HOW DOES THE PRESIDENT'S FY 2005 BUDGET REQUEST AFFECT SMALL BUSINESS?

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

WASHINGTON, DC, FEBRUARY 11, 2004

Serial No. 108–52

Printed for the use of the Committee on Small Business

Available via the World Wide Web: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

93–891 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
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Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

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WEDNESDAY, FEBRUARY 11, 2004

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Committee met, pursuant to call, at 2:20 p.m. in Room 2360, Rayburn House Office Building, Hon. Donald Manzullo, [chairman of the Committee] presiding.

Present: Representatives Manzullo, Bartlett, Kelly, Akin, Franks, Bradley, McCotter, Velµzquez, Udall, Ballance and Majette.

Chairman MANZULLO. Good afternoon. The Committee will come to order.

I will ask unanimous consent that my full statement be made part of the record. At this time, I will just summarize the high points.

Today, we examine the President's fiscal year 2005 budget request as it affects small business. Generally, the President's proposed budget is helpful to small business owners. Given the budgetary constraints, with a few exceptions, small businesses should be pleased.

I am especially heartened at the President's request to make permanent the tax relief Congress has already passed, including phasing out the punitive estate or death tax and the lowered rates on capital gains, stock dividends and small businesses so as to create incentives for job creation.

It is important to remember that 85 percent of small businesses pay taxes on an individual basis, so the rate cuts Congress passed into law in 2001 and accelerated in 2003, in addition to increased expensing and bonus deprecation, have provided critical assistance to our small businesses.

With increased confidence in the economy, it was only natural that small businesses seeking access to credit would use the guaranteed lending and venture capital investment programs of the SBA more than in past years. In addition, the number of self-employed are growing dramatically. These newly self-employed need the SBA guaranteed lending and venture capital programs now more than ever.

However, as the Committee and industry predicted, the 7(a) program experienced a cash flow crunch last month and is currently hobbling along. We need to fix this program now. That is why I was so pleased in the effort of Administrator Barreto to find another way to solve the 7(a) problem that does not involve raising borrower fees or requiring more appropriations or reprogramming accounts within the SBA.

My goodness. We have a full house here today. That is nice. It is good to have all of you here. Hector, why do you not come every day? Maybe that is why we have a full house.

Mr. BARRETO. I would be happy to, Mr. Chairman.

Chairman MANZULLO. Thank you.

This plan centers around raising the loan level from the SBA Express program so we will achieve the same goal—a zero subsidy rate—without having to raise fees. If we make this change apply now, it will also allow the SBA to restore the 7(a) program to its full statutory level.

The rest of the President's budget request for the SBA remains sound and reasonable, given the budgetary constraints, with a few exceptions. I have concern about the particulars of the President's proposal as it affects the SBIC issue.

I am also concerned about zeroing out SBA's contribution to the USEAC network. Each $1 appropriated to the SBA's export finance specialists in the USEAC since 1999 has supported loans generating over $200 in export sales, a sound return on any investment. We encourage the Administration to revisit its position on withdrawing support from the SBA for the USEAC system.

Thank you, and I now yield for an opening statement from the Ranking Minority Member, Representative Nydia Velµzquez of New York.

[Chairman Manzullo's statement may be found in the appendix.]

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

With the fiscal year 2005 Bush budget for the Small Business Administration, we have a proposal before us that represents the deconstruction of the only agency with the sole purpose of assisting our economy's most important sector—small business.

At a time when the economy continues to struggle and job creation lags, we should be investing in these programs, not turning our back on them. Not since the days of Reagan budget director David Stockton when elimination of the agency was proposed have we seen such a destructive plan.

At least in the early 1980s, the Administration was honest about its intentions. The current one, which is looking for the same outcome, is not being forthcoming; instead, hiding behind fake budget numbers and proposals that will never work.

Clearly, the worst is how this budget will deprive entrepreneurs of the capital they need to start their businesses. It is unbelievable that in this budget not a single dollar goes to the SBA loan programs. Not a single dollar. Not a single dollar for the general loan program. Not a single dollar for the micro loan program. Not a single dollar for the venture capital.

Adding insult to injury, the plan here is to pay for all these programs by hiking up the fees for borrowers. Even after we listened to this Administration harp on the need for the agency to make more small loans, it then turns around and eliminates the micro loan program, which does exactly that. It makes no sense.

The proposal now on the table to fix the 7(a) loan program is too little too late. It proposes to lower the guarantee fee to 50 percent of loans of $250,000 and below, eventually extending that up to $1 million. This would harm the very small businesses the program was created to help by blocking avenues of credit and will also deprive lenders out of the program altogether. This fix was either poorly thought out or it is an intentional way to destroy the program once and for all.

Another area where this budget falls short is in helping businesses access the federal marketplace. President Bush put this at the top of his small business agenda in 2002, but we have been told time and time again that the resources just are not there to back it up. This budget is no exception.

There are no enforcement dollars to hold agencies accountable for missing their small business goals. There is no funding for the women's procurement program that was made law four years ago. There is no money to ensure small businesses get their fair share of federal contracting dollars.

This budget has an unprecedented number of cuts to SBA programs. The rationale behind these cuts is to channel remaining funds to the agency's core programs, discarding those that are deemed duplicative. The problem is that the SBA's core program have been flat funded for three years now. When you account for inflation, this amounts to a more than $10 million cut. It is one thing to expect an agency to do more with less. It is another thing to expect it to make something out of nothing.

It is a shame because these programs help small business to stay afloat, expand and create jobs. They help to save taxpayers money and then even generate tax revenue. The failure to invest in them is completely shortsighted. It puts our nation's small businesses and our economy as a whole in jeopardy.

I believe in these programs. My Democratic colleagues believe in these program. It appears that the Administration does not. Even though President Bush spends a lot of time talking about the important role small businesses play in our economy, he went to Missouri. He went to New Hampshire. He visited a manufacturing plant in New Hampshire and Missouri. That is all it is. Talk. Let me tell you. Talk is cheap.

If this Administration really wanted to assist small businesses, it would have made the SBA budget whole. Without putting so much needed resources into small businesses, we simply cannot have a vibrant economy. We cannot put Americans back to work by creating jobs. We cannot spur economic development in our local community.

I would like to ask the Bush Administration where are its priorities? Where is its commitment? It is certainly not with small businesses.

Thank you, Mr. Chairman.

[Ranking Member Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Mr. Barreto, who has been one of the longest serving SBA administrators, now into his third year, and a person who was raised in small business and whose father started the Hispanic Chamber of Commerce appears again before us.

Based on your background and your experience, I have every confidence that SBA is in good hands. I look forward to your testimony.

STATEMENT OF THE HONORABLE HECTOR V. BARRETO, U.S. SMALL BUSINESS ADMINISTRATION

Mr. BARRETO. Thank you very much, Mr. Chairman, Ranking Member Velµzquez, Members of the Committee. Thank you for inviting me here today to talk with you about the Small Business Administration's 2005 budget and our strong commitment to continue to offer the very highest quality services to America's small business owners.

A lot has happened over the last few years both in America's small business community and at the SBA. When I became the SBA administrator almost three years ago, I wanted to change the culture of the SBA. I wanted to create a new environment at the agency and a new environment for America's entrepreneurs.

That meant not sticking to the status quo. That meant not doing things the way that we have always done them. That is what I would like to talk to you about today. The SBA is ready to send legislation to Congress that could add as much as $3 billion to our 7(a) lending program this year, while simplifying the application process and moving the program toward a permanent zero subsidy rate.

The President and I believe that this proposal provides a clear, long-term vision for a better, more successful 7(a) program, a bold, new 7(a) that addresses the real issues of the new economic times.

The plan calls for the expansion of the successful SBA Express program, which accounted for a remarkable 33,000 SBA loans in 2003 and has proven effective in reaching underserved and rural markets. Our proposals will move the 7(a) to a lower guarantee rate, allowing the agency to increase lending authority by 34 percent and remove the cap on 7(a) loans.

It will also allow lenders to use their own forms and procedures to apply for 7(a) loans, reducing the burden of excessive paperwork and making 7(a) more accessible for rural and community banks and their customers. This plan also helps move the 7(a) program towards our goal of a zero subsidy rate. There is also a long-term potential for reducing fees on lenders and borrowers.

But there is more. I am proud to say that the budget we are submitting also increases the 7(a) lending authority for fiscal 2005 by 30 percent. Thirty percent. That will allow us to reach thousands—perhaps tens of thousands—more entrepreneurs than we ever have before. There is an added benefit to these proposals because we are moving toward a zero subsidy rate for 7(a).

These tremendous increases in loan authority come hand in hand with tremendous savings for America's taxpayers. What is more, zero subsidy for 7(a) also translates into long-term stability for the 7(a) program, something our partner lenders will appreciate.

But that is not all we are doing. I am also extremely proud that this budget strengthens the SBA core service delivery system. We are investing in the successful delivery systems that we know get results for our customers—$88 million for small business development centers, $5 million for the Service Corps of Retired Executives, $12 million for women's business centers, $750,000 for National Women's Business Council, $750,000 for veterans outreach, $1.5 million for 7(j) technical assistance.

These proposals are part of our commitment to a new SBA with new ideas and new ways of serving our customers, new ways of reaching out like our Spanish language web portal, negocios.gov, and our business matchmaking events, new ways of fighting for things that small business owners need like less burdensome regulations and association health plans, new ways to help create an environment of success for small business.

That is the culture I want at the new SBA, and I am proud of the progress we have made. In 2003, the SBA approved 74,169 loans in our two major loan programs, more than ever before in our 50-year history, and almost a third of those loans went to minority business owners. In 2003, 2.1 million entrepreneurs received business counseling and technical assistance through SBA's counseling and training programs.

In 2003, the SBA's Office of Advocacy saved small businesses $6.3 billion in regulatory costs. In 2003, the SBA website recorded more than 54 million visits. In that same year, the SBA's disaster assistance loan program made almost 26,000 loans.

Now, those are real results, and that is what matters the most. Let me tell you why. At a business matchmaking event in Houston a few months ago, a businesswoman came up to me with tears on her cheeks. She said to me Mr. Administrator, I am not a statistic. I am a real, living, breathing business owner, and I want to thank you. After 9–11, it was an SBA disaster loan that keep my business open, and now I am here learning and make connections to make my business grow.

That is what is important. That reminds us of what our job really is. This is about real people and real lives. Our responsibility is great. I am proud of these proposals because I believe that they live up to that responsibility. I believe that they reflect an SBA that understands what is at stake. It is not about programs and statistics. It is about results measured by the success of our clients. I hope we can work together to get those results and help usher in more of that success for even more American entrepreneurs.

I want to thank you again for having me here. I would be glad to answer any questions you may have. Thank you.

[Administrator Barreto's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Administrator. The President's agenda for small business affects more than just the SBA, does it not? Could you explain what other parts of the President's budget request help small businesses?

Mr. BARRETO. Absolutely, Mr. Chairman, and I thank you for that question.

You know, we have had a wonderful opportunity this year to go around the country. In fact, I just came off of a trip where we did a regional event in Reno, Nevada. We did a business matchmaking event in Anaheim, and I flew in last night.

I want to tell you some of the things that we have been hearing all around the country. First of all, the small businesses are thanking us, this Administration, for creating the right environment for them to succeed. One of the things that they mention to us often is the appreciation for the Jobs and Growth package.

You know, a lot of people still do not understand that that Jobs and Growth package returned $10 billion into the hands of small businesses. Eighty percent of that benefit accrued to small business simply by lowering the top marginal tax rate.

We also quadrupled business deductions for those small businesses, and that helped a lot in getting that confidence going back up again and really started creating those jobs that we have been needing in our economy and those purchases that were not being made by small businesses.

I have to tell you that the top issue that we hear out there all across the country is association health plans. They still want access to affordable health care. They still feel that they have too many cumbersome regulations. They want us to do something about tort reform. They want us to do something about opening up new markets and new opportunities, unbundling contracts. There is a lot that is on small businesses' minds.

This budget helps us to advocate on behalf of those small businesses. We understand that they appreciate our programs and services, but they also expect us to be a champion for them. They want us to get it. They want us to understand what they go through every single day.

That is what we are hearing, and that is one of the reasons I am proud to present this budget to you because I really believe that it is going to help us to continue the momentum that we have built over the last year.

Chairman MANZULLO. Okay. Thank you.

We will keep the questions to five minutes, but, Mrs. Velμzquez, I am going to give you 10 minutes. I will double the clock on that for you.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Barreto, can you please list for the Committee the names of the programs that you asked for an increase in funding over last year's budget?

Mr. BARRETO. Well, the first program that we are looking at making a significant increase in, as you know, is the 7(a) loan program.

Ms. VELAZQUEZ. That is not an increase. You zeroed out. You did not ask for any money.

Mr. BARRETO. As you know, Congresswoman, we have several very important programs—the 504 program, the SBIC program—that also have zero subsidy.

Ms. VELAZQUEZ. Why did you mention 7(a)? You know quite well that that is not the case. Tell me about the women's business centers, the BDCs, venture capital, micro loan.

Mr. BARRETO. Sure. I would be happy to.

Ms. VELAZQUEZ. Let me go to the next question.

Mr. BARRETO. Absolutely.

Ms. VELAZQUEZ. In your January 8 response to the Senate, you wrote, and I quote, "Once SBA is able to reopen the program, we will take steps to ensure that every application is treated equally and fairly.'' You also stated that you look forward to working with us to rapidly resolve this issue.

Well, Mr. Barreto, many of those loans—over 750,000—were submitted on time before the cap was implemented, and yet they were returned by your agency. Three small businesses that are in this very situation will testify here today.

What can you tell these people, these small businesses that have traveled here to Washington in hopes of finding relief to assure them that the SBA will resolve their situation quickly and fairly?

Mr. BARRETO. I am very excited to tell them that we brought today a very important proposal that will help us greatly achieve many of the objectives that you just mentioned. This proposal that we are submitting today to expand the SBA Express program will mitigate a lot of the problems that you reference.

Ms. VELAZQUEZ. Mr. Barreto, please answer my question.

Mr. BARRETO. Yes, ma'am.

Ms. VELAZQUEZ. My question is based on a response that you provided to the Senate where you said that you will deal with those applications that were submitted on time before the cap restriction was invoked,——

Mr. BARRETO. Yes.

Ms. VELAZQUEZ [CONTINUING]These people made plans to expand their businesses, and they have been put on hold. So what are you going to tell them, that they have to wait until you submit a proposal? What do you know about the outcome of that legislative proposal here in Congress?

Mr. BARRETO. First of all, I am sorry. I want to make sure that I am very, very clear on your question.

First of all, we did have to return back applications that we received simply because we ran out of money. As you know, we were on continued resolution for the second year in a row. In other words, we did not have our budget approved, which would have helped us to be able to make some of those loans. We basically ran out of money.

The good news is that most of those loan applications have already come back to us. Most of those loan applications have already been approved.

I want to mention one other thing, Mrs. Velµzquez, Congressman Velµzquez. This is very, very important. Ninety-five percent of the loans that the SBA does are under $750,000. Only five percent of those loans are over the $750,000 cap. Unfortunately, those larger loans, which often times are for real estate and fixed assets, eat up a third of the money.

I am happy to tell you that now that we have a budget, we are not going to have a problem serving 95 percent of the small businesses that apply for loans at the SBA.

Ms. VELAZQUEZ. What are you going to do with those applications over $750,000 that were submitted before the restriction? I have an answer for you. I have a solution.

Mr. BARRETO. First of all, we have already processed most of those applications. They have already come back to us.

One of the things I want you to know is that as soon as we opened up the program, our lenders contacted us and said look, those applications that got sent back, can we send those back to you? We said absolutely, yes.

Many of those have already come in and have been processed. We work on that every single day to make sure that that backlog has already been dealt with, and it has been dealt with.

Ms. VELAZQUEZ. Okay. There are three business people that are here today. You are telling me that their situation will be resolved?

Mr. BARRETO. Congresswoman Velµzquez, I am not sure of the specific cases that you reference, but in every case we will do everything that we can to make the loan.

You know, one of the good things about the SBA is that it not only has a 7(a) loan program. We also have other loan programs as well that can accommodate those larger real estate loans.

Ms. VELAZQUEZ. It is quite simple. Their applications are for loans above $750,000.

Mr. BARRETO. We have a cap right now of $750,000.

Ms. VELAZQUEZ. But they were submitted on time. What are you going to do with those?

Mr. BARRETO. You know, one of the things is I think we have a chart here that I would like to show you. You know, one of the things that nobody could have anticipated is the spike in demand that we received during the holidays.

You see, for us usually we will see $25 million in a normal day. You can see from this chart here the incredible swings that we saw there at the break. We had some days where we were over $80 million, $100 million.

Ms. VELAZQUEZ. Excuse me. Excuse me. He gave me 10 minutes, and I have a lot of questions.

Mr. BARRETO. Okay.

Ms. VELAZQUEZ. For these three people, why can you not reprogram funding into the 7(a) program?

Mr. BARRETO. Well, one of the things that we did, Congresswoman Velµzquez, is we looked at the possibility of reprogramming some dollars, but, unfortunately, what we found out is because of the rules and the limitations we were not able to reprogram enough to get us to the level that we needed to be at to be able to absorb a lot of those larger loans.

It is one of the reasons why we still have a cap on the loans right now, and it is one of the reasons why we feel so strongly about the proposal that we have submitted today. You see, if Congress acts on that proposal we will be able to take that cap off immediately and be able to help those small businesses.

Ms. VELAZQUEZ. So, Mr. Barreto, your solution to this SBA created problem is to make this small business start the process all over again, go to the back of the line and repay application fees?

Mr. BARRETO. Absolutely not.

Ms. VELAZQUEZ. Lenders have already stated that under your new proposal they would not be able to make this type of loan, so a small business owner would be left to search for a new bank that is willing to provide them a loan. How is this fair? This is a non-starter, Mr. Barreto. This proposal is a non-starter. I can tell you that.

Mr. BARRETO. Well, I would like to explain because I think there may be some misunderstandings about the proposal.

You see, if this proposal is able to be enacted, we will be able to do some of those large loans because we are going to get about another $3 billion in budget authority, so I think there may be some confusion, especially in the short term, of our ability to do some of those larger loans.

Ms. VELAZQUEZ. Well, you have a lot of work to do because a lot of the banks are saying that they will not agree with it.

Mr. Chairman, this proposal would be submitted to us. We will have to conduct hearings, and we will have to mark it up.

Mr. BARRETO. I would be happy to continue to provide any information around this. We spent a lot of time thinking about this.

By the way, one of the reasons that we came up with this proposal is because of the things that the industry was telling us. They were telling us look, we need to do something to remove that cap. We need to do something that is going to make this program consistent and will be immune to these spikes in volume. We need to do something so that this program can grow this year; not only next year, but this year. This proposal allows us to do all those things.

Ms. VELAZQUEZ. This is a problem that was created by SBA. Quite clear, the Members of this Committee told you in your last budget that the funding that you were requesting was inadequate—you said no, it is fine—that you would be running out of money, and this happened. Now we are punishing small business for that.

Mr. BARRETO. One of the things I did was I brought a chart with me as well—I wanted to be prepared for these questions—that really shows you what the level of lending has been over the last five years.

You see, over the last five years, we have never had the kinds of volumes that we have had this last year. In a way, we are kind of a victim of our own success, but the reason that we had the problem is not because we decided to close down the program. The reason that we had the problem is we were on a continuing resolution because we did not have a budget approved for the second year in a row.

The reason that we had the problem is because five percent of the loans eat up a third of the budget authority, and that is why this proposal———.

Ms. VELAZQUEZ. Do you not have a budget now? Do you not have a budget now?

Mr. BARRETO. We do have a budget now.

Ms. VELAZQUEZ. But you still have a problem.

Mr. BARRETO. We are open for business now, and 95 percent of the loans are being made.

Ms. VELAZQUEZ. Let me go to the next question. Prior to the release of the budget, Mr. Barreto, could you explain to us at what point during your testimony before the Committee, during our negotiations with the SBA over the reauthorization or in any communication, either formal or informal, have either you or the Administration advocated allowing the claimed fee structure for the 7(a) loan program to lapse?

Mr. BARRETO. First of all, I want to be very clear on that point as well, Congresswoman Velµzquez. We are not increasing the fees.

What is happening is the legislation that Congress put in is expiring at the end of this fiscal year. All we are doing is going back to the original fee structure.

My understanding is the reason that legislation was put forward was to be able to incentivize these kinds of loans and to be able———.

Ms. VELAZQUEZ. What about the 504? Did it not expire too?

Mr. BARRETO. The fee structure on the 504?

Chairman MANZULLO. Talking about expiring, the time has expired.

Ms. VELAZQUEZ. Are you going to do the same with that?

Mr. BARRETO. I am sorry. With regards to the 504 program?

Ms. VELAZQUEZ. Yes.

Mr. BARRETO. We have actually a tremendous opportunity with the 504 program because we have $2 billion of additional budget authority that we never spent in the 504 program.

In fact, what is happening now is more of those larger real estate loans that were in that 7(a) portfolio are moving over to the 504 loan program, so we think that is a very important opportunity to help small businesses with the real estate and fixed asset loans.

Chairman MANZULLO. Mr. Bradley?

Mr. BRADLEY. Thank you very much, Mr. Chairman. It is certainly a pleasure to be here and certainly a pleasure to see you, Mr. Barreto.

I would like to just start out, first of all, by thanking you personally for intervening during this crisis time several weeks ago and making sure that a constituent of mine was given prompt treatment. It was an emergency closing and a lot of money at stake for him as it was a small business and a lot of personal savings.

Without your help and the help of your staff, it would have been a very real problem, so thank you. I know that given the budget situation and how we are waiting for the omnibus to pass, it was a very difficult situation. I just wanted to thank you.

As we look at difficult budget decisions and as certainly I have traveled around New Hampshire and there has been a lot of attention to New Hampshire recently, the small business owners I have been talking to have emphatically indicated to me that the bonus depreciation, the greater expensing limits, the reduction of the top individual rate which the small business owner pays, are critically important to their economic health.

Perhaps you would like to comment on that and how, you know, these incentives, these tax incentives for businesses that are hiring, that are trying to keep employees, are critically important, as well as the loan program and that we have to have a balance of both and that scarce resources cannot just be focused in one area.

Mr. BARRETO. Absolutely, Congressman Bradley. It is an honor to be able to help your constituent.

By the way, I would be happy to help those other constituents that are in this room to personally discuss their situation with regards to the 7(a) loan. If I could have their names and numbers, I will personally make sure that we follow up with them.

I appreciate your question and your comment, congressman, because you are absolutely right. A lot of people do not understand that small businesses shoulder some of the highest tax burdens.

You know, sometimes when you hear people talk about this tax relief it is like they do not understand that 23 million small businesses in the United States will get a tax relief of about $2,209.

Now, for some that may not seem like a lot, but for that small business who is trying to keep pace with the health insurance premiums or give an employee a raise or buy a software program, it is huge. You throw on top of that when you quadruple that business deduction, those kinds of purchases that were not being made before are being made now.

It is not an accident that the economy is starting to increase. You know, the President says all the time that small business is the engine that is fueling that because they are buying equipment. They are buying vehicles. They are buying technology. They are creating jobs. That did not happen by accident. It happened because this Congress, this President, worked together to create the environment for those small businesses to succeed.

If we really believe in small business, then we will give them back more of their hard-earned money because we know what they will do with it. They will put it back to work, and that is what we should be doing. That is what small businesses tell us, and that is what they tell the President of the United States.

You know, when the President of the United States goes around the country and meets with small businesses, he is not the one who is doing all the talking. He is talking to these small businesses and asking them the questions, and these are the kinds of things they are telling him.

I could not agree more with you. I think that we need to make the tax relief permanent for the small businesses so they can continue to fuel the economy forward.

Mr. BRADLEY. Thank you very much.

Chairman MANZULLO. Thank you, Congressman.

From the land of enchantment, Congressman Udall.

Mr. UDALL. Thank you. Thank you very much, Chairman Manzullo.

Chairman MANZULLO. From the Prairie State.

Mr. UDALL. From the land of enchantment. That is right.

Administrator Barreto, let me just begin by saying, and I think this in a way echoes what our Chairman and our Ranking Member just said, that we are very disappointed, I think, in certain respects with this SBA budget. I mean, you are talking about $120 million below what was requested last year, a 10 percent decline in program funding, zeroing out micro loan, 7(a), prime, business link, SBIR, rural outreach. I mean, these are significant changes in programs that I think many of us believe up here are good ones that help businesses.

Let me, first of all, just focus on one of those. In May of last year, a hearing was held on SBIR FAST, that program and the MEP program. In testifying about the FAST program, the SBA said, and I am quoting here. This is in the testimony. "The result is a strong knowledge base backed up by a network of professionals who support small businesses to become expert researchers and innovators and commercialize their innovations."

This testimony from your agency, this testimony certainly implies that SBIR FAST program is successful. What happened in the intervening months that led you to believe that the SBA should not request funding for this program?

Mr. BARRETO. Thank you for the question, Congressman. It is not really what happened in the last few months. It is really what has been happening over the last couple of years.

You see, we do believe in these programs, but one of the things that has been so difficult for us is that sometimes we will request funding for these programs and they will get zeroed out, and yet we still have the responsibility and there is an expectation that we are going to run these programs with no funding.

As you know, the SBIR program is an important program, and all agencies of government participate. This is a set aside program for research and development grants. Our part of it is really to help facilitate those opportunities, to really inform and educate small businesses how these programs work, and we are going to continue to do that through our incredible network that we have.

So, our commitment to the program is not necessarily going to end, but one of the things that we had to do is just face the reality that often times the appropriations for some of these programs are not there, and yet we need to continue to do the job for the small businesses that they expect us to do.

Mr. UDALL. The reality, Administrator Barreto, is that the appropriations were there. You did not ask for the money, and that is the fact of it.

A recent report of your Inspector General highlighted that the SBA had not provided sufficient measurable outcomes for FAST grant recipients. Further, the IG pointed out that the SBA had yet to receive performance reports from several grant recipients.

How do you respond to my concern that any failure of the FAST program has more to do with the failure of the SBA to implement the program adequately rather than any failure of the program itself?

Mr. BARRETO. You know, we work very closely with the IG. They obviously put out a lot of reports that we can be doing better. You know, a lot of times what we realize is that they are not aware of some of the things we are doing, so we have to sit down with them and make sure that we educate them on the deliverables and the results that we have accomplished on these programs.

Again, it is not to say that we are not committed and do not believe that there is benefit. You know, small businesses can play a very important role in the research and development that the government needs, remembering that 97 percent of all research and development that the government does is not part of the SBIR program and can still go to small businesses.

Mr. UDALL. The other part of this that you mentioned in your earlier testimony is the issue of continuing resolution. You have said several times here we have had no budget approved for the second year in a row, and we were on a continuing resolution and how it hurt your agency. Basically I think what you would probably tell me is a continuing resolution is a hard freeze. It hurts our ability to plan. We cannot move out and do things.

I think there are many of us on this Committee that are very disenchanted with our budgeting process, the fact that we are going into the fiscal years and not giving you a budget and then having that kind of thing happen.

You should know that that disenchantment is out there by many of us I think on this Committee, and I think we would be wise if we believed in SBA programs to fund these at the start of the fiscal year and give you the ability to plan.

Mr. Chairman, I just want to ask you to put my opening statement in the record and with that yield back and thank you very much.

Chairman MANZULLO. Without objection. I appreciate that.

Dr. Bartlett?

Mr. BARTLETT. Thank you.

Mr. Secretary, I would like you to know that your stewardship of the programs is recognized and appreciated. Thank you very much for your hard work and great successes. I have a couple of questions that deal with some of the detail of the budget and your program.

As you know, I, along with most of my colleagues on this Committee, are very supportive of the HUB Zone program. As America transitions through the so-called jobless economic recovery, far too many Americans are without work. The HUB Zone program targets the poorest areas of every state and brings good jobs and economic develop where we need it most.

That is particularly true in my district where in a very economically depressed area we have brought some jobs of very high calibre where they are being paid three and four times the average wage in that community, so it is a very successful program.

In my district, 36 HUB Zone certified firms produce more than $60 million in goods and services each year. These firms represent the job engines that create jobs where we need them most. Unfortunately, your 2005 budget submission cuts HUB Zone funding by nearly seven percent from 2004 levels, while increasing 8(a) funding by eight percent and increasing small disadvantaged business program funding by more than six percent.

Even more significant are the absolute numbers in these programs. The 8(a) program will receive $37 million in 2005, while the HUB Zone will receive less than $7 million, and that is in spite of the fact that there are 8,800 certified HUB Zone firms and only 7,300 8(a) firms.

For the past five years, the federal agencies have only achieved a small fraction of the statutory required minimum level of contracts for HUB Zones. Why will the Administration not adequately fund the HUB Zone program, which is an enormously successful program?

Mr. BARRETO. Thank you very much for that question, Congressman Bartlett.

First of all, let me say that we agree with you that the HUB Zone program is a very important program. What this budget does is it incorporates the funding that we would have for HUB Zone and puts it where we believe that it should have been all along—inside the government contracting and business development line item.

We are very proud of the increases that we are seeing in HUB Zones. We work very closely with HUB Zone firms and the HUB

Zone association. One of the things that we were concerned about is that sometimes that funding was going to be zeroed out altogether, and so to prevent that, to mitigate that, we have included the funding that we will put in HUB Zone inside of our GCBD area. That is included in there.

We think it is fantastic that there is more HUB Zone firms that are being signed up all the time. We think it is great that there are 8(a) firms that are being signed up all the time. As you know, we consider both of those programs at parody, not one more important than the other, even though 8(a) has been around a lot longer, the contracting is much larger there, even though there are less firms. One of the reasons there are less firms is the process of being certified for 8(a) takes a lot longer and is a little bit more cumbersome.

We are seeing some very good signs, Dr. Bartlett. Last year, the most recent figures available, we did an extra $1 billion to HUB Zone firms than the year before, and we see that trend continuing.

We work very closely with the industry. Yesterday I was in Anaheim at a business matchmaking event, and the HUB Zone organization was represented. HUB Zone firms were there meeting with buyers at the federal level and corporate level to get access to those contracts.

I want you to know that we are committed to this program. It is an important program for small business.

Mr. BARTLETT. Are you saying that you really have not cut the funding; you have simply moved some of it to another category?

Mr. BARRETO. That is right.

Mr. BARTLETT. Okay. You need to do two things. One is tell the world, the HUB Zone world, how much total money is available; that you really have not cut their budget if it is true that you have not cut their budget.

Mr. BARRETO. Right.

Mr. BARTLETT. The money is really there, and the program is being even better supported now than it was before. Will you provide us with the documentation for that, because our HUB Zone people are very concerned?

Mr. BARRETO. Yes, sir.

Mr. BARTLETT. Second question. If time runs out, you may submit this for the record.

Why was Mr. Maurice Swinton, who had strong support from small business technology companies, transferred from the Office of Technology where he managed the federal SBIR program to the Office of Management and Technical Assistance?

Is the transfer temporary and voluntary? If not, why not? Why is Mr. Swinton being transferred to a program that he may have little or no experience with?

Mr. BARRETO. First of all, Maurice Swinton has done a very good job for us in that program. One of the things that we have been doing over the last couple of years is moving people around. This is part of our transformation effort, our new SBA.

You know, the SBA is very fortunate to have some very talented individuals that can do a number of different things. One of the things that we have been very focused on is succession planning. We cannot always expect the people to always have to carry the load. We need to be able also to train people and make sure they can do a variety of different things.

The bottom line is we really needed Maurice in another program, and we were fortunate enough to have two individuals that could trade roles, if you will, to help us out. We appreciate the service that Maurice has given us. He has done a fine job. His replacement will do a fine job as well.

Please understand that this is no reflection on our commitment to that program.

Chairman MANZULLO. Mr. Akin?

Mr. AKIN. Thank you. Thank you, Mr. Chairman.

I think what I am picking up is that part of what we are seeing here in your proposal is an attempt to streamline the operation and to be able to deliver services more efficiently without the red tape and the hassle to the people that we are really serving with this sector of the budget.

Is that, first of all, an accurate summary of what you are trying to accomplish?

Mr. BARRETO. That is absolutely correct, Congressman Akin, and I appreciate the comment.

This is what SBA has been doing now for a long, long time. It is incredible, and I do not think that part of the story gets out. SBA has been doing incredible things, and yet it has been streamlining now for over a decade.

We break records every single year because we have good people, we have good programs, and we just do it better than we have ever done it before. We believe that we have not hit capacity yet. We can still do a lot more with this budget.

Mr. AKIN. With your track record of number of loans, in that way you are doing a better job. You are taking a look with this proposal at being able to do not only more loans, but more loans with less hassle and less paperwork.

To some degree, just because of the legislative process we create these stovepipe special programs. What you are saying is we can service those markets. We can do a good job for those people, but we are just not going to put it all into these stovepipe programs. We are going to put it all together and manage it more efficiently. I think that is what I hear you saying.

Mr. BARRETO. That is absolutely correct, Congressman. You know, with the small businesses, and we talk to thousands of them every year. They do not pay attention to the stovepipe. They do not care about the stovepipe. They just want to know is it going to be easier for me to get a loan, and, by the way, I may not need $1 billion. I may need $50,000 or $100,000. They want to know if they can get technical assistance when they want it, not when we want them to have it.

Last year we trained 2.1 million people. They want to know if we are bringing more opportunities to them, not something that is in a stovepipe, but maybe a new initiative like business matchmaking or some of the things that we are doing on line.

Mr. AKIN. In the case of these loans, are they pretty well distributed across the country in terms of geographically so it is not all just loans to Washington, D.C. business, but it is kind of a spread?

Is there good mix also in terms of the larger and smaller, the range, so that we are not just doing everything right at the max because it is easier from an administrative point of view to just do maximum loans?

Do we have good variety both geographically and in size of the scale of the loans?

Mr. BARRETO. That was one of the things I was the most proud of last year, Congressman Akin. We did more everywhere. We did 30 percent more loans to all American small businesses, but we did 38 percent more to minority small businesses.

There is a chart right here that I would like to share with you. Across the board, we did more to minorities and the African-American community last year. We did something in excess of 75 percent more loans. Yellow is the last year that we did. You can see how that spikes up over the previous two years. Hispanics, we did about 45 percent more loans. Asians, 30 percent more loans than the year before. We did more Native American. Women, 30 percent. Veterans, 20 percent.

We did more everywhere, and we got our average loan size down. When I first came on board, the average loan size at the SBA was a quarter of a million dollars. The average that a small business needs for working capital is $50,000 if you believe Inc. Magazine and their studies of it. That does not mean that we cannot do large loans. By the way, we did 20 percent more in our 504 loan program last year than ever before.

These changes that we have made are working, not because we say they are working, but because the outcomes we are getting for small business are so great, and the customers are telling us that.

Mr. AKIN. I really appreciate what you are saying, and I appreciate your taking an aggressive, and it may be that it is somewhat misunderstood because everybody has their little pet thing, but if the bottom line is you are able to do this kind of performance, you are getting more loans and it is for a diversity of different kinds of markets, a diversity of sizes of loan requirements, I think that is what we are all about. I really appreciate your good management.

Ms. VELAZQUEZ. Would the gentleman yield?

Mr. AKIN. No. You can go ahead and have your next 10 minutes if you would like, but I think my five are done.

Ms. VELAZQUEZ. It is still yellow. I just want the record to reflect that——

Chairman MANZULLO. There are 30 seconds left. Go ahead.

Ms. VELAZQUEZ [CONTINUING]The 7(a) loan program did $200 million less.

Mr. BARRETO. That is misunderstood, Congresswoman. Did you know what happened to those $200 million? A lot of the minorities that were getting those $200 million, they wanted larger loans. They wanted real estate loans. They wanted fixed asset loans. The $200 million went to the 504 loan program. We did $200 million more to minorities in the 504 loan program, so that is a little bit of a misnomer.

That $200 million did not disappear. The good news is we helped more minorities than ever before. We are very proud of that.

Chairman MANZULLO. Mrs. Kelly?

Mrs. KELLY. Thanks. Nice to see you here. Thank you very much for being here.

Mr. BARRETO. Thank you, Congresswoman.

Mrs. KELLY. I have really just one question, and that is in your budget I want to know if you have done anything that can help our returning service people.

When you are in the National Guard, if you are the owner of a small business and maybe you employ two or three people, when you go your business is gone. Is there something in there that is going to help those people reenter the business market as an entity?

Mr. BARRETO. Thank you very much for that question, Congressman Kelly.

You are absolutely right. I mean, we know this more than ever before. The people that are sacrificing the most for us right now are serving us in the armed forces. We have taken a very proactive, aggressive approach to making sure that they understand what their benefits are, what the opportunities are.

I will give you a couple of examples. We put a program together that we call MREIDL, military reservists economic injury disaster loans. It is a mouthful, but those are loans, low-interest loans for those businesses where an owner of a company is serving in the armed forces or maybe one of the employees are.

We did a tremendous amount of marketing and outreach. We did a lot of interviews on TV, radio. We are doing more than that. We are working very closely with the Department of Defense, with the Veterans Affairs. We have put in the hands of all returning veterans—not just the ones that we think are in business; all returning veterans—an SBA kit with all of the information on all of our programs and a couple of little mementos that we put in there. We have distributed 250,000 of those kits.

We are working right now with the Department of Defense to put kits together for 500,000 more service personnel, so this is very, very important to us. Last year we reversed a trend, a seven year trend of declining veterans loans. Last year we had an increase in veterans loans, and we are going to have an increase this year as well. It is one of the most important things that we can do.

If we are asking so much of these people right now in serving our country, protecting us, protecting our homeland security and fighting international terrorism, then we have to be there for them when they come back. I pledge to you the SBA will be there for them.

Mrs. KELLY. Thank you. I really want to applaud you on the business matchmaking program because I have found in my district and in other places where I have been small businesses get themselves certified, and then they do not know how to get in on the bid contracts. It is one of the reasons I have real problems with bundling.

I would applaud your efforts on that, and I hope that what you have done here is extend more toward educating the small businesses of America how they, too, can get in on the federal contract bids and win those bids. I think that is very important.

Mr. BARRETO. Thank you very much, Congresswoman.

Mrs. KELLY. Thank you.

Chairman MANZULLO. Thank you. We will take about a five minute break and then have the second panel.

Mr. BARRETO. Thank you.

[Recess.]

Chairman MANZULLO. The Committee is called to order.

The first witness will be Lee Mercer, president, National Association of Small Business Investment Companies. The red light, you know how it works. When it gets to yellow, you have one minute. When it gets to red, you are done.

Lee, I look forward to your testimony. There you are, right in the middle.

Mr. MERCER. In the middle of the group.

Chairman MANZULLO. If you could talk very closely to the mike, that would help.

Mr. MERCER. How is that? Am I being picked up now?

STATEMENT OF LEE MERCER, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES.

Mr. MERCER. Mr. Chairman, Ranking Member Velμzquez, Members of the Committee, the point I want to stress today is that the Participating Security SBIC program, by far the most active part of the SBIC program as a whole, will end effective October 1, 2004, if the Administration's proposal is adopted by Congress. We agree legislation must be passed. A restructuring must occur, but not the proposal of the Administration.

Today's hearing is the beginning of a critical path for the Participating Security program. My goal is to help the Committee understand why SBA's proposal will not work and why the proposal we have filed with the Committee will work for all stakeholders.

The Participating Security program is critical to the success of the SBIC program as a whole. Over $7.4 billion in Participating Security investments have been made since the start of the program in 1994. During the past 17 months, a critical period as U.S. business fought to recover from the recession, Participating Security funds invested $2.8 billion, a full 47 percent of the $6 billion invested by SBICs during the period.

Through January 23 of this fiscal year, Participating Security SBICs have accounted for 55 percent of all SBIC investments. Twenty-six of the 36 new SBICs licensed by SBA in fiscal year 2003, a full 72 percent, were Participating Security funds.

Clearly, the program is providing the equity capital Congress intended when it created the program in 1992 and increasingly so. NASBIC supports the $4 billion in Participating Security leverage authority for fiscal year 2005 that is proposed by SBA. However, NASBIC strongly opposes the program restructuring proposed by the Administration. That proposal simply will not work for talented management teams and knowledgeable investors. I cannot say it more plainly.

The current structure has worked for the private sector because there is a potential, and it is only a potential, for substantially enhanced returns to private investors investing in Participating Security funds versus non-SBIC funds if, and it can be a big if, the SBIC performs above an annual 12 percent level of profitability.

That potential for significant enhancement in the current structure is required to offset the many negatives associated with the program. Not the least of these are substantial up front fees paid to SBA, substantial risk posed by capital impairment and restricted operations regulations, SBA's preference in any liquidation event and the very real fact that private investors fare substantially worse than they would in a non-SBIC if the level of profitability falls below 12 percent.

S.B.A.'s proposal would destroy the balance of the current program in the following ways: First, SBA's proposal would require a current pay interest charge that is unheard of in funds making 100 percent equity investments, investments that provide the fund with no cash flow to pay current interest. The resulting mismatched cash flows is what got the SBIC program in trouble in the 1980s, leading to the creation of the current program.

S.B.A.'s proposal would result in UBTI, unrelated business taxable income, for tax exempt institutional investors, driving away the very investors SBA should want in the program. SBA's proposal would substantially increase the up front fees and preferred payments made to SBA before any payments to private investors. It would raise the level of profitability required for private investors to break even to at least 18.3 percent per year. The hurdle rate is a non-starter.

S.B.A.'s proposal would substantially reduce the percentage of remaining profits that went to private investors. Thus, SBA's proposal would increase all negative elements in the program while substantially reducing benefits for private investors.

N.A.S.B.I.C. proposed a restructuring that is simplicity in itself, prorata sharing of all profits and losses by all economic interests in the fund, including SBA. Based on 20-year venture capital industry returns and Treasury rates, this would work for all parties.

Structured as we propose, the new Participating Security program would stimulate investment in small businesses to the greatest extent possible during times of scarce capital availability. It would accomplish the mission at no cost, likely a gain to the government, attract the largest possible percentage of knowledgeable private investors and high-quality fund management professionals and create no distortion in private capital markets.

Chairman MANZULLO. With that, we are out of time.

Mr. MERCER. I am done.

Chairman MANZULLO. Thank you.

Mr. MERCER. I just did not get to read my thank you paragraph.

Chairman MANZULLO. That is okay. That is okay. I will note that for the record.

[Mr. Mercer's statement may be found in the appendix.]

Chairman MANZULLO. I am going to recognize Congressman Jim Cooper, who will introduce his constituent, David Pilcher from Nashville. Mr. Pilcher will then be the next witness.

Mr. COOPER. Thank you so much, Mr. Chairman. I appreciate this opportunity. I think that this Committee and this Congress can benefit from the testimony that you are about to hear.

David Pilcher is a fine man and a fine small businessman who has been seriously mistreated by the recent changes in the SBA 7(a) program. Mr. Pilcher is CFO of a 109-year-old, family-owned small business, a moving and storage company, a typical American firm. They were in the process of getting one of these loans when not only was the program capped, as you all are well aware of, but they outlawed piggybacking.

To me, two other very insulting and harmful things happened. Number one, as I understand it, this announcement was made at 5:00 in the evening of December 23, 2003. Now, is that a coincidence? No. I think that is an injustice. It is a slap in the face of every small business in this country that they could abuse the Christmas holiday to take away a valuable program like this.

Moreover, it is my understanding this company—you know, these SBA loan applications are not short and simple. It is a stack about six inches high. A lot of work goes into that material. They have not even been able to get the application back.

They applied for the loan. All this stuff happens. It is not their fault at all. We are going to lose the opportunity to create jobs in the Nashville area, and then they will not even give them their application back. This is a terrible injustice.

I know that this Committee is working hard to improve the program, to get the funding that it needs, but I am just embarrassed that this happened anywhere in America, much less in the Nashville, Tennessee, area.

Mr. Pilcher is here to give his outstanding testimony, and we appreciate that very much.

Chairman MANZULLO. Mr. Pilcher, we look forward to your testimony. If you could move that mike as close to you as possible? With the lights, when it is yellow you have one minute. Is this your first time testifying before Congress?

Mr. PILCHER. Yes, it is.

Chairman MANZULLO. You have a total of five minutes.

Mr. PILCHER. Thank you, sir.

Chairman MANZULLO. Thank you. You thought I said a total of one minute?

STATEMENT OF DAVID PILCHER, TED R. SANDERS MOVING & STORAGE

Mr. PILCHER. Thank you, Representative Cooper, for that introduction.

Chairman Manzullo, Ranking Member Velµzquez and Members of the House Small Business Committee, thank you for this opportunity to address you today regarding the SBA funding cap and related matters.

My name is David Pilcher, and I am the financial officer of Ted R. Sanders Moving & Warehouse, Inc., an agent of Allied Van Lines. We are a family run business, as you heard, with active participation by most of the owner's family, and we employ approximately 30 to 40 people. In fact, this will be, as he said, the family's 109th year in the business.

I joined the company about a year and a half ago. Shortly after that, we realized we could significantly improve our cash flow by refinancing the mortgage on our building. We were halfway through the 10-year term of our current mortgage, and interest rates were and continue to be very favorable.

After talking to several lending institutions without success, we contacted the SBA division of U.S. Bank in Nashville. We met with them and spent many hours accumulating the required paperwork. The outlook appeared positive for us.

In mid December, after doing virtually everything asked of us and within the required timeframe, we were told our application looked good and would receive approval for a new mortgage in the amount of about $1.5 million through the SBA 7(a) program.

Suddenly, in January, we learned that everything had been put on hold because of the SBA shutdown. Worse, when the program resumed, there was a cap of $750,000 with no additional participation or piggybacking allowed to make up the needed difference. That was only half of what we needed.

I cannot adequately express to you how devastating this bad news was for our company, but I am going to try. In effect, the rug had been pulled out from under us. Because this was a refinance, no alternative is currently available to us, including the 504 program. This SBA guaranteed loan would have freed up over $7,000 per month of real cash flow, almost $85,000 a year at the present interest rate.

To a small business like ours, this is a very significant amount of money. This money could be used in several ways—to improve and grow our business, which is hiring additional sales people, hiring labor staff, upgrading and adding to our truck fleet so we could bring in new business or upgrading our warehouse facilities.

I do not have to explain to you that this growth would also generate new tax dollars as well. Small business, as you know, is the lifeblood of this country, and it needs to be supported in positive ways wherever possible.

I realize we are not alone in this struggle. In one of our local papers, I read last week about a businessman who was trying to close an SBA loan also in a timely manner in order to purchase and remodel a building for a new business. I believe the reporter is here or was earlier. It was reported that he might lose a six figure downpayment because of these delays. That is a lot of money.

On behalf of Ted R. Sanders Moving & Warehouse and all the small businesses throughout this country, we urge you to restore the full funding for this program, restore the cap to the $2 million loan level and especially lift the piggyback prohibition.

Thank you for your time and attention, and I will answer any questions.

[Mr. Pilcher's statement may be found in the appendix.]

Chairman MANZULLO. Thank you for your testimony.

Our next witness is Don Wilson, president and CEO, Association of Small Business Development Centers. I look forward to your testimony.

STATEMENT OF DONALD WILSON, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

Mr. WILSON. Mr. Chairman, we appreciate being back with you again. On behalf of the 5,000-plus Small Business Development Center counselors and trainers around the country, we are very grateful for this opportunity.

I could not help but be struck by the comments of the Administrator, in which he kept talking about the struggles that SBA had in dealing with the continuing resolution--how being frozen at last year's levels or the previous year's levels was a burden that posed for them. Astoundingly, they are now proposing a budget that will allow them to spend even less.

It is shocking, in my opinion, to see the downgrading in funding for management and technical assistance programs at a time when the demand is greater than ever. The issue, Mr. Chairman, is really jobs and who creates them.

The reason we have a budget deficit is because people are not working. If they are not working, they are not paying taxes. Congress is absolutely strapped in how to fund education, health and so forth because for three consecutive years revenues to the Treasury have declined. That is the first time since the 1920s.

Now, if small business generates 52 percent of the GDP and nearly two thirds of the new jobs, and we do not have jobs for people to pay taxes so you have the dollars to appropriate, why do we keep cutting programs for small business? Small businesses are appreciative of the tax cuts that they receive. But if they cannot afford to buy $25,000 worth of equipment, raising the expensing allowance to $100,000 really does not do them much good.

Look at the numbers in my statistics that I provided in the testimony. I ask that my complete testimony be included in the record. Look at the small business sector of this economy compared to the world economies, and then look what we are investing in small business.

The Administrator spoke of the tremendous increase in loans that the SBA is making. Where do you think people go to get help filling out the forms that Congressman Cooper was just talking about? They go to the SBDCs and the Women's Business Centers. SBDCs are being cut. Women's centers are being level funded.

The New York SBDC, the Missouri SBDC, the Ohio SBDC, the Indiana SBDC, the Illinois SBDC-- They have dramatically less funding today than they did in 2002, and now we are proposing to cut them again.

SBDCs are flattered that we are viewed as one of the core programs, but as we watch management and technical assistance programs being eliminated, who is going to take up the slack?

Take, for example, Congressman Bradley's District. The SBDC in New Hampshire has not had a funding increase since 1997. There are 14 SBDCs in this country, including Delaware and the District of Columbia, which are here in the audience today. They have not had a funding increase since 1997, and SBDCs are expected to pick up the slack? We are closing centers and laying off counselors.

Two million Americans have been jobless for 26 months or more, the highest level of long-term unemployment in two decades. These people are out of desperation turning to self-employment. They do not know how to start a business. They may have a skill, and they are coming to the SBDC. Our productivity levels are the highest we have ever seen. We cannot continue to do more with less. We have been doing that for the last six years.

This Committee is the only committee that can get the attention of the budgeters and say you are simply not allocating enough for small business. It is not a matter of whether we get a tax cut. The issue is what is small business getting out of the dollars that are going into the Treasury. Every year, they are declining. We would submit that is the wrong message to send to small business in this country.

Mr. Chairman, we implore you and this Committee to speak to the budgeters. Ask for a fairer allocation of funding for management and technical assistance programs, so that those men and women who are unemployed, and those men and women who are trying to keep their businesses alive in the face of higher energy costs and higher health insurance costs can survive and create the jobs this economy must have.

Thank you very much.

[Mr. Wilson's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Mr. Wilson.

Our next witness is Mr. Chris Crawford, executive director of National Association of Development Companies. I look forward to your testimony.

STATEMENT OF CHRIS CRAWFORD, NATIONAL ASSOCIATION OF DEVELOPMMENT COMPANIES

Mr. CRAWFORD. Thank you, Mr. Chairman. Good afternoon. I am pleased to provide a comprehensive written statement on the SBA's 2005 504 program budget request and ongoing performance objectives. I would like to comment this afternoon on 504's desperate 2004 reauthorization situation.

N.A.D.C.O., CDC members and first mortgage partners provided nearly $8 billion in long-term capital to job creating small businesses last year representing a 27 percent increase from 2002. This is a clear tribute to the growing demand for the SBA 504 program and the capital needs of America's small businesses.

Our industry thanks Chairman Manzullo and Ranking Member Velµzquez for your support by temporarily reauthorizing the 504 program until March 15 of this year. Your actions have kept our program open. Our program receives no appropriation and is solely dependent on fees which must be reauthorized or we will be shut down on the 15th.

The number one issue for the 504 industry is House passage and enactment of the SBA reauthorization bill. Mr. Chairman, we understand that your negotiations with the staff of the Government Reform Committee have proved successful and that all the issues have been concluded on the contract bundling question.

We urge you to work directly with Chairman Davis to finalize the deal and then move the bill to the Floor under an open rule if necessary to ensure its timely passage to keep 504 alive.

Thank you.

[Mr.Crawford's statement may be found in the appendix]

Chairman MANZULLO. Thank you.

Our next witness is Anthony Wilkinson, president, National Association of Government Guaranteed Lenders.

Anthony, you have an apartment out here now?

Mr. WILKINSON. I am working on it.

Chairman MANZULLO. You are working on it. We look forward to your testimony.

STATEMENT OF ANTHONY WILKINSON, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

Mr. WILKINSON. Thank you, Mr. Chairman, Ms. Velµzquez, for having me back. As you know, I testified before this Committee a couple of weeks ago about the SBA shutdown of the 7(a) program and how many applicants have been adversely impacted by the actions taken by the Administration.

Since that hearing, basically nothing has changed. There are still many, many small businesses who cannot access capital due to the lending restrictions on the 7(a) program. You have already heard from one, and you are going to hear from three other small businesses who have been harmed by the 7(a) program restrictions.

I want to personally thank all of them for taking the time away from their families and businesses and coming to Washington to represent small businesses. Their stories will put in real life terms just what the unfair actions taken by the Administration have done to them. They are very, very interesting stories.

These businesses are from all over the country. They are different types of businesses, but the one thing they have in common is that they needed SBA assistance to meet their financing needs, and the SBA, who we thought was there to help them, is now not there.

Rather than cover my written testimony, I thought I would take the balance of my time and just respond to some of the statements made by the SBA Administrator. He said that the industry has said we need to get the cap lifted, that we need to get restricted lifted. He is exactly right. There are borrowers all over this country who do not have access to capital, and we need to find a solution quickly so that we can get the loan cap lifted and the piggyback restriction lifted and we can get back to meeting their financing needs.

The Administrator also said: "We had to return loans." That is simply not true. There have been other funding shortfalls in the past. The SBA never returned the loan applications. They simply would process them up to the final point of approval, put them in a queue and as funding became available start funding those loans in the order that they were processed.

The Administrator said that we processed all loans that have been resubmitted. I can tell you that there are some folks sitting at the table with me today whose loans were not processed.

The Administrator said we never had volume like this. There was no way to anticipate the kind of loan volume we had. Mr. Chairman, from their website it says they did $11.3 billion in lending last year, and there was a $500,000 loan cap in place for five months. They probably would have done close to $12 billion last year, so, yes, they knew what loan volume was.

There was some talk today about a new proposal being rolled out. We have not been briefed, nor were we consulted about what impact the changes in the proposal might have. I am beginning to wonder if this was an attempt to deflect any kind of heat that the Administrator might have gotten because their fiscal 2004 budget was a bust and the fact that the actions taken by the SBA earlier this year have financially harmed many small businesses. We cannot get away from the fact that many small businesses have been financially harmed by the actions taken by the Administration.

The Administrator said five percent of the number of loans or 30 percent of the dollars fall in loans of $750,000 or more. That number would have been higher had we not had a loan cap in place this year and for the five months in last year.

The Administrator said the new proposal is a savings for the taxpayer. From the fiscal year 2005 budget information, you will see that borrowers and lenders in the 7(a) program have been overcharged $1.2 billion—that is B for billion—in this program since the start of credit reform.

This program has been in effect at a zero subsidy rate for quite some time. Before we consider alternatives to address the funding shortfall, I think we need to take a look at the subsidy model. I am under the impression that Congress had asked GAO to validate and do a study of the econometric model to make sure that it was statistically valid, to make sure that it was fair, that it was reasonable.

Last I heard, the SBA had not been cooperative in providing the information that GAO needed. I know that Senator Snow's staff had to contact the White House asking them for help in getting SBA to turn over the data necessary for them to do their study.

I think before we discuss any options, we need to make sure that the model is validated, that it is fair and it is reasonable.

Mr. Chairman, I would be happy to respond to any other questions.

[Mr. Wilkinson's statement may be found in the appendix]

Chairman MANZULLO. Thank you very much. You know, Anthony, that I held the SBA Administrator and the head of OIRA hostage here to bring about a resolution on an issue that involved disaster loans to travel agents.

We have always considered ourselves to be a very active organization here. The budget parameters are there. Stuff is going to be moved around within the budget itself, okay, so nothing is set in stone just based upon the President's budget itself. It is simply a guideline.

The next witness is Mr. Phil Pegg, Jr. from 4D Solutions in Boyertown, Pennsylvania.

Mr. PEGG. Thank you, Mr. Chairman.

Chairman MANZULLO. We look forward to your testimony.

Mr. PEGG. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

STATEMENT OF PHIL PEGG, JR., 4D SOLUTIONS

Mr. PEGG. Good afternoon, distinguished Members of the House Small Business Committee. On behalf of 4D Solutions and the small business workforce of the United States, I appear before you in a time of crisis seeking your assistance; a crisis that has originated from the very government administration which was formed to support and protect the small business community.

As you know, the SBA has imposed a recent cap on the 7(a) loan guarantee program. This imposed cap will have devastating consequences for small businesses like ours. Please allow me to explain in the hope that this cap may be immediately repealed.

We have three specialized export working capital program loan guarantees through the SBA's U.S. Export Assistance Center located in Philadelphia, Pennsylvania, as well as an SBA disaster loan. For the last seven years, the SBA has told us that we could renew our loans as many times as necessary. We subsequently built our business model around that understanding.

Two of these loans were signed and approved for renewal on January 4, 2004, and had received a loan number. It was only after we had received approval that the SBA informed us that there was a cap, and we would not be renewed. We were told that SBA upper management decided to cap the 7(a) loan program to $750,000. Our loans exceed the $750,000 cap.

It is one thing to give borrowers a 12 month warning and a fighting chance. It is something entirely different when you present companies with no warning at all. The manner in which this cap has been imposed is effectively designed to hurt or mortally wound those small businesses that currently hold loans that are in excess of $750,000.

In other words, if these loans cannot be renewed due to the cap, they would subsequently become unguaranteed, and the lenders would undoubtedly call them in, effectively putting us out of business.

The EWCP loans have been the lifeblood of our firm. For over seven years, 4D has worked with the SBA, from the firm's inception to one of our crowning achievements, being presented in Harrisburg with the Pennsylvania Governor's Exporter Excellence Award for 2001. 4D has even been used repeatedly by the SBA as a success story in their own newsletter.

Our firm provides mission critical, interactive computer based training to the Royal Saudi Air Force. Most of these contracts are 18 to 24 months in duration and worth in excess of $1.5 million. Our solutions have been chosen over Lockheed-Martin and British Aerospace, just to name a few.

Make no mistake. The larger companies still have a huge advantage. They have money to spend in up front costs of developing and training programs for a major military aircraft. The SBA leveled that playing field. Without them, we could have never borne the initial start up or operating cost from one contract to another.

Now the irony is overwhelming. The SBA, who was so instrumental in our growth and success, in one stroke will be responsible for our demise and certainly many others like us.

Everyone knows that small businesses are the number one job creator in this country. Our business is located in Boyertown, Pennsylvania, a community that survives on small businesses just like ours. We hire people and buy goods and services all within 20 miles of our office. There is little doubt that this cap will impact our community and others.

This cap also sends a clear message to the Saudis we work with that the United States is pulling back on their financial support of international business relations with Saudi Arabia. It has taken us years to build up a track record of trust with them.

We examined all the other options, including EX-IM Bank, but they cannot legally finance military projects. As a result, my bank and the SBA are my only resource. I must add that our track record as a borrower has been excellent. We pride ourselves on being responsible corporate citizens, and today our firm has never missed a loan payment or by our own action put in jeopardy one of our guaranteed loans to the SBA.

In conclusion, at a time when America is losing its isolationist way of doing business and expanding our great economy globally, it just does not make logical sense to drop the funding to a program that has made a huge impact on my firm's ability to expand internationally.

Therefore, I ask you to immediately remove this newly imposed cap and expedite the funding of the SBA's 7(a) program, as well as the funding of the Division of International Trade and USIACs across the country.

Thank you.

[Mr. Pegg's statement may be found in the appendix]

Chairman MANZULLO. Thank you very much.

The next witness is John Sprague, managing partner, Everglades Adventures at Pahokee, Florida.

Mr. SPRAGUE. Yes, sir. Pahokee means grassy waters.

Chairman MANZULLO. It means grassy waters?

Mr. SPRAGUE. Yes, sir.

Chairman MANZULLO. We look forward to your testimony.

STATEMENT OF JOHN SPRAGUE, EVERGLADES ADVENTURES

Mr. SPRAGUE. Chairman Manzullo and Ranking Member Velµzquez, thank you very much for the opportunity to testify before this House Small Business Committee.

I am a managing partner of Everglades Adventure Company, LLC, that is based in Pahokee, Florida. To give you a little bit of quick background, this is in Palm Beach County's other coast. It is basically rural glades. We rely primarily on agriculture, a lot of sugar.

The city itself has a population of about 6,000. It is a poverty level of 29.4 percent of the population, a per capita income of $10,346. The mayor and city council felt that the only saving grace that the city may have to be able to pull itself up from this poverty is its location on Lake Okeechobee. Because it did not have the expertise to develop the waterfront, it did an RFP to bring a company in. We came and answered that.

What we are attempting to do is build a first-class recreational resort on the edge of Lake Okeechobee and bring tourists as the dollars needed for the city to build the city back up to what it was at one time. We have been doing very well in the development. It is ahead of schedule. However, one slight problem has arisen.

We are located on state lands. When you go for conventional financing, you cannot encumber state lands, which means the normal finance package for us we cannot obtain through traditional banks.

The SBA 7(a) program was the program that fit exactly what we needed. Our loan for $1,709,000 would have pretty much put the project very close to completion and additionally on toward doing 25 direct full-time jobs and 90 created in total in the area.

However, to give you an idea if we could get the other financing based on the $750,000 cap, our payments for that $1.709 million under the 7(a) program would be about $11,807 per month. If we did it with a $750,000 cap and went to conventional based on the short terms we would get, those payments now climb to $24,057 a month, which basically makes the project untenable and unprofitable to do.

We are very concerned that this type of action by the Administration at this point is very harmful to business aside from our individual project. It affects minorities. It affects actually the City of Pahokee to be able to pull itself out of its economic condition and bring it back to the area where so many of its residents presently are not on subsidies.

Secondly, it is very important to the State of Florida. Governor Bush has given us economic grants, along with Palm Beach County. Of course, he spearheaded the project in getting us the permission to do it on state lands and also waived all of their fees so the City of Pahokee would be a 25 percent profit maker as part of our company.

The project is coming along fine. We are hoping that everybody on both sides of the aisle, as well as the Administration, looks at this program and says you know, we might have made a mistake here. This is actually harming small business. It is harming minorities. It is harming companies all over this country.

Then to have us find out that really there is no subsidy to this program, that the overpayment in fees has made it self-supporting, definitely I believe would make it a reason that you need to relook at this program and put it back to where it was before so my company, along with the rest of them around the country that need this kind of funding to be able to provide the jobs for our towns and our cities and allow people that live in poverty to pull themselves up to a decent wage can continue to happen in this country.

Also, I would like to say that Mayor J.P. Sasser has come with me, and if possible I would like to give him a minute.

Chairman MANZULLO. Why do you not have him stand up so we can recognize him? There you are. Thank you.

Mr. SPRAGUE. Would it be possible, Mr. Chair, to have him just speak for a minute from a city perspective?

Chairman MANZULLO. You have 50 seconds left. Come on down. State your name and spell it for the record, Mayor.

Mr. SASSER. Okay. I am Mayor J.P. Sasser, and that is S-A-S-S-E-R. I want to thank you for this opportunity.

What Mr. Sprague said is very true. We are a very small city, predominantly African-American and Hispanic. Our primary employer is sugar, and the 90 jobs that Mr. Sprague will offer have just been offset by U.S. Sugar laying off 97 people this past week.

What we are doing is we are sinking, and we are sinking fast. We have hitched our wagons, so to speak, on our development of our marina and campground, and we are hoping our downtown redevelopment and our economic revitalization will be successful because of that.

Thank you very much.

[Mr. Sprague's statement may be found in the appendix]

Chairman MANZULLO. Mayor Sasser, thank you very much for adding to the testimony.

Our next witness is Mr. Elliot Moses, CEO of Daco Enterprises, from Sandy, Utah. We look forward to your testimony.

STATEMENT OF ELLIOT MOSES, DACO ENTERPRISES

Mr. MOSES. Thank you, Mr. Chairman, Congresswomen, Congressmen, ladies and gentlemen. Thank you for this opportunity to tell my story. I hope this effort will result in areas of change and possibly even some rectification of the issue for my company.

My wife and I had been nearly a year in negotiations to buy Daco Enterprises, Inc. We had a letter of intent, and we were very close to signing the final deal. Applications were made at several banks for $1.3 million. Our presentations were very strong, showing over $1.5 million of equipment and collateral plus a sizeable amount of cash that we were injecting.

Funding proposals were entertained, and we down selected to two. One was an SBA 504 and the other an SBA 7(a) loan guarantee. By mid December of 2003, we had everything together and submitted to the commercial loan officer. It was processing through Bank One's preferred lender program. This program expedites the processing since the bank's approval criteria has been preapproved by the SBA to meet the SBA's underwriting requirements.

We were told that the SBA's stated service level agreement to provide a funding number is 24 hours. On December 23, the SBA notified Congress of their intent to establish a loan cap for loans approved by the SBA on or after January 8, 2004. This is 15 days, as required by Congress. The choice to include so many holidays in this notice period is unmistakable.

On the 26th, Bank One approved our application for SBA eligibility. The final SBA application package was sent to Utah for our signatures on December 30. Four business days later, on January 5, the originals arrived at the Tempe, Arizona, Bank One loan coordinator's desk. She requested the SBA authorization number, and the SBA faxed back a control number the same day indicating they had received the package and it is in their funding queue.

Based on the assurances that funding would indeed be there, we closed on the business on January 8. The next morning, we received the shocking news of what the SBA did. On January 6, the SBA shut down funding. On the 8th, the SBA faxed a notice dated January 5 to Bank One with a control number indicating that the funding had been stopped, that the application package would be returned to Bank One and removed from the SBA queue.

It is very strange that the notice would be dated January 5. It is not clear whether that was inadvertent or deliberate. If the latter, it conflicts directly with congressional mandate.

By being bumped out of the queue, it is the SBA's intent to delay the dissipation of their funds, but in actuality it denies us legitimate opportunity to funding due to the loan cap which we no longer fit under.

In order to rescue our deal, we obtained bridge funding for the full amount. The concept was that the full authorization bill would restore funding and the old caps. The bank incurred and advanced us the funds. When the bridge funding is due to be paid back in less than three months, we must either have new funds in place or be foreclosed upon. I understand that we cannot apply under the 504 program because we have received bridge financing.

In the worst case, this will mean 25 persons will be out of work. We will be financially ruined, if not totally bankrupted. The previous owner does not have the funds to step in in front of the bank and also stands to lose a sizeable sum in deferred payments, thereby decimating his retirement plan.

In the best case, Congress will cause the SBA to remedy the effects of their misapplied funding curves or, even better, raise the funding caps to allow more significant business formation than ever before.

For ourselves, we wish the SBA would place us back in the queue where we originally were and simply fund that which we were mere hours from funding. This is the fair and correct method that should be applied in what I am to understand is about 200 cases. The lower funding cap should apply to those that apply on or after January 8, as Congress intended the notification method to operate.

Let me tell you a little bit about Daco with the spare moments remaining. We are located about 15 minutes from downtown Salt Lake City, Utah, in a high tech corridor that has invented television and the first implanted artificial heart. It has also been the birth of WordPerfect and Novell and many other companies.

Therefore, it is no surprise that Daco is a high tech, high tolerance machine company with laser welding and engraving capabilities. We serve the aerospace, electronics and primarily the medical industry. Your next x-ray may come from equipment with our parts in it. Your relative's chemotherapy may come from an implant we machined. The Air Force can get some parts only from us.

Our employees make good skilled labor wages. None of our employees are paid less than $10 an hour. We have the benefits in the top five percent of our state. We added one new employee last month and are adding another this month. Our backlog has already jumped 25 percent this year. We are looking to spend more than $100,000 on new equipment this year and half a million dollars over the next two or three years, all financed conventionally.

We and companies like us are the ones putting jobs into this recovery. Well, that is, unless things are allowed to remain as the SBA has made them.

I beseech you, the Members of this Committee, the SBA and all Members of Congress to allow businesses like ours to do what we do best, which specifically includes creating new jobs, paying significant taxes and growing our economy further with capital spending. Many countries would like to have these manufacturing jobs. Please do not make another reason to send them there.

I thank you for this opportunity to address this Committee and thank the staff for their most kind treatment.

[Mr. Moses' statement may be found in the appendix]

Chairman MANZULLO. Ms. Velµzquez, I am going to let you ask the questions here because we are going to run out of time.

Ms. VELAZQUEZ. Why can we not go vote and come back here?

Chairman MANZULLO. We can come back, but why do you not go ahead?

Ms. VELAZQUEZ. I would prefer for Mr. Ballance to go first.

Chairman MANZULLO. Mr. Ballance?

Mr. BALLANCE. Thank you very much, Mr. Chairman and Ms. Velµzquez.

Gentlemen, I did not hear all of your testimony, but I think I know the issue. Some have told us that you can get this money from regular channels, regular banks. Is that true? You do not need the SBA 7(a) program.

Mr. SPRAGUE. In our particular case, sir, we cannot because we are located on state lands. You cannot encumber state lands. Therefore, normal banks will not do most of the things that we need to do there—infrastructure, buildings, sewer extensions, the kinds of things that we need to do to expand the building. Where normally you could finance that conventionally, they will not do it.

Mr. WILKINSON. I would venture a guess that none of these gentlemen would be here today if they could have gotten conventional financing.

Mr. BALLANCE. Well, that is my thought. How do you feel, and I am just going to ask a couple of general questions. How do you feel that you have been treated in terms of getting notice regarding the cutbacks and the cutouts and the fact that the loans would not be available?

Mr. SPRAGUE. Putting this project together has been very lengthy because we are also located on the dike or the U.S. Army Corps that surrounds the dike, so we had to go through months and months of engineering for the Corps to make sure that we would not in any way cause any breaks or whatever in their dikes.

This process of putting everything together with grants, with Florida, Palm Beach County, getting approvals, permits and everything else, of course, has gone through a very long process. Of course, the final designs could not be completed until we knew what permits and how exactly we could design and what we could do. We had to go through that process before we could even apply to SBA.

I have been a Republican my whole life. I just never thought in my entire life cycle that what I believed stands for that we support small business, that they would look at a program that actually hurt small business. I just never thought that anything would happen with this program. It is a good program. It fits a niche need in this country that you cannot necessarily get with conventional financing.

It came as a total surprise, and I will say the number of days with Christmas probably is not the way to treat free enterprise and additionally that they would need that short—I mean, they must have known that they were headed for problems. I would say that they could have given a lot further notice than what they gave business.

Mr. BALLANCE. Let me ask one specific question. I did not hear your testimony, but as an exporter could you elaborate on why financing from the Export-Import Bank is not an option for 4D Solutions?

Mr. PEGG. Yes, of course. EX-IM Bank will not allow us to produce any kind of military training, military product and export it within their financing guidelines.

Mr. BALLANCE. I am getting a little help from my staff here. Mr. Pilcher, how will not receiving this loan affect the long-term viability of your company? Is the 504 program an alternative for Sanders Moving? What about a conventional loan?

Mr. PILCHER. Well, for starters, the 504 program does not even apply to our situation because it is a refinancing, so we do not even meet the guidelines for 504.

This time of the year is traditionally a slow time for the moving industry, the moving and storage industry. We were really counting on this loan being in place last month because it would have made this month a lot more bearable than it has been and it is going to be.

As I indicated earlier, every month of delay is costing us over $7,000 that we are having to spend maintaining our current loan situation. That is money that could be used to add new employees, to add a truck, put another crew on the road, take on new business and help make our company more profitable.

Mr. BALLANCE. Thank you.

Chairman MANZULLO. We are going to have to break and then come back here. We live by the bells here. We hope to be back in about 15 minutes.

[Recess.]

Chairman MANZULLO. Mrs. Velµzquez?

Does anybody here have to catch a plane right away?

[No response.]

Chairman MANZULLO. All right. Go ahead.

Ms. VELAZQUEZ. Tony, people assume that if you are a successful business, small business, you do not need the 7(a) loan program. Can you tell us why successful businesses do need the 7(a) loan program?

Mr. WILKINSON. Yes, ma'am. There would be a host of reasons. It could be that it is financing of collateral that will have a very specific nature like a single purpose facility or collateral that would not be readily liquidated if it was repossessed.

It is businesses where they are doing well, but they have some kind of credit deficiency that the lender turns to the SBA and that guarantee that the SBA provides to mitigate whatever the risk might be.

Yes, we hope they are successful businesses because that is why we are financing them. We use the SBA guarantee to mitigate the risk in the transaction.

Ms. VELAZQUEZ. Thank you. The Administrator said SBA's solution will permit the small businesses that are here today to get their loans approved.

I know you do not know the details of the proposal or the particulars of these businesses' applications, but can you tell us from what you know today whether these businesses will get their loans approved?

Mr. WILKINSON. With a 50 percent guarantee, I would bet at least two of them would be denied. Again, I do not know all the details of the application.

Ms. VELAZQUEZ. What is the percentage?

Mr. WILKINSON. Two of the four.

Ms. VELAZQUEZ. Two of the four?

Mr. WILKINSON. I think a third one could have perhaps been served if the piggyback restriction had been lifted and they could have gotten a piggyback first mortgage even with the cap in place.

Ms. VELAZQUEZ. Thank you.

Mr. Sprague, it is my understanding that your community was designated as an area for economic development by the State of Florida, and they contributed a significant amount of resources to this project.

What was the state's response when they found out that the federal government was pulling funding?

Mr. SPRAGUE. They do not know. I am meeting with Governor Bush's staff on Monday in Tallahassee. I think this has been one of the best kept secrets at this point.

I think it is a matter that a lot of the Members just do not understand this is going on, number one, because they just have not looked through all the budget at this point. Secondly, even if you read something, unless you are familiar with the program you may not necessarily understand the impact. I think it is a matter of educating both sides of the aisle on this issue.

We have a declaration that Pahokee is an area of critical economic concern, and they have helped us the best they can. The county has done the same thing. I am quite sure that when the Governor's office finds out about it, hopefully we will be soliciting his help.

Ms. VELAZQUEZ. Maybe the Governor of Florida knows someone here in Washington.

Mr. SPRAGUE. I am going to ask him that question.

Chairman MANZULLO. Mr. Moses?

Mr. MOSES. Yes?

Ms. VELAZQUEZ. If you were to lose SBA financing for your project, what are the chances that some of your customers will look elsewhere and take their business to some of your foreign competitors?

Mr. MOSES. Without the financing from the SBA, we will not have the working capital available to buy the machines that we plan on buying. We are talking about some pretty sophisticated, high tech machines. They are very close tolerance. They are multi-axis machines. We try and buy American wherever possible. Sometimes the stuff is not available.

I will tell you. There are foreign countries that would love to have that kind of equipment and that kind of stuff located in their country and produce it there. We are trying to make it American made.

Ms. VELAZQUEZ. Mr. Moses, can you please elaborate on why you are not eligible for the 504 program?

Mr. MOSES. Being caught between closing and pulling the funding right thereafter, we had to do something quick because we were in the middle of the contract period. We had to fund the purchase.

The 504 program does not allow for the bridge financing that we received. It would then be determined to be a refinance.

Ms. VELAZQUEZ. So if you do not receive the funding through the 7(a) loan program, what effect will this have on your employees?

Mr. MOSES. In the worst case, we would have to shut down. We would lose 25 employees. If we were able to find some other financing of some nature, it is not going to look nearly as good.

The cost on our working capital would probably eliminate our entire capital budget. We would not be buying any more machine tools and doing any more business, and we probably would also have to do some layoffs because we may not have the equipment to replace other equipment and continue producing what we produce.

Ms. VELAZQUEZ. You mentioned that this was a unique product. Can you please explain to the Committee why a conventional loan would not work?

Mr. MOSES. With a conventional loan, they rate buyouts as much more risky, and they assign a much higher interest rate to them. We also get much shorter payback terms.

One of the things we were looking for from the 7(a) program was the generous payback period. That payback period made the difference between growing or shrinking if we had to go even partial conventional, which a 50 percent guarantee program would do as far as weighting of the components.

Ms. VELAZQUEZ. Mr. Sprague, can you please explain to the Committee why a conventional loan would not work for you?

Mr. SPRAGUE. There are two parts to that. The biggest part is that the infrastructure which we are expanding in all areas in cabins and buildings and sewer connections and electrical and upgrades to the marina, building buildings, our development is spread over many, many facets. Part of them we have pieces of grants for and whatever, so it is kind of complicated, number one.

Number two and the biggest reason is when we turned to conventional financing they looked at the project. They looked through our paperwork. They looked at our balance sheets. They looked at income, our business plan, and said you are excellent. Wait a minute. You are on a lease. You are on state lands. I am sorry. We cannot do your loan.

Here is who can. The federal government has a loan program which is really designed for this type of thing. That is where you need to go because we are unable to fund you.

Ms. VELAZQUEZ. The small business people that are here who applied for a 7(a) loan and have not been able to successfully get it because of the unique circumstances, are your employees aware of what is going on? What is the morale?

Mr. PEGG. Our employees have just become aware, and they think we are going out of business.

Mr. PILCHER. Our rank and file employees are not aware of the refinancing activities we are trying to do. We have a very small office staff, and I am sure just about everybody in the office knows what is going on.

Three-fourths of the people in the office are related, family related, so they are all aware of it. As I mentioned earlier, in addition to the owner there are four sons who work in the business, and we are all on the same management team. They are all aware of it.

I spent the better part of my first year with the company trying to arrange conventional refinancing. We just could not get the terms we needed. In some cases they would not even talk to us at all.

You know, this really was going to be a life saver program for us. The monthly payment is about two-thirds of what our current payment is. As I mentioned in the testimony, we are going to have to refinance it anyway in a few years.

We could possibly struggle along for another four years, but this really would have helped us grow the business and get out of some of the problems that we are in.

Mr. SPRAGUE. In our case, most of the employees have not been hired yet. It is not just our employees. All the businesses downtown and the building owners are all expecting our project to be the catalyst for the city.

It is not just whether or not how our employees feel. It is that this was the catalyst for the whole downtown of the city. If we cannot generate the catalyst, what is the impact to the city, to all the residents of the city? It has major impacts at the end of the day.

Mr. PEGG. I would like to add one thing for the record. We approached several lending institutions over the last seven years and discussed with them other more traditional options.

The 7(a) program, as I put down in our testimony, has been critical to our company because our company is built on knowledgeable capital. We do not have smokestacks. We do not have plants. We do not have lots of capitalized equipment. We have lots of very smart, hard working people that get together and design and put together these projects and deliver them in an interactive, multimedia format to the people of Saudi Arabia.

That said, these projects in their nature, in their very nature, take anywhere between 18 and 24 months to complete. The sheer amount of expense that it takes to ramp up, getting everybody together, traveling over there, collecting the data, shooting the video, creating the graphics, creating the animation. We become this organization of highly motivated, hard working people, but again we are in a very plain building, and we wait for these large milestone payments at the end.

Every traditional lender that we have ever talked to says go to the SBA. You have a contract. Go to the SBA. The SBA will guarantee it. Then we will lend you the money. We cannot possibly survive if we do not have that guarantee.

If we do not have that loan, this next payment that we get, you know, we will not be able to draw it back down because our renewal has not been funded. We will go out of business, and we will default on this project.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

I want to thank all of you for coming here and sharing your experience and your pain. I am sorry that the federal government is failing you. It really saddens me that the Administrator could come here before this Committee, and he is so committed to small businesses that he did not stay to listen to your stories. He did not stay so that you could tell him that he knew darned well last year they would be running out of money.

Mr. Chairman, I think that you understand that this is a real crisis for small businesses in this country, and I hope that pretty soon you conduct a hearing on your proposal that has been submitted by the Administration and co-sponsored by you.

Chairman MANZULLO. Thank you, Mrs. Velµzquez.

Ms. VELAZQUEZ. Are you going to have a hearing?

Chairman MANZULLO. Give me a chance to think about it. Obviously if we have legislation, we will have a hearing.

Ms. VELAZQUEZ. We will? Thank you.

Chairman MANZULLO. Anthony, with regard to piggybacking loans, walk us through that.

Mr. WILKINSON. How it works?

Chairman MANZULLO. Yes.

Mr. WILKINSON. A piggyback is where a lender makes some piece of the financing transaction in a first lien position and then the SBA 7(a) loan comes behind in a second lien position. It is really basically the 504 type of loan structure where there is a private sector lender in the first and then SBA in the second. That is what a piggyback structure is.

Chairman MANZULLO. So the reason that the SBA eliminated the piggyback is that the budget authority has to show the first position as part of the budget authority?

Mr. WILKINSON. I believe the reason that they gave for eliminating piggybacks was a simple effort to lower loan demand.

Chairman MANZULLO. SBA still allows SBA taking a first position and anybody coming in afterwards. Is that correct? That is still allowed?

Mr. WILKINSON. That does not happen. A lender would not put itself in a second lien position.

Chairman MANZULLO. Let us talk about the responsibility of some banks around here. Mrs. Velµzquez and I sit on the Banking Committee, and I am really tired of these giant lending institutions only making "safe" loans and not making character loans and you guys having to go to the federal government time after time after time again being subject to the appropriations process.

Here you have people, Mr. Pegg. We have two manufacturers out of four people that are suffering. I spent about 85 percent of my time on manufacturing. In fact, I just gave an interview to CNN calling for the resignation of the chairman of the President's Council on Economic Advisors who is thrilled with the offshoring of the high value white collar jobs and does not think that any job in this country has been lost to China.

When I see people like you, Mr. Pegg, who are fighting back and you, Mr. Moses, in manufacturing, where are the banks? You have track records. Why do they not get involved in this thing?

Mr. MOSES. Would you like me to answer that?

Chairman MANZULLO. Yes, sir.

Mr. MOSES. My bank that I am working with—in fact, I was working with several of them. They were all willing to take their share of the risks with the program. They are right ahead of me in the risk amount.

I am taking the greatest risk. The bank was actually taking the next greatest risk, and then came the government taking the third greatest risk.

Mr. PEGG. I would just say in our situation that there was no incentive for the bank to take the risk. We have cleared up———.

Chairman MANZULLO. What is the incentive? Meaning what?

Mr. PEGG. Well, why should they take more risk? We have been operating through this SBA program for seven years.

Chairman MANZULLO. Through that same bank?

Mr. PEGG. Through the same banks, yes.

Chairman MANZULLO. Which bank is that? A local bank?

Mr. PEGG. M&T. It was All First. Before that it was Penn Business.

Chairman MANZULLO. Different names?

Mr. PEGG. Penn National. All the same people we have been working with.

Chairman MANZULLO. Okay.

Mr. PEGG. There is no need to fix it because it is not broken. It has been working fantastic.

Chairman MANZULLO. Maybe they should understand that it is broken, and they have an obligation as the local lender to come in there and help save some jobs.

Mr. PEGG. If anything, they have actually communicated to us that there have been rumblings that they were going to do less SBA type loan activity, but there was absolutely no verbiage, no conversation whatsoever that indicated that they would do any kind of traditional lending with us.

Chairman MANZULLO. Have you asked them to factor your bill of lading or your payments?

Mr. PEGG. We presented them with contracts, Mr. Chairman.

Chairman MANZULLO. That is not enough?

Mr. PEGG. No. They look at us, and they will say how big is your home? What does your private asset portfolio look like?

Chairman MANZULLO. That is the problem in America today. No one lends on the basis of somebody's integrity, even years and years and years of track record.

There is a problem with the SBA. We talked a year ago about the fact that there would not be enough money. It is very distressing, extremely distressing. This hearing did not have to take place with this.

Let me say this. There are people here from the SBA that have stayed the entire program. Karen Haas, Deputy Assistant Administrator, Office of Congressional Legislative Affairs.

Karen, why do you not raise your hand back there? Could you introduce some of the other folks from SBA that have sat through the hearing to make sure they listen to the testimony?

Ms. HAAS. John Whitmore.

Chairman MANZULLO. John Whitmore. Okay.

Ms. HAAS. Brian Worth.

Chairman MANZULLO. Brian. Okay.

Ms. HAAS. Emily Murphy, Will Meade.

Chairman MANZULLO. Karen, thank you.

Mr. Sprague, have you looked to the Department of Agriculture? There are certain types of loans that are available in low economic areas.

Mr. SPRAGUE. To be honest, no, sir. You know, this whole thing came down pretty recently, as you know. We got the phone call. I forget when my partner called me and said do you want today's bad news.

Chairman MANZULLO. Okay.

Mr. SPRAGUE. No, sir. First, we really believed that at the end of the day that the Members of both sides of the aisle would say at least the 7(a) needs to be taken back.

Chairman MANZULLO. It would take a special supplemental appropriation of $30 million in order to restore it.

Mr. SPRAGUE. $30 million in the realm of the——

Chairman MANZULLO. I understand.

Mr. SPRAGUE[CONTINUING]Federal budget is pretty small.

Chairman MANZULLO. We said that last year.

Karen, if I could be so bold? Could Mr. Sprague meet with you afterwards and any of the other folks that are here?

Go ahead, Karen. Perhaps you could help them because maybe there is money available through Agriculture on it.

Mr. WILKINSON. Could we set up times for the other 250 applicants that are in the same boat?

Chairman MANZULLO. Anthony, if you did not ask that question I would have been disappointed. Listen, you guys have been great.

Do you have any more questions over there, Frank?

Mr. BALLANCE. I did have one that I think I will ask Mr. Pegg. Do you do international business?

Mr. PEGG. Yes, sir.

Mr. BALLANCE. What would happen to your business, and I guess others who are in small business can consider this question, if you did not get the loan and you had to say go under? I am hoping that will not happen to you, but you are fulfilling a demand obviously. What is going to happen to that demand?

Mr. PEGG. We typically compete with not only other U.S. prime contractors that have offices in the Kingdom of Saudi Arabia, but also a whole host of other international competition primarily coming out of the U.K., coming out of France and Germany.

I would guess that on any given contract we probably have anywhere between six and a dozen competitors that are ready to jump in and take care of that work.

Mr. BALLANCE. Are any of those American businesses, or are most of them foreign?

Mr. PEGG. Most of them are foreign.

Mr. BALLANCE. How many of your jobs are on this side?

Mr. PEGG. Fifteen people.

Mr. BALLANCE. I represent a rural area, Mr. Chairman. SBA has always been looked upon as an agency that would help businesses who were either struggling or who were trying to get started or who maybe did not have a track record.

The banks, as you point out, are there. They do not promise to create jobs, at least the ones I have talked to. I am just wondering if any of you are from rural areas what the impact might be in terms of just that fact alone.

Mr. SPRAGUE. Pahokee is definitely rural. It is 6,000 people. It is stuck out kind of by itself on the other side of Palm Beach County.

Let me take one example of that. We have been putting in rental boats, and part of that is we want to do guide service and eco tours. We have had a maintenance man, a young, black guy, a really neat guy. As a matter of fact, I am going to hate to lose him on maintenance, but he really took an interest in the boats so Jim decided let us bring a captain teachers course out to Pahokee, and let us see if we can get enough people in Pahokee who would actually study and become captains.

This young man studied very, very hard. We gave a bunch of it on our time. Anyway, he has passed, and he has his captain's license. He will be the first black captain, as far as I know, in all of the Glades to ever receive his captain's license.

He is so happy that he would like I think us to take his diploma and blow it up and put it on a billboard, but that is what we are trying to do. We are trying to give people a different alternative than going out in the fields and picking agriculture or sugar or whatever it is and raise the standard of living through bringing recreation to Pahokee, Florida.

You know, we are going to have all kinds of jobs that we are going to create. It is going to raise the standard from $10,000 to what we believe is going to be the median of about $26,000 within the city when we do this project.

I hope that answers your question.

Mr. BALLANCE. I just think there is a tremendous need for this program. We just have to put the hammer down and see if we can find the money.

Chairman MANZULLO. Congresswoman Majette, do you have any questions? Congresswoman Velµzquez has a question.

Ms. MAJETTE. Okay.

Chairman MANZULLO. Let me go with her, and then we can bounce to you if you have a question.

Ms. VELAZQUEZ. Thank you. Thank you. Tony, it seems that there is a sense here of some people, some Members, that this situation is for the banks to be blamed. Can you comment on that?

Mr. WILKINSON. Well, that is interesting. First of all, there have been shutdowns in the past. One of the shutdowns, the first one I remember, prompted the legislation that now requires a 15-day notice because the SBA at this particular time just closed the program and did not accept applications.

Well, as all these applicants will tell you, you do not just put that application together overnight. It takes a while to put the application together. You spend lots of time and money getting to that point. To have the rug jerked out from underneath you just was not fair, so we suggested to Congress that we put in a notification requirement giving folks an opportunity to finish their application and hence the 15-day requirement was passed.

Since then there have been a couple more shutdowns. Every time the SBA announces that a loan cap is coming they have a spike in demand. That demand comes from the applicants who are in the middle of their application process. They hurry and get it finished and get it submitted before the deadline.

It is not surprising. It has happened in the past. SBA knew that there would be a spike in demand when the cap was announced. It is just the way it works.

Ms. VELAZQUEZ. So if they wanted to, they could have held the applications and waited until the money was available?

Mr. WILKINSON. Absolutely. That is what they have done in the past. These applications should have been retained and put in a queue and funded as money became available rather than returning the applications, and in some cases where the applications are like Express and PLP faxed applications, those applications were physically destroyed, run through a shredder.

Ms. VELAZQUEZ. Mr. Pegg, in your testimony you mentioned that you have a disaster loan, right?

Mr. PEGG. Yes.

Ms. VELAZQUEZ. Could you please tell us what will happen to this disaster loan if you cannot renew your capital line?

Mr. PEGG. We will probably default on the disaster loan because we will be out of business.

Ms. VELAZQUEZ. Has the SBA offered to defer the payments until this problem is worked out?

Mr. PEGG. No.

Ms. VELAZQUEZ. Maybe you can meet with SBA today and discuss that.

Mr. PEGG. That would be great. Thank you.

Chairman MANZULLO. Congresswoman Majette, did you have a question?

Ms. MAJETTE. Yes.

Chairman MANZULLO. Okay. Go ahead, please. You have to turn on your microphone.

Ms. MAJETTE. Thank you, Mr. Chairman, and thank you, gentlemen, for being here.

My question is for Mr. Sprague. I understand that you have had some challenges. Can you tell me? Is there a reason why your company would not be able to refinance through other non-SBA sources?

Mr. SPRAGUE. Yes, ma'am. We have a multifaceted project. It is infrastructure, sewer, water. It is buildings, swimming pools, fixtures, cabins, boats, rehabbing bathrooms. I mean, it is multifaceted.

We looked at everything we needed to complete and do this project, some of it immediately. We have finished the plans. The engineering is done. We have gone through the very intricate process with the Army Corps because we are on their dike so it is not the normal permitting process. We have to go through all kinds of additional hoops.

We got the package for it, and we went through to conventional financings with what we needed with the explanation that they went through the package, thought we looked real good. They went through our balance sheets, our business plan, profit and loss, everything, where we have been since we have been there.

Then they learned that we are sitting on state lands, and you cannot encumber state lands. Therefore, we do not fit in their financing box. They suggested we have the perfect program for you. It is SBA 7(a).

We started working on our SBA 7(a) documents, and we got that completed. We submitted it. I want to say we submitted it on the 6th, not even knowing that there was already happened in December. We were not even aware of that.

We turned it in because my partner is pretty good about a complete package. I believe that we had everything in our package when it was completed and given to them. Then we received a telephone call. He gave me the news a few days later about the SBA.

I do not believe at this point—the Chair said that we may be able to. There may be some Agricultural money. I do not know. I mean, the government has helped us a lot because it is a public/private partnership that we are doing with the city. We are an area of economic critical concern, and we have all these designations.

We are willing to do whatever we can, but we believe, and as has been shown to us by the banks, that this 7(a) program is perfectly designed for our type of facility. Unfortunately, we need a fair amount of money because it is not a little project.

Ms. MAJETTE. Has this change in circumstance cost you personally or cost the company? How has it affected you?

Mr. SPRAGUE. Well, every day. My partner and I have gone two and a half years without drawing a paycheck because we want to make sure everything we do goes back in. Somewhere my wife says, you know, there should be a paycheck coming our way one of these days.

What it does, though, is it slows the whole project down. I do not know how we are going to do this now. Some of it is grants. We have to look at those kind of dates. We are going to have to see how this thing goes together.

It is not just us. It is the whole downtown redevelopment because we are that catalyst for bringing people. This one will open that little shop, and this one will have a breakfast and lunch. This one will do this, and that one will do that. All these closed businesses will hopefully start reopening.

It is not just waiting to see how we are going to put our project back together and figure out how this is going to work and how many years it is going to slow us down in trying to achieve where we have to go and what is going to happen at the end of the day.

It is a whole bunch of other people that are sitting and waiting because they had high expectations that all of a sudden everything was coming together. It was all coming together. I mean, this thing came out of nowhere.

Ms. MAJETTE. So your project really is the linchpin——

Mr. SPRAGUE. Yes, ma'am.

Ms. MAJETTE[CONTINUING]In terms of development in that entire area?

Mr. SPRAGUE. Yes, ma'am.

Ms. MAJETTE. Sort of dropping the pebble in the pond, and the ripples would continue to go around.

Mr. SPRAGUE. That is it. The city council has been good. I mean, they have now looked. All right. The center of town down from the project. What do we need? We need parking. They have just gone out and committed that they are going to buy this property around here and commit parking for all the businesses down there.

We have people coming. Now, the businesses do not have parking. There will be public parking. You know, everybody is planning all going on here, and now all of a sudden somebody pulled the rug out from under everything.

Ms. MAJETTE. Is there any way that you can break up the financing to be able to———.

Mr. SPRAGUE. The problem is, I do not know. I am not saying that there are not a few pieces that we can do. In other words, like if we go like I just needed a front endloader. Yes, we went out and did conventional financing on it. Not a problem. You know, if we do not pay the payments, they have something they can grab.

A lot of what we are doing is not grabbable as far as the banks are concerned, or it is multifaceted. You know, it is a little bit here and a little bit there, and it is hard to go out and get that kind of stuff.

At this point we do not know how it is going to work. My partner is back, and that is his main penance I call it is to work on this kind of stuff. That is his half. He is trying to figure out where we are going to go. When I get back, I guess we will try to figure out where we proceed from now.

Ms. MAJETTE. I guess the Everglades adventure has become a misadventure.

Mr. SPRAGUE. It is still an adventure. I am not sure it is a misadventure yet, but it definitely got a little more adventuresome than it was.

Ms. MAJETTE. More adventurous than you intended it to be?

Mr. SPRAGUE. Yes.

Chairman MANZULLO. They need some venture capital.

Mr. SPRAGUE. Yes.

Ms. MAJETTE. Thank you. Thank you for your testimony.

Mr. SPRAGUE. Yes, ma'am.

Chairman MANZULLO. I want to thank all of you for coming.

Mr. Sprague and Mayor, I would suggest the EPA has all kinds of grants for wastewater treatment facilities, for drinking water. There is a tremendous amount of resources that are out there. If you pay taxes, I guess you are eligible to apply for these grants and loans if they are there.

Karen, you could help them and guide them into other programs that are available with the staff that is available? Thank you very much. We want to thank the SBA and their staff for being here.

We want to thank the witnesses, especially those of you who have come from long distances to be here.

Is this your first time to testify before Congress, David?

Mr. PILCHER. Yes, it is. I will be here all day tomorrow, so I can meet with you as long as you would like.

Mr. MOSES. Likewise for me also.

Mr. PEGG. Us too.

Chairman MANZULLO. Listen, I understand. You need to talk to the guys at the SBA. I would also suggest that you talk to your Senators and your U.S. Representative.

In our district we have a person that does full-time economic development. We are savaged with double digit unemployment in my district. It is getting worse because we have a heavy manufacturing base, and, Mr. Sprague, we have a good portion of the Mississippi River in our district. We are in the process of trying to develop things similar to what you are doing, so that is why I have a particular interest in what you are doing.

To all of you, thank you for coming here. It is a real privilege to be Members of Congress and to have people who are impacted by these government programs to come and testify before us.

The hearing is adjourned.

[Whereupon, at 5:15 p.m. the Committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

REMARKS OF CHAIRMAN DONALD A. MANZULLO
"HOW DOES THE PRESIDENT'S FY 2005 BUDGET REQUEST AFFECT SMALL BUSINESS?"
February 11, 2004 2:00PM Room 2360 Rayburn HOB

Good afternoon. The committee will come to order. Today, we examine the President's Fiscal Year 2005 budget request as it affects small business. Generally, the President's proposed budget is helpful to small business owners. Given the budgetary constraints, with a few exceptions, small businesses should be pleased. I am troubled by the deficit and I wish that the rest of the federal government followed the example of the Small Business Administration (SBA), which has experienced more than a 20 percent reduction in its funding since Fiscal Year 2001. However, at the same time, SBA was able to serve more small businesses than ever before. If Congress adopts the President's 2005 budget request for the SBA without change, it would represent another five percent real reduction in funding. If small businesses are requested to do their part to contribute to deficit reduction, other agencies, like the National Endowment for the Arts, which received a 13 percent increase in this budget request, should bear a similar load.

I am especially heartened that the President's request would make permanent the tax relief Congress has already passed including phasing out the punitive estate or "death" tax and the lowered rates on capital gains, stock dividends, and small businesses in order to create incentives for job creation. It is important to remember that 85 percent of small businesses pay taxes on an individual basis so the rate cuts Congress passed into law in 2001 and accelerated in 2003, in addition to increased expensing and "bonus" depreciation, has provided critical assistance to our small businesses.

With increased confidence in the economy, it was only natural that small businesses seeking access to credit would use the guaranteed lending and venture capital investment programs of the SBA more than in past years. In addition, the numbers of the self-employed are growing dramatically. In the monthly survey of households by the Bureau of Labor Statistics, many of the formerly unemployed now say they are working for themselves. This statistic is not picked up in the monthly payroll data. These newly self-employed need the SBA guaranteed lending and venture capital programs now more than ever.

However, as the committee and industry predicted, the 7(a) program experienced a "cash flow" crunch last month and is currently hobbling along with restrictions that do not live up to the full expectations of the use of the program as contained in the law. Plus, the SBA authorization bill that this committee passed further expands the use of the SBA lending and venture capital programs, particularly for small manufacturers.

While I am very grateful that the Administration recognizes the value of the 7(a) program by proposing a 30 percent increase in its program level, I have two concerns: first, the $12.5 billion program level may still not be enough, particularly after the reforms contained in the SBA reauthorization bill aimed at helping small manufacturers become law, and second, the practical effect of the 7(a) proposal will increase fees on small businesses seeking to borrow less than $700,000.

I am pleased that the Administration has proposed a zero subsidy rate for the 7(a) program, which means that no appropriations will be required, saving the taxpayer about $100 million. The new econometric model that we fought so hard to get into place has proved to be a much more accurate predicator of the future performance of the 7(a) program. As evidence, the budget re-estimates for SBA business loans made in 2002 and 2003 are near to zero as humanly possible as compared with past high re-estimates. Having a zero subsidy will produce much more predictability and stability into the 7(a) program in order to avoid pitfalls like what happened last month.

However, I believe there is a better way to achieve a zero subsidy rate without having to raise fees by as much as 50 percent on the smallest loan borrower, which translates into an average of $1,500 for a $100,000 loan. Congress passed this temporary fee reduction in 2001 precisely because we were in the midst of a recession and small businesses were being denied access to capital. We are still not out of the woods yet and that's why the SBA reauthorization bill extends the 7(a) fee reductions targeted at smaller borrowers for another two years. Raising 7(a) fees now, particularly as the budget request also proposes to eliminate the Microloan program, is counterproductive. If we are able to raise the loan level in the SBA Express program, which provides for only a 50 percent government guarantee (as opposed to a 75 percent guarantee) in return for reduced paperwork for the lender, from $250,000 to a higher level, we will achieve the same goal – a zero subsidy rate – without having to raise fees. If we make this change apply now, it will also allow the SBA to restore the 7(a) program to its full statutory level.

The rest of the President's budget request for the SBA remains sound and reasonable, given the budgetary constraints, with a few exceptions. I understand the current financial problems with the participating securities program of the Small Business Investment Company (SBIC) program and I recognize that changes need to be made. However, I strongly opposed making changes that could severely damage the long-term operation of the SBIC program in the future.

I am also concerned about SBA's contribution to the U.S. Export Assistance Center (USEAC) network. In the early 1990's Congress uncovered many unmet needs in export promotion programs plus waste and duplication of existing services. Congress then created the Trade Promotion Coordinating Committee (TPCC) to expand and streamline the delivery of export promotion of services. Key to this concept was co-locating several export promotion agencies together across the nation in order to provide a local one-stop shop for taxpayers. Pulling SBA out of the USEAC network essentially will make the vast majority of these centers adjuncts of the Department of Commerce and could lead to the repetition of the mistakes that lead to the creation of the TPCC in the first place. SBA offers some unique programs, particularly to those small businesses new to exporting, which might not be replicated in a Commerce-run USEAC system. Each $1 appropriated to SBA's export finance specialists in the USEACs since 1999 has supported loans generating over $200 in export sales – a sound return on any investment. I encourage the Administration to revisit their position on withdrawing support from the SBA for the USEAC system.

Thank you and I now yield for opening statement from the ranking minority Member, Representative Nydia Velázquez of New York.

STATEMENT
of the
Honorable Nydia M. Velázquez, Ranking Democratic Member
House Committee on Small Business
President's FY 2005 Budget Hearing/SBA
February 11, 2004

Thank you, Mr. Chairman.

With the FY05 Bush budget for the Small Business Administration (SBA), we have a proposal before us that represents the deconstruction of the only agency with the sole focus of assisting our economy's most important sector – small business.

At a time when the economy continues to struggle and job creation lags, we should be investing in these programs, not turning our back on them. Not since the days of Reagan budget director David Stockman – when the elimination of the agency was proposed – have we seen such a destructive plan.

At least in 1982, the administration was honest about its intentions. But the current one, which is looking for the same outcome, is not being as forthcoming, instead hiding behind fake budget numbers and proposals that will never work.

Clearly the worst is how this budget will deprive entrepreneurs of the capital they need to start their businesses. It is unbelievable that in this budget, not a single dollar goes to the SBA's loan programs. Not a single dollar for the general loan programs. Not a single dollar for the Microloan program. Not a single dollar for venture capital.

Adding insult to injury, the plan here is to pay for all these programs by hiking up the fees for borrowers. And even after we listened to this administration harp on the need for the agency to make more small loans, it then turns around and eliminates the Microloan program – which does exactly that. It makes no sense.

The proposal now on the table to "fix" the 7(a) loan program is too little, too late. It proposes to lower the guarantee fee to 50 percent on loans of $250,000 and below, eventually extending that up to a million dollars. This will harm the very small businesses the program was created to help by blocking avenues of credit, and will also drive lenders out of the program altogether. This "fix" was either poorly thought out, or it is an intentional way to destroy the program – once and for all.

Another area where this budget falls short is in helping small businesses access the federal marketplace. President Bush put this at the top of his small business agenda in 2002, but we have been told time and time again that the resources just aren't there to back it up. And this budget is no exception.

There are no enforcement dollars to hold agencies accountable for missing their small business goals. There is no funding for a women's procurement program that was made law four years ago. There is no money to ensure small businesses get their fair share of federal contracting dollars.

This budget has an unprecedented number of cuts to SBA's programs. The rationale behind these cuts is to channel remaining funds to the agency's "core" programs, discarding those that are deemed "duplicative."

The problem is that the SBA's core programs have been flat funded for three years now. When you account for inflation, this amounts to a more than $10 million cut. It's one thing to expect an agency to do more with less – it's another thing to expect it to make something out of nothing.

It's a shame because these programs help small businesses to stay afloat, expand, and create jobs. They help to save taxpayer money and they even *generate* tax revenue. The failure to invest in them is completely shortsighted. It puts our nation's small businesses – and our economy as a whole – in jeopardy. I believe in these programs. My Democratic colleagues believe in these programs. But it appears the administration does not.

Even though President Bush spends a lot of time talking about the important role small businesses play in our economy, that's all it is – talk. Let me tell you, talk is cheap. If this administration really wanted to assist small businesses, it would have made the SBA budget whole.

Without putting some much-needed resources into small businesses, we simply can't have a vibrant economy. We can't put Americans back to work by creating jobs. We can't spur economic development in our local communities. I'd like to ask the Bush administration where are its priorities? Where is its commitment? Because it is certainly not to small business.

Thank you, Mr. Chairman.

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ARMED SERVICES COMMITTEE
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RESOURCES COMMITTEE
SUBCOMMITTEE ON FISHERIES CONSERVATION, WILDLIFE, AND OCEANS
SUBCOMMITTEE ON NATIONAL PARKS, RECREATION, AND PUBLIC LANDS

SMALL BUSINESS COMMITTEE
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT, AND GOVERNMENT PROGRAMS

Madeleine Z. Bordallo

Madeleine Z. Bordallo

Statement of Congresswoman Madeleine Z. Bordallo
Small Business Committee Hearing on the Fiscal Year 2005 Small Business Administration Budget

February 11, 2004

Administrator Barreto, the Small Business Administration (SBA) plays an important role in creating opportunities for entrepreneurs to realize their dreams of owning, managing and growing their own businesses. The dream would be just that – a dream – if not for the various financing opportunities backed by the SBA, such as the 7(a) and 504 loan programs. The SBA plays a particularly important role on Guam, where 75% of all businesses are considered small. Therefore, it is a priority of mine to ensure that all affordable financing options offered by the SBA are fully funded, and that businesses on Guam are made aware of the services available to them.

Having become aware of the SBA's proposal to centralize all loan making, servicing, liquidation and guarantee purchase functions; I am concerned about the impact this centralization would have on small businesses on Guam, as well as on the Guam SBA Branch Office. As you are aware, business hours on Guam occur during nighttime in the contiguous 48 States. In fact, Guam is a 7-hour plane flight West from Honolulu, Hawaii. While centralization of most "back-office" functioning may prove to increase efficiency and lower costs to consumers, it is important that all staff working on SBA loan programs in the SBA Guam Branch Office be retained for the purposes of assisting local small businesses with loan processing. Small businesses on Guam must be able to communicate directly during business hours with SBA staff competent of SBA loan programs. Although the focus of local field offices may be shifted towards increased outreach and assistance for local small businesses, Guam's unique situation requires an experienced and flexible SBA staff. I respectfully request your consideration of Guam's unique situation as your office reviews possible workforce transformation proposals.

With regard to the actual budget allocations for the SBA, I am disappointed with the Administration's proposal to eliminate nearly all subsidies to support its loan programs. This proposal will create higher loan fees for small business owners attempting to access SBA loan programs. Programs such as 7(a), 504 and Microloan were created specifically because many small business owners could not gain access to necessary financing on reasonable terms in the marketplace. I understand that the average 7(a) customer could potentially end up paying approximately $5,000 extra in fees over the course of loan repayment if the Administration's proposal were to be implemented. At a time when our fragile economy is finally showing signs of improvement, I urge you to strongly consider the effects of increased loan fees on SBA financing programs and the small businesses they serve.

Finally, I understand that the SBA plans to emphasize increased outreach and assistance to local small businesses in its field office operations. I am pleased that the SBA will emphasize outreach to underserved areas. As you are aware, Guam is an important center of commerce for the entire Western Pacific region, encompassing the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI) and the Republic of Palau (RoP). Because of its geographic location, the Guam SBA Branch Office will be an asset to the SBA in carrying-out its mission to reaching underserved areas. As you know, H.R. 2802, *the Small Business Reauthorization and Manufacturing Revitalization Act*, contains a provision to elevate the Guam Branch Office to District Office status, covering Guam and the CNMI. I encourage you to strongly consider this proposal in any future plans for any reorganization at the field office level. It is my goal that the utilization rate of SBA programs on Guam be equal or greater than that of the mainland.

In times of economic recovery, the small business sector is increasingly becoming the incubator of innovation, employment and growth. On Guam, where the unemployment level is double the national average, the role of local small businesses has never been more critical. Whether it be expanding access to federally-backed financing or assisting local small businesses to better compete for federal contracts in the upcoming re-bid of the Navy's Base Operation Services (BOS) contract at Guam's Naval base, the Guam SBA office will be invaluable in assisting local small businesses grow and thrive. The Administration's proposed budget for the SBA stands in contrast to its rhetorical emphasis on the importance of small business, and I am prepared to utilize every tool at my disposal on the Small Business Committee and elsewhere to ensure that small businesses on Guam receive equitable and necessary federal support.

STATEMENT OF
HECTOR V. BARRETO
ADMINISTRATOR
U.S. SMALL BUSINESS ADMINISTRATION
SBA'S FISCAL YEAR 2005 BUDGET REQUEST

Mr. Chairman, Ranking Member Velazquez, and members of the Committee, thank you for inviting me here today to discuss the President's Budget Request for the U.S. Small Business Administration (SBA) for Fiscal Year (FY) 2005.

At the SBA, we have completed one of our most important years ever. The SBA has continued its drive to simplify and improve the Federal government's role in providing capital and technical assistance to America's entrepreneurs. The diversity and success of companies supported by the SBA has been a major factor in the current economic recovery. We're proud of that success. At the same time, though, we must keep a watchful eye on the taxpayers' stake in these programs. As much as we have achieved in the past, we have a change to improve upon our record.

As the President has emphasized, we can ease the unnecessary burdens on U.S. companies – high tax rates, litigation costs, workers' compensation and unemployment insurance, skyrocketing health care costs, tax preparation costs, high energy prices – and by doing so give those companies a better chance to grow and create new jobs. What's more, if we can encourage private risk-taking, then we can give entrepreneurs the boost they need to find partners, networks, customers, and access to capital. Encouraging private risk taking and investment is one the missions of the SBA.

President Bush understands the vital role that America's small businesses play in creating opportunities. He also recognizes that following times of economic downturn, small businesses play a leading role in economic recovery, and that it is small businesses that generate approximately two-thirds of all new private sector jobs. The President's plan for economic growth and job creation, along with his small business agenda, has been successful in creating an environment in which entrepreneurship can flourish. The SBA's FY 2005 budget is good for America's small businesses and good for the American taxpayers.

The SBA's total budget request is $678.4 million. This budget request provides for a strong, successful SBA that can effectively and efficiently meet the demands of its customers, America's small business entrepreneurs, while minimizing the cost to the American taxpayer. Through improved management and program reforms, the SBA will better serve America's small businesses.

The SBA requests $12.5 billion in lending authority for its 7(a) loan program – more than a 30% increase in authority over the level in the FY 2004 omnibus bill. The 7(a) subsidy rate for FY2005 is zero, putting our 7(a) loan program in line with our other major financing programs (504 and SBIC). This subsidy rate is a result of improvements in program design and management, in addition to the development of a new econometric model. The congressionally-mandated two-year fee reduction, designed to help small businesses during the recession, will expire at the end of FY2004 and the fees will return to their previous statutory level. The resumption to the statutory fee level will result in savings of nearly $100 million to American taxpayers, and also allow for a program that will be able to meet the demand of small businesses without being dependent on appropriations. Mr. Chairman, I am also recommending legislation that will give the SBA the permanent authority to adjust the 7(a) fees every year to keep the program at a zero subsidy.

This Budget Request will give SBA the authority to provide $4.5 billion in loans through its 504 Certified Development Company (CDC) program with no cost to the taxpayers. The 504 program, which was established to increase small businesses' access to real estate and other long-term fixed asset financing, continues to have job creation as an important program goal. The SBA has taken steps to increase small businesses' access to 504 loans by increasing competition among CDCs and streamlining processing. And, as requested, SBA developed an econometric model that is being used for the FY2005 budget request to more accurately measure the cost of the program.

During the course of the SBA's Microloan program's 12-year history, the private sector lending community has come to recognize that micro-borrowers are creditworthy and, further, that they represent substantial future growth opportunities. As a result, private sector lenders are now far more willing to lend to very small and to start-up businesses and in doing so are able to offer more competitive interest rates than the agency's microloan intermediaries. An SBA's analysis of the Microloan program discovered that every dollar lent under the program cost the taxpayers ninety-seven cents. At such a high cost, the agency believes that the SBA should not be competing with private sector lenders interested in developing this market, and has not requested funding for this program in FY2005. Further, the Agency believes that its 7(a) program provides an adequate incentive to lenders who feel that risk mitigation is required to make smaller loans.

In addition to the zero subsidy for our finance programs, this fiscally sound budget is consolidating delivery of services to small businesses which will provide better service to small business owners while resulting in savings of $30 million. The SBA provides a wide variety of technical assistance services to hundreds of thousands of small businesses annually, and it remains dedicated to providing those services in ways that best serve its clients, America's small business owners. Over the years, the agency's portfolio of small, specific, dedicated assistance programs has expanded dramatically. Unfortunately, funding for these programs has been inconsistent. In fact, many of these targeted programs did not receive funding in FY 2003. In addition, each individual, dedicated program requires specific infrastructure and delivery mechanisms, many of which are duplicative and wasteful.

The SBA believes it can provide a full range of technical assistance more effectively by using its core national delivery programs. The agency will work through its primary infrastructure of Women's Business Centers, Veterans Outreach, 7(j) Technical Assistance, SCORE chapters, the Small Business Development Centers and District Offices to meet the needs of all small businesses. These large core programs have proven their effectiveness. They have extensive resources and well-developed infrastructures. They can reach more customers and offer higher levels of service to targeted constituencies and, by eliminating the duplicative bureaucracy that is inevitably created by a large number of smaller programs, they can do it far more effectively.

This budget request includes $3 million to continue implementation of SBA's transformation efforts. I have spoken with many of you personally about the importance of transformation to SBA's future success. These efforts are crucial to the Agency's success in assisting small businesses in its second half-century.

The SBA has existed for 50 years, and much has changed. The agency now works principally through lending and other program partners to provide products and services to small businesses. To coincide with that changed business practice, the agency must realign its resources. The needs of the SBA's customers remain paramount, and modernizing and realigning the agency's human capital resources, operations, and organizational structure to match those needs is crucial to the agency's continued relevance. The SBA is consolidating back-office servicing functions, allowing field office staff to work more closely with their clients in the small business community. The agency's field offices are using technology, outreach, marketing, and customer relationship management to better meet small business needs. Through these modernization efforts, more SBA employees will be in more locations providing direct assistance to the small business community at a lower cost.

The SBA is implementing these modernization efforts based on the success of three district office pilot projects in which loan functions – specifically, 504 loan processing and liquidation and loan buyout processing – were moved to specialized, central locations. The pilots produced impressive results. The 504 program reduced processing time to just two days, seven times faster than the national average of two weeks. The liquidation and purchase pilot has been similarly successful – liquidation cases are now taking months instead of years, and purchases are at 23 days. These dramatic improvements directly affect the SBA's partner lenders, and ultimately, the agency's customers, America's small business owners.

The SBA' s Offices of Government Contracting and Veterans Business Development have been working closely with the Federal Acquisition Regulatory (FAR) Council on drafting regulations to implement PL 108-183, signed by President Bush on December 16, 2003. In order for the law to be implemented as expeditiously as possible, the new rules will be published as interim final rules, effective upon publication while at that same time allowing for a 60-day public comment period.

This budget request also includes continued funding for the agency's Disaster Loan Program. The SBA works very closely with the Emergency Preparedness and Response Directorate of the Department of Homeland Security to assist those small businesses and individuals directly affected by disasters such as tornadoes, floods and hurricanes. The SBA is a major part of the government's mechanism to get those people back on their feet in times of trouble when they most need assistance.

Mr. Chairman, I want to take a moment to recognize the hard work of our Disaster team in assisting the victims of Hurricane Isabel and the wildfires in Southern California. This has been a devastating year across the country in terms of natural disasters, and the SBA has consistently been there to assist victims in recovery.

When I appeared before you last year, Mr. Chairman, to present the SBA's budget, I testified about the accomplishments we had made so far, and outlined the challenges ahead. This year, I am proud to tell you that progress has been made in meeting those challenges.

Building on its success with the 7(a) econometric model, the SBA undertook an enormous effort to rebuild nearly all of our other subsidy models in 2003. As I pledged to you a year ago, we have completed a 504 econometric model, as well as new or modified models for the SBIC, Disaster Assistance, and Secondary Market programs. In addition, we have continued fine tuning the 7(a) model.

I would like to take this moment to recognize the extraordinary efforts of our CFO team which built these models. Building one econometric model in a year is an enormous amount of work, but our team built three and modified two others in less than a year's time. I am proud of their efforts.

These new or modified models will enable the SBA to allocate its resources more effectively, determine program risk more precisely, and increase our ability to target loans and programs to aspiring entrepreneurs who cannot obtain financing without a government guaranty. In short, implementing these models is a huge plus for small business and the taxpayers because we can now more accurately project the true cost of SBA's programs to the taxpayer.

Last year, I testified before you about the progress in establishing a loan monitoring system – and I am pleased to tell you that the system became operational in Fall 2003. LMS is an incredible success story for the SBA and the Federal government. We are utilizing industry best practices to measure the risk in our 7(a) and 504 loan portfolios. We are so proud of what we have achieved and believe it is the first time the Federal government has adopted such an approach for credit risk management purposes.

Last spring, we hired Dun and Bradstreet and Fair Isaac, two industry leaders in the field of risk management, to provide loan and lender monitoring services for the agency. Credit scoring is at the heart of the system delivered to us in September. Our 7(a) and 504 loan portfolios are credit scored quarterly allowing the SBA to quantify and evaluate loan and lender performance trends. The features of the system include an early warning component, risk ranking of all SBA lenders, and lender and portfolio benchmarking and peer comparisons. These tools, combined with our redesigned lender review process, results in a risk-based approach to oversight that provides the Agency with more meaningful information about SBA's lenders and is more streamlined and efficient, allowing us to better deploy our resources in those areas where the SBA has the most exposure while being less intrusive to the lenders.

Let me now address the issues raised by the SBA's recent financial statements. Let me assure you, I take financial management of the agency very seriously, and we are working diligently to address all of these complex issues.

Asset Sales: Soon after my confirmation in late summer 2001, I became concerned about financial management of the agency in general, particularly the asset sales program. In March 2002, I appointed Tom Dumaresq as the Chief Financial Officer and he in turn put a new financial team in place. This team identified discrepancies when reconciling the subsidy budget model with the actual performance of the sales. Losses were appearing on the financial statements while the model used to calculate the cost/benefit value of selling the loans showed a profit on the loans sold. The SBA then assembled a team of experts, including SBA staff, to identify the cause of this discrepancy. The assessment revealed that three separate areas caused the discrepancies. First, accounting entries overstated loan values and did not fully reconcile to subsidy estimates. Second, the agency's credit subsidy model, which assessed costs at a program level, did not always provide reliable loan cost estimates. Third, the model used to provide individual loan values for asset sales significantly underestimated the projected worth of performing assets and did not reconcile to the subsidy model. As a result, the SBA has rebuilt the disaster loan subsidy model and is now using all available loan data to project the cost of our disaster program. The bottom line is that the asset sales program provided a profit for the nonperforming 7(a) and 504 loans, but a loss for performing disaster loans. This has resulted in adjustments to the FY2001 and FY2002 financial statements as well as an upward re-estimate for FY2003.

Small Business Investment Company Program (SBIC): The venture capital industry suffered losses for the past several years, and the SBIC program mirrored that trend. Previously, the SBIC subsidy model did not use actual historical data, but rather used expert opinion based on industry experience of gains and losses. This year, the SBA is utilizing an improved risk model and actual historical data. The SBA has determined that the SBIC Participating Securities program needs approximately $1.86 billion more than was previously projected for the cost of guarantees made since 1994. This estimate includes $314 million in interest on the re-estimate (total re-estimate of $1.86 billion). The SBA is committed to maintaining the zero subsidy rate for this program and minimizing the costs to the taxpayer; therefore leverage fees will need to increase substantially to keep this program operating. The SBA submitted legislation in June 2003 that would make changes to the program, reducing the amount of the increase. The fee included in the FY2005 budget submission anticipates the enactment of this legislation. We look forward to working with you and with the venture capital industry to come up with additional improvements to the program.

Master Reserve Fund (MRF): The MRF was established to ensure that timely payments are made to investors that participate in the Secondary Market Guaranty (SMG) program. The SBA has improved the oversight and accounting practices of the SMG program for 7(a) guaranteed loans. To properly manage any risk associated with this fund, the SBA is budgeting for the government's liability as required by the Federal Credit Reform Act. This resulted in a $105 million upward mandatory re-estimate cost in the FY2005 budget. Due to administrative reforms being implemented in FY2004, this program will not require discretionary subsidy appropriations to operate in FY2005.

All of us at the SBA are quite proud of the Agency's legacy of achievement. Many businesses with household names today received SBA assistance in their formative stages. Who knows which of tomorrow's industry leaders are today receiving their 7(a) loans, their SBIC investments, their government contracting opportunities, or their counseling through the SBA's programs and services?

However, we at the SBA cannot rest on our laurels. The Agency must continue to keep up with and ahead of changes in the marketplace.

We at the SBA are committed to doing all we can to make sure those entrepreneurs receive all the assistance the Agency and its employees can provide. But the SBA cannot do this alone. I want to take this opportunity, while we are all together, to enlist you in these efforts so that this record of achievement will continue.

The SBA's FY 2005 request is a good one for America's small businesses and American taxpayers. It offers an opportunity for us to work together with you, our Congressional partners, to ensure that the SBA continues to assist small businesses into its next half-century. We ask for your support for this budget. Thank you for the opportunity to appear here today. I am happy to answer your questions.

NASBIC
America's Small Business Partners

Statement
of
Lee W. Mercer
President

National Association
of
Small Business Investment Companies

Before The

United States House of Representatives
Committee on Small Business

February 11, 2004

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Chairman Manzullo, Ranking Member Velázquez, members of the Committee:

Thank you for the opportunity to appear before you today to give NASBIC's views about the Administration's FY 2005 budget proposal as the same relates to the SBIC program. NASBIC is the only professional association dedicated to representing the interests of all licensed SBICs. We hope our views are helpful to the Committee as it considers the issues we will address today.

Before turning to the budget, I would like to stress some of the statistics we believe highlight the importance of the SBIC program to U.S. small businesses and the nation's economy.

- Since its beginning in 1958, the SBIC program has provided $40 billion of long-term debt and equity capital to 95,000 small U.S. companies, with $2.47 billion invested in 2,610 small businesses in FY 2003 alone. The number of U.S. small businesses receiving SBIC financing in FY 2003 was up 21% from the 1,979 that received SBIC financing in FY 2002.

- U.S. small businesses financed by SBICs in FY 2003 employed approximately 347,000 individuals—an average of 133 employees per company—at the time they received the SBIC financing. The median number of employees in SBIC-financed companies was 30.

- Companies less than three years old received 43% of all investments.

- SBICs play an important role in states not generally served by venture capital firms. Of the 2,610 U.S. small businesses that received FY 2003 SBIC financing, 1,112 (43%) were located in areas designated as Low- and Moderate Income (LMI) areas by the government. Those companies received $556 million (23%) of the total $2.47 billion in SBIC investments.

- SBICs are playing a vital role in our current national economic recovery. SBA reports that SBICs accounted for 59% of all venture capital investments, by number of investments for the period January through September 2003. For comparison, in 1997 it was just 38%.

- As of the end of FY 2003, there were 447 SBICs of all types operating in 45 states, the District of Columbia, and Puerto Rico. SBICs held $21.6 billion in capital resources—up 7.5% from $20.1 billion at year-end FY 2002—a significant increase given the contraction in all other sources of venture capital. Of the total, $12.4 billion was private capital and $9.2 billion was SBA-guaranteed capital or commitments. In FY 2003, SBA licensed 36 new SBICs with $743 million in initial private capital.

- Over the past three years (FY 2001-2003) hard-pressed small U.S. manufacturing companies have received $2.6 billion (27%) of the $9.6 billion in total SBIC investments for the period.

- Many well-known U.S. companies received early financing from SBICs, including America Online, Apple Computer, Callaway Golf, Intel, Staples, Quiznos, Federal Express, Outback Steakhouse, Costco, and Vermont Teddy Bear. Eight of the top 100 fastest-growing companies in America in 2003 received SBIC financing (*Fortune*, September 1, 2003), as did six of the top 100 "Hot Growth Companies for 2003" featured in *BusinessWeek* (June 9, 2003) and 10 of the 100 "Top Information Technology Companies" in the United States (*BusinessWeek*, June 23, 2003).

NASBIC supports the Administration's proposal for the Debenture SBIC program.

If approved by Congress, the proposal would make $3.0 billion in Debenture leverage authority available in FY 2005 at a zero subsidy rate. A zero subsidy rate has been in effect since the start of FY 2000 for the Debenture program. In order to maintain the rate in FY 2005, an increase of 16 basis points is required in the annual interest paid by Debenture SBICs pursuant to §303(b) of the Small Business Investment Act (SBIA). NASBIC supports that very small increase. Based on the most recent pricing of Debenture leverage, that of September 2003, the practical impact of the increase would be negligible—raising the likely interest paid for FY 2005 leverage from approximately 5.73% per annum to approximately 5.746% per annum. The two tenths of one percent increase in the annual cost of leverage will have no impact of any consequence on either Debenture SBICs or the small businesses they finance. No legislative change to the SBIA is required to implement the Administration's proposal. We ask the Committee to support the Administration's FY 2005 proposal for the Debenture program.

NASBIC supports the proposed $4.0 billion in Participating Security leverage authority for FY 2005, but strongly opposes the program restructuring proposed by the Administration.

The Participating Security program is critical to the success of the SBIC program as a whole. Designed to stimulate the flow of scarce equity capital to America's small businesses, it has done that very successfully. In FY 1995, its first full year of operation, the program saw Participating Security SBICs make $110 million in equity investments, just 8.8% of all SBIC investments that year. For the period FY 2002 through January 23, 2004—a critical economic period as U.S. business fought to survive the recession—Participating Security funds invested $2.8 billion, a full 47% of the $6.0 billion in all SBIC investments made during the period. In the current FY 2004, through the same January 23, Participating Security SBICs have accounted for 55% of all SBIC investments. Twenty-six (72%) of the 36 new SBICs licensed by SBA in FY 2003 were Participating Security funds. Clearly, the program is providing the equity capital Congress intended when it created the program its 1992 amendment of the Small Business Investment Act.

Of perhaps greater importance, Participating Security SBICs have proven to be a much more reliable source of equity capital for small business than all other sources during the recession we have just endured. The high water mark for all venture capital investments in the U.S. was the year 2000, with investments totaling $103 billion according to Thomson Venture Economics. In 2003, total venture capital investments fell to $18 billion—a decline of 83% during the period of recession. In contrast, the $1.1 billion in Participating Security investments made in FY 2003 were 77% of their FY 2000 total—a decline of just 23% compared to the 83% decline for the entire industry. That performance in a very difficult economic period is testimony to the importance of the Participating Security program to U.S. small businesses.

The Administration's budget proposal projects $2.0 billion in potential losses in the Participating Security program. That number includes both realized losses and estimated future losses. Thus, as a starting point, it is uncertain whether or not the final figure will total $2.0 billion. Of greater importance is the context in which the losses have occurred. Again referencing Venture Economics, the quarter that ended September 30, 2003 was the 11th consecutive quarter for which venture capital funds sustained losses for the preceding 12-month period—"by far the worst streak in the industry's history." That history dates to the start of the SBIC program in

1958, a period of 45 years. Of significant relevance to SBA's estimate of losses is the fact that the Participating Security program saw $4.3 billion (57%) of its total of $7.5 billion in investments to date made in the 5-year period that ended September 30, 2000—the period just preceding the economic collapse from which America is just beginning to recover. It should surprise no one that the Participating Security program will realize losses associated with investments during that period. NASBIC has mentioned the likely losses often during the past three years. Those losses will accrue to private investors as well as SBA, and it will be years before the true nature of the losses will be known.

Faced with its estimate of losses in the Participating Security program, the Administration has determined that the structural model in place since the start of the program is flawed. Whether or not this is true is open to question since 57% of investments to date were made in perhaps the worst period of at least the last 45 years in which to make equity investments. However, given the projections made by OMB in its subsidy calculations, it is unlikely that any agreement might be reached between the industry—both management teams and private investors—and the Administration that would see the current structure retained with minor adjustments that would satisfy both sides.

In order to achieve a "zero" subsidy rate, the Administration proposes several major changes in the Participating Security program for funds licensed after September 30, 2004.

1. The budget anticipates congressional enactment of the legislation proposed by SBA last July. That legislation would keep the current structure—with all its negative elements—while changing SBA's share of the profits in profitable Participating Security funds to one-half of the percent of total capital represented by SBA leverage. That would result in an effective 300% increase in SBA's profit share. NASBIC opposed that proposal when it was made.

2. The budget narrative states that a substantial increase in fees—in addition to passage of the July proposal—is required to keep the subsidy rate at "zero." Although the legislative proposal regarding fees has yet to be filed, we understand that the proposal will include the following:

    a. an increase in the leverage "commitment" fee from 1.0% to 1.5% (the leverage "draw" fee would remain at 2.0%);

    b. an increase in what is now the 1.454% prioritized payment rate dedicated to SBA pursuant to §303(g)(2) of the Small Business Investment Act to 3.85%; and

    c. a change in the nature of the §303(g)(2) fee so that the full 3.85% per annum rate on outstanding leverage would be paid to SBA irrespective of profitability of the Participating Security SBIC in question.

We believe the Administration's proposal was made in a good faith effort to address the structural problems the Administration believes has led to its current losses. We want to stress the fact that we enjoy an excellent working relationship with the Administration, even when we disagree. Unfortunately, we are now at a point of substantial disagreement. The proposed economic structure would all but destroy private sector support for the Participating Security program. This is so for several reasons.

1. First, the proposal would reintroduce an annual, current coupon, "interest" charge for leverage. Since the law requires that all Participating Security leverage must be invested in equity securities, the change would reintroduce the mismatched cash flows that saw the original SBIC program plagued with losses in the 1980s, the very result of which gave birth to the current program. Either the law would have to be changed to permit debt investments—unlikely given the express purpose of the program—or Participating Security funds would have to use a substantial amount of their capital for interest payments instead of investments—a purpose again at odds with legislative intent.

2. Second, the proposal would reintroduce Unrelated Business Taxable Income (UBTI) issues for Participating Security funds that raise private capital from tax-exempt institutional investors, the very investors SBA and SBIC management teams want to attract to the program. Funds that create UBTI for their institutional investors find it almost impossible to raise money from these investors. It is a major issue since tax-exempt institutional investors control approximately 65% of the capital in the U.S. available for investment in venture capital funds.

3. Finally, even if we were to assume that the 3.85% rate were to apply only to the extent of profits—perhaps unreasonable given the Administration's estimates—the proposal would leave all existing program negatives (e.g., capital impairment and restricted operations regulations) in place while substantially increasing the risk that an investor in a Participating Security SBIC would do less well than by investing in a non-SBIC fund.

   For example, assume a Participating Security fund with leverage to private capital ratio of 2:1 and a 6.0% prioritized payment rate attributable to the pool securities sold to raise the actual leverage. Both are reasonable assumptions for modeling purposes. Applying the proposed changes, the "new" program's fund IRR (internal rate of return) "hurdle" rate—the fund IRR rate at which an investor's net return is the same whether invested in an non-SBIC fund or a 2:1 leveraged SBIC—would increase from approximately 12.0% to 18.3%. That is an increase of 53%. At an 18.3% fund IRR, private investors would net approximately 11.3% whether invested in an SBIC or not. Above the "hurdle," a private investor in an SBIC would do better than an investor in a non-SBIC fund, but only marginally so at gross return rates that likely to apply at least for the near future. At a gross fund IRR of 20% an SBIC investor's net return would be approximately 14.6% versus 12.7% for an investor in a non-SBIC fund. At a fund IRR of 25%—a rate slightly above the 20-year average for all venture capital funds—the respective net returns would be approximately 21.5% versus 18%. For virtually all private investors, this substantially reduced potential for return enhancement would not be worth assumption of the substantially increased risk of worse returns (attributable to SBA's preferred status) that they would realize if they invested in a Participating Security fund that performed below the increased "hurdle" rate. The structure proposed by the Administration is simply one that cannot be made to work for knowledgeable private investors.

Before turning to NASBIC's proposed solution to the existing problem, we would like to highlight one additional problem with the Administration's proposal for the Participating Security program. The proposal leaves unanswered the question of what happens to existing Participating Security SBICs that may require leverage from commitments to be issued after September 30, 2004. The logical extension of the Administration's budget submission is that any leverage authority for years following FY 2004 that will be required to support Participating Security funds licensed before October 1, 2004—funds whose economic structures cannot be adjusted in line with the proposal for contract sanctity reasons—will have a positive subsidy rate and require an appropriation. However, no mention is made of the very real potential problem and no appropriation request is included for FY 2005. It may be that the Administration assumes that 5-year commitments purchased prior to October 1, 2004 will solve the problem. However, that will not be the case for many funds, especially those licensed in fiscal years 2002, 2003, and 2004. Is there a solution to the problem short of attaining appropriations for any relevant year? Perhaps. We would like to explore with the Committee the possibility of a legislative extension of the effective dates of commitments issued prior to October 1, 2004. If that is not possible, some other solution must be identified.

NASBIC proposes a new Participating Security program structure that meets the requirements of all program stakeholders.

If the current structure for the Participating Security program will not work for the Administration and the Administration's proposed structure will not work for SBIC management teams and their private investors, is there a structure that will meet the needs of all stakeholders? We believe there is. Attached to this testimony is a policy paper that outlines NASBIC's proposal. It is the same paper that we shared with this Committee, the Senate Committee on Small Business and Entrepreneurship, and the Administration in January. Following its submission, we forwarded to Committee staff a proposed draft of legislation that we believe would successfully implement that policy.

Simply stated, NASBIC's proposal would create a Participating Security structure within which SBA would enjoy 100% of its pro rata share of the profits of any profitable fund. The structure would create, at least in economic returns, a structure identical to that used in the private venture capital world. If such an economic structure been in place since the inception of the program, we believe SBA would be substantially better off financially than it is today—a fact that can be confirmed by SBA upon inquiry by this Committee. While it is true that SBA would have to surrender its preferred position with respect to private investors if our proposal were accepted, that preferred position has been of little economic comfort to SBA over the last ten years. That is precisely why it has found it necessary to propose the changes that are unacceptable to management teams and private investors. Those private investors include major banks who are members of the Small Business Investment Alliance, banks that have made substantial investments in SBICs in the past and would continue to support the program under the structure we have proposed. These banks are strong supporters of the community development role played by SBICs across the country.

The crucial question for the Administration will be how to project cost or gain to the government if NASBIC's proposal is accepted. Regarding that question, the 20-year net returns to investors in venture capital funds with economic structures such as we suggest have averaged, according to Venture Economics data, approximately 16% per year. The cost to SBA to guarantee interest for the pools of securities sold to raise Participating Security leverage has averaged 6.7% per year since the first pool was sold in 1995. Interest rates have been at very low levels for the past two years. Excluding the pool rates of those years yields an average rate of 7.0%. Thus, if Participating Security SBICs perform to industry averages, a program structured as we have proposed should make money for the taxpayers over and above the gain for the economy related to the economic activity of the small businesses receiving the equity investments. Under any reasonable analysis, the subsidy rate in a Participating Security program structured as we suggest should be zero—even if return data are discounted somewhat because SBICs invest in a wider variety of businesses that are more geographically dispersed, than non-SBIC funds.

Implementation of NASBIC's proposal would produce an additional benefit for SBA: reduced workload. SBA Investment Division personnel are severely taxed due to the complexity of the current program and the multiple subjective decision points that must be addressed for each Participating Security fund. There is no counterpart to that level of activity or substitution of judgment in the non-SBIC portion of the venture capital industry. Implementation of the NASBIC proposal would allow Investment Division personnel to focus primarily on the critical licensing process and, of equal importance, on compliance by operating SBICs with all investment requirements. The highest possible level of performance in both areas is critical to the success of the program in meeting its intended purposes. At a time when all organizations are called upon to "do more with less," this point is an important consideration.

Will private investors support the program without the possibility of enhanced returns? The answer for the largest majority of investors in venture capital funds—bank and non-bank institutional investors—is "yes." The large majority of those investors avoid the SBIC program because of the substantial number of negative elements in the program that are discussed in our policy paper. Institutional investors seek reasonable returns for the asset classes they invest in, venture capital being one of the classes. The complexity of the current program, the preferences accorded SBA, and the other negatives associated with the program, keep the large majority of institutional investors on the SBIC sidelines. The structure we have proposed will be seen as a great improvement by these critical investors.

Will talented fund management teams be attracted to the SBIC program if the structure proposed by NASBIC is accepted? Again, the answer is "yes." Notwithstanding the fact that institutional investors will find the structure acceptable, the universe of private capital from which SBIC management teams might draw will always be substantially smaller than the total universe of private capital dedicated to venture capital. That is so because SBICs can invest only in U.S. small businesses that meet the size and operational limits prescribed by the government. Thus, the government, by its guarantee, would serve as the creator of a substantial pool of capital from which qualified teams would be able to draw to achieve the fund sizes required to sustain operations if they want to invest in the types of opportunities dictated by the government.

In conclusion, thank you once again for the opportunity to appear today to give our views on the Administration's FY 2005 as the same pertains to the SBIC program. We look forward to working with the Committee this year to make certain the SBIC program, particularly a restructured Participating Security program, continues to meet the needs of all its stakeholders—especially the U.S. small businesses it is designed to serve.

NASBIC
America's Small Business Partners

Restructuring The SBA Participating Security Program

A. Summary

This paper discusses issues relevant to a possible restructuring of SBA's Participating Security (PS) program—created by Congress to increase the amount of equity capital invested in U.S. small businesses that meet size and operational requirements defined by the government. The program began in FY 1994, and the goal-oriented results through FY 2003 are impressive:

- More than $4.7 billion in private capital raised by the 221 privately managed PS funds.
- More than $7.4 billion invested by PS funds in U.S. small businesses during the period.

Notwithstanding its impressive start, the program's future is in doubt. SBA will lose substantial amounts associated with its guarantee of leverage for PS funds unable to generate profits sufficient to return that money. The 1997-2000 period was one of great increase in PS licensing and investment that was followed by a major collapse of the U.S. economy. Business failures and plummeting values of those that survived have made it all but inevitable that SBA will suffer substantial losses associated with investments made by PS funds during that period. In this regard, SBA is no different than virtually all investors making investments during the period.

OMB has used SBA's experience of the past ten years to change assumptions in the PS subsidy model that estimates how much the government might be expected to lose in the future. Not surprisingly, the model now predicts substantial future loses if the current economic structure of the PS program remains unchanged. While modeling based on results from such a short period, particularly one as abnormally volatile as the 1998-2001 period, is suspect at best, OMB has shown no inclination to change its opinion. A substantial increase in the subsidy rate would require a substantial—and likely impossible to secure—congressional appropriation to support the program at an effective level. Failure to secure the appropriation would reduce the PS program to a marginal program that would have virtually no impact on U.S. small businesses.

Industry is not opposed to an economic restructuring of the PS program. However, it cannot agree to a simple increase in SBA's of profits in profitable funds. Increasing SBA's profits without addressing program elements that are objectionable to private investors and management teams would yield the same negative result as trying to attain a major appropriation to support estimated program losses. The negatives elements are SBA preferences and debt-oriented credit restrictions in what is intended to be an equity investment program. The provisions do not protect SBA effectively and alienate the very private investors and management teams that SBA wants to attract.

A restructured PS program that eliminates these negative elements and sees SBA become, in economic terms, a pro rata investor in PS funds—an investor entitled to its full share of the profits of each fund it invests in—will best serve the interests of both government and industry. It will ensure a zero subsidy rate, the approval of the largest majority of private investors, and the availability of talented professional management teams crucial to the success of the program. NASBIC urges the Administration and Congress to support this restructuring approach.

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B. Current Status Of The Participating Security Program

1. Section 102 of the Small Business Investment Act (SBIA) provides the policy behind the SBIC program, including the PS program:

    "It is declared to be the policy of congress and the purpose of the Act to improve and stimulate the national economy in general and the small-business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply: Provided, however, that this policy shall be carried out in such manner as to insure the maximum participation of private financing sources."

2. The SBIA does not indicate what financial result the government should realize in its running of the SBIC program. The only admonition is found in §303(e), the section dealing with "Capital Impairment." It provides that before advancing leverage to an SBIC, SBA should determine that doing so would not "create or otherwise contribute to an unreasonable risk of default or loss to the Federal Government."

3. Working with SBA, OMB sets the government's subsidy rate for the program. These annual calculations produce results that dictate how much must be placed in "reserve" to pay for projected out-year losses associated with leverage issued under any given year's authority. If the required reserve cannot be met by projected fees, profit shares, and subsidy "buy-down" prioritized payments paid by PS SBICs, Congress must appropriate the difference if it wishes to continue the program.

4. Based on current losses in the PS program, if no changes are made in the program's structure, OMB will project substantial losses for SBA's guarantee of any leverage to be issued in FY 2005 and thereafter. Although this may not be justified based on long-term historical returns to LPs in the venture industry, OMB is unlikely to be challenged successfully by either Congress or the industry with respect to its assumptions.

5. Given the above, the FY 2005 PS budget might be submitted in one of two ways. The likely way would see the budget propose to make substantial leverage (e.g., $4.0 billion) available in FY 2005 at no cost to the government (a "zero" subsidy rate)—with the caveat that the budget assumes and is predicated upon passage of proposed legislation either already submitted (or to be submitted) to Congress by the Administration. The most likely reference will be to the legislative proposal made in July of 2003.

6. If restructuring legislation is not passed, projected losses will be accounted for with a positive subsidy rate, requiring an appropriation to support the amount of leverage authority desired. The original subsidy rate for the program was 9%. At that rate, $4.0 billion in authority (the FY'04 authority) would require a $360 million appropriation. Assuming that the "subsidy buy-down" prioritized payment rate (which did not exist in

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1994) would make up a portion of the requirement, a subsidy rate of something less than might be likely. However, even a 5% rate would require an appropriation of $200 million for $4.0 billion in leverage authority.

7. Any appropriation above $44 million—the high water mark that supported SBIC program leverage in FY'95—would likely be impossible to secure given the current budget environment, especially if no appropriation is requested by the Administration. Securing half that amount might be possible, although still difficult. Assuming a $40 million to $20 million appropriation range and a subsidy rate range between 5% and 10%, PS leverage availability in FY'05 might be anywhere from $200 million on the low side to $800 million on the high side. The current demand is estimated at $1.3 billion per year. The substantial shortfall would all but eliminate SBA's ability to issue five-year leverage commitments and leverage rationing would likely be inevitable. The program would continue, but would be marginalized. Support for the program by knowledgeable investors and talented management teams would evaporate.

C. Current Structural Elements Of The Participating Security Program.

1. Investment and Geographic Focus Requirements. The government imposes restrictions on the types and sizes of companies in which PS funds can invest. The government also takes into account the need for venture capital in the areas of investment focus stipulated by PS fund license applicants in deciding whether or not to grant a license. These foundation blocks will not change in any restructuring of the program.

2. Leverage Commitment and Draw Fees. Totaling 3.5% at present, all commitment and draw fees (with the exception of the 0.5% underwriting fee included in the total) are paid directly to the government. The fees are among the SBA cash flows used to predict future SBA losses in the program. With respect to private investors, they equate to preferred returns for SBA.

3. Leverage Pool Prioritized Payments. These contingent preferred payments (SBA's right to them dependent on an SBIC's profitability) are intended to reimburse SBA for the interest it has advanced to pay interest to investors purchasing interests in the pools of securities sold to raise the leverage drawn by the particular SBIC involved. The payments are preferred payments to SBA vis-à-vis private investors.

4. SBA-Dedicated Prioritized Payments. These SBA preferred payments, again made only if and when an SBIC becomes profitable, are based on variable rates set annually by Congress at the request of SBA / OMB. Like leverage commitment and draw fees, their purpose is to off-set predicted losses associated with the failure of SBICs to repay leverage principal and/or leverage pool prioritized payments.

5. A Reduced and Variable Profit Share For SBA. In return for investment restrictions, preferred returns, and debt-oriented credit risks discussed below, SBA receives a reduced, variable profit share from profitable PS funds. SBA's profit share is calculated by

reference to both an applicable 10-year Treasury bond rate and maximum leverage ratio—a formula that, for modeling purposes, is generally accepted to yield an approximate 9% SBA profit at a 2:1 leverage ratio.

6. Complex Distribution Rules. The distribution rules are designed to regulate the return of SBA's prioritized return (in profitable SBICs), capital (SBA leverage and private capital), and profits. The distribution rules are complex and alien to investors accustomed to investing in non-SBIC venture capital funds.

7. Conditional SBA Commitments. A statutory provision in the SBIA requires SBA to conduct what amounts to a credit evaluation before advancing any leverage, irrespective of the fact that an SBIC may have already paid for a commitment. Under this authority, SBA may dishonor its commitments based on its unilateral determination that advancement of additional funds would increase risk of loss to the government, notwithstanding the fact that advancement of the amounts would be required to implement the full business plan approved by SBA in the licensing process. Thus, all SBA commitments are, in a legal sense, conditional. Private investor commitments, required to secure the PS license, are unconditional.

8. Capital Impairment Regulations. By reference to the capital impairment section of the SBIA to its general obligation to protect the interests of the taxpayers, SBA has adopted capital impairment regulations that permit it to restrict or shut down the operation of a fund by restricting its ability to make any additional investments (even with private capital) and, at SBA's option, to call remaining private capital for the sole purpose of repaying outstanding leverage. Private investors are particularly upset by these rights. While they understand and accept the risk of loss if the capital is put to its intended purpose—investment in small businesses—they are adamantly opposed to having their capital paid directly to SBA.

9. Liquidation Preference. Once an SBIC has been moved to "liquidation" status, which may be based on either regulatory violations or degree of capital impairment, SBA enjoys a preference vis-à-vis private LPs with respect to outstanding leverage and any earned but unpaid prioritized payments.

10. Absolute Control of Significant LP Rights. Absent SBA approval, private LPs in SBICs have no right to take any action on significant issues (e.g., management change, "no-fault divorce," etc.) generally within their province in non-SBIC funds. Non-SBIC funds generally provide for LP action in certain areas by vote of a super majority of LPs in the fund. Experienced LPs are very uncomfortable with any one LP holding a dominant position in a fund. That is even more so when the LP is the government.

D. The Best Alternative For Restructuring the Participating Security Program

1. Any restructuring should address each of the following policy imperatives:

   (a) The program should stimulate investment in U.S. small businesses to the greatest extent possible during times of scarce capital availability.

   (b) The program should accomplish its mission at the least possible cost to the government.

   (c) The program should be attractive to the largest possible percentage of knowledgeable private investors.

   (d) The program should be attractive to the largest possible percentage of high quality venture capital fund management professionals.

   (e) The program should not distort private market dynamics any more than required to meet the objectives of the program.

2. The structural alternative that best meets all policy requirements would see SBA:

   (a) surrender its rights listed in §§2 through 9 of Paragraph C;

   (b) agree to a reasonable dilution of its voting "power" within the LP structure to the extent required by the "market" (defined as representative institutional investors); and

   (c) retain 100% of its pro rata economic interest in the fund.

3. Under this structure, SBA and private LPs would share profits and losses on a pro rata basis. Other than investment and geographic restrictions, a PS fund would be managed in almost all respects like non-SBIC venture capital counterparts in the private sector.

4. From the government's perspective, consideration of future losses should be eliminated so long as the government invested in SBICs on a regular basis. The average net return to private LPs in venture capital funds has been approximately 16% over the past 20 years according to Venture Economics. Even if discounted by some factor, returns to the government would still be positive over any reasonably projected period of time.

5. From the perspective of private investors, the only issue of importance would become whether the PS fund management team had the skills and business plan likely to produce standard returns for the asset class. There would be no distortion of investment decisions driven by the possibility of enhanced returns due to structural reasons alone. PS funds would still represent one of the best opportunities for investors to receive returns from investments in growing small businesses. The non-SBIC segment of the private equity industry has focused predominantly on larger investments in larger companies. SBICs would be of particular interest to those state pension funds and other institutional funds willing to invest in some venture capital funds that agree to invest in underserved markets. The current negative elements generally keep these investors on the sideline.

6. Finally, from the perspective of professional management teams required to actually "drive" the program, SBA would, for the first time, represent the possibility of securing "normal" capital that might satisfy up to two thirds of the amount required to reach the fund size required to start and sustain investment operations. To put the importance of this fact in perspective, many (if not most) institutional investors do not want their investment to constitute more than 10% of any venture capital fund. This fact would make the SBIC program very attractive to talented teams trying to raise capital during times when private capital is scarce—such as the present time—and at least very worthy of consideration during other times.

7. It is true that the very fact that the "government is involved" might make the program less attractive to management teams during times when private capital available for investment in venture capital funds is plentiful. However, that fact would make the program directly responsive to the policy articulated in the SBIA: a program "to stimulate and supplement the flow of private equity capital ... which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply...."

8. In view of the above, NASBIC urges the Administration to support a restructuring of the Participating Security SBIC program that would see SBA become a "regular" Limited Partner in the PS funds to the degree of investment committed to in the licensing process.

E. SBA's Pending Proposal Will Not Meet The Policy Objectives For The PS Program

1. In July 2003, SBA proposed a restructuring of the PS program that would increase the share of profits to which it is entitled by approximately 300%, but in all other respects would leave the program unchanged.

2. Although the potential for enhancement of private LP would remain, the potential would be greatly reduced from that of the current structure. Thus, the risk / reward balance would change dramatically with a 300% increase in SBA's profits and no corresponding reduction of complexity and / or private LP risk related to negative elements listed in Section C. This is particularly so given that many experts believe that average gross returns for venture capital funds may be no greater than the current SBIC "hurdle rate" of approximately 12% for the next decade.

3. SBA's proposal will not achieve the goal articulated in the SBIA or the other important policy considerations listed above. It retains all the unpopular complexity and unquantifiable risk elements of the current structure while reducing potential private investor returns. Adoption of the proposal would severely limit the pool of venture capital management professionals interested managing a PS SBIC. It would also limit the pool of likely investors to those who either did not understand the risks involved or who were attracted only by the potential for an enhanced return no matter how long the odds. Neither result would be good for the either the PS program—or for the U.S. small businesses the program is designed to serve.

February 11, 2004

Testimony before Congressional Committee on SBA funding

Chairman Manzullo, Ranking Member Velazquez, and members of the House Small Business Committee. Thank-you for the opportunity to address you today regarding the SBA funding cap and related matters.

My name is David Pilcher, and I am the financial officer of Ted R. Sanders Moving and Warehouse, Inc., an agent of Allied Van Lines. We are a family-run business with active participation by most of the owner's family, employing 30-40 people. In fact, this will be his family's 109th year in this business. Shortly after I joined the Company one and a half years ago, we realized that we could significantly improve our cash flow by refinancing the mortgage on our building. We were half way through the 10-year term of our current mortgage, and interest rates were, and continue to be, very favorable. After talking to several lending institutions without success, we contacted the SBA division of US Bank in Nashville, met with them, and spent many hours accumulating the required paperwork. The outlook appeared positive for us.

In mid-December, after doing virtually everything asked of us and within the required time frame, we were told our application looked good and would receive approval, for a new mortgage in an amount of $1,500,000 through the SBA 7a program. Then suddenly, in January we learned that everything had been put on hold because of the SBA shutdown. And worse, when the program resumes, there's a cap of $750,000 with no additional participation, or piggybacking, allowed to make up the needed difference. I can't adequately express to you how devastating this bad news was for our company. In effect, the rug had been pulled out from under us. Because this is a re-finance, no alternative is currently available to us.

This SBA guaranteed loan would have freed up over $ 7,000 per month of real cash flow (i.e. $84,000 annually) at the present interest rate. To a small business like ours, this is a very significant amount of money. This money could be used in several ways to improve and grow our business, such as, hiring additional sales and/or labor staff, upgrading our truck fleet, or upgrading our warehouse facility. I don't have to explain to you that this growth would also generate new tax dollars as well.

Small business, as you know, is the lifeblood of this country, and it needs to be supported in positive ways wherever possible. I realize we are not alone in this struggle. In one of our local papers, I read last week about a businessman who was trying to close an SBA loan, also in a timely manner, in order to purchase and remodel a building for a new business. It was reported that he might lose a six figure down payment because of these delays.

On behalf of Ted. R. Sanders Moving and Warehouse and all small businesses throughout the country, we urge you to restore full funding to this program, return the loan cap to the $2 million level, and especially restore the piggybacking provision. We thank you for your time and attention.

Respectfully submitted,
David M. Pilcher, CPA

David M. Pilcher

ASBDC Association of Small Business Development Centers®

Statement of

Donald Wilson

President, Association of Small Business Development Centers

February 11, 2004

Before the

U.S. House of Representatives Committee on Small Business

Chairman Manzullo, Ranking Member Velazquez, and Members of the House Small Business Committee; I am Donald Wilson, President and CEO of the Association of Small Business Development Centers (ASBDC). ASBDC's members are the sixty-three State, Regional and Territorial Small Business Development Center programs comprising America's Small Business Development Center Network. SBDC programs are located in all fifty-states, the District of Columbia, Puerto Rico, The Virgin Islands, Guam and American Samoa. The SBDC network is the federal government's largest small business management and technical assistance program with approximately 1,000 service centers nationwide serving more clients than all other Small Business Administration assistance programs combined.

Mr. Chairman, I would like to thank you and the House Small Business Committee on behalf of ASBDC, and the nearly 6,000 dedicated men and women who are a part of America's Small Business Development Center Network, for inviting the Association to testify at this important hearing on the Administration's FY 2005 budget for the Small Business Administration. In light of the nation's current economic conditions, it is extremely important that this committee and the Congress focus attention on what federal resources will be allocated in FY2005 to assist and support the small business sector of the economy which represents fifty-two percent of the nation's Gross Domestic Product (GDP). And rather than simply focusing on what the Administration's budget proposal means to small business, we need to focus on what it means for our entire economy.

I would also like to take a moment Mr. Chairman to thank you, Ranking Member Velazquez and the members of this committee for all of your efforts on behalf of small business throughout the 108th Congress. This committee by a unanimous bipartisan vote last session reported out a monumental and long-needed rewrite of the SBA Act. You worked hard to help address the crisis a few weeks ago in the 7(a) loan program which is critically important to so many small business owners and SBDC clients. You have approved and the House has passed HR 205, the Small Business Regulatory Assistance Act authored by Congressman Sweeney. This committee has approved and the House has passed HR 1166 authored by Congressman Udall to enhance the delivery of management and technical assistance to Native Americans. And you have approved and the House has passed HR 1387, the Vocational and Technical Entrepreneurship Development Act of 2003 authored by Congressman Brady.

We hope members of this committee will encourage their colleagues, both in the House and the Senate, to finish the SBA reauthorization bill, and encourage your Senate colleagues to act favorably on the Sweeney bill. Small businesses need these bills signed into law. Equally important Mr. Chairman, with you and Ranking Member Velazquez, working together in a bi-partisan fashion this committee has been used effectively as a bully pulpit to highlight, unreasonable and ineffective government regulations and policies that impede the ability of small businesses to grow and create jobs. I know I speak for SBDC clients and counselors across the nation when I say we are deeply appreciative of the efforts of this committee during the 108th Congress.

Let me focus my remarks for a few moments on the general state of the nation's economy, the overall SBA budget for FY 2005, and the contribution of small businesses to our economy. I will then focus my remaining remarks on the Administration's proposal to reduce the federal funding level for the SBDC national program to $88 million and what we believe is truly needed to adequately fund this vital program.

Members of this committee are well aware that the general health of the nation's economy, while apparently improving, is tenuous at best. Current economic data demonstrates that the economy is sending mixed signals. Fourth quarter GDP was a relatively strong 4.0 percent. However, that rate of increase represented a sharp drop from the third quarter's 8.2 % GDP growth. And many question whether 4% growth is sustainable.

Productivity for non-farm businesses rose 2.7 percent in the fourth quarter. But that was down sharply from the 9.5 percent growth in the third quarter. While productivity is up significantly during the last six months, that rising productivity uncharacteristically is not being translated into wage growth. Average hourly wages in December only increased from $15.47 to $15.49. Wage growth is crucial to sustain consumer spending, which is so vital to this economy. Consumer spending rose only 2.6 percent in the fourth quarter of last year. That represents a sharp slowdown from the 6.9 percent gain in consumer spending from last year's third quarter.

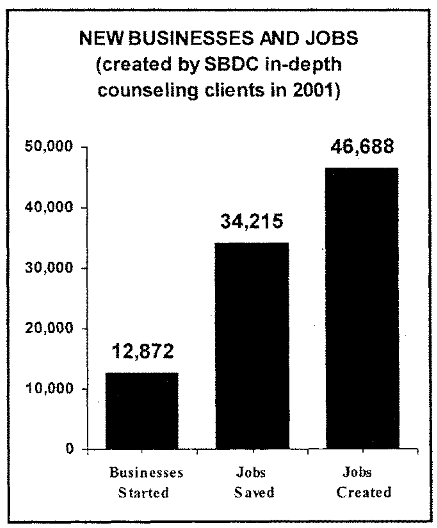
Individual bankruptcy filings were up in 2003. Fortunately, in 2003, business bankruptcy filings stopped rising and actually fell by 5.2 percent to 37,182 from 39,201 in 2002. And the stock market improved significantly during 2003.

But the real issue as always is jobs. The lack of job creation is of paramount concern to everyone, especially the millions of Americans who are currently out of work. The nation's unemployment rate, based on the household survey, declined from 5.9 percent in November to 5.7 percent in December and to 5.6 percent in January. Disturbingly, however, the number of initial jobless claims for the week ending January 31 increased by 17,000 to 356,000. In December we know that the decline in unemployment was directly attributable to the fact that more than 300,000 Americans gave up looking for work during December and left the labor force. In other words, the civilian labor force actually declined by 309,000 in December.

Despite significant economic stimulus from tax cuts that took effect last summer, the economy was only able to create 16,000 new jobs in December, 149,000 below the consensus estimate. And October and November payroll jobs were revised downward by 51,000. From the first of September through the end of December, the economy created 278,000 net new private sector jobs, an average of 70,000 jobs per month. That's an improvement compared to previous months. However, it is an extraordinarily weak figure when compared to the average of 210,000 jobs created per month during the period from January of 1992 through December of 2000. January job creation improved to 112,000 but that was 32% below the level anticipated by a consensus of leading economist.

In December, employment in retail trade declined by 38,000. Manufacturing employment, which I know is of particular concern to you Mr. Chairman, was down by 26,000 in December. The nation's manufacturing sector lost 516,000 jobs last year and has shed 2.8 million jobs since July 2000, the last month it recorded a gain. In January, the nation's manufacturing sector lost another 11,000 jobs, the 42nd straight month of falling factory payrolls. Today, nearly 9 million Americans are unemployed. Another 5 million are working part-time who would rather be working full-time. And 2 million Americans have been jobless for 26 weeks or more, the highest level of long-term unemployment since 1984.

And what is the reaction of respected economists to last Friday's employment numbers? For example, Lara Rhame, former Federal Reserve Economist and now senior economist at Brown Brothers Harriman said last Friday, "The report is certainly better than in December, but it just doesn't reflect the level of job creation we'd expect to see at this stage of the economic recovery." Richard Yamarone, chief economist at Argus Research said, "Two and a half years into this recovery, and the economy can only muster up 112,000 new jobs? That's a bad number, not a good number." I think Mr. Yamarone's comments reflect the reaction of most Americans. Last year at this time, the annual Economic Report of the President predicted the economy would generate 1.7 million jobs during the year. But the economy actually lost 53,000 jobs. On Monday, the newly released Economic Report of the President predicted job creation for this year at 2.7 million. We hope that report is more accurate than its immediate predecessor.

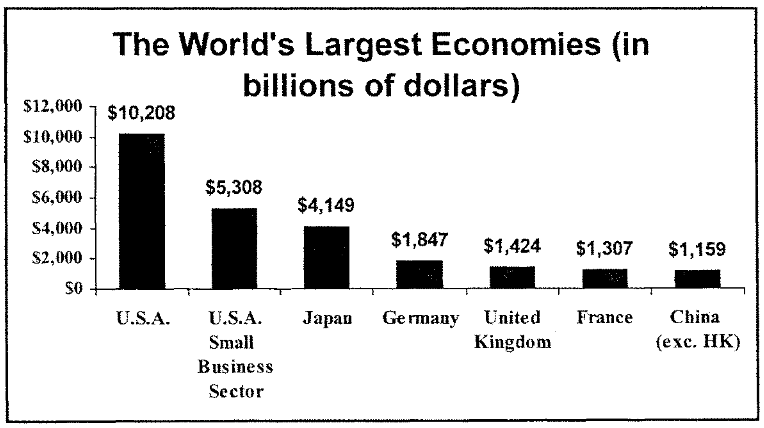


When Congress passed the Administration's tax cut package last summer, administration economists predicted those tax cuts would generate an additional 510,000 jobs by the end of

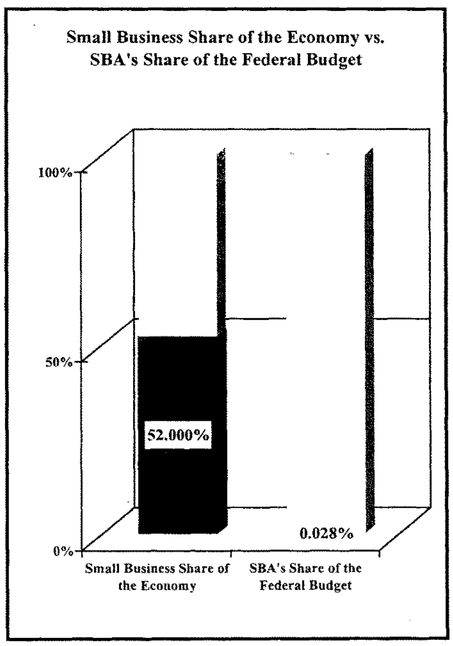
2003, above and beyond the number of jobs that an economy two years into recovery would normally be expected to produce. We now know that the 2003 level of job creation predicted to result from the tax cuts was not achieved. The Council of Economic Advisors (CEA) projected 5.5 million new jobs overall from July 2003 through the end of 2004. In the six months since the tax package was adopted, the economy has generated less than 350,000 new jobs. It is now evident that the level of job creation which the CEA predicted to occur by the end of 2004 and that we all hoped for, will almost certainly not be realized.

When reflecting on these disturbing unemployment numbers, I hope you will consider the findings of a Census Bureau working paper released early last year and authored by Zoltan Acs and Catharine Armington of the Center for Economic Studies. Their research found that "establishments that were less than two years old accounted for all net job growth" in the study period, 1995-1996. The working paper went on to report that "although most people work in older establishments, growth comes primarily from new establishments." (*Endogenous Growth and Entrepreneurial Activity in Cities by* Zoltan J. Acs and Catherine Armington, Center for Economic Studies, U.S. Bureau of the Census, Working Paper #CES-WP-03-2, January 2003). I should also point out that the 2002 economic impact study of SBDC long term counseling conducted by Dr. James Chrisman of Mississippi State University, (formerly with the University of Calgary), reported that **SBDC long term counseling clients generated 46,688 new jobs in 2001**. The Chrisman Study also reported that an additional **34,215 jobs were saved due to SBSDC counseling** and that **the average change of employment rate for SBDC established business clients was 8.4%, over ten times the rate of the average U.S. business.**

This committee is aware that America's small business sector employs 51% percent of non-farm civilian workers, creates roughly two-thirds of all new jobs and contributes roughly 42% of treasury receipts. This committee is aware that the small business sector of the American economy is responsible for 52 % of the nation's gross domestic product. But are you aware that the small business sector of America's economy is effectively the second largest economy in the world? Let me repeat that statement if I may. **The small business sector of America's economy is effectively the second largest economy in the world!**



Ranking Member Velazquez frequently makes the point that "small business is big business in America." And she is right. Our nation's gross domestic product for 2002 was $10.2 trillion. The gross domestic product generated by this nation's small business sector in 2002 was just over $ 5.3 trillion. That figure is larger than the entire Japanese economy. The GDP generated by America's small business sector is larger than the economies of Germany, France and Great Britain combined. Those three countries have the world's third, fourth and fifth largest economies. The gross domestic product generated by the small business sector of America's economy is larger than the total GDP of Canada, Mexico, Spain, Brazil, India, Korea, the Netherlands, Australia, the Russian Federation, Taiwan, Argentina and Switzerland **combined!** Those countries I just named are not third world undeveloped countries. Those nations are twelve of the 20 largest economies in the world. And to assist and help sustain the wellbeing of the 23 million American small businesses that are responsible for providing 52 % of this nation's GDP, our nation's budgeters are able to find just $678.4 million for the Small Business Administration out of a $ 2.4 trillion dollar budget. Some might conclude that those who crafted this year's federal budget are overlooking the obvious importance of the nation's small business sector to the present and future economic well being of this nation.



Some will respond that, at a time when we are fighting a war against terrorism, it is not reasonable to expect a larger share of the federal budget to be directed toward the needs of the small business sector of our economy. I would not presume to tell the Congress what is a reasonable figure for the SBA. But what I can tell you Mr. Chairman is that, at the height of the Vietnam War, Congress allocated two-tenths of one percent (.2%) of the 1968 Federal budget to the SBA . As recently as 1980, the SBA budget represented three-tenths of one percent of the federal budget. **The budget the Administration submitted to the Congress on February 3 rd, allocates only three-one hundredths of one percent (.03%) of federal resources to the SBA.** And the SBA budget essentially represents the federal government's resource commitment to small business. I cannot imagine that this committee with its understanding of the contribution that small businesses make to our economy can possibly believe this stunningly low figure represents a prudent allocation of federal resources.

With the economy continuing to struggle and with small businesses responsible for 70 percent of job creation and 52% of GDP, it is difficult to understand why OMB would propose spending an SBA budget for FY 2005 that is $119.5 million less than OMB proposed for SBA for FY 2004. That amounts to a 15% cut in SBA funding. Surely, the nation's small business sector deserves better. Administrator Barreto has done a solid job at the agency, initiating creative and beneficial programs like the Business Matchmaking program which SBA partnered with HP. But it is doubtful that any SBA Administrator will be able to effectively meet the needs of 23 million small business owners with the limited resources proposed in the Administration's FY 2005 SBA budget.

Mr. Chairman, the Labor Department's disturbingly weak employment numbers tell us that while small business job creation may be improving, it remains woefully inadequate. Attempted startups are increasing simply because hundreds of thousands of Americans, discouraged because they cannot find jobs, are turning to self-employment as a last resort to try and support their families. Many of these individuals have skills, but most have no business management experience or training. The unemployed furniture plant worker whose unemployment benefits have run out may be a fine carpenter. He or she may theoretically be able to craft cabinetry in the garage at home to sustain the family until economic times improve. But he or she likely has no experience in finance, marketing, developing a market niche, and they certainly do not know how to develop a business plan if they need access to capital. By providing displaced workers with the expertise and business management knowledge they need to be successful, SBDC's help thousands of unemployed persons who, of necessity have become aspiring entrepreneurs, to become successful business owners.

But America's Small Business Development Centers are certainly not just serving unemployed Americans who turn to self-employment out of desperation. The well regarded national survey on the economic impact of SBDC counseling activities conducted every two years by Dr. James Chrisman of Mississippi State University found that in 2000, fifty-three percent of SBDC long term counseling clients were established businesses and forty-seven percent were pre-venture clients.

The latest SBA figures for the SBDC national program show that SBDC counseling cases and training attendees combined increased from 650,000 in FY 2002 to 685,000 in FY 2003. Counseling hours increased from 1.47 million to nearly 1.57 million. Training attendees increased from 384,000 in 2002 to 408,000 in 2003. Training hours increased from 1.58 million in 2002 to 2.08 million in 2003. These figures clearly demonstrate that America's small business owners know they need help and are increasingly seeking it from the SBDC national network. ASBDC and the men and women who work in the SBDC national program are proud of those increases in productivity. We hope this committee is as well.

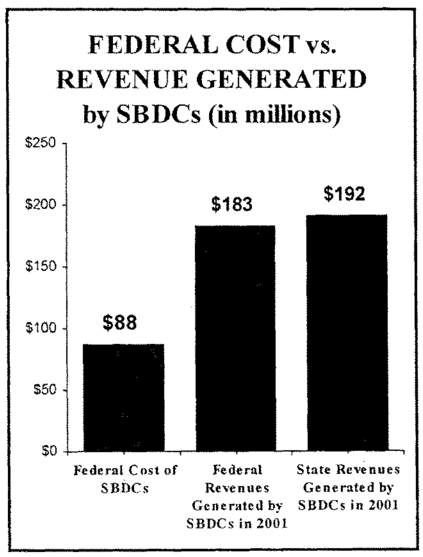
And who are these men and women who are SBDC clients seeking assistance? They are far more than simply SBA statistics. They are hardworking men and women, with dreams like Wai Tim Ho a restaurateur in Ms. Velazquez's district whose establishment was severely impacted by 9/11; Suzanne Joyce, President of Tech Guard Security in Chesterfield, Missouri in Congressman Aikin's district; an entrepreneurial veteran, Colonel Vincent Zike, owner of Challenge Coin Company in Congresswoman Sue Kelly's district; Theresa Hoffman a founding member of Maine's Indian Basketmakers Alliance in Congressman Michaud's District; Victoria

Archable, owner of a small Cincinnati manufacturing firm in Congressman Chabot's district and Edward Mitchell, proprietor of Mitchell's Barbecue in Wilson, North Carolina in Congressman Ballance's district. I would encourage every member of this committee to seek out business owners who have used SBDC services to learn about the real difference the SBDC program is making in these people's lives.

SBA's latest figures show that **41% of SBDC clients nationwide are women. Twenty-nine percent of SBDC clients are minorities. Over 9 % of SBDC clients are self- identified veterans**.

Those who crafted the President's budget will no doubt argue that they cannot find additional resources for SBA or the SBDC program because of a lack of financial resources. And federal revenues today Mr. Chairman are significantly below what they were in FY 2000. In FY 2000 Gross Federal Receipts were $ 2.025 trillion. Federal revenues have now fallen for three consecutive years to $1.991 trillion in FY 2001, $1.853 trillion in FY 2002 and to $1.782 trillion in FY 2003. These numbers are particularly concerning when you realize that there has not been a three year decline in federal revenues since the 1920s. But providing additional resources to SBDCs is not a drain on the Treasury. In fact, for every dollar appropriated to the SBDC national program, the program generates a better than two to one return for the Treasury. And every dollar appropriated by the federal government to the SBDC national program to assist small businesses to survive, grow, and create jobs leverages at least an additional dollar in small business assistance. That is so Mr. Chairman because, as you know, to secure a federal dollar, SBDCs must raise a non-federal matching dollar.

The 2002 national survey on the economic impact of SBDC long term counseling conducted by Dr. James Chrisman of Mississippi State University, reported that combined, the incremental performance of SBDC established business clients and pre-venture clients who started businesses, generated $182.9 million in new federal revenues in 2001 and an additional $192.3 million in state revenues. Comparatively, the SBDC national program received a federal appropriation of only $ 87.87 million in FY 2001.



More recent tax revenue figures from individual states are similarly impressive. Based on a 2003 survey of North Carolina SBTDC clients receiving long term counseling in 2001, Dr. Chrisman estimates that "the incremental performance of established business clients yielded $2.12 million in tax revenues; another $4.24 million in tax revenues were gained from pre-venture clients who started new businesses. The total amounted to almost $6.36 million in tax revues, of which approximately $2.74 million went to the state (North Carolina) and $3.62 million, went to the federal government." Please note that the North Carolina SBTDC received $ 2,248,292 in SBDC program funds from SBA in 2002.

Similarly in Missouri, based on a 2003 survey of SBDC clients receiving long term counseling in 2001, Dr. Chrisman estimates that "The incremental performance of established business clients yielded $3.7 million in tax revenues; another $3.9 million in tax revenues were gained from pre-venture clients who started new businesses. The total amounted to almost $7.6 million in tax revenues, of which approximately $3.9 million went to the state (Missouri) and $3.7 million, went to the federal government. Missouri in 2002 received $1,562,964 in SBDC program funds from the SBA.

And in Wyoming based on a 2003 survey of SBDC clients receiving long term counseling in 2001, Dr. Chrisman estimates that "The incremental performance of established business clients yielded $1.04 million in tax revenues; another $1.04 million in tax revenues were gained from pre-venture clients who started new businesses. The total amounted to $2.18 million in tax revenues, of which approximately $0.77 million went to the state (Wyoming) and $1.41 million went to the federal government. Wyoming in 2002 received $500,000 in SBDC program funds from the SBA.

And those numbers do not reflect what could be accomplished with a larger appropriation. Based on historical performance levels, an SBDC appropriation of $125 million (the level Congress authorized for FY 2003) would allow the network to assist its clients in generating over 100,000 new full-time jobs, and increase federal revenues by nearly $270 million and state revenues by nearly $400 million.

Mr. Chairman, I think this committee can readily see from the data I have provided that the level of new federal tax revenues generated by SBDC counseling clients is substantially greater than the appropriation the SBDC national program receives from Congress. And with the nation facing growing federal deficits it seems only logical that Congress would increasingly want to direct scarce federal resources to programs that have a positive return on investment (ROI). Unfortunately, that has not been the case.

Twenty-four state SBDC programs, including Illinois, New York, Missouri, West Virginia, Pennsylvania, Ohio, New Jersey, and Indiana receive fewer federal dollars today than they did in FY 2002. The SBDC national program in FY 2004 will receive less in actual dollars than it did in FY2003 and OMB has crafted a budget for FY 2005 that proposes to reduce SBDC national program funding even further.

Mr. Chairman, the statistics I have shared with you today demonstrates that the proposed FY 2005 Federal budget neglects the most critical job creating component of our economy, our nation's small and startup businesses. We can continue that neglect, but at what price? You need look no further than the millions of unemployed, the historically low level of job creation over the last three years, three years of declining federal revenues and record breaking budget deficits to know that we are not effectively allocating federal resources. Small businesses understand that to survive they must invest in those business lines that have a positive return on investment.

Regretfully, the folks who prepared this proposed budget do not seem to understand that principal, perhaps because they have never had to meet a payroll.

The mixed economic data being released indicate that the economy is at a critical juncture. The Federal Reserve has reduced interest rates to the lowest level in 70 years to try and stimulate the economy. The Congress and the Administration have enacted significant tax cuts trying to stimulate the economy at the risk of the largest deficits in history in actual dollar terms, (not as a percentage of GDP.) And still the economy appears unable to generate jobs in significant numbers. I am certainly not wise enough to suggest what changes in fiscal or monetary policy can improve the current situation. I can tell you, however, that there is one small program that gets big results. And that is the Small Business Development Center Program.

This committee in 2000 authorized $125 million for the SBDC program for FY 2003. You did so because you understood the needs of small businesses. If the Federal government does not allocate resources to the SBDC program at a level approximating $125 million for FY 2000, the management and technical assistance needs of tens of thousands of small firms will go unmet and thousands of existing and prospective private sector jobs will likely be lost. My daughter graduated from college last May. She was fortunate and found work relatively quickly. However, I have watched as many of her classmates struggled to find jobs. My son graduated from high school last June. He was able to go on to college. But tens of thousands of young men and women who graduated high school last June are looking for work today. And some of them will be looking for work a year from now unless Congress does more to help small businesses generate new jobs.

Hundreds of thousands, if not millions, of small businesses are struggling to cope with skyrocketing health care costs, rising energy prices, declining sales, etc. Some of our SBDCs are working with the Health Care Leadership Council to develop tools to better educated small business owners about available options for employee health care. Working with the American Public Power Association, Energy Star for Small Business at EPA, the Department of Energy and Rebuild America, ASBDC has produced Energy Efficiency Pays, A Guide for the Small Business Owner. That guide is available to any small business owner on the ASBDC website. ASBDC and its members are working with the Department of Veterans Affairs, the Veterans Entrepreneurship Taskforce and the Veterans Corporation to launch a major initiative to provide long term entrepreneurial education to an increasing number of our nation's veterans. The Pennsylvania SBDC has introduced the Pennsylvania Material Trader, a new on-line service that makes it easy for small businesses to exchange and reuse traditionally discarded materials. Every day SBDC counselors and center directors are developing new ideas and methods to help their small business clients survive and grow. These clients are in retail, service, and manufacturing. And reliable data demonstrates that SBDC counseling clients have a better chance of success than the average small business.

Research conducted for the Pennsylvania SBDC, by Dr. Chrisman found that 84% of Pennsylvania startup clients receiving counseling in 1992 were still in business in 2000. Seventy-five percent of startup clients receiving counseling in 1994 were still in business in 2000 and eighty percent of startup clients receiving counseling in 1996 were still in business in 2000. **This data indicates that startup firms receiving SBDC counseling have a survival rate approximately 35% higher than the general population of new businesses in the U.S.**

This committee has a unique insight into the needs of the small business community. You also understand better than most the contribution small businesses make to our economy. Mr. Chairman, very shortly now, you will be submitting a letter to the House Budget Committee regarding the needs of programs under this committee's jurisdiction. If this committee will not speak up and ask the Budget Committee to assure that the nation's small business sector receive a fairer and more realistic share of federal resources, who will? Congress needs to reassert itself in the budget process. OMB has essentially set budget priorities the last three years and the economic results are less than required to inspire continued confidence. And lest anyone think that I am being partisan and unduly critical of the current administration's budget office, I would remind this committee that in 1999 President Clinton's budget office recommended a $25 million cut in the SBDC national program for FY 2000. And I will never forget Congressman Pascrell's strong public criticism of that budget proposal before this committee despite that fact that the President who submitted that proposal was from his own party.

On January 23rd of this year, President Bush told the U.S. Conference of Mayors that "When more people own a small business, when people are starting their own business, when people are creating small businesses, they're creating jobs." I do not doubt that the President believes what he said. Unfortunately, his views have not been effectively conveyed to those who crafted his budget. I hope this committee shares the President's view and that you and your colleagues in Congress will help him translate his words into deeds.

Mr. Chairman, we are not talking large sums of money. Doubling the funding level for small business non-credit assistance programs at SBA would be less than a rounding error at virtually every other federal agency. A continued lack of jobs threatens the economic security of this nation just as surely as foreign terrorist groups threaten our personal security. If Congress is in fact committed to stimulating job growth, then continued neglect of management and technical assistance for small business should no longer be viewed as a viable budgetary option for our nation. We believe the SBDC national program for FY 2005 needs to be funded at it's currently authorized level of $125 million. America's small businesses need and deserve no less. In FY 2001 the SBDC national program was funded at $87.8 million. The Administration's proposed SBA budget calls for funding the program in FY 2005 at $88 million. That figure will not even preserve the program at its FY 2001 level in real dollar terms. At an absolute minimum Mr. Chairman, we hope this Committee will advocate that the program be given enough resources for FY 2005 to match what it received in FY 2001 in real dollar terms. That figure would be $94.7 million.

In closing let me say that this committee has repeatedly spoken out against government policies that were not in the interest of our nation's small business sector. I hope all of you, regardless of party will speak out against what some fear is the gradual dismantling of the SBA and the continuing failure of the government to adequately fund small business management assistance programs.

At this time, I will be glad to respond to any questions that you, Mr. Chairman, or other members of the committee may have.

National Association of Development Companies
NADCO

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program Status, Proposed FY 2005 SBA Budget, & SBA Performance Plan

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Mr. Christopher L. Crawford
President & CEO

February 11, 2004

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business concerning the SBA budget proposed by the Administration for FY 2005. NADCO is the trade association for SBA 504 Certified Development Companies (CDCs). We represent 250 CDCs and more than 200 affiliate members, who together provided more than 99% of all SBA 504 financing to small businesses during 2003. NADCO's mission is to serve as the key advocate for the 504 program, and to provide program technical support, marketing assistance, strategic planning, and professional education to our membership.

504's objective is economic development and specifically job creation by funding the expansion of successful, growing small businesses. No other Federal economic development program can claim to have created over 1,100,000 jobs, as the 504 program has done. This mission is more important today than ever before, with our economy stuck in a "jobless" recovery. 504 is a critical economic stimulus program designed to assist growing businesses create jobs and invest in their communities.

NADCO would like to thank Chairman Manzullo, Ranking Member Velazquez, and the entire Committee, for continued support of the 504 program. Your Committee has worked closely with the Congressional leadership, SBA, and our industry to ensure the availability of capital to small businesses through the 504 program through the years. We would especially like to thank the Chairman and Ranking Member for their strong support for the econometric subsidy model implementation for 504.

We have three objectives in providing this testimony to the Committee. First, NADCO would like to update the Committee on our current program status for 2004.

Secondly, we comment on the FY 2005 SBA budget. This includes the Administration's 504 authorization level, as well as the proposed borrower fees and subsidy model assumptions by SBA.

Third, we will comment on several program issues noted in the SBA's *Performance and Management Assessment*.

STATUS OF FY 2004 PROGRAM AUTHORIZATION

With no agreement between the Committee and the Administration on SBA's reauthorization bill, H. R. 2802, working in concert with the Senate, this Committee acted decisively to insure continuation of the 504 program in November by passing a temporary program reauthorization bill, H. R.1895. Unfortunately, those provisions expire on March 15, 2004, barely four weeks from today.

504 is unique among SBA lending programs, in that it receives no Congressional appropriation, and is thus not covered by the recently passed Omnibus spending bill. Without immediate action by this Committee to pass H. R. 2802, 504 will shut down on March 15th. This will close the door on access to almost $8 billion in long-term capital to America's small businesses.

504 has a long history of bi-partisan support for its job creation mission. Since the mid-1980s, we have added well over 1,100,000 new jobs to our economy. To keep this program going during the current "jobless" recovery, it must be reauthorized. NADCO urges quick Committee action to move H. R. 2802 and conference on the Senate's S. 1375, which was passed last year. Without your leadership and action, 504 will soon cease operations.

PROPOSED SBA FY 2005 BUDGET

1. 504 PROGRAM AUTHORIZATION LEVEL

SBA proposes an authorization level for 504 of $4.5 billion. We are concerned that this is insufficient and we support the level contained in H. R. 2802 of $5.5 billion. As the program continues to fund itself through borrower, CDC, and first mortgage lender fees, there is no cost to the Federal government, nor any Congressional appropriation. Program growth continues at a rapid pace this year, after growing 27% in FY 2003. Our expectation is for even more growth into, and beyond, FY 2005. We are concerned that, should banks continue their tight credit for small businesses into 2005, 504 demand may simply outstrip available authority.

The benefits to the country are numerous. New 504 projects provide new jobs in their communities by expanding the plants, equipment, buildings, and employment levels for our borrowers. In turn, this expansion leads directly to new tax bases, including:

- **City & County real estate taxes from new construction projects**
- **State & local sales taxes from increased business revenues**
- **Federal & State income taxes from new and expanding businesses**
- **Federal & State payroll taxes from new employees.**

It is clear that businesses assisted by this no-cost program are contributing to the tax revenues received by all levels of local, State, and Federal governments. We encourage this Committee to stand by its own higher authorization level during this economic recovery when every job we create is putting an American back to work.

2. 504 BORROWER FEE DECREASE

SBA's proposed FY 2005 budget decreases the annual fee charged each 504 small business borrower from <u>0.393%</u> to <u>0.288%</u>, a decline of 27% in fees for our borrowers. We appreciate this decline in the borrower fee, as it demonstrates that the subsidy model work of SBA is headed in the right direction.

This "subsidy" model is actually a program cost model. There is no Congressional appropriation needed to provide a 504 subsidy. The fees paid by borrowers, our CDCs, and our first mortgage lenders offset completely the program loan loss expenses. Thus, except for the small SBA staff required to maintain and implement program policy and oversight, this is a no-cost program for the taxpayer.

Two significant factors influence the program cost model, which leads directly to the annual borrower fee. This year's calculations indicate good news for both factors.

Loan Default Rate:

OMB budget documents state that the 504 loan default rate increased from 7.52% to 8.28%. However, the SBA CFO has just provided a correction to NADCO. The loan default forecast for 2005 actually DECLINES; going from 7.52% down to 6.89%. This likely reflects the strong economic conditions during which these loans will be made, resulting in lower expected defaults in the future.

Loan Recovery Rate:

SBA's forecast of recoveries on defaulted loan collateral improves – to a net rate of 44% from last year's forecast of only 17%. We believe this to be a much more accurate projection of future recoveries for the 504 program. 44% is much closer to the actual recoveries of the Congressionally-mandated 504 liquidation program, for which actual recoveries averaged better than 50% for the twenty CDCs in the pilot.

NADCO appreciates the efforts by the Administration and particularly the SBA Chief Financial Officer to implement the new econometric model for 2005 forecasting. A brief meeting to review this more sophisticated model indicates it may well result in much improved forecasting of critical portfolio performance factors. Given a projected reduction in defaults and an increase in recoveries for FY 2005, it is clear that the result will be a savings of millions in guaranty fees for several thousand small business borrowers over the twenty-year life of their new 504 loans. We hope to receive further information on this model from SBA shortly.

PERFORMANCE & MANAGEMENT ASSESSMENT

504 PROGRAM P.A.R.T. RATING:

The Office of Management & Budget last year devised a means of evaluating Federal programs in order to report on progress on the President's Management Agenda. This methodology is called the Program Assessment Rating Tool, or "PART". This system looks at the following areas:

- Program purpose & design — weight: 20%
- Strategic planning — weight: 10%
- Program management — weight: 20%
- Results/accountability — weight: 50%

I am pleased to report that OMB has improved its rating of 504 from "*results not demonstrated*" to "*adequate*". While NADCO believes the impact of 504 to be far better than just adequate, we recognize that this rating process primarily evaluates internal SBA management, planning, and accountability – issues that do not affect the financing impact on our borrowers. Our industry hopes that OMB will continue to view 504 in a positive manner.

However, a key criticism of the program concerns PART question 1.3: *Is the program designed so that it is not redundant or duplicative of any other Federal, state, local, or private effort?*

Answer: *NO.*

Explanation: *There is potential overlap between SBA's 504 and the 7(a) programs. While both may provide long-term loans for fixed asset purchases, the programs have different financing structures. The 504 program provides fixed rate lending with the government in a second lien position. The 7(a) program, which also can finance working capital requirements, provides financing at variable rates with lenders and the government sharing risk as first lien holders.*

We find the "NO" answer intriguing, since the PART itself goes on to highlight several of the significant differences between these two SBA loan programs.

NADCO believes that the programs are not redundant. In fact, the two programs are fundamentally very different from one another – as to purpose and to financing structure. The intent of 504 is economic development through job creation. 7(a) provides access to capital.

The 504 program exclusively involves financing long-term fixed assets, and its primary goal is providing community economic development through job creation. 504 does not provide short term or working capital loans. The 7(a) program can meet a variety of financing needs for small business, and its primary incentive is to induce private lenders to offer credit to borrowers who do not meet their regular lending criteria. Thus, 504 generally makes job creation loans to healthy, growing small businesses, while 7(a) may make loans to businesses with generally weaker credit that banks would not normally finance. Note that the results of these characteristics may be seen in the different default rates of the two programs. This demonstrates that each program is addressing its intended audience.

Additionally, the two programs provide very different credit structure to borrowers. Given the deposit volatility for most commercial banks, they will almost always provide variable rate small business loans, often tied to "bank prime". With today's prevailing interest rates, this is attractive to borrowers. However, banks cannot usually maintain such low rates as their cost of funds increases when overall market rates go up. Thus, the annual cost of a variable rate loan is almost certain to increase in the future, creating further risk for small businesses in planning their debt service requirements. To mitigate this risk to both the borrower and the lender, banks will usually provide shorter term loans.

On the other hand, the 504 loan provided by CDCs is always a fixed rate, ten or twenty-year loan. Given its length, businesses use 504 to acquire either expensive heavy equipment or buildings and real estate to house equipment that provides new jobs – the Congressional intent of 504. Further, 504 is viewed by our bank lending partners as an "inducement program". That is, in providing the SBA guaranteed 504 second mortgage, lenders are more favorably disposed to provide attractive terms to borrowers through their 50% first mortgage. They have a better loan-to-value ratio, and thus are taking less risk. This translates directly to improved borrower credit pricing by the bank lender. The result of this "blended" financing package is that a smaller, non-subsidized Federal guaranty leads to a lower borrower cost and potentially less overall risk for the business.

It is clear that neither the terms & conditions, the program structure, or even the Congressional program objectives are the same for both programs. NADCO believes it makes no more sense to consider combining these programs than putting together 504 and FHA-guaranteed residential lending. We urge rejection by this Committee of any attempt by the Administration to combine the 504 and 7(a) loan programs.

SBA INTEGRATED PERFORMANCE PLAN

Here are several of our recommended program and processing enhancements from last year:

- Set specific 504 loan production goals for all SBA District Offices.
- Streamline the loan approval and loan closing processes.
- Take advantage of twenty-first century computer and communications technologies to speed up the loan-making and loan closing processes, improve service to borrowers, and reduce SBA staff time commitments.
- Shift at least some 504 processing to more consistent loan review operations at several centralized loan processing centers.
- Update the job creation ratio to one job per $50,000 of 504 loan provided to a business.

NADCO and our many members must congratulate the Administrator and his management team for making substantial progress towards several of our recommendations. Among SBA's achievements and opportunities are:

1. Under its new 504 regulation, SBA has recognized the impact of years of inflation on our financing projects, and moved the job creation ratio to one job per $50,000. This will enable many more small businesses to utilize 504 for expansion capital.
2. It is our understanding that SBA is beginning to set specific performance goals for their District Offices for 504 lending. This action appears to have focused the attention of many more field managers and District Directors on serving the needs of their customers: America's small businesses. This achievement alone has likely aided hundreds of new 504 borrowers.
3. While SBA has not yet moved to take advantage of technology for the loan approval and closing processes, it appears to be making a quantum leap in the audit and oversight arena. Its new lender oversight procedure, utilizing information from both Dunn & Bradstreet and Fair Issacs financial databases, promises to both improve and speed up the identification of problem loans and even substandard lenders. NADCO awaits its final results.
4. Through a very promising centralized loan processing pilot in Sacramento, our industry hopes that both loan approval time and paperwork burden will be reduced, resulting in improved service to both small business borrowers and lenders. If anything, we believe this pilot should be more quickly expanded to all District Offices, given the budgetary constraints for FY 2005 and the decline in available field staff. However, as with any critical program process, we are very concerned with having only a single source of SBA 504 loan processing. Such configuration greatly increases business risk for any entity in the event of a catastrophic failure. We urge SBA to return to its previous critical business model by immediately establishing a second east coast processing center for 504.
5. NADCO believes that the Administration should more quickly move to further streamline the loan closing functions within the agency. There appears to be antiquated closing paperwork and field office review that is completely unnecessary and burdensome for

borrowers and lenders. This costs everyone, including SBA, both time and money and significantly reduces service level to small business borrowers.

6. Finally, the 504 loan liquidation responsibilities must be both centralized and increasingly privatized. SBA's shrinking and over-burdened field staff has simply not been able to keep up with the maintenance required for the rapidly growing 504 loan portfolio. This change appears to be moving forward for the 7(a) program, which has resulted in the departure or reassignment of many field office portfolio management staff. The unfortunate by-product is a greatly reduced effort to liquidate or work out the 504 loan defaults. We are concerned that this interim period until 504 liquidation is centralized may provide an opportunity for substantially higher loan losses. We urge quick action to establish a new liquidation process for 504 within SBA.

Given the substantial progress we see in many processing and lender support areas, we should recognize two critical and unsung SBA managers that have organized and are leading these efforts. Many of these projects are being directed and supported by Mr. Ron Bew, Deputy Associate Administrator for Capital Access. We also recognize one of his career department managers, Mr. James Rivera, Associate Administrator for Financial Assistance. Much of the time-consuming and difficult planning and execution work of this massive reorganization is falling to Mr. Rivera. We believe these two able managers are accomplishing much with the leadership and support of Administrator Barreto. We hope their actions will advance SBA's loan guaranty support departments into a new era of enhanced service to small businesses, lenders, and the American taxpayer.

SUMMARY

Our Certified Development Company industry remains focused on meeting today's critical capital access needs by small business. CDCs are closely tied to their communities through their membership, their volunteer boards of business, community, local government, and financial leaders. Industry success is based on this local CDC board and member involvement, in partnership with both first mortgage lending institutions and SBA staff.

Our CDCs are non-profit, so every dollar of their 504 servicing income goes right back into their communities to build stronger local economies and create more new jobs for Americans. <u>Job creation is the ONLY focus for every CDC</u>.

However, all of these entities, CDCs, first mortgage lenders, and SBA, can succeed only with the leadership and legislative support of Congress and the Small Business Committee. The 504 program, Federal government's largest and most successful economic development tool, today is dependent on this Committee for its reauthorization for the remainder of FY 2004, and into the future. Without this Committee's quick action, the program, and small business access to almost $8 billion in long-term capital, shuts down on March 15, 2004. NADCO urges the Committee and the Congress to act by passing H. R. 2802 as quickly as possible, even as it considers the President's FY 2005 SBA budget.

Thank you for allowing us to provide our comments. NADCO is pleased to work with the Committee and the Administration to improve the 504 program and help America's small businesses create more jobs.

House Committee on Small Business
"The SBA FY 2005 Budget"
February 11, 2004

Prepared Remarks of Mr. Anthony R. Wilkinson
President & CEO
National Association of Government Guaranteed Lenders, Inc.
Stillwater, Oklahoma

The National Association of Government Guaranteed Lenders, Inc. (NAGGL) is a trade association for lenders and other participants who make approximately 80% of the Small Business Administration (SBA) section 7(a) loans. Commonly called SBA's "flagship" program, the 7(a) program has proven to be an excellent public/private sector partnership. Over the last decade, the SBA has approved approximately 450,000 loans for almost $100 billion. We thank the Committee for the opportunity to testify on the SBA FY 2005 budget request and other current issues facing the SBA 7(a) program community.

Current Crisis

Late in the afternoon on December 23, 2003, the SBA notified the Senate and House Small Business Committees of their intent to cap the SBA 7(a) loan program in 15 days, or January 8, 2004. The SBA set the cap at $750,000, meaning the maximum gross loan size eligible under the 7(a) program was being reduced from $2 million to $750,000. The timing of the notification raises question. With SBA approving about $1 billion per month for several months prior to the notice, why didn't SBA admit their problem earlier?

The current problem is a result of an inadequate FY 2004 budget request. The SBA approved over $11 billion in 7(a) loans in FY 2003, yet the budget for FY 2004 was for only $9.4 billion in program authority. The SBA claimed that loan volume would decline in FY 2004 because the STAR loan program had expired. NAGGL argued last year that small business loan demand would not decline simply because a particular loan program expired. In fact loan demand in the last months of FY 2003 was almost $1 billion per month even though the STAR program had expired in January. In our testimony last year, NAGGL estimated FY 2004 7(a) loan demand would approximate $12.5 billion. Actual loan volume through the first quarter of FY 2004 was $3.122 billion, supporting the estimate of demand we made in February 2003.

On January 6, 2004, the SBA then announced that it was shutting down the 7(a) program, without warning, injuring thousands of small businesses and lenders that had submitted applications. The SBA had, in effect, closed the program before then because the

Agency stopped processing most large loans before January 6, 2004. The SBA then took the unprecedented step of returning all applications to the lenders rather than processing the loans to the point of final approval. During similar funding shortfalls in the past, SBA simply processed these loans but stopped just short of issuing a final approval, and, as additional loan authority became available, the pending loan applications were approved in the order in which they had been received. But not this time.

Instead, this year the SBA rejected all applications. When the SBA decided to restart the program a week later, applicants and lenders were required to resubmit their applications for processing. For those loans over $750,000 that were submitted prior to the deadline, SBA's response has been "too bad". The very federal agency that is supposed to be the small businesses advocate has caused many small businesses undue harm and led to many anxious moments. Applicants spent time and money to complete their applications, only to have SBA reject and return them; and many of these prospective borrowers had made irreversible commitments that they can no longer honor due to the denial of SBA assistance. We believe that this was an unconscionable act by the administration, and we hope that Congress will demand that SBA now process any application that had been received by the January 8th deadline. The SBA should not be allowed to circumvent the 15-day notice requirement in the Small Business Act.

Piggyback Restriction

When the SBA restarted the program, they did so by adding even more program restrictions. Once again the SBA ignores the 15-day notice requirement of the Small Business Act. This time, along with the $750,000 loan cap, the SBA announced the prohibition of 7(a) loans in larger loan packages, frequently called "piggybacking". A lender utilizes the 7(a) program because an applicant has a credit deficiency. In some instances an applicant has a need that is larger than the maximum loan size allowed under the 7(a) program. To mitigate the risk, a lender may utilize a piggyback structure so the lender can meet the borrowers' financing needs.

For example, assume today an applicant needs to borrow $1 million. A lender could provide a $250,000 conventional loan in a first lien position, and a $750,000 SBA 7(a) loan in second lien position.

This is a similar loan structure as provided in the SBA 504 program, with two key differences. With a 504 loan the SBA has 100% of the credit risk on the second mortgage loan. With a 7(a) loan, under the piggyback structure, the originating private sector 7(a) lender has at least a 25% pro-rata share of the second lien loan, meaning the lender is sharing in the credit risk. The second difference is that the government collects substantially more fees on a 7(a) loan than it does a 504 loan. From a subsidy perspective, the government would collect more fees on a 7(a) piggyback structure than they would on a 504 loan structure.

Piggybacks are especially useful when SBA institutes a loan cap. Some of the applicants now caught by SBA's unconscionable act, could have found financing through a piggyback loan structure. With the new piggyback prohibition, many applicants have no solutions to their need to find larger loan packages. We request that this Committee, through legislation if necessary, require that SBA allow the use of piggyback loans so that lenders have a vehicle to serve those small businesses that need larger loan packages.

Statistics

The SBA loan programs are the largest source of long-term capital for small business in this country. From bank "call" reports, the SBA office of Advocacy reports there are $485 billion in outstanding small business loans. From FDIC data, only about 20% of those loans (approximately $95 billion) have an original maturity over 3 years. The average original maturity of an SBA 7(a) loan is about 14 years, and the SBA 504 average is even longer. The balance of the outstanding 7(a) portfolio is approximately $40 billion or a significant percentage of all outstanding long-term small business loans. Small businesses simply cannot afford to have SBA take arbitrary actions that destabilizes their major source of long-term debt capital.

Small Businesses Harmed

The actions taken by SBA in FY 2004 have gravely and irrevocably harmed thousands of entrepreneurs at a time when the nation's economy is struggling to create jobs. Most disturbing about this occurrence is throughout 2003 the administration repeatedly ignored signs that loan demand was exceeding SBA's available funds and chose not to act, instead delaying action until Congress had adjourned for the year. Rather than foreseeing and acting to prevent this crisis, one of the federal government's most important economic development programs has been destabilized. SBA's recent action to reopen the program falls way short of what small businesses need. In fact the program remains closed to those borrowers who would account for 40% of the program prior to SBA's recent actions.

FY 2005 Budget

Why More Fees?

On the heels of an inadequate Administration program request for FY 2004, the Administration now proposes to raise fees even more in the 7(a) program. The FY 2005 budget calls for no appropriation support, or a zero subsidy rate. The plan is to allow the previously enacted 2-year fee reduction bill to simply sunset. About two years ago, Congress passed legislation that decreased the lender fee from .5% to .25%, decreased the guarantee fee on loans of $150,000 or less from 2% to 1%, and decreased the guarantee fee on loans over $150,000 up to $700,000 from 3% to 2.5%. The Administration plan is to have the fees revert back to their original levels.

The Administration is proposing no federal support for the 7(a) program. This would be the first time in the 50-year history of SBA that zero appropriations would be provided the 7(a) program. Additionally, the SBA is asking for authority to adjust fees in the future to make sure the subsidy rate remains at zero. As of the writing of this testimony, SBA has not provided any details of their proposal.

So what kind of trust level should we have that we will get a fair and reasonable subsidy calculation going forward? Legislation was required in order to force SBA/OMB to recalculate the subsidy calculation last year. This year Congress asked GAO to validate the new subsidy model, and the word from GAO is that SBA/OMB has stonewalled the issue by not providing the requested information. Finally, it is suspicious that the sunset of legislation coincidentally results in exactly a zero subsidy rate. As of the writing of this testimony, SBA has not provided the detail on how the subsidy rate changes from the current level of 1.06 to zero.

It is disturbing that the program would face further fee increases (taxes) given the fact that the lenders and borrowers have already returned, since the start of Credit Reform, over $1.2 billion in excess fees to the Treasury. And it does not seem to matter that the Administration had a budget bust this year (FY 2004), requesting too little program authority, putting loan caps and program restrictions in place, and hurting small business applicants who had timely filed their loan applications. So in addition to many borrowers being told "too bad " this year, next years' borrowers will be told "more fees" (taxes).

FY 2005 Loan Demand

With their FY 2005 estimate of demand of $12.5 billion, the Administration has finally recognized that small business loan demand has grown, albeit a year late. We question, however, the need to limit this program. If the Administration wants to support the 7(a) loan program and its' mission to provide long-term capital to small business, why limit the program to anything less than the authorization limit of $16.5 billion proposed in the pending reauthorization bill? If the Administration wants to support the 7(a) loan program and its' mission to provide long-term capital to small business, why not take steps now that will lift the lending restrictions and meet the needs of small businesses that exist today? We were told a few weeks back that the SBA was working on a formal reprogramming proposal. To the best of our knowledge, no such request has been submitted.

Conclusion

Last year NAGGL testified that a reasonable estimate of demand for FY 2004 would be $12.5 billion. The SBA adamantly opposed our estimate, saying that $9.3 billion would be sufficient. The result of the inadequate budget request and resulting inadequate program level has ended up harming many small businesses. Today many applicants cannot find financing for their larger loan packages. Then add to that the fact that 7(a) loan participants have returned $1.2 billion to the Treasury from excess program fees.

Small businesses do not need rhetoric about how important they are. Small businesses need to be treated fairly. Small businesses need access to capital. Small businesses need the Administration and Congress to support the SBA and its loan programs.

Thank you for the opportunity to testify before the Committee.

4dsolutions

329 East 2nd St.
Boyertown, PA 19512
Phone: 610.369.5962
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www.4dsolutions.com

February 5, 2004

Good afternoon distinguished Members of the House Small Business Committee:

On behalf of 4D Solutions Inc, and the small business workforce of the United States, I appear before you in a time of crisis seeking your assistance. A crisis that has originated from the very government administration which was formed to support and protect the small business community.

As you know, the SBA has imposed a recent cap on the 7(a) loan guarantee program. This imposed cap will have devastating consequences to small businesses like ours. Please allow me to explain in the hope that this cap may be immediately repealed.

We have three specialized Export Working Capital Program (EWCP) loan guarantees through the SBA's U.S. Export Assistance Center (USEAC) located in Philadelphia, PA as well as an SBA Disaster loan. For the last 7 years the SBA has told us that we could renew our loans as many times as necessary. We subsequently built our business model around that understanding. Two of these guaranteed loans were signed and approved for renewal on January 4th, 2004 and had received a loan number. It was only after we had received approval that the SBA informed us there was a cap and we would not be renewed. We were told that SBA upper management decided to cap the 7(a) loan program to $750,000.

4dsolutions

Our loans exceed the $750,000 cap. It's one thing to give borrowers a 12 month warning and a fighting chance, it's something entirely different when you present companies with no warning at all. The manner by which this cap has been imposed is effectively designed to hurt or mortally wound those small businesses that currently hold loans that are in excess of the $750,000. In other words, if these loans cannot be renewed due to the cap, they would be subsequently become un-guaranteed and the lenders would undoubtedly call them in, effectively putting us out of business.

The EWCP loans have been the life blood of our firm. For over 7 years 4D has worked with the SBA, from the firm's inception, to one of our crowning achievements, being presented in Harrisburg with Pennsylvania Governor's Exporter Excellence Award for 2001. 4D has even been used repeatedly by the SBA as a success story in their own newsletter!

Our firm provides mission critical, interactive, computer–based training to the Royal Saudi Air Force. Most of these contracts are 18-24 months in duration and worth in excess of $1.5 million. Our solutions have been chosen over Lockheed Martin and British Aerospace, just to name a few. But make no mistake, the larger companies still have a huge advantage – they have money to spend in the up-front cost of developing a training program for a major military aircraft. The SBA levels that playing field, without them we could have never borne the initial start-up or operating costs from one contract to another. Now the irony is overwhelming, the SBA who was so instrumental in our growth and success, in one stroke, will be responsible for our demise - and certainly many others like us.

Everyone knows that small businesses are the number one job creator in this country. Our business is located in Boyertown, Pennsylvania, a community that survives on small businesses just like ours. We

4dsolutions

hire people and buy goods and services, all within 20 miles of our office. There is little doubt that this cap will impact our community and others.

This cap also sends a clear message to the Saudi's we work with, that the United States is pulling back on their financial support of international business relations with Saudi Arabia. It has taken years for us to build up a track record of trust with them.

We have examined all of the other options, including EXIM Bank but they cannot legally finance military projects. As a result, my bank and the SBA are my ONLY resource.

I must add that our track record as a borrower has been excellent. We pride ourselves on being responsible corporate citizens and to date our firm has never missed a loan payment or by our own action put in jeopardy one of our guaranteed loans through the SBA.

In conclusion, at a time when America is losing its isolationist way of doing business and expanding our great economy globally, it just does not make logical sense to drop the funding to a program that has made a huge impact on my firm's ability to expand internationally. Therefore, I ask you to immediately remove this newly imposed cap and expedite the funding of the SBA's 7(a) program, as well as the funding of the division of International Trade and USEAC's across the country.

Phil Pegg Jr.
COO/Senior Vice President
4D Solutions Inc.

Testimony of
John Sprague
Everglades Adventures
Pahokee City, Florida

Before the U.S. House of Representatives
Committee on Small Business

February 11, 2004

Chairman Manzullo and Ranking Member Velázquez, thank you for the opportunity to testify before the House Small Business Committee. I am managing partner of the Everglades Venture Company, LLC that is based out of Pahokee, FL.

My partner James Sheehan and I started the Everglades Venture Company, which has been working on a project with the City of Pahokee to develop the Eastern shores of Lake Okeechobee into a first class recreational destination. This is a project will serve as an economic development engine for the community that will improve the quality of life of those in the area and support various ancillary businesses and jobs.

Our company was awarded the right to work on this project in 2001, and we are currently in the process of completing the first phase of the project. However, we have recently been affected by the decision by the Small Business Administration to place a cap on the amount of 7(a) loans. We were seeking a 7(a) loan in the amount of $1,709,000 for this project, but the SBA imposed a cap of $750,000 in January. The monthly payment based on an SBA guaranteed loan in the amount of $1,709,000 is approximately **$11,807.67 per**

month. The monthly payment for that same loan with a mix of a $750,000 SBA guarantee, and a conventional note of $959,000 (with a five-year payback) is **$24,057 per month**. That is a difference of $12,250 per month, as this project is on State Lands this financing may not even be available.

The unique nature of our project (as discussed in attachment) has made conventional lending an unlikely option, the 7(a) loan eligibility made this project feasible in an expedited manner. If we are forced to rely on conventional lending, it could have a severe impact on this project and make the project unfeasible. In my testimony, I have included a breakdown of not only the impact the cap will have on our business, but also the economic impact on the community of this project. Without the contributions from Everglades Adventures, the local and regional economy will be adversely affected, unable to create an estimated 90 new jobs and new sources of taxpayer revenue.

We hope the testimony today provides you with an insight on how devastating the proposed cutbacks on this program will have on Small Business.

I appreciate the opportunity to discuss with the House Small Business Committee ways that SBA and Congress can address this issue to ensure that 7(a) loans will continue to be available to companies like mine.

Testimony of Elliot Moses
Before the House Small Business Committee
February 11, 2004

Honorable Members of the Committee, Ladies and Gentlemen:

Thank you for this opportunity to tell my story. I hope that this effort will result in real change, and possibly even some rectification of the issue for my company.

My wife and I had been nearly a year in negotiations to buy DaCo Enterprises, Inc. We had a letter of intent and were very close to signing the final deal. Applications were made at several banks for $1.3 million; our presentations were very strong showing over a million and a half dollars of equipment in collateral plus a sizeable amount of cash that we were injecting. Funding proposals were entertained, and we down-selected to two: one was an SBA 504 and the other an SBA 7(a) loan guarantee.

By mid-December of 2003, we had everything together and submitted to the commercial loan officer. It was processing through Bank One's Preferred Lender Program. This program expedites the processing since the bank's approval criteria has been preapproved by the SBA to meet the SBA's underwriting requirements. We were told that the SBA's stated service level agreement to provide a funding number is 24 hours.

On December 23rd, the SBA notified Congress of their intent to establish a loan cap for loans approved by the SBA on or after January 8, 2004. This is 15 days, as required by Congress. The choice to include so many holidays in this notice period is unmistakable.

On the 26th, Bank One approved our application for SBA eligibility. The final SBA application package was sent to Utah for our signatures on December 30th. Four business days later on January fifth, the originals arrived at the Tempe, AZ Bank One Loan Coordinator's desk. She requested the SBA authorization number, and the SBA faxed back a control number the same day, indicating they have received the package and it is in their funding queue.

Based on assurances that funding would indeed be there, we closed on the business on January 8th. The next morning we received the shocking news of what the SBA did.

On January 6th, the SBA shut down funding. On the eighth, the SBA faxed a notice, dated January 5th, to Bank One, with the control number, indicating that funding had been stopped, and that the application package would be returned to Bank One and removed from the SBA queue.

It is very strange that the notice would be dated January fifth. It is not clear whether that was inadvertent or deliberate. If the latter, it conflicts directly with Congressional mandate.

By being bumped out of the queue, it's the SBA intent to delay the dissipation of their funds, but in actuality, it denies us legitimate opportunity to funding due to the loan cap, which we no longer fit under.

In order to rescue our deal, we obtained bridge funding for the full amount. The concept was that the full authorization bill would restore funding and the old caps. The bank concurred and advanced us the funds. When the bridge funding is due to be paid back in less than three months, we must either have new funding in place or be foreclosed upon. I understand we cannot apply under the 504 program because we have received bridge financing.

In the worst case, this will mean 25 persons will be out of work. We will be financially ruined if not totally bankrupted. The previous owner does not have the funds to step in front of the bank and also stands to lose a sizeable sum in deferred payments, thereby decimating his retirement plan.

In the best case, Congress will cause the SBA to remedy the effects of their misapplied funding curbs, or even better, raise the funding caps to allow more significant business formation than ever before.

For ourselves, we wish the SBA would place us back in the queue where we originally were and simply fund that which they were mere hours from funding. This is the fair and correct method that should be applied, in what I'm to understand is about 200 cases. The lower funding cap should apply to those that applied on or after January 8th, as Congress intended the notification method to operate.

Let me tell you a little bit about DaCo, with the spare moments remaining. We are located about 15 minutes from downtown Salt Lake City, Utah, in a high-tech corridor that has invented television and the first implanted artificial heart. It has also seen the birth of Word Perfect and Novell, and many others. Therefore it is no surprise that DaCo is a high-tech, high-tolerance machining company with laser welding and engraving capabilities. We serve the aerospace, electronics, and primarily the medical industry. Your next x-ray may come from equipment with our parts in it. Your relative's chemotherapy may come from an implant we machined. The Air Force can get some parts only from us.

Our employees make good skilled-labor wages. None of our employees are paid less than ten dollars an hour. We have benefits in the top 5% of our state. We added one new employee last month and are adding another this month. Our backlog has already jumped 25% this year. We are looking to spend more than $100,000 on new equipment this year and half a million dollars over the next two or three years, all financed conventionally. We and companies like us are the ones putting jobs into this recovery. Well, that is, unless things are allowed to remain as the SBA has made them.

I beseech you, the Members of this Committee, the SBA, and all members of Congress to allow businesses like ours to do what we do best, which most specifically includes creating new jobs, paying significant taxes, and growing our economy further with capital spending.

I thank you all for this humble opportunity to address this Committee, and thank the Staff for their most kind treatment.

ATTACHMENTS

Changes at SBA shut out Denverite

New loan limits nip plans at Dahlia St. moving firm

By David Milstead, Rocky Mountain News
January 28, 2004

The U.S. Small Business Administration's main loan program has billions of dollars in funding. It does not have any money, however, for Mike Berman.

Berman, the owner of Great Plains Moving and Storage on Dahlia Street, is one of the potential borrowers shut out by new restrictions designed to keep the SBA's 7(a) loan program running through the end of the year.

The SBA, which guarantees small-business loans made by banks and other lenders, threw its own 7(a) program into turmoil earlier this month when it suddenly stopped taking loan applications, and rejected others, because of budget uncertainties. Several days later, the program resumed after a new temporary appropriation from Congress.

Yet it resumed with two new restrictions designed to cut back on lending this fiscal year, which runs through the end of September. The hope is that loan demand, which ran at $1 billion per month from October through December, will slacken so that the SBA won't exceed its $9.5 billion budget.

Loan limits

One restriction: A loan guaranteed by the SBA now cannot exceed $750,000 - a substantial cut from the previous $2 million cap. While roughly 95 percent of SBA loans fit under the $750,000 cap, the new restriction makes it difficult for small businesses to use the loan program to finance real estate transactions, bankers say.

Another restriction: Previously, a bank could take on more risk and make a loan bigger than the SBA cap. In exchange, the extra loan would be ahead of the SBA loan for repayment if a borrower declared bankruptcy. It's called "piggybacking." Now, the SBA has banned that practice, meaning any extra loan has to be subordinate to the SBA loan.

This combination of changes is bad news for Berman, who was preparing his paperwork in December for a $1.9 million SBA loan. Berman wanted to refinance the moving company's mortgage at 4990 Dahlia St. and use the extra cash flow to take on new jobs - and employees.

His chances for a loan of that size at the same terms have now narrowed, if not disappeared. "It was a wasted exercise, but there's nothing I can do about it," Berman said.

"Washington needs to understand the importance of the SBA program on guys like Mike," said Dan O'Meara of Business Loan Express, the lender working with Berman.

On pace for shortfall

January's chaos shone a bright light on the SBA's budget issues and exposed a fault line between the agency and one of its biggest private-sector partners: The National Association of Government Guaranteed Lenders, called NAGGL, a trade group made up of bankers and lenders who participate in the 7(a) program.

The SBA, like all government agencies, had been operating for three months without a formal appropriation, as Congress continued work on the fiscal year 2004 budget. In the interim, the SBA was operating on temporary funding.

The problem: Loan demand was running well ahead of the SBA's expectations. With roughly $1 billion a month worth of SBA guarantees issued in each of the first three months, the 7(a) program was on pace to hit $12 billion in demand for the fiscal year.

Brian Burke, a NAGGL board member and the Denver-based head of Bank One's national SBA lending, said he warned the SBA as early as March that loan demand would be that high. U.S. Bank Executive Vice President David Bartram, another NAGGL board member who serves as national president of his bank's SBA lending, notes the nation was coming out of the recession. Plus, Bartram said, past lending from the 7(a) program and a supplemental program for businesses affected by the events of Sept. 11, 2001, had topped $11 billion each of the last two years.

But the SBA requested $9.3 billion, an amount above last year's 7(a) lending but below the $9.5 billion in fiscal year 1999. SBA spokeswoman Sue Hensley defends the SBA request, saying the current demand for loans is "unprecedented."

The temporary SBA funding, more in line with the SBA's request than with actual demand, was inadequate to cover the applications flowing in, if the SBA were to approve them. So the SBA took steps to halt lending.

On Dec. 23, the Tuesday before Christmas, the agency sent notification to Congress that it intended to implement new policies - the $750,000 cap and ban on piggybacking - in 15 days.

The result was a flood of applications from borrowers who fit under the $2 million cap but would be shut out with the new $750,000 limit. The SBA looked at the requests, looked at its budget and came to a conclusion: "We had no choice," Hensley said. "When we ran out of money, we had to suspend the program."

This explanation does not assuage the bankers whose clients got their applications in before the cap but had them sent back, unapproved, with no opportunity to re-file under the old limits.

"For the SBA to state they didn't anticipate a spike in demand is disingenuous," said U.S. Bank's Bartram. "The way they treated roughly 2,000 clients is awful."

Jeffrey Lee, CEO of Premier Bank, said his bank had four clients in the pipeline above the new $750,000 cap; two of them had Premier's approval. Premier led Colorado in the SBA's previous fiscal year with $55 million in SBA lending. "There's a surge all the time," he said. "Usually, they can manage a cap a lot better."

The SBA's Hensley said the agency felt federal law prohibited it from approving loans that would have made the SBA exceed its funding. "No one was more upset than the people at the Small Business Administration."

Program still kicking

The worst crises may be over, as the federal fiscal year 2004 spending plan passed Congress Friday. That gives roughly $9.3 billion to the SBA 7(a) program and eliminates the week-to-week or month-to-month uncertainty over funding. Had it not passed, said U.S. Bank's Bartram, "they probably would have had to shut the program down."

The key question is whether the new restrictions will choke off loan demand so that it falls below the previous $1 billion per month and settles in near the budgeted amounts. Bartram thinks "it's probably pushed some customers away who needed the financing."

Now that the budget bill has passed, the SBA will monitor loan demand and consider lifting the $750,000 cap and restrictions on piggybacking, spokeswoman Hensley said. But, "we have a limited amount of funds, and we're trying to reach the largest number of small business owners across the country."

NAGGL Gets It.

When timely, accurate information is key to your competitive advantage, trust NAGGL to provide it. Because we help make 7(a) industry news, we can be the first to share it with you, and because we don't report rumors, you know that when you hear it from us, you can trust it.

A Not So Merry Christmas From the SBA

As NAGGL has been warning of since October 1 (the beginning of fiscal year 2004), we have learned that the Administration has again moved to put a loan size cap on the 7(a) program. Initial reports from Congressional sources indicate that the cap will be $500,000, though the final number may be a little higher. The way the Administration has gone about putting the cap in place appears not to be in the spirit of the season.

At the end of the business day on Tuesday, December 23, the SBA alerted Congress of its intention to implement the cap. Congress had previously set in place a provision requiring the Agency to give notification 15 days in advance of any such change. This requirement is meant to allow lenders and borrowers with deals in excess of $500,000 in the works to get them approved before the ability to finance them disappears.

It is clear that Administration decision-makers premeditated the December 23 notification date to shut as many borrowers out of financing as possible, with the Christmas and New Year's holidays running interference.

It appears that January 7 will be the last day for lenders to push through deals over $500,000 until NAGGL is successful in seeing the loan cap removed. We encourage you to complete any large deals quickly, and to begin making inroads with your elected officials to let them know how this will affect economic conditions in their states and districts.

NAGGL will pass along additional information as it becomes available, and will fight this cap, as we did last year, until it is removed. In the meantime, please begin making Congressional letters from you and your borrowers a permanent part of your loan closing process to make our annual fight for funding easier (please see "Get Engaged" above right).

National Association of Government Guaranteed Lenders

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

APR 1 4 2004

Honorable Donald A. Manzullo
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Manzullo:

Administrator Barreto asked that I respond to your March 9, 2004, letter regarding follow-up questions from your hearing on the President's Fiscal Year 2005 Budget Request for the U.S. Small Business Administration (SBA). Please find attached the answers to those questions.

Should you or your staff have any further questions, please contact Michael Berkholtz ir my office at (202) 619-0297.

Sincerely,

Anthony R. Bedell
Associate Administrator
Office of Congressional
and Legislative Affairs

Questions for the Record submitted by Chairman Manzullo
House Small Business Committee Hearing
February 11, 2004
"The President's FY 2005 Budget Request"

1. On page 21 of Small Business Administration's (SBA) FY 2005 Budget Request, it appears that the SBA is reducing HUBZone funding from an FY 2004 level of $7.1 million to $6.6 million in FY 2005. Yet at the same time, the SBA appears to increase 8(a) Program funding from the FY 2004 level of $34.8 million to an FY 2005 level of $37.6 million. Also, on page 95 of the same document, the SBA projects that in FY 2005 it will cost the SBA $5,121 to help every 8(a) firm while SBA assistance per HUBZone firm drops to $493. How does the SBA justify increasing: 8(a) funding significantly while cutting HUBZone funding when each small business goal is suppose to be treated equally, particularly since SBA considers the 8(a) and HUBZone programs at parity?

The two programs are substantively different in programmatic intent and design. Accordingly, they have different resource requirements.

The 8(a) Program seeks to develop eligible businesses, over a structured nine-year program participation term, through intensive hands-on technical assistance and access to contract opportunities. About 250 staff members work in this program nation-wide. Because it is staff-intensive, significant compensation and benefits resources are required.

The HUBZone Program seeks to promote job growth and investment in distressed communities through award of contracts to firms located in, and employing residents of, such communities. Because its core business processes are substantially automated, and it achieves its objectives through operation of the procurement process with minimal intervention, it requires only modest staffing. About 10 Headquarters staff members are assigned to the program, and roughly 70 district office staff members serve as HUBZone Program District Office Liaisons. Therefore, compensation and benefits requirements are relatively modest.

These fundamental programmatic differences yield substantial variances in both aggregate resource requirements and per unit costs. Therefore, we estimate that the cost of providing necessarily labor-intensive service to 8(a) program participants will average $5,121, per firm in FY 2005, while the cost for HUBZone-certified firms will average $493 per firm.

We believe that our request for $6.7 million will adequately fund the HUBZone Program in FY 2005. With this level of resources, we will:

- Process approximately 3,000 applications for program certification, certifying 2,200 firms, and increasing our portfolio to about 13,500 firms.
- Conduct nearly 600 program examinations, intensively reviewing approximately 5% of the portfolio.

- Achieve high levels of productivity, because we have invested prudently in technology over several years, automating essentially all of the HUBZone Program's business processes – certification, program examinations, re-certification, and protests and appeals.
- Engage in substantive outreach and marketing to the acquisition community to help agencies use the program more effectively, and to achieve HUBZone procurement goals. For example, we are now building an electronic procurement monitoring system to identify requirements that should have been set aside for HUBZone competition, and to encourage contracting officers to use the program.

We believe that our request for $37.6 million for the 8(a) Business Development Program is necessary to accomplish the objectives of the program. With this level of resources, we will:

- Process approximately 3,600 applications for program certification (including approvals and declines), increasing our portfolio to about 7,350 firms at year end.
- Provide management and technical assistance to an average portfolio of approximately 7,125 firms. It should be noted that such assistance includes day-to-day hands-on support to program participants in preparation and updating of business plans, development of self-marketing skills, and identification of appropriate contracting opportunities for inclusion in the program.
- Conduct annual reviews for all firms in the portfolio.These reviews allow us to evaluate the development of each firm, update its action plans for the remainder of its program participation term, and determine its continuing eligibility for program participation.

2. While the 8(a) Program is projected to receive over $37 million funding in FY 2005 and the HUBZone program will receive less than $7 million, there are many more certified HUBZone firms than there are 8(a) firms. For the past five years, agencies of the federal government have only achieved a small fraction of the statutorily required minimum goal of HUBZone awards yet routinely achieve the Small Disadvantaged Business goal (of which 8(a) is a part). In light of these facts, shouldn't more (not less) resources be devoted to the HUBZone program? Please explain or reconcile these differences.

At this date there are 10,125 firms certified under the HUBZone Program, and 7,701 firms certified under the 8(a) Business Development Program. As discussed above, the two programs are conceptually and structurally very different. The 8(a) Business Development Program is labor-intensive, requiring hands-on support to firms over a nine-year program participation term. The HUBZone Program does not have an analogous labor-intensive firm-specific 'business development' component. Therefore, while the 8(a) Business Development Program's portfolio is approximately 24% smaller than the HUBZone Program's, its aggregate and per unit costs are substantially higher than those of the HUBZone Program.

As earlier noted, by FY 2005, substantially all of the HUBZone Program's business processes will have been automated. Given this circumstance, with the requested resources, we will be able to focus our efforts, at both national and local levels, on the outreach, marketing, and training necessary for agencies to use the program more easily and effectively, thereby enabling them to achieve HUBZone procurement goals.