

REAUTHORIZATION OF THE SBA'S ACCESS TO CAPITAL PROGRAMS

HEARING BEFORE THE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE ONE HUNDRED SIXTEENTH CONGRESS FIRST SESSION

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ONE HUNDRED SIXTEENTH CONGRESS

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REAUTHORIZATION OF THE SBA'S ACCESS TO CAPITAL PROGRAMS

WEDNESDAY, APRIL 3, 2019

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

The Committee met, pursuant to notice, at 2:50 p.m., in Room 428A, Russell Senate Office Building, Hon. Marco Rubio, Chairman of the Committee, presiding.

Present: Senators Rubio, Risch, Ernst, Inhofe, Young, Hawley, Cardin, Cantwell, Duckworth, and Rosen.

OPENING STATEMENT OF HON. MARCO RUBIO, CHAIRMAN, A U.S. SENATOR FROM FLORIDA

Chairman RUBIO. Today's hearing of the Senate Committee on Small Business and Entrepreneurship will come to order.

Thank you for your patience. I apologize. The good news is the Ranking Member and I were on the same committee previously, so we do not have to suffer the dirty looks of being late. That ran a little longer than it should have, but thank you for being here. I am pleased.

This hearing is titled "Reauthorization of the SBA's Access to Capital Programs," and it is the beginning of our reauthorization of the Small Business Act, our work to do that, and programs in the Small Business Investment Act.

Today we begin that work with a robust discussion of the SBA's Access to Capital programs, and so to frame this discussion, it is important to first lay out the reasoning for the reauthorization process. It takes a lot of work, and I know there have been questions asked about it.

Historically, this Committee, along with our colleagues on the House Small Business Committee, undertook the process of reauthorizing the Small Business Act, and they did so periodically. Most recently, the process was undertaken every 3 years. That process, as is true of multiple other committees on different subjects and areas of jurisdiction, had fallen by the wayside, and the last time a reauthorization was completed in its entirety was 19 years ago in the year 2000.

When that authorization expired in 2003, Congress began a long series of extensions of the Small Business Act. In 2011, Congress stopped reauthorizing the Small Business Act altogether, instead deferring to the Appropriations Committee to set authorization levels.

It is my view that it is the responsibility of this Committee, and Congress, to review programs under the Small Business Act on a regular basis. This is not a hostile act. It is not meant to accuse anyone of anything. It is the job of this Congress to ensure that we are serving small businesses, as intended, and that taxpayer dollars are targeted to the most efficient and effective programs.

When operating at their peak, the Small Business Administration's programs provide an integral service and opportunities to entrepreneurs and small businesses who play an important role in our Country's economy and the health and prosperity of our Nation.

We know the statistics. According to the SBA's Office of Advocacy, small businesses comprise 99.9 percent of all firms and accounted for 65.9 percent of net new job creation from 2000–2017.

When we talk about small business being the backbone of the economy, this is not just a talking point. These statistics bear it out.

However, we also know that net new small business formation is still below the 36-year average, which should concern us. In order to maintain a growing economy and competitive workforce, we need to have a robust and a growing small business sector.

One of the major barriers that entrepreneurs and small businesses face is access to capital. Even with a booming economy, lending to small businesses is below pre-recession levels by approximately \$65 billion.

According to the Federal Reserve's latest reports on the availability of credit to small businesses, lending to small businesses is still 10.5 percent below 2008 levels, at which point the recession was hitting hard.

Lending to startups and small businesses has clearly not recovered from the recession, and SBA's programs have filled a real gap in the small business lending market. The SBA serves a critical function by offering a range of loan products that provide financing to small businesses who are unable to access capital in the private marketplace.

The four lending programs we will discuss today include programs with a wide range of uses and loan amounts. These programs are the 7(a) Loan Guaranty Program, the 504/CDC Loan guaranty program, the 7(a) Community Advantage pilot program, and the Microloan program.

The 7(a) program is the flagship one, with more than \$25 billion in loans in fiscal year 2018. The entry point of this program is the inability for borrowers to receive credit elsewhere on reasonable terms and conditions, meaning they are unable to receive a conventional loan with terms that will work for them and their business.

The 504/CDC program provides long-term, fixed-rate financing, ideal for large equipment and real estate purchases. This program also includes a job creation or public policy requirement in order for the loan to be financed.

The 7(a) Community Advantage program provides small-dollar loans under \$250,000 and requires 60 percent of these loans be made in underserved, or emerging, markets.

And the Microloan program provides loans of up to \$50,000 to entrepreneurs and small businesses, with an average loan size of

\$14,000. The program also provides technical assistance to help borrowers before and after they receive the loan.

These access-to-capital programs, including the four I just mentioned, and the Office of Capital Access represent the largest office and portfolio at the agency.

Since we have not undertaken a full reauthorization of the Small Business Act in many years, it is integral that we assess the programs, that we look at the history and impetus for the creation of each program, that we discuss their current state, and pull suggestions and ideas for how to improve it, how to modernize it, and to do so for members and witnesses so that we can continue to fine-tune these programs to better serve small business.

This process is going to give this Committee the opportunity to consider modernization of the programs, if necessary, as well as programmatic changes to improve the delivery and efficiency in their management at SBA.

This is an opportunity for modernization and reform, and so it is vital that we continue to move forward, particularly on the access-to-capital programs relevant to and meeting the needs of tomorrow's entrepreneurs and small business owners.

And now I turn it over to the Ranking Member.

**OPENING STATEMENT OF HON. BENJAMIN L. CARDIN,
RANKING MEMBER, A U.S. SENATOR FROM MARYLAND**

Senator CARDIN. Well, Mr. Chairman, first, let me thank you for your leadership in directing the Committee to start the process on the reauthorization of the SBA programs.

Today we have our hearing on access-to-capital programs. On May 1st, we will have the entrepreneurial development programs. May 15th, we will have a hearing on the SBIR/STTR programs.

I thank you for recognizing that it is our responsibility to recommend to the full Senate on a regular basis the reauthorizations and authorizations of SBA programs. We are the authorizing committee, not the appropriator, so it is important that we act.

This hearing is both timely and necessary. As this Committee begins the reauthorization process, it is vital that we have a firm understanding on how SBA loan programs are working, what gaps they fill in the conventional credit market, the steps we need to take to make the SBA loan program more inclusive, and how SBA can collaborate better with its lending partners.

The overreaching goal should be to modernize the SBA programs so that they meet the needs of today's small business owners.

Reauthorization of the SBA lending programs is long overdue. Right now, the statutory program level for the 7(a) loan program is \$17 billion, \$8 billion less than the \$25 billion in 7(a) loans SBA backed last year. It is important that we as the authorizing committee set program levels that provide a roadmap to guide congressional appropriators and the SBA.

Capital is the lifeblood for businesses. For many small businesses, an SBA-backed loan is the lifeline and the difference between success and failure. I see the benefit every day when I pass the headquarters for Under Armour. Without an SBA-backed loan, Under Armour may not have been able to go from a small business

run, literally in a basement, to a global brand with thousands of employees in Baltimore that it is today.

Last year alone, SBA-backed loans helped nearly 72,000 small businesses access more than \$30 billion in financing and supported more than 619,000 jobs. While the importance of SBA role in the American economy is without question, we must use reauthorization as an opportunity to improve the inclusiveness of SBA loan programs, which are not adequately reaching underserved communities, especially minorities, women, and veterans.

Minority-owned firms are two to three times more likely to be denied credit, more likely to avoid applying for loans based on the belief that they will be turned down, and more likely to receive smaller loans and pay higher interest rates on the loans they do receive.

Last September, I held a field hearing in Baltimore at Morgan State University to learn more about the struggles minority entrepreneurs face in accessing capital. Mr. Manger was gracious enough to testify at that hearing as well, and he has come back for another round with our Committee.

The key takeaway from the hearing was that minority small business owners need SBA to fill the gap, where private lenders often fall short. Moreover, the witnesses stressed that the increased investment in minority-owned small businesses will help close the unemployment and wealth gaps.

One way the SBA can fill those gaps is to build on the efforts such as the Community Advantage pilot program that have done a better job of reaching underserved communities than the traditional 7(a) program.

In Fiscal Year 2018, when comparing the two programs, we find that black business owners received only 4.5 percent of SBA 7(a) approvals, while receiving 12 percent of the Community Advantage approvals. Quite a difference.

Similarly, Hispanic business owners received 8.5 percent of the 7(a) approvals compared to 17 percent of the Community Advantage approvals.

Today we will hear testimony that the 7(a) program has made progress in reaching underserved markets, such as black-owned businesses. While I am pleased that we are moving in the right direction, the fact remains that black people are receiving less than 5 percent of all 7(a) loans while making up 13 percent of the U.S. population.

Additionally, black-owned firms report the greatest challenges in accessing capital, according to the Federal Reserve. So we have a lot of work to do to ensure that 7(a) is filling the gaps that it exists to fill.

We also need to explore the question of fee waivers for both borrowers and lenders to help address barriers to small business loans. The administration's Fiscal Year 2020 budget proposes \$250 million in fee increases on borrowers and lenders as well as cuts in the Microloan program that would do great harm to American small businesses.

I look forward to hearing from our witnesses today, and I look forward to working with the Chairman and all members of this Committee so that we do fine-tune through the authorization process the tools that are available to help America's small businesses.

Chairman RUBIO. Thank you.

Our first panel, there is only one witness. It is Mr. William Manger. He is the Associate Administrator of the Office of Capital Access at SBA. He has been serving in this role since appointed by Administrator McMahon in March of 2017, and he has responsibility over the SBA loan program policy, technology, operations, and oversight. This includes the four flagship programs that we have discussed.

Thank you for being here today. Welcome to the Committee.

STATEMENT OF WILLIAM MANGER, ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS, SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. MANGER. Thank you very much, Mr. Chairman, and thank you also, Ranking Member Cardin, for welcoming me back to one of the Senate hearings and members of the Committee for inviting me to testify here this afternoon.

I have had the honor to serve for 2 years now as the Associate Administrator for the Office of Capital Access. Previously, I served at the agency as a regional administrator in New York and in Washington, D.C., as the Associate Administrator for Field Operations.

From the beginning of my time with SBA, I have been able to witness the positive impact our programs have on small businesses across the country. In my current role, it is my job to administer programs that make capital available to small business entrepreneurs who would otherwise be unable to access capital to start or expand a business through conventional means. This is primarily achieved through our two main loan programs, 7(a) and 504.

Our 7(a) program offers guarantees on loans to small businesses of up to \$5 million, with guarantees ranging from 75 percent to 90 percent, depending on the loan amount.

In FY18, SBA guaranteed over 60,000 loans for over \$25 billion. Within this is our Community Advantage pilot program, which makes 7(a) loans of up to \$250,000 available in underserved communities. For small businesses that need fixed interest rate loans for the acquisition or improvement of property, plant, or equipment, SBA offers the 504 loan program. These loans are made available through certified development companies, CDCs, which are SBA's community-based partners. In FY18, SBA made over 5,800 loans for almost \$5 billion in this program.

The SBA's Microloan program makes capital available directly to intermediaries, which in turn lend to small businesses. The program has been effective in providing capital to traditionally underserved communities with an average size microloan of just under \$14,000. In FY18, SBA facilitated over 5,400 microloans for over \$75 million, and that was actually a record in the agency's history.

Throughout our loan programs, we continue to modernize and streamline our 7(a) and 504 applications, and we have now done entirely this electronically. And our SBA One Platform has simplified our loan process. So many of our lending partners have been able to take advantage of that.

Over the last 2 years, we have been able to cut our loan approval times in half through process improvements, which also greatly enhanced our ability to process loans following the recent lapse in appropriations.

Now let me share a few ideas for the Committee to consider as you review the agency's capital access programs. First is a recommendation to increase the express loan limit from \$350,000 to \$1 million. This cap has been set in statute for 15 years, with the exception of 1 year during the Recovery Act when it was increased to \$1 million. This loan product is used by many small businesses that need a revolving line of credit. An increase will go a long way to helping them, especially businesses with seasonality.

Next, I would like to ask you to consider increasing the 504 loan amount for small manufacturers from \$5.5 million to \$6.5 million. Increasing the maximum loan amount would greatly benefit America's manufacturing industry and help small businesses access credit to reenter the marketplace. Loans to manufacturers perform very well and typically create more jobs.

Another recommendation is within our Microloan program regarding the manner in which funds are made available during the course of the fiscal year. We would recommend eliminating the current 1/55th rule, and we will continue to review ways to provide for a better flow of funds throughout the year while still preserving funding access for all states.

Also, regarding our 7(a) loan program, we will continue to discuss with the Committee various policy options outlined in the agency's budget submission. A foundation of the program is to account for risk and the accompanying cost share with our lending partners.

Lastly, I would recommend providing SBA with flexibility to manage the 7(a) Secondary Market Guarantee Program by introducing a small fee not to exceed 0.05 percent on the outstanding balance of loan pool certificates.

Mr. Chairman and Ranking Member Cardin, thank you again for the opportunity to testify today, to share an overview of our capital access programs and to outline a few policy recommendations.

I look forward to answering your questions. Thank you.

[The prepared statement of Mr. Manger follows:]



**Statement of William M. Manger
Associate Administrator
Office of Capital Access
U.S. Small Business Administration**

**before the
Senate Committee on Small Business and Entrepreneurship**

**Hearing on "Reauthorization of the SBA's Access to Capital Programs"
April 3, 2019**

William M. Manger
Associate Administrator
U.S. Small Business Administration

Thank you, Chairman Rubio, Ranking Member Cardin, and members of the committee for inviting me to testify this afternoon. I look forward to building a strong and collaborative relationship with this committee to ensure we are serving America's small businesses and entrepreneurs to the best of our abilities.

As Associate Administrator for the SBA Office of Capital Access, it is my job to administer programs that make capital available to small business entrepreneurs who would otherwise be unable to access capital to start or expand a business through conventional means. Before assuming my role as the Associate Administrator for the Office of Capital Access, I had the honor to serve at the agency as the Regional Administrator for Region 2, based out of New York, from 2005 to 2007, and then as the Associate Administrator for the Office of Field Operations in Washington, D.C. from 2007 to 2009. From the beginning of my time with SBA, I have been able to witness the positive impact our programs have on small businesses across this country.

The Office of Capital Access has several programs that help small businesses obtain access to capital, but the most common and widely known is the 7(a) loan program. The 7(a) loan program is a powerful tool for helping create and retain jobs for American workers. This loan program offers guarantees on loans to small businesses of up to \$5 million on reasonable terms and conditions that can be used for almost anything including: acquiring land, purchasing or constructing a building, purchasing equipment, or for working capital. On loans up to \$150,000, the guarantee is 85% of the amount of the loan. For loans over \$150,000, the guarantee is 75%.

For small businesses that need longer-term loans for the acquisition or improvement of fixed assets such as land, a building, or heavy equipment, SBA offers the 504 loan program. These loans are made available through Certified Development Companies (CDCs), which are SBA's community-based partners. The 504 Loan program is a powerful economic development tool that offers small businesses another avenue for business financing, while promoting business growth, and job creation. 504 loans are typically structured with a lender providing 50% of the cost of the project, the CDC providing the next 40% (that's the 504 loan), and the borrower contributing the remaining 10% of the project cost. The advantage of this program is that it provides terms of 10 years, 20 years, and 25 years, all at fixed interest rates. This is especially important in a rising interest rate environment.

The SBA's Microloan Program offers small businesses loans of up to \$50,000 from not-for-profit lending intermediaries. SBA makes capital available directly to intermediaries which, in turn, lend to small businesses. The average size of a microloan is just under \$14,000. The program has been very successful in filling a need for small loans and technical assistance to small businesses that cannot secure credit from conventional lenders or SBA guaranteed loans. The program has also been effective in providing capital to traditionally underserved communities, including small businesses owned by minorities, women, and veterans. For

example, Microloans to African-American owned small businesses have risen to almost 38% thus far in FY19.

At SBA, we are continuing to modernize and streamline our programs and are revamping our website to be more user-friendly. It is crucial that SBA continues to innovate and keep up with an increasingly digital credit marketplace. As you may know, both our 7(a) and 504 applications are now done entirely electronically, and our SBA One Platform has really simplified our loan process for so many of our lending partners. I think it's important to share with you how our process improvements have vastly improved turn-times for SBA loans. For example:

- Over the last two years, Small Loan approval times, which are loans of less than \$350,000, have decreased from 6 days down to 2.
- 7(a) Regular Loans, which are loans of \$350,000 and over, have also drastically improved their approval times from an average of 15 days to 8 days, a significant gain in efficiency over the last two years.

An aspect of our consumer outreach is Lender Match, which my office launched 18 months ago. Lender Match is a technology platform that allows entrepreneurs to complete a quick online form, without registration or cost, in order to be connected with an approved SBA lender within 48 hours. Our Lender Match Tool serves as a perfect example of how the government can use technology to improve our public-private partnership. To date, Lender Match has produced over 4 million email leads for small business borrowers in search of financing assistance. These leads have resulted in over 185,000 small business borrowers receiving a "lending match" with an approved SBA lender.

Currently, we are exploring new Lender Match features, which would allow lenders to turn leads into loan applications seamlessly without leaving SBA's system. Lenders would be able to request additional loan application data from the prospective borrower. SBA would begin validating the loan thus increasing the certainty of both parties' financing expectations.

In addition to these innovative steps, OCA's Office of Credit Risk Management, known as OCRM, continues to make changes to the staffing and methodology it employs to provide lender oversight and portfolio monitoring. As you know, the Small Business 7(a) Lending Oversight Reform Act of 2018 codified OCRM and established several requirements for the division. One of these requirements calls for development of a new regulation to define OCRM's authority in supervision and enforcement of 7(a) Lenders. This rulemaking has been drafted and is in review. It incorporates for the first time the option for a civil monetary penalty for egregious lender activity.

As the committee reviews our Office of Capital Access programs and services, I wanted to mention a few items for your consideration that were outlined in the agency's Fiscal Year 2020 budget submission:

- The authority for the SBA to increase the Express Loan limit from \$350,000 to \$1,000,000. This cap has been set in statute for 15 years, with the exception of one year

following the Small Business Jobs Act of 2010, when it was increased to \$1 million. This loan product, with only a 50% guaranty, is used by many small businesses that need a revolving line of credit. The increase will go a long way to helping them.

- The authority to introduce an annual fee not to exceed .05 percent per year of the outstanding balance of pool certificates. This provides the SBA with additional flexibility to manage expected costs of the 7(a) Secondary Market Guarantee Program.
- The authority to increase the total maximum dollar amount that a small manufacturer may borrow, per project, in 504 loans from \$5.5 million to \$6.5 million. Increasing the maximum loan amount would greatly benefit America's manufacturing industry and help small manufacturers access credit to re-enter the marketplace.

Mr. Chairman and Ranking Member Cardin, as you can see, a lot of great work is being done at SBA and our agency remains committed to help advance opportunities for the millions of American small businesses that contribute so much to our economy. Thank you again for the opportunity to testify today, to share an overview of our capital access programs, and to outline a few policy recommendations. I look forward to answering your questions.

Chairman RUBIO. Thank you.

Mr. Manger, as we undergo this reauthorization process, it is imperative that—I hope we will take a holistic view not only of programmatic changes, but needed modernizations, for example, on the IT systems, the internal processes used to manage these programs.

Can I ask, what is the SBA doing to streamline processes in the lending programs to improve the IT systems, to manage the programs in a way that promotes the efficient delivery? And I guess I start by—are all the lending programs online, and if not, why not?

Mr. MANGER. Thank you very much, Senator.

So all of the programs are now handled electronically. That is something we have done in the last 2 years.

We are making advances further in our 504 loan program to allow a central repository for all the documents involved in closing a 504 loan. That could be quite complex and timely, and we think it will be much more efficient if we can have a central repository for all the documents so that we can look at that in the centers as well as if we need to look at them from the Office of Credit Risk Management. So that is something that is ongoing right now.

We are right now making enhancements to the MPER system, and I want to thank the Senate for allowing us to reprogram some of the money, \$1.2 million, so that we can apply that to a new version of the recording system for the Microloan program. That is in process now, and we are working on that. And we hope to have something by the end of this calendar year for the Microloan program.

Otherwise, we are also making IT enhancements to our lender-match program, and just briefly, to explain that to you, that is a program that allows a potential borrower to go online, put into the system what they are looking for in terms of a loan, and then that is fed out to—electronically out to approved SBA lenders so that they can then, if they are interested, reach out to that individual, that small business, and talk further about making a loan.

Over the last couple of years, we have had 4 million hits on that site, and over 186,000 connections have been made between a small business owner and an approved SBA lender. We are going to make further enhancements to see if we cannot make that even more seamless and take somebody from again coming in and then actually closing a loan with the SBA.

Chairman RUBIO. The President's budget for 2020 included a request to increase fees to maintain zero subsidy in the program. According to the budget request, the programs are expected to have a \$99 million subsidy in Fiscal Year 2020.

Did the subsidy model change for Fiscal Year 2020?

Mr. MANGER. So, Senator, the subsidy model has not changed since 2014. There are always enhancements made to it, and we actually, obviously, each year have another whole cohort to factor into analysis in our review of the performance of the program.

Right now, we have 26 years that we are able to look at, and we combine that obviously with assumptions from the Office of Management and Budget, and that really is how formulating of the subsidy model comes about.

Chairman RUBIO. Well, were performance metrics for the 7(a) program taken into account in the model?

Mr. MANGER. Absolutely. Twenty-six years of performance of the 7(a) program were taken into account, and we have seen—

Chairman RUBIO. Do you know how it is weighed?

Mr. MANGER. I do not. I do not have those weights.

So just let me explain to you, Senator, because this is important too. The modeling is done completely separately from my office in the Office of the Chief Financial Officer. He has a modeling team that is removed from the Office of Capital Access, and they do all of the work in their office. They have someone who actually does the model. Then they have someone in the office who actually double-checks their work in that office. Then we actually send it out to an independent third party for verification and validation of the model before it is sent to OMB, where once again they validate the model that we are using. So it is really looked at many times, and eventually, it goes to our auditor who reviews the model as well.

Chairman RUBIO. So is that model available for the Committee, including the OMB projections, the SBA assumptions and how they were weighed? I mean, we are asking for a \$100 million subsidy to close the gap. I think it is important as we work through this process to have a better understanding of the OMB projections but also the assumptions made from the model.

Mr. MANGER. Right. So, Senator, again, as I said, all of the calculations in the modeling are done in the CFO's office. They have access to that. I actually do not have visibility into the actual modeling that goes on there, nor do I actually have access to OMB's assumptions. That is sent over by OMB to the Office of the Chief Financial Officer where it is input into the model, and that is where they run the numbers.

I can share with you, though, that in our most recent report that we just received, because interest rates have been so low and because now they are starting to increase, that we are seeing more loans that are stressed because the small businesses are having to pay a higher interest rate, and that is having an effect.

So, in fact, our 7(a) early default rate is now where it was in January of 2014. That was on the end of the Great Recession, but we have noticed for the last year and a half that our defaults in the 7(a) program have been increasing, increasing slightly, but after 18 months, it has actually gotten back to the same level we were at in January of 2014. So that is of some concern, and that is why we want to maintain, again, a very efficient program for the taxpayers and want to make sure that we have the fees to be able to pay for the losses.

Chairman RUBIO. Well, just to close a loop and then turn it over to the Ranking Member, as I understand it, you do not have insight. You know what the model consists of, more or less, on general terms.

Mr. MANGER. Yes.

Chairman RUBIO. And you see the end product.

Mr. MANGER. Yes.

Chairman RUBIO. But the actual model itself is run in the CFO's office, and OMB has its own assumptions. So you do not actually

see the details of the guts of it. You only see the end product, and you know what it entails generally.

Mr. MANGER. That is correct.

I mean, obviously, it takes into account interest rates. It takes into account the unemployment rate, different—

Chairman RUBIO. But how each of these things are weighed is not—

Mr. MANGER. I have no visibility into that. That is done in the CFO's office and then in conjunction with OMB.

Chairman RUBIO. Ranking Member.

Senator CARDIN. Well, thank you for your testimony. Particularly, I thank you for the specific recommendations that you have made.

I certainly am very sympathetic to increasing the limits on the different programs you mentioned. I will want to talk about how we can better target to underserved communities.

But let me start with the point the Chairman was raising in regards to the subsidy fee. I agree with the Chairman. We need to understand these numbers better.

Congress made an intentional effort to keep the fee waiver program. The administration presented a budget last year that would have eliminated a good part of the fee waiver, except, I believe, on the programs that are required by statute, the veterans program where you are required to give the waivers, express loans to veterans.

But Congress expressly provided the resources so that we could continue the fee waiver program, and it is something that we feel pretty strongly about, the cost of SBA loans.

It seems to me that you are compounding the problem by requesting a separate fee on the lenders that is in your prepared testimony.

I must tell you, I have been to several meetings of small businesses and bankers where they all tell me they are still concerned about the cost of small business loans through the SBA, and if we make it more expensive, are not we cutting out one of the major avenues for businesses that have no other option for mainstream financing?

Mr. MANGER. So, Senator, let me first say that fee waivers were not in place until 2014. There have never been fee waivers, and in fact, some of the fee waivers were brought about because of the new model that I spoke about earlier for the calculation of the subsidy model.

Since that time, though, every year, we actually have less money, less money to allocate to fee waivers. So that is why it has had to be reduced.

Senator CARDIN. But the President's budget is cutting the budget, so putting even more pressure on you to—

Mr. MANGER. There was not an appropriation for fee waivers in the budget, sir.

Senator CARDIN. Well, if I understand the President's budget versus the FY19 budget, if you compare the two, the appropriators and Congress provided sufficient resources to fund your basic agencies and maintain a fee waiver program.

Mr. MANGER. That is correct.

Senator CARDIN. The new budget, as I understand it, submitted by the President has cut the SBA budget, assuming that they would not have the losses that they are currently paying on fee waiver. Am I reading that wrong?

Mr. MANGER. Well, all I can say is that in the budget, there are three scenarios. The current loss scenario shows that if we were to continue, just as we are now, we would need \$99 million in order to pay for what we anticipate would be the necessary amount to cover any losses in the program.

As the statute is written, if there is not sufficient funding, we cannot offer the fee waiver to the veterans in the Express program. The only way we can do that is if it is not going to be an additional cost. So if we have to ask for \$99 million more, that is an additional cost, an additional appropriation. We are not allowed by statute to then give the fee waiver to the veterans.

Senator CARDIN. You are talking about the veterans Express loan.

Mr. MANGER. Yeah.

Senator CARDIN. I think we are two ships passing in the night here. I think Congress has expressly provided the resources within the SBA budget, so the fee waiver program can continue beyond the veterans' Express loans.

Mr. MANGER. That is not the case, sir.

Senator CARDIN. So you are saying that legally, even if we give the money in the budget, you have to follow the——

Mr. MANGER. The way the statute is written is we are only able to give the fee waiver to veterans on the Express program if there is no additional appropriation or cost to the program. There has to be, again, some sort of a surplus for us to be able to offer that fee waiver.

Senator CARDIN. And Congress cannot make that surplus through appropriation?

Mr. MANGER. Yes, of course, you can.

Senator CARDIN. That is what I am saying.

Mr. MANGER. No, you can do that. But I am just saying that the way the statute is written, the fee waiver——

Senator CARDIN. Is that not what we did last year?

Mr. MANGER. No. We have not——

Senator CARDIN. You had a fee waiver. How did you do it with the fee waiver last year?

Mr. MANGER. Because in the modeling, we showed that we actually had additional money so we could offer the fee waiver. Now because of the circumstances we see coming forward, we do not have that ability. We have to reduce what we give as a fee waiver.

Senator CARDIN. I want to move on to one more question.

Mr. MANGER. Sure.

Senator CARDIN. I am going to ask our staffs to drill down on that because the information I have shows that the budget request from the administration assumes that the fee waiver program is no longer there, except for the veterans' Express loan program, and therefore, they have reduced appropriations in other areas to the SBA. That is what at least I have been informed on the SBA budget.

Senator CARDIN. Yeah. The two other scenarios show the veterans' fee relief still being there, but it shows that we would have to increase the fees to generate the additional monies that we would need to offer the fee relief.

Senator CARDIN. What I want from you is, what do we need to do as a Congress to make sure the fee waiver program continues?

Mr. MANGER. For veterans?

Senator CARDIN. No. I am talking about the fee waiver program that has been applied since 2014.

Mr. MANGER. So, Senator, the fee waiver that we have been doing has only been available because we have a surplus.

Senator CARDIN. I understand what you are saying. So what do we need to do in order to make sure you can continue that fee waiver program?

Mr. MANGER. We would have to increase the fees to the program. We would have to increase the fees and then be able to offer fee relief to certain lower, smaller loans, as we have done in the past.

Senator CARDIN. I think there are other ways we can get that done.

Mr. MANGER. All right. We are happy to work with you, Senator.

Senator CARDIN. The other question—and maybe I will have to do it for the record because of the time restrictions.

Mr. MANGER. Sure.

Senator CARDIN. I want your views as to how—and let me just acknowledge you are making progress in reaching underserved communities in the 7(a) and 504 loan programs. The trend lines are positive. I acknowledge that.

But the absolute numbers are way too low, and you have the Community Advantage program that is doing much better.

You have taken steps through regulation to restrict the new lenders under the Community Advantage program, which I quite do not understand and some of the other restrictions. What can we learn from the programs that are working, Community Advantage pilot program, Microloan program which is also cut in the administration's budget, which reaches more minority and women—what can we learn in modifying the 7(a) and 504 program so that we can do a better job of reaching underserved communities?

Mr. MANGER. I think that is an excellent question, but let us just be clear that the Microloan program had a record year last year. And, in fact, we are not cutting the budget for the Microloan program.

If you look at the budget that was submitted, in loan making and loan servicing, the numbers actually increase slightly. For loan liquidation, the number is flat, and the only category where you see any slight deviation is in the grant part of the Microloan program. But the reason why we were doing that is because the grant money is 2-year money, and we were able to roll over from last year into this year, \$8 million in the grant-making part.

So we are absolutely fully funded as we were last year in the Microloan program, and that program is doing extremely well. It had a record year last year. We now saw a 16 percent increase in loans going to African Americans in that program. In fact, a full 38 percent of the Microloan dollars are now going to African Amer-

ican-owned small businesses. That program is doing extremely well.

We have seen actually that over 8 percent of a recipient of a microloan comes back later to the SBA to use one of our larger loan programs. They come back and they get a 504 loan or a 7(a) loan, and so we have seen this continuum of growth because they have been able to build up a credit history with the Microloan program. So that is really a phenomenal program, and we want to see that program grow.

In fact, I have had my folks in that office put together a marketing plan to go across the country to see how we can get that program to grow even further because we agree with you, Senator, that that is an excellent, excellent program.

We made the changes to Community Advantage because we believe in the Community Advantage program. I believe in the Community Advantage program. We wanted to strengthen it so that it can stand on its own and be made permanent, but when we looked at how some of its performance was doing about a year ago, we had some concerns with some of the program.

So we made those changes. They are not in rule. It is a pilot program. In fact, we extended the pilot program by 2½ additional years so that we could, again, make sure that we make this program as strong as possible so that it can stand on its own and become a part of our full breadth of programs available to small businesses.

Senator CARDIN. Thank you.

Mr. MANGER. Thank you, sir.

Chairman RUBIO. Senator Duckworth.

Senator DUCKWORTH. Thank you, Mr. Chairman.

Mr. Manger, last month, this Committee held a hearing on cybersecurity threats to small businesses. The discussion focused on the need for more information and access to basic cybersecurity assistance and training for small businesses. However, programs—I know your leadership at SBA has been dedicated primarily to deploying dollars to small business owners and entrepreneurs. However, a program like the Microloan program which pairs technical assistance with loans of \$50,000 or less serves as a vehicle to deliver critical education and training to small businesses, and I want to see how that can be applied towards cybersecurity training.

We already know that small businesses must strengthen their cyber defenses, resiliency, and recovery in the face of a growing and ever-present cyber threat. Can you address what more SBA could do with respect to the Microloan program to ensure these borrowers have access to cybersecurity training in particular? Because we had a panel here where every one of them said, “We need this.”

Mr. MANGER. Thank you very much.

So with the Microloan program, you are exactly correct. There is a mandatory training and technical assistance that is made available through grant money to a recipient of a microloan, and we can certainly—we provide training to our microloan intermediaries all the time. And we can certainly work with them to make sure that they are making sure these small businesses are aware of cybersecurity and take full advantage of everything at their disposal so

that they can guard against any cyberattacks at their small business.

We understand that is obviously very important. We take that very seriously, obviously, at the SBA, and we would be able to do that, I think, through the technical assistance and training.

We also have grants that go out for more assistance like this through our Office of Entrepreneurial Development, our SBDCs, Small Business Development Centers, our SCORE resource partners, as well as our women's business centers. And we can work with them to also educate small businesses further on the need for cybersecurity and protection against cyber threats. So I think we have a few avenues we can work on.

And, also, I was the Associate Administrator for Field Operations. We can certainly work with our field to make sure that when they go out and make presentations to small businesses that they keep them aware of cybersecurity and the threat that that poses to their small business.

Senator DUCKWORTH. But are you doing that now, and is that part of the training that occurs when small businesses come to you? Because I get the sense that many small businesses, at least from that panel we had, do not know where to go, do not know who to trust, and do not know what type of training exactly they need, and choose, instead, almost to willfully just ignore it and maybe the problem will not—"Maybe I will not get hacked," and they move forward.

I do think there needs to be more proactive initiatives on your part, and is that happening now?

What you just told me is that we have all of these ways of doing it, but are you actually doing it in a proactive way? Because when we talk to small businesses or some of those associations, they are saying that actually they are not quite sure what to do or who to listen to or what those particular resources are.

Mr. MANGER. Right. So, quite honestly, I cannot tell you that we are doing all of that right now, but I can tell you that I will go back to the agency and make sure that we begin to incorporate that in the technical assistance and training that we provide to small businesses. I think you have a very good point, and I will make sure that I take that back to the agency.

Senator DUCKWORTH. Thank you.

If you could keep my office informed and perhaps—I do not know if the rest of the Committee is interested or not in seeing the progress that you are making—because I will follow up to see if we have actually enhanced this process, because I think that the problem only gets worse over time.

Mr. MANGER. Certainly. I appreciate that. Yes, I will. Thank you.

Senator DUCKWORTH. Thank you.

I yield back, Mr. Chairman.

Mr. MANGER. Thank you.

Senator INHOFE [presiding.] Thank you, Senator.

Just so I can explain to people what is going on here, we have votes in progress. Neither Ms. Duckworth nor I know how many votes are going to be, but—

Senator DUCKWORTH. One or more.

Senator INHOFE. Yeah, something like that.

[Laughter.]

So I have already voted on this one, and so I do have—before we dismiss you as the first panel, I want to take my turn here.

What I would like to do is go ahead and give the background of a case that you are familiar with so that I can get it in the record and find out a little more clearly where we are in resolving, hopefully, this issue, which I think should be resolved at some point.

So I will go ahead, Mr. Manger. The SBA acted in two policy notices early in 2017 that have resulted in staffing firm franchisees' inability to qualify for SBA loans and other services that previously they qualified for. So we are talking about people out there who are no longer qualified, and that was one of the changes that took place in 2017.

SBA's actions have overturned years of SBA precedent and as a result are preventing small businesses across the Nation, including those owned by veterans, women, minorities, from obtaining SBA loans.

The issue at hand is whether the franchisers of staffing firm companies like Express Employment Professionals in Oklahoma City directly control their franchisees and as a result whether or not these franchisees should be classified as small businesses. Unlike what SBA's 2017 notice implies, Express Corporate does not directly control its franchisees. Direct Corporate does not hire or fire its franchisees' employees, and the 2017 notice does not take into account the unique product of staffing firm franchises. Express Corporate simply requires that its franchisees' employees get paid on time and in full in order to ensure compensation for those workers.

The minimal level of oversight exercised by staffing firm franchises like Express Corporate should be clear that they do not directly control their franchisees, and I understand there are ongoing discussions between the SBA and Express on this issue. However, staffing firm franchisees are continually being denied SBA votes.

So the votes have been denied in this process, and so I would—I guess the best way to start this off, Mr. Manger, should Congress provide SBA more clarity on this issue so as to ensure small businesses like Express and franchisees are not denied SBA loans? Do you think that Congress should provide clarity in this?

Mr. MANGER. So, Senator, let me just tell you what we have done in the last couple of years.

Senator INHOFE. Yes.

Mr. MANGER. We did change the franchise policy at the agency. As you know, per the Small Business Act, we are only allowed to make capital available to a small business. We cannot make capital available to a business through affiliation that really is a big business.

So we did change the franchise rules. We took in-house an SBA directory. I am happy to say that the eligible franchises on the SBA directory have increased 90 percent since we put the new policy in place. We went from having just over 2,000 brands, eligible franchises on the SBA directory, and now we are up to over 3,800 brands that are eligible for SBA financing.

Since the change was made, we have also seen an increase in the dollars going to franchises over the last 2 years of 43 percent. So the franchise program is doing extremely well at the agency.

I understand the situation that you are speaking about, and we are addressing that situation, sir. And I am pleased to say that we have an agreement in principle with this company, and we are prepared to move forward.

Senator INHOFE. I see. Have you personally been involved with any of these principals?

Mr. MANGER. I had met with them actually when they came in to Washington. I met with them in a conference room at the SBA Headquarters, and I have had people in my office as well as the Office of General Counsel working diligently with them for the past few months, as you know, and again, at this point, we have an agreement. And we are going to move forward.

Senator INHOFE. Well, we are looking forward to that, and I appreciate that very much. I was thinking if clarity is needed, it would probably have to be in the form of legislation, but I will assure you anything that we would do, we would be working closely with you because we have in the past and would continue to do that.

Mr. MANGER. I appreciate that very much, Senator. Thank you.

Senator INHOFE. Now let me ask—

Senator CANTWELL. Thank you, Mr. Chairman.

Senator INHOFE. Have you already had a chance to visit?

Senator CANTWELL. No. I would so much like to.

Senator INHOFE. Okay. We will recognize Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman, and thank you for holding this important hearing.

Obviously, I would like to thank Mr. Manger for your work at access to capital, writ large. When I happened to be the chairman of the committee, we did a lot of great work on access to capital for women entrepreneurs, and I wanted to ask you what more do you think we could be doing right now as we increase both the sole-source access and then smaller loan sizes so that SBA—we found that SBA packages, women were not as enamored over the big \$500,000 package and were much more comfortable with a smaller loan portfolio.

I do also want to welcome Patty Kibbe, who is going to be on the next panel, Mr. Chairman, and look forward to hearing from her because, obviously, in various rural parts of the country, women need access to capital. And Evergreen Business Capital of Seattle is one of the largest 504 lenders. So I will look forward to hearing from her as well.

But, Mr. Manger, what else? Has this been a priority for your administration, and what else do we need to be doing to increase access to capital, given the small percentage of loans that are taken out by women?

Mr. MANGER. Certainly. Thank you, Senator.

Working with Administrator McMahon, she has been a huge proponent for making sure that women have access to capital as well as other resources provided through the agency, whether it is government contracting, entrepreneurial development help. So we

have worked very closely on trying to increase the numbers of lending and loans going to women.

We have had great success, as you were saying, in some of the smaller-dollar programs, the Microloan program, Community Advantage.

In fact, going back to the franchises, we have seen an increase of 26 percent in women getting franchises. This is something that we have not seen ever. That that has increased this much. Usually, it has been men coming in for franchises, sometimes couples coming in, but now we have seen women on their own coming in. And the increase over the last year and a half has been 26 percent.

So we believe we are doing a good job. There is always more work to be done, but we are definitely focused on trying to make sure that we get out as much capital to women as possible.

Senator CANTWELL. Is there a correlation on the franchise? Is there something that the agency has done to increase that?

Mr. MANGER. I was just saying when you were walking in that we actually have changed our policy, and we have now increased the number of eligible brands for SBA financing from just over 2,000 brands to over 3,800 brands nationwide that are eligible for SBA financing. And we have seen a 43 percent increase in dollars going to franchises over the last 2 years, and that is also a reason why more women are now able to access that.

We made it very easy. The 3,800 franchise brands are listed on our website. That was never the case. That was something I introduced. We now have 3,800 eligible franchise brands on our website that anyone can look at in the public and determine if they would like to be involved with one of those franchises.

Senator CANTWELL. So you think volume, or do you think there is something else to the brands themselves?

Mr. MANGER. You know, that is a good question. I would have to study that further.

I think, honestly, though, making this much more accessible and having broader visibility to the public about what brands are eligible for an SBA loan has really created more of an incentive and an interest on behalf of everybody.

Senator CANTWELL. I appreciate that, and thank you for that leadership.

I think for us, in doing the report that we did on the Committee, we found that women were only receiving something like 4 percent of SBA product. It was appalling to us to find that out, but we found a bunch of things that we tried to correct. Obviously, one of this was this sole-source issue, but the other—and the loan package size. But a lot of the counseling programs that existed were also much more geared towards—well, let us just say some of the ideas that women were bringing to the table, the advisory committees had a lot less familiarity with it. So I would be curious on that brand if you ended up listing brands that women were attracted to, for whatever reason, because their business interests lined up with that.

I think we have to keep pushing this envelope to get—if 50 percent of our society is going to be startups from women, I mean, if we want more startups and we want—we cannot leave out half of

our society not borrowing to get that entrepreneurial spirit going. So I appreciate your efforts here.

Mr. MANGER. Absolutely.

And let me just add, though, that in terms of, again, our Microloan program having a record year last year, we now are showing that almost 48 percent of our microloans are going to women.

Senator CANTWELL. That is great.

Mr. MANGER. So we are getting near that 50 percent mark, and so we are making progress.

Senator CANTWELL. Thank you.

Thank you, Mr. Chairman.

Chairman RUBIO [presiding.] Senator Hawley.

Senator HAWLEY. Thank you, Mr. Chairman.

Mr. Manger, let me ask you about microloans, since you were just talking about those. My understanding is when the Microloan program was first authorized back in 1992, there was a requirement that half of all loans be made in rural areas.

Now, I do not know if at some point along the way that rule was removed or maybe it is just being ignored, but the Congressional Research Service reported in a 2019 report that today, 81 percent of all microloan borrowers are located in urban areas.

As you know, the largest intermediary for these microloans is based in my State, in St. Louis, Justine Petersen, and when my team asked the folks there and the SBA regional team members who are based in Missouri about expanding access to these programs for rural businesses and entrepreneurs, they were very frank. They said that they want to do it, but it is hard for at least two reasons. One is the 1-in-55 cap rule that keeps the funds tied up, but the main impediment, as you might imagine, is geography. Staff can either spend hours in the car visiting rural communities to facilitate these loans and provide all of the pre- and post-loan technical assistance, or they can just operate in major urban areas, where there is plenty of demand to keep them busy.

And all of that is understandable. I am not here to criticize anybody for their choices, but what I want to know is what can we do to structure this program and provide resources needed to ensure that all of our citizens are benefiting, especially those in rural areas that is the majority of my State and where I grew up, where the need is very great.

Mr. MANGER. I appreciate that. And, Senator, let me just tell you that my grandfather was from Boonville, Missouri.

Senator HAWLEY. Oh, very good.

Mr. MANGER. So I just wanted to add that.

So for places like that and other rural parts of your State, we want to make sure that everybody has access to capital. So we are doing everything that we possibly can.

We have an agreement now, as you may know, with the U.S. Department of Agriculture. There was a signed MOU between Administrator McMahon and Secretary Perdue. So we are actually now working together.

And let me just give you one example of a success story that we had down—I am sorry. It is not in Missouri. It is in Louisiana, where Senator Kennedy—but in Louisiana, we actually worked

with USDA to provide a grand total of \$30 million to a manufacturer of denim, the material of blue jeans, and they are actually exporting that material.

So this company, Vidalia Denim Mills, got \$25 million from the USDA, \$5 million through the SBA, and now they have been able to hire 300 workers in a rural part of northern Louisiana for this company to make denim to sell overseas. So that is a success story, and we want to see more of those successes. We will bring them out to Missouri.

Senator HAWLEY. That is fantastic.

Are there other steps that you can think of that this Committee should take or should look at to continue to expand that access for rural business folks?

Mr. MANGER. You know, Senator, at this point, we are trying to do it through our field operations. We have 68 district offices. I used to be the head of field operations at the agency. We have 10 regional administrators, and we are trying to get them out as much as possible.

We are currently offering some fee relief to loans that are made in rural areas. We have included in the 504 program a relaxed job—dollars-for-job formula so that it encourages 504 loans to be made in rural areas.

We have also included in the Community Advantage pilot program an incentive to have Community Advantage loans made in rural areas because 60 percent of the loans had to be made in the low- to moderate-income areas.

We have now included rural in that 60 percent as well. So we are taking lots of steps to try to make sure we are getting out to those rural areas, but I look forward to working with you and then the Committee to figure out how we can even do a better job.

Senator HAWLEY. Great. Thank you very much.

Thank you, Mr. Chairman.

Chairman RUBIO. All right. I hope you have something good for Nevada like Missouri.

Senator ROSEN. Thank you. Thank you, Mr. Chairman. Thank you for being here today.

Actually, we have a lot of veterans in Nevada, so I want to talk about veteran-owned small businesses. Actually, there is roughly 2.5 million veteran-owned small businesses across the United States. In Nevada, we have over 220,000 veterans, and so this sector represents nearly one in 10 U.S. businesses generating an estimated \$1 trillion in revenue. So we know our veterans are tremendously talented, but sometimes they need help transitioning from the military using those skills into civilian employment or launching a startup.

Last year in the House, I cosponsored the Veterans Job Opportunity Act, which provides tax credits to veterans to open a small business in an underserved community. So this proposal would help veterans, their spouses, reserve, and national guard members invest and revitalize small business through their entrepreneurship.

So I know that you offer specific training and loans for veterans as well. So can you tell us a little bit about what you are doing for

veterans, and do you think that creating a tax credit like those in my bill last session would be helpful?

Mr. MANGER. Thank you very much, Senator.

Again, in the Microloan program, we are doing very well in getting loans out to veterans. In fact, we are just about where we were last year, which has been the best year since before the great recession. So we have seen in the Microloan program, the loans to veterans come back very strongly.

We do still offer, again, by statute, the fee relief to veterans in the Express program. Certainly, we would be pleased to talk to your further—you and your staff, the Committee—about possible tax credits for veterans.

We have our Boots to Business program that actually has been very successful, and we again continue to promote that. I feel like we are doing quite a bit to try and get out to veteran communities and make sure that they are able to partake in the loan programs and access to capital that they need for their business.

Senator ROSEN. That is terrific. Thank you.

I would like to switch over to some of our minority-owned businesses. Of course, we have a lot of that in Nevada. So one of the top concerns I hear about from small business owners and my local chambers is the need for quicker and easier access to capital.

So despite you have lots of many great SBA programs, but there seems to be a disconnect between available capital and actually getting it in the hands of the minority business owners.

So data consistently shows that African American- and Hispanic-owned businesses struggle. They really struggle to get access to the most affordable and quality capital, and only 7 percent of the loan approvals go to minority businesses. And that does not really, nearly reflect the needs of the community.

So how do you think you can address and rectify some of this imbalance for minority communities?

Mr. MANGER. So we want to make sure that, again, we have the most efficient process possible.

You were talking about the speed. Unfortunately, we are competing against some lenders that operate online that have very high interest rates. It is very easy to get that capital. We want to make sure that we have the ability to make capital available on reasonable terms, and our programs offer those reasonable terms.

In fact, our interest rates, where they are within the band that we allow them, are lower than what you would get on credit cards. Many small businesses, as you know, max out credit cards to get—

Senator ROSEN. Right.

Mr. MANGER [continuing]. The business to start their business. We want to make sure that the SBA programs are out there.

For example, I mean, with the—again, I am going to talk about the Microloan program again because we are doing very, very well getting out those loans to small businesses at rates much lower than the predatory rates that you would receive on the street.

Senator ROSEN. So let me ask this question. Is it a problem of getting information out to the small businesses? Is there a central repository at the SBA website where I can direct small business owners so they do not have to go out and find it in other places

in the community? Would it be helpful to have some kind of consolidating feature within the SBA for cyber hygiene loan access?

Mr. MANGER. Yeah.

Senator ROSEN. All the kinds of platforms that we know small businesses need to succeed, especially in their first year. Are you working on something like that, or how can we help you do that?

Mr. MANGER. No, no. I appreciate that, and we are constantly trying to put as much information on our website as possible.

We update the CDCs, the certified development companies, that participate in our program. Again, we have the franchise list on the website so that anyone can look at eligible franchises, and if they want to start one of those franchises, they know that the SBA will guarantee the loans enabling them to purchase one of the licenses for one of those franchises.

So, again, we can always do more. I think we are trying to get out as much information as possible through our district offices, and we are bringing people in through the Microloan program that graduate then later to larger programs.

Community Advantage program is doing very well in areas bringing in—

Senator ROSEN. Shall we change that from pilot program to the—

Mr. MANGER. You know, we want to make that program strong enough so that it can be made a permanent program. That is our objective, and we have taken steps to make that program have a stronger foundation so that it can be built upon and grow. Again, the pilot was expanded so that we can observe it a little bit longer and then, yes, make it a permanent program.

Senator ROSEN. Fantastic. Thank you.

Mr. MANGER. Thank you, Senator.

Chairman RUBIO. Thank you.

Two quick questions. The first is on the—and this may have been asked while I was out, and I apologize. I think we will have another vote here in about 45 minutes.

On the 504, we hear a lot about the CDC loan guarantee program. One of the complaints we have heard is that the application and the other processes are not completely online. The closing process can be complicated and cumbersome, and it is causing some lenders to move borrowers or move—to shift these borrowers over to the 7(a) product, even when the 504 product might be a better fit. That is a concern we have heard. What are we doing to address it?

And I apologize if that was already asked.

Mr. MANGER. No, no. It was not already asked, Senator. Thank you.

So let me just start by saying that actually this year, so far in 2019, we have seen the 7(a) program down 8.5 percent, and the reason why we are seeing that is many people now are going to get conventional loans. Banks have opened up their credit box because the economy is doing well, and they are making these loans conventionally.

What they are not doing, though, is making long-term loans at a fixed interest rate, and that is where the 504 loan comes in.

I am happy to report this year that a 504 program is up 7.5 percent, and that is because of the rising interest rate environment, people wanting to lock in a fixed interest rate for 25 years.

You may know that Administrator McMahon, one of the first things she did when she came on board, she introduced the 25-year term. The longest term in that program prior to that was 20 years, so we added 60 additional months in which to repay that loan. So that is one of the reasons why we have seen a huge upsurge in the 504 loan.

So, for example, to date, we have seen about—since the 25-year debenture was introduced, we have seen almost 3,000 loans made for almost \$3 billion, and that is in one year. One year.

Chairman RUBIO. In 504.

Mr. MANGER. In 504. And so that is people taking advantage of a fixed interest rate for 25 years. In fact, the rate right now is below prime. So someone can get a 504 loan for up to \$5.5 million at comparable rate.

Chairman RUBIO. But I guess the point, that it is not the structure—right. And that obviously improved the structure and the—

Mr. MANGER. And it is up 7.5 percent.

Chairman RUBIO. Right. So I guess when we hear people say that they think the process is cumbersome and the paperwork is difficult, they have not been able to do it online, is that valid? Is that historic, and it has changed? I mean, or is it—

Mr. MANGER. No, no. So now that the program actually is fully automated, the 504 program is fully automated, it is a more cumbersome product than the 7(a) program. There is no doubt about it. I mean, you know the way it is—

Chairman RUBIO. What does fully automated mean? You can do it online?

Mr. MANGER. Well, the lender, the CDC—

Chairman RUBIO. Right.

Mr. MANGER [continuing]. When they are putting in the data, yes, they do that online. Yes, correct.

So you need a third-party lender to provide 50 percent.

Chairman RUBIO. Right.

Mr. MANGER. Forty percent is done through the CDC with SBA's guarantee, and then 10 percent—

Chairman RUBIO. But your interface with the lender is all electronic?

Mr. MANGER. Yes. That is correct. Yep.

Chairman RUBIO. Does each lender, then, intermediary lender, do they have different products or different ways to handle it with the borrower? How do they—

Mr. MANGER. Yes. How they interact with the borrower is really up to them.

I will admit that sometimes we will wait for an intermediary to be able to provide all the data and the paperwork that is required to close a 504 loan because, again, a lot of times it is for—

Chairman RUBIO. But that is lender-dependent. That is their processes for gathering information, not yours.

Mr. MANGER. That is correct. That is correct.

Chairman RUBIO. The Ranking Member might have another question, and then we got to get to the other panel as well.

Under the Microloan program, the intermediaries are being asked to collect and regularly submit data, correct, to the SBA? It is unclear, at least to me—perhaps this was covered in the past—about what happens with this information. It is not—my understanding, it is not related to industry or to Congress. So what types of data do we believe that they are collecting to help measure borrower outcomes? I guess walk us through what they do with the data, how we use it, why it is relevant.

Mr. MANGER. Right. So, actually, in fact, right now, Senator, we are working, as I mentioned earlier, to improve the electronic submission program referred to as MPERS for the Microloan program, and it really has not been updated in 25 years.

So we thank you for, again, the programming of the \$1.2 million. We are working on that for a new system. We are going to be able to capture more information on the microloan sheet.

So, for example, we want to find out how many jobs were created. What type of revenues were enhanced because of the receipt of the loan? We want to be able to make sure that after the 6 years that is the term of a loan that the small business is actually still in business.

We have seen some microlenders go out of business, but they continue to pay off the loan because they are dedicated to making sure they pay off that loan. So there are certain metrics that—you are correct—we need to capture, and our new system will allow us to do that. So I think we will be able to do that.

The one thing that our Office of General Counsel says we cannot share is some of that data because we are not the maker of the loan. It is actually a not-for-profit lending intermediary that makes the loan. So the information really belongs to them, and we are not allowed to give out the information that they are capturing from their customers.

Senator CARDIN. I would just request if you would make available to the Committee the dollar amount under the fee program, under the veterans Express loan, how much that fees are being waived, the dollar amount in the last couple fiscal years, and then if we had fee waiver on the small loans, how much revenue is involved in the fee waivers? If you would just give us those two numbers, I would appreciate it.

Mr. MANGER. Sure. I will get that back to you, Senator. Absolutely.

Chairman RUBIO. I also had one more, since you are already sitting there, and we will get some of this for the record as well. But I know that, I guess, in September of last year, there was published a notice in the Register making some changes to the agency's Community Advantage program. Among the changes were a moratorium on new lenders entering the program.

Kind of what was the intent of this change, and how have we assessed? Has that change been made, and is it now effective? How do we assess the program under that new parameter?

Mr. MANGER. I appreciate that question, Senator. Yes.

So when I came in, the Community Advantage program, I was introduced to it as a pilot program. I was watching it. It is performing very well in getting loans made, but we wanted to look more deeply into how the actual loans were performing.

So we had, in collaboration with our Office of Credit Risk Management, Dun & Bradstreet do a review of the performance of the program, and it showed that there were some problems, especially on some of the larger loans. Loans that had a low credit score, we were allowing lenders, the CA lenders, to make loans on a delegated basis with a credit score below 140.

The problem with that was we noticed that the loans that were being made below 140 credit score had a default rate of over 10 percent. That caused us concern. This is a subset of the 7(a) program. We thought that was too high.

What was amazing was the minute the credit score went above 140, the default rate dropped to just over 4 percent. So what we did in this notice that you are citing from last fall, in September, was we said, "Look, from now on, the delegated loans may only be made with a credit score above 140, where there is less risk. If the loan is going to be made below 140, we will still allow that, but it needs to go into one of the SBA centers to be really underwritten and looked at so that we do not have the threat of, again, over 10 percent default rate." So that was one of the changes we made.

We also made some other changes that we think were very helpful to small businesses. We restricted some of the fees that they could be charged because we saw that there were some very high fees being charged to the small business to get one of these rather small loans.

We also expanded the areas in which they could be made. For example, Senator Hawley was talking about rural loans. We included rural as another category of where we would encourage these loans to be made.

And, finally, again, as I said earlier, we wanted to look at the program and really study it, just the way you would almost do a science experiment, and you need a static group so that you can study exactly how it performs.

So we said, "Look, right now, we are going to ask for a moratorium to be put in place so we can study this group, how it performs, and then make any adjustments necessary to make sure that this program is on a firm foundation and that it can go forward and become a permanent program in the SBA's array of programs."

Chairman RUBIO. So it is the intent—you just said it could be a permanent program. Is permanency a goal?

Mr. MANGER. It is a goal of the agency, absolutely, and we want to be able to study it and make sure that it is as strong as possible so that it can be a permanent program. Yes.

Chairman RUBIO. And the moratorium was designed to free sort of the status quo so you could study and learn from it?

Mr. MANGER. Absolutely. So that we would have a controlled group participating in the program so that we could observe how the program performs.

Over the years, since it was introduced in 2011–2012, there have been many, many new entrants into the program. That skews our ability to really study the program.

Chairman RUBIO. Right.

Mr. MANGER. If you have a static group in the program, as I said, like a science experiment, you can really study and see how the program is performing with the lenders.

Chairman RUBIO. So, to paraphrase it, you froze it in place so you could study it, learn what works and what does not, create those conditions, I imagine at some point lift that moratorium, open it up for new lenders under those new conditions, and have the confidence to come back and ask us to make it permanent?

Mr. MANGER. Absolutely. Thank you for the question, Senator.

Senator CARDIN. I would just observe that at least from a lot of the stakeholder groups that I have heard from in regards to the changes you made in the Community Advantage program, there did not appear to be consultation with the stakeholder community. I think they were kind of surprised to see the rules that come out.

Your rationalization is something that I think is helpful to have discussions with stakeholders before you make that type of a major change.

Mr. MANGER. I appreciate that, Senator. Thank you.

Chairman RUBIO. All right. Well, thank you.

We have been joined by our Chairman Emeritus, but he is going to submit a question for the record.

Anything on foreign policy you want to ask the SBA? Nothing? All right.

[Laughter.]

How many offices do you have in Afghanistan?

Senator RISCH. We covered that at lunch, did not we?

[Laughter.]

Chairman RUBIO. Thank you so much. I appreciate you being here. Thank you.

Do you have anything else?

Senator CARDIN. No.

Chairman RUBIO. All right. We are going to welcome our second panel. We want to thank you for being here.

Mr. MANGER. Senator Risch, I am sorry I did not get any questions from you.

Senator RISCH. Well, I got a tough one, but we are going to do it for the record.

Chairman RUBIO. I will start introducing our second panel as they position, and I want to start out by saying to the second panel, we are going to try to—I am going to limit my questions, obviously, so that other members have time to fully ask theirs as they come and go.

We have a series of votes, potentially beginning at around approximately 4:30 or so, which means about 4:45 is the limit for those of us who have to get over there and do it. So that should give us enough time to kind of get through this, but your input is very important. And we are glad that you are all here.

Our panel today, Julie Huston is the president and CEO of—immito. Is that right? Did I say it—

Ms. HUSTON. immito.

Chairman RUBIO. All right. You are going to tell us how to pronounce it.

Out of Denver, Colorado. They phonetically spelled it for me here, but I guess I just botched it. Out of Denver, Colorado, she has

worked for over 30 years in the small business lending sector, participated in three successful nonbank startups and one division turnaround, and spent 19 years in executive leadership roles where she has worked to build programs, development products, and improve delivery systems for small business lending.

Patricia Kibbe is president and CEO of Evergreen Business Capital based in Seattle, Washington, and I know Senator Cantwell was here earlier. If she is able to return—I know she had some other commitments on committees as well, but she wanted to have a few moments to also introduce. We will make that happen if she is able to return. Based in Seattle, Washington, but also serves Washington, Idaho, and Alaska, and has served in that role since 2013. And, in 2015, Ms. Kibbe helped set up Evergreen Business Capital Community Finance.

Robert Villarreal is the executive vice president of CDC Small Business Finance in San Diego, California. As executive VP, he is responsible for grand and capital development, strategic partnerships, and government relations.

And Connie Evans is the president and CEO of the Association for Enterprise Opportunity based here in Washington, D.C. Ms. Evans has worked on microlending policy since 1986, when she was the founding president of the Women's Self-Employment Project.

So we want to thank all four of you for being here today. I know each of you have an opening statement you would like to give.

So why do not I start with you, Ms. Huston, so you can tell me how to accurately pronounce that and then move from there.

Senator RISC. Mr. Chairman, for the record, Julie does a fact-finding trip to Idaho every year, so we are always glad to have her.

**STATEMENT OF JULIE HUSTON, PRESIDENT AND CEO, immito,
DENVER, COLORADO**

Ms. HUSTON. Chairman Rubio, Ranking Member Cardin, and members of the Committee, thank you for allowing me to have the opportunity to testify. My name is Julie Huston. I am currently the CEO and president of immito, a nonbank 7(a) lender which holds a Small Business Lending Company license, providing access to capital nationwide.

I am also currently the chairwoman of the National Association of Government Guaranteed Lenders, NAGGL, and in that role, I have the honor of representing over 800 financial institutions and partners that participate in the 7(a) lending industry.

At the heart of the SBA's successes, the 7(a) lending program, the agency's largest public-private partnership, last year financial institutions provided about \$25.4 billion in loans to over 60,000 small businesses nationwide, creating or retaining over 540,000 jobs.

7(a) lenders are prepared to roll up our sleeves to discuss ways to modernize the program and improve the outcomes available to small business borrowers. In fact, this Committee and the 7(a) industry had a landmark year passing legislation to make a massive amount of positive changes to the Small Business Act, including but not limited to a historic oversight bill.

I now need to address the 7(a) industry's number one priority. The President's FY20 budget request sent a shockwave through the

industry when it included a subsidy calculation requiring an additional funding of \$99 million for the 7(a) program. This is a major shift from the program's track record of operating at a zero subsidy, which means that the fees collected from borrowers and lenders cover the costs of the loans.

The FY20 positive subsidy rate means SBA is proposing borrowers and lenders pay \$99 million more in fees over and above the fees already collected.

These fees are currently being collected at their statutory maximums, as authorized by the Small Business Act. What does this mean for this Committee and Congress? Unless the administration formally amends its projected FY20 subsidy rate, by September 30th of this year, Congress will need to either appropriate \$99 million or amend the Small Business Act to raise the current fee caps on borrowers and lenders. Otherwise, the 7(a) program will shut down on October 1st.

My plea to this Committee is that you challenge both OMB and SBA to fully disclose the subsidy assumptions and provide adequate oversight of the subsidy's calculation. The 7(a) subsidy and the FY20 budget does not follow logic on a number of fronts.

Number one, the portfolio's performance data projects a sharply different picture than this positive subsidy estimate suggests. The performance of the 7(a) loan portfolio has never been better with the FY18 charge-off rate at an all-time low of 0.51 of 1 percent.

The 5-year average recovery rate on defaulted loans as reported to Congress last December was 50 percent. In sharp contrast, the FY20 budget assumes a project recovery rate of only 37.29 percent.

In addition, since FY 2010, the model used by SBA and OMB has overcharged borrowers and lenders by \$3.2 billion in just the last 9 years. This is a tax on small businesses borrowers, plain and simple. What this really means is that borrowers and lenders have been paying substantially more fees than required to cover the cost of 7(a) loans.

In this year's budget, the FY18 subsidy estimate alone acknowledged a \$757 million overcharge, with another \$143 million overcharge already predicted for the current FY19. Repeatedly overcharging borrowers and lenders means the model is not working and needs to be reviewed, and now they want \$99 million more.

In a 2004 GAO report requested by this Committee to review SBA subsidy calculations, GAO and two other independent reviewers could not determine whether a bias existed in the model by systematically excluding variables to influence the subsidy rate in a particular direction. The report also states SBA could not provide adequate documentation to demonstrate the rationale for the model. These are alarming conditions and should be looked into as it applies to the FY20 calculation.

What are the real-life consequences of raising fees on borrowers and lenders in SBA's proposed budget? Costs will be increased to small business borrowers, which will have a chilling effect on access to capital. If the program does not make financial sense for lenders, then they will participate less in the 7(a) program, and access to capital will be further restricted.

Without appropriate oversight of OMB and SBA, a flawed financial model for the 7(a) portfolio will dictate access to capital rather

than allowing this Committee and the Small Business Act to exercise that authority.

SBA has been overcharging borrowers. Performance of the portfolio has never been better. This is a small business tax. Let us collectively make sure that this does not happen.

Thank you.

[The prepared statement of Ms. Huston follows:]

"Reauthorization of the SBA's Access to Capital Programs"

Testimony before the Senate Committee on Small Business and Entrepreneurship

April 3, 2019

**Submitted by
Julie Huston, CEO and President
immito, LLC
Denver, CO**

Julie Huston, President & CEO, immito, LLC

Chairman Rubio, Ranking Member Cardin, and Members of the Committee—my name is Julie Huston and I am currently the CEO and President of immito, LLC. I started working as an SBA lender in 1986, and over the span of my 33-year career in lending I have had the privilege to manage and lead SBA departments that range from the traditional bank to the non-bank lender model, and from small institutions to some of the largest in the country with 12,000 SBA loans and \$2.2 billion on the books. My career has weathered the ups and downs of several economics cycles, and I know firsthand what that means for small businesses. And I can tell you that I remain as committed now to providing access to capital for small businesses as I was on February 3, 1986—my first day.

In my current role at immito, LLC, I am in a unique position to assist small business borrowers. immito, LLC is a non-bank SBA 7(a) lender and holds a Small Business Lending Company (SBLC) license with the SBA that provides access to capital nationwide. We believe that starting, building, growing and supporting small business is a powerful strategy for transforming communities. I am also currently the Chairwoman of the National Association of Government Guaranteed Lenders (NAGGL), and in that role, I have the honor of representing over 800 financial institutions and partners that participate in the 7(a) lending industry. I thank this Committee for giving me the opportunity to testify both in my capacity as a veteran lender, but also as a voice for the thousands of lenders who devote their careers to helping small businesses.

WHY 7(a) LENDING:

Given the opportunity this hearing presents to reflect on the importance of these programs and the gap in access to capital it serves, I would like to touch on the importance of the 7(a) loan program and why the program has enjoyed consistent support from this Committee since its inception. It is particularly timely that we have this opportunity today, given the grave danger in which the President's budget submission has placed the 7(a) program, surprisingly requiring this Congress to either appropriate dollars or approve fee increases on small business borrowers just to continue the program next year, even though the program's credit performance has never been stronger. I will have much more to say on this critical topic later in my testimony.

Today, the American entrepreneurial spirit is stronger than ever. Unfortunately, there is a gap in conventional bank lending in this country and even the most qualified business owners often struggle to secure financing that meets their needs. While consumer optimism reports suggest an overall recovery since the Great Recession, feelings of optimism are a far different matter than a small business borrower successfully finding suitable financing to start or grow their companies. A small business seeking capital is often offered loans with short maturities when they really need long-term financing to survive. The needs of this country's small businesses are frequently a depository mismatch for banks that are often unable to tie up capital in long-term loans. Despite improvement in some sectors of business lending since the Great Recession, there is still a need for more financing options that provide greater stability for small businesses.

At the heart of the SBA's success is the 7(a) lending program, the agency's largest public-private partnership with approximately 2,000 participating private-sector financial institutions who have one or more SBA loans on the books. These lenders make private-sector loans with their own capital based on their own financial decisions to small business borrowers who meet program standards for creditworthiness and financial health, but who fall into the very common lending gap for American small businesses. In sharp contrast to what many small businesses borrowers would find in the

Julie Huston, President & CEO, immito, LLC

conventional markets, 7(a) lending has a maximum term of 25 years with an average term of 16 years, and interest rates that are governed by set by statute and regulation, usually far below interest rates charged for business credit cards and online fintech lenders. In other words, 7(a) lending is the kind of financing that small businesses need to survive, but generally cannot find in the conventional market, especially in a climate where loans to small businesses are often deemed the most risky by lenders and most often fall outside of the conventional credit box. The 7(a) loan program is a rare anomaly in the broad spectrum of federal programs because SBA has figured out how to leverage private-sector expertise and take on a shared risk relationship in the portfolio. Lenders know how to make loans. As a result, SBA is not in the business of picking “winners and losers” because SBA does not make the loans and its 7(a) program is open to any eligible, creditworthy small business borrower.

The cornerstone principle of the 7(a) loan program is the credit elsewhere requirement in the *Small Business Act*, ensuring that the program complements, but does not compete with conventional small business lending. The non-competitive status of the program is assured by the fact that before any SBA 7(a) loan guaranty can be approved, the participating lender must certify that the loan could not be made without the SBA guaranty on reasonable terms and conditions. Recently, this Committee and your colleagues in the House amended this credit elsewhere language in the *Small Business Act*, and while I will touch on these changes further in my testimony, I want to take the opportunity to say that the resulting clarification of that change was critically important to assuring that the loans made under the program continue to fill the existing small business credit gap. It should be no surprise that given today’s conventional credit box for small businesses, a credit elsewhere program would grow and thrive. The fact that we have seen this program continue to reach into the market in the aftermath of the Great Recession, reaffirms that 7(a) lending is fulfilling the intent of Congress that these loan programs not compete with the private sector’s conventional markets or make loans to borrowers who could receive a conventional loan.

The nature of the 7(a) loan guarantee also helps to ensure that lenders have skin in the game. Generally, SBA will reimburse the lender a percentage of the outstanding loan balance if the loan defaults—generally up to 85% for loans up to \$150,000, and up to 75% for loans over that amount up to the current program maximum of \$5 million with trade loans qualifying for a maximum 90% guaranty. However, SBA’s guarantee is a *contingent* guarantee, which means that if a lender fails to fully satisfy its compliance requirements under the program, the SBA can—and does—reduce the amount of the guarantee payment to the lender *if* the loan defaults and a deficiency balance remains after the lender has exhausted the remedies available to it to collect on the unpaid balance. In some serious cases, the SBA is permitted to deny all liability under the guarantee. These aspects of the contingent guarantee relationship serves to assure that lenders comply with the various SBA program requirements while engaging in quality lending. The guarantee program is a sharing of risk and not a complete transfer of risk away from the SBA 7(a) lending community. Beyond responsibilities to SBA and the taxpayer as responsible stewards of the program, the lenders have an ongoing responsibility to their federal and state regulators, their internal regulatory oversight group, and even their shareholders to ensure that safe and sound lending practices are maintained. In part, this skin in the game is what makes the private sector such ideal partners in the SBA 7(a) program, serving as an incentive to all lenders to be prudent stewards.

THEN AND NOW: A LOOK AT 7(a) LENDING:

From the Agency’s inception, among the programs that it offered was loans to small businesses as authorized by section 7(a) of the *Small Business Act*. The 7(a) program was created in recognition of the

Julie Huston, President & CEO, immito, LLC

fact that small businesses have a more difficult time than their larger counterparts in accessing the capital needed to start and grow their businesses.

Originally, 7(a) loans were provided on a direct basis, financed with taxpayer dollars, with SBA staff evaluating the eligibility and creditworthiness of the applications and taking all actions to approve, disburse, service and, if necessary, liquidate the loans. But, over time, the program has evolved to a loan guaranty program where SBA's private-sector partners – banks, and other commercial lenders, including a few SBA-authorized Small Business Lending Companies – provide the loans to small businesses applicants. The migration from a direct program to a guaranteed program was completed by the late 1990s when Congress discontinued funding to support any of the remaining direct 7(a) loan programs authorized by the *Small Business Act*.

As SBA delegated more responsibilities to lenders, it recognized the need to protect the integrity of the program by providing meaningful oversight over the lenders that were providing loans and taking necessary servicing and liquidation actions. So, in the mid-1990s, SBA established an office to review program compliance by lenders that held the delegated authority designated as Preferred Lender Program (PLP) status. Over the next two decades, in order to better manage program risk, this oversight function became much broader, taking on the responsibility for regulating non-federally regulated lenders, and for overseeing the activities of other regulated lenders and of the integrity of the 7(a) program. Now, the Office of Credit Risk Management (OCRM) plays a critical role in the continued success of 7(a) lending.

Today, the numbers tell a story of great success in the 7(a) program. In Fiscal Year (FY) 2018, financial institutions large and small provided about \$25.4 billion in approvals to about 60,350 small businesses nationwide through the SBA 7(a) program. Roughly 543,100 jobs were created or retained just last year thanks to the SBA 7(a) program-- if we assumed just \$30,000 in average annual wages for those employees affected by the program, that means the 7(a) program is responsible for supporting at least \$16.3 billion in income across the country. The impact does not stop with just those topline numbers—there are other benefits that are often hard to measure, like employment opportunities, increased tax revenue for federal and local governments, and community growth driven by small business expansion in cities, small towns and rural areas across the country. There is a never-ending domino effect of benefits gained from the 7(a) loan program.

The performance metrics also tell a success story. I am pleased to report that the performance of the SBA 7(a) loan portfolio has remained sound. Repurchase rates on defaulted loans remains near an all-time low, while recovery rates on collateral is at an all-time high. Putting the two together, SBA reports a record-low charge off rate for the portfolio in FY 2018.

Over the past several years, lending to nearly every underserved market — from rural communities, urban areas, women, Hispanics, and African Americans to name a few — has increased. For at least the last decade, roughly 75% of the 7(a) portfolio's loans have been small dollar loans, or \$350,000 or lower (prior to FY09, loans up to \$350,000 were not publicly reported in the same way). Having spent my career emphasizing the need to focus on underserved markets, I am proud that 3 out of every 4 loans are small. In fact, since the portfolio as a whole has grown by 42% in dollars and 30% in units, small dollars loans consistently composing roughly 75% of the portfolio actually means those loans have been increasing as

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well. In the past five fiscal years, small dollar loans have actually increased 33% in dollars and 31% in units.

In addition, there have been marked improvements over the past five fiscal years in providing access to capital to specific underserved markets. For instance, while a cursory assessment might show that the proportion of the portfolio has seemingly plateaued in lending to African-Americans, since the entire portfolio has grown by 42% in dollars and 30% in units, in the past five fiscal years lending has increased by 145% in dollars to African-American borrowers. For Hispanic borrowers, the proportion of the portfolio has increased by a couple percentage points, but actual dollars going to Hispanics has increased by 79% in the past five fiscal years. This is true for many other demographics over this same five fiscal year period from FY2013-FY2018: lending to American Indian borrowers increased by 107% in dollars, lending to Asian-Pacific Islander borrowers increased by 57% in dollars, lending to women-owned borrowers (when the business is over 50% woman-owned) increased by 50% in dollars and 39% in units, lending to rural populations increased by 37% in dollars, and lending to urban populations increased by 43% in dollars. In fact, lending to all minorities has increased by 67% in dollars and 47% in units. I am confident that the SBA 7(a) lending industry is fulfilling the intent of Congress to serve the country's small businesses. I stand at the ready to discuss these issues in more detail with this Committee today and in the coming months and to explore ways we might make even further progress on this topic.

SMALL BUSINESS ACT REAUTHORIZATION EFFORTS:

This Committee and its colleagues on the House Committee on Small Business have been incredibly active in taking a closer look at the 7(a) loan program over the past two Congresses, and as a result, a number of significant and historic legislative accomplishments were realized last year by updating the *Small Business Act*'s provisions as it pertains to 7(a) lending.

First, the Committee and its House colleagues drafted and passed into law the *Small Business 7(a) Lending Oversight Reform Act of 2018*, a bipartisan, bicameral effort that spanned two Congresses and three and a half years of work on the part of this Committee. The 7(a) lending industry partnered with the Committee every step of the way. I know it might sound strange that banks partnered with Congress to explore ways to refine and create stronger oversight standards on themselves—it certainly is not the norm for most regulated businesses. However, the 7(a) lending industry is keenly aware that we have the *privilege* of being stewards of a government program with a public mission, and while we are all private-sector companies, this privilege is not lost on us. Without the proper resources, tools, and oversight guidance, government programs have a way of losing their course, as well as the trust of Congress and the country. At a time of great success in the 7(a) program, it was a worthwhile and significant exercise to have gone through with this Committee and its colleagues in the House.

Specifically, the *Small Business 7(a) Lending Oversight Reform Act of 2018* reformed the *Small Business Act* in a number of significant ways, such as codifying OCRM's existence in statute, providing clarity to the credit elsewhere provision of statute to ensure the program's cornerstone principle is better understood by lenders in order to strengthen compliance, improving oversight reviews and the timeliness of providing those reviews to lenders, providing appeal rights to lenders, and finally, requiring consistent reporting and communication with Congress regarding the performance of the portfolio. This is by no means an exhaustive list of this bill's accomplishments. The 7(a) loan program is only as strong as SBA's ability to encourage good behavior and conduct enforcement when appropriate, and the *Small Business 7(a) Lending Oversight Reform Act of 2018* provided the SBA with significant tools to do just

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that. The entire 7(a) lending industry looks forward to SBA promulgating proposed regulations in the coming months, as it is critically important for industry to be a part of the comment period to share stakeholder views. According to statute, final regulations are required to be published by June 21, 2019.

I also want to specifically highlight another key legislative priority for the 7(a) industry that was addressed in the *Small Business 7(a) Lending Oversight Reform Act of 2018* by the legislation's inclusion of flexibility language for the Administrator, which would allow for an increase to the 7(a) authorization cap by 15% if the pace of lending is set to exceed that fiscal year's given cap. In past years, such as FY14 and FY15, when the 7(a) authorization cap was not sufficient to meet volume and the organic growth in the portfolio, lenders would adjust their behavior and create a run on the bank scenario, resulting in a momentary mid-year shutdown of the portfolio in the case of FY15. This also forced Congress to pass an emergency measure in order to reinstate 7(a) lending. While this flexibility should never supplant the role of Congress in setting authorization caps, it will serve as a common-sense safeguard against last-minute panic—a panic which this program has seen repeatedly given the challenges that come with anticipating the exact number of borrowers who will be applying for SBA 7(a) loans 18 months or more in advance during the budget process. NAGGL drafted this provision in 2015 and advocated for this common-sense safeguard on behalf of the industry for years; I am proud to say that this is now a part of the *Small Business Act*.

Yet another legislative achievement in updating the *Small Business Act* last Congress included this Committee and its colleagues in the House passing the *7(a) Real Estate Appraisal Harmonization Act*, which was also a bipartisan, bicameral effort that was signed into law in December 2018. The legislation amends the *Small Business Act* to allow SBA to use the federal regulators' threshold as its standard for requiring appraisals of commercial real property that will be secured by 7(a) loans. In the wake of a regulatory change made jointly by the federal banking regulators in April 2018, the legislation effectively raised, from \$250,000 to the regulators' current threshold of \$500,000, the size of a 7(a) loan that requires an appraisal of real estate collateral by a State licensed or certified appraiser. By setting the SBA appraisal threshold to match the federal regulators' threshold (or the lesser amount of the three federal regulators' thresholds if there is a discrepancy between them), as opposed to specifying a specific dollar threshold, this language makes the *Small Business Act* much more durable and avoids the need for future statutory changes if any of the regulators change the appraisal threshold in the future. And most importantly, just as the federal regulators made sure that their regulatory update would not compromise the safety and soundness of loans secured by commercial real estate in conventional portfolios, the change for SBA lending also ensures the continued sound performance of the SBA portfolio.

I am proud of the industry's involvement in these significant updates to the *Small Business Act* last year, but I also understand that looking forward, the Committee is now focusing on efforts to reauthorize the *Small Business Act* in its entirety. In my capacity today, as a representative of the 7(a) lending industry, I can tell you that 7(a) lenders are prepared to roll up our sleeves to discuss ways to modernize the program and improve the outcomes available to small business borrowers in the program.

Both NAGGL and I stand ready to discuss a variety of potential proposals with the Committee in the coming months. We would expect during the reauthorization process to spend additional time developing suggestions for positive enhancements to the program, similar (but not limited) to the following examples: (1) modernizing outdated provisions in the *Small Business Act* by striking many

Julie Huston, President & CEO, immito, LLC

sections that are no longer applicable to current use of the program; (2) considering an increase to the maximum cap on Express loans to \$500,000 after careful scrutiny of any potential subsidy impact; (3) including in the OCRM scores for lenders' risk-assessment reviews (also known as PARRiS) lenders' concerted efforts to focus on underserved markets, and accomplishing this without altering the OCRM rating related to any performance issues that may exist with the lender; and (4) discussing any challenges facing export lending and how to better encourage those lenders who are suited for that particular, niche type of lending. In addition, as we consider other appropriate legislative changes to the *Small Business Act*, it may also be appropriate to consider the possibility that Congress may need to provide additional legislative guidance on issues that SBA is seeking to address in the proposed Express regulations that it published for public comment in September 2018, and which are incredibly significant and broad in their impact to borrowers and lenders. The industry and NAGGL would like to request that Congress examine the final provisions to determine whether the rules that SBA would be imposing are appropriate given the mandates of the *Small Business Act*, or whether statutory guidance should be considered.

I would also stress that future needs for legislative changes to the *Small Business Act* are sometimes dictated by events that are impossible to predict as I sit here today. This is demonstrated by the legislative need for a technical fix to the real estate appraisal threshold amount in the *Small Business Act* last Congress—a change that became crucial once the federal regulators adjusted the same threshold in their regulatory framework. I know the Committee, given its experience in overseeing these programs, will agree that we must recognize the need for flexibility as we approach the challenges that face the 7(a) loan program in the near future and in the years to come. For instance, once fully implemented, an accounting change to be applied to banks across the country, known as Current Expected Credit Losses (CECL), is likely to have an effect on 7(a) loan volume as more lenders will turn to the 7(a) program as a resource for small business borrowers. We are undoubtedly a part of a larger fabric of macroeconomic influences that effects the program and requires a constant eye to the necessary modifications.

FY2020 BUDGET TAXES BORROWERS & SHRINKS ACCESS TO CAPITAL:

I now need to address the 7(a) industry's number one priority and concern—one which could very well require a modification of the *Small Business Act*, so an appropriate topic given the context of this hearing. The President's FY20 budget request, presented a little over two weeks ago to Congress, sent a shock wave through the 7(a) industry when it included a subsidy calculation requiring additional funding of 33 basis points (0.33%), or \$99 million, for the 7(a) program. This is a major shift from the program's track record of operating at zero subsidy since FY05 (except during the years covered by the Recovery Act), which means that the fees collected from borrowers and lenders cover were projected to cover the cost of making the loans. By projecting a positive subsidy rate for FY20, the budget request is triggering Congressional action to collect \$99 million more in fees from small business borrowers and lenders *in addition* to the fees already collected in order to cover the cost of making loans—which are currently being collected at their statutory maximums as authorized by the *Small Business Act*.

What does this mean for this Committee and Congress? Unless the Office of Management and Budget and SBA formally amend their projected subsidy rate for 7(a) loans made next year, Congress will need to either appropriate \$99 million to the 7(a) program or amend the *Small Business Act* to raise the current caps in order to collect more fees from borrowers and lenders to cover the cost of the program. If there is not an amendment to the subsidy estimate or if Congress does not complete one of these two options by September 30 of this year—which will need to pass the Senate, House, and be signed into

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law by the President—the 7(a) program will shut down on October 1. I’m sure by now, you can see why this is the industry’s primary focus.

Before we can even consider how Congress might best move forward before October 1st in order to prevent a very successful, popular small business program from simply shutting down, we must first collectively question the positive subsidy calculation. As a lender and Chairwoman of NAGGL, I have a number of serious concerns with this subsidy projection. My plea to this Committee is that you challenge both OMB and SBA to explain this subsidy estimate in detail, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model.

I urge you to keep in mind throughout this conversation that OMB and SBA are simply making projections, basically educated guesses, about how loans that are made during FY20 might perform over the lifetime of those loans. Of course, this is no simple task and the model behind this subsidy calculation is complex, but it bears stressing that this subsidy calculation is really not a mathematical absolute based on a formula that cannot be challenged. Rather, subsidy calculations are made using historical data, but also a lot of assumptions or predictions. These are both assumptions made about how the portfolio performs at various cycles in the economy and assumptions based on the President’s economic assumptions (PEA) released each year. Modeling assumptions that were included, assumptions that were determined should not be included, and how these assumptions are weighted in the model must be reviewed and challenged—and it’s appropriate to do so as members of this Committee and as the industry. Absent holding OMB and SBA accountable for correcting or amending the subsidy calculation, this Committee is going to have to bless an appropriation or approve raising fees on borrowers and lenders to carry out the results of a calculation that it seems no one, except OMB and SBA, understands.

The 7(a) subsidy calculation in the FY20 budget does not follow reason or logic on a number of fronts. First, the portfolio’s actual performance data projects a starkly different picture than this positive subsidy estimate would suggest. The portfolio has seen a steady decline in charge-off rates over the past ten fiscal years on an annualized basis and risk has generally declined since September 2012. The 7(a) program’s recovery amount on defaulted loans as a percentage of the purchase amount, as reported to Congress last December, was at 50% as of June 2018, with the preceding years showing a steady uptick in that percentage. In sharp contrast and at odds with this data, the FY20 budget assumes a projected recovery rate of only 37.29%. Why has the subsidy modeling ignored this established trend of steadily increasing recovery rates?

Another indicator of excellent portfolio performance is the repeated and significant downward re-estimates in every cohort of loans since FY2010, as reported in the FY20 budget request’s Federal Credit Supplement. These downward re-estimates mean that the portfolio is consistently performing better than originally projected in each fiscal year’s original subsidy calculation and that the model used by SBA and OMB has been significantly overestimating program costs. The fact is that borrowers and lenders have been paying substantially more than required to cover the credit costs of 7(a) loans for the past eight years. These excess charges are simply returned to the Treasury as miscellaneous receipts, according to the *Federal Credit Reform Act of 1990*. For example, the FY20 budget re-estimate for FY18 alone, identified \$757 million of fees collected from borrowers and lenders *in excess* of what was required to cover the cost of 7(a) loans made in prior years, with another \$143 million overcharge

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already predicted for the current FY19. Remember that the subsidy model, according to the Federal Credit Reform Act of 1990, is intended to estimate each cohort's projected costs over the lifetime of those loans, but the data shows that the model has been very much getting it wrong. In fact, since FY10, borrowers and lenders have been overcharged by approximately \$3.2 billion. This is nothing but a clandestine tax on small business borrowers. The model is not succeeding and needs to be reviewed.

With this Committee's successful passage of the *Small Business 7(a) Lending Oversight Reform Act of 2018* and SBA's significant, positive strides forward in new SOP guidance and overall oversight functions that ensure the portfolio stays between the lines, the state of the program has been markedly improved. It is difficult to follow that in light of these significant programmatic changes, continued excellent portfolio performance, and clear and repeated overcharging of borrowers and lenders that this program would have a positive subsidy in FY20. I urge this Committee to raise these concerns with all parties involved in the formulation and implementation of the budget for next fiscal year.

This very Committee and GAO have a track record of looking into the accuracy of subsidy calculations, joining its colleagues in the House to request a GAO report approximately 15 years ago. The report was published in March 2004 and titled "Model for 7(a) Program Subsidy Had Reasonable Equations, but Inadequate Documentation Hampered External Reviews." Among its most important findings was that GAO and two other independent reviewers could not determine whether a bias existed in the model by systematically excluding variables to influence the subsidy rate in a particular direction. This is an alarming conclusion and one that should be looked into as it applies to the FY20 calculation. The report goes on to state that SBA could not provide adequate documentation, a key internal control, to demonstrate the rationale and basis for key aspects of the model. One of GAO's recommendations to OMB was not implemented, which was to update and improve OMB's Circular A-11 guidance which is either silent or unclear about the level of documentation necessary for credit subsidy model development.

In addition, GAO has performed multiple reviews over the years on the inherently difficult, and therefore often flawed, effort to accurately estimate subsidy calculations for credit programs, generally. In March 1998, GAO published a report titled, "Greater Effort Needed to Overcome Persistent Cost Estimation Problems," and as recently as July 2016, issued another report titled, "Key Agencies Should Better Document Procedures for Estimating Subsidy Costs." These reports should provide this Committee with the foundation from which to continue the much needed exercise of asking the difficult and ongoing questions about what goes into these models and why.

In SBA's FY20 budget request, the agency includes a proposed new framework to Congress to restructure fees in the *Small Business Act*, noting that raising fees on borrowers and lenders is SBA's preferred solution. Fee increases mean negative consequences for the program and borrowers. Make no mistake—this is a tax on small business borrowers, especially in light of the repeated overcharging of borrowers to operate this program for the past eight fiscal years, and borrowers may be dissuaded from considering a SBA loan in the future, resulting in a reduction in access to capital.

The benefits of having a program that is built on private-sector participants are numerous, but it also means there is a stark reality that the program needs to make sense financially for private-sector banks as well. If the program does not make financial sense for lenders, then they will participate less in the 7(a) program and access to capital will be further restricted. **Without appropriately holding OMB**

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and SBA accountable for their assumptions, something as arcane and bureaucratic as a flawed financial model for the 7(a) portfolio is essentially dictating the parameters of access to capital, rather than allowing Congress and the *Small Business Act* to exercise that authority.

There are several other concerning provisions in the President's FY20 budget request that warrant discussion, such as the continued request for borrowers and lenders to pay for SBA's employees' salaries and expenses by collecting excess fees beyond what SBA needs to cover the credit costs of the program. This is an outrageous request given the questionable positive subsidy calculation this year, and the 7(a) industry will staunchly oppose this provision as an additional tax on small business borrowers that they cannot afford. Most surprising is that this policy proposal completely disregards the Federal Credit Reform Act of 1990 which requires that the subsidy be calculated, excluding administrative costs. OMB and SBA attempt to circumvent that clear statutory requirement by collecting exactly what they need for administrative costs from all SBA loan programs, and then later transferring and merging that amount into SBA's salaries and expenses account—doing indirectly, what they cannot do directly. But the 7(a) loan industry is encouraged that Congress firmly rejected this proposal in the FY19 President's budget request, and urges Congress to once again reject such a burden on SBA participants.

As a lender who focuses on underserved markets, I have particular concern over the fate of fee waivers to borrowers in rural and HUBZone areas that were authorized in FY19 and the fee waiver for veterans in the Express program. With respect to the fee waivers on rural and HUBZone areas, the only way those may be provided in FY20 is if Congress appropriates enough or borrowers and lenders pay enough additional fees, presumably a part of the calculated 33 basis points subsidy rate, in order to cover the cost of those waivers—otherwise, fees may only be reduced “consistent with reducing to zero the cost to the Administration of making such guarantees,” according to the *Small Business Act*. While SBA states in the FY20 budget request that they intend to offer fee waivers for veterans in the Express program in FY20, it is entirely unclear how that is possible given the *Small Business Act*'s clear direction on how SBA can implement these waivers. The provision in the *Small Business Act* governing the fee waiver for veterans in the Express program are very prescriptive in stating that “If the President's budget for the upcoming fiscal year, submitted to Congress...includes a cost for the program...that is above zero, the [fee waiver]...shall not apply to loans made during such upcoming fiscal year.” In other words, the fact that the FY20 budget included a positive baseline subsidy rate immediately rendered that fee waiver null and void as of the moment the submission went to Congress, which stated that “In the absence of [Congress adjusting fees on borrowers and lenders], the 7(a) program will not be able to operate at zero subsidy under current law in 2020.” These are not the outcomes that NAGGL or I would like to see—the industry wants to see fee waivers in order to help facilitate increased lending, but we also question policy announcements that violate the *Small Business Act*.

Thank you for holding this hearing and I appreciate the opportunity to testify before this Committee. As lenders, we are incredibly proud of who we serve and the role we play in each of the states you represent. The issues that SBA 7(a) loans solve for are the issues that every Main Street business across the country is struggling with and which every Republican and Democrat wants to desperately find an answer to over the next four years — jobs, community rejuvenation, and opportunity - which is why it is so important to come together to ensure we protect this portfolio. I look forward to your questions.

Chairman RUBIO. Thank you.
Ms. KIBBE.

**STATEMENT OF PATRICIA KIBBE, PRESIDENT AND CEO,
EVERGREEN BUSINESS CAPITAL, SEATTLE, WA**

Ms. KIBBE. Good afternoon, Chairman Rubio, Ranking Member Cardin, and members. I am Patti Kibbe—

Chairman RUBIO. Chairman Emeritus.

Ms. KIBBE. Chairman—

[Laughter.]

Well, he is from one of my states, so I feel obligated.

I am a nonprofit certified development company headquartered in Seattle, Washington. We have offices and 32 staff members that preside in Washington, Alaska, Oregon, and Idaho. I came to the CDC from the banking world. I was a senior-level banker, and I wanted to come to Evergreen because of its mission to help small businesses have access to capital. I felt that it helps America grow.

Our CDC is an SBA 504 lender. We are an SBA Community Advantage pilot program. We also have other non-SBA small business loan programs. We also have Evergreen Business Capital Community Finance that we are in the process of submitting our application to become a Community Development Financial Institution, or a CDFI.

Since 1980, Evergreen has supported borrowers to create and retain over 20,000 jobs. We have assisted nearly 2,800 businesses with SBA funds totaling \$2.6 billion, supporting projects of \$7.5 billion.

There are over 200 CDCs nationally, and my CDC is not unique. To our industry, we have impact at the local and regional levels. We play an important part. The role of our Nation's economy as nonprofit lenders, we use our excess capital on economic development to help the communities we support.

The 504 program is an economic tool that helps small businesses reach—purchase commercial real estate or equipment with a fixed-rate long term, giving them stability and allowing them to preserve capital for working and operations.

The 504 loan is a result of a partnership involving our third-party lenders, such as banks and credit unions, business owners, and the Federal Government. A typical structure, as Bill Manger said, is a 50/40/10. The lender provides 50 percent of the project financing. The CDC or SBA provides 40 percent, and the small business is 10 percent.

The 504 portion is a guarantee by the SBA funded through a debenture sale on Wall Street and not directly by the government.

The CDC works with borrowers for the life of the loan. I think that makes us very unique as well.

The 504 story, I just want to tell you one. Monaco Tool Company, which is out of Eugene, Oregon, was started in 1986 by Joe Monaco out of his garage. He purchased a building after he really had business started going, and now this last year, he purchased another building. This helped manufacturing. This retained jobs, and it also created 12 new jobs, allowing the building that he bought to actually be futuristic in that he could grow even further.

I could tell you stories like that all day long. The ones that I think might resonate with you on the Committee is Schneider's of Capitol Hill and La Loma Mexican Restaurant. I could tell you about successes like Chobani, which is a national.

Amazingly, the 504 process has these successes while operating at a zero subsidy from the government. This program is self-funded, and by law, we are required to create one job for every \$75,000 lent.

Job creation and retention is unique to the 504 program and is a valuable tool for economic development.

One of the areas that I think is of the biggest concern is the lack of modernization into policy and technology by SBA. We are required to implement duplication and multiple paper, and the electronic tracking of the loan process, while SBA has made some progress, there is a whole lot more progress that needs to be made.

Modernization includes the practical methods of speeding up low-dollar, low interest rates. I just want to say as a former banker, the only way to eliminate risk is to not do the loan. There is risk. It is up to us to manage risk. The CDC industry is very committed to that. The SBA needs to manage risk, not eliminate risk. It is crucial to our businesses.

The CDC work, I can assure you we want to eliminate the risk. We need to make the processes better for our small businesses so that they are not subject to predatory lenders. That is a huge concern out there, as I am working with businesses in the community.

I ask for your leadership in assisting to fix the challenges of the growing economy. I have put more detail into my written testimony. I want to thank you for inviting me to testify, and I am happy to answer any questions.

I also invite you and all members of the Committee to go visit your local CDCs. We are in your states, and you can see firsthand the work that we do.

Thank you.

[The prepared statement of Patricia Kibbe follows:]

United States Senate Small Business and Entrepreneurship Committee

Reauthorization of the SBA's Access to Capital Programs

Testimony Submitted by Patricia "Patti" Kibbe
President & CEO, Evergreen Business Capital

April 3, 2019

Patti Kibbe
 Chief Executive Officer
 Evergreen Business Capital

Good afternoon Chairman Rubio, Ranking Member Cardin, and members of the committee. My name is Patti Kibbe and I am here on behalf of Evergreen Business Capital, where I've served as the organization's CEO since 2013. A non-profit Certified Development Company (CDC), Evergreen Business Capital is headquartered in Seattle, Washington with offices in Alaska, Oregon, and Idaho. I started with Evergreen Business Capital as the Chief Operating Officer in 2002, prior to which I worked as a senior-level banker. I moved to Evergreen due to my belief in its mission of providing America's growing small businesses with access to affordable capital, and the integral part Evergreen plays in helping small businesses to seize opportunities and create jobs. Since 1980, when Evergreen was established as the 11th CDC in the country, its mission has been to strengthen the communities it serves through small business financing. To that end, our CDC offers an array of lending options including the Small Business Administration (SBA) 504 program, SBA Community Advantage Pilot Program, and other non-SBA small business support programs such as loans through our internal Evergreen Business Capital Community Finance. Additionally, Evergreen is in the process of becoming a Community Development Financial Institution (CDFI). I envision, through these tools, a region where growing small businesses serve as the foundation of healthy American communities, from urban to rural.

Our dedicated 32 staff members are located across all four states in which we operate to ensure outreach everywhere we are authorized to make loans, especially rural and underserved markets. Since Evergreen is a mission lender dedicated to small businesses, it is important to have employees who are also members of the local communities, in order to provide the best input and support.

I am pleased to report that our lending mission is routinely successful. Evergreen Business Capital authorized 113 loans for over \$85 million in 2018. These loans are anticipated to create over 500 jobs in our communities. Since 1980, Evergreen Business Capital has supported borrowers by providing capital to create or retain over 46,900 jobs. We have assisted nearly 2,800 businesses with SBA funds totaling over \$1.5 billion, supporting total projects of over \$7.5 billion. These statistics do not account for the impact of other CDCs, of which there are over 200 nationally.

The reason Evergreen and CDCs around the country exist is to help small and startup businesses become bankable for the next level of growth. We work with partners like the Small Business Development Centers (SBDCs) and SCORE. These partnerships are crucial in helping small businesses to thrive. Last year alone Evergreen connected over 124 business owners to resources and capital. Without the financing through the 504 and Community Advantage programs, these businesses simply would not have been able to start or grow. Community Advantage loans, earmarked for very small businesses, are crucial to helping the most underserved markets. I urge the committee to support permanentizing this pilot program so that these small and startup businesses can continue to access capital.

While the story of Evergreen is special to me, it is not unique within the CDC community. CDCs are mission-based lenders, connected to the community not just physically but financially. As non-profit lenders, we use our excess capital on economic development for the communities we support. Many of my colleagues at other CDCs help small businesses access programs beyond the SBA 504 program, as Evergreen does, be it the USDA IRP program, state and local programs, or our own internally created and funded programs to fill gaps we see in the areas we serve. CDCs are leaders in communities across the nation on many fronts, and

Patti Kibbe
 Chief Executive Officer
 Evergreen Business Capital

you can see that here at the witness table with me. My friend Robert Villareal serves as Executive Vice President of another CDC, CDC Small Business Finance, and is here to discuss the wonderful work that they and others, including Evergreen, do through the Community Advantage program. It is a privilege to be part of this community and representing it here today.

I want to turn my attention to the 504 program and the work our CDC does through this. The 504 program is an economic development tool that provides small businesses with long-term, fixed rate loans to help them acquire major fixed assets for expansion or modernization of their businesses. These loans are most frequently used to acquire land, buildings, machinery, or equipment. A 504 loan can be 10, 20, or 25-year term, which is beneficial for small business owners. Pairing the fixed rate aspect with these term options gives a small business owner stability, allowing them to budget and better manage cash flow, without concerns about rising rates or balloon payments. In the rising rate environment that we have been in the last two years, this is particularly critical.

504 loans are a result of a partnership involving third party lenders (such as banks and credit unions), small business owners, and the federal government. Typically, the financing structure is a 50/40/10 split. A bank or credit union provides 50% of the project financing, the 504 portion is 40%, and the small business puts 10% down - giving the small business a lower down payment than a conventional loan, which helps it to preserve working capital for operations. The 504 loan-the "40" in the 50/40/10 - is guaranteed by SBA and funded through a debenture sale on Wall Street. The 504 loan component is not financed using funds from the government. The CDC works with the small business borrower to get the SBA 504 loan portion approved and funded. CDCs work with the small business borrower through the life of the loan. Let me share with you some of those businesses we currently work with.

Evergreen recently assisted a small business in Seward, Alaska called Zudy's Café, a cozy restaurant that boasts "Cake with a View," touting delectable desserts and the spectacular view of Resurrection Bay. The building in which they leased space is on the National Historic Registry and had just celebrated its 100th birthday. The small business owners had the opportunity to buy that building and to expand their business into additional space. To do that, they used a 504 loan with an SBA guarantee. Financing was provided using a low borrower down payment, the 504 loan facilitated by Evergreen Business Capital and guaranteed by the SBA, and the conventional loan financed by First National Bank of Alaska. Beyond the actual loan, financial assistance also came through another SBA supported program-the Kenai Peninsula Small Business Development Center. The project was eligible for a 504 through our public policy goals, being a rural business and being located in a designated Labor Surplus Area.

Back in the Lower 48, Monaco Tool Company designs and manufactures tools that are used by diesel mechanics to repair diesel engines. The company was started 1986 when one man, Joe Monaco, started making tools out of his garage. Inventory complete, Joe pounded the pavement, visiting independent truck stops, and handing out parts catalogs to solicit business; at which point the business began to grow. The growth didn't stop, even after Joe moved out of his garage. In fiscal year 2018, the company realized it had outgrown its location once again, and used a 504 loan to purchase a new building on the west side of Eugene, OR that will allow the business to meet current production demands, and will allow for continued growth. Through this loan, the 504 program supported a manufacturing company that created 12 new jobs with its move, retained existing jobs, and will allow for new growth and new jobs into the future.

Patti Kibbe
 Chief Executive Officer
 Evergreen Business Capital

I could tell 504 success stories all day long-including ones just steps from this room that you all may be familiar with, such as Schneider's of Capitol Hill and La Loma Mexican Restaurant, both just over at Third and Massachusetts Avenue NW. I could also tell you about the nationally known successes such as Chobani, Fat Boy Ice Cream, and the local Port City Brewing company that at one point could not find financing outside of the SBA 504, but because of the program they are now household names. The successes of Zudy's Café, Monaco Tool Company, and all other loans within the 504 program are wonderful for the small business owners and for their communities. But they are also wonderful in another way: all of these loans are done with zero subsidy from the government. Let me say that again-this program requires no appropriation, it is self-funding. In addition, this program guarantees jobs. Congress statutorily mandates that each 504 loan fulfill job retention or creation requirements, community development requirements, or public policy goals to support economic development. For every \$75,000 lent in the 504 program, a job MUST be created or retained by a small business. No ifs, ands, or buts. If a CDC maintains that job ratio, it can also make loans to small businesses who fulfill a statutory public policy or community development goal, such as minority or women-owned business ownership or increasing businesses in manufacturing. This job requirement is unique to the 504 program, and CDCs are proud to fulfill it.

These are just a small sample of the work Evergreen Business Capital has been able to do with the 504 loan program. It is a truly valuable tool for economic development and job creation throughout the country. However, small businesses who want to use this program do face some unnecessary challenges. Some of these challenges revolve around speed and modernization. While my territory has the last Blockbuster in the world, as you may have read in the *New York Times* this weekend, our small businesses deserve a 504 program that is the Netflix, not the Blockbuster, of small business lending. What does that mean? It means modernization in policy and technology by SBA, such as elimination of the majority of hard copy forms in favor of data entered directly and passed electronically throughout the system; enhanced user interfaces for small business applicants and CDCs working with them; data validation processes that would eliminate incomplete and incorrect submissions, saving SBA, small businesses, and CDCs time and money; transparency in loan progress and status so small businesses can better plan their financial future; instant electronic access to background checks and other federally-sourced information; normalization of electronic signatures; and other changes such as streamlining the refinancing programs.

This modernization also means looking at ways to speed up low dollar, low risk loans to small business owners, to help keep them from predatory online lenders. These lenders charge exorbitant amounts but small businesses sometimes are trapped into accepting their help because no timely alternative exists. Appendix A to my testimony includes a proposal outlining how a responsible, faster, small dollar 504 program could be implemented by Congress or SBA to help protect these small business owners.

There are other statutory changes this Congress could make that reflect the real-world structure of businesses today. For example, current law requires a 504 borrower who purchases an existing building to occupy 51% of that building. However, this prevents small businesses from buying a building with equally split floors. In urban areas, it is easy to come across buildings where the first floor is zoned commercially and the second floor is zoned residentially. It is also common for a small business to want a building where they can grow without having to move. In buildings with an equal footprint on a first and second floor, the small business cannot

Patti Kibbe
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lease out the second floor while they grow to the size that will occupy that space as well. Changing this requirement by just 1%, from 51% to 50%, will open up these options to small businesses.

There is another statutory requirement that needs a 1% adjustment. Right now, for a small business to be eligible for a 504 under a public policy goal, the ownership and management control must be 51% consistent with that public policy goal. However, that poses a problem to jointly owned small businesses. For example, say a small business is owned 50% equally by a husband and wife who are both active in all daily management; the wife is of Asian descent and the husband is a US Army veteran. While this small business is 50% woman-owned, 50% veteran-owned, and 50% minority-owned, the business does not meet any existing public policy goals for a 504 because the husband and wife have an equal say in running their business. Surely this is a business we want to encourage lending for, not shut out based on a 1% difference in ownership structure.

Beyond statutory changes, there are regulations and policies that hamper small businesses in their attempts to grow through a 504 loan. You, me, and the SBA share the goal of getting to “yes” for small businesses. However, SBA policies do not always reflect that goal. While we respect and value responsible lending, lending from the SBA should follow policies that manage risk, not completely eliminate risk. Between my banking background and my CDC work, I can assure you: the only way to eliminate risk is to eliminate small business loans. But that’s not in the government’s best interest—you know from your time on this committee and your time with your constituents that small businesses make up the overwhelming majority of our businesses, and that their growth is our economy’s growth.

One way to ensure that SBA hears about the problems their policies can unintentionally cause is to reform the process by which SBA issues their Standard Operating Procedures, or SOP. This document, over 400 pages, is updated and re-released almost every year. It contains almost every detail necessary to get a 504 loan to a small business. However, there is no way for small businesses or practitioners to have input in the drafting, nor is a draft released with a chance to comment and receive responses or explanations from SBA about the changes. This leads to unnecessary confusion for small businesses, and a switch in the “rules of the road” sometimes without an explanation from the Agency.

Another policy unnecessarily harming small businesses is SBA’s restrictions on the relationship between Eligible Passive Companies and Operating Companies, or EPCs and OCs. This business structure is common and provides benefits recommended by accountants and lawyers. However, EPC/OC relationships within the 504 program have their rent structures dictated by SBA, their lease structures dictated by SBA, and restrictions placed on other business activities outside of the 504 loan project. All of these are outside the norm of conventional commercial business practices and come at the detriment of the legal and tax advice these small businesses receive. A small business who structures their business this way should not be penalized by the SBA.

We are also concerned about the reinstatement of an SBA regulation that was repealed several years ago, called the personal resources test. Draft SBA regulation last fall included a reinstitution of this rule, which requires small business owners to put down even more money from their savings than previously required, limiting the amount of liquid assets a 504 borrower could have. When SBA removed this requirement only five years ago, it stated that elimination of the personal resources test would enable more robust borrowers to participate in SBA’s loan

Patti Kibbe
 Chief Executive Officer
 Evergreen Business Capital

programs, thus mitigating risk to SBA's loan portfolio while facilitating job growth. As you recall, job creation or retention is a statutory requirement of the 504 loan. In addition, the Agency stated it was concerned that even borrowers whose principals had liquidity in their personal resources may be unable to obtain long-term fixed asset financing from private sources at reasonable rates.

Reinstituting this requirement would harm small business owners. The proposed regulation does not adjust for personal circumstances that require liquidity, such as cost of living (which varies significantly throughout the country), childcare, health care, and education needs (such as college tuition for children). The regulation also does not adjust for the variety of business needs, such as business development and training, other business opportunities that may arise, market changes, or increased competition, all of which require liquidity. As a result, the small business that must abide by this will lack the necessary capital required for growth, job creation, and continued economic development within its community and beyond. Finally, the proposed regulation disincentivizes prudent business practices and penalizes small business owners who are economically prudent and are reserving funds for future market changes, expansion, and growth.

Finally, I must briefly address the FY2020 SBA Budget Proposal, which recommends an increase in fees for the 504 program. To do so would be a harmful mistake. This is a zero subsidy program providing loans to small business owners who support jobs or fulfill a public policy goal described by Congress. The program is administered by mission-based lenders, 98% of which are non-profits. Adding on additional fees to small businesses punishes our entrepreneurs and hinders economic development that emanates from the small businesses and CDCs. In addition, the Budget Proposal unnecessarily limits the size of the 504 refinancing program beyond its congressionally authorized level. Congress wisely did not include either of these policies in the FY19 budget when they were previously was proposed, and I urge you to again reject these requests.

By solving these problems, we will help our small businesses and our economy grow. As I stated earlier in my testimony, the 504 program is statutorily required to create or retain jobs for every \$75,000 it lends to entrepreneurs. The easier it is for responsible small businesses to access this program, the more jobs we create. It's that simple. I ask for your leadership and assistance in fixing these challenges and growing our economy.

Again, thank you for inviting me to testify today. I am happy to answer any questions and I invite you all to visit the CDCs in your state to see the great work my colleagues do right in your backyards.

Patti Kibbe
Chief Executive Officer
Evergreen Business Capital

Appendix A

Pilot Streamlined ALP-CDC Program for Smaller Debentures

Patti Kibbe
 Chief Executive Officer
 Evergreen Business Capital

504 Express – Pilot Streamlined ALP-CDC Program for Smaller Debentures

Opportunity

The e504 Modernization Project, combined with SBA's new tools for properly managing risk (D&B SBPS Scores, SMART Scores, etc.), provides an opportunity to create a new streamlined program to deliver smaller 504 loans. The streamlined program proposed herewith, **504 Express**, would allow smaller, lower risk credits, to be processed more quickly. This streamlined process will negate the inefficiencies created by processing smaller, lower risk credits through the same processes and procedures that are in place for larger, more complex loan structures. The time and resources saved by both SBA and CDC staff will benefit the borrower experience in speed and service provided.

This proposed pilot program, **504 Express**, would only be delivered by ALP-CDCs. Since the ALP application and renewal process involves the input of all relevant SBA divisions, the SBA could feel a level of confidence regarding the credit underwriting of **504 Express** loans. In addition, access to **504 Express** would encourage existing ALP-CDCs to maintain their high standards and offer a strong incentive for non-ALP-CDCs to improve their overall performance in order to qualify for ALP-CDC status.

In the long term, it is the CDC industry's hope that the e504 Modernization Project will result in a credit scoring model for the processing of smaller debentures for all CDCs. However, the **504 Express** pilot program can provide current relief to small businesses as we work towards that credit scoring goal.

Background Information

Current SBA policies require the same steps and processes to finance a smaller, lower risk 504 loan as a multi-million dollar transaction, whereas in the private sector and other SBA loan programs, there are distinctly different processes for small and large commercial loans because of the inherent difference in risk for those various sizes. The fixed costs of 504-financed projects (land surveys, for example) that may or may not be applicable in the private sector are often required on a 504 loan, regardless of size, which again does not reflect the risk of these loans.

The inefficiencies and costs of this program have led many banks to the conclusion that the value the 504 program brings to their customers is not worth the effort and expense of going through the 504 process on smaller projects. This is one reason that small business owners may not be told about the 504 program when they visit their bank. Often, and particularly in the case of smaller projects, the bank recommends small business owners take more efficient and faster options.

One of the results of banks not presenting 504 as an option has been an emergence of a cottage industry of 504 non-bank lenders marketing aggressively to high risk industry sectors and projects that cannot be done any other way. **504 Express** is an effort to create a more relevant product in today's lending environment, while properly mitigating risk and best using the time

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and resources of the CDCs and SBA staff. Because strong underwriting will be of paramount importance to ensure the success of **504 Express**, access would be limited to ALP-CDCs. In addition, only smaller 504 projects would be allowed during the pilot period.

Proposed Improvements/Solutions

504 Express Pilot Program

- 1) The **504 Express** Pilot Program would only be available to ALP-CDCs.
- 2) The maximum standard 504 or 504 Refi loan (504 loan) allowed to be processed under the program would be \$500,000.
- 3) SLPC would develop a streamlined, reduced combined checklist (only SBA Form 1244, SBA Form 2450, Supplemental Information and the CAIVRS report would be submitted) and the credit memo would have a focus on financial analysis and reduce the duplicative information from other SBA documents (sample attached). In addition, the relevant audit processes (IPERIA, etc.) would be modified in recognition of this new, abbreviated approval process.
- 4) Small businesses engaged in high default industries or high default franchises, as defined annually by SBA based on a 20-year rolling average, would not be eligible for the **504 Express** Program.
- 5) ALP-CDCs, due to the lower risk of these loans, would have delegated authority (same authority currently given to PCLP) on **504 Express** loans to approve the appraisal and environmental reports per current SOP requirements.
- 6) The following items that currently require 327 actions could be processed with unilateral authority for **504 Express** loans:
 - a. Corrections to names or formation of any EPC, OC, Borrower, or Guarantor;
 - b. Corrections to the Project Property address (Note: CDCs shall not exercise unilateral authority to change the Project Property);
 - c. Corrections to the Interim Lender or Third Party Lender name;
 - d. Change the Third Party Lender or Interim Lender, provided that they are a federal or state regulated financial institution;
 - e. Make a Guarantor a Co-Borrower or vice versa;
 - f. Add a Guarantor;
 - g. Reduce standby debt prior to loan closing as a result of regularly scheduled payments;
 - h. Reduce project costs; and,
 - i. Re-allocation of project costs in an amount equal to 10% of the allocated cost.
- 7) District Counsel would rely solely on the opinion of the Designated CDC Attorney for these **504 Express** loans.
- 8) If the 504 borrower is current on their **504 Express** loan, then the following servicing actions would be unilateral:
 - a. No cash out subordination;
 - b. Addition of guarantors;

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- c. Assumption by a new party as long as the existing borrower is not being released;
 - d. Release lien on collateral w/ FMV \leq 10% of Debenture amount or \$10,000;
 - e. Force place insurance coverage;
 - f. Endorse insurance checks \leq \$100,000.
- 9) The **504 Express** pilot program can provide current relief to small businesses, and additional efficiencies can be gained once SBA has the capability to incorporate a credit scoring model for these smaller debentures.

Benefit to Small Business

Small business concerns would benefit from a faster and more predictable approval process. This could help prevent them from taking loans from predatory lenders with high interest rates that put small businesses farther into debt. Additionally, an easier process would encourage greater bank participation, so more small businesses would be aware or have access to the benefits a 504 loan can offer them.

Chairman RUBIO. Did I hear you correctly? Chobani, the yogurt people, are a part?

Ms. KIBBE. Yes, sir.

Chairman RUBIO. We got to get this program going.

[Laughter.]

Senator RISCH. They have a plant in Idaho.

Chairman RUBIO. They do.

Senator RISCH. They do.

Chairman RUBIO. All right. Mr. Villarreal.

STATEMENT OF ROBERT VILLARREAL, EXECUTIVE VICE PRESIDENT, CDC SMALL BUSINESS FINANCE, SAN DIEGO, CA

Mr. VILLARREAL. Good afternoon, and thank you, Chairman Rubio, Ranking Member Cardin, and members of the Committee.

My comments today are focused on the SBA Community Advantage program, or CA for short, a pilot program launched in 2011. The program has effectively increased SBA lending to emerging markets and we believe should be granted full program authority within the SBA 7(a) flagship program.

I am here today representing both the largest CA lender in the Nation, CDC Small Business Finance, and the Mission Lenders Working Group, a group of CA lenders which has represented almost 50 percent of all the loans made today.

My organization, CDC, has for 40 years been an advocate for small businesses. Headquartered in San Diego, we operate in California, Arizona, and Nevada.

We provide all of the SBA programs: the 504, the CA, and the Community Advantage. And we have provided over \$13 billion in capital to small businesses and helped create over 200,000 jobs.

When the CA program was launched in February of 2011, it was a bold step for the SBA because for the first time, they extended the administration 7(a) program to mission lenders. Three types of mission lenders were allowed into the program: Certified Development Companies; SBA microlenders; and Community Development Financial Institutions, or CDFIs. And these three types of organizations have made an impact under the CA program.

For example, our organization has funded 656 CA loans for \$91 million with 51 percent of those loans going to startups as defined by the SBA. As an industry, we have helped 5,200 small businesses, with nearly \$700 million in small business lending, all with a loss rate of 1.5 percent through last fiscal year.

As a percentage, we are one-third of 1 percent of all 7(a) lending, yet this small program has had a great impact on many small businesses.

So, as this Committee looks to modernize the SBA to keep it relevant, I ask that they recognize that it is this delivery system of working with mission lenders that makes the program unique. Via a high-touch model that pairs business advising with affordable capital, mission lenders have expanded the credit market by allowing more small businesses access to capital, and we have demonstrated that we play an important role in the entrepreneurial ecosystem.

Most importantly, many of us prepare our borrowers for lending at the next stage working with banks.

Since its launch, the program has undergone numerous changes, many of which are the result of the SBA and mission lenders working together. It is in this spirit of cooperation that a number of responses were put into our written testimony.

Right now, I want to just focus on two. First, we want to work on modifying the same institution debt refinancing policy. Right now, the program says that we have to wait 12 months before we can refi one of our own loans with a CA loan. This hurts small businesses, such as the one by Elena and Grayson who came to us with three online FinTech loans, and they were paying \$20,000 a month on these loans. We were able to get them into an affordable CA loan, but that took about 3 months to do. If we had been able to do a bridge loan with our own money and then take it out with a CA loan 3 months later, we would have saved them \$32,000 in that 90-day period. So we want to work with the SBA in changing that program.

Finally, I want to speak about permanency. The CA program is 8 years old and has met the expectations of the administration. It has delivered nearly \$700 million in affordable and responsible capital to small businesses in the emerging markets, all with the loss rate of less than 2 percent. The program can and should be established as the relevant small-dollar 7(a) program for the SBA, particularly as other programs aim for larger markets.

We are prepared to work with this Committee and the SBA in structuring language and developing a program that works, most importantly that works for small businesses.

In closing, I would like to quote from the study requested by the SBA to evaluate the program and published May of last year. It states, "The combination of what the CA program provides—financing with reasonable terms at a critical stage in a businesses' trajectory, through a trusted and accessible partner, with targeted technical assistance—makes the program an effective and important resource for small businesses."

Thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Villarreal follows:]



Robert Villarreal
Executive Vice President
CDC Small Business Finance

Testimony for the Record submitted to
The Senate Committee on Small Business and Entrepreneurship

For the hearing:
Reauthorization of the SBA's Access to Capital Programs
Wednesday April 3, 2019

Chairman Rubio and Ranking Members Cardin, thank you for convening this important hearing to discuss the US Small Business Administration's Capital Access programs. My comments are focused on the SBA Community Advantage (CA) program, a pilot launched in 2011 under the SBA's 7(a) loan guarantee program that has effectively and efficiently increased SBA lending in emerging markets and underserved communities and should be granted full program authority within SBA's flagship 7(a) program.

I represent both the largest CA lender in the nation, CDC Small Business Finance (CDCSBF), and the Mission Lenders Working Group (ML Working Group)¹. The ML Working Group was formed in 2015 by a group of active CA lenders to share best practices and to inform the SBA, and each other, of what is working in the program and what could be improved. As a group, we have been responsible for the creation and retention of over 20,000 jobs through CA lending and nearly half (49%) of the CA loans funded. The group is comprised of knowledgeable small business lenders, representing all the three types of lenders allowed in the program (noted below). All of the organizations are seasoned small business lenders who understand what it takes to reach, finance, and grow sustainable small businesses in emerging markets and all of us are committed to moving our borrowers into a banking relationship so we can free up our capital to reach more good businesses who aren't yet bankable.

CDCSBF is celebrating 40 years of supporting small businesses. As an economic development organization, CDCSBF provides a number of programs and products that support underserved small businesses and the entrepreneurial ecosystem. We are advocates for ALL small businesses but have a particular passion for and belief that small business ownership is a tool for closing the racial wealth gap. Headquartered in San Diego, California, we provide services throughout the State and in Arizona and Nevada. These

¹ See attached description of the Mission Lenders Working Group

programs include an array of SBA programs such as: the SBA 504 commercial real estate product for small business owner-occupants (CDCSBF is the largest 504 lender in the country); 7(a) Community Advantage, and the SBA Microloan Program. In fact, in 2018, CDCSBF was recognized as the Jody C. Raskind SBA Microlender of the year. CDCSBF also controls or manages six other corporations, including a Community Development Financial Institution (CDFI).

Through these multiple programs CDCSBF has provided over \$13 billion in capital to small businesses and has created over 200,000 jobs. That's 13 jobs per day, everyday, for 40 years! The organization also provides business advising or "Technical Assistance" and in the last two years has delivered nearly 14,000 of Business Advising to small businesses.

What is the Community Advantage Program

The SBA Community Advantage Pilot Program was launched in February 15, 2011.

For the first time the SBA's flagship 7(a) program was extended to experienced mission lenders, with the goal of assisting small businesses that were not yet "bankable" but needed access to affordable and responsible capital. This was an acknowledgement that the lending industry needed to do a better job in providing small dollar loans to businesses in underserved communities, or those businesses classified as "emerging markets."

The programs goals, per the initial Community Advantage Participant Guide were:

- To increase access to credit for small businesses in underserved markets;
- To expand points of access to SBA 7(a) loans by engaging non-traditional mission lenders with experience working in underserved markets;
- To provide management and technical assistance to small businesses as needed; and
- To manage portfolio risk by utilizing the underwriting knowledge of mission lenders with successful track records lending in underserved markets.

As noted above, the critical component of the program was to expand the 7(a) program to mission lenders. The SBA defined mission lenders as falling into one of three groups: SBA certified development companies (CDCs); SBA microlenders; and Community Development Financial Institutions (CDFIs). The Administration understood that these lenders were the best situated to meet the capital needs of the underserved business populations not being met by traditional SBA lenders. Mission lenders have a deep knowledge of their communities, are accountable to their communities via resident representation on their board of directors, and, as an explicit purpose and mission, assist small businesses that are located in underserved areas or are owned by woman and minority entrepreneurs.

While guided by the Standard Operating Procedures (SOP) of the traditional 7(a) program, lenders under the Community Advantage program have different, or additional, requirements or parameters which traditional 7(a) lenders are not subject to. These include:

- \$250,000 Maximum loan limit

- 60% of loans must be to a designated Target Market²
- Cash Loan Loss Reserve requirements of 5% for the guaranteed portion sold and 5% for the un-guaranteed portion. This was recently increased from 3% to 5% for the guaranteed portion
- A 12-month period of perfect payments by a borrower before same institution debt refinance allowed
- Technical Assistance recommended
- Can serve applicants with an SBSS score as low as 120
- Allowed a spread of 6% above Prime (this changed from 4% one year into the program)

Regarding the 6% spread, mission lenders were provided this consideration because of the increased cost of delivering this program to the riskiest borrowers and the close relationship required between the mission lender and the small business client. In addition, almost all CA lenders provide business advising at no charge to the small business client. In fact, in the report, "Evaluating Technical Assistance and Economic Opportunity Outcomes of the Community Advantage Pilot Program" prepared for the SBA in May 2018, the relationship with the client and the business advising component of the program are noted as key factors in the successful performance of the CA program.

Impact of Community Advantage

CDC Small Business Finance was one of the first six mission lenders approved by the program and has consistently been one of the leading CA lenders in the nation both in terms of loan volume and performance. Through March 2019 CDCSBF had funded 656 CA loans for over \$91 million. More than 70% of our CA loans financed are to businesses in an SBA designated "underserved or target market" – including 51% of our loans to start-up businesses (less than two years old), over 27% of our CA loans financed businesses located in low-moderate income communities and/or have a workforce that is at least 50% low-moderate income - and to date the businesses we financed with CA loans have supported over 4,700 jobs. As a CA lender, we intentionally assume risk that traditional banks would/could not, but our intensive underwriting process, attention to the needs of each business and each client keeps our loans performing and our portfolio sound – thus less than 3% of our CA loans have been charged-off.

While not currently considered target markets under the SBA CA program, 12% of CDCSBF's CA loans are to Latino-owned businesses, 8% to Black-owned businesses and 29% to women-owned businesses. CDCSBF targets its outreach to these markets because historically, it is these groups that have not been served well by traditional financial institutions and have not had access to affordable and responsible capital. The Community Advantage program has allowed mission lenders to serve woman and minority populations with a main street product, that provides the small business fair and responsible capital and starts them off in the continuum of responsible capital.

² Target Market - Low-to-Moderate Income (LMI) communities; Businesses where more than 50% of the full-time workforce is low-income or reside in LMI census tracts; Empowerment Zones and Enterprise Communities; HUB Zones; Promise Zones; New "start-up businesses (Firms less than two years in business); Businesses eligible for SBA Veteran's Advantage; and Business located in Opportunity Zones (added 10/1/2018).

As an industry, since the CA program was launched in 2011, over 5,200 loans have been funded, totaling over \$696 million (through March 12, 2019). The average CA loan size is just under \$133,000 as compared to the average 7(a) loan, which is \$417, 300. While CA lenders may lend at 6% above prime, the majority of loans have been 4% to 4.5% above Prime. CA lenders are required to target at least 60% of their lending to the SBA's Target Markets and more than 70% of all CA loans have been in the underserved Target Markets.

One of greater impacts of the Community Advantage program has been its success in lending to the Black and Latino small business community. For example, in fiscal year 2018, 12% of all CA loans were to Black-owned businesses and 17% to Latino businesses. Compare this to the 7(a) SBA Express Loans under \$250,000, where loans to Black businesses in fiscal year 2018 represents 5% of the lending under \$250,000 and 10% to Latino businesses.

There are currently 99 active CA lenders across the country and a CA loans has been made in 45 different states. While there is an understanding that CA loans are riskier, the cumulative charge-off rate on CA loans through FY 2018 has been 1.5% and the cumulative default rate has been 3.6%. This rate is significantly lower than what the SBA anticipated when the CA pilot was first conceived, which I credit to the experience of CA lenders like CDCSBF.

As a percentage of total 7(a) lending from the launch of CA through FY 2018, the CA loans represents .36% of all 7(a) lending; approximately one-third of one percent. Yet this small program has made an incredible impact in the lives of many small business owners.

Continuum of Capital within the Entrepreneurial Ecosystem

Mission lenders play an important role in the continuum of capital. They provide affordable and responsible capital to small businesses and prepare them for the next stage of financing, which most often is conventional financing from a bank or a larger SBA loan from a bank or traditional financial institution. In other words, mission lenders are the bridge to bank financing. For example, the average length in portfolio for Community Advantage loans for CDCSBF is thirty-months and 16% of the portfolio has prepaid (representing 108 loans). Nearly 50% of those pre-pays were refinanced by banks.

Many other CA lenders have target goals of moving their Community Advantage client through and out of their portfolio. MoFi, which operates in Montana and Idaho, has a goal of referring their CA clients to a bank in 28 months. Evergreen CDC in Washington State has a similar goal of 24 months. Traditional banks are an important partner to mission and Community Advantage lenders. First, banks are the source of lending capital for mission lenders. Mission lenders are not deposit taking institutions, so banks are a vital source of lendable capital. Most bank partners are champions of the CA program, as they recognize that the money they lend to a mission CA lender will have a 75% or 85% guarantee. Second, for most mission lenders, 30% to 50% of their referrals come from banks. For CDCSBF, this has historically been 50%, with one in four (25%) of bank referrals resulting in a funded loan. This compares to a 10% funding rate from all other referral sources.

Mission lenders therefore are important starting points in the continuum of capital. We expand the credit market by allowing more small businesses access to capital and as

mission lenders committed to their success, improve their chances of survival. In most cases small businesses would not get started, "if not but for" mission lenders and the CA program.

As noted above, mission lenders look to banks to refinance their clients out of their portfolio. Bank refinancing is the next step in the continuum of capital after a loan from a mission lender. However, equally important for mission lenders is that the CA program has allowed the industry to sell the guaranteed portion of the loan. This is critical, as it allows the lender to re-cycle the capital and continue making loans in their community. For this reason alone, the CA program has been a game-changing product. CA lenders do not have to continuously borrow new capital from banks if they are able sell 85% of the loan. This allows capital to be leveraged as high as five or six to one. For example, a \$5 million loan from a bank to a CA mission lender can result in over \$27 million in lending (with all loans under \$150,000 and all guaranteed portions sold).

Finally, maybe the most crucial roles mission lenders and the CA program play in the continuum of capital is two-fold; being the first option of alternative and responsible capital as opposed to high cost capital (on-line or fintech lenders being the most recent) and second, assisting small businesses trapped in high cost loans escape their situation through refinancing them with responsible and affordable capital as well as business advising/education.

Nearly one-third of CDCSBF's CA loans include refinance of some type of high interest rate loan, whether it be from an on-line lender or a merchant cash advance. The interest rates on these loans range from 17% to as high as 94%, with APRs in the triple digits, when fees are included. Attached is an article entitled "Failing to Grasp Loan Terms Can Be Costly to Companies" from the San Diego Business Journal³. The article details the story of a CDCSBF client, Kindred Bravely, and their regret of taking an on-line loan. CDCSBF was able to assist them, and this small business was recently refinanced by a community bank, First Foundation Bank.

Recommended Changes to the Program

As the Committee looks to modernize SBA and keep it relevant, the Community Advantage program and its current delivery system needs to be made a permanent part of the 7(a) statute.

The mission lenders that are part of the Community Advantage program applaud the SBA for launching this pilot program. As noted above, mission lenders were selected for their experience and expertise in delivering capital to underserved communities. We deploy more than just capital; we provide up-front business advising and continued support through-out the life of the loan. For example, at CDCSBF, if the client is part of the underserved Target Market and not qualified for a loan, we take the extra step of referring the entrepreneur to our internal business advising staff, who work with them and prepare them for a loan. For example, in fiscal year 2018, we funded forty businesses for just under \$5 million which we had "off-ramped" from our sales pipeline (they were not "loan-ready") to our business

³ See Attached Article

advising platform. This is what differentiates Community Advantage mission lenders from traditional SBA lenders.

In recognizing this distinction and partnering with mission lenders the SBA is staying relevant to the fastest growing segment of the small business population; those located in low-moderate communities, start-ups, and entrepreneurs of color.

Since the program launched, it has undergone numerous changes and has had at least four Participant Guides published. Industry and the SBA have had a good working relationship and many of the changes have been the result of the two groups working together. This includes allowing the use of Lender Service Providers for CA lenders (initially disallowed), increasing the spread over Prime from 4% to 6% and developing the concept of the Community Advantage Associate.

Most recently, on October 1, 2018 SBA Notice 2018-0008 went into effect. This notice extended the pilot to September 30, 2022 and added Opportunity Zones as an eligible Target Market, both very positive changes. However, other changes in this Notice, and other earlier changes, we believe, need to be re-examined and further discussed with industry. The below are a list of recommended changes to the program that would result in increased lending to the small business community, specifically in the designated Target Markets. We also believe that these changes do not result in an elevated risk to the SBA or the 7(a) program.

Reducing Restrictions to Same Institution Debt Refinancing

To better serve the small business client, particularly those trapped in high-cost loans, it is recommended that the SBA revert back to the 6-month, same institution debt requirement in place prior to the issuance of SBA Notice 2018-0008. Further, we encourage dialogue as to how we can work together to improve the process of getting small businesses out of high cost loans.

The new rule states that for CA lenders to refinance a same institution, non-SBA guaranteed loan, the SBA will require "a transcript showing the due dates and when payments were received for the most recent 12 month period, rather than six months. If there are any late payments in the most recent 12 month period, the debt may not be refinanced with a CA loan." The new rule makes it more difficult for a CA lender to be nimble in responding to the needs of a small business, and it is unclear what the SBA is seeking to address in making this rule change.

It is worth noting that over 80% of the CA lenders surveyed by the Mission Lenders Working Group reported that a significant number of prospective borrowers are seeking to refinance a high-priced loan from an online lender. Several CA lenders reported that 25-30% of these businesses are near a financial breaking point due to unaffordable daily automatic payments, requiring a quick refinance of the unaffordable debt in order to stabilize the business and prevent it from going under. Some CA lenders offered short-term bridge loan as immediate relief while they processed a CA loan for the borrower. This process was feasible under the previous rule which allowed same-institution debt refinancing after six months. With the new rule requiring 12 months of on-time payment history before same-

institution debt may be refinanced into a CA loan, it is more difficult, and less feasible, for CA lenders to provide bridge products and provide relief to a small business.

We suggest that the Administration work with CA mission lenders to streamline the ability to refinance same-institution debt, particularly when it comes to high cost loans. This can include reverting back to the six-month rule or even developing a pilot program when it comes to refinancing loans that are over a certain APR.

For example, CDCSBF worked and funded a pre-school in San Diego that had three on-line, high cost loans, one with a daily withdrawal of \$710. The total monthly payments for the three loans were over \$19,800 per month (on outstanding debt of approximately \$150,000). Working with CDCSBF, the wife and husband team that co-owned the pre-school were able to drop their monthly payments to \$3,000, saving the small business over \$16,000 per month. However, the SBA loan took over three months to close and fund. If there had been a streamline process where CDCSBF could have provided a bridge loan in the first month that could be taken out by the SBA CA loan at closing, the couple would have saved two months' worth of payments, or \$32,000!

Review Loan Loss Reserve Required for Loans Sold on the Secondary Market

There have been at least three changes to the Loan Loss Reserve (LLR) requirement since the inception of the program. Initially, the LLR required mimicked the one for the SBA microloan which is 15%. This 15% was applicable to the un-guaranteed portion. That changed to 5% on the un-guaranteed and 3% on the guaranteed portion, if the loan was sold. Most recently this latter LLR was increased to 5%, resulting in a 5% LLR for the un-guaranteed portion and 5% on the guaranteed portion if the loan is sold. This is a required cash LLR.

This additional LLR requirement will have an impact on the unrestricted cash of **all** CA lenders selling loans on the secondary market without regard for their performance as a lender or the health of their portfolio.

As CA lenders actively grow their portfolios, the funds that would have otherwise been available to finance more CA loans to businesses in underserved businesses will now be diverted to cover a lender's LLR requirement. Selling CA loans into the secondary market has been an important way for mission lenders to raise loan capital, finance more businesses, and maximize the impact of CA as a financing tool.

For example, CDCSBF funded \$12,637,677 in CA loans since the new 5% rule took effect. If we assume a blended average of an 80% guarantee, it equates to \$10.1 million being under a guarantee, which CDCSBF will sell in the secondary market. The new additional 2% (moving from 3% to 5%) LLR requirements results in over \$202,000 in cash from CDCSBF that has to be deposited into the LLR.

The combination of the increased LLR requirement and potential secondary market softening could impact the decision of CA lenders to continue being active SBA lenders. If lenders decide it would be financially prudent to hold their CA loans rather than selling them into the secondary market, they give up the benefit of increasing liquidity to make more loans and

serve more businesses in underserved markets. This isn't a viable option and not the intended consequence desired by the SBA or the mission lending industry.

We recommend that SBA look at reducing the 5% LLR requirement on CA lenders that meet certain performance thresholds. This standard is used in the SBA Microloan program, where high performing intermediaries can have their LLR reduced from 15% to 10%. A similar policy should be applied to CA lenders.

Continued Training for Community Advantage Lenders

We recommend that SBA provide upfront and ongoing training and technical assistance to CA lenders. We appreciate that SBA recently offered two mandatory online trainings for CA lenders and hope there are additional trainings being planned. While online trainings and webinars can be effective, there is no substitute for in person trainings especially for a new initiative like CA. We would welcome the opportunity to work with SBA to identify areas where additional training and/or technical assistance would be beneficial.

We also support and encourage additional resources for the SBA. We recognize that it is a challenge for the Administration to provide adequate oversight with existing resources. Under the CA program, 100 new lenders were added to their portfolio, yet no additional resources were provided. The Administration would benefit from additional staff to assist in oversight. In addition, mission lenders, particularly those that are more experienced and have performed well in the program, are willing to be trainers and mentors to active and new CA lenders.

Develop an Alternative Risk Assessment Protocol for CA Lenders.

Mission lenders in the program are open to working with the SBA's Office of Credit Risk Management (OCRM) to develop a risk assessment protocol for CA Lenders. CA lenders are asked to finance the businesses left behind by traditional 7(a) lenders, resulting in an inherently riskier portfolio of SBA loans. This is especially true when financing start-up businesses, which may be as high as 50% in most CA lenders portfolio. While the new CA rules work to mitigate CA portfolio risk there is no guidance to lenders regarding what SBA considers an appropriate level of risk. Industry and the MLWG would like to work with the Office of Capital Access and OCRM to develop a risk assessment protocol that recognizes the capacity of mission driven lenders to manage risk, to explore what 'acceptable' risk looks like, and come up with PARRiS scoring and peer comparisons that work for CA lenders.

Raise the Maximum Loan Size to \$350,000

Many mission lenders in the program have requests higher than \$250,000 and have to provide two or more loans to meet the need of their small business client (this was the case with the pre-school discussed above). Raising the maximum to \$350,000 will allow additional affordable capital to reach the small businesses in underserved areas. The \$350,000 cap also puts the CA program in line with other 7(a) lenders under the Small Loan Advantage Program, of which the CA program is a subset.

To mitigate risk to the program, the administration can place performance requirements on those CA lenders that are eligible for the \$350,000 maximum. It could also require that loans above \$250,000 be processed as non-delegated and be reviewed by the loan processing center.

Adding Demographic Populations to Target Market

The CA Pilot program was launched with the intention of providing affordable and responsible capital to underserved small businesses. The program has been very successful in delivering to the Target Market established by the SBA. However, we strongly believe that the Target Market definition needs to be expanded to include three critical groups; women and Black and Latino owned businesses.

Studies have demonstrated that these three groups have consistently faced barriers in accessing capital. The SBA monitors/measures performance in lending to this groups and has historically encouraged lending to this demographic via past and current programs. In addition, many of the CDFIs that participate in the CA program focus on one, two, or all three of these groups and are held accountable by the CDFI Fund to a 60% lending threshold to that market. We believe and encourage congruency between federal programs that are working with similar organizations for the delivery of programs.

Permanency for CA Program

The CA program is eight years old and has met the expectations of the administration. It has delivered nearly \$700 million in affordable and responsible capital to small businesses in the emerging markets that are historically shut out of the traditional lending markets, all with a loss rate of less than 2%. It has developed a core of high performing mission lenders that are now experienced in SBA lending and are reaching markets not met by banks. The program has also allowed these lenders access to the secondary market, so that they can re-capitalize quickly by selling the guaranteed portion of the loan, thus leveraging their capital five-fold.

The SBA Express program, whose lending cap is being requested to increase from \$350,000 to \$1 million, was a pilot program for nine years before becoming permanent (1995-2004). Making the CA program permanent, provides the SBA with a focused small dollar program that reaches deep into low-moderate income communities, minority and woman owned businesses, as well as start-up businesses. This can, and should be, the relevant small dollar 7(a) program for the SBA, particularly as other programs aim for larger markets.

Permanency is also important so that the program can grow. Without the security and knowledge that the program is going to become permanent, many mission lenders are reluctant to invest in the program. Making the decision to be an SBA lender is one that cannot be taken lightly and requires both intense human and capital resources.

To address the Administration concerns about the program growing too quickly, industry is willing and open to work with the SBA in scaling the program appropriately. First, SBA needs to be provided additional resources to adequately manage the program appropriately. Second, new lenders can be phased in, with a limit on the number of new lenders allowed access to the program every year. This allows the SBA to properly train and prepare the new lenders. New lenders can also be paired with an experienced CA lender. Finally, there can be a maximum limit on CA lenders in the program. This is similar to the parameters set within the SBA microloan program.

While there are some that believe there needs to be continued study, the impact of the program has been significant in a very short time frame and the results have been impressive. The program is serving the Target Market (or emerging markets); the CA program places the borrower in position to obtain financing from another source, such as a traditional bank; and business growth through the CA program has far-reaching impacts on borrowers and their communities.

In closing, I would like to quote from the study requested by the SBA which is referenced above and was published in May of 2018. One of the conclusions of the study states:

The combination of what the CA program provides – financing with reasonable terms at a critical stage in a business’s trajectory, through a trusted and accessible partner, with targeted technical assistance – makes the CA program an effective and important resource for small businesses.⁴

Thank you for the opportunity to submit testimony and I am available to answer any questions or provide additional information.

⁴ “Evaluating Technical Assistance and Economic Opportunity Outcomes of the Community Advantage Pilot Program,” Final Report, May 2018; Prepared by Industrial Economic Incorporated; Prepared for the US Small Business Administration, Office of Performance Management and Office of Capital Access.

Attachments

- I. Overview of Mission Lenders Working Group
- II. Article – San Diego Business Journal, “Failing to Grasp Loan Terms Can Be Costly to Companies”



Mission Lenders Working Group

About the Mission Lenders Working Group

CDC Small Business Finance is one of the founding members of the Mission Lenders Working Group – a network of active CA lenders that includes SBA Certified Development Companies (CDCs), Microloan Intermediaries and Treasury certified Community Development Financial Institutions (CDFIs). We organized the working group in 2015 because as stewards of the CA pilot we recognized the importance of demonstrating the capacity of mission lenders to finance businesses in underserved markets when granted SBA loan guarantee authority.

A recent survey of CA lenders was conducted by the Working Group. A total of 24 active CA lenders responded to the survey (a cross section that included 14 CDFIs, 6 CDCs, and 4 organizations identified as both.) While these lenders account for 24 percent of the active CA lenders they are responsible for 49 percent of the CA loans deployed (or 47% of the loan dollars. The CA lenders in our sample were certified to lend in a total of 39 states with half of the lenders working in multiple states and the other half serving multi-county or statewide service areas.

CA lenders in the MLWG sample have supported 20,000 jobs accounting for over half of the jobs supported by CA lenders to date.

In terms of institutional experience, on average the CA lenders surveyed had been financing small businesses for 14 years and had 5 years of CA lending experience. Four of the lenders surveyed closed their first CA loan in 2011 and 2 closed their first CA loan in 2017.

The majority of the CA lenders surveyed exceed the minimum 60% threshold for making loans in underserved communities.

All CA lenders in the MLWG sample lend in low to moderate income communities and almost all identified new businesses as an underserved market they intentionally target as CA lenders. A significant number of lenders also identified veteran owned businesses as an intentional target market.

More than 90% of the lenders surveyed provide business support services to their CA borrowers – with 58% reporting that support services are provided to all CA borrowers and 33% offering services to borrowers on an ‘as needed’ basis.

All CA lenders in the MLWG sample are committed to moving their CA borrowers into a bank loan as soon possible, both as a benefit to the business borrower and to free up capital that can be used to finance another business.



Mission Lenders Working Group

We analyzed SBA 7(a) lending reports to compare the experience of CA lenders in our sample to the experience of all active 7(a) CA lenders. In addition, we compared several 7(a) CA data points with available 7(a) loan data based on lending in FY 2012 through 3rd Quarter FY 2018, we found:

- Looking at all active CA lenders, the average loan size was \$130,000 while the average loan made by a lender in the MLWG sample was \$125,000. Average 7(a) loan is \$377,000.
- The overall charge-off rate for 7(a)CA loans was 1.5% and the charge-off rate for CA loans in the MLWG sample was 1.8%. The overall charge off rate for 7(a) loans was 0.83%.
- 7(a) CA lending constitutes a very small percentage of total 7(a) lending. According to SBA, 7(a) CA lending accounts for **0.36%** of all 7(a) lending.

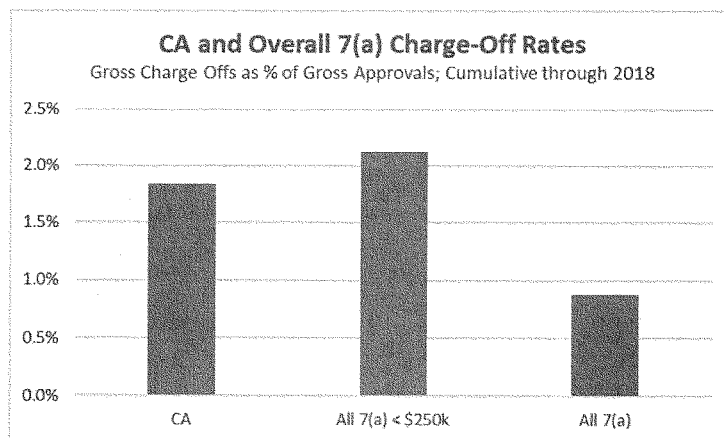


Mission Lenders Working Group

SBA Community Advantage Loan Guarantee Pilot

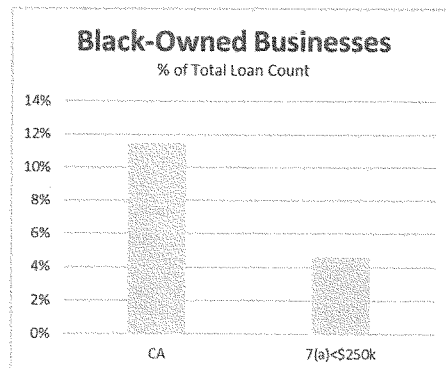
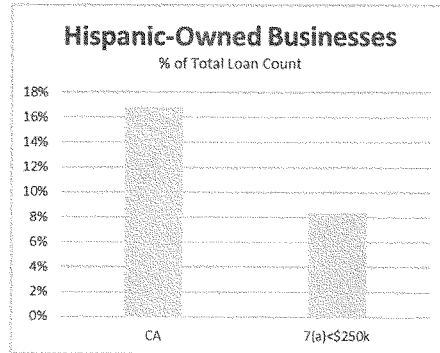
Number of Active 7(a)CA Lenders	99
Total Number of 7(a)CA Loans Dispersed to Date*	5,279
Total \$ Amount of 7(a)CA Loans to Date*	\$ 696,436,700
Average \$ Amount of a 7(a)CA Loan	\$132,500
Cumulative Charge-off Rate for 7(a) CA Loans	1.8%
7(a)CA Lending as a Percentage of Total 7(a) Portfolio	0.36 %
Federal Subsidy Required to Support CA Lending	\$0

*Cumulative lending activity since the CA pilot was launched in April 2011



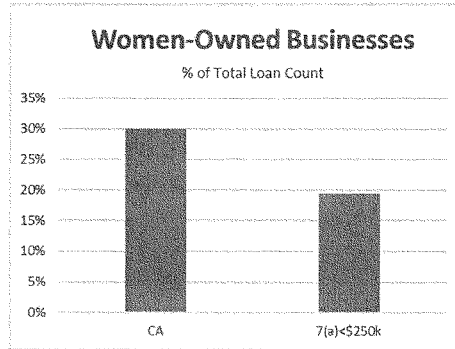


Mission Lenders Working Group





Mission Lenders Working Group



SAN DIEGO BUSINESS JOURNAL

Failing to Grasp Loan Terms Can Be Costly to Companies

FINANCE: Online Lenders Offer Fast Cash at a Price

By SARAH DE CRESCENZO
Published June 22, 2017

Garret Akerson, who with his wife, Deeanne, founded the Oceanside-based e-commerce company Kindred Bravely, says it's easy for small business owners to get in financial trouble by borrowing money from online lenders promising fast cash at high interest rates.



For the husband-and-wife team behind Kindred Bravely, an Oceanside-based e-commerce retailer of maternity clothing, it was their business success — not their struggles — that prompted them to turn to a well-known online lender.

Garret Akerson, who founded four startups before Kindred, his wife Deeanne's brainchild, said the simplicity of the process was appealing.

"You can get funds within a week, whereas (the U.S. Small Business Administration) is going to take three months," he said.

But as the Akersons discovered, that fast cash comes at a price: high interest rates that can quickly become crippling, threatening the financial stability the business sought in the first place.

Apparently, the couple is not alone.

Fast Cash

An increasing number of businesses are getting tripped up, many of them because they don't understand the terms of the loan, especially the annual percentage rate (APR), said Chuck Sinks with CDC Small Business Finance, one of the country's largest Small Business Administration lenders.

"There aren't a lot of finance majors out there that stop and put a calculator to this, and even those who are skilled at it, it's very difficult to suss your way through all the variables to get a general idea what the APR is of that money," he said.

One business owner told him she found it nearly impossible to resist offers of quick cash to tide over her struggling business.



Chuck Sinks

CDC Small Business Finance

"The money is there the next day, so they'll pay anything to get it, or they don't know what it costs, which I think is more often the case," he said.

Industry Efforts at Transparency

Online lenders, those tech-enabled companies that provide cash to borrowers sight unseen in a fraction of the time it would take to get a conventional loan, grew rapidly in the wake of the recession. Small businesses in need of working capital, their lifeblood, found themselves scrambling when banks retreated.

A number of alternative lenders, including Kabbage Inc., have responded to customer concerns about the loans' lack of transparency. The lender is a founding member of a trade association called the Innovative Lending Platform Association that has developed a set of common pricing metrics and calculations for companies to use in their loans documents. A similar group, the Marketplace Lending Association, requires members to disclose transparent prices, including the APR for loans.

The Cost of Success

The Akersons knew the price they were paying for their online loan, but they needed the cash to scale their business. Shortly after the e-retailer started out in June 2015, it turned to CDC Small Business Finance, borrowing \$100,000 to launch two more products, one of which remains the company's best-selling product.

"From there it was kind of meteoric," Garret Akerson said. "To finance a rapidly growing company causes almost as many cash problems as a company that's in the decline. It just eats up so much cash, especially if you're having to pay for inventory."

To accommodate that growth, they decided to take another \$100,000 loan, this time from online lender Kabbage. The lender has provided more than \$3 billion in funding to more than 100,000 businesses, according to its website.

"Their (Kabbage's) process is very simple, which I think is what makes it very attractive," Akerson said. "Based on your earnings they submit an offer almost right away."

Payment — either one-sixth or one-twelfth of the loan total, plus a fee — is made monthly, which the lender bills as a method of providing businesses with capital without hidden costs. But as a business makes payments, reducing the principal, the equivalent annual percentage rate rises.

"We had already poured in all our personal savings and didn't have any more to contribute at the time unless we wanted to get external funds, and we didn't want to get an external investor, at least not yet," Akerson said. "In our case we ended up paying an APR over 20 percent. We should never have done it."

Within three months, the Akersons ended up working with CDC to get another \$100,000 loan to pay off the one they had taken from the online lender, which they owed nearly \$10,000 each month.



Deeanne Akerson
Kindred Bravely

This year the company, which employs 16 employees — all stay-at-home mothers — expects to take in about \$5 million in revenue.

'Last Resort Type Thing'

For another San Diego business, it was a matter of borrow or bust.

Kid Ventures, founded by Darren and Debbie Solomon about a decade ago, operates three indoor play venues for children in San Diego County.

But when the company's original location in Pacific Beach had to close a few years ago due to unexpected zoning issues, Darren Solomon said conventional lenders weren't interested in lending to Kid Ventures until its revenue returned to previous levels.

"Cash flow became a real challenge," he said.

They turned to Kabbage and got a line of credit for \$75,000 for six months.

"It was a last resort type thing," he said.

He found the qualification process innovative — when underwriting the loan, the lender took into account some untraditional business metrics, such as social media following — but like the Akersons, the monthly payments became onerous.

Eventually, they decided to get a loan from a private lender using their home as collateral to pay off the funds from Kabbage.

"You have high payments in a much shorter time frame than traditional banks or lenders so you get the money, but it's hard to fulfill the payback requirements," he said. "Ultimately, it created a lot more strain than it did benefit."

Terms Clearly Spelled Out

Both the Akersons and the Solomons said the lending platform spells out its terms clearly, but that even experienced business owners, when in a bind, can be susceptible to offers of money they might not be able to pay back.

Sinks said he recommends business owners expend more effort — whether that means meeting with someone in person or filling out additional paperwork — in exchange for lower-cost capital through the SBA or community development financial institutions.

"On the one hand, (online lenders) are filling a need, but on the other hand, you have to almost be an MBA to really figure (the APR) out," he said.



Darren Solomon
Kid Ventures

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Chairman RUBIO. Thank you.
Ms. Evans.

STATEMENT OF CONNIE EVANS, PRESIDENT AND CEO, ASSOCIATION FOR ENTERPRISE OPPORTUNITY, WASHINGTON, DC

Ms. EVANS. Good afternoon, Chairman Rubio, Ranking Member Cardin, and members of the Committee. My name is Connie Evans, and I serve as the president and CEO of AEO, the leading voice of innovation in microfinance and microbusiness in the country. Since 1991, AEO and its members have helped millions of entrepreneurs contribute to economic growth while supporting themselves, their families, and their communities.

We are also an authentic innovator, responsible for creating myWay to Credit, the first bank referral marketplace for small business lending, linking bank declines to CDFI mission lenders.

Today's hearing on capital access is critical, as the Committee and this Congress consider broad improvements to the SBA. While our members utilize many programs to meet entrepreneurs where they are, I am here today to focus on the SBA Microloan program.

Established in 1991 as a 5-year pilot, the program was originally created to assist women, low income, veterans, and minority entrepreneurs and offset disadvantages faced by very small businesses and gaining access to credit by making funds available to nonprofit community-based lenders who in turn make small loans to eligible borrowers.

The program also provides technical assistance to microloan borrowers.

The program was made permanent in 1997, and AEO has been its focal advocate over the last 27 years. Since we are unique in receiving direct loans from the SBA, we also have specific eligibility standards. Our lenders must have made and service loans for at least 1 year and have provided technical assistance for 1 year.

Congress wanted to ensure rural and urban areas could both benefit and put exact wording in the statute for that. They created the 1/55th rule, which limits the amount of loans each State can make for the first 6 months of the year. Congress also wanted to ensure that not all technical assistance dollars were spent before a loan was originated and created the 25/75 rule, which caps at 25 percent the amount of assistance that can be provided to a business before a loan is actually made.

As we move now from its origins to today, there are 144 active microloan intermediaries serving 49 states, the District of Columbia, and Puerto Rico. Last year, the SBA made 58 loans to intermediaries, our members, totaling \$37.7 million, and in turn, lenders provided 5,500 loans totaling more than \$75 million with an average of \$14,000 per loan.

Since the program's inception, a total of \$845 million in loans to small businesses have been made, which has helped create or retain about 246,000 jobs. Minority-owned firms received nearly 49 percent of the microloans issued, while women entrepreneurs received about 47 percent of loans in 2018.

We are delivering on our mandate to reach communities in those market segments without traditional credit access or capital access.

Behind this data, though, are enumerable stories, like that of Fatimah Ray, who was turned down for her initial loan to launch a fitness studio until ACE in Georgia, one of our members, helped improve her credit score and secure a loan for \$20,000 to open the doors of Edgy Girl Fitness Studio. She is already—see, you looked up. She is already expanding, but we can and must do more.

The program must align with total—today’s marketplace and the needs of diverse business owners. Additional funding and streamline reporting requirements will help the SBA and its intermediaries better serve entrepreneurs in their communities.

The 1/55th rule as well distorts the lending market, delaying for months loans in various states. Repealing this rule can be done, while making sure all states have access to the needed resources based on historical need.

Similarly, the 25/75 rule, now the 50/50 rule, thanks to a legislative change from this Committee, it is still a reporting burden on both lenders and the SBA and ignores how we help future borrowers become credit-ready with business training and with guidance. This is an essential function to support non-bankable borrowers.

Notably, the 1/55th and 50/50 rule eliminations are recommended by the SBA, and we are aligned with the agency on these views.

As I turn to robust funding, we know it is critical, and AEO was joined by others in the microloan community in requesting \$45 million for lending and \$35 million for technical assistance in Fiscal Year 2020. However, in response to Mr. Manger’s testimony, I must acknowledge that there is a budget cut in the current budget, although he indicated that there was no such budget cut. It goes from \$42 million to \$40 million in lending, \$31 million down to \$25 million in technical assistance, and it totally zeroed out the prime program. Again, we are requesting \$45 million for lending and \$35 million in technical assistance.

Many of our ideas are included in Senator Duckworth’s recently introduced bill, the Microloan Program Enhancement Act of 2019. As a resident of Illinois, I want to send my regards and thank you for these efforts to the Senator on behalf of the hundreds of thousands of underserved entrepreneurs that benefit from this critical program and the modernizations called for in the bill.

AEO is grateful for this Committee’s continued bipartisan support of this very essential program, and I appreciate the opportunity to testify today.

I will be submitting additional success stories from across the country in the coming days. I look forward to answering any questions.

[The prepared statement of Ms. Evans follows:]



Testimony of

Connie Evans

**On behalf of the Association for Enterprise
Opportunity**

to the

U.S. Senate

Committee on Small Business &
Entrepreneurship

*Re-Authorization of the SBA's
Access to Capital Programs*

April 3, 2019

Testimony of Connie Evans

President & CEO

Association for Enterprise Opportunity (AEO)

Thank you, Chairman Rubio, Ranking Member Cardin, and distinguished Members of the Committee, for the opportunity to share this testimony with you. My name is Connie Evans, and I serve as the President and CEO of the Association for Enterprise Opportunity.

The Association for Enterprise Opportunity (AEO) is the leading voice of innovation in microfinance and microbusiness in the United States. Since 1991, AEO and its member and partner organizations have helped millions of entrepreneurs contribute to economic growth while supporting themselves, their families and their communities.

Numbering more than 1,700, AEO's members and partners include a broad range of organizations that provide capital and services to assist underserved entrepreneurs in starting, stabilizing, and expanding their businesses. Together, we are working to change the way capital and services flow to underserved entrepreneurs so that they can create jobs and opportunities for all.

Beyond being the voice for financial inclusion through entrepreneurship, AEO is a fintech innovator that is responsible for creating myWay to Credit—the first bank referral marketplace for small business lending. myWay to Credit was developed with JP Morgan Chase, Woodforest National Bank, and the U.S. Treasury CDFI Fund. myWay to Credit gives options to small businesses that do not currently qualify for bank financing by connecting them to a vetted network of mission-based community lenders and small business mentors.

Today's hearing on capital access is critical as the Committee and this Congress consider broad improvements to the Small Business Administration. While our members leverage the differing authorities across the programs to meet entrepreneurs where they are, I am here today to focus on the SBA Microloan program created by Section 7(m) of the Small Business Act.

History of the Microloan Program

The Microloan Program was established by Congress in 1991 as a five-year pilot program and went into effect in 1992. The program was originally created to serve distinct populations that had historical barriers in accessing capital. The statute identified that the purpose was to "assist women, low-income, veteran...and minority entrepreneurs...possessing the capability to operate successful business concerns."¹

The program was meant to offset "perceived disadvantages faced by very small businesses in gaining access to capital" by making funds available to nonprofit, community-based lenders who in turn make very small loans (up to \$35,000) to eligible borrowers.²

¹ 15 U.S.C. 636(m)(1)(A).

² CRS Report: Small Business Administration Microloan Program, pg. 2 (3/8/19); the loan amount was increased to \$50,000 as part of the Small Business Jobs Act of 2010 (P.L. 111-240)

Testimony of Connie Evans

President & CEO

Association for Enterprise Opportunity (AEO)

The program also provides marketing, management, and technical assistance to microloan borrowers, who are often unable to access traditional bank loans due to poor credit, a lack of credit, or a lack of business experience. The program was made permanent in 1997.

AEO was involved in the early years of conceiving and launching the Microloan Program. We helped to draft and pass the legislation that created the original five-year pilot program. In fact, then Senator Bumpers (D-AR) visited the Women's Self-Employment Project (WSEP) in Chicago, which I founded as one of the first microlenders in the country. Together, we helped inform the creation of SBA Microloan Program. Later, AEO played a leading advocacy role that resulted in the increase of the micro loan limit from \$35,000 to \$50,000. We also worked with Congress and the SBA to strengthen the program by increasing the minimum number of loans required to be eligible for technical assistance grants. While that decision, at the time, was not necessarily popular with our membership, it is one of several instances where our commitment to accountability and the business owner came first.

The Microloan program is unique from other SBA lending programs. Most notably, the Microloan Program does not guarantee loans but instead provides direct loans. As such, the program includes specific eligibility standards and operating requirements for lenders and borrowers. Although these requirements are well documented by the Congressional Research Service, I will focus on a few today that illustrate how the program works and those that deserve your attention as you consider reauthorization and modernization.

Most importantly, our lenders cannot be new to the microlending space. For entry into the program, the applicant organization must have made and serviced loans for at least one year and have provided technical assistance for one year. This should inspire confidence that lenders know their local markets and, being mission-focused, will make sound program decisions.

In addition to ensuring that only qualified organizations can access the program, Congress also wanted to ensure that all areas of the country could benefit, noting in statute that:

In approving microloan program applicants and providing funding to intermediaries under this subsection, the Administration shall select and provide funding to such intermediaries as will ensure appropriate availability of loans for small businesses in all industries located throughout each State, particularly those located in urban and in rural areas.³

Furthermore, Congress created the 1/55th rule, which dictates that during the first six months of each fiscal year, at least \$800,000 or 1/55th of available loan funds (whichever is less) is required to be made available for loans to intermediaries in each U.S. state and territory including the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, and Guam.⁴

³ 15 U.S.C. 636(m)(8).

⁴ 15 U.S.C. 636(m)(7)(B)(i).

Testimony of Connie Evans

President & CEO

Association for Enterprise Opportunity (AEO)

Congress also wanted to ensure that not all technical assistance (TA) dollars were spent before a loan was originated (pre-loan) and that funds remained to help businesses thrive after the loan was made. This was a function of the perceived riskiness of the program. With an intent to protect those funds, Congress created the “25/75 rule”, which caps (at 25%) the amount of TA that can be provided to a business before a loan is actually made.⁵

The Microloan Program Today

Currently, there are 144 active microloan intermediaries serving 49 states, the District of Columbia and Puerto Rico.⁶ In Fiscal Year 2018, the SBA made 58 loans to intermediaries totaling \$37.7 million, with an average intermediary loan of \$643,724.⁷ Microloan intermediaries in turn provided 5,459 microloans totaling \$76.8 million. The average size of a microloan through the program was just over \$14,000.⁸ In Fiscal Year 2019, the SBA was expected to support around \$42 million in lending to intermediaries.⁹ In addition, an appropriation of \$31 million was allotted for technical assistance given to the borrower by the lender or by third-party contractors.

Since the program’s inception, a total of \$845 million in loans to small businesses has been made by intermediaries, which has helped create or retain about 246,000 jobs.¹⁰ Minority- owned or controlled firms received 48.7% of the microloans issued and 38.9% of the number of the amount issued.¹¹ This is compared to about 9.9% of conventional small business loans that are issued to minorities, according to data from a study conducted by the Urban Institute.¹² Microloans have also been a significant source of capital for women entrepreneurs, who received about 47% of those issued in FY 2018.¹³ This data highlights the importance of the Microloan Program to communities and market segments without traditional capital access.¹⁴

⁵ Congress changed the rule to 50/50 as part of the Consolidated Appropriations Act of 2018.

⁶ 6 SBA, “Fiscal Year 2019 Congressional Budget Justification and FY2017 Annual Performance Report,” p. 37, at https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_19_508Final5_1.pdf. For a list of all Microloan intermediaries, regardless of lending volume, see SBA, Microloan Program: Partner Identification & Management System Participating Intermediary Microlenders Report, June 21, 2017, at https://www.sba.gov/sites/default/files/articles/microlenderrpt5_20170621.pdf

⁷ CRS Report: Small Business Administration Microloan Program

⁸ CRS Report: Small Business Administration Microloan Program

⁹ SBA FY19 Congressional Budget Justification Report (2018).

¹⁰ House Small Business Committee Subcommittee on Economic Growth, Tax, and Capital Access hearing memo, “Small but Mighty: A Review of the SBA Microloan Program” (3/7/19)

¹¹ SBA, “Nationwide Loan Report, October 1, 2017 through September 30, 2018,” October 26, 2018. 1,020 of 5,459 Microloan borrowers (18.7%) did not report their race. These borrowers received \$11.3 million in loans. Because the race of these borrowers is unknown, their borrowing was removed from the calculation of the proportional share percentage figures provided for minority-owned or -controlled firms.

¹² Kenneth Temkin, Brett Theodos, with Kerstin Gentsch, Competitive and Special Competitive Opportunity Gap Analysis of the 7(A) and 504 Programs (Washington: The Urban Institute, 2008), p. 13, at http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf.

¹³ CRS Report: Small Business Administration Microloan Program

¹⁴ Appendix B tracks recent statistics of the program by state.

Testimony of Connie Evans
President & CEO

Association for Enterprise Opportunity (AEO)

The story of Fatimah Ray brings these statistics to life. Fatimah is a client of one of our members, Access to Capital for Entrepreneurs (ACE). In March 2017, she began searching for funding to open a personal training business, but she was turned down from multiple lenders because she didn't meet all of their requirements. Growing frustrated, she Googled "business loans for minorities and women" and found a link to ACE's website. After attending a workshop at ACE's Women's Business Center on access to capital, she applied for a \$50,000 loan. She was denied due to her credit. Her story didn't end there, however, because ACE arranged for her to have one-on-one consultation with a financial expert who advised her on how to improve her credit score. Fatimah eventually closed on a loan for \$20,000 in August 2017, and one year after opening the doors of Edgy Girl Fitness Studio, she is ready to expand her business. Fatimah's success would not have been possible without both the funds and the technical assistance she found at ACE.

While sufficient capital and credit enable entrepreneurs to get their businesses off the ground, sometimes those with a vision and a passion lack the technical skills necessary to keep their doors open. Nurse practitioner Mary Williams saw a need in her community for an urgent and after-hours clinic in Clarksdale, Mississippi. Before she opened the Urgent and Primary Clinic of Clarksdale, patients could only seek care at the hospital emergency room on nights and weekends, which required high copays and long waits. While her business fulfilled a critical need in a poor, rural community, she had no outside financing and her billing system for insurance companies was not established. She sought assistance from AEO member, Communities Unlimited (CU), who helped her secure a \$12,000 microloan and provided her with technical assistance from a CU management consultant to ensure that her business was properly credentialed with various insurance providers. The emergency loan and TA which Mary received helped her keep her doors open. Urgent and Primary Clinic of Clarksdale now employs 9 full time people and provides health care to 25 to 45 people a day who could not previously access care without waiting in the emergency room.

Modernizing & Improving the Microloan Program

The Microloan Program has been tremendously successful, and AEO is committed to working alongside Congress to ensure it continues to generate positive impact in communities across the country. In order for this impact to continue, Congress must modernize the program and align it with today's marketplace and the needs of diverse business owners. Additional funding and streamlined reporting requirements will help the SBA and its intermediaries better serve entrepreneurs and their communities. I call your attention to additional pressing needs, namely: elimination of both the 1/55th rule and the 50/50 rule; increased access to SBA data; and, increasing the aggregate loan limit for intermediaries after their first year of participation from \$6 million to \$7 million.

Testimony of Connie Evans
 President & CEO
 Association for Enterprise Opportunity (AEO)
Eliminate the 1/55th Rule

The 1/55th rule has long been a concern for AEO and the SBA as it distorts the lending market in an effort to ensure each state has access to resources needed for lenders, regardless of the size of the state or the needs of the small business community. The reality, however, is that it simply becomes a burden on states like Florida and Maryland who face unnecessary delays in loans made to entrepreneurs. Changing this rule can be done while still making sure states have access to needed resources based on historical need.¹⁵

Eliminate 50/50 TA Restrictions

Another operating requirement for lenders is the 50/50 technical assistance (TA) rule. When the Microloan program first launched, it required that 25% of the technical assistance given to the entrepreneur by the lender be provided pre-loan and 75% post-loan. In 2018, Congress changed these percentages from 25/75 to 50/50 in the Consolidated Appropriations Act of 2018.¹⁶ While this change was valued, the 50/50 rule is still a reporting burden on both lenders and the SBA which stymies intermediaries by dictating how much of their TA grant fund can be used during the pre-loan phase vs. borrower support.

The rule also ignores how microlenders help future borrowers become credit-ready with business training and counseling. This is an essential function to support non-bankable borrowers. The 50/50 rule should be re-considered in light of these challenges, as every business's needs are unique, and intermediaries are the most appropriate party to determine the best use of their grants to support the local market, as they work so closely with borrowers and potential borrowers day in and day out. Take the case of Mary Williams previously mentioned. Mary's story is unique in that she received the majority of her TA post-loan, yet many of CU's loans are made to micro-enterprises in persistently poor, rural communities, and thus CU must provide a significant amount of TA before making a loan in order to mitigate their risk. The current 50/50 rule for pre-and-post TA is very challenging to manage for CU, and many other microlenders, and it is not reflective of the needs of their clients.

Streamline Reporting Requirements and Make the Data Available

While intermediaries invest precious time and resources into burdensome reporting requirements, this data is unfortunately not made publicly available by the SBA, similar to data available for the 7(a) program. This data could provide valuable insights to supporters of the program on the borrowers who use the Microloan program, such as geographical location, loan amount, interest rate, and terms, to name a few. Currently, the only way to access this data is to file a Freedom of Information Act (FOIA) request, which is time consuming, burdensome, and the data often takes over 6 months to obtain.

Ensure Adequate Funding for Lending and TA & Related Programs

¹⁵ Appendix A notes states impacted by the 1/55th rule.

¹⁶ P.L. 115-141

Testimony of Connie Evans
President & CEO

Association for Enterprise Opportunity (AEO)

Robust funding is an important part of the Microloan program, a program that has a proven track record helping small businesses thrive, create jobs, and support communities. Only two-thirds of small businesses survive two years in business, and half of all businesses do not survive five years.¹⁷ Small businesses who receive financing and technical assistance through the Microloan program have much higher rates of success. In the research publication, *The Power of One in Three: Creating Opportunities for All Americans to Bounce Back*, AEO found that the median annual revenue growth was 30 percentage points higher for micro businesses who received capital and technical assistance as compared to those businesses who received only capital.¹⁸

Increase Aggregate Loan Amount

The aggregate loan limit for intermediaries after their first year of participation in the Microloan Program is currently set at \$6 million. The Consolidated Appropriations Act of 2018 made this increase from \$5 million, but this cap is still too low for a number of microlenders who cannot meet their communities' needs with \$6 million. AEO proposes the aggregate loan limit be increased to \$7 million. These additional funds will allow microlenders in high-need areas, as well as those who are the sole microlenders in their state, such as the Economic and Community Development Institute in Ohio, to service a larger number of in-need entrepreneurs in their communities.

Role of Microloan in SBA Continuum

Today's hearing is a discussion of the broad capital access options at SBA. We are pleased this Committee is viewing the entirety of the system as a continuum and is considering modernizations and re-authorization comprehensively. We believe the Microloan Program is a critical underpinning of the broader capital access programs.

Many of our members are not only Microloan intermediaries, but also engage in other lending programs. The ability to offer a suite of SBA-related products furthers our goal to meet entrepreneurs where they are – and with the product that meets their needs. There's no question that all small businesses share some common characteristics, yet they have unique needs and the programs on the SBA Capital Access continuum helps to meet those diverse needs.

One program that our membership is keenly aware of is the Community Advantage pilot program in the 7(a) program. While others today are providing an in-depth overview of that program, AEO is committed to ensuring it remains a strong option for entrepreneurs who are unable to access bank credit. As this Committee considers SBA capital access legislation, we would urge

consideration of legislation that makes permanent this vital program. We commend Ranking Member Cardin for his leadership on legislation to make this change.

¹⁷ United States Department of Labor, Bureau of Statistics, Business Employment Dynamics, available at <https://www.bls.gov/bdm/entrepreneurship.htm>.

¹⁸ The Power of One in Three: Creating Opportunities for all Americans to Bounce Back, Association for Enterprise Opportunity, https://aeoworks.org/publications/One_in_Three.pdf

Testimony of Connie Evans
President & CEO
Association for Enterprise Opportunity (AEO)

Conclusion

Many of the ideas we have put forth today are included in Senator Duckworth's recently introduced bill, the Microloan Program Enhancement Act of 2019. As a resident of Illinois, I want to thank you for your efforts on behalf of the hundreds of thousands of underserved entrepreneurs that benefit from this critical program and the modernizations called for in this bill, which will allow these entrepreneurs – and many more – to access much-needed capital.

AEO is grateful for this Committee's continued bipartisan support of this very essential program, and I appreciate the opportunity to testify today. I will be submitting additional success stories from across the country in the coming days. I look forward to answering any questions.

Testimony of Connie Evans

President & CEO

Association for Enterprise Opportunity (AEO)

APPENDIX A – States Impacted by 1/55th Rule: Current (FY2019) and FY2018

Based on data provided by the SBA, AEO understands that the following states are impacted by the 1/55th Rule (i.e. loan delays).

In FY2019 (current year) the following states were delayed:

- MA
- NY
- PA
- MN
- NC
- MT
- ME

In FY18 the following states were delayed:

- NC
- VT
- MO
- MA
- NY
- MI
- CA
- NE
- PA
- GA
- ND

Testimony of Connie Evans
 President & CEO
 Association for Enterprise Opportunity (AEO)

APPENDIX B – Microloan Production by State: FY2017 and FY2018

Microloan Production by State - FY2018

Row Labels	Sum of LOANAMT	Count of LOANSEQNMB
AL	468,092.69	22
AR	932,976.00	40
AZ	704,422.51	31
CA	5,817,642.44	254
CO	3,156,910.20	168
CT	1,069,750.00	54
DC	2,277,680.65	620
DE	260,000.00	7
FL	293,500.00	20
GA	946,126.42	46
IA	239,000.00	9
ID	78,769.00	14
IL	288,235.91	33
IN	2,639,366.66	97
KS	182,563.00	13
KY	1,653,256.74	144
MA	1,761,735.27	81
MD	153,650.00	16
ME	1,490,234.00	93
MI	1,810,506.03	73
MN	3,881,741.12	196
MO	1,746,652.64	392
MS	268,636.00	13
MT	512,248.40	15
NC	2,473,083.06	71
ND	285,291.49	10
NE	2,044,024.92	128
NH	380,000.00	9
NJ	2,805,931.17	150
NM	1,125,953.43	68
NY	11,117,749.03	1028
OH	1,894,786.24	257
OK	501,148.00	25
OR	2,511,390.60	226
PA	4,448,226.02	359
PR	235,521.30	10
SC	2,301,245.19	86
SD	199,500.00	14
TN	594,659.50	33
TX	2,900,263.19	157
UT	1,260,617.43	37
VA	3,152,948.70	124
VT	413,691.96	24
WA	984,223.80	59
WI	2,214,168.14	122
WY	265,351.60	9
Grand Total	76,743,470.45	5457

Microloan Production by State - FY2017

State and Intermediary	\$ of Loans Closed	# of Loans Closed
AL	216,857.00	14
AR	1,254,056.41	54
AZ	1,053,849.11	33
CA	4,801,511.31	223
CO	2,236,011.60	126
CT	1,168,096.37	54
DC	726,227.12	124
DE	335,000.00	9
FL	1,097,840.77	67
GA	1,237,666.33	49
IA	368,500.00	10
ID	112,611.95	13
IL	779,183.22	152
IN	1,647,623.87	93
KS	500,225.87	33
KY	2,234,802.06	166
LA	93,763.68	9
MA	1,874,126.17	109
MD	1,845,834.13	196
ME	848,987.95	45
MI	1,845,466.07	81
MN	2,766,024.81	149
MO	1,892,398.31	376
MS	315,462.24	14
MT	84,852.50	7
NC	1,800,758.31	64
ND	237,165.87	8
NE	1,501,314.62	138
NH	121,048.90	7
NJ	3,615,416.66	202
NM	807,627.84	57
NV	29,000.00	2
NY	8,622,089.36	842
OH	1,516,023.63	223
OK	294,774.55	24
OR	1,085,345.60	150
PA	3,598,914.17	280
PR	482,223.69	23
RI	247,969.34	12
SC	1,262,159.03	50
SD	244,900.00	13
TN	738,427.44	34
TX	4,327,374.46	264
UT	842,152.00	27
VA	1,833,553.55	118
VT	652,615.24	45
WA	1,283,497.06	72
WI	1,998,809.08	106
WV	617,774.12	15
WY	209,871.73	10
Grand Total	69,307,785.10	4,992

Chairman RUBIO. Thank you all for being here.

Let me start with this chart on the 504 closing process, which I like to call the Chobani impediment chart.

[Laughter.]

But what the chart does is it illustrates the closing process for a 504 construction loan.

So, as you can see—and I think, Ms. Kibbe, you would know from personal experience—it is long—it appears—I mean, just look at the chart. It looks long. It is complicated. It is an arduous process. That is what we are hearing. That is what the chart indicates. Approximately 56 separate documents.

So in the context of what we are trying to do here in reauthorization, I guess the first thing I would ask is—because you heard the SBA talking. This is good news. There is more utilization of this program than in the past, evidence at least that there has been a reduction in sort of pushing them to the other product because of interest rates and market conditions and the like.

But it strikes me that even at the interface between the lender and the SBAs is now digitized and done electronically, the front-end process and the cumulative process appears to remain cumbersome.

So, as we go through reauthorization, I think you already did in your opening statement, but speak a little bit more to the detrimental effects that this process has on borrowers, on CDCs, on bank partners, and then sort of dig in a little deeper on suggestions you have on policy that could improve this process.

Ms. KIBBE. I would love to. Thank you, Chairman Rubio.

I will say that this process is very accurate with one exception. It is very optimistic because it does not take into account a construction loan, and a construction loan can take up to 6 to 18 months to get the construction done before we even get to this process. So this would be what we classify in my certified development company as just a straight purchase, you know, vanilla ice cream kind of deal, and it is not Rocky Road because it should be Rocky Road. So this is very optimistic because it does not take into account the construction.

I would say, just my two comments—and we can go into more detail with our staff and yourself later, but the forms are very cumbersome. They are not now in a repository, as Mr. Manger said that it should be, because that would eliminate some of it.

The other thing is that the Office of General Counsel, I do not think really looks at lending practices. I think they look at, like to my other point, eliminating risk. So they have layered on some things to this process that are really very antiquated and need to be addressed.

Chairman RUBIO. Okay. So you are saying this is actually optimistic?

Ms. KIBBE. Optimistic.

Chairman RUBIO. All right. You said the forms are not—you are referring to the front-end forms, the collection between the borrower and the lender?

Ms. KIBBE. Right. If those were put into some type of a repository so that they could be looked at throughout the process—what happens—

Chairman RUBIO. They are uniform?

Ms. KIBBE. They are uniform. Some of them are a little antiquated.

But what happens is we are having to, at the end of the process, give all of the closing documents that we have already given at the front of the process. So you are basically kind of restarting the whole thing over again, and then there are certain forms that we have to repeat several times throughout the process. So it gets very cumbersome.

And we can provide a lot more detailed information outside of the hearing.

Chairman RUBIO. Ms. Huston, you have already—I think you spent the bulk of your opening statement talking about this. I want to revisit it for just a moment. In your testimony, you talked about the implications of the President's budget request, the positive subsidy for the 7(a) program, which is going to require addressing it. It is going to require congressional action, whether it is appropriations or an increased fee.

I wanted to give you an opportunity to go—you talked about just the lack of understanding, but you said that the subsidy calculation in itself, we have reason to believe is flawed, and as a result, people are being overcharged.

I just want to give you a chance to kind of go deeper into that because we clearly would also—I mean, you heard the testimony before you, the administration and the SBA, about how they do not have access to the analytic tool. They just see the back-end product, but somebody has it, and somebody needs to understand what they are accounting for, what they are weighing, and how they are making these determinations.

What about the results leads you to that conclusion that this deserves to be challenged?

Ms. HUSTON. There has been historical GAO reports, at least three that we have been able to reference, where this has been a challenge in terms of understanding and getting behind the SBA subsidy calculation.

I referenced in my testimony or my oral the 2004 report, but I will add another one to that right now. There was an SBA agency—excuse me. They hired Pricewaterhouse to conduct a diagnostic review of the SBA's existing internal controls, and in September of 1997, that study said that the credit subsidy process is not viewed as a way of assessing the future risk and costs of the program for management purposes. Rather, the rate calculation is perceived by SBA to be a tool for gaming the congressional appropriation process.

I quoted that, in large part, because it is rather controversial in my mind.

The other thing that Mr. Manger mentioned, which is why this feels convenient, is that—he mentioned 2014 in that the SBA and the OMB projected a zero subsidy with lower GDP growth, higher unemployment, based on—and then based on actual performance, they now say we have a negative subsidy. That means they overcharged in 2014 by nearly 2 percent. They are comparing an increase in default rates that they anticipate right now to 2014,

which they have had tremendous positive performance in. So I find it interesting that they reference 2014 specifically.

So now with the higher GDP growth projection, lower unemployment, and better program metrics, they say we have a positive subsidy. So it is not adding up.

Chairman RUBIO. Mr. Villarreal, the SBA says the Community Advantage loans continue to exhibit more risk, with the last 12-month default rate standing at around 4 percent; the default rate for the underserved small loans under the larger 7(a) program, around 3 percent. Obviously, zero percent would be considered no risk or low risk, and greater than 4 percent being high risk.

I know this is a tough question to answer, but for a program like this to be viable or to be some hope, one day be extended, what would be an appropriate default rate and amount of risk for something like the Community Advantage program?

Mr. VILLARREAL. Thank you for the question, Chairman.

So those numbers, I think, are incredible, the fact that we have that default rate at 4 percent. The Community Advantage program is being asked to serve the hardest to serve. In fact, for almost all of us, 50 percent of our referrals come from traditional banks. So these are not conventional or even 7(a) SBA. They are being referred to us.

The SBA microloan historically, which has been around a few decades, I think has a loss rate of between 5 and 7 percent. We think that Community Advantage may be better than that.

In fact, we have sat with Mr. Manger and the SBA staff, and we have asked them if they could come up with a risk assessment, so we know as a lender what to be shooting for.

Chairman RUBIO. But you heard the testimony. They have frozen it. They want to look at it, and one of the things they talked about is the credit score number. Above 140, everything was great; below 140, they have problems. So they want to change the process by how they handle that.

I wanted to ask about that, the 140 credit score at origination. What has been your experience with a credit score of borrowers under this program and its correlation to defaults? Even that calculation is different from what we would think of as a consumer credit score.

Mr. VILLARREAL. Right. The score that is referenced is called the SBSS score, which is a predictive index from the SBA. Actually, as an industry, we were not opposed to the changes, that change that the SBA did in terms of requiring us to send loans—

Chairman RUBIO. I am sorry. Which change? You are about to say it, I guess.

Mr. VILLARREAL. Yeah.

Chairman RUBIO. But the change where anything under 140 would have to go for secondary screening?

Mr. VILLARREAL. Correct, correct.

As an industry, not a lot of us were operating in that space. Of about the 20 or so defaults that we have had, only one has been below 140, had a score of 138.

We have not seen a correlation, really. We looked through our defaults between credit score and defaults. In fact, the majority of

our defaults have had personal credit scores of above 700 and above a 160 SBSS score.

Really, where we see a correlation more in defaults is with industry. So there is greater risk in the food industry, restaurants, and we have seen greater risk in health and fitness, yoga or Pilates. So that is where we have seen the risk but we have not seen a correlation with credit score at this point.

Chairman RUBIO. So you did not have a problem on the change, but you frankly do not—it sounds like what you are saying is that the credit score, when it comes to this program, is not really—the risk is really more industry-specific than it is based on the credit score. In essence, if you are in the wrong industry with a high credit score, your chances of default could be much higher, riskier than someone with a lower credit score in the right industry.

Mr. VILLARREAL. You know, as a mission-based lender, we look at the entire picture. So credit score is just one of the things that we are looking at. We are looking at a number of factors, including industry, including work experience and history of management. So, for us, really it is just one factor that we look at.

Chairman RUBIO. Yeah. Again, I mean, just thinking through it, obviously, we have got some work to do to think about it. On the one hand, if you want this program—if we want this program to be viable and be able to make the case or the argument—and the Ranking Member believes in this—that this should be made permanent, then you have got to have a program that has some acceptable risk, even though we know it may be riskier, given the population and the industries you are trying to serve.

The flip side of it is that if you try to make decisions on the basis of industry, which seems to be a leading indicator of risk, you end up sort of picking winners and losers between industry. So it is a tough balancing act, obviously.

Mr. VILLARREAL. It is, but what we do—because mission lenders are so uniquely poised with both the capital, but the most important part, that business advising, that technical assistance, I think that when we find industries such as the restaurant industry or the health and fitness, it just means we underwrite more carefully, take more time, and apply more business advising with that client.

Chairman RUBIO. Yeah. The irony is the restaurant and the fitness. So you overeat, and then you have to go work out, either one. So that just tells you.

[Laughter.]

All right. Ms. Evans, you mentioned intermediaries are frustrated with what they call the 1/55th rule and how it does not efficiently encourage microlending in rural areas. A good argument, I think could be made that this rule is not operated entirely the way it was intended, and in fact, some could make the argument that it is counterproductive for the intermediaries that are trying to work with business in certain areas across the country, rural areas.

But an alternative mechanism is also sort of difficult to come up with on the fly. It still needs to make sure that we do not leave these communities behind. In your estimation, do you have some ideas about—and you sort of touched on it a little bit already, but what a workable statutory alternative would be that at the same time achieves the goal of geographic disbursal of these loans?

Ms. EVANS. Thank you, Mr. Chairman, for the question. It is a great question.

Before I answer that question, could I just correct one piece of information about the default rate for the Microloan program?

Chairman RUBIO. Yes.

Ms. EVANS. It is a little high that you quoted. It is actually about 2.7 percent. So the Microloan program is doing well, and the default rate, if you want to compare that in terms of thinking about Community Advantage.

But on to your question, sir. Serving rural areas is a key priority of the Microloan program. As I mentioned in my oral testimony, it is actually in the statute. It is important to remember that the statute for this program already requires equitable distribution of intermediaries.

We would encourage, as is in Senator Duckworth's legislation, SBA reporting on where the gaps are.

There is also some misconception about states impacted by the 1/55th rule. It is not just states with urban populations. In 2017, Kentucky and Nebraska delayed loans because of this rule, one of the reasons Senator Fischer has championed removing this provision.

And in 2018, Vermont, North Dakota, Georgia, New Mexico, and again, Nebraska were delayed. So far this year, Montana, New Hampshire, and Maine have all delayed deploying capital to entrepreneurs. They are just a few examples that I am mentioning, but coming from states where rural entrepreneurship is actually happening.

Now, instead of providing a new rule, which like the 1/55th rule may have made sense at the time, we would urge focusing on collecting the data about how this program is actually serving rural entrepreneurs. Past data has shown great demand for this program in rural areas. So we would want to know the challenge better before creating a statutory solution, which may take another 27 years to change.

Chairman RUBIO. Twenty-seven years.

Ms. EVANS. Yes.

Chairman RUBIO. All right. Well, I think it is one of those things—it is one of the reasons why the reauthorization is so important. It is to kind of look through the options that exist under current law and how that could be reinterpreted or reapplied, and our goal here is to really continue to fine-tune this.

It sounds, if I could paraphrase what you are saying, that the solution may already be there, but applying it differently than we are doing now, as opposed to going out and trying to create a new rule to replace what we are doing today.

Ms. EVANS. Exactly. But also, again, just eliminating the rule altogether.

Chairman RUBIO. Let me ask you one more question on data. I do not know if you saw the question that I had to the agency about—and it really goes back on data to the 2017 report in which the Inspector General found deficiencies in the collection of data by intermediaries and in the SBA's evaluation about data. So the weak links in data collection and program evaluation, if they remain, make it difficult for Congress to make decisions on a variety

of different issues and for the Committee to make informed decisions as well about programs.

So if you could talk a little bit about, first of all, that—and I know that this is different across the spectrum, but generally because one of the answers we got is they did not know what kind of data the intermediaries were collecting. What kind of data do intermediaries collect, and then how is that reported to SBA?

Ms. EVANS. Sure. Most intermediaries maintain a database with significant qualitative and quantitative information, including location, whether it is rural or urban, gender, race, jobs created, jobs saved, sales, and other impact data.

The data is reported via the SBA's data collection system, MPEs, what we heard Mr. Manger mention, which is not an ideal system to use as it is not intuitive and it is time consuming.

Intermediaries can only view this data. They do not have access to other locations or another location in terms of other intermediaries reporting on that data.

Chairman RUBIO. You can only view your data?

Ms. EVANS. You can only review your own data, correct.

Chairman RUBIO. What you do not have is a sort of holistic view of what all the data means put together?

Ms. EVANS. You do not only have a whole sense of the whole picture of the program in terms of the data, what is taking place. It is also very time consuming. We heard Mr. Manger talk about that they have made changes and are making other changes, but a new user-friendly database with spreadsheet upload capabilities would allow the intermediaries to report from a database like Nortridge loan software, something that they are already using to manage their program effectively and efficiently and be able to upload from that system into the SBA database without having to re-key every single entry.

The data should also, of course, we think be made publicly available, so not only could the intermediary view this data across the program, but so could Congress.

Chairman RUBIO. It is just interesting because, literally, the 21st century is becoming a data-driven century. Everything, decisions we are making on a bunch of things are being driven by data because of new analytic tools that are being applied to make decisions.

I know that across various industries, writ large—in fact, across almost every industry, data-driven decisions are going to be driven by analytic tools that are constantly going to be improved to make decisions on which way to go, what is the right direction, potentially even lending practices that will take into account factors that the human mind or traditional measures may not take into effect. So it is just interesting as a brainstorming exercise to think how analytics could eventually improve how we use data if it can be appropriately collected and updated in real time across the board to tell us more about a borrower than simply an old-school credit score might be or just look at an industry and say just because they are in a certain industry, that in and of itself is going to make us feel a certain way versus another.

Obviously, there are always concerns that the analytic tool that could be applied is prone to bias itself, and so that has to be devel-

oped. But they are going to be developed across the board for all sorts of things, including risk assessment and health care and travel and the like. So it will be an interesting exercise as we move forward to see what the role could be, but it all begins with accurate real-time data collection that is available for collaboration, so you are not just siloed off geographically or across one intermediary.

I appreciate the time you have all given us here today, and I apologize with the vote schedule. We have been a little bit chaotic moving back and forth, but again, I am grateful to all of you for being a part of this important hearing.

We probably will submit some additional questions to you for the record. I know the Ranking Member is going to. He had an issue, State issue that he had to go address, and so he could not be here. But I know he is going to be submitting some as well.

But your expertise in the real world, your application of these programs on how they are functioning is going to be really important to us, and so any further input that you would have for us on an ongoing basis would be very useful. And we are grateful.

This is enough formality here, but the hearing record is going to remain open for 2 weeks. Any statement or questions for the record should be submitted by Wednesday, April 17th, at 5:00 p.m.

Thank you all so very much. We are very grateful to you for your time.

With that, this hearing is adjourned.

[Whereupon, at 4:43 p.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Senator Duckworth Statement for the Record:

The Small Business Administration's (SBA) Microloan program was established as a 5-year pilot program in 1992 and permanently authorized in 1997. The SBA Microloan program has evolved over the years to better increase small business access to capital and meet the needs of small business interests. This statement summarizes the legislative history of Congressional efforts to modify SBA's Microloan program from 2010 to 2018.

In the 111th Congress, former Representative Barney Frank of Massachusetts introduced the Small Business Jobs Act of 2010, which was subsequently signed into law. This legislation increased the maximum amount of a microloan offered from intermediaries to borrowers from \$35,000 to \$50,000. It also increased the maximum total amount of loans to one intermediary participating in the Microloan program from \$3.5 million to \$5 million.

In the 113th Congress, Senator Maria Cantwell of Washington introduced S. 2693, the Women's Small Business Ownership Act of 2014. This bill would have increased the aggregate loan limit for intermediaries after the first year of participation from \$5 million to \$7 million, and sought to eliminate the 25/75 rule, which limited intermediaries from using more than 25 percent of their technical assistance grant funding for information and technical assistance to prospective borrowers. It also prevented intermediaries from using more than 25 percent of their technical assistance grant funding for third party contracts for technical assistance to borrowers.

In the 114th Congress, Senator Deb Fischer of Nebraska introduced S. 1445, the Microloan Act of 2015. This bill would have repealed the 25/75 rule, as well as repealed minimum allocation requirements that prohibit SBA from distributing more than 1/55 of funding to any given State or territory until the second half of the fiscal year— a requirement that is often referred to as the 1/55 rule.

Senator Fischer also introduced S. 1857, the Microloan Modernization Act of 2015. This proposal sought to raise the maximum outstanding loan to an intermediary from \$5 million to \$6 million, remove changes to the 1/55 rule and included an option for intermediaries to use a waiver for the 25/75 rule instead of repeal, among other provisions. The Senate Small Business Committee favorably reported S. 1857. In addition, Senator Fischer introduced S. 2850, the Microloan Program Modernization Act of 2016 that again sought to increase the funds given to any intermediary from \$5 million to \$6 million and repeal the 25/75 rule. The Senate Small Business Committee favorably reported S. 2850 with amendments.

In the 115th Congress, Senator Fischer worked to amend the Microloan program through H.R. 5515, the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (FY19 NDAA) and H.R.1625, Consolidated Appropriations Act, 2018. Section 853 of the FY19 NDAA increased the aggregate intermediary lending limit from \$5 million to \$6 million and included an SBA study of microenterprise participation and a GAO study on microloan intermediary practices. Section 532 of the Consolidated Appropriations Act, 2018 increased the 25/75 rule to 50/50. These provisions were also part of S. 526, the Microloan Modernization Act of 2018, which passed the Senate with an amendment, unanimously by voice vote.



Robert Villarreal
Executive Vice President
CDC Small Business Finance

Testimony for the Record submitted to
The Senate Committee on Small Business and Entrepreneurship

For the hearing:
Reauthorization of the SBA's Access to Capital Programs
Wednesday April 3, 2019

Chairman Rubio and Ranking Members Cardin, on behalf of CDC Small Business Finance (CDCSBF) we want to thank you for convening the hearing to discuss the US Small Business Administration's Capital Access programs. CDCSBF's comments in this testimony are focused on two important SBA programs: the SBA Community Advantage (CA) program, a pilot launched in 2011 under the SBA's 7(a) loan guarantee program; and the SBA Microloan Program.

Community Advantage

CDCSBF submitted testimony to the Committee on April 1, 2019. The purpose of the comments here are to clarify some points around questions asked by Chairman Rubio of Robert Villarreal, witness for the CA program, at the hearing regarding the Community Advantage program and to add additional comments about the CA program.

Chairman Rubio inquired about an appropriate default rate for the program. He stated that the CA program was at 4% while the 7(a) small loan program was at 3%. In my response I noted that the SBA Microloan default rate was a 5%-7%. When Chairman Rubio was questioning Ms. Evans about the SBA Microloan program she stated a correction to my 5%-7% default rate and noted that the default rate was just over 2%. In fact, we were both referring to different aspects within the SBA microloan program. As a reminder, in the SBA Microloan program, there are two steps in deploying the capital to small businesses. The first is a loan from the SBA to the Microloan intermediary. The second is a loan from the intermediary to the small business. Ms. Evans default rate percentage of 2.7% was in reference to the loan from the SBA to intermediaries. The default rate to which I was referring to is for loans from the intermediaries directly to small businesses. This rate of 5%-7% more directly answers Chairman Rubio's question of an appropriate default rate for the CA program, as it is based on loans from lenders to small businesses.

One of the recommendations discussed in the previous submitted testimony of April 1, included eliminating the twelve-month waiting period for a CA lender's ability to re-finance same institution debt. As described, this is particularly burdensome for the small businesses that are trapped in high-cost loans, such as those from on-line lenders and Merchant Cash Advance lenders. If the CA lender had the ability to provide a quick bridge loan to the small businesses and get them out of the high-cost loan, the lender could then take out the bridge loan with a CA loan, which can take up to three to four months to close. This is to no fault of the SBA Loan Processing Center; it is the nature of the SBA loan and the documentation it entails for both the lender and the borrower. Therefore, having the ability to provide a bridge loan and refinance could save the small business owner thousands of dollars.

We wanted to provide a few more examples of small businesses that were trapped in high-cost loans which we were able to assist. A sole proprietor in San Diego that provides Computer Assisted Design (CAD) services to engineering firms had four on-line loans ranging from 29.78% to 34% APR. While each loan was small, combined they totaled approximately \$5,000, with monthly payments exceeded \$1,300. And each loan had a fee, which totaled to \$712 for the four loans. CDC Small Business Finance was able to provide the small business-owner \$45,000 to pay-off the high-debt instruments and have the appropriate amount of working capital. Monthly payments dropped nearly in half to just over \$700 for our loan.

Another small business, a heating and air conditioning company in Riverside California, had a 55.54% APR on-line loan and multiple high interest credit cards, in all totaling nearly \$140,000 or \$5,319/month in payments. CDCSBF was able to refinance all those loans plus provide him \$100,000 in working capital with a \$250,000 CA loan. This resulted in monthly payments of \$3,270, saving him over \$2,000/month. However, it took 4 months to close the loans. If we had been able to provide a bridge loan up-front, the small business could have saved \$6,000-\$8,000.

An additional example of refinancing high cost loans is from our colleague Debra Salas in Florida with Neighborhood Lending Partners. They worked with Latin Beauty Academy in West Palm Beach, which had two high cost loans, on which they were paying nearly \$17,000 per month on approximately \$176,000 in loans. Neighborhood Lending Partners was able to refinance the loans and provide working capital to the small business. They dropped their monthly payments to just over \$2,000 per month. Unfortunately, the loan took six months to close. If Neighborhood Lending Partners had been able to provide Latin Beauty a bridge loan in the first month, they could have saved the small businesses nearly \$13,000-\$15,000 per month for 5 months!

We also wish to continue to reiterate that traditional 7(a) lenders are not the best suited to serve the market that CA lenders are currently serving. We were hoping for a greater opportunity under questions and answers at the hearing for a discussion on the impact CA lenders have in their community, as well as draw a distinction between CA and 7(a) lenders. Senator Cardin did a nice job of highlighting the numbers regarding CA lending in Black and Brown communities, versus 7(a). In FY18, 12% of CA dollars went to Black-owned businesses and 17% to Latino-owned businesses. For SBA 7(a) Express Loans these numbers were 4% and 9% respectively. And these are not even considered Target Markets by the CA Program!

A greater distinction is in loans to start-ups, which traditional lenders do not finance. For CDC Small Business Finance, over half of the portfolio are start-ups, as defined by the SBA (less than two years in business). Further, in FY18, 44% of CDC's approved loans were to "pure" start-ups, meaning these were projection-based loans. Almost no traditional 7(a) lender will finance a pure start-up and start-ups cannot be served by on-line lenders, as they rely on cash-flow for their analysis. This leaves the CA lenders to fill the void in the market of financing new small businesses, which represents new jobs, particularly in underserved neighborhoods and those with a high concentration of minority residents. More importantly, the pure start-ups are those businesses most often in need of business advising, and it is only the CA lenders that provide "TA" within the 7(a) programs.

Finally, as an example of the type of start-up small business CA lenders finance, which traditional 7(a) lenders will not, we offer Georgia's Restaurant. Georgia's was a black-owned start-up restaurant in a redevelopment project in old downtown Anaheim which 7(a) banks would not finance. Georgia's owner and her partner brought management experience to the project, as well as a vision. We worked with the restaurant owner for nine months as the project was built-out and funded in 2014. Within three years she was on the Food Network and is now expanding into a second location. The new restaurant was financed by a traditional lender which refinanced and paid-off our CA loan. This is a perfect example how the CA program builds small businesses and provides new clients to banks.

SBA Microloan Program

CDC Small Business Finance agrees with the written comments provided by Ms. Connie Evans regarding the SBA Microloan Program. CDCSBF has been an SBA Microlender since 2001 and funded over 300 small businesses for \$10.5 million. 52% of the loans have been to either women or minority entrepreneurs.

As outlined in the testimony referred to above, CDCSBF supports: the elimination of the 1/55th rule and the 50/50 rule; increased access to SBA data; and, increasing the aggregate loan limit for intermediaries after their first year of participation from \$6 million to \$7 million. Below we will focus on the 1/55th rule and the 50/50 rule.

The 1/55th rule has long been a concern for the industry. While it may have been a practical approach to ensure equitable coverage at the launch of the program, the program is nearly three decades old and the Administration has data to verify that the concerns officials had about smaller states not receiving sufficient capital are unfounded. In fact, the rule now has the adverse effect of impacting states with high volume lenders. CDCSBF exhausted its last SBA loan in September of 2018 and did not have access to new SBA funds between October 2018 and April of this year because of the 1/55th rule, although there were funds available. We are now awaiting a new loan, which will not close until May of this year. Shifting a pipeline of projects to other programs for funding is burdensome for the intermediary and costly to the small business owners, as SBA microloan funds are some of the most affordable loan funds in the market.

Regarding the 50/50 rule, when the Microloan program launched, it required that 25% of the technical assistance provided by the lender be pre-loan and 75% post-loan. In 2018,

Congress changed these percentages to 50/50 in the Consolidated Appropriations Act of 2018. The industry appreciated the change, but the 50/50 rule is still a reporting burden on both lenders and the SBA. The rule dictates to intermediaries how much of their TA grant funds can be used during the pre-loan phase vs. borrower support. First, the rule ignores how microlenders help future borrowers become credit-ready with business training and counseling. This is an essential function to support non-bankable borrowers. Second, most microlenders work with 10 small businesses before they can qualify one for financing. The 50/50 rule should be re-considered in light of these challenges, as every business's needs are unique, and intermediaries are the most appropriate party to determine the best use of their grants to support their local market.

Once again, we appreciate the opportunity to comment on the modernization of the SBA programs and we look forward to working with the Committee in keeping relevant, programs that have effectively and efficiently increased SBA lending in emerging markets and underserved communities.

Senate Committee on Small Business and Entrepreneurship Hearing

April 3, 2019

SBA Office of Capital Access

Follow-Up Questions for the Record

Questions for Mr. Bill Manger

Questions from:

Chairman Rubio

QUESTION 1:

During the question and answer period, you noted the Office of Capital Access does not interface with the Chief Financial Officer's (CFO's) office on the modeling for the subsidy calculations for the lending programs. Can the CFO's office provide the Senate Small Business and Entrepreneurship with the assumptions and weight of assumptions for the model used to calculate the 7(a) subsidy for FY 2020?

SBA RESPONSE:

While the Office of Capital Access does not interface on the subsidy model calculations performed for government accounting purposes, the Office of the Chief Financial Officer provided the following answer: "We do not apply weightings to our assumptions. To estimate purchases and prepayments (the main driver of program cash flows) we use a regression to measure the relationship between a dependent variable (purchase, prepayment, or pay as scheduled) and one or more independent variables (loan characteristics and macroeconomic variables). We use 7(a) loan performance data and macroeconomic data since 1988 as the input to the regression. We then use these relationships (driven by past performance) and our expectations of future loan characteristics and macroeconomic variables to project future loan performance."

QUESTION 2:

Although all export loans are made by 7(a) lenders, the export finance programs at SBA are not administered under the Office of Capital Access (OCA), but rather the Office of International Trade (OIT). What coordination, if any, does OIT conduct with OCA in administering these loan programs?

SBA RESPONSE:

As authorized in Section 7(a) of the Small Business Act, participating lenders may request loan guarantees for their eligible small business applicants which includes loans to small businesses that export goods or services. OIT is authorized to support and promote small business exporting, which includes facilitating access to capital using the 7(a) loan program. OCA provides the written requirements for all lenders to make loans using the program, which includes specific guidance for Export Working Capital, Export Express, and International Trade loans developed in cooperation with OIT. OCA, in consultation with OIT, drafts and clears all Standard Operating Procedures (SOPs) and regulations related to the export financing programs. OCA conducts monthly informational sessions and training on loan programs for all SBA field offices, U.S. Export Assistance Centers (USEACs) and loan guaranty processing centers through regular monthly webinars. OCA provides quarterly outreach to 7(a) lenders and Certified Development Companies (CDC) on the business loan programs, which includes information on export-related and international trade loans. USEAC employees participate alongside the

regular 7(a) and 504 programs at regional and national lender conferences to increase awareness of financing opportunities for exporters.

QUESTION 3:

What, if any, barriers exist to 7(a) lenders' participation in the export programs due to them being administered by a different office?

SBA RESPONSE:

SBA has ensured that 7(a) lenders have no barrier to accessing the three types of export loans. The requirements for these loans are included with the standard 7(a) guidance and loans are submitted the same way using OCA's ETran electronic platform, which increases efficiency for the lenders who want to participate in 7(a) lending. However, consolidation of responsibility for all types of 7(a) loans, including loans made under the three export financing vehicles, would enhance consistency, clarity and efficiency and would reduce confusion.

QUESTION 4:

I understand that SBA routinely provided "redline" or "track changes" versions of new SOPs to help the small business and practitioners in the programs that are governed by this 400 plus page document see each change SBA deemed important enough to make. However, this has not been provided recently, starting with the release of SOP 50 10 5 (J). Can you explain why these important documents are no longer provided and what, if any, statutory or regulatory provisions prevent you from issuing them?

SBA RESPONSE:

Section 508 of the Rehabilitation Act of 1973 requires that federal organizations and websites make all electronically-available federal information accessible to users with disabilities. SBA is restricted to posting on the public website only documents that are 508 compliant. Using current technology, "track changes" and "redlined" versions of documents cannot be formatted to be universally accessible to all; therefore, they do not meet the requirements for public posting.

QUESTION 5:

Last year, Congress passed, and the President signed into law, a bill that amended the Small Business Act to provide statutory authority for the SBA's Office of Credit Risk Management (OCRM). With this legislation, the SBA was given enforcement tools to assess monetary penalties on bad actors that violate 7(a) lender requirements. What additional enforcement tools, if any, does the SBA need to further ensure the integrity of the portfolio and dissuade improper activities by lenders?

SBA RESPONSE:

SBA appreciates the Committee's actions in passing last year's 7(a) lender oversight bill and providing SBA with enforcement tools to improve oversight of the 7(a) program and to address improper activities by lenders. SBA would like to work with the Committees to develop appropriate legislation for the Certified Development Company (CDC) program that would produce a similar result.

QUESTION 6:

In your testimony to our Committee, you suggested that the SBA One platform has "really simplified our loan process." Please provide more detail on SBA One. In particular, how many 7(a) loans, and what percentage of the total number of 7(a) loans, were processed using SBA One in FY 2018?

SBA RESPONSE:

Roughly, 25% of our 7(a) lending is processed via SBAOne: In FY 2018, 15,560 7(a) loans for \$4.9 billion were processed via SBAOne. Many of these loans are processed by smaller lenders who do not have a dedicated SBA lending staff and thus benefit greatly from the "TurboTax"-like decision trees and compliance tools enabled by SBAOne.

QUESTION 7:

How have delegated lenders responded to SBA One?

SBA RESPONSE:

Some delegated lenders choose to use SBAOne, but most of our delegated lending comes directly through E-Tran via web screens or with the help of third-party software vendor products.

The original intent of SBAOne was to assist less experienced SBA lenders by using sophisticated decision-tree technology that aligns with our program requirements. Most of our delegated lenders are very comfortable originating their loans without the assistance of decision tree tools for eligibility, use of proceeds, etc.

QUESTION 8:

How much faster is it for lenders to use this platform?

SBA RESPONSE:

For lenders just beginning to process SBA loans, SBAOne is significantly faster for several reasons:

- Decision-tree technology guides and mandatory fields help inexperienced lenders through eligibility and other program requirements;
- SBAOne is designed to ensure that all mandatory fields for a loan application are completed before it is sent electronically to our Loan Processing Center for review. In the past, "screened-out" loan packages would delay processing and frustrate customers; and
- SBAOne logic is updated after every change in policy, so lenders are not required to staff an in-house SBA expert to stay abreast of SBA loan origination changes.

Questions from:

Ranking Member Cardin

Reauthorization of the 7(a), 504, Community Advantage, and Microloan Programs

I often hear from small businesses that SBA is hard to navigate; the numerous sub-programs are confusing; and many often don't know that SBA programs exist.

QUESTION 1:

How can we raise awareness of SBA's programs?

SBA RESPONSE:

SBA continues to provide focused training to our 68 SBA field offices to increase staff value and support in marketing of SBA programs at the local level. This translates into hundreds of SBA employees who are able to educate the public about our programs and who can direct interested parties to additional SBA and other resources for further information and assistance. This is further amplified by the activities of SBA's resource partners across the nation including SBDCs, SCORE, WBCs, and VBOCs.

SBA has developed and deployed new branding and multi-pronged marketing material for print and website access that provides current information on all SBA's loan programs and initiatives (including Microloans, Community Advantage Pilot, 7(a), 504, loans to ESOPs/CO-OPs, and International Trade loans).

SBA's Office of Capital Access has increased participation in regional training and informational events sponsored by SBA as well as local economic development and industry trade events to further increase awareness.

SBA has also signed an MOU with the Department of Agriculture to share information, and to jointly market and promote the business loan programs for both agencies.

Finally, OCA will work to generate earned media coverage that highlight small businesses that have succeeded with SBA-guaranteed financial assistance.

QUESTION 2:

What should we be thinking about during this reauthorization effort in order to help SBA lending programs reach more of the underserved and non-traditional small businesses, such as those owned by returning citizens, that SBA was created to serve?

SBA RESPONSE:

SBA and its resource partners are promoting financial literacy and online tools, such as SBA's Lender Match, to help a broader audience access capital through SBA lenders.

SBA's Microloan Program is specifically designed to assist women, low-income, veteran, and minority entrepreneurs and businesses, as well as other individuals possessing the capability to operate successful business concerns. This program has made very good progress in increasing its reach into underserved communities. SBA has requested targeted legislative changes (e.g. the 1/55th rule change) to the Microloan Program in the President's budget submission that will allow the program to expand on its current success. Furthermore, OCA has designed and is executing a comprehensive marketing and outreach effort to expand the Microloan Program and its impact in historically underserved communities.

We also note that Congress has requested that GAO study the Microloan Program and issue a report later this year. SBA looks forward to learning whether GAO has suggestions to increase the reach of the program.

SBA has other lending initiatives that are specifically targeted to underserved small businesses, such as the Community Advantage Pilot Program and the 504 Rural Initiative. SBA is in the process of further assessing those initiatives and is not recommending any related legislation at this time.

QUESTION 3:

What are your top legislative priorities for reauthorization?

SBA RESPONSE:

My top legislative priorities for the business loan programs are as follows:

To increase the Express Loan limit from \$350,000 to \$1,000,000. This cap has been set in statute for 15 years, with the exception of one year, when it was increased to \$1 million. This loan product is used by many small businesses that need a revolving line of credit. An increase will go a long way to helping them.

Next, we recommend an increase in the 504 loan amount for small manufacturers from \$5.5 million to \$6.5 million. Increasing the maximum loan amount would greatly benefit America's manufacturing industry and help small manufactures access credit to re-enter the marketplace.

Another priority is within our Microloan program regarding the manner in which funds are made available during the course of the fiscal year. We would like to work with you to review the impact of the current 1/5th rule and examine ways to provide for a better flow of funds throughout the year while still preserving funding access for all states.

Lastly, we recommend providing SBA with flexibility to manage expected costs in the 7(a) Secondary Market Guarantee Program by introducing a small fee adjustment of the outstanding balance of pool certificates.

Questions from:

Senator Risch

When looking at the FY20 budget request from SBA, you are asking 7(a) program borrowers and lenders to pay an additional \$99 million in fees this year, in addition to what they already pay in fees. But your own budget says you have overcharged borrowers and lenders \$3.2 billion since FY2010—which means SBA has been asking borrowers and lenders for more fees than what the agency needed to cover the cost of the program. This additional \$99 million is a tax on borrowers.

QUESTION 1:

If you have been overcharging borrowers by \$3.2 billion since FY 2010, why are you asking for \$99 million more from borrowers and lenders on top of what they already pay?

SBA RESPONSE:

We would welcome the opportunity to talk to you about the assertion of overcharging borrowers, as there appears to be a misunderstanding about the program's history and performance figures.

Regarding the FY2020 subsidy request, as the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "In accordance with the Federal Credit Reform Act of 1990 (FCRA), we estimate the lifetime cost for the loans approved in a given fiscal year. When taking into account expected portfolio composition of FY20 loan approvals, macroeconomic assumptions, and historical performance data, we estimate the need to charge an additional \$99 million of fees to maintain a zero subsidy cost. The goal of our model is to accurately estimate the lifetime cost of the program. Since 1992, the 7(a) model has underestimated the program cost by \$1.9 billion on \$317 billion in loan disbursements."

QUESTION 2:

SBA is supposed to best estimate how loans will perform in a given Fiscal Year--do you think that a model that overcharges borrowers and lenders by \$3.2 billion since FY 2010 is a model that is getting it right, or is that a model that is getting it wrong?

SBA RESPONSE:

We would disagree with the assertion of overcharging borrowers and would welcome the chance to discuss previous program performance.

Further, as the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "The goal of our model is to accurately estimate the lifetime cost of the program. Since 1992, the 7(a) model has underestimated the program cost by \$1.9 billion on \$317 billion in loan disbursements. We believe the model performance is reasonable. We continuously seek to improve the model accuracy by analyzing historical model performance to reduce future overestimations and underestimations in cost."

Questions from:

Senator Coons

7(a) Subsidy Model Changes

The recent changes to the 7(a) subsidy model, inputs, and/or weightings for FY20 have resulted in an estimated \$99M subsidy.

QUESTION 1:

Were these specific model changes considered in previous years?

When was the last significant change to the 7(a) subsidy model, inputs, and/or weightings, and what were those changes?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: “Every year we perform research and implement enhancements to improve the model. These enhancements are implemented during our development cycle. Any enhancements that cannot not be implemented during the development cycle are postponed until next year. We prioritize our implementation based on factors such as the benefit to the model, the level of effort required, and other costs associated with implementation and maintenance. For example, the change to better predict future purchase amounts that we implemented this year was done to better align model projections with historical performance. We have not incorporated weightings in our assumptions.

The last change that had a significant impact on the 7(a) subsidy rate was implemented in the FY14 model. The pre-FY14 model used a simple approach to estimate the effects of unemployment on loan performance. Historical data showed there was a more complex relationship to unemployment and loan performance. The model was adjusted to better account for this complexity, with the goal being a better model fit during varying macroeconomic conditions. This change greatly improved how the model performed during times of increasing and decreasing unemployment and resulted in the 2014 cohort returning to zero subsidy.”

7(a) program Fiscal Year Performance Weighting**QUESTION 2:**

Does the 7(a) subsidy model consider the Fiscal Year performance of the 7(a) program, and does a demonstrated multi-year positive performance of the 7(a) program reduce the calculated subsidy?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: “The model considers loan performance for all fiscal years going back to 1988. This loan performance is considered in combination with loan characteristics and macroeconomic conditions.

Multiple years of performance exceeding expectations may reduce the calculated subsidy, but it depends on the reason the expectations were exceeded. If this is due to model performance assumptions that underestimate the positive performance, then as this positive experience is added to the model the subsidy rate will decrease, assuming all other assumptions remain the same.”

QUESTION 3:

How is the Fiscal Year performance weighted in the 7(a) subsidy model, and what other parameters are more highly weighted than the 7(a) Fiscal Year performance?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: “We do not apply weightings to our assumptions. Past performance, essentially, is the driver in the model, but it is the correlation between this past

performance and the loan characteristics and macroeconomic factors that make up the model assumptions.

To estimate purchases and prepayments (the main driver of program cash flows) we use a regression to measure the relationship between a dependent variable (purchase, prepayment, or pay as scheduled) and one or more independent variables (loan characteristics and macroeconomic variables). We use 7(a) loan performance data and macroeconomic data since 1988 as the input to the logistic regression. The regression calculates the relationship each of the independent variables has with a purchase or prepayment event. We then use these relationships (driven by past performance) and our expectations of future loan characteristics and macroeconomic variables to project future loan performance.”

FY20 Projections Using the Previous Version of 7(a) Subsidy Model

QUESTION 4:

If the previous version of the 7(a) subsidy model utilized in FY19 projections was not amended, and used for FY20 projections, what would be the predicted loan subsidy be for FY20?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: “Due to the Federal Credit Reform Act (FCRA), SBA is unable to use a prior year model for future financial projections.”

QUESTION 5:

Would the previous FY19 version of the 7(a) subsidy model, updated with latest available data, project a subsidy lower than \$99M?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: “It is not appropriate to use a static model for future year projections. It is prudent to update the model based on past performance to ensure the better prediction of future performance. Every year we review the model and determine whether enhancements can be made. These enhancements are implemented during our development cycle. In accordance with the Federal Credit Reform Act of 1990 (FCRA), we estimate the lifetime cost for the loans approved in a given fiscal year. When taking into account expected portfolio composition of FY20 loan approvals, macroeconomic assumptions, and historical performance data, we estimate the need to charge an additional \$99 million of fees to maintain a zero subsidy cost.

Sensitivity Analysis and Documentation of the 7(a) Subsidy Model

QUESTION 6:

What procedures and processes does the SBA use to document changes to the 7(a) subsidy model and what internal and external verification and validation are performed on the model changes?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "SBA develops a suite of documentation to accompany all model changes. We develop a memo that describes all the changes to the model from the previous version. This memo also includes all the lines of code that changed. We develop a decomposition table that shows the impact each model change/update had on the subsidy rate. We update our document that describes the technical functionality of the model to reflect all the changes we made.

After we implement the changes, the model is reviewed by a peer using a structured model validation procedure. Next, the model is reviewed by an independent Internal Validation and Verification (IV&V) contractor who reviews the model changes and the documentation updates to ensure the changes were methodologically sound and implemented correctly and that the documentation was properly updated to reflect all the model changes. The model performance assumptions are also reviewed by our financial statement auditors. Finally, the model and changes are reviewed and approved by OMB."

QUESTION 7:

For the inputs that were changed, was a sensitivity analysis performed to understand which parameters have high or low impact to the model calculations?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "We do perform a sensitivity analysis annually on our major assumptions and have a good understanding of how changes to certain parameters would impact the subsidy rate."

QUESTION 8:

Can SBA provide documentation on the parameters that were changed in the FY20 model and provide the range of values for each of those parameters that were evaluated to understand how the FY20 model outputs were influenced by each parameter?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "We refined the FY20 model to include additional indicator variables for 7(a) subprograms in the prepayment and purchase equations. We implemented a more robust methodology to predict the dollar amount of purchases. We updated our recovery rate assumptions to better account for the difference in recoveries on revolving lines of credit versus term loans. We refined our secondary market premium income assumptions. We made these enhancements to improve model precision and diligently tested their impact as part of our development process. We can continue to brief the committee and your staff if additional information/detail is requested."

7(a) Express Loans to Veterans

The SBA states that the waivers for the 7(a) Express loans to veterans program can only be waived when the President's budget does not include a cost above zero for the overall 7(a) loan program.

QUESTION 9:

Can Congress appropriate funds to continue these important waivers for Veterans, and if not, what statutory changes are needed to allow Congress to provide funding for 7(a) Express loans for veterans?

SBA RESPONSE:

Yes. Congress can appropriate additional funds and specifically provide that those funds are intended for the purpose of these waivers.

QUESTION 10:

Can SBA provide a projected amount of funding that would be required to continue these waivers?

SBA RESPONSE:

As the Office of Capital Access is not responsible for the model, the Office of the Chief Financial Officer provided the following answer: "SBA used our current law FY2020 model as the basis for the estimates. In order to offer upfront fee relief for SBA Express loans to Veterans, assuming a \$30 billion program level, we would need additional subsidy appropriations of \$1.2 million. Please note that these amounts are in addition to the \$99 million to operate the loan program."

In addition to these questions, I respectfully request for a member of the SBA staff that is familiar with the 7(a) subsidy model to meet with my economic policy staff before June 3, 2019 to discuss the FY20 model changes. Please contact Marc Santos at Marc_Santos@coons.senate.gov or 202-224-2519 to arrange this meeting.

Question from:

Senator Duckworth

Mr. Manger, in the Fiscal Year 2019 and 2020 budget requests, the Small Business Administration (SBA) proposed to eliminate the 1/55 rule from the SBA Microloan program. The rule was initially intended to make sure rural States and territories get their fair share of SBA Microloan program dollars. Now, the rule hinders the deployment of dollars to the rural States that it was meant to ensure funding to, as well as more populous States.

That's why I introduced S. 996, the Microloan Program Enhancement Act of 2019, which seeks to eliminate the 1/55 rule, among other provisions.

QUESTION 1:

Mr. Manger, using SBA data, please explain how eliminating the 1/55 rule would help small business interests in all States, from rural to densely populated, by helping the SBA Microloan program provide financing to small business interests as efficiently as possible.

SBA RESPONSE:**CURRENT STATUTE – 1/55th Rule**

Small Business Act - Section 7(m)(7)(B) ALLOCATION.----

(i) MINIMUM ALLOCATION.— Subject to the availability of appropriations, of the total amount of new loan funds made available for award under this subsection in each fiscal year, the Administration shall make available for award in each State (including the district of Columbia, the Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, and American Samoa) an amount equal to the sum of—

(I) the lesser of—

(aa) \$800,000; or

(bb) 1/55 of the total amount of new loan funds made available for award under this subsection for that fiscal year; and

(II) any additional amount, as determined by the Administration.

(ii) REDISTRIBUTION.—If, at the beginning of the third quarter of a fiscal year, the Administration determines that any portion of the amount made available to carry out this subsection is unlikely to be made available under clause (i) during that fiscal year, the Administration may make that portion available for award in any one or more States (including the District of Columbia, the Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, and American Samoa) without regard to clause (i).

In most years the SBA enters a new fiscal year operating under a continuing resolution. This means looking back at the prior year's lending authority and prorating that amount for the period of the CR. As an example, if last year's lending authority was \$40 million and the current CR is for 3 months, SBA would use \$10 million as its current lending authority. The next step is to apply the 1/55th rule to determine what loan size can be approved for intermediaries in each state. In this example, the application of the 1/55th rule results in a loan amount of only \$181,818 being available for each state.

In FY 2018, the average loan request received by SBA between 10/01/2017 and 4/1/2018 was \$671,000. Only 3 loans out of 24 requested during this time were funded because the loan amount requested for each of the remaining 21 loans exceeded what SBA could fund under the CR with the 1/55th rule. The loans that were made were for \$100,000 in one case, and \$152,000 each for two others. These loans went to intermediaries in ID, AL and WI. Loans that were requested and not made were in states such as NC, VT, MO, MA, NY, MI, CA, NE, PA, NJ, NM, GA and ND. Most intermediaries do not want to accept small loans from SBA because each new loan carries its own reporting requirements.

In FY 2019, the average loan requested between 10/01/2018 and 4/1/2019 was \$755,353. Only one loan out of 17 requested was funded prior to 3/19/2019 for \$121,000. The loan that was funded went to NH, but intermediaries that had to wait were located in MA, NY, PA, MN, NC, MT, ME, and VA.

If the 1/55th rule were eliminated, intermediaries that requested new loans would have been accommodated on a first-come, first-served basis without having to wait for the first half of the fiscal year to pass. The current statute results in delays in getting loan funds to intermediaries, which in turn can mean delays in helping small businesses with the funds they need to start and grow.

An alternative to the complete elimination of the current statute is to set a limit on the percentage of lending authority SBA can commit during certain portions of its FY. As an example, if SBA allocated no more than 75% of its lending authority during the first 6-months, that would allow a greater number of intermediaries to get loans without delay in the amount desired, while still requiring SBA to hold back 25% of the lending authority for new loan requests that come in during the remainder of the fiscal year.

Senate Committee on Small Business and Entrepreneurship Hearing
April 3, 2019
Follow-Up Questions for the Record

Question from: Chairman Rubio

QUESTION 1: Ms. Huston, in the hearing, you outlined the reasons you believe the subsidy proposal for the 7(a) program in the President's FY 2020 budget should be challenged. Can you expand on your testimony and provide a detailed outline of your argument with supporting background?

The President's FY20 budget request, presented a little over three weeks ago to Congress, sent a shock wave through the 7(a) industry when it included a subsidy calculation requiring additional funding of 33 basis points (0.33%), or \$99 million, for the 7(a) program. This is a major shift from the program's track record of operating at zero subsidy since FY05 (except during the years covered by the Recovery Act), which means that the fees collected from borrowers and lenders cover the cost of making the loans. By projecting a positive subsidy rate for FY20, the budget request is triggering the necessity for Congressional action. Now, Congress needs to either appropriate \$99 million to the 7(a) program or amend the *Small Business Act* to raise the current fee caps in order to collect \$99 million in additional fees from borrowers and lenders on top of what participants already pay to cover the cost of the program. Both of these paths forward will need to pass the Senate, House, and be signed into law by the President by September 30—or the 7(a) program will shut down on October 1.

But before we can even consider how Congress might best move forward to prevent a very successful, popular small business program from simply shutting down on October 1, we *must* first collectively question the positive subsidy calculation. **My plea to this Committee is that before you simply take the FY20 subsidy calculation at face value, you first challenge both OMB and SBA to explain this subsidy estimate in detail, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model.** Not only do the FY20 budget documents provide insufficient justification for a \$99 million increase in estimated subsidy costs, but there is ample evidence to suggest that a troubling pattern exists in the way SBA and OMB model the subsidy cost.

The Government Accountability Office (GAO) has been raising the same concerns about SBA's ability to appropriately estimate the cost of the 7(a) portfolio before this Committee and Congress since 1997, spanning multiple Administrations. In a series of reports, GAO has looked into the accuracy of SBA's subsidy rate- or lack thereof- no less than on four occasions over the past twenty-two years—this is a pattern, and one we cannot ignore.

Allow me to also take the time to briefly explain what a subsidy calculation is and how this is reported every fiscal year. The 7(a) subsidy calculation is an estimate of the cost of the loan program to the government for loans originated in a given fiscal year and is governed by the *Federal Credit Reform Act of 1990* (FCRA). This statute dictates that the cost of credit portfolios shall be the net present value of the portfolio, excluding administrative costs to the government. By enacting FCRA, Congress delegated to the Executive branch the responsibility for estimating the future credit performance of loans into a subsidy rate, which Congress then uses to determine any necessary appropriations for each fiscal year.

The majority of the Administration's budget requests are just that—proposals that make up a sort of budget wish list from the Executive branch to Congress. Some of these proposals in this year's budget request will always stay proposals—for instance, I expect Congress will once again not act on charging all borrowers and lenders to pay for SBA's employees' salaries and expenses in what the budget calls "counter-cyclical measures," namely because it is an egregious violation of FCRA. However, the portion of the FY20 budget request that is not a proposal is the statement of a positive subsidy. SBA's proposed fee increases to borrowers and lenders in order to cover the positive subsidy *is just a proposal*, giving Congress one option to cover the cost this fiscal year, and we all know that there are more options than the increased fee structure SBA presented.

But Congress does not have a choice but to react and address the fact that the 7(a) program has a positive subsidy calculation starting the first day of the new fiscal year—and Congress has been given a limited timeframe in which to do so. Otherwise, absent a way to cover the stated costs for FY20, the program will not be permitted to operate past September 30.

Why is the 7(a) industry questioning the FY20 subsidy calculation?

Performance—Discrepancy between Actual v. Projected

First, the portfolio's actual performance data projects a starkly different picture than this positive subsidy estimate would suggest. Since the subsidy calculation is the projected performance of the portfolio, it stands to reason that SBA may have detected a significant decline in the current performance of the portfolio to lead them to this conclusion. However, by SBA's own reporting to Congress and the industry, the health of the 7(a) portfolio is strong. The portfolio has seen a steady decline in charge-off rates over the past ten fiscal years on an annualized basis and risk has generally declined since September 2012.

In fact, there is a significant discrepancy over actual portfolio performance and projected performance in FY20. The program's five year average recovery rate on defaulted loans, as reported to Congress last December, was 50%. In sharp contrast, the FY20 budget assumes a projected recovery rate of only 37.29%. Why has the subsidy modeling ignored this established trend of steadily increasing recovery rates?

GAO reports on SBA's subsidy calculations have highlighted this very issue of repeated discrepancies between actual loan performance and projected performance. In an August 2001 GAO letter and briefing to the Senate and House Committees on Small Business titled "Section 7(a) General Business Loans Credit Subsidy Estimates," **GAO describes a consistent pattern of SBA's estimations showing a marked disconnect with actual performance, resulting in repeatedly overestimating the cost of the program.** GAO states "review of actual and originally estimated defaults and recoveries showed that, on a cumulative basis since 1992, defaults were overestimated by approximately \$2 billion... During this same period, SBA overestimated the cost of the 7(a) program by \$958 million as evidenced from a trend of downward reestimates. The majority of these downward reestimates can be attributed to the overestimate of defaults." GAO goes on to explain that at the time, SBA was in the midst of proposing a new methodology to OMB that uses the 5 most recent years of actual loan performance, rather than all actual loan performance which can often include anomalies from various economic cycles that have no bearing on the current economic climate.

Since this 2001 report, SBA's model has been adjusted and there has been a shift to a more sophisticated econometric modeling that attempts to create relationships between performance and economic trends and other indicators—but it seems more pertinent than ever for Congress and industry to understand how SBA and OMB currently utilize historic loan performance and for what period of time given what seems to be history repeating itself.

In a hearing held on April 10, 2019 in the House Committee on Small Business titled, "SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes," the SBA's CFO, Tim Gribben, testified that "The model looks at the actual performance of the portfolio over 26 years—that has a bigger impact on the model than anything else." This statement leads us to believe that SBA is not using the 5 most recent years of data that they had proposed to OMB as appropriate methodology in 2001, but rather incorporating years of data that includes extreme anomalies in the economy including September 11th and the Great Recession. Is this appropriate? Is this the best methodology for predicting current cohort performance? It is within SBA and OMB's discretion, per FCRA, to determine the appropriate methodology to determine net present value of a cohort of loans over the lifetime of those loans, but both Congress and the industry should have a seat at the table in discussing what methodology is most appropriate—especially when the results of SBA's chosen methodology force Congress and the industry to react in the form of appropriations or fees to support SBA's resulting calculation.

Pattern of Overcharging Borrowers, Lenders, and Congress

Another concerning element of the FY20 budget request that should lead to many questions about the accuracy of the 7(a) model is the documentation of repeated and significant downward re-estimates in every cohort of loans since FY10, as reported in the FY20 budget. Downward re-estimates mean that the portfolio is consistently performing *better* than originally projected in each fiscal year's original subsidy calculation, and that the model used by SBA and OMB has been significantly overestimating program costs. In other words, data that shows in dollars the net lifetime amount of a particular fiscal year's downward re-estimate is how much borrowers and lenders have been *overcharged* in fees to cover the cost of the program. These excess charges are simply returned to the Treasury as miscellaneous receipts.

In the FY20 budget, SBA reported for FY18 a \$757 million excess subsidy reserve that captured re-estimates from all prior years over what had been reported for FY17, and another \$143 million is already expected for FY19 (see Table 1 below).

[Table 1.]

Loan Levels By Program (FY20 Budget Appendix)

Summary of Loan Levels, Subsidy Budget Authority and Outlays by Program (in millions of dollars)				
		2018 actual	2019 est.	2020 est.
Guaranteed loan re-estimates:				
235002	7(a) General Business Loan Guarantees	-757	-143	-----
All Other Loan Programs Or Subjects:				
235003	7(a) General Business Loan Guarantees—STAR	-3	-1	-----
235004	Section 504 Certified Development Companies Debentures	-484	-344	-----
235006	SBIC Debentures	-134	-109	-----
235007	SBIC Participating Securities	-90	-97	-----
235008	SBIC New Market Venture Capital	7	-10	-----
235010	Secondary Market Guarantee	20	-41	-----
235015	Secondary Market 504 First Mortgage Guarantees-ARRA	3	-5	-----
235016	ARC Loan Guarantees—ARRA	-1	-1	-----
235017	7(a) General Business Loan Guarantees—ARRA	-----	3	-----
235018	Section 504 Certified Development Companies—ARRA	-12	-2	-----
235026	Section 504 Certified Development Companies Debentures—ARRA Ext	-15	-7	-----
235027	504 Commercial Real Estate (CRE) Refinance Program	-27	-17	-----
235028	Section 504 Certified Development Companies—ARRA	1	7	-----
235999	Total guaranteed loan re-estimates	-1,492	-767	-----

These are not isolated incidents – overfunded subsidy reserves have occurred for every cohort of 7(a) loans since FY10. In fact, since FY10, borrowers and lenders have been overcharged by approximately \$3.2 billion, all transferred to the Treasury as miscellaneous receipts during that period (see Table 2 below). This is a staggering amount of money that has unnecessarily burdened the delivery of these important small business loans, and is a clear indication of the degree to which the process for developing 7(a) subsidy estimates appears to be badly broken. A subsidy model certainly cannot be perfect and it is wrong to expect that it will ever be a perfect estimation—but a pattern this egregious is concerning, especially considering that now SBA is asking for \$99 million more from borrowers and lenders.

[Table 2.]

**Loan Guarantees: Subsidy Reestimates
(FY20 Federal Credit Supplement)**

Agency, Bureau, Program, Risk Category and Cohort Year	Characteristics of Subsidy Reestimates		
	Original Subsidy Rate	Current Reestimated Rate	Net Lifetime Reestimate Amount (\$ Thousands)
7(a) General Business Loan Guarantees			
FY 2010.....	0.46	-0.12	-13,933
FY 2011.....	0.97	-1.79	-266,417
FY 2012.....	1.05	-3.41	-472,474
FY 2013.....	1.64	-2.63	-474,138
FY 2014.....	0.01	-1.08	-158,901
FY 2015.....	0.00	-1.53	-321,895
FY 2016.....	0.00	-0.79	-174,388
FY 2017.....	0.00	-0.07	-154,910
FY 2018.....	0.08	-0.07	-11,721
ARC Loan Guarantees—ARRA			
FY 2010.....	76.15	24.06	-96,885
7(a) General Business Loan Guarantees—ARRA			
FY 2010.....	4.23	2.11	-57,430
7(a) Disaster Flood Plan			
FY 2011.....	0.56	-3.80	-490
FY 2012.....	0.49	-4.18	-577
FY 2013.....	0.47	-4.06	-323
7(a) Disaster Flood Plan—ARRA			
FY 2009.....	3.14	-0.98	-561
FY 2010.....	3.29	-0.21	-2,437
7(a) Business Loan Guarantees—ARRA Extension			
FY 2010.....	4.21	1.53	-154,886
FY 2011.....	5.48	0.36	-416,560
Total			5,154,719

In fact, Congress has *also* been overcharged since FY2010. In FY2010- FY2013, following the Great Recession, the 7(a) program received appropriations from Congress in order to cover the cost of the program, on top of fees charged to borrowers and lenders. Since those same years of congressional appropriations have shown significant downward re-estimates into the negative, just a few years of distance has shown that appropriations were not even necessary to cover the cost of the program.

A GAO report from March 1998 to the Senate Committee on Budget, titled “Greater Effort Needed to Overcome Persistent Cost Estimation Problems,” highlighted a concern with consistently inaccurate subsidy calculations at SBA. This report discussed when SBA hired Price Waterhouse to conduct a diagnostic review of SBA’s internal subsidy estimation process and states that, “This September 1997 study said that ‘the credit subsidy process is not viewed as a way of assessing the future risk and costs of the program for management purposes. **Rather, the rate calculation is perceived [by SBA] to be a tool for gaming the congressional appropriations process.**’” SBA went on to insist this report was inaccurate, while Price Waterhouse continued to assert its accuracy. I would hope that this is not currently an accurate representation of SBA’s subsidy calculation process, but given the repeated downward reestimates that have overcharged small business borrowers, lenders, and also Congress, the subsidy model, methodology, and assumptions deserve a closer look.

Macroeconomic Assumptions and their Role in the Subsidy Model

As a lender, it is particularly concerning that SBA’s CFO testified at the April 10th House hearing when answering a question from Ranking Member Hern that SBA does not take into account how lenders make lending decisions or whether or not their lending behavior has shifted over the years—that is a disturbing admission. Understanding how participating lenders make 7(a) loans and under what conditions is critical to understanding this portfolio and projecting performance, and this understanding *should* shape assumptions in the model.

In the April 10th House hearing, the CFO outlined that there were major changes to the model made in 2014 to include macroeconomic trends and their effects on the portfolio’s performance—particularly long-term projected unemployment rate, which the CFO stated has one of the biggest impacts on the model, along with all available historical data. As a lender, I am baffled by the significance that SBA has placed on unemployment

rate. Regardless of unemployment rates, my credit characteristics and parameters that determine what borrowers receive a loan stays the same, and I have never observed a correlation between unemployment and the quality of my borrowers. It could be that if there is a starkly worsening unemployment rate, the *volume* of SBA loans made is effected because unemployment is one indicator of overall national economic health. But volume of loans and the quality of the loans actually made are very different issues, and when we discuss subsidy rate, we are only looking at the quality of the loans on the books and their projected performance. My portfolio performance is effected because of my credit decisions, not because of unemployment projections from each Administration. In this context, SBA's admission that lender behavior is not taken into effect when examining subsidy calculations is disturbing given that SBA is making blanket assumptions about how loans that lenders make will perform under certain conditions.

In addition, if unemployment rate is weighted heavily and SBA is projecting a significant increase in cost, we should see a correlating worsening of unemployment rate in the President's Economic Assumptions, which are the long-term unemployment projections that the portfolio's subsidy model must use. But we do not see a downturn in this Administration's projected unemployment rate—rather, the President's economic assumptions for FY20 project a *plateauing* unemployment rate that is not worsening to any level of significance and is actually at a historic low. I cannot see how an unemployment trend that plateaus would affect the quality of my borrowers negatively. More concerning is that in past years since FY2010, unemployment rates were projected to be worse, yet in those years (even since the model placed increased significance on unemployment rate in FY2014) the subsidy rate for the 7(a) program was zero. If SBA is weighing long-term projected unemployment rates as one of the most significant components of the subsidy calculation, the Committee should have a serious conversation about the validity of this assumption.

In the April 10th House hearing the SBA CFO also illuminated another macroeconomic assumption SBA uses in the subsidy model—an *adverse selection assumption*. This assumption presumes that loans originated when the economy is good will perform worse than loans originated when the economy is bad. This is not an appropriate assumption for the 7(a) program. The inverse relationship between 7(a) lending and conventional lending absolutely has an effect on volume—when the economy is healthy, the 7(a) program volume tends to plateau and when the economy worsens, the 7(a) program tends to fill the resulting gap in access to capital and 7(a) lending volume increases.

However, the subsidy calculation is not intended to address volume trends—we are discussing cost, or projected portfolio performance, and adverse selection has NO bearing on projected performance of loans in the portfolio. Why? My credit box as an SBA lender never changes—in good times and in bad. As a lender, I still need to have a portfolio that meets safety and soundness standards reflected in our credit policy. There are prudential limits on the amount of credit risk we take, as we answer to credit risk departments, boards of directors, regulators, and shareholders, and we do not adjust those limits in order to make a quota or target number of loans, which seems to be what SBA's adverse selection model assumes to be happening.

In addition, there are a number of SBA rules and guidelines that govern 7(a) lending regardless of economic swings, such as always requiring a personal guaranty from the borrower, requiring borrowers to have a certain amount of skin in the game, prescribed debt service coverage ratio, and additional collateral requirements to name a few. Again, given SBA's admission that lender behavior is not taken into account when calculating subsidy, it seems irresponsible that wide-sweeping assumptions such as an adverse selection assumption would be a part of the subsidy model without properly understanding how lenders approach their portfolios.

I would also point out that these assumptions have merely been mentioned generally, they have not been discussed in detail. We also don't know what other assumptions besides unemployment and adverse selection are involved in this complex model, how each assumption in the model is weighted, and whether those weightings are appropriate as drivers of the outcomes of the model. I strongly encourage the Committee to promptly pursue these important matters with all entities and individuals involved in the subsidy rate estimation process.

Programmatic Improvements Should Factor Into the Subsidy Calculation

Further, I am concerned that the model fails to take into account significant programmatic changes. The successful passage of the *Small Business 7(a) Lending Oversight Reform Act of 2018* led by this Committee and its Senate counterparts improved SBA's oversight capabilities and provided changes to the program to ensure lenders stay between the lines. These changes do not seem to factor into the Administration's view of the program in the FY20 7(a) subsidy calculation. SBA's Office of Capital Access has made significant improvements to ensure the program operates with integrity, including updating the agency's Standard Operating Procedure (SOP) to require that borrowers have more skin in the game—this change does not seem to matter when the Administration is assessing the future performance of this program in its FY20 budget request. When Congress increased the maximum loan size to \$5 million from \$2.5 million in the *Small Business Jobs Act of 2010*, lenders were able to make loans involving real estate and which contributed significantly more fees to the 7(a) subsidy account—two factors that provided more stability to the portfolio. These are just some examples of the countless programmatic changes to the 7(a) program over the past decade that SBA and OMB should factor in to the current subsidy calculation, and which do not seem to weigh heavily in current subsidy calculations.

As far back as July 1997, GAO provided testimony before this Committee titled “Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs” that stated, “In the President's budget for fiscal year 1997, SBA estimated that the costs of 7(a) and 504 program loans to be made in fiscal year 1997 would be significantly higher than the costs of loans made in fiscal year 1996, **despite legislated program changes designed to keep costs down.**” There is a long-established track record of repeated over-estimations of cost, followed by an attempt on GAO's part to determine whether significant programmatic changes appropriately affected assumptions—these inquiries are just as relevant today.

Assumptions and Models Should Not Be Off-Limits from Congressional Oversight

I urge you to keep in mind throughout this conversation that SBA and OMB are simply making projections, basically educated guesses, about how loans that are made during FY20 might perform over the lifetime of those loans. Of course, this is no simple task and the model behind this subsidy calculation is complex, but it bears stressing that this subsidy calculation is really not a mathematical absolute based on a formula that cannot be challenged. Rather, modeling assumptions that were included, assumptions that were not included, and how these assumptions are weighted in the model must be reviewed and challenged—and it's appropriate to do so as members of this Committee. Absent holding SBA and OMB accountable for correcting or amending the subsidy calculation, this Committee is going to have to carry out the results of a calculation that it seems no one, except SBA and OMB, understands. It hardly seems appropriate that the subsidy calculation's econometric assumptions and modeling should be shrouded in mystery. Yes, Congress gave the Executive branch authority to calculate subsidy costs, but Congress did not give *unfettered* authority to be carried out in a manner lacking in transparency or otherwise not responsive to Congressional oversight.

To this end, the findings in a March 2004 GAO report to the Senate and House Committees on Small Business, titled “Model for 7(a) Program Subsidy Had Reasonable Equations, but Inadequate Documentation Hampered External Reviews,” point to a consistent inability to really discern whether the 7(a) subsidy model is most accurately estimating cost. Among the report's findings is that GAO and two other independent reviewers **could not determine whether a bias existed in the model by systematically excluding variables to influence the subsidy rate in a particular direction.** This is an alarming conclusion and one that should be looked into as it applies to the FY20 calculation. **The report goes on to state that SBA could not provide adequate documentation, a key internal control, to demonstrate the rationale and basis for key aspects of the model.** Even after SBA provided 800 pages of documentation to GAO, the report “concluded that this information would be of questionable or no usefulness in assessing SBA's development of the assumptions and selection of variables used in the modeling process.” In addition, one of GAO's recommendations to OMB was not implemented, which was to update and improve OMB's Circular A-11 guidance which is either silent or

unclear about the level of documentation necessary for credit subsidy model development. I would urge the Committee to look into these seemingly open-ended conclusions.

Impact of SBA's Proposed Fee Structure: Shrink Access to Capital

In the FY20 budget request, SBA indicates that its preferred method to cover the 7(a) program's cost is to restructure fees in the *Small Business Act*, raising costs for borrowers and lenders. The industry could understand this proposal if the portfolio was displaying a troubling pattern of poor performance in the portfolio. However, in this instance, there are no apparent performance issue that can be identified in the portfolio, the budget's own data shows significant and repeated overcharging of borrowers for nearly the last decade, and SBA and OMB have yet to reveal the model's methodology and assumptions. Given these factors, SBA's proposed fee increases are actually imposing a hidden tax on small business borrowers.

The consequence of SBA's proposals will be shrinking access to capital. Small business borrowers may be dissuaded from considering a SBA loan in the future, resulting in a reduction in access to capital. The benefits of having a program that is built on private-sector participants are numerous, but it also means there is a stark reality that the program needs to make sense financially for private-sector banks as well. If the program does not make financial sense for lenders, then they will participate less in the 7(a) program and access to capital will be further restricted.

In the aforementioned 1998 GAO report to the Senate Committee on Budget, we are reminded that we have been here before—OMB and SBA made a correction to their stated subsidy calculation mid-year for FY97 after noticing a “technical error” which GAO describes as a “large error” resulting in a significantly higher cost estimation than necessary. GAO goes on to state that by **“correcting this error...SBA was able to guarantee approximately \$2.5 billion more in section 7(a) small business loans.** OMB and SBA officials acknowledged that better oversight and improved internal controls at both OMB and SBA are needed to prevent similar errors in the future.” Over-estimations of cost are not just philosophical arguments—they have real consequences that translate to real dollars that otherwise could be available to this country's small business borrowers.

Without appropriately holding OMB and SBA accountable for their assumptions, something as arcane and bureaucratic as a flawed financial model for the 7(a) portfolio that has never been shared with Congress or the industry is essentially dictating the parameters of access to capital, rather than allowing Congress and the *Small Business Act* to exercise that authority.

Questions from: Ranking Member Cardin

Reauthorization of the 7(a), 504, Community Advantage, and Microloan Programs

I often hear from small businesses that SBA is hard to navigate; the numerous sub-programs are confusing; and many often don't know that SBA programs exist.

QUESTION 1: How can we raise awareness of SBA's programs?

It is my understanding that SBA does market its programs nationally and especially through the district offices, and while efforts can always be increased and made better, additional marketing might require more dedicated funding beyond what the Agency already receives.

That said, immito works closely with our district offices to raise awareness of SBA's programs. As a Small Business Lending Company (SBLC) lender, we find this relationship helps us to align our efforts with the needs that invariably differ from one community to another. There is no better way to connect with these needs than spending time with the district office and our peers in those markets to complement their efforts. Whether it be rural, HUBZone (urban), export, small loans, serving the underserved or need for SBA product expertise, we work to address those unique gaps.

No one institution can be all things. The SBA has products (those you have listed and then some) that address these needs. These products are delivered by nearly 2,000 institutions that invest in developing the expertise to participate in one or more of these products. Confidence in the program(s) is key to maintaining participation is any and all of our programs. Each plays a unique role that together comprises a small business capital access ecosystem. Some will be able to support a team to provide small loans, lines of credit for contractors or exporters, franchise, agriculture or perhaps construction to meet the plant needs of a manufacturer. Given the broad range of business models among SBA lenders, many of my peers employ widely differing marketing strategies to different types of businesses and in different markets across the country. What works for a bank with a national footprint and thousands of brick and mortar locations will not work for smaller banks, credit unions, CDFI's or non-banks. In addition, more and more lenders are making use of technology platforms to market available programs as many potential borrowers start to approach access to capital differently and with more of an online emphasis. However, personal relationships are still critical to supporting small business. That said, what those relationships look like is as varied and customized as the businesses themselves.

I would like to also note that some of the national trade associations work closely with SBA to try to advance awareness of SBA programs. For instance, NAGGL developed an extensive training program that it donated to SBA that assist community and faith-based groups to educate their constituencies in the basics of financial literacy and small business ownership. Launched in September 2015, the training program was designed to specifically help increase small business ownership in underserved markets throughout the country. One of the modules in the training program details the various programs offered by SBA and aims to increase awareness of various opportunities for prospective borrowers. Some of the community and faith-based groups that partnered with SBA and NAGGL to deliver these services included the U.S. Black Chambers of Commerce, 100 Black Men of America, the U.S. Hispanic Chamber of Commerce, and the N.O.B.E.L. Women (National Organization of Black Elected Legislative Women), among many more.

NAGGL just recently recommitted to SBA to work closely with them to update the three-tier training program, with a special focus on greater assistance to small businesses in today's economic environment, particularly in Opportunity Zones that have already been designated. As you are aware, of the 149 Census Tracts in Maryland designated as Opportunity Zones by the U.S. Treasury, 42 are in Baltimore City, so NAGGL would anticipate a particular focus on these areas in Baltimore. In this capacity, as Chairwoman of NAGGL, the trade association looks forward to working with you and your staff to focus on these efforts.

QUESTION 2: What should we be thinking about during this reauthorization effort in order to help SBA lending programs reach more of the underserved and non-traditional small businesses, such as those owned by returning citizens, that SBA was created to serve?

As the Committee looks at efforts to reauthorize the *Small Business Act*, I would urge that the subsidy calculation in the 7(a) program's FY20 budget be a top priority in these discussions.

As my detailed response to Chairman Rubio's question for the record on the FY20 budget outlines, SBA included in the FY20 budget a subsidy calculation requiring additional funding of 33 basis points (0.33%), or \$99 million, for the 7(a) program. Now, Congress needs to either appropriate \$99 million to the 7(a) program or amend the *Small Business Act* to raise the current fee caps in order to collect \$99 million in additional fees from borrowers and lenders on top of what participants already pay to cover the cost of the program. Both of these paths forward will need to pass the Senate, House, and be signed into law by the President by September 30—or the 7(a) program will shut down on October 1. However, before we can even consider how Congress might best move forward, we *must* first collectively question the positive subsidy calculation. My plea to this Committee is that before you simply take the FY20 subsidy calculation at face value, you first challenge both OMB and SBA to explain this subsidy estimate in detail, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model. Not only do the FY20 budget documents provide insufficient justification for a \$99 million increase in estimated subsidy costs, but there is ample evidence to suggest that a troubling pattern exists in the way SBA and OMB model the subsidy cost.

One of the most concerning parts of the FY20 budget request that should lead to many questions about the accuracy of the 7(a) model is the documentation of repeated and significant downward re-estimates in every cohort of loans since FY10, as reported in the FY20 budget. Downward re-estimates mean that the portfolio is consistently performing *better* than originally projected in each fiscal year's original subsidy calculation, and that the model used by SBA and OMB has been significantly overestimating program costs. In other words, data that shows in dollars the net lifetime amount of a particular fiscal year's downward re-estimate is how much borrowers and lenders have been *overcharged* in fees to cover the cost of the program.

What does this mean for underserved markets and small dollar loans? If SBA had not overcharged participants every year since FY10, significantly more fee waivers could have been made in those years to help increase lending efforts with certain segments of borrowers. It goes without saying that if we do not address the looming questions around the subsidy calculation we will not have a 7(a) program come October 1. However, it should be noted that if we do not insist that SBA and OMB are held accountable for their subsidy calculation that we could have yet another year of overcharging participants and not offering the kind of fee waivers to underserved markets that we otherwise could.

I would also bring your attention to one of the suggestions I highlighted in my testimony to consider during the reauthorization process, which is including in the OCRM scores for lenders' risk-assessment reviews (also known as PARRiS) lenders' concerted efforts to focus on underserved markets. This was part of extensive conversations that NAGGL and SBA had beginning in 2015 in light of SBA and Congress encouraging lenders to make more loans to underserved markets, which are primarily small dollar loans, yet dingling lenders in their PARRiS reviews for having a preponderance of small dollar loans. This is a mixed message that many lenders have expressed is a frustration with the PARRiS methodology. However, this minor policy change was finalized as the new Administration was coming into office and it was never made final with the Administrator's signature. This revision to PARRiS can easily be accomplished without altering the OCRM rating related to any performance issues that may exist with the lender and would in no way mask any issues with that lender's performance. I would encourage you and your staff to look into this recommendation, and I am happy to discuss more with you at your convenience.

QUESTION 3: What are your top legislative priorities for reauthorization?

This Committee and its colleagues on the House Committee on Small Business have been incredibly active in taking a closer look at the 7(a) loan program over the past two Congresses, and as a result, a number of significant and historic legislative accomplishments were realized last year by updating the *Small Business Act*'s provisions as it pertains to 7(a) lending.

First, the Committee and its House colleagues drafted and passed into law the *Small Business 7(a) Lending Oversight Reform Act of 2018*, a bipartisan, bicameral effort that spanned two Congresses and three and a half years of work on the part of this Committee. Yet another legislative achievement in updating the *Small Business Act* last Congress included this Committee and its colleagues in the House passing the *7(a) Real Estate Appraisal Harmonization Act*, which was also a bipartisan, bicameral effort that was signed into law in December 2018. As a result, many of the legislative priorities as it relates to the 7(a) program were addressed last Congress.

As a lender, my top priority for reauthorization efforts would be to use this opportunity to have significantly critical conversations with SBA and OMB to question SBA's positive subsidy calculation for FY20 in the 7(a) program. SBA and OMB have still not provided any justification for their calculation or provided any details on the assumptions made in the subsidy model and how they are weighted in the model. Without addressing this issue, either Congress or 7(a) borrowers will pay nearly \$100 million for a subsidy calculation that is both alarming and not justified, or there will be not be a 7(a) program available to the thousands of small business borrowers that depend on the 7(a) program. There is no priority that is more important than solving this existential crisis to the program and stopping a flawed subsidy model from shrinking access to capital year after year.

I would also note that as we consider other legislative changes to the *Small Business Act*, it may also be appropriate to consider the possibility that Congress may need to provide additional legislative guidance on issues that SBA is seeking to address in the proposed Express regulations that it published for public comment in September 2018, and which are incredibly significant and broad in their impact to borrowers and lenders. The industry and NAGGL would like to request that Congress examine the final provisions to determine whether the rules that SBA would be imposing are appropriate given the mandates of the *Small Business Act*, or whether statutory guidance should be considered.

Questions for the Record – Access to Capital Hearing

Ranking Member Cardin:

The 7(a) Community Advantage Pilot Program

SBA's largest loan program does a lot of good in this country through its traditional 7(a) loans, but not enough for minority- and women-owned firms. The 7(a) Community Advantage pilot program has shown great promise of reaching more underserved small firms, which helps the 7(a) loan program fulfill its mission to serve small businesses that can't get affordable credit elsewhere.

To Mr. Villarreal, Ms. Kibbe, and Ms. Evans, do you agree with SBA's view that the CA pilot program should not be made permanent until closer to the sunset date in September 2022 so that SBA can assess the program with the changes the Agency implemented in October 2018? Please explain why or why not, including the benefits of making the program permanent, and the negatives of delaying permanency.

No, the CA pilot program should be made permanent now because the need for access to reasonable capital for underserved markets is now. This program is so important because part of our goal within CA is making the small business borrowers bankable for the next level of lending. This requires technical assistance and working with the small business on requirements that need to be met as part of their loan approval. We have seen success with our small businesses that we have worked with and continue to work with. This puts them on a strong path as a business for stability and growth. If we wait to make the CA program permanent until the economy starts slowing down, it will be too late for so many of our small businesses, particularly those who need this support now to endure another downturn. Additionally, the SBA tends to retrench during economic slowdowns when in reality they should be making access to capital a priority.

The length of this pilot has continued to move along, with no clear fixed date for permanency and no communication from SBA on when that date will be set. This uncertainty harms small businesses who don't know if they can rely on this resource, and on the mission lenders who must make a significant investment of time and money to set up the program. It has been long enough—Congress needs to step in.

To Mr. Villarreal, Ms. Kibbe, and Ms. Evans, do you believe a comprehensive reauthorization bill of SBA's capital access programs should include permanency of the CA program? Please explain why or why not. Are there changes we can make to CA as part of permanency that would increase the capacity of the CA program to reach more borrowers in more parts of the country?

Yes, this bill should include the permanency of the CA pilot program, and that permanency should include changes. The CA lenders that are out there pounding the pavement on Main Street can see there are more businesses that need assistance than we can serve with the current restrictions the SBA imposes on CA. In addition to the SBA's restrictions on the

definition of underserved, the SBA CA program is too complicated for what it is intended to do. CA has the same closing requirements, the same guaranty fee requirements, the same SBSS score as the traditional 7a program, yet it is a mission lending program with the requirement that the majority of loans go to underserved communities, which is quite different from 7(a). The oversight and metrics of this program should reflect that difference. Mission lending to underserved markets will inherently include risk, and more risk than with those borrowers who can access a bank through traditional 7(a) lending. As I highlighted in my oral testimony, the program rules must responsibly manage that risk, but cannot and should not try to eliminate it. That distinction is not captured in the current oversight and discussion of the program from SBA.

Reauthorization of the 7(a), 504, Community Advantage, and Microloan Programs

To all the witnesses. I often hear from small businesses that SBA is hard to navigate; the numerous sub-programs are confusing; and many often don't know that SBA programs exist.

How can we raise awareness of SBA's programs?

On the CDC and 504 side, it is on the 200 plus CDCs in this country to be speaking about the resources we have and the role we play in supporting our communities. That engagement needs to be with bankers and businesses, which we do a decent job of, but also with policymakers on the local, state, and national level, which we can improve on. We need to spend more time ensuring that these leaders know what resources are available to their constituents looking to become entrepreneurs.

On the SBA side, SBA field offices and SBDCs should have enough staff and programmatic training be proactively engaged in educating small businesses on financing options. SBA has experienced success with its Lender Match online platform and should dedicate the resources to increase the visibility of this tool (through SEO and/or sponsored ads). If a small business starts a search for capital options online, SBA should be the preeminent search result, as opposed to high-cost fintech lenders. SBA should also take steps to ensure that small businesses are advised of the rates/terms of a 504 loan when offered a 7a loan for real estate by a bank (potentially by a disclosure statement).

What should we be thinking about during this reauthorization effort in order to help SBA lending programs reach more of the underserved and non-traditional small businesses, such as those owned by returning citizens, that SBA was created to serve?

First, as mentioned in earlier QFRs, making the CA program permanent and including the changes I previously listed will help those underserved markets. By definition, 60% of CA dollars go to underserved markets, so providing that program with stability and clear metrics through permanency will help it grow. Second, making the CA program permanent will also help the 504 program access more underserved and non-traditional business markets. Since 504 is for purchasing equipment and real estate, businesses may turn to it after initially starting

in a leased space or with leased equipment during their first few years. Once they have some experience with their business and can see long term success, they are ready to permanently invest in a space. By increasing the number of businesses created by the underserved community through CA, more underserved community businesses will enter those first few years of entrepreneurship as leasers, grow and stabilize, and reach the point where they are eligible for a 504 loan.

What are your top legislative priorities for reauthorization?

I have included a bulleted list below of the top priorities. My written testimony includes longer discussions on each of these, and I am always happy to provide additional details beyond that to the committee.

- Create a 504 “express” program to speed up low dollar, low risk loans to small business owners, to help keep them from predatory online lenders by getting them access to long term, fixed rate financing for real estate and equipment purchases faster.
- Look for modernization and streamlining opportunities, be it through SBA’s technology systems, reducing redundancy in documentation, or other creative ideas.
- Adjust the occupancy requirements from 51% to 50%.
- Adjust the public policy ownership and management control requirement from 51% to 50%.
- Reform the Standard Operating Procedure process at SBA to increase transparency and input from small businesses and actual loan practitioners.
- Adjust SBA’s requirements on the relationship between Eligible Passive Companies and Operating Companies to reflect conventional commercial business practices.
- Ensure the personal resources test is not reinstated.
- Make Community Advantage permanent.

Senator Inhofe:

Ms. Kibbe, as you well know, one of the requirements of SBA’s 504 loan program is job creation for small businesses. In most cases, a small business must create or retain one job per \$75,000 borrowed to obtain one of these loans. As one of the staunchest advocates in Congress for skilled trade careers, I know small businesses need more skilled workers. For example, Big Elk Energy in Tulsa desperately needs more highly skilled welders but struggles to find enough adequately trained workers.

QUESTION 1:

Ms. Kibbe, how well are the public policy goals of SBA’s 504 loan program working in regard to workforce development, specifically as it relates to businesses that employ skilled workers like welders and plumbers?

For the most part, 504 public policy goals are related to geography and individual demographics. Currently, there are no public policy goals that specifically focus on workforce development related to skilled/unskilled labor composition.

QUESTION 2:

Should Congress do more to encourage businesses to further invest in their workers in order to advance the development of the skilled workforce?

Yes, Congress should do more. Public policy goals could be expanded to include workforce development by the small business. Example requirements might be “1/3 workforce hired under skilled training program”, “1/2 of jobs created are categorized as apprenticeships”, etc. Another tool within the 504 program is to give CDCs credit for investing in workforce and training programs. Each year, SBA requires CDCs to report what work they do to fulfill their economic development mission. SBA should clearly identify that CDCs that invest in workforce development and training programs can list that as part of their economic development requirement fulfillment. Outside of SBA, and outside of my area of expertise, perhaps Congress could consider tax credits. For example, Congress could broaden the target group eligibility for employer tax credits under the current Worker Training Tax Credit (WOTC) program to include businesses that hire new workers and provide them with a congressionally mandated minimum length of training.

**Senate Committee on Small Business and Entrepreneurship Hearing
April 3, 2019
Follow-Up Questions for the Record**

Questions for Mr. Robert Villarreal

Questions from:

Ranking Member Cardin

The 7(a) Community Advantage Pilot Program

SBA's largest loan program does a lot of good in this country through its traditional 7(a) loans, but not enough for minority- and women-owned firms. The 7(a) Community Advantage pilot program has shown great promise of reaching more underserved small firms, which helps the 7(a) loan program fulfill its mission to serve small businesses that can't get affordable credit elsewhere.

QUESTION 1:

Do you agree with SBA's view that the CA pilot program should not be made permanent until closer to the sunset date in September 2022 so that SBA can assess the program with the changes the Agency implemented in October 2018? Please explain why or why not, including the benefits of making the program permanent, and the negatives of delaying permanency.

CDC Small Business Finance (CDCSBF) does not agree with the SBA's view that more time is needed to evaluate the CA pilot. In fact, we would argue that waiting until 2022 to grant CA full SBA program status as part of 7(a) would be a mistake. Such a delay would deny mission lenders and their bank partners, not to mention businesses in underserved markets, the stability needed to sustain the success of the program. We believe it is time that CA graduate from the uncertainty of a pilot to the stability granted to a fully authorized SBA program.

The CA pilot has been operating since 2011 and CA lenders have deployed over 5,200 loans for nearly \$700 million. In fact, when compared to many of the other specialty programs that SBA has launched in the past, Community Advantage is one of the most successful programs in terms of volume, low loss rate and most importantly, impact.

One of the most important reasons for making the program permanent is the demonstrated success that CA lenders have had financing underserved small businesses – often in underbanked communities. CA lenders provide an affordable and responsible alternative to the high priced loans offered by predatory lenders. The average CA loan size is just under \$133,000 as compared to the average 7(a) loan, which is \$417,300. While CA lenders are allowed to lend at 6% above prime, the majority of CA loans have been 4% to 4.5% above Prime. Further, CA lenders are required to deploy a minimum of 60% of their lending to the

SBA's Target Markets¹ while in fact more than 70% of all CA loans have been in the underserved Target Markets.

In September 2018, the SBA issued Notice 2018-0008 which extended the CA pilot for two additional years, placed a moratorium on certifying new CA lenders, and instituted several new rules which took effect on October 1, 2018. There was no consultation or outreach to CA lenders prior to the issuance of the Notice.

Community Advantage lenders were caught off guard by the SBA's move to extend and amend the pilot. Based on the experience of CA lenders, the lessons learned and shared with the SBA, and based on data showing how CA lenders were reaching underserved businesses that conventional 7(a) lenders couldn't, we were anxious to see CA graduate from the uncertainty of a pilot to secure the stability granted to a fully authorized SBA program. Moreover, the SBA had commissioned a study² released in May of 2018 that was highly complementary of the program, its impact and its performance.

SBA's decision to extend the pilot phase of CA raised concern and uncertainty among mission lenders – both participating lenders as well as those eager to become CA certified. Participating lenders raised practical concerns regarding the new rules, particularly the increased loan loss reserve requirement for lenders selling on the secondary market and new restrictions on using CA to refinance existing loans which will hinder efficiency of successful CA lending. The testimony I submitted to the committee offers more detail on the specific concerns we share, along with other CA lenders.

An additional reason to confer permanency is the impact of CA mission lenders in lending to the Black and Latino small business community. For example, in fiscal year 2018, 12% of all CA loans were to Black-owned businesses and 17% to Latino-owned businesses. In the same year, 5% of the 7(a) SBA Express Loans under \$250,000 were to Black-owned businesses and 10% were to Latino-owned businesses. While entrepreneurs of color are not a designated Target Market under the program, the CA mission lenders have demonstrated that they are the best suited to reach minority entrepreneurs, as its part of their mission and how they measure their performance.

Authorizing CA as a program under SBA 7(a) sends an important message to both existing and potential CA lenders, as well as to conventional banks, which have been the primary source of loan capital for most CA lenders. A number of mission lenders poised to become CA certified are currently not allowed because of the October 2018 rules restricting new lenders. There is also a group of lenders waiting for permanency before investing in the program and another cadre of lenders that will increase their investment in CA lending once

¹ Target Market - Low-to-Moderate Income (LMI) communities; Businesses where more than 50% of the full-time workforce is low-income or reside in LMI census tracts; Empowerment Zones and Enterprise Communities; HUB Zones; Promise Zones; New "start-up businesses (Firms less than two years in business); Businesses eligible for SBA Veteran's Advantage; and Business located in Opportunity Zones (added 10/1/2018).

² "Evaluating Technical Assistance and Economic Opportunity Outcomes of the Community Advantage Pilot Program," Final Report, May 2018; Prepared by Industrial Economic Incorporated; Prepared for the US Small Business Administration, Office of Performance Management and Office of Capital Access.

CA is stabilized as an authorized SBA program. Developing an SBA 7(a) lending program is an investment of resources, both human and capital. Some mission lenders are reluctant to enter the CA program until they are confident it will be there for the duration. Further, making the program permanent will bring in additional mission lenders and drive the program into geographic areas that are not currently served by 7(a) lenders.

Funders (primarily banks) of mission lenders are looking for permanency, as this provides them with consistency and stability in the program and allows them to invest more resources and capital into the program. As an example, one national institution, Bank of America, invested millions of dollars into a number of CA mission lenders when the program launched in 2011. They provided CA lenders with loan loss reserve capital (grants) and a line of credit for funding the guarantee portion of CA loans. No other lender since has made such a commitment to the program.

Funders of CA mission lenders appreciate the program because when CA lenders deploy their capital, a credit enhancement is on their funds; a guarantee of up to 85%. Therefore, they are more apt to extend credit to mission lenders. Further, if they fund CA mission lenders that sell the guaranteed portion of their loans, their \$5 million loan/investment, can be leveraged into a total of \$25 million in small business loans. This lessens the frequency of requests and total capital needed by CA mission lenders. Finally, banks appreciate the ability to refer their clients to CA mission lenders. They understand that their depository client is going to be treated fairly and receive an affordable product. Nearly all major financial institutions have funded CA lenders and have been supportive of the program.

QUESTION 2:

Do you believe a comprehensive reauthorization bill of SBA's capital access programs should include permanency of the CA program? Please explain why or why not.

Yes. We strongly encourage the committee to include CA program authority in its comprehensive Small Business Act reauthorization. We applaud the Committee's commitment to modernizing the Act in order to ensure that SBA programs and financing products are addressing the needs of underserved businesses and emerging communities.

The field of mission-driven lending has grown significantly since the Small Business Act was last reauthorized as evidenced by the success of the mission lenders participating in the CA pilot. We urge the committee to recognize the capacity of mission lenders and the demonstrated success of the pilot by granting CA program authority under the SBA's 7(a) loan guarantee. They are a critical part of the small business financing ecosystem.

The CA program is serving a segment of the small business community that 7(a) lenders are not, cannot, and in some cases should not serve because they lack the experience of mission lenders. Nearly half of the businesses CDCSBF finances with a CA loan are bank referrals. Without the CA Program these small businesses, would be unable to secure bank financing and would likely turn to a higher priced Fintech lender where they will pay

upwards of 104% APR on a loan. And start-up businesses would fare even worse. For example, in the current fiscal year through March 29th, 17% of all 7(a) loans were to "pure (not open yet, projection-based) startups" (CA loans are included in this statistic, so they are inflating the overall 7(a) numbers). For most CA mission lenders, nearly 40%-50% of all CA loans are to "pure start-ups."

For our organization, over half of the portfolio are start-ups, as defined by the SBA (less than two years in business) and in FY18, 44% of CDCSBF's approved loans were to "pure start-ups." As noted above, traditional 7(a) lender are very reluctant to fund pure start-ups (unless they are doctors) and start-ups cannot be served by on-line lenders, as they rely on cash-flow for their analysis. This leaves the CA mission lenders to fill the critical void in the continuum of capital of financing new small businesses. New small businesses represent new jobs and capital, particularly in underserved neighborhoods and those with a high concentration of minority residents. More importantly, the "pure start-ups" are those businesses most often in need of business advising, and it is only the CA lenders that are equipped to provide "TA" within the 7(a) programs.

QUESTION 3:

Are there changes we can make to CA as part of permanency that would increase the capacity of the CA program to reach more borrowers in more parts of the country?

First of all, we applaud the SBA for launching the CA pilot program. In recognizing this distinction and partnering with mission lenders the SBA is staying relevant to the fastest growing segment of the small business population; those located in low-moderate communities, start-ups, and entrepreneurs of color.

Mission lenders were selected for their experience and expertise in delivering capital to underserved communities. SBA recognized that mission lenders, like CDCSBF, deploy more than just capital; we provide up-front business advising and continued support throughout the life of the loan. We provide the support that our business borrowers need to succeed because we are committed to the sustainability of our business borrowers. At CDCSBF, if the client is part of the underserved Target Market and not qualified for a loan at application, we take the extra step of referring the entrepreneur to our internal business advising staff, who work with them and prepare them for a loan. In fiscal year 2018, we funded forty businesses for a total of \$4.8 million which we had "off-ramped" from our sales platform (they were not "loan-ready") to our business advising platform. We worked with them to get them "loan-ready" and referred them back to our sales pipeline. This is what differentiates Community Advantage mission lenders from traditional SBA lenders.

Since the CA pilot launched, the SBA has made numerous changes to the program rules and at least four Participant Guides have been published. Since the pilot was first launched, the industry (CA lenders) and the SBA have had a good working relationship and many of the CA rule changes were the result of the two groups working together to identify ways to improve the ability of CA lenders to reach, finance, and sustain businesses in underserved

markets. For example, after consultation the SBA allowed the use of Lender Service Providers for CA lenders (initially disallowed), SBA increased the CA interest rate cap from Prime plus 4% to Prime plus 6% and developed the concept of the Community Advantage Associate (a model worth further discussion below.)

Most recently, on October 1, 2018 SBA Notice 2018-0008 went into effect. as noted above, this extended the pilot to September 30, 2022 and added Opportunity Zones as an eligible Target Market, both very positive changes. However, other changes in this Notice, and other earlier changes, we believe, need to be re-examined and further discussed with industry.

There are several changes which we recommend to the CA Program. Some of these are statutory, such as permanency and raising the maximum loan size to \$350,000. Other recommendations are best suited to be managed through the regulatory process. The below are a list of recommended changes to the program that would result in increased lending to the small business community, specifically in the underserved Markets. We also believe that these changes do not result in an elevated risk to the SBA or the 7(a) program. The first three recommendation are focused on expanding the reach of CA lenders and the last three are focused on enhancing the efficiency of CA lenders.

1. Adding Demographic Populations to Target Market

The CA Pilot program was launched with the intention of providing affordable and responsible capital to underserved small businesses. The program has been very successful in delivering to the Target Market established by the SBA. However, we strongly believe that the Target Market definition needs to be expanded to include three critical groups; women, Black, and Latino owned businesses.

Studies have demonstrated that these three groups have consistently faced barriers in accessing capital. The SBA monitors/measures performance in lending to these groups and has historically encouraged lending to this demographic via past and current programs. In addition, many of the CDFIs that participate in the CA program focus on one, two, or all three of these groups and are held accountable by the CDFI Fund to a 60% lending threshold to that market. We believe and encourage congruency between federal programs that are working with similar organizations for the delivery of programs.

2. Expand Training for Community Advantage Lenders

We recommend that SBA provide upfront and ongoing training and technical assistance to CA lenders. We appreciate that SBA recently offered two mandatory online trainings for CA lenders and hope there are additional trainings being planned. While online trainings and webinars can be effective, there is no substitute for in person trainings especially for a new initiative like CA. We would welcome the opportunity to work with SBA to identify areas where additional training and/or technical assistance would be beneficial.

We also support and encourage additional resources for the SBA. We recognize that it is a challenge for the Administration to provide adequate oversight with existing resources. Under the CA program, 100 new lenders were added to their portfolio, yet no additional resources were provided. The Administration would benefit from additional staff to assist in

oversight. In addition, mission lenders, particularly those that are more experienced and have performed well in the program, are willing to be trainers and mentors to active and new CA lenders.

In addition to the training, SBA must provide greater up-front screening and enforcement. Just because a mission lender meets one of the three requirements to be a CA lender³ doesn't imply that they are ready to be an SBA 7(a) lender. SBA needs to perform greater vetting and a site visit prior to approval. Regarding enforcement, SBA should have the ability to provide targeted enforcement. This is preferred to enforcing rules on all lenders, when in actuality it may be two to three bad actors.

3. Develop an Alternative Risk Assessment Protocol for CA Lenders.

CA Mission lenders in the program want to work with the SBA's Office of Credit Risk Management (OCRM) to develop a risk assessment protocol for CA Lenders. CA lenders are asked to finance the businesses not served by traditional 7(a) lenders, resulting in an inherently riskier portfolio of SBA loans. It is not reasonable, and in fact hypocritical, to ask CA mission lenders to provide lending options to those small businesses not served by banks yet hold them accountable to the same risk standards as those banks not providing the service and making \$5 million commercial real-estate loans. We believe the SBA should explore further distinction and rules for the CA program that are separate from traditional 7(a) lenders.

This is especially true when financing start-up businesses, which may be as high as 50% in most CA lenders portfolio. While the new CA rules work to mitigate CA portfolio risk there is no guidance to lenders regarding what SBA considers an appropriate level of risk. Industry and the Mission Lenders Working Group (MLWG)⁴ would like to work with the Office of Capital Access and OCRM to develop a risk assessment protocol that recognizes the capacity of mission driven lenders to manage risk, to explore what 'acceptable' risk looks like, and come up with PARRIS scoring and peer comparisons that work for CA lenders.

4. Reducing Restrictions to Same Institution Debt Refinancing

To better serve the small business client, particularly those trapped in high-cost loans, it is recommended that the SBA revert back to the 6-month, same institution debt requirement in place prior to the issuance of SBA Notice 2018-0008. Further, we encourage dialogue as to how we can work together to improve the process of getting small businesses out of high cost loans.

The new rule states that for CA lenders to refinance a same institution, non-SBA guaranteed loan, the SBA will require *"a transcript showing the due dates and when payments were received for the most recent 12-month period, rather than six months. If there are any late payments in the most recent 12-month period, the debt may not be refinanced with a CA*

³ Mission lenders allowed in the program are: Certified Development Companies (CDC), SBA microlenders and Community Development Financial Institutions (CDFI).

⁴ MLWG - was formed in 2015 by a group of active CA lenders to share best practices and to inform the SBA, and each other, of what is working in the program and what could be improved.

loan.” The new rule makes it more difficult for a CA lender to be nimble in responding to the needs of a small business, and it is unclear what the SBA is seeking to address in making this rule change.

It is worth noting that over 80% of the CA mission lenders surveyed by the MLWG reported that a significant number of prospective borrowers are seeking to refinance a high-priced loan from an online lender. Several CA lenders reported that 25-30% of these businesses are near a financial breaking point due to unaffordable daily automatic payments, requiring a quick refinance of the unaffordable debt in order to stabilize the business and prevent it from going under. Some CA lenders offered short-term bridge loan as immediate relief while they processed a CA loan for the borrower. This process was feasible under the previous rule which allowed same-institution debt refinancing after six months. With the new rule requiring 12 months of on-time payment history before same-institution debt may be refinanced into a CA loan, it is more difficult, and less feasible, for CA lenders to provide bridge products that provide relief to a small business.

We suggest that the Administration work with CA mission lenders to streamline the ability to refinance same-institution debt, particularly when it comes to high cost loans. This can include reverting back to the six-month rule or even developing a pilot program when it comes to refinancing loans that are over a certain APR. For example, experienced CA lenders could be granted designation as SBA Express lenders. While this would limit the guarantee to 50% for the CA mission lender, it would allow them the option to expedite the SBA loan for the small business.

An example of a CDCSBF client where a bridge loan or an expedited SBA loan would have benefited and saved the small business money, is a pre-school in San Diego that had three on-line, high cost loans, one with a daily withdrawal of \$710. The total monthly payments for the three loans were over \$19,800 per month (on outstanding debt of approximately \$150,000). Working with CDCSBF, the wife and husband team that co-owned the pre-school were able to drop their monthly payments to \$3,000, saving the small business over \$16,000 per month. However, the SBA loan took over three months to close and fund. If there had been a streamline process where CDCSBF could have provided a bridge loan in the first month that would have been taken out by the SBA CA loan at closing, the couple would have saved two months’ worth of payments, or \$32,000!

A second example of refinancing high cost loans is from our colleague Debra Salas in Florida with Neighborhood Lending Partners. They worked with Latin Beauty Academy in West Palm Beach, which had two high cost loans for \$176,000, on which they were paying nearly \$17,000 per month. Neighborhood Lending Partners was able to refinance the loans and provide additional working capital to the small business. They dropped their monthly payments to just over \$2,000 per month. Unfortunately, the loan took six months to close. If Neighborhood Lending Partners had been able to provide Latin Beauty a bridge loan or an expedited SBA loan in the first month, they could have saved the small businesses nearly \$13,000-\$15,000 per month for 5 months!

Changing the 12-month rule will allow CA mission lenders to assist more small businesses trapped in high-cost loans, saving them tens of thousands of dollars in interest payments. This will allow them to be sustainable and hire additional employees.

5. Review Loan Loss Reserve Required for Loans Sold on the Secondary Market

There have been at least three changes to the Loan Loss Reserve (LLR) requirement since the inception of the program. Initially, the LLR required mimicked the one for the SBA microloan which is 15%. This 15% was applicable to the un-guaranteed portion. That changed to 5% on the un-guaranteed and 3% on the guaranteed portion, if the loan was sold. Most recently this latter LLR was increased to 5%, resulting in a 5% LLR for the un-guaranteed portion and 5% on the guaranteed portion if the loan is sold. This is a required cash LLR.

This additional LLR requirement has an impact on the unrestricted cash of **all** CA lenders selling loans on the secondary market without regard for their performance as a lender or the health of their portfolio.

As CA lenders actively grow their portfolios, the funds that would have otherwise been available to finance more CA loans to businesses in underserved businesses will now be diverted to cover a lender's LLR requirement. Selling CA loans into the secondary market has been an important way for mission lenders to raise loan capital, finance more businesses, and maximize the impact of CA as a financing tool.

For example, CDCSBF has funded \$124,563,377 in CA loans since the new 5% rule took effect. If we assume a blended average of an 80% guarantee, it equates to \$11.6 million being under a guarantee, which CDCSBF will sell in the secondary market. The new additional 2% (moving from 3% to 5%) LLR requirement on the guaranteed portion results in \$233,013 in additional cash from CDCSBF that has to be deposited into the LLR.

The combination of the increased LLR requirement and potential secondary market softening could impact the decision of CA lenders to continue being active SBA lenders. If lenders decide it would be financially prudent to hold their CA loans rather than selling them into the secondary market, they give up the benefit of increasing liquidity to make more loans and serve more businesses in underserved markets. This isn't a viable option and not the intended consequence desired by the SBA or the mission lending industry.

We recommend that SBA look at reducing the 5% LLR requirement on CA lenders that meet certain performance thresholds. This standard is used in the SBA Microloan program, where high performing intermediaries can have their LLR reduced from 15% to 10%. A similar policy should be applied to CA lenders.

6. Raise the Maximum Loan Size to \$350,000

Many mission lenders in the program have requests higher than \$250,000 and have to provide two or more loans to meet the need of their small business client (this was the case with the pre-school discussed above). Raising the maximum to \$350,000 will allow additional affordable capital to reach the small businesses in underserved areas. The \$350,000 cap also puts the CA program in line with other 7(a) lenders under the Small Loan Advantage Program, of which the CA program is a subset.

Further, with the latest budget request, SBA is requesting to raise the SBA Express Loan maximum from \$350,000 to \$1 million. This leaves the CA program as the one 7(a) loan program exclusively targeting small dollar loans.

Reauthorization of the 7(a), 504, Community Advantage, and Microloan Programs

I often hear from small businesses that SBA is hard to navigate; the numerous sub-programs are confusing; and many often don't know that SBA programs exist.

QUESTION 4:

How can we raise awareness of SBA's programs?

Many of the businesses that come to CDCSBF seeking financing are referred to us by one of our bank partners. Most of my mission lender colleagues – including my fellow CA lenders, micro lenders and 504 CDC lenders – get a significant portion of their borrowers from banks. The SBA could encourage more 7(a) lenders, particularly the larger lenders, to refer businesses not yet ready for bank financing to a CA lender or an SBA microlender. By encouraging these referrals, the SBA would be generating more interest in and awareness of SBA programs, encouraging collaboration between lenders, and promoting a better experience for the business borrower. Granted, this could be challenging as banks consider SBA lending as a “second-look” program where clients are referred internally after they are declined for a conventional product. There is not an incentive to market SBA products exclusively. In fact, we don't market SBA products to small businesses; we market solutions that work and awareness that there is fair and responsible capital. Most small businesses don't care where they are getting the money, just that they are getting funded.

With that said, we think there are opportunities for SBA to use their network of lenders to market the full range of SBA financing products.

The following are some suggestions on how to make the SBA more visible and relevant and how to improve customer experience:

- Lender Match: We commend the SBA for investing in the Lender Match program and raising the online visibility of SBA capital access programs. SBA's Lender Match has helped connect borrowers with responsible capital, and we encourage SBA to look at ways that Lender Match can be used to raise the visibility of CA lenders as a

source of financing for small businesses. The lesson from Lender Match is that the SBA needs to listen to its customers (small businesses) and provide them with information, resources and tools that are user-friendly and result in a positive experience. When Lender Match, then known as "LINC," was first launched it was not successful and was not user friendly for either the business or the lender. As one of the early users, CDCSBF did not receive many referrals and when we did, they were not strong referrals. But three years ago, SBA streamlined the process for the small business user and the information received by the lender was more relevant. In fact, as a result of the streamlined system and increase in referrals, CDCSBF hired an additional loan officer to manage the referrals.

- Promote SBA Success Stories: We suggest SBA launch a campaign to promote the role SBA financing played in the launching small businesses. While there may be a tendency to highlight well known and successful businesses such as Nike, Under Armour, Chabani, and Fed-Ex, we recommend that smaller businesses be highlighted, particularly those owned by veterans, women and entrepreneurs of color. Emphasis should not be on the loan itself but build awareness of alternative and responsible capital and solving the access to capital issue for the small business.

- Strengthen SBA's Website: The SBA should streamline its website and make it user friendly. This may even result in the SBA having two websites for its two set of customers; a website for consumers (small businesses) and one for lenders. The current site is trying to appeal to both, making it difficult to navigate. Information is often buried in multiple layers, difficult to find, or not posted at all. For example, the site does not include a list of CA lenders – or if it does, we were not able to locate it.

We believe the bigger question is if it is truly important that the SBA be recognized by the small business community. The SBA does its work through banks and other intermediaries. One could argue that the SBA's customers are the lenders and to increase its impact, SBA needs to improve and streamline their processes and make its programs more user-friendly for its lending partners. Then the lending partners will be more apt to use the programs.

QUESTION 5:

What should we be thinking about during this reauthorization effort in order to help SBA lending programs reach more of the underserved and non-traditional small businesses, such as those owned by returning citizens, that SBA was created to serve?

Authorizing CA as part of the SBA's flagship 7(a) loan guarantee program will significantly extend SBA's capacity to effectively reach more underserved businesses, emerging markets and underbanked communities where entrepreneurs lack access to affordable and responsible financing options.

To further empower the current CA model and enable CA lenders to effectively reach more of these markets I would suggest two program changes.

Expand the CA target markets to intentionally include women-owned, Black-owned, Latino-owned, businesses. As noted above, studies have demonstrated that these three groups have consistently faced barriers in accessing capital. The Stanford Latino Entrepreneurship Initiative 2018 publication, "State of Latino Entrepreneurship"⁵ notes that while Latino small businesses contribute 2.8 million jobs and over \$510 billion in annual sales, there exists a \$1.5 trillion opportunity gap. This gap represents what could be contributed by Latino - owned businesses if they grew to match the average revenue of their non-Latino counterparts. CA mission lenders can be partners in assisting small businesses grow to close that gap.

Second, institute a strengthened CA Associate program through which mission lenders that may not have the capacity or interest in becoming a CA certified lender can partner with a CA mission lender to refer qualified business borrowers who would benefit from a CA loan. This model would expand the reach and impact of CA lending without putting additional oversight burdens on SBA.

This program could be further strengthened by modifying some of the current rule's SBA has regarding paying referral fees. First, the SBA requires that referral fees be paid upon the referral and not upon the funding of the loan, which the SBA refers to as "contingency fees." CA lenders will not partner with smaller mission lenders or TA providers if they are required to pay a referral fee upon the referral. If the CA Associate program were waived of this rule, we believe more CA lenders would partner with smaller and rural technical assistance providers and chambers of commerce.

A second rule that is regulatory (13 CFR.120.222) states that the premium received from the sale of an SBA guaranteed loan cannot be shared with the loan referral source. We believe that if the CA mission lender were allowed to share a small portion of the premium with a CA Associate, more organizations would find it economically feasible to become CA Associates.

QUESTION 6:

What are your top legislative priorities for reauthorization?

Granting CA full program status – an authorization under SBA's 7a loan guarantee program is the top priority of CDCSBF and our fellow CA lenders.

The CA program is eight years old and has met the expectations of the administration. It has delivered nearly \$700 million in affordable and responsible capital to small businesses in the emerging markets that are historically shut out of the traditional lending markets, all with a loss rate of less than 3%. It has developed a core of high performing mission lenders that are now experienced in SBA lending and are reaching markets not met by banks. The program has also allowed these lenders access to the secondary market, so that they can

⁵ "2018 State of Latino Entrepreneurship," Stanford Graduate School of Business/Latino Business Action Network.

re-capitalize quickly by selling the guaranteed portion of the loan, thus leveraging their capital five-fold.

And in making the program permanent – we urge the committee to provide statutory language expanding CA target markets to include women and minority owned businesses (as described above), to establish the Prime plus six interest rate for CA lenders, and to raise the cap on CA loans to \$350,000. In addition, we suggest the statute adopt the language identifying CA covered institutions to include SBA 504 CDCs, SBA microlenders and Treasury certified, non-federally regulated, CDFIs. We would also suggest including language directing SBA to rescind the CA rules that went into effect on October 1st, 2018. Unless otherwise specified in law, CA lenders would operate under the 7a statute, but we encourage SBA to work with the CA industry to develop further distinctions between the programs in the regulatory process.

One reason we feel so strongly about making CA permanent is that we need continued investment in the program, and this will only happen if CA is fully authorized. SBA needs to be provided additional resources to adequately manage the program appropriately. Second, new lenders can be phased in, with a limit on the number of new lenders allowed access to the program every year. This allows the SBA to properly train and prepare the new lenders. New lenders can also be paired with an experienced CA lender. Finally, there can be a maximum limit on CA lenders in the program. This is similar to the parameters set within the SBA microloan program.

While there are some that believe there needs to be continued study, the impact of the program has been significant in a very short time frame and the results have been impressive. The program is serving the Target Market (or emerging markets); the CA program places the borrower in position to obtain financing from another source, such as a traditional bank; and business growth through the CA program has far-reaching impacts on borrowers and their communities.

This impact will only continue if the program is made permanent. Reaching the underserved market is not the strength or job of for-profit 7(a) lenders. Some 7(a) lenders have argued that they can serve this market if they are provided the spread of 6% above Prime. However, they currently can go 6.5% above prime for SBA Express loans under \$50,000. We believe that encouraging banks to work more closely with CA mission lenders and building referral programs with CA mission lenders is the best way to get capital to underserved communities and enhance the small business ecosystem.

The second priority is **raising the maximum loan amount under the program to \$350,000**. As described above, a \$350,000 loan limit will allow more small businesses to be served, particularly in higher cost states, such as Florida, California, New York and Washington. Not every CA lender will automatically deliver loans at the higher amount, as each serves a different market. However, the larger loan size will not only allow CA mission lenders to provide more loans but will streamline the process for the client. For example, approximately 20%-25% of all CDCSBF loans are greater than \$250,000. In these circumstances, our organization must put together two different loans from either two

different entities or programs, each with their restrictions or set of rules on rate, term and fees. This is confusing for the borrower, can increase cost and slow the process considerably.

**Senate Committee on Small Business and Entrepreneurship Hearing
April 3, 2019
Follow-Up Questions for the Record**

Questions for Ms. Connie Evans

Question from:

Chairman Rubio

In your testimony, you mentioned a cut to the microloan program in the President's FY 2020 request. Were you referring to a reduction in the President's budget request from FY 2019 or the difference between what was appropriated last fiscal year and what was requested in the President's budget request for FY 2020?

QUESTION 1:

In our testimony, AEO responded to what we believe was Associate Administrator Manger's assertion that there is no proposed cut to the microloan program in the SBA's FY2020 budget request. As noted in Table 6 (page 11) of the Congressional Justification, the SBA requests \$25 million for Microloan Technical Assistance, a \$6 million cut from the FY2019 enacted level of \$31 million. On the lending side as well, the budget requests (p. 38) \$33,098,000, well below the \$39,064 enacted in FY2019 (we do note the funding mechanism for the actual loans is more complicated than just these numbers – and the agency asks for \$4 million to support \$40 million in lending, again below the FY19 enacted lending number of \$42 million.) Finally, we also note the agency's proposed elimination of the PRIME program, which it groups into the Microloan section of the budget request (p. 39).

AEO, in unison with others in the microlending community, strongly encourage Congress to reject these cuts and instead demonstrate a commitment to entrepreneurship at the following funding levels for FY2020:

Microloan Technical Assistance: \$35 million
Microloan Lending: \$45 million
PRIME Program: \$10 million

We would be happy to provide any additional details on funding levels and impact cuts would have to the system and entrepreneurs.

Question from:

Ranking Member Cardin

The 7(a) Community Advantage Pilot Program

SBA's largest loan program does a lot of good in this country through its traditional 7(a) loans, but not enough for minority- and women-owned firms. The 7(a) Community Advantage pilot program has shown great promise of reaching more underserved small firms, which helps the 7(a) loan program fulfill its mission to serve small businesses that can't get affordable credit elsewhere.

QUESTION 1:

Do you agree with SBA's view that the CA pilot program should not be made permanent until closer to the sunset date in September 2022 so that SBA can assess the program with the changes the Agency implemented in October 2018? Please explain why or why not, including the benefits of making the program permanent, and the negatives of delaying permanency.

No. AEO firmly believes the CA pilot program should be made permanent now. The program is already eight years old and has met and exceeded the expectations of the SBA by delivering \$700 million in affordable and responsible capital to small businesses in underserved markets and to entrepreneurs who have been historically shut out of the traditional banking system. The program has done this with a loss rate of less than 2%, despite the inherent riskiness of these loans.

The benefits of making the program permanent now include allowing the program to grow by providing the security and knowledge that the program is permanent, and providing the SBA with a focused small dollar credit program that reaches into low-income communities and serves woman and minority owned businesses and start-up businesses. While other SBA programs aim for larger markets, the CA program fills a necessary niche by reaching traditionally non-bankable borrowers.

Delaying permanency will make it difficult for the CA program to grow. It also risks opening the program to additional changes without legislative oversight that may not be beneficial to CA lenders or the entrepreneurs they serve.

QUESTION 2:

Do you believe a comprehensive reauthorization bill of SBA's capital access programs should include permanency of the CA program? Please explain why or why not.

Yes. Permanency now will protect the CA program from undergoing changes without legislative approval. The CA program serves a critical purpose, servicing a subset of the population that has not been served well by traditional financial institutions. While the CA program is small, it has had an incredible impact on the lives of small business owners, many of whom would not have

been able to access responsible and affordable capital through any other avenue. Since its inception, the CA program has provided over \$700 million in capital to small business owners in underserved markets. Permanency will allow the program to grow even more, expanding its impact and benefiting often-overlooked communities around the country.

Moreover, any re-authorization that did not include permanency for CA would immediately create a list of items for the next bill. In our view, we should take advantage of the leadership this Committee is showing and act boldly and not leave items for future Congresses that can be settled today.

QUESTION 3:

Are there changes we can make to CA as part of permanency that would increase the capacity of the CA program to reach more borrowers in more parts of the country?

Yes, there are a number of changes that could be made to the program to ensure that more borrowers are reached in more parts of the country. The first would be to revert back to a 6-month, same institution debt requirement that was in place prior to SBA's issuance of Notice 2018-0008. SBA Notice 2018-0008 states that CA lenders can only refinance a same-institution, non-SBA guaranteed loan if the borrower has had no late payments in the past 12 months. Reverting back to the 6-month rule will help better serve borrowers who are trapped in high-cost loans.

Another change we suggest is for the SBA to reduce the 5% Loan Loss Reserve (LLR) requirement on CA lenders that meet certain performance standards. This same type of standard is used for AEO's members in the SBA Microloan program in which high-performing loan intermediaries can have their LLR reduced from 15% to 10%.

We also recommend that the SBA provide continued training and technical assistance to CA lenders, preferably in-person trainings, and that SBA's Office of Credit Risk Management (OCRM) works closely with Mission lenders in the program to develop an alternative risk-assessment protocol for CA lenders.

Additionally, the maximum loan amount should be raised, as this will allow additional capital to reach small business owners in underserved areas.

Finally, demographic populations should be added to the Target Markets established by the SBA. By including female, Black, and Latino owned businesses to the Target Market, these groups, which have consistently faced barriers in accessing affordable capital, will have increased opportunities to become economically stable.

Reauthorization of the 7(a), 504, Community Advantage, and Microloan Programs

I often hear from small businesses that SBA is hard to navigate; the numerous sub-programs are confusing; and many often don't know that SBA programs exist.

QUESTION 4:

How can we raise awareness of SBA's programs?

Currently none of the funds received by intermediaries from the SBA are set aside for marketing purposes. Effective marketing of the Microloan or other SBA programs requires resources. Additional funds specifically for marketing could help local intermediaries raise awareness of the program online and in their communities.

Social media is also a powerful tool. Every member of this Committee can help raise awareness of the SBA's programs simply by mentioning the programs often on their own social media accounts and highlighting success stories of constituents who have benefited from the programs.

QUESTION 5:

What should we be thinking about during this reauthorization effort in order to help SBA lending programs reach more of the underserved and non-traditional small businesses, such as those owned by returning citizens, that SBA was created to serve?

The Microloan program was specifically designed to get capital in the hands of entrepreneurs that may traditionally be described as "unbankable." Modernization of several aspects of the Microloan program, which are laid out in Sen. Duckworth's Microloan Program Enhancement Act of 2019, can help intermediaries reach more of these small business owners. The data highlights how this program is serving the underserved: minority- owned or controlled firms received 48.7% of the number of microloans issued and 38.9% of the amount issued in FY2018. This is compared to about 9.9% of conventional small business loans that are issued to minorities, according to data from a study conducted by the Urban Institute. Microloans have also been a significant source of capital for women entrepreneurs, who received about 47% of those issued in FY 2018.

QUESTION 6:

What are your top legislative priorities for reauthorization?

Our top legislative priorities for reauthorization are permanency of the Community Advantage program and updating and modernizing the Microloan program to ensure that more entrepreneurs, especially the historically underserved, receive capital and technical assistance to start and grow small businesses. We are also supporters of the NEW START Act which would address prisoner re-entry entrepreneurship.

Questions from:

Senator Duckworth

The Small Business Administration (SBA) Microloan program helps fill gaps in commercial financing where traditional lenders are less likely to offer low dollar amount loans to smaller and newer business owners and less capitalized businesses. For example, The Urban Institute conducted a study that found only 31 percent of SBA microloan borrowers reported that they would have been able to find acceptable financing absent the SBA Microloan program.

As the Committee considers reauthorizing SBA's access to capital programs, I am focused on strengthening existing initiatives and doubling down on proven programs that work. For instance, I introduced S. 996, the Microloan Program Enhancement Act of 2019. This legislation would enhance technical assistance funding to intermediaries, repeal the 1/55 rule and increase the total amount of microloans intermediaries may offer to better meet small business demand for this type of financing.

QUESTION 1:

Ms. Evans, would you support the Small Business and Entrepreneurship Committee considering and favorably reporting S. 996 to improve the SBA Microloan program and help expand small business access to small dollar financing?

Yes, I support bill S. 996 because it improves the SBA Microloan program in critical ways. It eliminates the 1/55th rule which creates unnecessary delays in the funding pipeline for many states. The arbitrary disruptions caused by this rule mean that the SBA delays the flow of funds to the intermediary, which in turn delays the flow of capital into the hands of the entrepreneur. When business owners are told they must wait 2 or 3 months for additional capital to become available, it can significantly disrupt a business plan and even cause some businesses to close their doors, which is the worst possible outcome.

S. 996 also increases the cap on the aggregate debt that intermediaries can have to the SBA from \$6 million to \$7 million. This \$1 million increase is important to those lenders that are approaching their maximum and would otherwise have to stop lending to businesses in need of capital. In some states, such as Ohio, there is only one intermediary in the entire state. Intermediaries in this situation undoubtedly reach their cap over time. The additional \$1 million ensures that those intermediaries can keep money flowing to businesses in that area.

The bill also enhances technical assistance funding to intermediaries, which is an important part of helping future borrowers become credit-ready with training and counseling.

QUESTION 2:

Given your expertise, do you believe that Congress passing the Microloan Program Enhancement Act of 2019 would result in more dollars getting into the hands of small business owners and entrepreneurs, from rural communities to urban centers?

Yes, passing the Microloan Program Enhancement Act of 2019 would undoubtedly ensure that more entrepreneurs, from rural communities to urban centers, would receive capital to help start and grow small businesses. Eliminating the 1/55th rule ensures that the flow of money to small business owners is not delayed, increasing the aggregate cap on the amount of debt that each intermediary can hold by \$1 million ensures that more funds are available for intermediaries to loan to entrepreneurs in areas of high need, and strengthening the enforcement of the program's mandate to serve rural and urban communities via an annual report by the SBA, as well as making that report publicly available, ensures oversight and allows stakeholders to identify areas of unmet needs.

As was submitted with our testimony and can be provided to the Committee by SBA, the states that delay loans to entrepreneurs are diverse, and negatively impact small businesses in both rural and urban states.



3 Corners, LLC. – Pyramid Grocery

Chloé Floyd grew up in a family of entrepreneurs that owned and operated small neighborhood businesses within the Pittsburgh community for more than 30 years. Chloé stated "she has witnessed the rise and decline of the community, and that her business has also been affected by the changes."

Chloé's personal experience, dealing with the lack of resources in her neighborhood growing up, inspired her to do more for the NPU-V families. As an active advocate in the community, Chloé has taken a proactive approach to increase awareness to the families in her neighborhood on the importance of preparing healthier meals for their children. 3 Corners Groceries, LLC, in collaboration with Pyramid Groceries, has started a campaign called Healthy Eats and committed their efforts to introduce and make available fresh fruits, vegetables, made to order meals, and healthier items in the stores.

In their effort to remain socially involved with the families in the community, 3 Corners Groceries has also partnered with Bee Glad Café, a business owned by her sister, Tenille Floyd, who will prepare meals for families at cost who need some assistance with daily meal preparation and healthy meal choices. This is also part of their Healthy Eats Community Campaign.

3 Corners Groceries plays an important role in the Pittsburgh community, especially for the families that lack transportation and/or are dealing with some type of physical disabilities that hinder their regular visits to other food markets 3 - 5 miles away. Chloé has a genuine love for the families in her community and will continue her support, engagement and her focus, on having a presence in the NPU-V that is committed to community equality, change and personal growth. Chloé has remained steadfast and committed to help build a community that supports small businesses located in the Southwest corridor of the City of Atlanta.



ACE is an equal opportunity provider and employer.
ACE is a Community Development Financial Institution (CDFI), SBA Microlender, Intermediary, SBA Community Advantage Lender, and a USDA intermediary.

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Craft Yarn Co.



When Barrie Turney was 15, her grandmother taught her how to knit. "I just took to it," she says. "I had a hard time sitting still so knitting gave me a fun way to occupy my hands." She kept it up as a hobby, even when she was working as a Harley-Davidson mechanic. "I knitted on my lunch breaks," she says.

Last year, though, Turney decided to take her artisanal craft to another level. "There wasn't a good yarn shop in the Rome area," she says. "I saw a need for it, and I already had the passion for it."

With assistance from ACE, Turney established Craft Yarn Company, turning her love for fiber arts into a successful business that is both colorful and cozy. She used the \$15,000 loan for inventory and construction costs. "I did everything I could to reduce the start-up costs and make it work," says Barrie, who added her father as a guarantor.

In a building that once served as a recording studio, she did some spiffy remodeling. "I could not have opened this business without the love and support that came from ACE," she says. "Believe me, I called just about every day with a jillion questions, and everyone was so patient and helpful."

Avoiding acrylics, Craft Yarn Company specializes in natural yarns – wool, bamboo, cotton, and cashmere. The shop works with independent, boutique yarn dealers who employ some dyes that are exclusive for Turney. "We have colors that you simply can't get anywhere else," she says, "and we sell supplies to get you started." The shop has one employee, who teaches classes in knitting and crocheting.

Barrie has become a fixture in this part of town, which is gentrifying into an arts district with several restaurants and plenty of foot traffic. She conducts several workshops and social events, such as the "Sip & Stitch" networking series, and she serves as a donation site for Knitted Knockers, a group that provides comfortable prosthetics for women who have undergone mastectomies. She also sells yarn, knitting and crochet accessories through her website.

"So far, so good," she says. "I stay very busy, and I'm living my dream."

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Although her time is limited now for events and outside activities, Fatimah did attend the ACE Annual Speed Coaching and "How to do Business with the Government" workshop. After her coaching to get the loan and get started, she sees the value in getting mentoring to further her business.

Edgy Girl Fitness Studio, LLC

A year and a half ago, Fatimah Ray was at a point in her life where she wanted to combine her passion of personal training and empowering women to start a business instead of continuing to work in the radiation oncology department at Emory. Up to that point, Fatimah had been training as a bodybuilder in her spare time and had also taken on clients from her church as their personal trainer.

In March 2017, she began searching for funding. She was turned down because she didn't meet all the requirements and became frustrated. She finally Googled "business loans for minorities and women" and found a link to ACE's website. Right away she picked up the phone and called the WBC. After attending the workshop "Access to Capital for Small Businesses" she applied for a \$50K loan; however, her application was denied because of her credit. But her story doesn't end there, because at ACE we believe in helping people achieve their dreams! So the WBC arranged for her to have a one-on-one consultation with a financial expert. The first recommendation was to pay off some of the bills, which she did, and her credit quickly began to improve. She no longer had a job as she had quit to pursue her dream, so it was recommended that she get a guarantor and apply for less funds. Her boyfriend became the guarantor of the loan, and instead of purchasing new equipment, she had to start her business with used equipment. Fatimah finally closed on her loan for \$20,000 in August 2017 and was able to lease space to start training her clients from her own location.

Since then she has been extremely busy growing her business, from training one client when she first started, to training 60+ women.

A year after opening the doors of Edgy Girl Fitness Studio and working countless hours daily, she has reached out again to obtain additional funding. She wants to expand her business by leasing the space next door, offer classes, and purchase better equipment to attract more clients. She sees herself expanding the studio again in 2-3 years. She relies on the faith of God, family and friends to continue to be successful in her entrepreneurship journey!

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Holistic Occupational & Physical Therapy, LLC



"I plan to continue using the resources at ACE," Keitoria LaCount says, citing marketing, bookkeeping and business investing advice. "I couldn't have done all of this without ACE."

One patient had suffered a debilitating stroke. "With traditional therapy, it typically would've taken a year for him to recover 100 percent," says Occupational Therapist Keitoria LaCount. "With aquatic therapy, he was going back to work after just five months."

LaCount is the founder and owner of Holistic Occupational and Physical Therapy in Atlanta. She uses individual "Hydroworks" water tanks with treadmills that are wheelchair-accessible. "The buoyancy of water offers patients an increased range of motion while removing the factors of gravity and pain," she says. "It really speeds up the therapeutic outcome. The treadmill is especially good for helping hip-replacement patients get back to a normal gait."

LaCount grew up in Bainbridge, Georgia, and earned her OT degree at Florida A&M. She practiced for 16 years, all the while wondering what it would be like to own a business. "It's an idea I've had since college."

After traditional banks turned her away, a real estate agent suggested she check out ACE. LaCount received a loan of \$45,000, which she applied to equipment, leasing, and marketing. She opened her doors in 2015. Today, she oversees five employees, and she intends to expand her practice into the two office buildings that currently flank her existing location.

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"ACE helped refinance my debt and gave me working capital when I needed it."

Couleen LaGon
military veteran and founder
The Märchen Sagen Academy.



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The Märchen Sagen Academy

Shortly after leaving the Navy, Couleen LaGon found himself homeless and sleeping in a friend's studio. He used his love of music and production skills to obtain funds for a project, worked with a developing artist and found himself in a production deal with Ceelo Green.

A few years later, he was inspired to create an organization teaching children the skills needed to transition from homelessness to gainful employment in his personal life as an artist and entrepreneur. Children are now taught and inspired daily at the Märchen Sagen Academy in a warm and nurturing, century old historic home in the middle of Downtown Decatur. The after school program involves hands-on, in studio exercises, walking field-trips, and in small groups, collaborative use of professional and consumer level cameras, lighting and recording. The vision is to inspire and develop a community of youth and their ideas through the arts. A full-day program during Summer and breaks called "K.A.M.P." (kids and multimedia production) is also offered.

The Academy currently has 43 students enrolled and employs 1.5 FTEs plus 2 interns.

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Client Spotlight: RL Commercial Systems



Pictured: Rob Landers, owner, RL Commercial Systems



When Rob Landers applied for a loan from ACE four years ago, he was declined.

"However, we worked together to improve my credit and analyze how the money was coming in and going out to develop a sound business plan," he says. "Less than 12 months later, I was approved."

Today Rob Landers Commercial Systems (RLCS), which employs 50 workers, specializes in janitorial and maintenance services across the state. His clients include Georgia Tech, the Department of Transportation, and the city of Smyrna, among others. At 32, he is considered the youngest entrepreneur with multiple contracts in the public sector, and he is the first African-American to operate a business of this kind in the state, and possibly in the country, he says.

"By helping me come up with an action plan, ACE has been pivotal in my growth," he says. "The capital is important, but ACE offers so many other important resources such as marketing and technical assistance. I always recommend ACE to other business owners who need help."

Landers grew up in St. Louis and majored in sports medicine at the University of Kansas. While he was in school, he made pocket money by cleaning dorms and student apartments. "I really enjoyed doing that," he says.

A job with the Spirit Group brought him to Atlanta, where he started moonlighting with a cleaning service as a "one-man show."

"I've always had an entrepreneurial spirit, so I thought: Why not turn something I enjoy into a business?"

Landers derives great satisfaction from his business. "Think about it," he says. "You're in charge of other people's livelihoods. That's a big responsibility, along with customer service and creating a solid company culture."

Landers strives to keep his employees happy. "We're not exclusively focused on just the bottom line -- we're a family-oriented business," he says. "We have casual Fridays when workers can bring their families to the office. We have bowling events. We try balance work and life, and I've learned that these measures make our employees more passionate about their work."

He has big plans for the future. "We are expanding into South Carolina now," he says, "and our goal for 18 months from now is to establish a franchise. We're at the point where we replicable. I owe much of this success to ACE."

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Salon Honey II



"Partnering with the ACE WBC allowed my impossible dream to become a Possible Reality! I am confident that this was a divine collaborative moment whereas this story will 'repeat' itself over and over. With the resources that I am now privy to, I can join forces with my partners at ACE WBC and make a difference in the community by creating and growing a sustainable business(s) which generate jobs. – Rebecca Smith

Rebecca Smith had been going to the same hairdresser for years. When the owners decided to sell the business, they encouraged Rebecca to consider purchasing it. At first, she was reluctant because she didn't know anything about running a hair salon, nor was she an entrepreneur. Ironically, her younger sister is the owner of Salon Honey I in Mississippi and encouraged her to embark on the journey of entrepreneurship.

Her biggest obstacle was fear of the "unknown" – who could help her navigate through this path, who would be her trustworthy resources? Rebecca was first referred to ACE's Women's Business Center (WBC) by the Georgia Department of Economic Development. She contacted the WBC, attended an orientation workshop where ACE services were presented, and a loan officer spoke about the requirements to obtain a loan. She scheduled a one-on-one meeting with a WBC consultant and discussed the possibility of acquiring the salon and was encouraged to proceed. After initially creating her business plan with DreamBuilder, she needed additional assistance with the financial projections section, was referred to a consultant at the SBC, and guided through the completion of the business plan. Rebecca then met with an ACE loan officer and was approved for a small business loan. She acquired the business in March.

Throughout the planning stages, Rebecca used resources offered from the WBC and our partners. She attended the Smart Start Course presented by the SBC. To increase her financial skills, she attended a workshop presented by ACE WBC about finances, credit analysis and loan products. She has been a regular participant in the monthly Lunch & Learn webinars presented by ACE WBC about marketing and other topics. Now that she's a business owner, Rebecca sees how important it is to expand her knowledge and business skills and plans to continue attending events and trainings offered through the WBC.

Rebecca registered her business with the Secretary of State in February as an LLC, and on April 1st, opened the doors of Salon Honey II. The salon now has 6 stylists and a makeup artist, and she is projecting to have 8 stylists by July 1st. Rebecca says, "I am on a mission." In the next 1-3 years, her goal is to own her own building with salon suites. She loves sharing her experiences and is encouraging her children to get involved in the business. She's living the dream of entrepreneurship and thanking God for his very generous gift!

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BBL's Initial Clients and their Stories

Rox Wine Shop, LLC, d/b/a Off the Rox is a startup wine and beer shop, conveniently located in Baltimore's Highlandtown neighborhood. Rox Wine Shop is owned by African-American couple, Jeryl Cole and Tyrekia Jackson. Both were born and raised in East Baltimore, both Patterson High School and Coppin State University graduates. With a combined twenty years of experience in the retail and service industries, a love of good wine brought this husband and wife team together to start Rox Wine Shop. They wanted to share their passion with their community and they wanted their friends and neighbors to know that they don't have to be connoisseurs to enjoy, learn about, and experience fine wine; they just have to stop by Off the Rox. Jeryl and Tyrekia worked hard and planned ahead, saving as much as they could to make an initial investment in their new business, they just needed enough to purchase refrigerators. BBL was able to help make that happen, and Off the Rox was the first BBL borrower. Since they opened their doors in September 2018, they have been growing in popularity.

Danae, Inc. was the second BBL borrower by a mere two hours, a startup African-American owned company that allows lower-limb amputees to take part in designing and creating covers for their own prosthetic devices through 3-D printing. Winston Frazer, the founder and CEO, was born in Gaithersburg and raised in Bethesda, received his BA from Maryland Institute College of Art in 2016. While a junior at MICA's fine arts program, he participated in a Summer Travel Intensive to the island nation of São Tomé and Príncipe, and that experience brought his future into focus. Winston says, "I met a lot of amputees in São Tomé and Príncipe, and I didn't have the mental resolve they did. They inspired me to change the way I look at and approach life, and as a way to say thank you, I wanted to make something that empowered them as much as they empowered me." Frazer believes that innovative thinking along with 3D printing technology will break through mental and physical limitations that amputees face every day, and his company Danae, Inc., is setting the stage to do that. Winston participated in Conscious Venture Lab and Startup Gym, and was awarded \$25,000 by MICAprenurship's Up/Start program. BBL was able to help Winston finance the production of the demo and initial customer products.

Keller Professional Services, Inc., is a staffing and management consulting firm established in 1997 by African-American founder & CEO Debra E. Keller-Greene. Debra received her BS in Business Administration from the College of Notre Dame University/Maryland. She was awarded the SBA Streetwise MBA from the Boston University Entrepreneurial Management Institute in 2010, and was a 2017 graduate of the Goldman Sachs 10K Small Businesses Program at JHU in Baltimore. A three-time recipient of the top 100 MBE Award, and winner of the 2016 Mayor's Minority and Women-Business Award for Woman-owned Business Enterprise

of the Year, Debra currently serves as the Board Chair for the Greater Baltimore Black Chamber of Commerce. The firm specializes in workforce development and Human Resource consulting through subcontracting on statewide contracts with large firms, such as Whiting Turner. With development in Maryland picking up, BBL is helping Keller Professional Services increase her workforce and expand her subcontracting opportunities.

Charmed. Inc., is a startup café located in Mt. Vernon owned by Danae Schrock, whose restaurant experience runs the gamut from serving to bartending to cooking. Danae grew up watching her mother run a small bakery and cafe on the Eastern Shore "and fell in love with it," she said. "I've always wanted to own my own place." Schrock draws from her family's culinary traditions at Charmed, including made-from-scratch meals and freshly baked pastries. "My mom is Mennonite so she makes some of the most amazing food," Schrock said. "I really want to bring that here." Schrock operates the cafe with her sister, both Baltimore transplants from the Eastern Shore. After Charmed invested in build-out of the café at a prime location, BBL was able to help them put together the equipment and working capital required to open their doors.

FINANCIAL TECHNICAL ASSISTANCE SPOTLIGHT

Lesline Powe Barton Hair in Motion of NY

Hair in Motion was founded by owner Lesline Powe-Barton, Master Stylist. Her salon has professionally licensed stylists, estheticians, a massage therapist, and a nail specialist to service its clients. Lesline has practiced in the cosmetology industry for over 25 years.

When Lesline first came to the BBIF Florida Technical Assistance Roundtable Program, she had very little business acumen. She ran her business off of her "passion & gifts," as Lesline explained to the Director of Technical Assistance, Lamont Jackson.

The monthly roundtable taught Lesline, and other business owners the fundamentals of business from a true understanding of business financials, marketing, pricing, inventory, and other tools necessary to grow her business.

"BBIF Florida not only taught me about my numbers, but taught me how to maximize the space in my salon. Now my business is self-sufficient," said Lesline.

Thanks to the BBIF Roundtable Program, Lesline has grown her salon, opened a second location, and is slated to open the first African American school of beauty in Central Florida. She attributes her secret to success to the foundations she learned from BBIF Florida as well as the loan she received to fund her dream.



HAIR IN MOTION
OF NEW YORK

**"Thanks to BBIF
Florida's Roundtable,
my business is ran not
just on passion, but on
smart business
strategies!"**

- Lesline Powe Barton

Success story 1

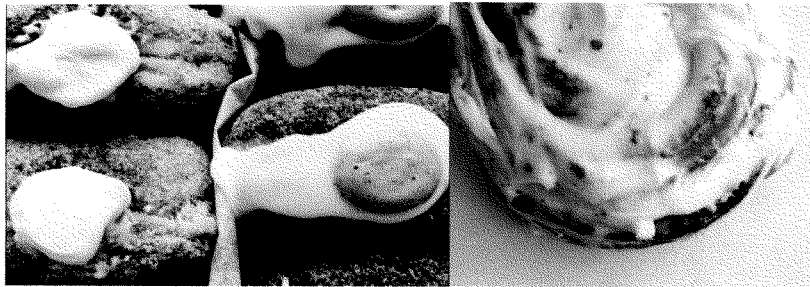
Business: GET YOUR FIX LLC, DBA (Full circle and artisan palace)

Owner: Courtney Fix

Courtney Fix is the owner of “Full Circle an Artisan Palace”, a bakery in the Hampden neighborhood of Baltimore City (<https://full-circle-artisan-palace.business.site/>). Courtney has many years of experience in the food industry and has worked for many well-known shops and restaurants in MD such as Atwaters, UpslideDown Daves and Bdoughnut. When Full circle started operating at the beginning of 2018, Courtney decided to lease a space in Hampden that would allow her to manufacture her own doughnuts, cinnamon rolls, doughnut buns, and cookies and also have a storefront. In May 2018, Courtney was in need of a small business loan to help the business grow. Courtney was denied a business loan by local banks and instead she was referred to LEDC.

LEDC was able to provide her with a SBA microloan of \$15,000. The loan amount she was approved for was enough to fully acquire the business and still left her with some working capital to purchase equipment and inventory. Full circle has been doing well and its client base has been growing.

Courtney’s special made doughnuts have become popular in Hampden and its surrounding neighborhoods. Courtney only uses locally sourced ingredients to create many different flavors. Some of her popular doughnuts are the Cereal Milk, Vietnamese Coffee, Buffalo Chicken Wing, Espresso Sugar, and French toast. Every week Courtney has a new doughnut that she sells in store or at events she attends with other local businesses. As of August 2018, Courtney hired her first worker to help her manage the storefront and production.







Success story 2

Business: Jerk 'N Jive, LLC

Owner: James Smith

James Smith is the owner of Jerk 'N Jive, LLC. The 1,200 sq. ft. Caribbean restaurant is located in Frederick, MD. Jerk 'N Jive is a family owned business that started on November of 2017, and since then, James has been micromanaging the restaurant's operations on a daily basis. The business venture has been turned into a profitable family owned business with sales surrounding half a million dollars a year with only one location.

In February of 2019, James was in need of a small business loan to conduct some updates to his store. LEDC was able to provide his business with a SBA microloan of \$20,000. The loan amount he was approved for was enough to fully complete the location renovation he had planned. Jerk 'N Jive has been doing well and its client base has exponentially grown since the loan was disbursed.

Success Story 3

Business: Petals to the Metal Florist LLC

Owner: Oscar Andrade

One such example of a small business owner LEDC has supported is Oscar Andrade who for 15 years worked for a large floral company in the D.C. area. Having been raised by a mother with a floral shop, he dreamed of opening up his own floral business in D.C. Thanks in part to an initial LEDC seed loan back in August 2018 he was able to leave his job and launch his own business, Petals to the Metal Florist LLC. In the 8 months since its inception, the business has generated over \$150,000 in revenue, helping Oscar hire two additional staff members.

In February 2019, LEDC was able to award him with an additional \$14,000 SBA microloan to help him purchase a company van and hire a part-time employee to deliver his products. This has greatly helped to reduce business expenses associated with delivery. He plans to hire an additional employee this year to secure his ability to provide the work ordered by long-term contracts with local businesses.



Mission Lenders Working Group
Building Success in Underserved Communities

Testimony for the Record
Submitted to the
Senate Small Business and Entrepreneurship Committee

For the hearing:
Reauthorization of the SBA's Access to Capital Programs
Wednesday, April 3, 2019

Submitted by Alison Feighan on behalf of the Mission Lenders Working Group

Chairman Rubio and Ranking Member Cardin, and members of the Senate Small Business and Entrepreneurship Committee, my name is Alison Feighan and I respectfully submit this statement for the record on behalf of the Mission Lenders Working Group.

The Mission Lenders Working Group (MLWG) was organized in 2015 by a group of SBA certified Community Advantage (CA) lenders. MLWG members are committed to demonstrating how experienced, mission-driven lenders effectively utilize the power of an SBA loan guarantee to reach, finance, and grow underserved small businesses. Two of the Committee's witnesses on April 3, Robert Villareal with CDC Small Business Finance (CDCSBF) and Patti Kibbi with Evergreen Business Capital, are members of the MLWG. Robert's testimony focused on the SBA Community Advantage (CA) pilot program, referencing both the experience of CDCSBF as the largest CA lender in the nation as well as the experience of other CA lenders in the MLWG. We write to reinforce Robert's message regarding the success of the 7(a) CA pilot and urge the Committee to grant CA full program authority under 7(a) as you work to reauthorize the Small Business Act.

As a network of CA lenders, we see ourselves as stewards of the 7(a) CA program and as such are committed to advancing the stated goals of this SBA pilot program:

- Increase access to credit for small businesses in underserved areas;
- Expand points of access to the SBA 7(a) loan program by allowing non-traditional, mission-oriented lenders to participate;
- Provide management and technical assistance to small businesses as needed; and
- Manage portfolio risk.

We firmly believe the CA pilot has achieved these goals and has demonstrated how the SBA can utilize experienced mission lenders to reach new and emerging small businesses that traditional

7(a) lenders are unable to finance. The CA pilot was launched in February 2011 and the first CA loan was deployed in 2012. Over the last seven years, CA lenders have disbursed over 5,000 loans totaling nearly \$700 million in financing with an average loan size of \$133,000. CA loans make up a very small portion of overall 7(a) lending from – one third of one percent (0.36%) from 2012 through 2018 – and the cumulative charge-off rate on CA lending to date is 1.8%.

We appreciate the efforts of the SBA to ensure that the CA pilot is both effective and sustainable in the long term. We heard SBA Associate Administrator Manger testify before the Committee that the SBA “*made changes to the CA program because we believe in it ... [and] we want to make this program as strong as possible and make it a part of our full breadth of programs available to small businesses,*” indicating that more time was needed to evaluate CA. An SBA Notice issued in September 2018 announced a two-year extension of the CA pilot and made several unexpected rule changes that raised concerns among mission lenders. Despite statements of support from the SBA leadership many CA lenders are trouble by the program’s uncertain fate – especially in light of its proven success.

In addition to lack of permanency, CA lenders have expressed concern with the new debt refinancing rule that went into effect on October 1, 2018. The new rule requires that a loan must be on the lender’s books for 12 months, rather than six months as was required previously, before it can be refinanced as a CA loan. This change has made it difficult for CA lenders to be responsive to the needs of small businesses seeking capital – particularly those businesses caught in a high priced predator loan. As more small businesses are being targeted by predatory online lenders offering high-cost loans with unclear or misleading terms, it is especially critical that the SBA enable CA lenders to provide responsible, affordable financing alternatives to underserved entrepreneurs. We recommend rescinding the same-institution refinance change. A reduced waiting time for refinances of same-institution debt will allow CA lenders to offer short-term bridge loans and better meet the needs of small businesses.

SBA’s Lender Match has helped connect online borrowers with responsible capital, and we believe that continuing to promote CA lenders through Lender Match will help more small businesses find affordable capital before falling victim to predatory alternatives. We commend the SBA for investing in the Lender Match program and raising the online visibility of SBA capital access programs.

In addition, we urge the SBA and Congress to provide CA lenders with the assurance of expedient CA program permanency. Some lenders are reluctant to invest fully in the staff, training, and systems necessary to increase lending volume and best serve Community Advantage target markets before the program is made permanent. The MLWG shares the SBA’s interest in protecting the program’s long-term success and viability and maintaining lender confidence in the SBA’s long-term goals is a critical component of this success. We hope to continue working with the SBA to identify a path forward that provides both lenders and the Administration with the assurances they need to promote and protect the Community Advantage program.

We thank Congressional leaders for including a discussion on CA in this hearing as you begin to consider reauthorization of the Small Business Act. The field of mission-driven lending has grown significantly since the Act was last reauthorized, and the CA program's success has demonstrated how SBA can promote sustainable small business growth in underserved markets. By making Community Advantage part of the 7(a) program in the upcoming reauthorization bill, this Committee will ensure that the SBA and mission lending industry continue to serve viable businesses that traditional 7(a) lenders cannot reach. The unfortunate reality is that the longer we wait to grant CA full program status under 7(a), the longer businesses in underserved markets will be without an alternative to the predatory lenders targeting small businesses that are not bankable.

Granting 7(a) CA full program status is the impetus needed to foster innovation within the SBA and the 7(a) industry.

Thank You.