8-10 years. Did I mention that I've never missed a payment and was never in jeopardy of missing one? I was getting down to the few homes on my books that were not as desirable i.e one didn't have a back yard and one had a steep driveway. It was during this period that the banks took on an aggressive stance in our relationship. By this point TARP money had been doled out and my banks were recipients.

PO Box 2915
Durham, NC 27715
O- 919.422.2818 | F-919.640.8548
www.collins-design-build.com

I had made money on a few on my transactions and the banks refused to release the funds claiming that the other inventory might move at a loss and they wanted to protect themselves. That I understand but I have been a revenue stream for them for so long. I would like to share a letter that I wrote on March 5th 2009 to a local regional bank after this bank would not release our proceeds from a closing again, fearing a loss or a short sale from one of our homes that didn't have a backyard or like the one that had a steep driveway. I have retracted names and amounts.

Ones mission to help clients achieve economic success is to understand the client's business and the environment in which they operate so that one can better identify and customize the services they need to succeed. Collectively, the relationship between Collins Design-Build, Inc. and you has resulted in many challenges, many of which have been unpunctual requiring last minute arrangements. This is unfortunate. This has caused undue stress to all affected members of Collins Design-Build, Inc.

By the dominant tone of your correspondence we would believe that the bank is unaware of the current economic environment and is unwilling to customize its services to help both [retracted] and Collins Design-Build, Inc. succeed. Imposed fees and interest rate increases, while contractually are viable, adds only stress to the health of Collins Design-Build, Inc. and cripples its ability to survive this economic storm. [Retracted] has yet to be in peril of monies due from our contractual agreements. It would be of great value to the sustainability of our company and it would be immensely appreciated, if [retracted] could truly consider our business challenges of today's market.

Everyone is current. By not releasing our proceeds in the said amount, in our opinion, indicates [retracted] unwillingness to adapt to our current surroundings and will only stranglehold our ability to operate.

PO Box 2915
Durham, NC 27715
O- 919.422.2818 | F-919.640.8548
www.collins-design-build.com

As for the remainder of our proceeds from the sale of [retracted]; currently, Colins Design-Build, Inc. would like to use said monies for interest payments. Ideally, you would release our proceeds to us and we would write you checks on or before due dates like professional businessmen. Questionably, [retracted] doubts our ability to do that.

We now would like to open the conversation of what to do with [retracted – home with steep driveway]. As in previous requests, how can [retracted] and Collins Design-Build, Inc. team together to move this property? Maturing the note on an accelerated scale while feeling the need to do such; increasing the interest rate and demanding more collateral will only compound the issue and not allow ether of our companies to succeed. How can we customize our relationship module to accomplish both of our goals with respect to this property? I received a letter from your CEO, [retracted], indicating that [retracted] received $ [retracted] million from the TARP Capital Purchase Program mostly, and I quote, *"...to continue to grow, to make new loans and to protect against the impact what appears to be an extended economic downturn."* Point is, we are no different than [retracted] in today's market. Only we're not looking to grow or take advantage of the situation. We are just trying to survive. We are requesting your help to breathe. Please consider Collins Design-Build, Inc. with your resources in the same manner in which you were helped by the American tax payers via our government.

Respectfully,

Chad D. Collins

Current day. I have sold my entire inventory at zero loss to any bank. No dings on my credit, no late payments. Whole. And now the regional banks whom I've proven to be such a revenue stream for will not even consider lending for speculative real estate without providing unrealistic capital. Then the loan terms themselves would fall short of being enough money to complete the project. "We have too much real estate on our books" is a common response. So, I went out and tracked down a private investor with the purpose of contacting regional banks and looking at land opportunities that lenders may have on their books. Knowing that there is growth in non-performing assets on

PO Box 2915
Durham, NC 27715
O- 919.422.2818 | F-919.640.8548
www.collins-design-build.com

these regional banks balance sheets, the goal would be to strike a dealbefore prior to foreclosure while these lots are in the non-performing status. Almost like a short sale. I was met with "We don't have anything like that." The banks are in denial.

Let me summarize:

A- I am creditable company. Awesome credit.
B- Banks will not lend without unobtainable capital. Stating they have "too much Real Estate on their books."
C- I have a willing Private Investor to remove Real Estate from their books.
D- Banks Claim they don't have any "non-performing" Real Estate.

Yes, I use someone else's money to earn a living. And to date the lending intuitions' have always profited from loaning me money. But I provide jobs for a lot of people. By not loaning money for real estate improvements, this revenue stream has stopped. And the three hundred or so people that earn a living just through my companyare out of work. As am I.

Sincerely,

Chad D. Collins

President
Collins Design-Build, Inc.
PO BOX 2915
Durham NC 27715

919-422-2818 Office
919-640-8548 Fax

chad.collins@live.com
www.collins-design-build.com

Patricia A. Montanarella
Builder/Developer
P.O. Box 58623
Raleigh, NC 27658

January 28, 2010

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

Dear Mr. Miller;

I am a Residential Builder/Developer in Raleigh, NC. I realize how busy you are, so I will get right to the point.

I completed construction of my last 5 unit Townhouse building in the end of 2007, about the same time that the Real Estate Market began to crumble. I spent all of 2008 trying to sell these units and was not able to, because financing was no where to be found.

As a result of not selling these units I had no choice but to lease them out, therefore they remain my financial responsibility, in my name which completely halts me from moving forward. I could not build anything new again in 2009. I am in this business to build and sell, not to hold onto. Having to hold on to these properties has put me right out of work.

It is now January 28, 2010 and I am still not able to build new product, nor am I seeing much improvement with sales if any. I keep hearing unemployment numbers. Well I can tell you from my heart, there are many of us that are not being counted in those numbers.
We are out of work, not being counted, and not receiving any benefits.

I am 57 years old. I left a corporate position to start this small business before I am too old to be in the work force. Never did I expect to see this happening to small business in The United States of America.

Sincerely,
Patricia A. Montanarella

January 27, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My wife and I own two small businesses and we have been in business for 17 years. Our "Woman Owned" environmental equipment business employs 14 people and is located in Charlotte, NC. Enviro-Equipment, Inc. rents and sells environmental monitoring equipment and environmental remediation equipment. Our Customers include environmental consulting companies, universities, Federal and State agencies and manufacturing industries. Our second business is a commercial real estate company that is run by just the two of us. Chew Properties, LLC, located in Pineville, NC owns 10 commercial buildings that are rented to small businesses including our own.

Both of our businesses were started with funding from my father as the banks we contacted to would not lend to us even though we both had professional positions and excellent credit. After we were established we were able to get loans from small regional banks for operating capital and equipment purchases. During the last several years this money dried up or the terms became unreasonable even though we never missed a payment and still had excellent credit. A friend of ours told us about the credit unions and that we could become members. Ever since we have had a wonderful relationship with two credit unions and our businesses have grown and added new employees even during the current recession. The issue we have now is that our business continues to grow and has the need for additional capital, but the credit unions have very low lending caps that prevent them from helping us as they would love to do.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners need more options – not fewer! I urge you to allow credit unions to better serve small business owners like us by passing HR 3380. This is vital for our on going growth.

Sincerely,

Enviro-Equipment, Inc. & Chew Properties, LLC

Brian E. Chew Sr. P.G.
Vice President

Denise L. Chew
President

CALABASH FIRE DEPARTMENT

Calabash, North Carolina

892 Persimmon Road
Calabash, North Carolina 28467
E-Mail – cvfd@atmc.net

Emergency Calls Only - 911
Business Phone (910) 579-2355
Fax - (910)-579-5024

January 28, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

Let me introduce ourselves. We are a Not For Profit Corporation known as the Calabash Fire Department, Inc. The function of the fire department in our community is to protect and serve, not only Fire, but to include Rescue, and EMS. The Calabash Fire Department is located in Calabash, North Carolina and serves 29.5 square miles. The 29.5 square mile area consists of the Town of Calabash, the Town of Carolina Shores and parts of the surrounding area in Brunswick County. We have 11 full time employees, 12 part time employees, and 26 volunteers.

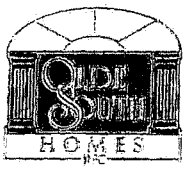
The name of our Credit Union is LGFCU which stands for Local Government Federal Credit Union; the main office is located in Raleigh, NC 27626-2561. The relationship between the Calabash Fire Department and LGFCU began when we were looking to consolidate the loans we had under one umbrella. Mr. Bill Carter of LGFCU was able to provide better rates and terms that fit our Corporation perfectly. We had looked elsewhere, and just could not find a fit, interest rates to high, and the duration of the loan was just too long.

We want to thank you, Chairman Frank, for holding a hearing in the House Financial Services Committee to discuss HR 3380, promoting lending to America's Small Businesses Act. In this economy, small business owners, and Community Service Corporations need more options – not fewer! I urge you to allow credit unions to better serve small business owners, like us by passing HR 3380.

Respectfully yours,

Randall T. Bork, Chief

YOUR SAFETY IS OUR CONCERN



3921 Sunset Ridge Road, Suite 201
Raleigh, NC 27607

919-420-7400
Fax: 919-420-7405

January 25, 2010

The Honorable Brad Miller
U.S. House of Representatives
1127 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Miller,

I am a Homebuilder/ Developer from Raleigh, NC and over the past 15 years my company has consistently produced between 75 and 125 homes per year in the Triangle area. As a small business owner I have typically employed 25 hard working men and women to accomplish the work required to build homes for our homebuyers.

I am specifically writing to express my deep sense of concern for the survivability of our small businesses in North Carolina and the incredibly difficult banking environment that we now are having to deal with. In the current economic crisis I have pared my staff to 5 employees and have over the past 2 years liquidated my land holdings from over 200 building lots to a current inventory of 89 ready to build on lots. I was strongly encouraged by my banks to reduce my inventories and have done so under the pressure of that encouragement at a tremendous financial loss. I would continue to sell off these lots but I am not able to find a buyer who can find a financial institution who will make a loan for a building lot that does not already have a home sold on it. I have historically worked with a single lender to finance my acquisition, development and construction (AC&D) loans. In September of last year one of my AC&D loans came up for renewal. As I have always done I called 60 days in advance to begin the process of communicating my desire to extend the loan for another year. I was told that because my loan was a real estate loan it was now being handled by the bank's Troubled Assets Department and that they would contact me and that I should continue to make the interest payments. It took 60 days for the appropriate folks to call me at which time I was asked to appear personally before several Troubled Assets Managers. We began a process that included the bank defaulting my loans which they later rescinded and the negotiation to extend the loans took over 8 months. I am now cross collateralized, I have a much greater equity position in the deals and every asset which I own is now tied to the performance of the real estate market. The privilege of having my loan extended for 6 months through the end of 2009 cost me over $100,000.00 in legal fees, of which over two-thirds were incurred by the bank which I was required to pay as a condition to the extension. Another condition to my extension was that the bank was not obligated to fund construction loans for any homes sold. Fortunately, I was able to find a local lender who allowed me to finance the construction of homes sold. We built 26 homes this past year.

It is now the end of January and I am once again in the process of renewing this loan for what I hope will for a 12 month term. However, I am once again at the mercy and subject to the timing of the financial institution. Last year when I was in the slow process of renewing my AD&C loans with my bank I had

been shopping for another bank to see if I could move some of my loans before the bank had absorbed all of my equity out of the land assets. I entered into discussions and had a verbal approval to move one of the communities I had developed which had about 40 lots left in it to another bank. The beauty of the deal was that I had paid the initial loan back in such a manner that the new bank had agreed to finance a deal in which the exposure to the bank amounted to just twenty five cents on the dollar! While the bank had verbally agreed to make the loan I was informed that regulators had visited the bank and that a closing would need to wait until they had completed their review of the bank. Upon the completion of the FDIC review the loan officer called me and informed me that the bank had no choice but to rescind their verbal approval due to the fact that their loan portfolio relating to real estate had been systematically written down and they could not add another real estate loan to their portfolio. I was however, encouraged that once things stabilized they would love to make a loan on my project because it was such a low risk investment. I mention this story to reflect that I have to the point of exhaustion attempted to relocate my AD&C loans with other lenders, private equity firms and or brokers and the above example is as close as I got on any one of the four loans I am currently working through. I have continued to seek other banks or funding sources for the construction of homes and have been unable to locate a bank willing to do business with someone in my industry that they are not already working with. I have also in the past several months had to let a couple of projects which were under contract for a couple of years but not closed go into default because I could not find a source for acquisition and construction financing in order to complete the terms of my agreements with developers to whom I have forfeited earnest money deposits due to the defaults.

My story is not unique, every time I find myself in the company of my builder and developer peers the greetings of "How are you doing?" and "How's business?" tend to have the meaning of "Are you still alive?" As I stated earlier in this letter I am gravely concerned for the ability of small businesses to survive without the flow of credit in our communities. I am abhorred to read the stories of record profits by financial entities and bonuses paid to workers which received bailout money paid for by the US taxpayers from the Congress and in the meantime I as a small business owner have used all of my resources to keep my company, which my employees and I have built with our sweat, alive in order to provide my employees and their families as much security as possible. I am afraid that the message I am receiving from my federal elected officials is that unlike the Wall Street firms which were "too big to fail" Olde South Homes in Raleigh, NC is disposable and insignificant.

I plead to you and your colleagues to encourage our lending institutions large and small to begin making credit to small businesses who are the financial backbone of our communities. I am happy to discuss my situation with you any time.

Sincerely,

Frank Wiesner

Frank Wiesner
Olde South Homes, Inc.

JTV MANAGEMENT CO.
1508 Military Cutoff Road
Suite 302
Wilmington, North Carolina 28403
(910) 256-0101

January 29, 2010

Senator Richard Burr
Representative G.K. Butterfield, Jr.
Representative Walter B. Jones
Representative Virginia Foxx
Representative Mike McIntyre
Representative Sue Myrick
Representative Heath Shuler
Representative Brad Miller

Senator Kay Hagan
Representative Bob Etheridge
Representative David Price
Representative Howard Coble
Representative Larry Kissell
Representative Patrick McHenry
Representative Mel Watt

Dear Senators and Representatives:

This letter is written to inform each of you as leaders of our great state that the financial market for small business loans, especially those involved in real estate related development projects is nonexistent. It is not for a lack of need or desire that small businesses can't find financing and continue a downward spiral creating massive unemployment. The fundamental problem lies in our financial system whose business philosophy as gone from overzealous lending to fear and panic retrenchment.

We are all told that banks will not loan money to any real estate related projects in North Carolina especially in the coastal region because of the pressure bank Boards and Management receive from both the FDIC and State auditors. It is amazing to me as a real estate developer, taxpayer, former Chairman of a small community bank, how our federal government continues to speak out of both sides of its mouth. We constantly hear of programs that are available to small businesses and are constantly shown the door at banks on Main Street to each and every loan request proposed.

I am sure you understand as elected officials of our great state that what happens on Wall Street does not happen on Main Street. The government saved the banking and financing systems from collapse at the expense of the same taxpayers who were asked to

bail them out. Now our federal government through its regulators (FDIC) is foreclosing on businesses and properties of the same tax payers that they called upon to save the financial system.

I recommend that Federal government grant the FDIC authority to allow banks to serve their customers and community with a lot more compassion and a lot less fear and trembling. Wall Street and Washington, DC can talk about the emergence of a recovery all they want but Main Street in North Carolina is still mired in a deepening, prolonged recession with the end nowhere in sight. Please answer one fundamental question - why did banks receive Tarp Money and businesses they loaned money to are either being foreclosed on or constantly pressured to make loan curtailment payments? Anyone wonder why our unemployment rate in North Carolina is growing? To produce jobs a business needs capital. Bank loans are the principle source of business capital. No lending equals no jobs, it's truly that simple! It is unbelievable what is really happening on Main Street.

Sincerely,

Jon T. Vincent

JTV/slg

SHELBY RESCUE SQUAD, INC.
927 W. MARION STREET • P.O. BOX 777
SHELBY, N.C. 28150
PHONE 482-3339

January 29, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee

Dear Chairman Frank,

My name is Keith Strickland; I am the Chief Director of Operations for Shelby Rescue Squad Inc. in Shelby, NC. Shelby Rescue is a small business that provides EMS and Rescue services to Cleveland County. We have been in operation since March, 1959. At the present time we have 6 ambulances, 1 Heavy Duty Rescue Truck. We run 24 hrs. A day, 7 days a week, 365 days a year. Shelby Rescue has a total of 35 full time and part time employees.

A few years back Shelby Rescue needed to update their ambulances due to being several years old and having a lot of miles on them and cost of repairs. We went to our hometown bank to try and get another loan for a new ambulance but the payment and interest plan was too high for us to try and pay 2 loans each month.

Shelby Rescue shopped around to try and find a solution and finally found it. The Local Government Federal Credit Union! Not only did they give us a loan, but LGFCU refinanced one ambulance for us. They lowered our interest rate on both loans plus saved us hundreds of dollars each month on payments. If LGFCU had not stepped up and agreed to help us when we needed it we would still be driving out dated and run down equipment.

Chairman Frank, thank you for standing up for our Small Business in Washington, DC.

In this day and time small business need more options, not fewer ones. In my opinion it is the small business owners and employees that keep this great country of ours going. By passing HR3380 this will give small business's a chance to stay alive and create jobs. Not everyone can do the job that we do here at Shelby Rescue. If this bill passes it will give

us the best chance to have state of the art equipment and the best trained personnel to keep our community safe. To me it's a win win situation for all small business's to be able to get the best service to meet their needs.

Sincerely,
Keith Strickland

Keith Strickland
Director of Operations, Shelby Rescue Squad Inc.

No. 7 Township Fire Department
of Craven Co. N. Carolina

P. O. Box 3062 New Bern, N. C. 28560

28 January 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee

Dear Chairman Frank,

I am the treasurer of No. 7 Township Fire Department in Craven County, NC. We have been established since 1959 and serve the citizens of New Bern, NC. We are an all-volunteer department with 51 firefighters. We are established as a non-profit corporation and receive the majority of our funding from the county.

As a non-profit corporation governed by a board of directors, we must obtain our own financing when we need to purchase the equipment required to adequately protect the community we serve. Back in 2007, we needed to purchase 42 new and updated air pack breathing apparatus for our volunteer firefighters. We were able to get a loan from Local Government Federal Credit Union for the purchase of this new equipment and to refinance an existing fire truck loan, all at a lower rate than our current bank was offering.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, fire departments and small business owners need more options--not fewer! I urge you to allow credit unions to better serve us by passing HR 3380.

Sincerely,

Ed Weigl
Treasurer
No. 7 Township Fire Department

PARKWOOD VOLUNTEER FIRE DEPARTMENT, INC
PO Box 12224, Research Triangle Park, NC 27709

1409 Seaton Road, Durham, NC 27713

Phone 919-361-0927 • Fax 919-544-7296

www.pvfd.com

January 28, 2009

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

The Parkwood Volunteer Fire Department is a non-profit organization that contracts with Durham County Government in providing fire protection and emergency medical services to citizens of Durham County, NC. We have more than 56 paid and 52 volunteer fire/EMS professionals. In 2009, we responded to 5,370 fire/EMS calls for emergency assistance.

We are currently renovating one of our three stations to enhance our EMS operations to the citizens of Durham County. After a month researching local banks, we discovered the Local Government Federal Credit Union (LGFCU) offered our fire department the best terms and loan rate. The LGFCU offered us a common sense approach in securing the financial resources needed for our station renovation.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners need more options – not fewer! I urge you to allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

William L. Colley, Jr.
Chief

The Piney Grove Volunteer Fire and Rescue Department, Inc.
Chief Randall T. Bork
"Save Lives and Conserve Property"

January 20, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

The Piney Grove Volunteer Fire and Rescue Department, Incorporated is a combination fire department (paid personnel and volunteers) located in Piedmont North Carolina between Winston-Salem and Greensboro. We serve a district of over seven square miles and 7000 citizens in a suburban/rural setting. Our four full time and ten part time personnel along with our thirty volunteers provide emergency medical, rescue and fire services to a community of single family homes, schools, churches and several small businesses. Our budget is supported by direct property taxation through our County.

Nearly two years ago the Department began searching for attractive, low interest, negotiable termed loans for an existing truck loan and a new loan for new apparatus. After approaching local traditional banks in the region we looked at the Local Government Federal Credit Union located in Raleigh, North Carolina (LGFCU). LGFCU was able to assume our existing loan on a fire truck and make a new loan for a needed purchase at lower rates and a per annum payment that was better to budget for and saved the tax payers considerable monies in loan interest. We were able to decrease our truck payment by over $5000 on one apparatus and secure a new truck loan for less than 4%.

We have whole heartedly supported our local credit union and have let other departments in our area know of the value of service and commitment the Credit Union has shown us. Our Board is investigating the purchase of a new fire truck in the near future and we will certainly call upon our friends at Local Government Federal Credit Union to assist us in this endeavor.

Chairman Frank, thank you for your consideration of the bill HR 3380 and we urge you to support the credit unions in lending to businesses like ours. *Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners need more options – not fewer! I urge you to allow credit unions to better serve small business owners like me by passing HR 3380.*

P.O. Box 338 • 1109 Piney Grove Rd.
Kernersville, NC 27285-0338

Emergency Dial: 911
Phone: 336.993.5721

The Piney Grove Volunteer Fire and Rescue Department, Inc.
Chief Randall T. Bork
"Save Lives and Conserve Property"

Sincerely,

Randel K. Temples

Randel K. Temples
President of the Corporation
The Piney Grove Volunteer Fire and Rescue Department, Incorporated
P.O. Box 338
Kernersville, North Carolina 27284

P.O. Box 338 • 1109 Piney Grove Rd.
Kernersville, NC 27285-0338

Emergency Dial: 911
Phone: 336.993.5721

WESTERN WAKE FIRE RESCUE

4021 District Drive • Raleigh, NC 27607 • (919) 836-1900 • Fax: (919) 834-2944

January 27, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

Western Wake Fire Rescue, Inc., located in Raleigh, N.C., is a private non-profit Fire Department organized to meet the needs of Wake County citizens and businesses who don't have access to municipal fire and rescue services. We are staffed by both paid and volunteer members, totaling approximately 50 in number, and provide services as a Fire District and mutual aid services to other Fire Services in Wake County.

Western Wake Fire Rescue, Inc. has enjoyed the services and support of the Local Government Federal Credit Union for nearly two years. Our relationship began when we were looking for a less expensive way to manage loans for two of our fire trucks. We found the loan rates and options to be the best available to us for refinancing over a timeframe which allowed us to stay within our budget and still maintain the vehicles at the high quality needed to meet the emergencies in our district.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses. In this economy, small non-profit businesses need more options – not fewer. I urge you to allow credit unions to better serve small non-profit businesses like Western Wake Fire Rescue, Inc. by passing HR 3380.

Sincerely,

Name: David L. Cates
Title: Fire Chief, Western Wake Fire Rescue, Inc.

FEB-1-2010 03:56P FROM: TO:7550193 P.2/2

Rockfish Fire Department
7600 Phillppi Church Road
Raeford, N.C. 28376
910-875-4660

January 29th, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

The Rockfish Fire Department is in a growing community in the eastern part of Hoke County. Our Fire Department provides fire, rescue and ems services to the community and surrounding areas. We had a need to expand the department due to the increasing number of calls we receive each year and the number of members on the department, 45-50 members. The building we were in became too small for our daily operations and the needs of the community.

Working with the Credit Union was very easy and was very helpful in seeing that our needs were met and that we were able to do more with our money than the other banks were allowing us to do. The Credit Union had the best rate as we shopped with four other banks and we could easily see that they wanted to help us with our expansion of the station and any other future needs that we may need. We feel strongly that if it hadn't been for the credit union that we may not have been able to build the current building that we are now in.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners need more options - not fewer! I urge you to allow credit unions to better serve small business owners like ours by passing HR 3380.

Sincerely,

G. Todd Wood

G. Todd Wood
Rockfish Fire Chief

February 2, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank:

In anticipation of your scheduled hearing on business lending issues I am writing to express Self-Help Credit Union's support for HR 3380, the *Promoting Lending to America's Small Businesses Act.*

As you know HR 3380 would raise the credit union business lending cap from the current 12.5% of assets to 25% of assets. This change is estimated to provide an additional $10 billion in small business credit nationwide in the first year and result in 108,000 new jobs nationwide.

Since NCUA low-income designated credit unions can make business loans without regard to the current 12.5% business lending cap, this legislative change would not affect Self-Help Credit Union. However, based on our long experience as a small business lender, Self-Help believes it would be good for small businesses and good for the country if the cap was increased and the vast majority of credit unions were given greater leeway in providing credit to small businesses.

As President Obama underscored in his State of the Union remarks, job creation is a key priority in 2010 and the main engine in job creation has always been small businesses. Increasing the cap on credit union business lending will only help small businesses, especially in this time of tight credit availability. And further, this change is budget neutral.

Thank you for your consideration of HR 3380. If Self-Help Credit Union can be helpful in discussing our history of business lending then we are glad to do so.

Sincerely,

David Beck
Director of Public Policy
Self-Help Credit Union
301 W Main St Durham NC 27701
(919) 451-1810
david.beck@self-help.org

A Tasteful Solution
Catering & Event Planning

February 1st, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My name is *Erin Lamberti* I own *A Tasteful Solution, Catering and Events.* We provide *catering and event planning* for consumers in the area. We are located in *Davidson, NC* and currently our company employs *three people.*

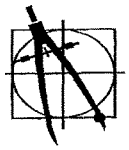
We have been members of Truliant Federal Credit Union for one year. During that time we approached them about a loan for our business and the folks there listened to our needs and provided us the credit to help us. They truly wanted to understand my business and help us succeed.

Chairman Frank, thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners like me need more options – not fewer! Please allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

Erin Lamberti, Owner
A Tasteful Solution, Catering and Events

Executive Chef & Owner: Erin Lamberti
tastefulsolution@carolina.rr.com
704-258-8294
www.tastefulsolution.com



Can-Am Custom Trucks, Inc.

January 27, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

We are a woman-owned small business located in Charlotte, North Carolina that specializes in modification and installation of equipment on heavy duty trucks as well as the manufacturing and installation of truck beds and bodies in the medium duty truck market. We are leading our industry in the "Green Initiative". Last year, we completed the "re-powering" of 90 FedEx vehicles by converting their older model units into hybrids. These units are the first in the United States and are being currently utilized in California. We currently have 12 employees but was able to add more than 40 jobs during the FedEx project.

We had several large projects, such as the one for FedEx that could only be completed with the help of a Line of Credit. We had previously utilized Bank of America for our checking and had a good banking relationship with our "Small Business Specialist". We had invited him a number of times to visit our facility to see what we do and he never came. When we attempted to open the Line of Credit, it was sent off to their "Small Business Center" located somewhere in the North and we were informed that the local branches cannot make any of those decisions. Several weeks later, we received a letter of denial, without anyone contacting us from the bank.

We have built our business by building strong relationships with our customers and had always hoped to develop the same type relationship with a bank. Charlotte Metro Credit Union opened a branch near our facility so we decided to give them a try. We immediately felt "at home" and have developed great relationships with a number of their employees. We are frequently visited by Charlotte Metro's Business Development Consultant. During one of his visits, we shared with him some of the upcoming projects and the opportunities they presented but also the strain that it would put on our cash flow. Within days, he had a Line of Credit opened for us. Without Charlotte Metro Credit Union and the Line of Credit, we would be limited on the projects that we could bid on which would greatly decrease our work load, and ultimately lead to loss of jobs. We truly value Charlotte Metro Credit Union and praise them for the impact that they have had on Small Businesses in our area.

Thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Business Act. In this economy, small business owners need more options, *not* fewer! I urge you to allow credit unions to better serve small business owners like us by passing HR 3380.

Sincerely,

Terry Potts, President Tammy McElreath, Vice-President

Fifth Wheels
Wheelbase Changes
Lubrication Systems
Retarders
Suspensions
Lift Axles
Pump Systems
PTO/Pump Installations
Fenders
Computer Systems
Bug Shields
Cab Guards
Safety Equipment
Tool Boxes
Decals- Install and Removal
..... And More

1622 Parker Drive
Charlotte, NC
28208

Phone:
704-334-0322

Fax:
704-334-0374

E-mail:
canamtrk@
carolina.rr.com

Xpress Shop & Xpress Shop # 2
1920 Back Creek Dr. Ste B
Charlotte, NC 28213
(704) 494-3874

January 28, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My name is Bankim Patel; I work for/own Xpress Shop & Xpress Shop #2. We provide convenience store / gas station for consumers in the area. We are located in Charlotte, NC and currently our company employs six employees

We have been members of Truliant Federal Credit Union for more than 6 months. During that time we approached them about a loan for our business and the folks there listened to our needs and provided us the credit to help us. They truly wanted to understand my business and help us succeed.

Chairman Frank, thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners like me need more options – not fewer! Please allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

Bankim Patel

Bankim Patel
President

FAMILY SUPPORT SERVICES, INC.

P.O. Box 18574, Charlotte, NC 28218

Tanya Jones
President/ CEO

Cynthia Carter
CFO

Board of Directors

Kermitt N. Waddell, Esq.
Chairman

Barbara Barber
Vice Chair

Dot Gibson
Treasurer

Donald Flowers
Member

Larry Melton
Member

Dexter Hill
Member

Corporate Attorney

Shirley Fulton, Esq.
(Retired Chief Superior Court Judge)

931 Wilann Drive
Charlotte, NC 28215
704-563-4586 office
704-563-4587 fax
Email: fsstj@bellsouth.net

January 27, 2010

The Honorable Barney Frank, Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My name is ***Tanya Jones.*** I work for/own ***Family Support Services Inc.*** We provide *Community based residential services to Adults with Developmental Delays and /or Mental Illness* for consumers in the area. We are located in ***Charlotte, North Carolina*** and currently our company employs ***46 people.***

We have been members of Truliant Federal Credit Union for ***2 years.*** During that time we approached them about a loan for our business. The folks there listened to our needs and provided us the credit to help us! They truly wanted to understand my business and help us succeed.

Thank you, Chairman Frank, for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners like me need more options – not fewer! Please allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

Tanya Jones

Tanya Jones
President/CEO

XPRESS TRANSPORTATION, INC.

3300 BATTLEGROUND AVE. SUITE 330
GREENSBORO, NORTH CAROLINA 27410
U.S. 800-461-0152 LOCAL 336-856-0440 FAX 336-856-0444
Web: www.Xpressli.com E-MAIL: xpressli@triad.rr.com
MEMBER: UHA

January 27, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My name is Richard Alston I work for/own Xpress Logistics, Inc. We provide Trucking and Logistics for consumers in the area. We are located in Greensboro, North Carolina and currently our company employs 30 employees.

We have been members of Truliant Federal Credit Union for ***6 years.*** During that time we approached them about a loan for our business and the folks there listened to our needs and provided us the credit to help us. They truly wanted to understand my business and help us succeed.

Chairman Frank, thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners like me need more options – not fewer! Please allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

Richard Alston
President
Xpress Transportation, Inc.

NORTH CAROLINA CREDIT UNION LEAGUE
Committed to helping credit unions succeed

Post Office Box 49379
Greensboro, NC 27419-1379

4160 Piedmont Parkway
Greensboro, NC 27410-8109

800-822-8859
336-299-6286

www.ncleague.org

January 29, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank:

Thank you for scheduling a hearing on business lending issues. As you know credit unions have been asking Congress to ease the restrictions on the business lending we do by passing HR 3380, the *Promoting Lending to America's Small Businesses Act*. This critical legislation will enable credit unions to offer needed credit to businesses throughout the country.

As President Obama underscored in his State of the Union Remarks earlier this week, job creation is a key Federal priority in 2010. As they have been doing since the beginning of the credit crisis, credit unions in NC are ready to assist small business owners in their efforts to create and preserve jobs.

Raising the credit union business lending cap to 25% of assets will provide up to an additional $10 billion in small business credit nationwide in the first year, resulting in 108,000 new jobs nationwide. This benefit to both small business owners and to unemployed people comes at absolutely no cost to taxpayers.

Credit unions did not participate in the risky loan practices that caused the financial crisis, but we have been and will continue to be part of the solution to the problems we face in NC and across the country.

On behalf of the 95 credit unions and more than three million credit union members in NC, we appreciate your commitment to the hearing. We are happy to answer any questions you and your staff may have in the coming weeks.

Sincerely,

John Radebaugh
President/CEO

AMERICA'S CREDIT UNIONS™
Where people are worth more than money.

Residential Sales and Developement • General Contractor

January 27, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank,

My name is John K. Marks; I own John Marks & Associates, Inc. My company is celebrating its 30th year in business. We provide real estate services including brokerage, developing, and new home construction for consumers in the area. We are located in Greensboro, NC and currently use mostly small business vendors with a total of over 100 employees for the construction division.

We have been members of Truliant Federal Credit Union for over 5 years. During that time we approached them about a loan for our business and the folks there listened to our needs and provided us the credit to help us. They truly wanted to understand my business and help us succeed.

Chairman Frank, thank you for holding a hearing in the House Financial Services Committee to discuss HR 3380, Promoting Lending to America's Small Businesses Act. In this economy, small business owners like me need more options – not fewer! Please allow credit unions to better serve small business owners like me by passing HR 3380.

Sincerely,

John K. Marks
President-Owner

P.O. Box 9332 Greensboro, North Carolina 27429 336/272-6224

NORTH CAROLINA CREDIT UNION LEAGUE
Committed to helping credit unions succeed

Post Office Box 49379
Greensboro, NC 27419-1579

4160 Piedmont Parkway
Greensboro, NC 27410-8109

800-822-8859
336-299-6286

www.ncleague.org

January 29, 2010

The Honorable Barney Frank
Chairman
House Financial Services Committee
Washington, DC

Dear Chairman Frank:

Thank you for scheduling a hearing on business lending issues. As you know credit unions have been asking Congress to ease the restrictions on the business lending we do by passing HR 3380, the *Promoting Lending to America's Small Businesses Act*. This critical legislation will enable credit unions to offer needed credit to businesses throughout the country.

As President Obama underscored in his State of the Union Remarks earlier this week, job creation is a key Federal priority in 2010. As they have been doing since the beginning of the credit crisis, credit unions in NC are ready to assist small business owners in their efforts to create and preserve jobs.

Raising the credit union business lending cap to 25% of assets will provide up to an additional $10 billion in small business credit nationwide in the first year, resulting in 108,000 new jobs nationwide. This benefit to both small business owners and to unemployed people comes at absolutely no cost to taxpayers.

Credit unions did not participate in the risky loan practices that caused the financial crisis, but we have been and will continue to be part of the solution to the problems we face in NC and across the country.

On behalf of the 95 credit unions and more than three million credit union members in NC, we appreciate your commitment to the hearing. We are happy to answer any questions you and your staff may have in the coming weeks.

Sincerely,

John Radebaugh
President/CEO

AMERICA'S CREDIT UNIONS™
Where people are worth more than money.

19th District of Texas Statements for the Hearing Record
Submitted by Congressman Randy Neugebauer
Joint Hearing Houser Financial Services and Small Business Committees
February 26, 2010

First Financial Bankshares is a $3.2 billion publicly traded bank holding company with 10 separately chartered banks and 50 locations. Our footprint extends from the Panhandle of Texas through North Central Texas and around Fort Worth and Dallas. Our company is committed to providing outstanding service to our customers, our communities and our nation by making every good loan we can to help our economy grow and prosper. The burden of additional regulations is slowing the process and hurting consumers. The increased regulation proposed by Congress and various federal agencies will continue to make our jobs more challenging and costly. Our hope is that Congress will stop much of the pending regulatory legislation and realize that community banks have not caused today's economic problems and are already over-regulated.

Respectfully,

F. Scott Dueser
President and CEO
First Financial Bankshares, Inc.
Abilene, Texas

Tige Boats, Inc. currently has 81 employees and has Dealers throughout the United States and overseas. Just as the auto manufacturers our boats are placed on our Dealers lot for sale, the Dealer would sell the boat and pay off the flooring company who had already paid us for the boat. Boat show response for our products are incredible and our Dealers are desperately trying to secure flooring however most of the flooring opportunities have disappeared like many other boat manufacturers and dealers.

We were hopeful that TALF (The Term Asset-Backed Securities Lending Facility) would be able to help us by helping our Dealers however I believe it has only helped one boat transaction and the program is ceasing certain areas in a few short months.

Our business used to be determined by the quality of our product & effectiveness of advertising however now our business mostly depends on flooring.

Kimberly Knight
Controller
Tige Boats, Inc.
1801 Highway 36
Abilene, Texas

A critical factor in economic growth and jobs creation is some sense of certainty and a sense that we can plan our future. With congress and the executive branch planning so many changes that add both uncertainty in decisions and certainty in higher taxes to pay for everything, small businesses have no choice but to take a wait and see approach to future growth. Unfortunately, time is not in our favor because jobs, even companies, continue to go oversees where their future is more certain and predictable.

Please, for the future of our country, allow businesses to plan their own future; allow us to have input into legislation that controls our future; and go slow enough that one law can be absorbed and evaluated before more pile on top of them.

Thanks for hearing my concerns.

Steven Leggett
An Independent Agent representing Aflac

Although this hearing may deal primarily with small business credit and commercial real estate, I want to make you aware of a major problem with residential real estate lending in rural areas such as ours. The Real Estate Settlement Procedures Act (RESPA) changes which went into effect January 1, 2010 are so complicated and burdensome that we are forced at this time to stop making residential mortgage loans. I suspect there are many other rural banks such as ours that are in the same situation. We do not make many of these types of loans because of our small population. Therefore, it is extremely difficult to have personnel that are proficient in the new requirements. We cannot have personnel dedicated to this only, or a "mortgage lending department" because of the limited demand. However, even though there may be limited demand, the availability of credit for these loans has now been more limited for those seeking to purchase a home. Also, many of these applicants are low to moderate income families which do not appeal to the large mortgage lending companies. In summary, the new RESPA rules have made it more difficult for folks in rural areas to obtain home loans.

Thank you for this opportunity.

John Krey
President
The First National Bank of Tahoka
PO Box 1030
Tahoka, TX 79373

I have been in this business now for over 30 years and I have never seen such a difficult time to make a loan or to accept a deposit. The new Regulation Z rules along with the high priced

mortgage definition will soon prohibit us in making loans to the very people that I have heard that congress wants to help. There is not a customer and I would dare say a congress man or woman who can make sense of the disclosures that we are required to give today!
If you will look at First Financial Bank Hereford, Texas, we have 47% market share in a minority community that has approximately 70% Hispanic and I am frustrated because I am being forced to tell my customers that I cannot make the loans due to documentation and compliance issues that are being crammed down by the federal government. Or to be frank, the cost of such disclosures and rules have driven the cost to a point that customers are changing their mind about the transaction. You could give me or any other common sense banker a note pad and a pencil along with a day and we could prepare documents that customers could read and make sense of as well as understand what they are signing. We have laws to insure fair lending and we have been rigorously examined in relation to fair lending. Now we are duplicating this regulation by coming up with a high priced mortgage regulation.

Those asking why we have trouble making loans should get a mirror and understand that it is not that we are not making loans, but we are being driven out of making loans by those who are asking us to make loans. Our bank as well as the banks that I know surrounding me continually looks for ways to make more loans, but due to ridiculous regulations we are being forced out and only the institutions who caused this mess are big enough to comply. Talk about speaking out of both sides of your mouth. If congress does not pay attention and change what they have done, woe be to the consumer.

Why do we need a new regulatory body such as the CFPA? If we want more oversight on those large institutions, set up a systemic regulator and apply regulation and examination to keep an eye on them. But remember the majority of banking institutions did not cause this mess, but we are sure having to pay for it! If the CFPA becomes the rulemaking authority for banks as proposed, we will send this industry into a total tailspin. I would love for you or any other congress man or woman to come to my bank and look at specific examples and also to talk to the people in Hereford. The consumer just wants a safe and sound environment where they can get their business taken care of easily. Currently they have a safe and sound environment but due to required regulation and documentation they have to struggle to get their transaction done. Please don't make it worse. Let's work on accomplishing what we all want together. Please do what you can to communicate this message for the benefit of all citizens.

Thank you for the opportunity,

Mike Mauldin
President/CEO
First Financial Bank
Hereford, Texas

One of the challenges of providing members business loans is the expense and commitment of resources to set up a member business loan program. With the cap of 12.25% imposed on credit unions it is difficult for many credit unions to justify such an investment of the members

resources. Prior to 1998 the credit union's board of directors made the decision how best to meet the members needs rather than an arbitrary limit set in Washington, DC. This arbitrary limit makes it very difficult to serve our members in this market.

Our preference would be to see the cap eliminated completely restoring to us the ability to determine how best to meet the needs of our members. If Congress were to repeal the limit on member business loans it would increase credit availability to small business without another taxpayer infusion or another new government program. Credit unions could then function as they were designed, serving the credit needs of the members as determined by their membership. If eliminating the cap cannot be done, certainly raising the cap to 25% as it is written in HR 3380 will provide additional resources for loans to small businesses and encourage additional credit unions to provide member business loans.

Thank you for allowing me to provide input on this issue. I hope Congress will move quickly to lift this cap allowing credit unions to provide needed loans to our credit union members working to start and build businesses in West Texas. I look forward to meeting with you again in Washington later this month.

Respectfully,

James Boyd
CEO
Abilene Teachers Federal Credit Union

HCSB, a state banking association

Plainview, Texas 79073-0970

806/293-3635

February 3, 2010

Hon. Randy Neugebauer

U. S. House of Representatives

Washington, DC

Via EMAIL to Legislative Assistant: Kathy Bergren

Subject: **Current Lending Environment Experiences for HFSC Hearing Record**

Dear Randy,

As a community banker in your district, this letter is in response to Kathy Bergren's invitation to respond for the Record of the House Financial Services Committee's hearings on the current lending environment, scheduled for February 5th, 2010. It is my understanding the Committee has agreed to include in the hearing record letters from banks such as HCSB giving specific anecdotal evidence of the impact of the current regulatory environment on CRE, small business and other commercial lending via my member of Congress.

Community banks WANT to lend . . . that's how we serve our communities, increase our capital for growth and is what we do. The only thing we want more than to lend is to get paid back, preferably on time and with interest. Given the present uncertainty in the economic and political climate, banks are understandably anxious regarding extensions of new credit. There is money available for "good deals", but clearly our underwriting standards have tightened.

Small business lending (including equipment, real estate and operating loans) is the primary business line of most community banks. Our bank like many others also serves agricultural production markets; therefore, we are also "Ag" lenders; however, this is still generally small business lending. These categories of lending are generally more risky than other types of lending, and don't fit into a bigger bank's "box". In other words, virtually all small business loan relationships bring unique challenges and

nuances, unlike making mortgage loans, car loans or even underwriting large commercial loan deals, all of which are done pretty much by formula.

We have been hearing for the last 18 months or so that the "next shoe to drop" will be in the commercial real estate (CRE) sector. Many of my colleagues around Texas are concerned that this may become a self-fulfilling prophecy. Community banks have significant holdings of loans fitting into this broad category. The regulators have justifiably expressed concerns for several years about concentrations of any kind within a bank, but have focused on concentrations of CRE as one of the more risky parts of the loan portfolio. The dilemma is that smaller banks focus on small business lending and most of these loans include the financing (or at least a lien) of the small business borrower's land and building - which in many cases makes the loan a CRE category credit. This is prudent banking practice, and I've found that when a borrower gets in trouble and is in a workout scenario, land and buildings generally retain much more value than inventory, accounts receivable, equipment, furniture and fixtures and other typical collateral. Because of regulatory restrictions/guidelines, many community banks simply aren't making new small business loans with real estate as the primary collateral for fear of regulatory criticism. These loans include not only small business facilities, but also single family interim construction loans and even church loans. No one quarrels with the idea that a spec office building or strip center is risky business at this juncture in this recessionary cycle (and new loans for such purposes simply aren't happening to the best of my knowledge), but some additional regulatory deference regarding concentration limits for owner occupied small business properties appears in order. We realize that owner occupied loans are not as critically looked at by the regulators; however, real estate related collateral continues to be central in small business lending.

I currently serve as Chairman-Elect of the Independent Bankers Assn. of Texas (IBAT). Currently the two topics that we (IBAT) are getting the most feedback from our member banks are the Reg. Z changes and the escrow requirement in the HPML rules (recently amended by the FED). Many of our members think that both of these issues are game changers in the owner-occupied real estate lending market. According to a survey of our members, the escrow requirements may drive many rural banks out of the mortgage lending business (48% IBAT member banks responding). If this holds true, what options will rural consumers interested in home ownership have? The big banks and mortgage companies are not serving this market. Much of the property in these types of loans is rural or non-conforming. For the most part, these loans are held in-portfolio (on the originating bank's books), and, even if a bank wanted to sell them, a large majority of them wouldn't qualify for the secondary market.

Below is an excerpted/redacted email that we received from an IBAT member bank on January 27, 2010:

"First, you don't need to respond to this e-mail. I just need to vent to someone. Here are my points of concern:

1) *Most community banks do not have existing software or manpower to handle the operational burden this activity brings (servicing including escrow.)*
2) *Many banks, including mine, will not offer this service (single-family mortgage lending) in our communities. We make homestead loans on properties with acreage, on older homes, and for*

small amounts. Our customers will not be left with any choices to get these types of homesteads financed. (Generally these types of loans cannot be sold into the secondary market.)

3) *At year end 2009, I had over $13 million in 1-4 family mortgages. Only $150k was over 30 days past due. It was a non-homestead loan.*
4) *At a time when lending is tight, why would the Federal Reserve want to further tighten credit on homestead lending?*
5) *To perpetuate economic recovery, why would the Fed not want to encourage the growth of the housing market?*
6) *Community banks have continued to lend…does the Fed not realize our role in our communities?*
7) *House loans do not go bad because of escrow payments, they go bad from poor underwriting on creditworthiness and collateral.*

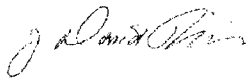
In reading the regulation, it appears the escrow agreement can be cancelled after the first year. What is the purpose of the requirement if you can cancel it after a year?

In my 35 years of working in a bank, I have never had anything which has bothered me to the extent this has. The timing could not be worse. It drives small community banks out of a market which has been important to them and their community. The major banks with mortgage companies have the volume to make it work. Most of us don't."

Randy, these are the types of problems we, as community bankers, experiencing trying to lend and provide credit to the communities we serve. I sincerely urge you (and your colleagues on the HFSC) to consider my comments as they are truly "real world."

I will be pleased to provide further information, and again I sincerely appreciate the opportunity to comment.

Thank you,



J. David Williams, Chairman

Direct: 830/89-5000 x 1501

Jd.williams@hcsb.com

HCSB, a state banking association

Plainview, Texas 79073-0970

806/293-3635

February 11, 2010

Hon. Randy Neugebauer

U. S. House of Representatives

Washington, DC

Via EMAIL to Legislative Assistant: Kathy Bergren

Subject: **Current Lending Environment Experiences for HFSC Hearing Record-Education Loans**

Dear Randy,

As a community banker in your district, this letter is in response to Kathy Bergren's invitation to respond for the Record of the House Financial Services Committee's hearings on the current lending environment, scheduled for February 11th, 2010. It is my understanding the Committee has agreed to include in the hearing record letters from banks such as HCSB giving specific anecdotal evidence of the impact of the current regulatory environment on CRE, small business and other commercial lending via my member of Congress. This is my second letter. My first was dated Feb. 02 and discussed small business, real estate and community banking's portfolio mortgage lending. This second response for submission into the record addresses new complications in EDUCATION LOANS.

The Private Education Loan industry really took off about 2005 (as best I can recall). These were non-guaranteed consumer loans to cover the gap between the cost of education and sources of funding from Federal Student Aid, scholarships, and grants; to emphasize the size of this gap, in August, 2009 was estimated to be $138 billion. They were set up to mirror the guaranteed loans with repayment beginning after completion of the education. One program (HCSB participated in) that was set up by Panhandle-Plains Student Finance Corporation had a variable rate that was the same as prime, then in repayment, the rate increased to prime + .75%. Origination fees were 3% for cosigned notes and 6% for other loans. These loans had a repayment period of 10 years. There were a number of these programs set up around the country. The number of these programs drew

the attention of the federal regulators. The Federal Reserve Bank of Dallas sent our bank a survey to complete around 2 -3 years ago, so they were beginning to delve into these loans back then. This was the first time that the regulators had asked any questions about student loans (to our knowledge).

On July 30, 2009, the Federal Reserve Board approved the final amendments to Reg. Z that revised the disclosures for private education loans. The rules were effective on 9-14-09 with mandatory compliance beginning 2-14-10. Quick highlights of the amendment are:

- At **application**, creditors must provide general information about loan rates, fees, terms, including an example of the total cost of a loan based on the maximum interest the creditor can charge
- At **approval**, creditors must give the consumer a set of transactions-specific disclosures, including information about the rate, fees and other terms of the loan,
- At **consummation**, creditors must provide updated cost disclosures similar to those provided at approval. The consumer's three-day right to cancel the transaction must be disclosed,
- The creditors must obtain a self-certification form with information about the cost of attendance at the school attending before the loan can be consummated.

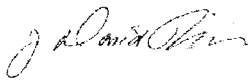
Again, postsecondary educational expenses include tuition and fees, books, supplies, **miscellaneous personal expenses,** room and board, and an allowance for any loan fee, origination fee, or insurance premium charged to a student or parent for a loan incurred to cover the cost of the student's attendance.

To some extent, I can understand documentation and disclosures for a specific private education program that a lender may develop, but **the problem is drawing an occasional consumer loan for the above mentioned expenses into the disclosure requirements of a full-blown program. This is "way too much" for regulators to require compliance with this amendment for an occasional loan.** The preliminary response from a Review Examiner at the Federal Reserve (as of 1-05-10) is that "it looks as though the occasional consumer loan for student loan expense would apply as a Private Education Loan." I have not received any additional information since that date. We find it difficult, if not impossible to operate or lend in this environment; therefore, our only alternative is to withdraw from this type of lending. Is that what Congress wants? I don't believe so. It makes it that much more difficult to serve our communities needs....why? Again, we find ourselves (community banks) withdrawing from another lending market.

Randy, these are the types of problems we, as community bankers are experiencing trying to lend and provide credit to the communities we serve. I sincerely urge you (and your colleagues on the HFSC) to consider my comments as they are truly "real world."

I will be pleased to provide further information, and again I sincerely appreciate the opportunity to comment.

Thank you,



J. David Williams, Chairman

Direct: 830/89-5000 x 1501

Jd.williams@hcsb.com

Cosden Federal Credit Union
400 E. Marcy Dr
Big Spring, TX 79720
(432)264-2600

February 3, 2010

The Honorable Randy Neugebauer
US House of Representatives
1424 Longworth HOB
Washington, DC 20515

Dear Congressman Neugebauer:

In many of our meetings in the past few years we have had a number of discussions concerning the many issues facing the people in our 19th Congressional District, the state of Texas and the country. One of the issues is the lack of credit available to many small business owners. Our Community Banks and Credit Unions are working hard to meet these credit needs with, for credit unions, Member Business Loans.

One of the great challenges of providing members business loans is the expense and commitment of resources to set up a member business loan program. With the cap of 12.25% imposed on credit unions it is difficult for many credit unions to justify such an investment of the member's resources. Prior to 1998 the credit union's board of directors made the decision how best to meet the member's needs rather than an arbitrary limit set in Washington, DC.

We would prefer to see the cap eliminated completely restoring to the credit union the ability to determine how best to meet the member's needs. By congress repealing provisions such as the limit on member business loans it would increase credit availability to small business without a taxpayer infusion or new government program. This would allow credit unions to function as they were designed, serving the credit needs of the members as determined by the membership.. If eliminating the cap cannot be done, certainly raising the cap to 25% as it is written in HR3380 will provide additional resources for loans to small businesses and encourage additional credit unions to provide member business loans.

Thank you for allowing me to provide input on this issue and I hope congress will move quickly to lift this cap allowing credit unions to provide needed loans to our credit union members working to start and build businesses in West Texas.

Respectfully,

David A. Roman, CEO
Cosden Federal Credit Union
400 E. Marcy
Big Spring, TX 79720

February 10, 2010

The Honorable Barney Frank
Senate Office Building
United States Senate
Washington, D.C.

Dear Mr. Frank,

I have been in the mortgage business since March of 1992, serving as a loan officer, branch manager, regional manager, and now for the last nine years as the owner of my own company. For nine years I worked for various companies as a mortgage banker, my duties ranged from originating loans to securing the sale of the mortgage and pricing of the loan to the investors. Currently I am a mortgage broker providing the same services at a reduced rate to the customers. Every position I have held was always involved with the borrower in assisting them with their loan. I believe I have an excellent working knowledge of the industry, particularly when it comes to the needs of the consumer.

As you are well aware, our industry has come under fire for the last several years and legislation and regulatory reform has been the hot topic in the most recent twelve months. Unfortunately, the reform and the idea of protecting the consumer, while noble ideas; have not worked as well in practice as they do in theory.

HVCC, MDIA, and most recently RESPA Reform have all had a detrimental affect on the housing industry. The intent of all these packages is to protect the consumer from lenders that are not working in the best interest of the customer, who use their influence to sway appraisers, and in general are not trustworthy professionals. Let me see if we can follow the path that this industry has taken the last fifteen years to see how we got to this position.

In June of 1995, President Clinton stated in the Fair Housing Initiatives Program (FHIP) that the goal was to reduce the financial, information and systematic barriers to homeownership. The goal for homeownership was to get to 67.5%. Every one in the industry understood that this meant lowering underwriting, qualifying and documentation standards.

FNMA rolls out Desktop Underwriter in 1995-1996. I worked for First Bankers Mortgage and we were a Beta Test Site for DU. In 1996 I was amazed at the loans the system would approve that would have never made it through a live underwriter. As the system was refined, more and more loans were being approved at higher and higher ratios. I attended a DU training in Dallas and asked the instructor why the parameters were becoming more and more lax. The response was that they were trying to comply with FHIP and needed to continue to monitor the percentage of approvals and adjust the system to get to higher approvals to meet the homeownership goals. Interestingly enough, the fourth quarter of 2006, homeownership was at 68.9%, just before it all started to unravel.

3102 South Clack Abilene, Texas 79606 325.795-1000 FAX 325.795-1020 email: chris@lovemortgage.com or linda@lovemortgage.com

Pandora's Box was now open. Companies like FNMA and Freddie Mac that had long standing solid financial histories were now racing toward the FHIP goal. Fast forward several years and Wall Street gets involved and starts buying mortgages that FNMA and Freddie would not. The sub-prime market was rolling and Wall Street, companies like Merrill Lynch and Bear Sterns were packing B&C paper and representing to their buyers that they were buying AAA rated mortgages.

During the height of the sub-prime boom, I was getting visits from two to three sub prime reps a week. I did not participate in the sub-prime lending since I felt it was not doing the customer a favor to get them into a house they could not afford, and with a loan that would increase in rate in two years. A 2% increase was appalling since their start rate was 4% over the going rate. I was told by several reps that I was uncaring and unethical for not providing my customers with their service. They stated there wasn't a loan that they couldn't do and I was discriminatory for not doing sub-prime loans. Interestingly enough, the company that was the most aggressive for the sub-prime business was Countrywide. Imagine my disgust to see the founder of Countrywide testify before Congress that the reason for Countrywide's problems was the brokered loans they received. Let me make one thing perfectly clear. Countrywide received exactly what they solicited from the brokers!

Sub-prime loans were closed under the parameters set forth by Countrywide, as underwritten by Countrywide, and as funded by Countrywide. A broker typically cannot close a loan unless the investor has underwritten it and given the loan its blessing. However, it is my opinion that due to Angelo Mozilo's testimony, and the "friends of Mozilo" loans that he made to members of Congress, the broker is being blamed for the housing collapse. I would agree that there were unethical lenders in the market. The money was easy and the rules were non-existent, or at least not enforced. Those individuals and companies are now out of the business and the mortgage professionals that are still in the business are dealing with the regulatory burdens aimed at those who are no longer in the business.

I believe your question was looking for the reasons for lack of lending. Given the government's beating of the mortgage industry looking for a scapegoat while turning a blind eye to the investment firms that were committing fraud misrepresenting the value of the investment to their buyers, this industry has recoiled to strict guidelines. Often we are processing loans and need to contact the underwriter to see what they will require over and above the guidelines that FNMA, FHA and VA have in writing. These are called "overlays". In short, my almost 18 years of experience and qualification is almost useless due to the paranoia that exists today.

Is the answer more regulation, more government involvement, more oversight? I would tell you it is not. We are here today because our government started manipulating an industry that they did not understand. I would state that prior to the FHIP, a very conservative investment for a retirement fund would have been FNMA or Freddie Mac stock. I would also suggest that FHA was so flush with cash that for the last ten years, the upfront MIP has been reduced for the borrowers. FHA just had too much money to justify charging a higher premium. An example of that is the Katrina disaster when FHA stepped in and helped homeowners by not requiring a house payment for up to a year. That bankroll came from the excess MIP money. Currently FHA is planning to increase the MIP because they are short on what FHA feels is a comfortable level of reserves.

Why is FHA short on funds? I believe FHA was asked by Congress to participate in refinancing sub-prime mortgages to keep a large number of homes from being foreclosed upon. Evidently that did not work as foreclosures still occurred, but now FHA is paying the bills on those claims. Once again, while the intention was honorable, the result of manipulating an industry that Congress does not understand has dire consequences. Now the taxpayer not only is paying for

the foreclosures, but when Mr. Consumer tries to buy a home, he has to pay a higher MIP to get FHA to insure his property to the lender against default. He is paying twice. He is also paying in increased regulations, lender compliance that is costly and the bill is passed on to the consumer.

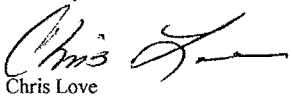
The most recent change that almost single handedly stalled the industry is RESPA Reform. Imagine an entire industry of seasoned professionals not being able to perform the most basic process of filling out a Good Faith Estimate. Currently I am not allowed per RESPA to give the applicant a Good Faith Estimate until he has a property identified. I am not allowed to do any processing of his loan until he has a contract. Now the borrower has a contract on a home that he may not be able to buy, but I am not allowed to do the necessary pre-work to ensure he is buying a house that he qualifies for, he just has to hope that he can get a loan when he signs a contract.

So where do we go from here? Do we go forward with more policy, more reform, and more regulation of the lenders? I think you are seeing the effect government intervention is having on the housing industry. OR, may I suggest we look back, to a time when foreclosures were at a manageable level, when FNMA and Freddie Mac were solid companies and underwriting standards were reasonable. Let's consider what the housing market looked like before the government's push to get homeownership to an unsustainable level., FHIP's goal of 67.5% I find it interesting that sub-prime loans had to be white hot to meet FHIP's goal.

I suggest that if the government wants to be involved that they stop treating professionals in the business like they are convicts and sentenced for crimes they did not commit. I suggest that free enterprise be allowed to work to bring us out of this financial mess. Do we need regulations, yes sir we certainly need regulations. However, regulations that are not enforced are meaningless, and writing more regulations just burdens those that currently comply. At the very least, I would like to see mortgage professionals involved in the solutions, and not EVPs of companies that have not sat in front of a customer in years. Anyone that is dealing with a customer would not have come up with the mess that is now called a Good Faith Estimate. Involve someone with a solid track record of making good loans, someone that is still in the trenches dealing with the consumer.

I would be happy to discuss this further with you if you would like ask me any questions.

Sincerely,



Chris Love
Vice President
Love & Love Mortgage Inc
325 795-1000

T & P FEDERAL CREDIT UNION

101 Main Street • P.O. Box 3819 • Big Spring, Texas 79721 • (432)263-1631
208 Lamar Street • P.O. Box 698 • Sweetwater, Texas 79556 • (325)235-8835

February 4, 2010

The Honorable Randy Neugebauer
US House of Representatives
1424 Longworth HOB
Washington, DC 20515

Dear Congressman Neugebauer:

In the years prior to 1998, a credit union's board of directors made decisions regarding the best way to meet its members needs concerning member business loans. Since that time, Congress has set an arbitrary limit of 12.25%. This has created a great challenge to credit unions who want to provide business loans to their members. It is difficult to justify the investment of our members' resources when 12.25% is the maximum portfolio we are allowed to maintain. The expense of setting up and maintaining a business loan program is just to great with these restrictions in place.

Our preference would be to have the cap eliminated, thus restoring the ability of individual credit unions to determine what is best for meeting its members needs. Credit unions were designed to serve the credit need of their membership in a cooperative manner. Elimination of the cap would allow them to make the best decision for their members in regards to business loans. In turn, the nation would see an increase in credit available to small businesses without a new government program or a taxpayer infusion. If elimination of the cap cannot be accomplished, certainly raising the cap to 25% as written in HR 3380 will provide additional resources for loans to small businesses and encourage additional credit unions to provide member business loans.

I want to take this opportunity to thank you for allowing me to provide input on this issue and I sincerely hope Congress will move quickly to lift this cap which will allow credit unions to provide needed loans to our credit union members working to start and build businesses in West Texas.

Respectfully,

Sherry Roman
President

Serving West Texas Since 1947

February 11, 2010

Chairman Barney Frank
House financial Services Committee
2128 Rayburn House Office Building
Washington, D.C. 20515

Chairwoman Nydia Velazquez
House Small Business Committee
2361 Rayburn House Office Building
Washington, D.C. 20515

Ranking Member Spencer Bachus
House Financial Services Committee
B371A Rayburn House Office Building
Washington, D.C. 20515

Ranking Member Sam Graves
House Small Business Committee
B363 Rayburn House Office Building
Washington, D.C. 20515

Dear Members of Congress,

I am writing this letter in response to a request by Congressman Ed Perlmutter, who was instrumental in connecting our restaurant group, Big Papa's BBQ, Inc. to a lender, that after eight frustrating months of attempts to obtain a loan for our third restaurant , approved a loan package which finally allowed us to open on January 11, 2010. This third restaurant has created 50 new jobs, as well as economic benefit to the contractors, architects, engineers and others involved in the $500,000 construction project which will create long-term tax revenues, income tax, etc. for the community. I am sending this letter to your committee in the hope of finding a way to make SBA lending more effective and attainable to small business in these current economic conditions.

Big Papa's BBQ opened the first store in a small retail leased space in Denver, Colorado, on June 18, 2004. At 2,000 sq. ft., it houses a 50-seat dining room with 30-40% of business projected in to-go sales and catering. We opened to rave critical and customer reviews. Things continued so well that nine months later, we negotiated a lease and opened a similar sized retail store in a new southwest suburban location in Ken Caryl on April 7, 2005. Our first quarter at the new location sales exploded and Q2 profit was $39,000 on $455,000 of sales and we felt we had arrived.

Reality set in after the honeymoon period as we need to get our hands around all of the costs associated with our business model and the somewhat seasonality of the barbecue business. Focusing in 2006 and 2007 on developing catering sales and cost management, we realized that to create consistent profitability as a company we needed to open a third store. We began to search for a true multi-store operations guy and additional manager to update store #1. In February of 2008, we accomplished this

and with some additional investor capital made some upgrades to the dining rooms and then proceeded to shave five points off our cost side.

We began in earnest to search for the proper site for the third store. Through the first three quarters of 2008, Big Papa's BBQ had $60,000 in profit, with sales up 11% year over year. As this committee knows as well as any of us, in Q4 2008, the bottom fell out of retail sales and we lost $45,000 for the quarter. This made us marginally negative for the year after interest and depreciation. Having assembled a top executive team with our core business continuing to win awards and dazzle customers, my partner Frank Alfonso and I chose to go into our own pockets to fund the company in the winter of 2009, not knowing how severe the economic downturn had become.

We knew the only way to save our existing team and grow out of this environment was to find the right third location and fund and open a third store by the summer of 2009. After a six month search of the market, an excellent free-standing building was found in February of 2009. After negotiating a $499,500 purchase price with $425,000 seller financing, for five years at 6.5% interest, we took the risk by putting $75,000 down and spending $20,000 for architectural drawings and a liquor license application. Over the next two months, we had a verbal agreement from a local bank for a construction loan and hoped to begin construction on July 1st and open September 10th. With two existing stores, a tremendous executive team, in business since June of 2004 and a property we had acquired at 50% of 2008 market value, Big Papa's BBQ felt it was reasonable to expect a construction loan approval. In June of 2009, the local lender ultimately pulled out of the deal and I personally spent the next four months with over 40 banks and financial institutions attempting to complete funding necessary to open this restaurant.

Frank Alfonso and I finally went to our local congressmen to tell our story and see what, if any, help they would be. Everyone understands and talks about the need to create jobs and have small business lending available, but no bank or financial institution was willing to take any risk at all. We met with an aide of Congressman Mike Coffman, who represented the district of the new restaurant as well as Congressman Ed Perlmutter personally, who represented the district where Frank Alfonso lived. After passionately telling our stories, Big Papa's BBQ was given a small local bank through Congressman Coffman's office, which had incentive to loan to local businesses because of deposit relationships in Arapahoe County. Unfortunately, this bank looked at our package and immediately responded that they could not loan at this time. Congressman Perlmutter had recent conversations with the top representatives from US Bank and Wells Fargo who indicated they wanted to do small business lending. Congressman Perlmutter relayed our story and told these bankers that Big Papa's BBQ was worth looking at especially considering the 50 new jobs that would come with a loan.

I personally contacted both of the banks and spoke with Congressman Permutter's contacts. Wells Fargo went straight SBA and after several meetings with their local senior banker, who loved our concept and our product, our package was sent to their manager of underwriting, but ultimately, denied. Rick Hartnick of US Bank and I worked together on our package and after several weeks of underwriting, Rick also believed in the value of our loan request and the potential for Big Papa's BBQ to successfully grow and prosper with this loan. After consulting with George Buchanan, Rick's head of credit underwriting, they concluded that an SBA loan would not be doable because of constraints within the current program. The irony was that they felt 18 months ago, SBA could do this deal. Thankfully, Big Papa's BBQ was approved for a conventional loan by Rick Hartnick and US Bank and within seven days of this approval, we had a loan and began construction in November of 2009, saving the Christmas season for countless contractors as well as the 50 new employees being hired for this store. If not for of Rick Hartnick, George Buchanan, US Bank and Congressman Ed Perlmutter's willingness to go above and beyond to help get a deal done, Big Papa's BBQ not only wouldn't have opened a third store and created

the economic impact we now have, but very likely, the existing two stores would have folded under the continuing burden on small business in this environment.

I believe with all my heart that small business, which is the foundation of job creation, should not have to scale the mountains I and Big Papa's BBQ scaled to survive the current economy. It is my hope that our story can be used to allow Congress to make SBA function as a true lender partner with banks in this current environment and be allowed to underwrite the needs of small businesses, especially when job creation is part of a loan request. I would be happy to make myself available in person or otherwise to this committee for more insight into the struggles we small businessmen face today. I appreciate the attention your committee is placing on this most critical part of a true economic recovery in this great country.

Sincerely,

Bill Cossoff

CEO, Big Papa's BBQ, Inc.
6265 E. Evans Avenue
Denver, CO 80220

Helping Credit Unions Serve Their Members

February 11, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Nydia Velázquez
Chairwoman
Small Business Committee
United States House of Representatives
Washington, DC 20515

Dear Chairman Frank and Chairwoman Velázquez:

On behalf of the Michigan Credit Union League, I want to thank you for this opportunity to submit written testimony before the joint hearing of the House Small Business Committee and House Financial Services Committee on the "Condition of Small Business and Commercial Real Estate Lending in Local Markets". The MCUL is the statewide trade association representing 96 percent of the state's credit unions with a combined membership of over 4.5 million Michigan residents.

As you are aware, President Obama recently announced a proposal to create a Small Business Lending Fund using $30 billion in unspent Troubled Asset Relief Program (TARP) money that would be available as capital investments for community banks as an incentive to increase their small business lending. We oppose this proposal for a couple of reasons. First, this proposal continues to ignore the fact that other alternatives exist as a means to get capital into the hands of small businesses. After billions of stimulus dollars were previously injected into the financial sector in an attempt to stabilize our national economy, for-profit institutions have only further tightened their available credit. Instead of looking to again utilize repaid TARP funds in a similar manner for unsuccessful capital infusions, we should focus on creating a matching fund program which helps create some risk mitigation for both banks and credit unions that will help ensure all institutions can participate equally and will incentivize them to lend more.

Second, as the proposal is entirely focused on small and community banks, it includes nothing for credit unions, ignoring the potential contribution that credit unions could make toward national economic recovery. We respectively encourage all members of Congress to please also oppose the president's proposal.

Instead, I am strongly suggesting that our industry advocate for the creation of a federal Capital Access Program (CAP) similar to the program we have here in Michigan, which is administered by the Michigan Economic Development Corporation. Our program in Michigan works to use small amounts of public resources to leverage private credit union and bank financing to provide small businesses access to capital. The Michigan CAP has been very successful by achieving a leveraging ratio of 24:1 of private funding to state resources. Attached is some more information for your review on Michigan's CAP.

Having a federal CAP would be a clear alternative to current proposals being discussed which seek to use remaining or repaid TARP funds, which has been a politically charged topic. The program would most likely either be administered by the SBA and/or create a block of grant funds that could be used by states that create their own funds with matching funds from each state. Creating a program such as the CAP on the federal level would mitigate the risk on higher risk start-up loans by utilizing government funds to help leverage credit union capital. If a federal program was created to provide matching funds, this could be

Headquarters: 101 S. Washington Square, Suite 900, Lansing, Michigan 48933 • Livonia Office: 38695 W. Seven Mile Road, Suite 200, Livonia, Michigan 48152-7997
Mailing Address: P.O. Box 8054, Plymouth, Michigan 48170-8054
Toll-Free: 1.800.262.6285 • Web Site: www.mcul.org

leveraged in a big way by financial institutions across the country to help our nation's small businesses. I encourage the House Financial Services Committee to consider this alternative proposal.

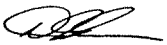
While credit unions in Michigan play an important role in providing financial services to more than 4 million consumers state-wide, you have heard us make the argument time and time again there is more we can do to help and therefore we again ask for your continued support of credit unions and our small business community by passing H.R. 3380, the *Promoting Lending for America's Small Business Act.*

As you are aware, the legislation sponsored by Representatives Kanjorski and Royce would make an additional $10 billion in capital available to small businesses without costing the taxpayer a dollar by increasing the current cap on credit union business lending from 12.25% to 25% of their assets. This effort would also help in the creation of more than 117,000 jobs nationally, and an estimated 3,800 jobs in Michigan. There is broad support from several national trade groups for this proposal, the most recent group to join being the National Association of Realtors.

Michigan credit unions continue to increase lending during this recession. Even small business member loans are up 17% over the last year. A recent article by Detroit Free Press syndicated columnist Susan Tompor on January 24 highlighted this fact that credit unions are doing more to help consumers in this economy. However, there has never been a more critical time to increase the available capital to Michigan's small businesses and we feel that increasing the member business lending cap for credit unions and considering alternative proposals which create a reserve pool to help spread lender risk will assist that effort.

Please continue to include credit unions in any future discussions of helping our small businesses with their capital needs. Feel free to contact us anytime with any questions or concerns. Thank you again for this opportunity.

Sincerely,



David Adams
President and Chief
Executive Officer

Questions for the Record

U.S. House of Representatives

Committee on Financial Services
Committee on Small Business

Hearing on "Condition of Small Business and Commercial Real Estate Lending in Local Markets"

Assistant Secretary for Office of Financial Stability Herbert M. Allison

February, 26 2010

Representative Bill Posey (R-FL)

For all members of Panel 2:

1) **For the record, are you aware of any policy—either official or unofficial—from any federal regulator to reduce the number of small banks in the United States?**

   No, Treasury is not aware of any policy—official or unofficial—from any federal regulator to reduce the number of small banks in the United States. Treasury supports the diversity and strength of our financial system and has reflected that support by proposing regulatory reforms that will level the playing field for the thousands of community banks across the country.

2) **Why is regulatory forbearance, which could enable a troubled institution to work out credit issues over time, generally discouraged?**

   Treasury does not have supervisory authority with regard to depository institutions. As a general matter, Treasury believes that depository institutions should accurately reflect their assets on their books and have sufficient capital to absorb losses. Federal bank regulators have authority in appropriate situations to work with depository institutions in managing credit issues, consistent with minimizing losses protecting safety and soundness, and protecting the Federal Deposit Insurance Fund.

3) **Under what conditions, if any, would you allow for regulatory forbearance?**

   Please see the answer to question 2.

4) **What flexibility do regulators have to help troubled institutions besides closing them?**

   Please see the answer to question 2.

Questions Submitted to John E. Bowman,
Acting Director, Office of Thrift Supervision
from the hearing entitled: Condition of Small Business and Commercial Real Estate Lending in Local Markets
February 26, 2010

1. For the record, are you aware of any policy – either official or unofficial – from any federal financial regulator to reduce the number of small banks in the United States? If yes, which federal financial regulator?

   I am not aware of any policy to reduce the number of small banks in the United States.

2. Why is regulatory forbearance, which could enable a troubled institution to work out credit issues over time, generally discouraged?

   For a number of reasons, regulators engaged in forbearance during the banking crisis of the late 1980s. Subsequent studies indicated that the use of forbearance during that crisis generally increased resolution costs of banks that eventually failed. As a result, Congress enacted legislation in 1991, the Federal Deposit Insurance Corporation Improvement Act (FDICIA), that specified actions that regulators must take based on the capital condition of the bank. The Prompt Correction Act (PCA) rules classify banks based on their levels of capitalization and they mandate supervisory action of increasing severity as the banks' capital ratios fall. The supervisory actions put restrictions and requirements on banks that tend to reinforce market discipline. This system of capital trigger levels and associated supervisory actions provides a deterrent against regulatory forbearance, and limits the degree of supervisory discretion so as to reduce the cost to the insurance fund of bank failures.

3. Under what conditions, if any, would you allow for regulatory forbearance?

   Prompt corrective actions are required by law and, based on the bank's capital position, do not permit supervisory forbearance. However, OTS, through its issuance of guidance, off-site surveillance, and its onsite examination process, will alert institutions to areas of increasing risk, such as commercial real estate lending, or to specific activities of the institution that require management's immediate attention. Unless the specific actions of the institution are deemed to be unsafe and unsound, the institution is typically given a reasonable, but brief, amount of time to reduce its risk, raise additional capital, or take other actions to correct any weaknesses or deficiencies noted.

4. What flexibility do regulators have to help troubled institutions besides closing them?

   Once an institution is deemed to have dropped to PCA category "undercapitalized", "significantly undercapitalized", or "critically undercapitalized", it is required to file with its regulator a written capital restoration plan within 45 days. Regulators then have sixty days in which to approve such a plan. A capital restoration plan may include asset sales, additional infusion of private equity, a potential merger with a stronger institution, among others actions. Within this framework, OTS works diligently with troubled institutions to find acceptable alternatives to closure.

5. What policies are in place to ensure that examiners take into account short-term and long-term impacts on communities, businesses, and households?
   a. How do you ensure that these policies are effectively implemented?
   b. How can these policies be improved?

   OTS recognizes the critical role thrifts play in providing credit to small businesses and other credit-worthy borrowers in their communities and encourages them to continue to provide credit within the bounds of safety and soundness.

   OTS and other federal banking agencies issued guidance twice in recent months to prevent any possible overreaction that would make credit less available at a time when borrowers most need loans for small businesses and commercial real estate (CRE). To send a clear message to financial institutions and examiners, the agencies issued the "Policy Statement on Prudent Commercial Real Estate Loan Workouts" on October 29, 2009, and the "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers" on February 5, 2010.

   In particular, the "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers" underscores the responsibility of a regulated institution to understand the long-term viability of the borrower's business and to focus on the strength of a borrower's business plan, including its plan for the use and repayment of borrowed funds.

   OTS ensures nationwide consistency in its guidance to the industry, taking steps to make certain that its regional offices do not discourage OTS-regulated institutions from lending by imposing on them stricter underwriting and examination practices than those prescribed by OTS policies.

   OTS ensures that its regional offices implement national guidance consistently through several mechanisms. For example, the agency holds Regional Manager Group meetings where the Regional Directors discuss supervisory and examination issues with senior management from Washington, D.C. The agency also holds bi-weekly conference calls with its Regional Deputy Directors to discuss problem bank cases, emerging issues, and to reinforce and discuss new

guidance. We hold monthly conference calls for our entire examination staff to discuss current policies, including recent calls on commercial real estate workout programs, troubled debt restructuring, and appropriate loans classification procedures.

How can this process be improved? OTS regulated institutions make diligent efforts to serve the needs of these businesses and have been successful to a certain degree. However, statutory caps on thrifts' small business lending make it difficult for them to fulfill these needs.

The limitation on thrifts adversely affects even lenders that have not reached the statutory limits and that want to serve the small business segment of their communities. OTS-regulated institutions are wary of facing sanctions for violating regulations by inadvertently exceeding the statutory limits on small business lending. Also, due to the statutory limits, many thrifts are unable to achieve efficiencies of scale that would make small business lending profitable.

The Home Owner's Loan Act currently caps the aggregate amount of credit that thrifts can lend for commercial purposes at 20 percent of total assets, provided that amounts in excess 10 percent of total assets may be used only for small business loans.

A legislative proposal that OTS supports would remove the cap entirely on small business lending and increase the cap on other commercial lending from 10 percent to 20 percent. This change would be completely consistent with the focus of the thrift charter on consumer and community lending. The existing ceiling on small business lending limits the pool of credit available to small businesses and limits thrifts' ability to provide a line of credit that would help them serve the important needs of their communities. The caps also limit the alternatives for thrifts wishing to diversify their lending operations and credit risk.

Questions submitted by Representative Posey

1. For the record, are you aware of any policy - either official or unofficial - from any federal financial regulator to reduce the number of small banks in the United States? If yes, which federal financial regulator?

We are not aware of any policy – official or unofficial – from any federal financial regulator to reduce the number of small banks in the United States. We continue to charter new national banks, the vast majority of which are community banks.

2. Why is regulatory forbearance, which could enable a troubled institution to work out credit issues over time, generally discouraged?

As noted in my written testimony, the OCC actively encourages national banks to work constructively with troubled borrowers. We also recognize and expect that a bank's level of problem assets, including classified loans, will increase during periods of economic stress, and that working through these problem credits will take time. We do not criticize a national bank that is engaged in prudent workout arrangements with borrowers, provided that bank management is being realistic in its assessments, has reasonable workout plans, and is maintaining adequate loan loss reserves and capital levels.

We do, however, object to calls for "regulatory forbearance" in applying appropriate regulatory and accounting standards for the recognition of well-defined weaknesses and losses within a bank's loan portfolio and the maintenance of prudent capital levels. We believe regulatory forbearance increases taxpayer costs, adversely affects the economy, and creates market distortions that adversely affect healthy banks.

The savings and loan crisis of the 1980's demonstrated that allowing financial institutions to defer loss recognition on the hope that borrowers' conditions may improve with time, or that an institution can earn its way out of its problems, not only masks the condition of those institutions, but results in much larger ultimate losses to the financial system, and to taxpayers. This conclusion is supported by the Congressional Budget Office (CBO), which issued a 1991 staff memorandum that estimated forbearance policies increased the ultimate cost of resolving the thrift crisis by about $66 billion (in 1990 dollars) and that regulatory forbearance "permitted the thrift industry to deteriorate."[1] Other studies estimate that the present value of regulatory forbearance during the S&L crisis was twice the cost of taking more immediate action.[2,3]

Regulatory forbearance also has adverse economic consequences, decreasing GNP growth as the economy recovers. A CBO study completed in 1992 estimated that the

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[1] *See*: CBO staff memorandum – *The Cost of Forbearance During the Thrift Crisis*, 1991, at: http://www.cbo.gov/ftpdocs/99xx/doc9927/1991_06_thecostofforbearance.pdf.

[2] Ramon P. DeGennaro, Larry H. Lang, and James B. Thomson, Federal Reserve Bank of Cleveland, "Troubled Savings and Loan Institutions: Voluntary Restructuring under Insolvency," Working Paper 9112, September 1991.

[3] Ramon P. DeGennaro and James B. Thomson, "Capital Forbearance and Thrifts: An Ex Post Examination of Regulatory Gambling," *Bank Structure and Competition*, chap. 9 Bank Closure, pp. 406-420.

misallocation of resources resulting from the S&L crisis resulted in lower GNP during the years following the crisis.[4] Another study estimated that S&L forbearance in the 1980's increased T-Bill rates and Treasury's borrowing costs by $100B per year.[5] Additionally, maintaining non- or underperforming assets on banks' balance sheets for an extended period of time represents a significant drag on banks' capital, funding, and earnings, thus lessening the amount of productive new assets (e.g., loans) that banks can fund. The Japanese experience in the 1990's illustrates the dampening effects such assets can have on a country's economic growth and recovery.

Regulatory forbearance also creates moral hazard and market-place distortions that penalize well-run institutions. During the S&L crisis, troubled thrifts would bid down lending rates and bid up deposit rates on the hope their condition might improve with time or that they might earn their way out of problems.[6] The unintended consequences of these aggressive practices were to create distortions in local markets, affecting the performance of healthy banks.[7] Similar dislocations are occurring in economically stressed areas of the country, where well-capitalized banks are paying more for deposits than counterparts in less stressed markets.[8]

3. Under what conditions, if any, would you allow for regulatory forbearance?

Regulatory forbearance typically means forgoing the application of long-established regulatory and accounting standards for loss recognition and required capital minimums across a broad spectrum of banks. Because such policies generally just delay the recognition of problems, I believe they are counterproductive to restoring the overall health and vitality of the financial system. There may be limited and isolated cases where allowing an individual institution additional time to obtain capital or restructure its balance sheet may be appropriate, given the particular facts and circumstances at hand. In practice, however, such decisions are very fact dependent and must be based on a realistic assessment of the bank's prospects and ability for successful rehabilitation. Similarly, there may be exigent and limited instances where temporary relief on a particular regulatory rule or guidance may be warranted, such as immediately following the events of September 11, 2001, and Hurricane Katrina when some banks were

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[4] The CBO estimated the economy underperformed by $200B in GNP through 1992, with the total potentially reaching $500B by 2000. Congressional Budget Office, *The Economic Effects of the Savings and Loan Crisis*, Washington, D.C.: CBO, January 1992.

[5] John B. Shoven, Scott B. Smart, and Joel Waldfogel, "Real Interest Rates and the Savings and Loan Crisis: The Moral Hazard Premium," *Journal of Economic Perspectives*, vol. 6, no. 1 (Winter 1992), pp. 155-67.

[6] Edward J. Kane, The S&L Insurance Mess: How Did it Happen?, Washington D.C., The Urban Institute Press, 1989, pp. 4-5.

[7] For example, healthy Texas thrifts in the late 80s and early 90s paid 50 or more basis points for deposits than thrifts in other areas of country due to the aggressive practices of troubled Texas thrifts. Lawrence J. White, The S&L Debacle: Public Policy Lessons for Bank Thrift Regulation, New York, Oxford University Press, 1991, chapter 8.

[8] For example, in GA, where about half of all banks and thrifts are stressed, healthy banks are paying 45 basis points more for deposits than their counterparts in other parts of the country. Paul Wexler, "Deposit Pricing at Troubled Banks and Thrifts and its Impact on Healthy Institutions: Lessons from the 1980s & 1990s Crisis Years," OCC Global Banking & Financial Analysis working paper, January 14, 2010.

concerned about sudden increases in draw downs in lending facilities. In these cases, we urge banks to contact us so that we can work with them in addressing these problems.[9] More recently, in October 2008, the OCC and other federal banking agencies allowed banking organizations that suffered losses on certain holdings of Fannie Mae and Freddie Mac preferred stock to recognize the effect of the tax relief provided in Section 301 of the Emergency Economic Stabilization Act of 2008 in their third-quarter 2008 regulatory capital calculations even though those tax effects could not be recognized in financial statements prepared under generally accepted accounting principles until the fourth quarter of 2008.[10]

4. What flexibility do regulators have to help troubled institutions besides closing them?

We have and we use a variety of tools to help troubled institutions. Our primary tool is early intervention – identifying and obtaining corrective action at the earliest possible stage before problems become rampant or so severe that they threaten a bank's viability. Often we can achieve such action through our ongoing supervision, examination reports, and various informal enforcement actions. In other situations, or when problems are more severe, we will use formal enforcement actions to direct actions that we believe are necessary to address the bank's problems. As a bank's condition worsens, such that it is depleting its capital and its ongoing viability is in question, we will work with bank management to obtain resolution through a possible sale or merger. When we have determined that a problem bank has exhausted all reasonable options, including the prospect for raising capital; is facing insurmountable liquidity problems; or for other reasons is no longer viable, we will notify the FDIC's Division of Resolution and Receivership (DRR) so that it may begin preparing for receivership. The OCC's goal is to provide the DRR with early access to the bank and the maximum amount of time possible to prepare for the closing in order to minimize disruption to the depositors and customers of the bank and the FDIC's cost to resolve the bank.

The Federal Deposit Insurance Corporation Improvement Act of 1991 and the Prompt Corrective Action (PCA) regulatory regime it sets forth are essential elements to the OCC's framework for working with troubled banks. PCA establishes a capital-based framework that requires the OCC and other federal bank agencies to place increasingly stringent restrictions on banks as their regulatory capital levels decline, and generally to place a bank in receivership or conservatorship within 90 days of notifying a bank that it is critically undercapitalized.[11]

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[9] *See:* For example, see OCC Bulletin 2001-44 on joint interagency statement on temporary balance sheet growth in aftermath of 9-11 at: http://www.occ.gov/ftp/bulletin/2001-44.txt and guidance issued by the federal banking agencies in response to Hurricane Katrina at: http://www.ffiec.gov/press/pr100605_hurricane.htm.

[10] *See:* OCC Bulletin 2008-31 at: http://www.occ.gov/ftp/bulletin/2008-31.html.

[11] *See: An Examiner's Guide to Problem Bank Identification, Rehabilitation, and Resolution* for a more thorough discussion of the OCC's approach towards troubled institutions. A copy may be found at: http://www.occ.gov/prbbnkgd.pdf.

5. What policies are in place to ensure that examiners take into account short-term and long-term impacts on communities, businesses and households? How do you ensure that these policies are effectively implemented? How can these policies be improved?

The OCC recognizes the vital role that national banks and their lending activities play in the health of our communities and citizens. This is one reason why we have emphasized to banks that we expect and encourage them to work constructively with troubled borrowers.

Under the Community Reinvestment Act, for example, national banks are expected and encouraged to meet the credit needs of their communities. We assess and evaluate banks' performance under the CRA through our CRA examinations and ratings. The OCC and other federal banking agencies also publish frequently asked questions (FAQs) about the CRA to address emerging issues and concerns. In January 2009, the agencies published updated FAQs that, among other issues, state that CRA consideration will be given to financial institutions that participate in foreclosure prevention programs that have the objective of providing affordable, sustainable, long-term loan restructurings or modifications for homeowners who are facing foreclosure on their primary residences.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ELIZABETH A. DUKE
MEMBER OF THE BOARD

April 16, 2010

The Honorable Bill Posey
House of Representatives
Washington, D.C. 20515

Dear Congressman Posey:

I am providing written responses to the questions you asked at the February 26, 2010, joint hearing before the Committees on Financial Services and on Small Business. Specifically, you asked what policies the agencies have in place to make sure that examiners take into account the short-term and long-term impact of locally-oriented institutions on the communities, the businesses, and the households that they serve, as well as on taxpayers. In addition, you asked how the agencies make sure that these policies are being implemented effectively.

As I mentioned in my written statement, the most important step policymakers can take to support community banks and improve credit availability to small businesses, as well as other businesses and households, is to achieve a sustainable economic recovery. Over the course of the past two years, the Federal Reserve has taken aggressive action in response to the financial crisis to help improve financial market conditions and promote the flow of credit to households and businesses. We have acted on multiple fronts by instituting accommodative monetary policy, expanding existing liquidity programs for depository institutions, and establishing new liquidity facilities to support market functioning. The Term Asset-Backed Securities Loan Facility, for example, has helped restart securitization markets, which are an important source of credit to small businesses and consumers.

Throughout this time, the Federal Reserve has placed particular emphasis on ensuring that its supervision and examination policies do not inadvertently impede sound lending to businesses, both large and small, and we will continue to do so. Small businesses are vital to a sustainable economic recovery and that is why, on February 5, the banking agencies issued guidance to examiners that institutions should strive to meet the credit needs of creditworthy small business borrowers. This guidance is the latest in a series of actions taken by the Federal Reserve and the other banking agencies to support sound bank lending and the credit intermediation process. For example, in October 2009, the Federal Reserve and the other banking agencies issued a policy statement regarding loan restructurings and workouts in connection with commercial real estate (CRE) lending, an area of particular relevance to community banks and small businesses because owner-occupied CRE often serves as collateral for small business loans.

Importantly, we have complemented these issuances with training programs for examiners and outreach to the banking industry to underscore the importance of sound lending practices. In January, Federal Reserve staff instituted a System-wide examiner training initiative that is expected to reach approximately 1,000 Federal Reserve and state examiners across the United States by the end of March 2010. Additionally, an interagency training program has been developed specifically for CRE examiners involved in the shared national credit program, which includes the largest commercial real estate loans in the nation. The focus of this training, which is scheduled to begin in late March 2010, is to ensure that shared national credit examiners properly follow the interagency policy statement when evaluating individual loans at banks.

In addition to our outreach to banks and bank examiners, the Federal Reserve has conducted several forums in recent months to better understand the difficulties faced by small businesses. In mid-November, the Board and the Federal Reserve Bank of San Francisco, in conjunction with the Small Business Administration (SBA), held small business forums in San Francisco and Los Angeles. We are now conducting a series of meetings on small business access to credit hosted by the Reserve Banks. The meetings will be followed by a capstone event at the Board of Governors. These forums examine the evolving difficulties faced by small businesses and will inform additional efforts to help this important sector.

Because of the importance of small business lending, early this year the Federal Reserve Board formed a working group comprised of staff from the Divisions of Research and Statistics and Banking Supervision and Regulation to develop additional metrics to monitor credit availability trends in the small business sector. Board staff recently has completed an examiner survey of banks' workout practices, which will serve as a baseline for collecting information to assess the effectiveness of supervisory guidance going forward. We also are asking examiners to capture, where possible, information on troubled debt restructurings and other types of loan workouts and dispositions as part of the ongoing examination process. In addition, we are exploring the feasibility of more formal statistical approaches for measuring and evaluating the effectiveness of the November 2009 interagency CRE workout and restructuring policy statement.

Taken together, these efforts should help address two of the causes of reduced small business lending—weak economic conditions and potential concerns by banks that they will be subject to criticism from examiners if they engage in prudent lending to small businesses. However, as I indicated in my testimony, there are other factors that also have contributed to the decline in lending to small businesses. Accordingly, the response by policymakers also should be broad-based, particularly given the importance of small businesses to the overall economy.

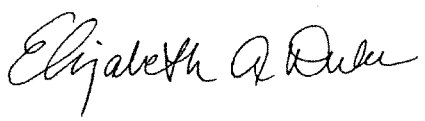
For example, some banks may be hesitant to make new small business loans due to concerns about the creditworthiness of borrowers. Loan guarantees provided by the SBA can help address these concerns by providing lenders protection against possible

credit losses on new small business loans. To help promote SBA-guaranteed lending, Congress in the American Reinvestment and Recovery Act ("Recovery Act") raised the percentage of an eligible small business loan that could be guaranteed by the SBA under its flagship 7(a) loan program from 75 percent to 90 percent, and reduced the fees payable by borrowers under the SBA's 7(a) and 504 loan programs. Congress has acted twice to extend these provisions, most recently through March 28, 2010. These actions leverage both the SBA's experience with providing guarantees for loans to small businesses and the existing lending relationships, credit underwriting processes, and broad footprint of SBA-approved banks and other lending institutions.

While some banks may be reticent to provide new loans due to concerns about potential credit losses, others may be unable or unwilling to increase their small business lending due to their own weakened capital positions. To help address this factor, the Administration has proposed legislation that would establish a Small Business Lending Fund ("SBLF") through the transfer of $30 billion from the Troubled Asset Relief Program ("TARP"). The SBLF would provide low-cost capital to banks with less than $10 billion in assets. To encourage participating banks to increase their lending to small businesses, when consistent with safety and soundness, the dividend rate on the capital would be reduced if the bank increased its small business lending. Broad participation by eligible banking organizations in the proposed SBLF is key to maximizing its potential effects on small business lending. For this reason, the Administration has proposed establishing the SBLF outside of TARP and would allow eligible banking organizations that have received capital under the Treasury's Capital Purchase Program to refinance that capital through the SBLF.

I hope this information is helpful.

Sincerely,



Response to questions from the Honorable Bill Posey
by Martin J. Gruenberg, Vice Chairman,
Federal Deposit Insurance Corporation

Q1. For the record, are you aware of any policy--either official or unofficial-from any federal financial regulator to reduce the number of small banks in the United States? If yes, which federal financial regulator?

A1. There is no federal regulatory policy initiative or other action the FDIC is aware of to reduce the number of small banks in the United States. As regulator for nearly 5,000 community banks, most of which have total assets of less than $1 billion, the FDIC understands smaller institutions and acknowledges their critical role in providing credit and depository services to towns, cities, and farms across the country. The Corporation is a strong advocate of community banking, and we believe those institutions' locally focused lending can help facilitate an economic recovery on Main Street.

Q2. Why is regulatory forbearance, which could enable a troubled institution to work out credit issues over time, generally discouraged?

A2. The federal banking agencies recognize the gravity of the weak economy and real estate market as we contend with the spillover effects on the financial sector. The agencies have historically taken a variety of steps to encourage bank lending, reduce regulatory burden, and streamline the supervisory process in response to banking crises. However, regulatory forbearance has not been viewed as an optimal course of action because it may bring about potentially adverse outcomes for the financial institution and the Deposit Insurance Fund (DIF). From the deposit insurance and supervisory perspective, the FDIC has strongly endorsed accurate and transparent financial reporting. We require institutions to conform their financial reporting processes to generally accepted accounting principles, which generally require that losses be recognized on non-bankable assets in a timely manner. Regulatory forbearance, delays in the recognition of losses, or reticence in acknowledging or remediating any aspect of poor operating performance may unnecessarily prolong an institution's troubles and heighten the risk of loss to the DIF.

Q3. Under what conditions, if any, would you allow for regulatory forbearance?

A3. The Corporation would have to consider regulatory forbearance proposals at the time they are presented based on market conditions and aspects of the proposal. However, the FDIC would not be comfortable with a forbearance program that would delay the recognition of losses on non-bankable assets for an extended period of time or subject the DIF to an increased risk of loss.

Q4. What flexibility do regulators have to help troubled institutions besides closing them?

A4. As deposit insurer and banking supervisor, the Corporation clearly understands the very high cost of bank closings, both in terms of losses to the DIF and the adverse impact on local communities. We take numerous steps in the supervision process to help banks correct any deficiencies so that viability is not compromised.

In most cases, institutions that become troubled are notified of their deteriorating condition well in advance of a failure situation. Troubled institutions are typically encouraged to adopt a corrective program designed by the regulators to help return the institution to a safe-and-sound condition. There are certain flexibilities in our approach to corrective programs, especially during difficult economic times such as the present. We provide banks with time to revise strategic plans, augment capital positions, address credit quality issues, and fill any gaps in management or staffing. Although we require banks to implement these and other corrective measures over a certain period of time, we do offer flexibility as banks address challenging, time-consuming initiatives, such as raising external capital.

The FDIC was charged by Congress to resolve failed institutions under Prompt Corrective Action guidelines at the least cost to the DIF. We take this responsibility seriously, but are sensitive to the needs of troubled institutions and work with them constructively as they strive to remain viable.

Q5. What policies are in place to ensure that examiners take into account short-term and long-term impacts on communities, businesses and households? a. How do you ensure that these policies are effectively implemented? b. How can these policies be improved?

A5. As federal supervisor for most of the nation's community banks, the FDIC understands that financial institutions are the lifeblood of our economy, providing essential loan and deposit services on Main Street for business and consumers. The FDIC's bank examiners work out of duty stations in 85 communities across the country. They are knowledgeable of local conditions and very experienced in their profession and the FDIC's approach to bank supervision. Many have seen more than one previous economic down cycle and recognize the critical role that banks play in local communities. We believe our examiners do their jobs with a keen understanding of the economic environment and real estate conditions in which banks are operating. Moreover, results of examiners' work are subject to secondary review to ensure accuracy and consistency in the Corporation's supervisory process.

We do not believe bank examinations directly affect credit availability or depository services at the local level; however, we recognize that the supervisory process mirrors the underlying economic, financial, and managerial challenges many banks are facing. Even at the most troubled institutions, our primary goal is to help the institution return to

financial health and sound operation. We have taken recent steps to enhance our supervision process through examiner training and issuance of guidance to the industry on ensuring that the needs of creditworthy borrowers are met.

February 26, 2010

The Honorable Barney Frank
Chair
House Financial Services Committee
2129 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Spencer Bachus
Ranking Member
House Financial Services Committee
B371A Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Nydia Velázquez
Chair
House Small Business Committee
2361 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Sam Graves
Ranking Member
House Small Business Committee
B-363 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank, Chairwoman Velázquez, Ranking Member Bachus, and Ranking Member Graves:

On behalf of Associated Builders and Contractors (ABC), a national association with 77 chapters representing 25,000 merit shop construction and construction–related firms with 2 million employees, we appreciate the opportunity to provide our position regarding lending programs for small businesses in response to the joint hearing entitled, "Small Business Lending Programs."

Access to capital is a major concern within the construction industry, which has already been severely impacted by the economic downturn. Industry-wide, 1.9 million jobs have been lost since December 2007, and we continue to experience massive job losses, including 75,000 in January 2010 alone. With a current unemployment rate of nearly 25 percent, the construction industry simply cannot continue to endure limited access to capital in this economy.

The near freeze on lending for private sector construction projects must be addressed immediately. The long delay in lending or outright refusal by financial institutions to fund private sector projects has had an extremely detrimental impact on the construction industry. Many ABC members have viable, low risk projects/contracts that simply need funding in order for work to commence. Additionally, many ABC members also rely on community banks for capital. It is important during this time of economic recovery that small businesses continue to have access to much-needed funds.

Sincerely,

Brewster B. Bevis
Senior Director, Legislative Affairs

4250 North Fairfax Drive, 9th Floor • Arlington, VA 22203 • 703.812.2000 • www.abc.org

Testimony of John R. Elmore
Executive Vice President
U. S. Bank
Submitted for the Joint Hearing of the Committees on Small Business and Financial Services
United States House of Representatives
2128 Rayburn House Office Building

February 26, 2010

9:00 am

Chairman and members of this Committee, I thank you for the opportunity to address you this morning.

My name is John Elmore and I am an Executive Vice President with U.S. Bank with responsibility for the executive management of the Community Banking Division, based in Lawrence, Kansas.

First, please allow me to provide my personal background. I was educated at Kansas State University (B.S. in Accounting). I have been active in the banking industry since 1978. During this period covering over 30 years, I have performed many diverse functions in the industry including serving as a bank examiner, auditor, credit analyst, senior lender and regional president. Since 1999, I have served as the head of Community Banking for U.S. Bank.

Of greater importance in this testimony is the experience and background of U.S. Bank. In that regard I would like to provide some information on our institution:

- U.S. Bank is the fifth largest commercial bank in the America with total assets in excess of $280 billion and deposits over $170 billion.
- We are headquartered in Minneapolis, Minneapolis and operate over 3,000 branches in 24 contiguous states from Ohio to California.
- We serve over 15 million customers across the United States.
- Most observers would agree that we are one of the highest performing and strongest banks in the country.
    - U.S. Bank scored among the highest on the government "stress test"
    - Global Finance listed us among the World's Safest Banks
    - Euromoney magazine called us the "Best Bank in the United States"
    - Ponemon Institute named us the #1 most trusted bank for the 4th straight year.

The Community Banking Group is a significant part of U.S. Bank - representing one of the largest divisions within the company. We run our community banking model in 780 different communities in our 24 state branch footprint. Our community banking model delivers all the products

and services of a large bank holding company through local management. For Community Banking to be successful, the local communities where we do business must be successful.

Under this model – U.S. Bank provides financing to all types of businesses and individuals including but not limited to - agricultural customers, builders, developers, manufacturers, service industries and Private Banking customers. We are also active in SBA lending as well as participating in USDA and FSA programs.

At U.S. Bank, we are in the business of lending money and assisting businesses in processing their receipts. Our Community Banking model requires local bank management to be active participants in their markets, and as such we participate extensively, both in time and direct financial investment, in the economic development activities across our footprint. Again, we only prosper if our hometowns succeed.

In my testimony this morning, I am providing perspective on the results in my business unit, Community Banking at U.S. Bank. However, it should be understood that the trends across the bank are very similar in all respects.

In the last 14 months, we have experienced a weakening in demand for commercial and Commercial Real Estate loans. In Community Banking at U.S. Bank, our loan outstandings to agricultural and commercial customers for non-real estate related activities have dropped from $5.4 billion to $4.9 billion. During this period, our line of credit usage - i.e. lines of credit where all a borrower has to do is ask for an advance - has decreased from $2.35 billion to $1.9 billion. The percentage of line usage in January is at 31%, or near an all time low.

It is important to understand that these declines in loans outstanding are solely the result of diminished demand for loans, not from diminished willingness to lend by U.S. Bank.

At the same time, charge offs are running at near record levels, with certain industry sectors such as builders and developers, companies that supply the building trade, and companies impacted by the slowdown in auto sales and manufacturing, are experiencing much higher levels of losses than many of the other industries.

Geographic differences are certainly evident as well. Among the 24 states where we have branches, the West Coast and resort communities in the

Rocky Mountains have been more stressed than the lower growth markets of the traditional Midwest.

During this period, businesses and consumers have been de-leveraging as quickly as possible, and many are now sitting on large sums of liquidity as is evidenced by the fact that our business deposits are up over 22% year over year. When we discuss their needs over the next year or so, most business owners express an abundance of caution and the likelihood they will not be increasing their borrowings. When pressed, most express the concern of not knowing what their cost of doing business will be in 2010 and beyond, due to the heightened uncertainty in the economic, legislative and regulatory landscape.

At U.S. Bank - we are now and will continue to seek proactive solutions to help our customers and prospects be successful. We have an active calling program that we monitor across all our markets.

In 2009, relationship managers made over 89,000 calls on customers and prospects, while branch managers made over 150,000 calls. As an example, during a week in December, in Community Banking we called on over 24,000 businesses, of which 7,000 were prospects, to discuss their outlook in 2010 and what we might be able to do to assist them in their efforts. These types of efforts are ongoing.

Following, please find some examples of recent successes we have had in servicing our customers needs and assisting our communities:

- At U.S Bank, we are actively using tax credits to provide financing on certain projects to rehabilitate properties and expand employment. In Dubuque Iowa, we were able to help provide this type of financing to rehabilitate a building in a distressed part of the community, which helped bring over 1,000 new jobs to the market.

- In Mankato Minnesota, we helped provide financing to locate a new manufacturing business - converting plastic waste from agricultural operations into clean plastic pellets. This company will initially employ 42 people.

- In Colorado, we worked closely with the SBA to provide financing for a barbeque restaurant to open their third location, resulting in 50 news jobs and economic benefit to the surrounding businesses including contractors, engineers, and architects.

- In Central Minnesota, a company was closing down their well drilling operation. U.S. Bank worked with a group to purchase the assets of the division, which has saved 25 jobs for the area.

- In Waterloo Iowa we worked with HUD officials to help a local cold storage group expand and create 45 new jobs.

- When the auction bond market ceased to function, we provided financing for many of our local hospitals and non profits to help them through their crisis- saving many jobs and operations.

Our business customer segment (those customers who are borrowing less than $100,000) grew at an annualized 11.5% last year – representing 12,900 loan customers.

In 2009, we also issued 15,800 new business credit cards in Community Banking.

In Community Banking we presently have over 60,000 borrowing customers and for the month of January we approved approximately 1,500 customers for new extensions of credit. This occurred during a typically slow month.

Our lending efforts to small businesses in major metropolitan markets have been growing at a 12 percent annualized rate.

U.S. Bank is the second largest SBA lender in the country both in dollar volume and units extended.

In the small business market segment, there is evidence of very weak loan demand, lower utilization of credit lines, and higher loan losses. Increasing loan demand will occur when concerns about the future become less of an issue. Business thrives in times of stability and anything our elected leaders can do to remove doubts will help this economy move forward.

At U.S. Bank, we are very supportive of recommendations offered by the Financial Services Roundtable that would enhance the programs operated by the Small Business Administration (SBA). The members of the Financial Services Roundtable believe that several of these recommendations listed below would immediately strengthen existing SBA programs and encourage more people to start small businesses, increase the flow of capital to small

businesses, and reduce the administrative burden facing small businesses by providing the necessary flexibility to respond to current market conditions.

- Support funding and extending the SBA fee waiver and the 90% loan guarantee program thru December 31, 2010
- Decrease capital requirements for loans guaranteed by the SBA
- Allow debt refinancing of conventional real estate loans through 504 program to enhance credit support for the 504 program
- Raise the caps on both 7(a) and 504 programs to loan amounts of $5 million; and increase the loan guarantee to 75%
- Increase lending limits on the Microloan program from $35,000 to $50,000
- Allow preferred lenders to approve Capital Access Program (CAP) loans and allow for multi-year approvals rather than year to year
- Reduce turnaround time and increase resources to the Certified Lenders Program (CLP)
- Update CAP line program to reflect current asset lending guidelines and pricing
- Extend Dealer Floor Plan (DFP) and increase the $2 million loan cap
- Maintain the traditional role of banks in the existing SBA programs
- Request more flexibility in allowing Preferred Lender Program (PLP) lenders to refinance their own debt

In the end, increased demand for products and services is the key. Any incentive that encourages businesses and consumers to purchase today, what they might postpone into the future, should be considered.

At U.S. Bank, we pride ourselves on being a consistent and prudent lender during these last few years which is evidenced by our strong performance during this significant economic downturn.

This approach has allowed us to continue to be "Open for Business" and out actively pursuing new business opportunities.

At U.S. Bank, we will continue to seek every opportunity present in our marketplace.

Thank you very much for the opportunity to participate in these hearings and I look forward to the opportunity to respond to your questions.

STATEMENT FOR THE RECORD

THE FINANCIAL SERVICES ROUNDTABLE

On

The U.S. House Committee on Financial Services, and U.S. House Committee on Small Business Joint Hearing on

"Condition of Small Business and Commercial Real Estate Lending in Local Markets."

February 26, 2010

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record to the U.S. House Committee on Financial Services, and U.S. Committee on Small Business joint hearing on "Condition of Small Business and Commercial Real Estate Lending in Local Markets."

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

The Roundtable supports Small Business:
The Small Business Administration (SBA) plays a key role in helping small businesses obtain the capital they need to meet their startup challenges, but changes are needed to ensure the continued success of SBA's programs. Targeted congressional reforms will encourage business development, spur innovation, reduce regulatory barriers, and stimulate and job creation.

Small businesses are a vital component of the nation's economic growth and well-being. Small businesses have led job formation during previous economic recoveries. Access to capital and credit is a critical issue facing small business today. As a nation, we must ensure that viable small businesses have access to financing so that entrepreneurs can again play a prominent role in leading our country's economic recovery. Enhancing SBA programs will increase opportunities for small businesses to access needed capital, maintain and expand operations, increase inventory, and most importantly, recruit, train, employ and retain quality employees.

Recommendations to Enhance SBA Lending:
As the House Financial Services Committee and the House Small Business Committee review proposals which aim to increase lending to small businesses, the Financial Services Roundtable respectfully requests that you consider our recommendations to enhance programs operated by the SBA.

The Roundtable believes the following recommendations, if implemented, will immediately strengthen SBA programs by encouraging more people to start small businesses, increase the flow of capital small businesses, and reduce the administrative burden facing small business by providing the necessary flexibility to respond to current market conditions.

- Increase and make permanent the SBA Express loans to $1 million and increase the guaranty to 75%;
- Support funding and extending the SBA fee waiver and the 90% loan guarantee program thru December 31, 2010;
- Decrease capital requirements for loan guaranteed by the SBA;
- Allow debt refinancing of conventional real estate loans through 504 program to enhance credit support for the 504 program;
- Raise the caps on both 7(a) and 504 programs to loan amounts of $5 million; and increase the loan guarantee to 75%;
- Increase lending limits on the Microloan program from $35,000 to $50,000;
- Allow preferred lenders to approve Capital Access Program (CAP) loans and allow for multi-year approvals rather than year to year;

- Reduce turnaround time and increase resources to the Certified Lenders Program (CLP);
- Update CAP line program to reflect current asset lending guidelines and pricing;
- Extend Dealer Floor Plan (DFP) and increase the $2 million loan cap;
- Request more flexibility in allowing Preferred Lender Program (PLP) lenders to refinance their own debt.
- Maintain the traditional role of banks in existing SBA programs

Conclusion:

The Roundtable encourages each respective committee to review the recommendations above, as well other alternative avenues, to help create business opportunities through innovative policy solutions that will help create a foundation to build a strong and prosperous economy.

February 26, 2010

The Honorable Barney Frank
Chairman
Financial Services Committee
United States House of Representatives
Washington, D.C. 202515

The Honorable Spencer Bachus
Ranking Member
Financial Services Committee
United States House of Representatives
Washington D.C. 202515

The Honorable Nydia Velazquez
Chairwoman
Small Business Committee
United States House of Representatives
Washington, D.C. 202515

The Honorable Sam Graves
Ranking Member
Small Business Committee
United States House of Representatives
Washington D.C. 202515

Dear Chairman Frank, Chairwoman Velazquez and Ranking Members Bachus and Graves:

On behalf of the National Council of Textile Organizations (NCTO) I write in support of H.R. 3380, Promoting Lending to America's Small Businesses Act of 2009. The textile industry believes that the federal government should utilize all authority and available resources to meet the credit and financing needs of small and medium manufacturers.

As you know, businesses have seen credit markets dry up and continue to experience serious challenges in securing the financing necessary to continue operations and preserve jobs. The duration of the current crisis has impacted virtually all businesses and manufacturers but certain industries have been disproportionately affected. The textile industry for example has lost more than 11 percent of its employees since December 2008.

Textile manufacturers have export opportunities but many are being forced to forego business opportunities due to shortfalls of credit, credit guarantees, and working capital. In many cases we understand U.S. textile manufacturers are losing business to competitors in Asia whose governments have stepped in to provide financing. If the United States is to double its exports as outlined by the Obama Administration, the Congress must enact legislation like H.R. 3380 so that business owners who are members of credit unions have access to additional credit sources to finance their business operations.

As our economy emerges from one of the most severe recessions since the 1930's we urge the Financial Services and Small Business Committees to explore all policy options available to assist manufacturers rebuild their businesses and hire workers.

Sincerely,

Wally Darnielle
President

910 17th St., NW • Suite 1020 • Washington, DC 20006
202-822-8028 • fax: 202-822-8029 • www.ncto.org

Rick Wieczorek
President & CEO
Mid-Atlantic Federal Credit Union

House Financial Services Committee/ House Small Business Committee

February 26, 2010

"Condition of Small Business and Commercial Real Estate Lending in Local Markets"

Again, I want to thank Chairwoman Velazquez, Chairman Frank, ranking members Graves and Bachus and the members of the House Financial Services and Small Business Committees for the opportunity to testify last week about the ways I believe credit unions can help restore the flow of credit to American small businesses.

I would like to expand and clarify my response to the question Chairwoman Velazquez asked me about President Obama's proposal to create a new $30 billion fund using Troubled Asset Relief Program (TARP) monies to infuse community banks with capital. It is my understanding that the Administration believes this would encourage additional small business lending by offering lower dividend payments on the fund.

To be clear, I was not suggesting that Mid-Atlantic Federal Credit Union or other credit unions want to receive TARP funds, whether it be from the President's recent proposal or otherwise. Credit unions have capital available for additional small business lending. The stumbling block in helping small businesses to access funds, as outlined in my testimony, is the arbitrary cap of 12.25 % of assets that credit unions are subject to with regard to member-business lending. I strongly support the passage of H.R. 3380, the Promoting Lending to America's Small Business Act of 2009, which would raise the member business lending cap to 25%. This legislation would also raise the definition of what constitutes a member business loan from $50,000 to $250,000. It's worth noting that this proposal would not cost the taxpayer a dime, and would help small business owners obtain the credit they need to keep our fragile economy growing at a time of uncertainty and high unemployment.

In short, if Congress were to move ahead with the President's proposal to infuse community banks with capital born from TARP funds, I believe it should be coupled and moved in tandem with relief from the arbitrary member business lending cap for credit unions.

If Congress were to create a new hypothetical program not tied to TARP funds or government capital infusions (and the regulatory restrictions that come with them) to promote small business lending, I think it would be important to be designed in such a way that credit unions could be included, and my answer was meant to infer that my credit union would be interested in looking at such a program. As our members lose

additional sources of business funding, they are turning to us more and more to be a solution to their small business needs and we want to do everything we can to serve them and meet their needs.

Please do not hesitate to contact me should members of the committees have any additional questions about my testimony before Congress or this supplemental statement.

○