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SUBCOMMITTEE ON FINANCE AND TAX HEARING ON LEGISLATIVE PROPOSALS TO REFORM THE SBA'S CAPITAL ACCESS PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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SUBCOMMITTEE ON FINANCE AND TAX HEARING ON LEGISLATIVE PROPOSALS TO REFORM THE SBA'S CAPITAL ACCESS PROGRAM

Thursday, July 23, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC

The Committee met, pursuant to call, at 10:00 a.m., in Room 2360 Rayburn House Office Building, Hon. Kurt Schrader [chairman of the Subcommittee] presiding.

Present: Representatives Schrader, Moore, Kirkpatrick, Halvorson, Buchanan, Luetkemeyer and Coffman.

Also Present: Representative Ellsworth.

Chairman SCHRADER. I now call the hearing to order for the Finance and Tax Subcommittee of the Small Business Committee.

In the current environment, businesses everywhere in every industry face a common problem. They cannot access affordable capital. This means that entrepreneurs are looking to expand and hire more workers, cannot. It also means that small companies who want to borrow money to stay afloat are unable to secure credit. In previous downturns when credit dried up, the Small Business Administration's lending programs helped filled in the gaps, providing firms the capital they need to drive the economy back towards prosperity.

Unfortunately, in this recession, SBA's Capital Access programs have been unable to fill their traditional role, leaving many small businesses with very few options. Small business' capital challenges are not confined to the SBA lending programs. Commercial lending has been greatly restricted, and a recent Federal Reserve survey found that 69 percent of domestic lending institutions have tightened their lending standards on commercial and industrial loans. I'd argue it's much higher than that.

Equity capital is also falling off. Venture capital investments were cut in half during the spring, making the second quarter in a row with a decline of more than 50 percent. The American Recovery and Reinvestment Act, which the President signed into law in February, took important steps towards addressing some of the small business capital needs. By making loans less expensive for small business borrowers, and increasing government guarantees, this law will generate $20 billion in new lending authority. However, we are far from where we need to be. The number of 7A loans is down 50 percent compared to fiscal year 2008. Clearly, if we're going to meet the small business' capital needs, much more needs to be done.

Today, we have before us a set of proposals, all of them aimed at getting capital flowing to small businesses by modernizing SBA's programs, and I look forward to the panel's testimony on their value. As we discuss these proposals, we should keep three central goals in mind, in my opinion. First, we should work to broaden the range of options available to small businesses seeking capital. And SBA program that works for a family-owned business in Salem, Oregon may not be the right solution for a high-tech startup in Pittsburgh, or a manufacturer in Akron, Ohio. Our efforts must help all types of firms access capital, whether they choose to raise capital through micro loans, government guaranteed loans, or equity investments.

Second, we need to make capital more affordable. Being able to find a small business lender is one thing, securing a loan at terms that work for the borrower are another. And, thirdly, we need to help small businesses recover after natural disasters. Hurricane Katrina and other catastrophes, even on my Pacific coast, have made clear there are deep and longstanding problems with the SBA's disaster recovery initiatives. It is vital that we correct those problems. When disaster strikes, small businesses must have the resources they need to rebuild our communities, and help restore economic prosperity.

The challenges facing the small business community were not created in a day. Indeed, many of the problems in SBA's Access to Capital programs can be traced back to eight years of neglect and mismanagement. These issues will take time and patience to resolve, but one thing is clear, small firms are going to remain our country's primary job creators. They need access to capital, and that will require strengthening and improving the programs here in the Small Business Administration.

With that, I'll recognize Ranking Member Mr. Buchanan for his opening statement.

[The prepared statement of Chairman Schrader is included in the appendix.]

Mr. BUCHANAN. Thank you, Mr. Chairman. I appreciate the opportunity, especially for holding this meeting today, looking for capital.

I know as a person that I'm not a career politician. I've been in business, self-employed for 30 years. I've been very fortunate and blessed to live the American dream, created thousands of jobs. I was involved probably about five years ago as Chairman of the Florida Chamber, so I've seen it. And I can tell you there, I've never seen the environment, I remember going through the early '80s with interest rates at 19, 20 percent. I remember the early '90s, the S&L Bank crisis, but this is about one of the toughest crises that I've seen. And the main thing is, three years ago there was an abundance of credit. I mean, it just seemed like there was too much credit. There was credit everywhere, and I've been involved. I see the bankers here from 20 years on bank boards.

Today, there's very little or no credit. And I'd say probably pretty much no credit. I talked to a banker this past Friday who is town. He was asking me about having some trouble with his equity in his bank, and we were just talking about it. And he's very involved with all the bankers in our community. And I asked him, I said, "Is there much credit or any credit?" If someone wants to borrow $1 million, real estate, he said, "Well, if they want to borrow $1 million today, you've got to put up a $1 million CD." I mean, that's basically no credit. Talked to another banker on Friday where they've got a presence all across the southeast, 11 states. I mean, Sunday night actually, we were out a little boat cruise thing, and talking to her, and the same type of reality.

Now, southeast might be tougher than some areas, but I know I'm in southwest Florida. I see the home builders here today. We've been devastated. I don't know that we have maybe one or two homebuilders left, because a lot of them had been very profitable, very successful for a lot of years. There is no capital. Most of the loans are actually being called today.

So, I look forward to working with the Chairman to see what we can do to draft some bills to get some capital flowing until the banks can get back on line. I know a lot of banks say they are still lending. There's some lending out there. But, again, as I think back on Sunday night when I talked, I asked the banker, I said, "Are there any businesses in our community that are really making any money?" And she looked over at me, and she says, "I don't know of any." I mean, that's pretty scary when you think about it. '08 was tough. A lot of the people in '08, I'm in a small group of CEOs that we meet for the last 20 years, very successful over that period of time. And most of them lost—and we were sitting down, this is a pre-Christmas party meeting, lot of CEOs, big companies, billion dollars in sales type companies, and most of them lost a third of their net worth in '08 alone. When you look at—there was nowhere to hide. So, this is really impacting small business.

The Florida Chamber, we had 137,000 businesses we represent in our federation. Ninety-nine percent of those businesses were small business, and they created 75 percent of the jobs in Florida. With no capital available to these small businesses, we're going to have a record number of people that have either gone out, or are on the verge of going out. So, we really have—this is a serious problem.

That's why I challenge my friends in the administration. We really need to focus on the number one priority, getting our economy and jobs, helping working families. That's where it needs to happen. To make that happen, we've got to have access to capital, small companies.

So, I appreciate your time and effort for being here today. We're looking for answers, and as I—many people that know me, this isn't a Democrat or Republican thing. This is an American thing. We need to work together to figure out how to get out of this crisis. Thank you.

[The prepared statement of Mr. Buchanan is included in the appendix.]

Chairman SCHRADER. Do any of the other members have any opening statement they would like to make?

All right. Seeing none, we'll go to testimony from the witnesses. Just so everyone understands the rules of engagement here, you have five minutes to make your statement, so please summarize your written remarks. A green light indicates go, yellow means you've got a minute, so be thinking of summarizing, and red means I'm going to have to stop you. I apologize for that in advance.

So, our first witness will be Mr. William Humphreys. Mr. Humphreys is the President and CEO of Citizens Bank located in Corvallis, Oregon, a community bank with 150 employees. He is testifying today on behalf of the American Banker's Association. ABA is a trade association for banks representing over 95 percent of the industry's $13.6 trillion in assets, and employ over 2 million men and women. Welcome, Mr. Humphreys.

STATEMENT OF WILLIAM HUMPHREYS

Mr. HUMPHREYS. Chairman Schrader, Ranking Member Buchanan, and members of the Subcommittee, my name is Bill Humphreys, President and CEO of Citizens Bank, Corvallis, Oregon. Citizens Bank is a 52-year old community bank, which focuses on small business, lending to small businesses and farmers in 10 communities throughout Oregon's Williamette Valley.

The focus of this Committee is extremely important. Consistently, small businesses are drivers of new ideas, new employment, and new economic growth. For banks like mine, small businesses are our bread and butter. While some might think that the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks, small businesses in their own right. In fact, over 3,400 banks, 41 percent of the total, have fewer than 30 employees.

The efforts that we've made, that have been made by this Committee, the Congress as a whole, and the Administration to improve the environment and opportunity for small business through changes to the SBA program have been needed for many years. The SBA's programs have struggled over the last few years, loan volumes fell by 30 percent last year, and continue to fall this year, as well. The economy is certainly playing a significant role in this decline. However, it's also due to the SBA programs being too costly, and difficult for lenders and small businesses who wish to access the program.

Chairwoman Velázquez has introduced a legislative proposal, which ABA believes would make the SBA programs more effective.

First, the legislation calls for establishment of a program within the SBA to assist with outreach to small lenders who are not participants in the SBA's 7(a) program. This is vitally important. SBA lending is very specialized, and lending requires skilled personnel with expertise in SBA policies and procedures. Providing a dedicated outreach effort to these lenders, primarily community banks like mine will only increase lenders' willingness to participate in the agency's program.

Second, the legislation seeks to make the Rural Lender Outreach Program, Community Express, and Patriot Express Programs permanent. This is laudable. Although, the SBA has fallen short in promotion and marketing programs.

ABA has a number of recommendations we believe will help to expand the reach of the SBA programs amongst small businesses.

First, Congress should extend provisions that expand both the 90 percent guarantee and fee relief for an additional two years beyond the 2010 expiration date. Both of these have provided much needed boost for lender participation in the programs.

Second, the SBA should eliminate, or reduce, the restriction on refinancing. The restriction often prohibits the borrower from obtaining new financing that is critical to continued success of that business, and often causes the bank to write new loans without the help of the SBA, or to ask the borrower to seek help of another lender.

Third, the SBA should improve the quality of the guarantee itself. As the current guarantee is only valid if certain conditions are strictly adhered to, the collateral assets, and often the business itself, must be liquidated prior to payment on the guarantee by the SBA. This process can be delayed by bankruptcy, by difficult repossession issues, and other factors.

Fourth, the guarantee approval process should be improved. Generating the information and documentation required by the SBA is not easy for the lender. Many small banks have found it necessary to seek the help of a third-party packager, who would gather necessary data to gain approval, creating additional time and expense for the borrower.

Finally, the human resources capacity of the SBA should be expanded in order to ensure adequate staff is available to implement from a market, and manage the many initiatives of the SBA.

The American Bankers Association would be happy to work with this Subcommittee on these and other ways to improve the SBA. And I'd be happy to answer any questions. Thank you.

[The prepared statement of Mr. Humphreys is included in the appendix.]

Chairman SCHRADER. Thank you very much, Mr. Humphreys. Thanks for coming from so far away.

Mr. HUMPHREYS. Thank you. Thanks for having me.

Chairman SCHRADER. The next witness is Ms. Carol Wayman. She's the Senior Legislative Director of the Corporation for Enterprise Development, the CED is a leading non-profit association dedicated to expanding economic opportunity, helping Americans start and grow their businesses. Welcome.

STATEMENT OF CAROL WAYMAN

Ms. WAYMAN. Thank you, Chairman Schrader, and thank you, Ranking Member Buchanan, and members of the Subcommittee. It's an honor to testify today in support of the Small Business Administration's Microloan program. We'd like to thank Chairwoman Velázquez and the Administration for support for the SBA Microloan program, and making it a priority, and helping to improve the economy, and create jobs.

CFED knows that self-employment can build wealth for low-income and minority families, and we strongly support the SBA Microloan program, which provides capital, training, and technical assistance to disadvantaged entrepreneurs. Since its authorization in 1991, this program has continued to receive bipartisan support, and we believe that the draft legislation under discussion provides an excellent opportunity to strengthen a program that reduces poverty, and creates jobs.

I have five more points to make on the legislative proposal. First, we are pleased to see that the Subcommittee has included language that allows Microloan Intermediaries to offer more flexible credit terms, such as lines of credit.

Second, we welcome language that expands eligibility requirements for prospective Microloan Intermediaries. We agree with the Subcommittee that SBA should have the discretion to determine the type of experience necessary to become an Intermediary.

Third, we are pleased to see the Subcommittee recommend increases on the cap on borrowing by Intermediaries. Many of the highest performing Intermediaries in the Microloan program have reached that $3.5 million limit, and more businesses are coming back to them for loans, and they can't make loans that they'd like to make. So, the recommendation to increase it to $10 million is something we strongly support.

Fourth, we are pleased to see an increase in the maximum loan amount that an Intermediary can make to a borrower from $3,500 to $50,000. We think this increase reflects the key market reality, the investor return on a $50,000 loan is frequently deemed too low for most mainstream financial institutions. I note, however, that the majority of Microloans remain small, at about $13,000.

Lastly, we support the proposal to increase the percentage of technical assistance grants that may be used for providing information and technical assistance to prospective borrowers. We also support the proposed increase in percentage that Microloan Intermediaries can use for third-party technical assistance.

In this economy, Microloan Intermediaries need flexibility to serve future entrepreneurs, instead of the current restriction to provide technical assistance mainly to current borrowers.

We also recommend the Subcommittee consider the following four changes to the Microloan program as part of any final legislation.

First, we'd like to lower our remove the loan loss reserve requirement. Intermediaries in the SBA Microloan program must maintain a 15 percent loan loss reserve fund that really results in unnecessary levels of passive capital. The SBA Microloan program has made loans that no bank would dare take on; and, yet, has the lowest default rate of any SBA lending program.

While SBA regulations allow this requirement to be lowered to 10 percent, the Microloan program is the only SBA lending program that requires a loan loss reserve fund. And this limitation forces the SBA to limit its best performing program.

Second, we would allow the use of one-time use of SBA Microloan funds for Microloan Intermediary capital improvement projects. This enables these high volumes Intermediaries to expand and improve their facilities to meet increased demand.

Third, we recommend eliminating the requirement that Intermediaries cannot operate in more than one state without prior and burdensome approval. Permitting multi-state use of Microloan funds will facilitate regional economic development.

And, finally, we'd like to expand SBA reporting requirements. Unfortunately, SBA provides very little information on the Microloan program. Without data, it is very difficult for the Microenterprise field to target areas for improvement, and efficiency.

Ideally, we would like to see annual SBA reporting requirements, such as loans made, loan dollar volume per Intermediary, credits for improvements, and jobs created.

In closing, we would like to thank the Subcommittee once again for the opportunity to testify today, and we look forward to partnering with Congress, and the Administration to enable low-income entrepreneurs, who are ready to go from business curious, to business capable. Mr. Chair.

[The prepared statement of Ms. Wayman is included in the appendix.]

Chairman SCHRADER. Very good. Thank you very much. Your expertise is appreciated.

Our next witness is Mr. Joe Robson from the Robson Companies, Incorporated located in Broken Arrow, Oklahoma. A builder of residential and commercial properties, Mr. Robson is testifying on behalf of the National Association of Home Builders, which has represented more than 800 state and local homebuilder associations since its founding in 1972, and perhaps you can say bearing the brunt of our current crisis. Welcome, sir.

STATEMENT OF JOE ROBSON

Mr. ROBSON. Thank you very much. That's 1942, so -

Chairman SCHRADER. Oh, excuse me. I apologize.

Mr. ROBSON. It maybe a typo. But, thank you, Mr. Chairman.

Since the onset of the economic downturn, Congress and the Administration have taken several important steps to respond to the crisis. Our members certainly appreciate those efforts. However, the crisis wears on, and more resources are needed.

We welcome the opportunity to comment on how to potentially expand the role of the Small Business Administration and its Capital Access programs to help struggling small businesses, including homebuilders.

The current housing recession is the worst since World War II. Housing starts are down 80 percent since January of 2006, and virtually every housing indicator reached an all-time low in the last two quarters. Glimmers of hope, however, suggest that the three plus year decline in housing may have stabilized. These buds of growth notwithstanding, a number of specific headwinds will continue to buffet any significant housing recovery. The strongest of these include excess inventory of vacant homes and apartments, foreclosures that continue to feed this inventory, continuous downward price pressures from too much supply and not enough demand, tight mortgage underwriting and low appraisals, and extremely difficult financing terms and availability for builder acquisition development and construction loans, or AD&C loans.

The data suggests that residential construction is now bounding along a bottom. We forecast that housing starts face a low slow, recovery that will take several years. NAHB forecasts 525,000 housing starts for 2009, and 650,000 for 2010. This is less than half of our forecast for long-term housing demand.

Of the issues I mentioned, two stand out for their acute impact on home builders, low appraisals, and lack of financing for AD&C loans. My written statement explains in detail the key components of these issues, but suffice it to say that taken together, they are placing enormous pressure on home builder's bottom lines, and for many endangering their ability to survive the economic downturn. Additional credit resources could help them survive until the economy recovers.

Historically, NAHB builder members have not been able to access SBA loan programs, because they do not serve the primary need of most builders, access to AD&C credit. Non-builder NAHB members, such as suppliers, manufacturers, and others likely can utilize SBA programs. However, SBA guarantee loans cannot be used to finance real estate development activity.

As part of the American Recovery and Reinvestment Act, the SBA toolbox was expanded with the creation of the America's Recovery Capital Loan Program. This program allows for loans of up to $35,000 for payments on principal and interest on existing loans, qualifying small business debt, including mortgages, and for other purposes. NAHB strongly supports this program, and is hopeful that it can help our members.

Turning to the new proposals the Committee is crafting for SBA, we applaud the proposed improvements of the 7(a) program, especially the Capital Backstop program. This could help expand the pool of participating SBA lenders, while also providing a backstop for loans, if no lender can be found.

One potential improvement we suggest is to further specify the borrowers who are eligible to participate. It is unclear to us, for example, if homebuilders would qualify.

Finally, we support the Committee's proposal to establish a Supplemental Loan Assistance program to compliment the lending initiatives currently administered by the SBA. Providing for significantly larger loan amounts than the 7(a) or ARC programs, and targeting businesses in the construction industry would be extremely helpful to NAHB members.

Further, creating a role for SBA as a backstop lender can help insure liquidity for these loans. But to help homebuilders specifically, we urge the Committee to include residential AD&C financing, as an eligible use of these funds.

We are glad to work with the Committee as it further develops this proposal. And that concludes my remarks. And, again, thank you for allowing me to testify today.

[The prepared statement of Mr. Robson is included in the appendix.]

Chairman SCHRADER. Thank you very much, Mr. Robson.

Our next witness is Ms. Zola Finch. Ms. Zola Finch is the Director of Finance of RMI CDC based in Jefferson City, Missouri. Thank you for coming.

Ms. Finch is testifying on behalf of the National Association of Development Companies, the leading trade association of certified development companies, which administers the SBA's 504 CDC program. Welcome to the Committee.

STATEMENT OF ZOLA FINCH

Ms. FINCH. Good morning. My name is Zola Finch, and I'm the past Chairman of NADCO. And I'm pleased to provide a statement about our industry's proposals to improve access to capital by small businesses.

I would like to thank Chairman Schrader and Ranking Member Buchanan, and the entire Subcommittee for continued support of the CDC industry in the 504 program. The Subcommittee has worked closely with SBA and our industry to insure the availability of this program to small businesses for many years.

First, I'd like to discuss the need to reduce the cost of the 504 program. SBA has informed us that the 2010 budget increases the cost of the 504 program by 38.9 basis points. This is due to at least two factors in SBA's econometric model; the national unemployment rate, and the forecast of the 504 default rate. With both of these factors being impacted by the current recession, but the effect is expected to be short-lived, we ask the Subcommittee to support an appropriation sufficient to offset the fee increase for the next two years, as small businesses return to a growth mode, and improve their cash flow.

We request this to be taken up as soon as possible in order to change the impact of the subsidy fee increase on our FY 2010 borrowers. It does not seem right in this economy to provide small businesses fee relief in the Stimulus Bill in February of '09, and turn around and increase their cost of borrowing in October of '09.

Second, we need to reach out to more small businesses with new capital. Congress and the Obama Administration have worked hard to put more fixed asset financing and working capital into the hands of small businesses hard-pressed by this recession. However, our industry believes that more should be done quickly to have added impact on small businesses that can create the jobs needed to pull America out this recession. We believe that many small businesses either need access to larger guaranteed loan amounts, or have already used up their allocated maximum under the current 504 law. The current restrictions can be addressed in three ways.

First, to increase the maximum 504 debenture beyond its $1.5 million limit. Second, to allow a borrower to maximize the use of both 504 and 7(a) loan limits. And, third, eliminate the regulation that restricts business owners with higher net worth from participating in the 504 program.

Next, I'd like to comment on the need to reduce loan losses with more effect devoted to the loan liquidation and recovery process. At Congress' direction several years ago, SBA created a new regulation that enabled taking advantage of recovery expertise within the CDC industry. Many CDCs already perform these tasks for other loan programs that they administer, but CDCs have not been given the ability and freedom by SBA to do this on a broad scale. NADCO believes that losses can be reduced if CDCs perform recoveries and seek settlements from loan guarantors of 504 projects.

NADCO also recommends other program changes to reduce loan losses. We should make the program more flexible in allowing higher owner equity injections to reduce the high cost of first mortgages. If we reduce the overall cost of borrowing, we enable small businesses to save more cash for working capital.

Also, we need to make the SBA programs more relevant and productive. Loan volume for both 504 and 7(a) has improved slightly since the passage of the Stimulus Act, but many of those benefits have not been yet implemented by SBA. Both programs are still down around 50 percent from levels two years ago.

Part of this volume loss is clearly due to small businesses pulling back on demand, but a substantial part could be due to SBA, and even our own lending industries failing to respond to the ever-changing need of the small business financing world.

Both the SBA 504 and 7(a) programs are over 20 years old, and with an environment of restrictive and overbearing regulations having evolved within the federal bureaucracy, with the new administration and fresh thinking from senior policy makers, NADCO sees an opportunity to break out of the old program's restrictions and bureaucracy. We see the chance to work with new leadership teams, and with the new Congress to expand program benefits to more borrowers. And with that expansion comes more jobs.

NADCO believes the first step in the process of expanding and enhancing the 504 program is to clarify the structure of CDCs that deliver the program in order to insure and enhanced level of services by CDCs.

We thank the Subcommittee for considering several program changes that will increase the focus of our industry on community development through our CDC non-profit organizations in future years. We also thank you for developing legislation to more tightly define the security that funds the 504 program.

SBA has become one of the largest economic development agencies in the federal government. By leveraging its guarantee authority in lender industries, SBA has directly assisted in the creation of over 5 million jobs, through more than $200 billion in 504 first mortgages, 504 second mortgages, and 7(a) guaranteed bank loans. But, like any mature agency, SBA has to re-evaluate its products to serve the changing needs of small businesses.

NADCO encourages Congress to collaborate with the new SBA management and lenders to tear down those restrictive walls, and create the financing and economic development programs vital to America's future. Small businesses that are healthy and successful will lead us out of this recession. Let's help them now. Working together, we can get America working. Thank you.

[The prepared statement of Ms. Finch is included in the appendix.]

Chairman SCHRADER. Very good. Thank you.

Our next witness is Mr. Steve Swartzman, and he's a principal in C3 Capital in Kansas City, Missouri. Mr. Swartzman is testifying today on behalf of the National Association of Small Business Investment Companies, the professional association for companies that administer the SBA's SBIC program. Welcome to the Committee.

STATEMENT OF STEVE SWARTZMAN

Mr. SWARTZMAN. Chairman Schrader, Ranking Member Buchanan, and members of the Subcommittee, thank you for giving me a chance to testify on behalf of the National Association of Small Business Investment Committees.

My name is Steve Swartzman, and my partners and I at C3 Capital manage two funds that hold SBIC licenses. SBICs are private equity firms that raise private capital, and agree to invest exclusively in American small businesses in return for being able to access SBA leverage to multiply the amount of capital available to small businesses. SBICs invest, putting our money at risk first, in small businesses that we think will succeed.

First, let me say that this is a great program that has worked very well for us, and our investors, and the 33 companies in which we have invested over $137 million over the past six years, all the way from Florida to Oregon. Our companies have created thousands of jobs, and greatly added to the economy in countless ways; all at no effective cost to the taxpayers.

The program works, and has great and dedicated people in place. So, I come here not to criticize, but to promote the growth and utilization of the program. This is a market place program, not any kind of a handout. The SBA is paid back in full with interest and fees. There is also a market need for SBICs, which invest in small businesses that larger funds overlook. We invest in a highly inefficient part of the capital markets that is made more efficient by this program, particularly in a recessionary environment like the current one.

We provide loans to small businesses that are beyond the risk profile of banks. And, as you can imagine in the current environment, that risk profile has changed pretty dramatically.

The SBIC Debenture program is authorized to provide $3 billion a year in leverage. Less than $1 billion was utilized last year. All the money left on the table by the under-utilization of the program is money that is not going to grow out best job creators, which are small businesses.

Over the next four years, assuming full utilization, as much as $10 billion could be made available to small businesses under the current program, again, at no net cost to taxpayers. The SBIC Debenture program has paid for itself through interest payment and fees, and has done so for the past 50 years.

So, how do we reform the program? First, successful SBICs should be welcome to stay in the program by creating a clear and predictable re-licensing system. Our second license took over a year, despite the fact that our first fund had already gone through a lengthy licensing process, and we had the same management team in place, and the same strategy, and had a successful fund.

If a fund has already been fully vetted, licensed by the SBA in the past, proven itself financially, complied with federal regulations and passed annual examinations by SBA regulators, also, has adequate infrastructure in place, and wants to continue to invest in small businesses, then we believe it should be able to receive a new SBIC license quickly.

The family of funds limit, not the individual fund limit, should be raised to allow for successful repeat funds to grow and stay in the program. Successful SBICs are being driven out of the program, because the repeat licensing process is so onerous, unpredictable, and expensive. It makes no sense to graduate funds out of the program that have proven themselves to be successful in the small business space. These are exactly the kinds of funds that should be kept in the program. And, given that the program is operating at below 30 percent capacity, there's clearly no danger in using up the program's budget by keeping successful funds in the program.

There are a few other additional reforms that we'd like to propose. The Energy Saving Debenture, which was passed by Congress in 2007, is still not available. The SBA needs to implement this investing tool. And Congress needs to fix the technical error in the statute that excludes most SBICs from the Energy Debenture program.

Currently, even if the regs were in place for the program, only 11 licensees, which have been in place since October of 2008, are eligible to utilize the program. Small businesses, not just large multi-nationals, should have the ability to compete in the green economy.

Further, SBICs should not be disadvantaged as they compete in the market. We need more rules to reflect the market realities and protect taxpayer's investments.

I also want to mention the Financial Regulatory Reform, and how that may affect SBICs. SBICs are already highly regulated, and should not be regulated twice by adding additional layer of SEC regulation on top of that, that's already in place. This would add additional infrastructure, and cost compliance expenses. And we're already highly regulated by the SBA.

In conclusion, I just want to say that a fully utilized SBA program can provide billions in capital to domestic small businesses that will create more jobs than any other part of the economy. The Recovery Act was projected to save or create 4 million jobs at a cost of nearly $197,000 a job, but it costs only between $11-33,000 to create a job by a small business investment. If the existing SBIC program were fully utilized, it could create hundreds of thousands of jobs over the next four years, and do so at zero net cost to the taxpayers.

[The prepared statement of Mr. Swartzman is included in the appendix.]

Chairman SCHRADER. Excellent points. Thank you very, very much. Good testimony.

Our last, but not least, witness is Dr. Sterling Ransone, a family physician from Deltaville, Maryland. He's testifying on behalf of the American Academy of Family Physicians, one of the largest national medical organizations at the center of our healthcare reform discussions, with more than 94,600 members in 50 states and territories. Welcome to the Committee, sir.

STATEMENT OF STERLING RANSONE

Dr. RANSONE. Thank you, sir. Chairman Schrader, Ranking Member Buchanan, and members of the Subcommittee on Finance and Tax, I'm Dr. Sterling Ransone, a practicing family physician from Deltaville, Virginia.

I'm here representing the 94,600 members of the American Academy of Family Physicians. I'm pleased to be here today to support the Small Business Health Information Technology Financing Act. Congresswoman Dahlkemper's bill goes a long way in helping family physicians adopt health information technology, or HIT.

To give you some context, let me share with you some information about the AAFP and Family Medicine. The AAFP is the only medical society devoted solely to primary care. Nearly one in four of all office visits made to physicians are made to family doctors. This is 208 million visits each year.

In our fragmented world of healthcare, family physicians treat the whole person across all ages. Due to the number of patients that we see each year, and the wide range of medical services we provide, the AAFP is committed to HIT as one way to improve quality and cost-effectiveness of healthcare in the United States. H.R. 3014 will be a welcome adjunct to the provisions contained in the Recovery Act, which passed last February.

The AAFP worked closely with Congress to craft the Recovery Act provisions on HIT. The law makes an unprecedented investment in HIT, and it reflects an understanding that HIT is critical in any reformed healthcare system. However, the Recovery Act funding does not contain a crucial piece that this bill provides; that's access to up- front capital for physicians seeking to purchase HIT systems.

We appreciate that H.R. 3014 includes guarantees for loans to physicians and practices, and helps providers using HIT to improve care and help patients. We also appreciate that this legislation recognizes that solo, small, and medium-sized physician offices still find it difficult to afford health information technology.

While everyone benefits from these HIT systems, the physician bears the cost of acquiring the system and implementing it in the practice. Unfortunately, primary care practices are seeing declining reimbursements, and increasing operating costs. This has severely restricted the access to capital to invest in HIT.

Right now, about one half of family physicians are using electronic health records, and we are proud of that fact. Nevertheless, based on an August 2008 survey, the other half said that cost was the most important reason that they were not adopting HIT.

Let me give you a personal example. I've got a friend in solo practice in Richmond, Virginia, who employs one nurse and one administrator in his three exam room office. Since my physician friend is aware of the benefits of HIT, he undertook a serious review of the available electronic health records to find one that would fit his practice, was affordable, and appropriate to use.

Unfortunately, despite his due diligence, he came to the reluctant conclusion that as a small business owner, he simply could not afford to make that investment. My friend is precisely the type of small practice this bill would target.

Let me close with three others points. The specifics of the Recovery Act are still unclear, especially the definition of meaningful use. Loans such as these, and H.R. 3014 could at least help physicians determine how they'll pay for HIT. Meeting the eventual meaningful use requirements and staying current will mean both time, and money for family doctors. Consulting, training, and work flow redesign must be considered in addition to hardware and software issues. These are going to be ongoing costs for each physician.

Last, a streamlined application process with minimal paperwork also will be key to attracting the busy physician in solo, small, or medium-sized practices. We ask the other witnesses at this hearing to develop applications that are as simple as possible.

Healthcare is a significant component of our economy. Our committees are working right now to pass healthcare legislation that will improve quality and cut costs. We appreciate that H.R. 3014 will help physicians to adopt HIT, which is an essential component to any quality improvement initiative.

While health information is only one portion of this highly complicated industry, investment in HIT at the practice level is critical to improving the healthcare of our patients. It will reduce costly medical errors. It can help patients manage their healthcare more efficiently, and will contribute to the nation's economic recovery.

Thank you for this opportunity to testify.

[The prepared statement of Dr. Ransone is included in the appendix.]

Chairman SCHRADER. Thank you very much, Doctor. Appreciate your coming, and the quality of the testimony regarding HIT.

I guess I'll start with the questions. I'll start with Mr. Humphreys, if that's all right.

Legislation we're considering would require the SBA, theoretically, to finally pay its guarantees promptly. What sort of benefit do you think this would have, and what are the real roadblocks, from your perspective, in actually making that happen here?

Mr. HUMPHREYS. Well, the realistic roadblocks are the fact that you still need to realize on the collateral. If there are assets held as collateral, they need to be liquidated. Oftentimes, in the process of liquidation, the borrower hires an attorney, the bank hires an attorney, they go through the liquidation process. It's very difficult on a borrower. That can mean survival, just in the liquidation of a single SBA transaction. Oftentimes, it tips them into bankruptcy delays. And then once you go through that process, and who knows how long it takes, then you can make application to the SBA to realize on the guarantee.

Currently, that's held up, but if that's expedited, that will help, but it doesn't help the real issues of the damage that can be done in the process.

Chairman SCHRADER. Very good. Thank you.

If we're able to actually expedite things, do you feel more lenders will come into the program?

Mr. HUMPHREYS. Based upon what I see right now, it could help somewhat. I don't really think it is a significant improvement in terms of gaining more participation in the program.

Chairman SCHRADER. And of the proposals you mentioned, which do you think is the most important one that would get more people into the program?

Mr. HUMPHREYS. Well, refinancing current debt is a very big issue. And if it could be expedited to the point where upon default an application was made to the SBA, and the SBA then would start working immediately with the bank in advance of liquidation, or in advance of bankruptcy, to try to resolve the issue. And allow, maybe, a refinance, allow, maybe, restructuring of the transaction, instead of just following strictly the rules of liquidation of existing collateral. That might be helpful.

Chairman SCHRADER. Okay. Thank you very much.

Mr. Robson, homebuilders, as I said before, have been hardest hit, it seems like, of anybody; although, some of my small business friends might argue that. What do you think about the federal efforts so far? I mean, increasing the 7(a) guarantees, and some of the fee elimination. I mean, the dollar amounts sometimes think were a challenge, I would assume, for your men and women. So, could you comment, please?

Mr. ROBSON. Well, the dollar amounts generally, probably, are a problem. Really just having specifically not being able to use the 7(a) program for development activity, that's going to be most of our members' needs, as far as construction loans, and development loans. And even in this market, there are still some building going on that need to be financed someway. So, expanding that so that it would include development activity would be very helpful.

Chairman SCHRADER. Do you have a size in mind?

Mr. ROBSON. Not particularly. I mean, we could work with you on that. I don't-

Chairman SCHRADER. A range, perhaps?

Mr. ROBSON. You know, I would have to get back with you on a specific size. Our members are all across the board, so to say a specific size on 7(a) program would be difficult for me to do, but I'd be happy to get back with you.

Chairman SCHRADER. I appreciate that. I appreciate that.

Ms. Finch, in your testimony, you touched on the fact that it would be nice to have the CDCs get expanded authority for liquidation, kind of plays to some of the discussion that Mr. Humphreys had. Could you expand on that a little bit?

Ms. FINCH. As I said in my testimony, yes, the law was passed to allow CDCs to do liquidation. And, currently, we just don't have the guidelines, and regulation, and policies from the SBA to really fulfill that. So, we have—CDC industry does deliver many other types of loan programs, and we have years of experience in doing liquidations, so we feel like we are competent, and able to do that, but we do need to have regulations, SOPs, et cetera, so that we have the tools to move forward and do those liquidations, and maximize recoveries on 504.

Chairman SCHRADER. Okay. Thank you. Very good.

Dr. Ransone, Ransone, excuse me.

Dr. RANSONE. That's fine.

Chairman SCHRADER. I'm not good at this.

Health IT, that's a big deal. I mean, it was in the Recovery Act, it's talked about by a number of groups here on Capitol Hill. And certainly, as a veterinarian, I've tried to incorporate some of that in my little business world, and seen great improvements.

Is there any other particular aspects in terms of making sure that doctors are aware of opportunities that might be forthcoming with new legislation for them to access some capital, or at least have the opportunity to get this into their practices?

Dr. RANSONE. Oh, absolutely. The example I used in my testimony was a good friend of mine who was in my class, and the doctors want to adopt HIT technology. The problem is that so many of us are small businessmen, just finding that capital—my friend, when he went out, he did a good search. And this was last year. It was going to cost $40,000 for three people in his office in order to buy the hardware to adopt HIT. And that's exclusive of buying licensing fees the next few years, and things like that.

The biggest thing about the current bill, H.R. 3014 is going to be a deferral on the loan for the first one to three years. When any-one adopts Health Information Technology into their office, you can't go into it right away. When you've been using pad and paper to take notes about a patient, that's how we were trained. That's what I've done for the last 15 years. And it's a very innate thing. Having to put a computer between you and a patient, you need to learn how to use it, especially folks like me who aren't touch typists. So, there's an incredible loss of productivity for the first three months.

For me, personally, when we adopted HIT, it took me about two years before I finally got up to my initial—or back to my original productivity. And it was—HIT is essential, and it's going to benefit the patients, and it's going to benefit the economy. The problem is, is that the local family doctor out there, it takes a while to get things going. So, we are very excited, and we would love to see any type of deferral on these loans for the first one to three years, so that while our productivity is down, we're not having to pay it back.

An example would be, I buy my car. I just bought a new F150. Okay? So, I got a loan, and I'm paying it back right away. I'm driving the car right away. The problem—and I'm getting the benefit of that F150. The problem is, with HIT, as soon as we adopt it, and we do the research, and we get the computer system in our office, we're not at that same productivity. We have to drop off, and we're not making as much money to pay off our loan, so the deferral is really important in that.

Chairman SCHRADER. Very good. I certainly experienced that in my own veterinary world. It took me a couple of years to get back up to speed, but wouldn't do without it at this point in time.

I'll defer now to Ranking Member Buchanan for some questions.

Mr. BUCHANAN. Thank you, Mr. Chairman.

Mr. Humphreys, I mentioned earlier, and I'll talk a little bit about SBA. Three years ago, I said roughly, two and a half, there was an abundance of credit, and today there's very little or no credit, unless you have a lot of capital.

I talked to a community banker, as I mentioned earlier, Friday for last, this past Friday, and I've sensed that in the community. A lot of it is because they claim regulators and they're putting pressure on their capital, most banks are leveraged 10-1, 12-1, whatever it is. What's your thought on that statement? Do you think that's the reality today, that most small businesses find themselves in, where there's little or no capital available, other than they put a $1 million CD to get $1 million. I mean, how far is that off, or is it?

Mr. HUMPHREYS. Well, I know that things are difficult around the country, and for many, many small businesses and banks, as well. I can only refer to my bank, and the experience that I have. And that's not exactly true for our bank.

We increased our business loan total, so now we're working with a fairly small base, $310 million in loans.

Mr. BUCHANAN. Do you lend in Florida?

Mr. HUMPHREYS. We don't lend in Florida. We increased— we stick with our market area very consciously, but we increased by 8 percent our loan totals in '08. And year over year to June, we're up 5 percent. And we anticipate, we're budgeting another 5 percent through the end of this year. We just hired three lending officers, two of which are managers of branches, and lending officers, another commercial lending officer. So, we're open for business, and we're making loans. And just the replacement, just to replace the paydown of the existing base requires quite a bit of lending. We're closing about 100 new deals a month in our small bank.

Mr. BUCHANAN. How has the criteria changed? Let's put it a little different way, for the bank in three years, how you looked at a loan three years ago, and what you might look at today?

Mr. HUMPHREYS. We've not—we believe that good business credit underwriting is good business credit underwriting. We haven't changed. We're using the same standards we used for the last 10 years, and we will continue to use those same standards going forward. A good deal is a good deal, and a good deal today is no different than a good deal yesterday.

Mr. BUCHANAN. I think, probably, regionally, different parts of the country, because every bank will say the same thing as what you said. If I find something that meets the criteria, but the problem is everybody had a pretty rough '08, '09 isn't much better, so the banks, the underwriting is a higher standard. And, yet, you can't find a lot of those companies making it.

Let me jump over in terms of the SBA. You know, you've got this 90 percent guarantee. Why isn't more banks taking advantage of it, in your opinion? Because it sure seems to me, I mean, it would be a great way to get more capital out. The banks are guaranteed 90 percent. I know it's not 100 percent, but 90 percent, we'd want to have the banks have some sense of obligation, some risk, because it's the taxpayers' money. But why don't we have more banks?

And I've got to tell you, in the '80s, I was completely frustrated. We were trying to help people get loans through SBA, and it was just aggravating, cumbersome, took forever, the bureaucracy. You know, there's not enough in it to make it work, because of the energy you've got to put in to get one. But that was—I'm hopeful that that gets better. The reality of it is, we need to get more capital out there for small businesses. But I was just curious, your experience. I don't know if your bank is using it. And, if it is, what's been your experience?

Mr. HUMPHREYS. We've been an SBA lender over the years. We have not used SBA 7(a) in recent years. We are an active 504 lender.

One of the reasons I think SBA 7(a) grew in volume, and now has fallen in volume, is because of the liquidity issue. Banks used 7(a) loans to create liquidity, because if you have a 7(a) loan, there's a ready market to sell the loan, and replenish the funds back into the bank. And liquidity issues right now aren't what they were two years ago, or even a year ago. Banks have more liquidity today for a number of reasons, so they're not seeking the SBA 7(a) participation.

The underwriting standards are still the same. If you write a 7(a) loan, it needs to be a good loan. You can't make it a better loan by putting the guarantee—you can't make a good loan out of a bad loan by putting a 7(a) guarantee. And the SBA works with the bank. They're good underwriters there, and they agree with the underwriting conditions. So, right now, banks have liquidity. When they can make a loan, they will make a loan. If the underwriting criteria are there, that loan will be made. And in most cases, the bank doesn't need the 7(a) guarantee to make it a good credit transaction. So, I think right now, primarily, liquidity is causing the downturn.

Mr. BUCHANAN. Ms. Wayman, I was going to ask, what is the profile of a person that walks in for a Microloan? I mean, what—tell me what that person, I know they're entrepreneurial, I've had some people ask me about it. I've seen it. People said if I could get $15,000, I could set up my sprinkler company, or whatever. I just need some seed money, but I was interested, because I'm not sure I have the right impression, but I'd be interested in your thoughts on that.

Ms. WAYMAN. Thank you for the question. And the average entrepreneur who comes into our business, comes into the Microloan Intermediaries and request the loans are low- income, or moderate income. They increasingly more are looking to self-employment, because they've been laid off from a job. They have business ideas, but they can really benefit from business coaching, business planning assistance, getting their credit score all set. And then helping them develop their business plan.

We tend to give—the Microloan Intermediaries provide credit primarily to women. Over half of the loans are made to women, African Americans, Latinos, Asian Americans, and Native Americans, so the Microloan Intermediaries are serving disadvantaged populations.

Mr. BUCHANAN. Now, let's say someone comes in for a Microloan for $20,000. You approve it, and then they come back a year later, nine months later, and need another 15. Normally most people, I found over the years, that go out of business, they're out of capital, and they've got to shut down. Maybe if they had a little bit more—what is the possibility of that?

Ms. WAYMAN. The Microloan Intermediaries are very flexible, and work with the credit needs of whatever the entrepreneur is. And, in many cases, they come in with smaller loan requests, and then pay that back, and build it up. We're actually seeing that you can—if you've been paying, and you're in great shape, you can always come back for more loans up to that $35,000 maximum, of course. But what we are seeing now is, part of the goal of the Microloan program is to move these entrepreneurs into the mainstream financial sector. And what we're finding is a number of those entrepreneurs we thought were working with the various banks, and commercial banks, are now having difficulty in coming back, and their lines of credit have been terminated. So, they're coming back to the microlender and get as much of the loan as they can.

Mr. BUCHANAN. And then in terms of—one last question. In terms of, you mentioned that line of credit, what do you— how do you term out a line of credit? I mean, obviously, it's paying interest on the outstanding, but what kind of terms would they come in and sign up for a line of credit? Is that a one-year deal, and then it resets, or you ideally want to pay it off, or does it term out after interest only for a year, then a five-year amortization, or what do you do?

Ms. WAYMAN. The microloans right now are typically three to six year loans. They're not lines of credit. That's one of the things we're hoping to see in the re-authorization. It's more flexible, it uses four lines of credit, so that folks, especially folks like air conditioning repair services that are seasonal, aren't saddled with a three to six-year loan.

Mr. BUCHANAN. Mr. Robson, I wanted to—I'm interested in—because the thing that's really, in my opinion, really hurting a lot of homebuilders is the amount of foreclosures. I want to just jump on that for one second, and we'll get back to the other thing.

I don't see how someone in our area, who is so over-built, and so hyped, southwest Florida, Florida, Nevada, different parts of the country that really things were going up 20 percent a year. But, when you're faced with communities with a lot of foreclosures, and you can—say a guy gets cost of building a house, the land, the dirt, the land, and sticks and bricks, and all, that's $250,000. But someone can buy a house down the street, or next to it, for 175, or short-sale. It seems like we've got to get through that inventory for builders to have an opportunity, many of them, to get back, unless they've got someone who's just go to have a new house.

I wouldn't go buy a new house, if I can buy it for a third less next door. How big of a problem is that to the homebuilders of America?

Mr. ROBSON. In certain markets, certainly, that's a problem, but that's really limited to only about four major markets. The rest of the country, unfortunately, has that whole mentality spilling over to appraisals, and that sort of thing. So, I think there's—you can't pinpoint one market and say that's a problem on a national basis.

And, as I mentioned in my oral statement, there are even in the south Florida market, opportunities where somebody has owned their own land, and have held it for a long time. Frankly, with building materials and that sort of thing, the way they are right now, it's not a bad time to build, if that is what you are so inclined to do.

Certainly, there are price ranges, and certain types of products that may be more over-built than others. So, it's hard to do a broad-brush as far as real estate markets are concerned. But, absolutely, foreclosures are a problem, whether it's owner-occupied, or investor, or whether it's something in inventory that builders had been holding.

Mr. BUCHANAN. You mentioned low appraisals. What were you referring to there, just the industry, the banks appraising things? I just want to get your—I have my own thoughts on that, but just get your thoughts, and what you were referring to. I got the impression you were saying it's hurting the industry, low appraisals.

Mr. ROBSON. Well, in fact, we had meetings this morning with one of the appraisal groups. You know, what tends to be happening is, there's been a shift primarily to the appraisal management companies that tend to be kind of a low dollar appraisal source, where they are demanding two- day turnarounds for appraisals, very short time frames. A lot of the appraisers that are doing those, frankly, don't know the market. They're using short sales, and foreclosed properties when there are actually other comparables out there to use. Some of the code that is being talked about that's going to be implemented, actually started in May, where—not that it says this, but there can't be any collaboration. You can't talk—the lender can't talk to the appraiser, and the buyer can't talk to—I mean, in reality, that has to happen, so there's a number of issues and fixes that need to be made to appraisals. And I'll give you an example in Tulsa, Oklahoma.

We have a house, a builder came up to me. He sold the house for $230,000, same house for a custom, and in Tulsa, Oklahoma, it's a small enough market that going a few miles down the street isn't going to be a problem. And we're actually one of the few markets that actually have price appreciation in homes. It came in below cost for a construction loan. That is a problem, even in markets that are doing fairly well, so the appraisal issue is a major, major concern.

Mr. BUCHANAN. The last question was just, the ARC loans you mentioned, how does that—what size should they be? How is that going to help? Will that help homebuilders, and maybe also just—I don't know many homebuilders that have really worked with SBA much in the past.

Mr. ROBSON. Well, they haven't—certainly, we have had some of our builders try to access ACR loans. One—I think there's two or three problems with it. If you don't deal with a bank that's already in the program, if you're a new customer, you're probably not going to get it. I think banks are using those programs to help their existing customers. If you're not with a bank currently, trying to get one as a new customer is going to be very, very difficult.

Secondly, what we're finding is that on the ARC loans, a $35,000 limit, you've got the same pack of material, I mean, the same processes, and everything else that go into a regular SBA loan for $35,000. So, I'm not sure how cost- effective it is with the amount of red tape that you have to go through to make it worth somebody's while, unless it's with an existing customer.

Mr. BUCHANAN. Ms. Finch, I was just going to ask you, on CDCs, would they support changes to the program if authorized debenture is greater than $4 million?

Ms. FINCH. Yes, we would. And the reason being is because, as I said in my testimony, we're looking at multiple projects. So, I've got borrowers out there, personally, that have hit the $1.5 million, or if they're public policy, a $2 million limit. And if they're a manufacturer, they hit the $4 million limit. So, in order to do multiple loans to a borrower, we would be supportive of that.

Mr. BUCHANAN. Mr. Swartzman, I wanted to run through. You said that if you're already doing business as SBIC, it takes a year. Why does it take that long if you're looking to expand, or whatever?

Mr. SWARTZMAN. That's a good question. I'm not sure I know the answer.

Mr. BUCHANAN. I mean, does it take that long to implement it, or does it take that long to get an answer? I mean, because it's one thing-

Mr. SWARTZMAN. From start to finish. I mean, that's from starting the process, it's a fairly—it's a multi-stage process to get a license. You go, you make an application. Then they invite you, once you make your application, to come in for an interview. If the interview goes well, you've got something called a Go-Forth letter, which invites you to make a secondary aspect of the application process. And then there's some back— you go back and forth. We're very diligent about going through that process. And whenever we have questions about our application, we would typically get back within two to three days. So, a lot of it, I think, is just staffing issues there, and just-

Mr. BUCHANAN. How long does it take, if you're starting from scratch, wanted to set up an SBIC?

Mr. SWARTZMAN. Well, the first time we went through it, it took us two years, which, I'd say for somebody who's going through that, as you're going through it, if you knew it was going to take two years, you probably wouldn't do it.

Mr. BUCHANAN. Yes.

Mr. SWARTZMAN. Clearly, at the time we were doing that in the beginning, it was around the 2001 time frame.

Mr. BUCHANAN. I can't imagine anything taking two years.

Mr. SWARTZMAN. Yes. Yes.

Mr. BUCHANAN. I tell my bankers I want a quick yes or no. No, is okay, if you don't want it, or whatever, but the bottom line, I don't want to drag for 30 days, but two years, that's-

Mr. SWARTZMAN. It's not—certainly, that was acceptable. I think they were going through a period where they had a lot of problem loans, and we're changing the procedures, and making them much more rigorous. And we fully support that, and understand it should be a very rigorous and thorough process, because there's a lot of taxpayer capital at risk.

On the other hand, I think what we're proposing is once they've gone through that vetting process, however long that takes the first time around, and you've got funds, you've got an existing fund, you have a management team that's proven, you have an infrastructure in place, it ought to be a really expedited process. And a year is way too long.

Mr. BUCHANAN. Just the last question. What kind of companies— you said you had 33 companies, and how many employees in those companies?

Mr. SWARTZMAN. Oh, gosh. It ranges from probably the smallest investment, the smallest company has maybe seven or eight employees, but wonderful margins, and a great little business. And the largest ones are maybe 2,000, so there's a huge range.

Mr. BUCHANAN. Thank you. I yield back.

Chairman SCHRADER. Thank you very much. Good questions, good answers.

At this time, the Chair recognizes the gentleman from Kansas, Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman. I would like to just take a personal privilege here to welcome Mr. Swartzman, who is a constituent in my district, and thank you for being here today, Mr. Swartzman, and the other witnesses for your testimony.

Mr. Swartzman, in your testimony, you make a point that SBA regulations often provide a disincentive for equity firms to receive the SBIC designation, and debenture guarantee. Specifically, do you have suggestions as to how you believe the SBA regulations could or should be changed, and would many more firms if these changes were made be willing to participate in the SBA program?

Mr. SWARTZMAN. Yes. I mean, I think the main one would be just making the process for existing funds, again, which have proven themselves, and have infrastructures, expediting that process to keep them in the program, that's certainly the easiest way to utilize more of the capital that's available. And, again, each year Congress provides a certain amount of capital. And I think the program has been using less than a third of that.

I think there are a few other areas that were listed, and I want to put forward, if we could provide some of the same incentives to companies owned by veterans as low and moderate income types of—low and moderate income areas that there are already some incentives in place.

I think it's important when we look at regulatory reform that's going through, making sure that there's a way that SBICs can sort of be set aside. And we have some personal experience, having—we were in the State of Missouri, we're in Kansas City on the Missouri side, and on advice of counsel, we registered as an investment advisor in the State of Missouri. And they had just gone through changing the process from a handwritten system to a—a manual system to an electronic version. There was a glitch in our application. And, again, it's something that we thought we had to do, but it didn't really apply to anything that we did. And three years went by. Every year we sort of updated and sent it, and we found out—then we'd pay our annual dues. We found out that there was a problem with our application, and they came at us and told us that we had to pay like a $200,000 fine, and all sorts of legal, sign some documents. And we went back and spent—we probably spent $100,000 in legal fees to fight this, and we found out we were the only firm in the State of Missouri that had even tried to register.

So, when we presented them with all this, look, guys, we're going to do this. You're going to fine us. What are you going to fine the other private equity groups that have been around for 10 years, 12 years, and been operating? And they quickly dropped it. But I think it just shows that for firms our size, clearly present no systemic risk, to stay in compliance and do the things you need to do, you need to have an infrastructure in place for that.

Mr. MOORE. Thank you, sir.

Mr. Humphreys, recently, my office was contacted by a constituent who is a small business owner, and she was interested in obtaining an American Recovery Act, or ARC loan. As you know, the ARC loans were authorized by the Recovery Act, and provide up to $35,000 to small businesses struggling to meet existing debt obligations. The loans are backed by the federal government 100 percent.

My constituent contacted the bank she'd used for four years. They told her the bank had decided not to participate in the ARC loan program. She then checked with both the local SBA office, and the local Business Development Center. She found that although the ARC loans are very new, only a handful, approximately six to eight, have been issued in the entire Kansas City area.

On July 1st, I held a forum in my district on access to capital for small businesses, and I know there's a great real demand for ARC loans. Can you tell us, if you know, why aren't more banks issuing these loans? Why can't more businesses access these loans?

Mr. HUMPHREYS. Well, somebody mentioned earlier that there's as much work, research, employment of people to round up information to make an ARC loan as any other kind of SBA loan, a tremendous amount of documentation. And, yet, the underwriting standards on the SBA side aren't what the 7(a) demands, or the 504 program demands, and certainly not what the bank would expect.

The ARC Loan program is a little bit more like a grant. The expectation for repayment is not as high. It's an opportunity to help out and, in our opinion, it's a little bit of help. But, in most cases, it isn't what the business needs. The business needs a restructuring. They need help not just $35,000 here, and then maybe another quicker response to a guarantee claim on another SBA loan.

I think the SBA and the banks need to work together to be creative to restructure the business so that it can work going forward. The ARC program, to me, and a lot of other bankers, is just a thumb in the dyke.

Mr. MOORE. Thank you, sir.

And, finally, to Dr. Ransone, is it Ransone, sir?

Dr. RANSONE. It's Ransone.

Mr. MOORE. Ransone. Excuse me.

Dr. RANSONE. Yes, sir.

Mr. MOORE. I appreciate your testimony, what you were talking about, electronic medical records, a system nationwide. In fact, I filed a bill two or three years ago that would do—the bill is not the one we're talking about here. But I tell folks back home, the first thing you do when you walk into a doctor's office or a hospital, is you're given a piece of paper, and say here, complete your medical history. And I say sometimes the patients get the information right, and if they do, the doctors can provide correct medical care. And if they don't, who knows what's going to happen.

Dr. RANSONE. Yes, sir.

Mr. MOORE. But you're exactly right. I think we need a nationwide system of electronic medical records that would end up saving money, even there's an up-front cost. But, also provide better care to— enable physicians, and care- givers, healthcare-givers to provide better care to patients. So, I applaud what you're doing, and keep going.

Dr. RANSONE. Thank you.

Mr. MOORE. Thank you, Mr. Chairman. Yield back my time.

Chairman SCHRADER. Thank you very much. Thank you very much.

We'll go to the good gentleman from Colorado, Mr. Coffman.

Mr. COFFMAN. Thank you, Mr. Chairman.

First of all, to Dr. Ransone, in the Recovery Act, or the Stimulus Act, money was appropriated for Health IT. Is your organization aware—is that filtering down to, in terms of access?

Dr. RANSONE. Not yet. The money that was provided towards HIT adoption under the Recovery Act is provided in additional incentives for physicians. An example right now, under Medicare, CMS right now, starting at the beginning of the year, for each Medicare patient that I see and bill, I get an additional 2 percent if I file my prescriptions electronically. Two percent for my 40 percent, give or take, Medicare patients isn't enough to give me enough capital to buy a new system.

The concern that I have for the physicians over the next few years is that number is going down. In two years it will be 1 percent additional bonus, I guess you could call it. Two years after that, it's half a percent, and then after that we're actually going to be fined for not e-prescribing.

Now, e-prescribing is interesting, because I've had an electronic medical record in my practice now for about seven to eight years or so, and I thought I was e-prescribing. I've faxed prescriptions when a patient comes to see me. I can do it on the computer, and it's a wonderful thing. And, as Representative Moore said, the system is wonderful. I can't tell you how many patients I have who come in, who say well, what did the ER doctor put you on? Well, a pink pill and a white pill. Well, what was that? I'm not really sure. What was it for? I don't know.

With my system now, I can pull up the patient's record from the emergency room from the night before, and I can know exactly what that ER doctor thought, what he put him on. And I can give a lot better care, and I can save lives doing this.

The problem with the money right now, back to your question, in the Recovery Act, it's just it's not accessible yet. And what is accessible, isn't enough for us to put an outlay for small businessmen to put these computer systems in our office. So, that's been the big problem.

Mr. COFFMAN. Well, it sounds like a negative net effect, because at the end of the day, with the mandate to do the e-prescriptions, and if people aren't able to do that with Medicare, if it's not cost-effective for them to do that, then they just may not see Medicare patients.

Dr. RANSONE. Oh, absolutely. And, eventually, it's going to be an access issue. For me, personally, I live in a town that is 20 minutes from where I grew up, and I see a lot of patients that my dad saw. He was a family doctor, practiced for 30 years in this rural area. And I see a lot of folks. And the Medicare folks who come in, I'm not going to be able to say Aunt Sookie, I can't see you any more. You know, that's not going to happen. But what's going to happen is, new Medicare patients, and as the baby boomers grow up and come in, I'm not going to be able to see them.

In Virginia right now, this kind of speaks to healthcare financing, in general, Medicare reimbursement hadn't changed for 17 years. This is not Medicare, this is Medicaid. But the amount that I was paid for the last 17 years hasn't changed. Okay? I pay my nurse more. I pay the power company more. I pay more in rent, but my reimbursement or pay hasn't changed at all. So, I'm operating at more and more of a deficit every year.

A good friend of mine did a study in his practice, and he said well, what if everyone paid what our best insurer pays? What if everybody paid Medicare rates, and what if everybody paid Medicaid rates? If every single one of his patients paid Medicaid rates, each one of the physicians would have been $75,000 in the hole at the end of the year. So, when we see a Medicaid patient, we are losing money in our practice. And then put on top of that other requirements that are going to make us lose money, in a few years, if I don't have e-prescribing, I'm going to be fine 1.5 percent because I'm not doing this. It's just—the requirements that are placed upon us, and then the administrative burden that doesn't allow us to see enough patients, it's not a financially viable model to run a small practice. So, what happens? A lot of the small business physicians end up going working for hospitals or larger groups, and the rural areas are the ones that suffer, because—when I came out, I knew where I wanted to go, and I wanted to go back and serve the people that I grew up with. And I did it, and I was fortunate to do it. But, in order to do it, I decided to work for a hospital.

Unfortunately, most people who come out of medical school, current medical school debt is about $148,000 when you come out of school. Most of them don't see that. I can move to a rural area and service that kind of debt. I'm sorry. I got away from the question.

Mr. COFFMAN. That's okay. It's a good discussion for another committee.

Dr. RANSONE. Yes, sir. Sorry about that.

Mr. COFFMAN. And we're about to expand that whole system for you here pretty soon.

Mr. Robson, a question for you on financing. And that is that for homebuilders, I understand that there was a requirement in multifamily housing, condominiums, say town homes, but it dealt with FHA, that made it difficult with homebuilders to say you had to had to have a certain threshold sold before FHA financing was available. Can you tell me where that is right now from your industry's perspective?

Mr. ROBSON. Well, we're talking to them about getting that renegotiated. I think it's 75 percent.

Mr. COFFMAN. Seventy-five percent?

Mr. ROBSON. Which is extremely difficult in today's market.

Mr. COFFMAN. Pre-sales have to be about 75 percent?

Mr. ROBSON. Right.

Mr. COFFMAN. Okay.

Mr. ROBSON. And, also, there's a certain limit on how many FHA loans will be allowed. I think it's a maximum of 03 percent.

Mr. COFFMAN. Thirty percent? Okay. How significant is that to your-

Mr. ROBSON. That's very significant, especially if you are—well, given the financing, in general, if you're in that kind of price range, FHA is the only game in town. I mean, as far as mortgage markets across the spectrum, FHA, or Fannie and Freddie conventional mortgages are 75 percent, and FHA is 25 percent. There is no other market. So, if you're looking at first time home buyer, condos, lower income condos, to have a concentration limit of FHA loans means you only sell 30 percent of the condos.

Mr. COFFMAN. Okay. My final question then. Mr. Humphreys, it just seems like from a regulatory standpoint what I'm hearing from my local bankers that the control of the currency has come down unreasonably hard, with a mentality of zero risk in hiking their capital reserve requirements. And that that—you can't have a zero risk mentality when it comes to credit markets in a free enterprise system. Is that your view? Could you speak to that for just a minute?

Mr. HUMPHREYS. Well, that's certainly my view. You can't have a zero risk mentality. The banking business is a risk business, and we balance risk versus reward constantly. That's what we do when we underwrite loans.

You mentioned the Comptroller. We're audited and regulated by the FDIC, our bank, and we feel like the FDIC is a good regulator. They're very professional. They do a good job. It's been tough for them, because there is so much to do out there, and the banks need their help. But, at the same time, it's a difficult market to regulate in, as well, because of the number of defaults in banks, et cetera.

Mr. COFFMAN. Thank you, Mr. Chairman. I yield back time.

Chairman SCHRADER. Thank you very much.

The Chair will recognize the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

To follow-up with Mr. Humphreys, with Mr. Coffman's questions here, I know that the regulatory authorities have really kind of gone overboard, and have been rather harsh in their criticism on some of the requirements for some of the loans that have been made. And, as a result, there's a little bit of access-to-credit problem as a result of their push-back. Have you seen the regulators look rather harshly, or with a very discriminate eye at SBA loans? Have they given some problems with those, as well?

Mr. HUMPHREYS. I haven't seen that SBA loans, specifically. But loans, in general, including SBA loans, are looked at very closely. When the FDIC comes into a bank, if the bank is under-capitalized, or is not producing net earnings, there's a question about the reserves. There is a tendency, I think, by the regulator to take a more difficult, serious look at all loan transactions. And they have been— it's been tough. We have really had to tape-up, so to speak, for every examination. There's no doubt about that.

But I also think on the other side of the question, if the bank is in good condition, reasonably well- capitalized, generating some earnings to replace reserves, adequate reserves, and not a lot of defaulted loans on the books, the regulators go above and beyond to try to work with the bank to make sure that they don't go overboard on their assessments.

Mr. LUETKEMEYER. I love that comment, "Tape- up". As a former bank regulator, I know what you're talking about.

A question for you with regards to your 90 percent guarantee, your comment was you'd like to see an extension of that. I know that one of the bankers at home that I talked to made the comment to the effect that, you know, if we could get to the 90 percent level, it would certainly be helpful. And I know that by extending this, I'm sure it's going to help some more folks. Have you seen the benefits of this 90 percent guarantee already in your bank?

Mr. HUMPHREYS. Yes. Although, we haven't made any new SBA 7(a) 90 percent guaranteed loans, I see it as a benefit. Ninety percent is better than 80 percent, or 70 percent. And if you make a loan with an SBA guarantee, you've got some reasons to do so. And having that guarantee at 90 percent is certainly an advantage. And I mentioned earlier, liquidity is also an advantage. I think a 90 percent guaranteed loan is a much more saleable commodity than an 80 percent guaranteed loan, for example. So, it's a positive thing both for the customer, and for the bank.

Mr. LUETKEMEYER. Well, my constituent was telling me that it looked to him it was—it was very helpful to him from the standpoint that suddenly because of the increased regulatory environment, and pressure by the regulators, this is a way to shift some risk over here, and sort of minimize their criticism of some of his loan portfolio.

Mr. HUMPHREYS. Well, it's hard to shift risk by virtue of the guarantee. As I mentioned earlier -

Mr. LUETKEMEYER. Go from 50 percent to 90 percent, though.

Mr. HUMPHREYS. Yes.

Mr. LUETKEMEYER. That's a little bit of shift.

Mr. HUMPHREYS. The regulators look at the loan as being a—for what it is. If the loan has an elevated level of risk in it, having that guarantee might be somewhat helpful, but it doesn't erase the risk involved with respect to the loan transaction. Because the regulators know that you have to go through the process of collection, and that process might be very painful. In fact, it might put the rest of the business in jeopardy, just through the process of collection.

Mr. LUETKEMEYER. Thank you.

Mr. Swartzman, with regards—you made a comment with regards to one of the programs, that there's only roughly about a third of the money that actually is loaned out it in. Is that correct? Did I misunderstand that?

Mr. SWARTZMAN. Yes. No, that's the amount of capital that's authorized every year.

Mr. LUETKEMEYER. Why was not the balance of the funds used, not enough demand, or was it over-funded, too much paperwork, nobody wants to go through the process?

Mr. SWARTZMAN. Well, I can -

Mr. LUETKEMEYER. Can you speculate?

Mr. SWARTZMAN. I can't comment on whether it's too much that's authorized, but the reason that not more is utilized, is a combination of the fairly slow rate at which new licenses are being issued. I think the number of licenses issued last year was only six or seven, and it used to be a multiple of that. So, there are far fewer licensees. Obviously, that's going to reduce demand for the program. And then regular fluctuations in the market in terms of needs for capital, so it's a combination of those two things, one of which, there's nothing we can do about in terms of the demand in the market, but the number of licensees.

Mr. LUETKEMEYER. Dr. Ransone, very quickly, you're testifying with regards to the medical technology stuff.

Dr. RANSONE. Yes, sir.

Mr. LUETKEMEYER. Maybe this is a moot question here, but how far do we go with the SBA program with regards to helping a doctor in his practice finance purchase of medical equipment, operating costs, buying buildings, refinancing debt? Any of that, all of that, some of that?

Dr. RANSONE. The bill, itself, is strictly for health information technology, and for the initial capital outlay. The problem that I can foresee in the future is, once we get people over that hump, is how do we continue to manage that? And that's what I think most of the physicians who are small business owners are concerned about. And they're trying to look towards the future.

Part of the future is, right now, we don't have interoperability standards amongst computers, so if my computer can talk to my local hospital, it might not work in four years to talk to somebody else's hospital. And if— we've asked the folks at CMS to come up with certain standards that will help us. And that's been a second barrier that a lot of physicians have had, is we're worried that you make the initial investment, and then I can't—my computer can't talk to the hospital any more.

The other things that you mentioned, right now, that's where some of the stimulus funds will help cover. Increased funding will help us pay for software licenses. If we can expand our practices, it will help us pay for new hardware. If things happen where we don't meet interoperability standards, it will help us go with new technology, and things like that.

Mr. LUETKEMEYER. Very good. Thank you.

I yield back. Thank you, Mr. Chairman.

Chairman SCHRADER. Thank you very much. I'd like to thank the panel for a very excellent presentation, and obviously got us all interested with a lot of good questions. Appreciate your interest in supporting the bill, and additional suggestions that we'll take into consideration as we move forward. Thank you for making the trip to Washington, D.C. Some came a little further than others, but that's still all very good.

I ask unanimous consent that members will have up to five days to submit statements and supporting materials for the record. Without objection, so ordered. And this hearing is now adjourned. Thank you all.

[Whereupon, at 11:38 a.m., the Committee was adjourned.]

KURT SCHRADER, OREGON
CHAIRMAN

VERN BUCHANAN, FLORIDA
RANKING MINORITY MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
Subcommittee on Finance and Tax
2361 Rayburn House Office Building
Washington, DC 20515–0315

STATEMENT
Of the Honorable Kurt Schrader, Chairman
U.S. House Committee on Small Business, Subcommittee on Finance and Tax
"Legislative Hearing on Access to Capital Legislation"
Thursday, July 23, 2009

In the current environment, businesses everywhere, in every industry, face a common problem—they cannot access affordable capital. This means that entrepreneurs who are looking to expand and hire more workers cannot. It also means that small companies that want to borrow money to stay afloat are unable to secure credit.

In previous downturns, when credit dried up, the Small Business Administration's lending programs helped fill in the gaps, providing firms the capital they need to drive the economy back toward prosperity. Unfortunately, in this recession, the SBA's capital access programs have been unable to fill their traditional role, leaving many small businesses with few options.

Small businesses' capital challenges are not confined to the SBA's lending programs. Commercial lending has been greatly restricted. A recent Federal Reserve survey found that 69 percent of domestic lending institutions have tightened their lending standards on commercial and industrial loans. Equity capital is also falling off: venture capital investments were cut in half during the spring, marking the second quarter in a row with a decline of more than 50 percent.

The American Recovery and Reinvestment Act, which the President signed into law in February, took important steps toward addressing small businesses capital needs. By making loans less expensive for small business borrowers and increasing government guarantees, this law will generate $20 billion in new lending and investment. However, we are far from where we need to be—the number of 7(a) loans is down 50 percent, compared to the Fiscal Year 2008.

Clearly, if we are going to meet small businesses' capital needs, more must be done. Today, we have before us a set of proposals, all of them aimed at getting capital flowing to small businesses by modernizing the SBA's programs.

As we discuss these proposals, we should keep three central goals in mind. First, we should work to broaden the range of options available to small companies seeking capital. An SBA program that works for a family-owned restaurant in Salem, Oregon, may not be the right solution for a high-tech startup in Pittsburgh, Pennsylvania or a manufacturer in Akron, Ohio. Our efforts must help all types of firms access capital, whether they choose to raise capital through microloans, government guaranteed loans or equity investment.

Second, we need to make capital more affordable. Being able to find a small business lender is one thing. Securing a loan at terms that work for the borrower is another.

Third, we will need to deal with how small businesses recover after natural disasters. Hurricane Katrina and other catastrophes have made clear that there are deep and longstanding problems with the SBA's disaster recovery initiatives. It is vital that we correct those problems. When disasters strike, small businesses must have the resources they need to rebuild our communities and help restore economic prosperity.

The challenges facing the small business community were not created in a day. Indeed, many of the problems in the SBA's access to capital programs can be traced back to eight years of neglect and mismanagement. These issues will take time and patience to resolve. But, one thing is clear: if small firms are going to remain our country's primary job creators, then they need access to capital. That will require strengthening and improving the programs at SBA.

U.S. HOUSE OF REPRESENTATIVES

SMALL BUSINESS COMMITTEE REPUBLICANS

REPRESENTATIVE SAM GRAVES, RANKING MEMBER

Opening Statement of Ranking Member Vern Buchanan
"Legislative Proposals to Reform the SBA's Capital Access Programs"
Committee on Small Business
United States House of Representatives
Washington, DC
July 23, 2009

I would like to thank the Chairman for holding this important hearing on legislation affecting the SBA's capital access programs. There is no issue more personal to me than helping an entrepreneur realize the American Dream. I've lived that dream ...I know its risks and rewards, its pains and successes. I've seen it from the bottom up trying to start a small business... and from the top down as Chairman of the Florida Chamber of Commerce. And right now the view isn't very pretty.

Job losses in this country are staggering. Most economists expect unemployment to surpass 10 percent in the near future. That means, now more than ever, we must rely on small businesses to help revive the economy. But small businesses do not have millions of dollars of available cash to tap for job growth and expansion. Instead, these businesses rely on credit, which remains all too difficult to get. Lack of credit and capital for small businesses places a strait jacket on their ability to lead us into a recovery.

And small businesses clearly are hand-cuffed. News reports talk about banks slashing credit lines of small businesses with top-notch credit ratings. And just last week, we all heard about CIT Financial- one of the nation's largest lenders to small business - facing possible bankruptcy and foreclosure. Solutions must be found to the severe limits on credit availability for small businesses. Today, we will hear from a cross-section of the small business community on the potential answers to the problems in the markets for funding the growth of small businesses.

I look forward to working with Chairman Schrader in a bipartisan manner to improve the draft bills discussed today and move them rapidly through the full Committee, the House floor and to signature by the President. I would like to thank the witnesses for taking time out of their busy schedules to come to Washington, DC and provide their views on the draft legislation.

I yield back.

Testimony of

William V. Humphreys

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Finance

Of the

Committee on Small Business

United States House of Representatives

Testimony of
On Behalf of the
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Before the
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Chairman Schrader, Ranking Member Buchanan, and members of the Subcommittee, my name is William V. Humphreys, President and CEO of Citizens Bank, Corvallis, OR. Citizens Bank is a 52 year old community bank, with over $410 million in assets, serving 10 communities throughout Oregon's Willamette Valley. We are proud to have been designated in a recent US Banker Magazine to be among the strongest 200 community banks in the nation. Our strategic business focus is on funding small businesses and farmers throughout our market area. I am pleased to be here today on behalf of the American Bankers Association (ABA), which brings together banks of all sizes and charters into one association. The ABA works to enhance the competitiveness of the nation's banking industry and to strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

The topic of SBA lending for small businesses is important and timely. The efforts that have been made by this Subcommittee, the Congress as a whole, and the Administration to improve the environment and opportunities for small businesses through changes to the SBA program have been needed for many years and, more importantly, are beginning to have an effect. The SBA program will be an important source of credit to the small business community as our nation struggles to recover from the recession.

Even during this recession, banks continue to be active lenders. Increasing the total volume of loans is indeed a challenge as the demand for loans continues to fall significantly. History shows that during a recession loan demand declines as businesses experience slowdowns, reduced cash flows make it hard to repay debt, and loan underwriters become more cautious about risk. In spite of these challenges, two out of three banks increased their total volume of loans in the first quarter of this year.

Citizens Bank increased total business loans by 8% in 2008, the fastest growing portion of our balance sheet.

Naturally, banks are following prudent underwriting standards to avoid losses, and bank regulators demand that they do so. Against the backdrop of a very weak economy, it is only prudent that all businesses exercise caution in taking on new financial obligations. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they conduct examinations. Let me assure you that banks will continue to be the source of financial strength in their communities by meeting the financial needs of businesses and individuals in both good times and bad. Banks in every state in the country are actively looking for good loan opportunities. Even in a weak economy, many small businesses are strong borrowers. The SBA, **in partnership with America's banks,** can play an even larger role in helping small businesses meet the challenges of this economic downturn by expanding their guarantee program and by reducing some of the restrictions currently built into the system.

The focus of this Committee is important, because small businesses are drivers of new ideas, new employment, and new economic growth. Banks like mine are only as strong as the quality of our small business borrowers, so it is an imperative that we find ways to offer them the financing they need to ensure success. While some might think the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, the Small Business Administration defines a small business as one that has fewer than 500 employees. By this measure, over 8,100 banks – 97 percent of the industry – would be classified as small businesses. Even more telling, ***over 3,500 banks (41 percent) have fewer than 30 employees.*** Banks like mine have been an integral part of our communities for decades – sometimes more than a century – and we intend to be there for many more years to come.

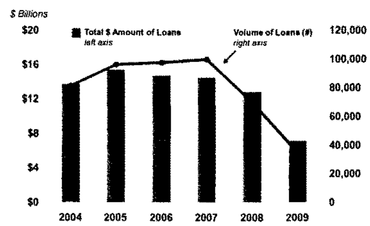
I would like to focus on three critical points today:

- Changes that enhance bank participation in SBA programs have made strides in creating opportunities for small businesses, yet more needs to be done.
- Recent legislative proposals contain additional changes to SBA that should stimulate lending.
- Further changes would stimulate more lending to small businesses.

I will address each of these points in turn.

I. Changes that enhance bank participation in SBA programs have made strides in creating opportunities for small businesses, yet more needs to be done.

SBA 7(A) Loans



2009 values equal SBA's 1st and 2nd fiscal quarter values annualized.

Source: Small Business Administration

The SBA program has struggled over the last several years. As can be seen on the chart at the right, SBA fiscal year 2008 loan volume figures showed a 30 percent decline from 2007 in its flagship 7(a) loan guarantee program, and fiscal year 2009 figures put the 7(a) program on pace to have a 50 percent reduction in volume compared to fiscal year 2008. The economy is certainly playing a significant role in overall loan volume decline. However this decline is also due to SBA programs becoming too costly and difficult for lenders and small businesses who wish to access the program. Banks like mine have determined that the cost, inconvenience, and risk associated with obtaining a SBA guarantee often exceeds its value. In order to reverse the current downward trend in the 7(A) program, the SBA needs go beyond an increase in the amount of the guarantee; it needs to offer an improved value proposition. Current restrictions involving cost, collateral, refinancing, and prepayment penalties, among others, should be addressed.

Although many improvements are needed, much has already been done. This Committee has consistently worked to maintain the integrity of the 7(a) program and we applaud your efforts on the Recovery Act to enact the small business provisions. Already, the SBA is making progress to implement these important provisions.

Less than one month after the Act's passage, SBA had made $375 million available – over half of the funding provided in the legislation – to make access much easier for the two most popular lending programs. The act temporarily increases the guarantees **to up to 90 percent on SBA's 7(a) loan** program, which will be helpful as banks work to extend credit during the recession. It also temporarily eliminates fees for borrowers on 7(a) loans and eliminated fees for both borrowers and lenders on 504 Certified Development Company loans. SBA Administrator Karen Mills noted that average weekly loan volume was up 28 percent in the 7(a) program and 22 percent in the 504 program immediately following passage of the Act, and that participation among banks had likewise increased.

Further, the SBA expanded eligibility to small businesses in the 7(a) program by applying the broader standard used currently in the 504 program. Now, businesses will be able to qualify with a net worth that does not exceed $8.5 million and an average net income under $3 million (after federal income taxes) for the preceding two fiscal years. These very positive changes will mean that an additional 70,000 among the largest of our small businesses will be eligible to participate in the 7(a) program.

Just last month the America's Recovery Capital (ARC) program was initiated, which provides funding of up to $35,000 for six months to help small businesses facing immediate financial difficulty. These loans are interest-free to the borrower, and are 100 percent guaranteed by the SBA. In addition, the loans have no fees associated with them and repayment will not begin until 12 months following the final disbursement. This is an important source of funding for many of our smallest businesses.

Other provisions from the Act include provisions that raised the maximum contract that can qualify for an SBA Surety Bond guarantee from $2 million to $5 million, and additional funding to microloan intermediaries, as well as funding for the technical assistance needed to accompany these loans.

All of these initiatives promise to help small businesses during this recession, and should be continued past their current authorization periods in order to reach even more small businesses.

II. Recent legislative proposals contain additional changes to SBA that should stimulate lending.

Chairwoman Velazquez has introduced a legislative proposal which the ABA believes could move the SBA programs forward even more.

First, the legislation calls for the establishment of a program within the SBA to assist with **outreach to small lenders who are not participants in the SBA's 7(a) loan program. This is vitally** important. SBA lending is a very specialized area of lending that requires skilled personnel with expertise in the policies and procedures of SBA lending. When a community bank decides to serve the SBA marketplace they are making a commitment that goes beyond simply making the loan, they are making a financial commitment to hire the personnel to supply and market this type of loan product to their customers. Providing a dedicated outreach effort to these lenders – primarily community banks like mine – will only increase lenders' **willingness to participate in the agency's program.** Currently, there are over 2,000 lenders that are either Certified Lenders Program (CLP) or Preferred Lenders Program (PLP) lenders in the 7(a) program. This number represents just one-quarter of the over 8,000 banks in this country. A program that specializes in outreach to non-participating lenders will be helpful to reach these lenders, which in turn will help small businesses receive capital.

Second, the legislation seeks to make the Rural Lender Outreach Program[1], Community Express[2] and the Patriot Express Program[3] permanent. Clearly, each of these programs shares a common goal: to assist borrowers that have not accessed SBA programs or have traditionally had limited access to capital. The Rural Lender Outreach Program, for example, was established to address the needs of borrowers and lenders in remote rural areas of the country. However, information is not readily available about the program on SBA's Web site. I feel that the SBA has fallen short on a critical part of establishing a new program – promotion and marketing. Because of this, the potential benefit of these programs has not been fulfilled. In order to reach more borrowers through the Rural Lender, Community Express and Patriot Express Programs, it is vital that the agency expand its human and technology resources to promote these programs to both lenders and their target markets.

III. Further changes would stimulate more lending to small businesses.

In spite of the many improvements this Committee has endeavored to make, there are a number of improvements that would provide additional incentives to small businesses and banks that would enable even broader participation.

Extend the Provisions of the Stimulus Package

Congress as part of the economic stabilization package increased the loan guarantee level in the 7(a) program to 90 percent and also decreased the fees for both the borrowers and the lenders. Both actions have provided a much needed boost for lender participation in the program. Both the guarantee and fee relief are scheduled to expire at the end of the next fiscal year. We believe these provisions that expand both the guarantee and fee relief should be extended for an additional two years beyond the 2010 expiration date. While we are all hopeful that the economy will regain its footing over

[1] The Rural Lender Outreach Program was designed to alleviate the trend of declining lender participation in the 7(a) program, particularly among lenders in rural areas, by reducing application burdens for borrowers and lenders in rural areas through abbreviated application and documentation requirements.

[2] The Community Express Program is a Pilot Loan program which was recently redesigned to enable approved SBA lenders to adopt SBA's most streamlined and expedited loan procedures to provide a unique combination of financial and technical assistance to borrowers located in underserved communities.

[3] The Patriot Express Program is a Pilot Loan Initiative for veterans and members of the military community wanting to establish or expand small businesses.

the next six months, we are also realistic in understanding that the recovery may be very slow. ABA's Economic Advisory Committee (EAC) believes that the recession will officially be over by year-end, but the growth will not be strong enough to generate a large quantity of new jobs. The compounding affect of job losses since the recession began is severely impacting small businesses, and will continue to do so even after the economy returns to growth. The more that we are able to supply additional capital to our country's small businesses, the better chance we have at keeping businesses alive, which in turn will prevent further layoffs. Additional capital through lending will create an environment where small businesses will begin to rehire or add new jobs. Maintaining the 90 percent guarantee, with lower fee levels, through fiscal year 2012 will assist in that effort.

Eliminate or Reduce the Restriction on Refinancing

The SBA allows no refinancing of existing debt by the bank that currently holds the debt. This restriction often prohibits the borrower from obtaining new financing critical to continued success. In many circumstances banks would like to make new and consolidated advances, but if the bank already has a deal on the books, that loan cannot become part of the new deal. This restriction often causes the bank to write new loans without the help of the SBA, or ask the borrower to seek help from another lender.

Improve the Quality of the Guarantee

The SBA guarantee is only valid if certain conditions are strictly adhered to. The collateral assets, and often the business, must be liquidated prior to payment on the guarantee by the SBA. This process can be delayed by bankruptcy, by difficult repossession issues, and other factors. The SBA also sends the claim to their legal department where lawyers seem to seek ways to find the bank in violation of the guarantee agreement.

Improve the SBA Guarantee Approval Process

Generating the information and documentation required by the SBA is not easy. Many small banks have found it necessary to seek the help of third party "packagers" who help with gathering the data necessary to gain approval. This only creates additional time and expense for the borrower. This process could be significantly streamlined.

Enhance the Human Resources Capacity of the SBA

There is a very practical barrier to the success of these programs: having the staff necessary to implement, promote, market, and manage the many initiatives of the SBA. We request that the Committee investigate the human resource needs of the SBA. Over the last eight years, the SBA staff has been reduced by nearly 1,000. This has been done through consolidation, retirements and attrition. Since January 2009, the SBA has taken on nearly eight new loan programs and seen a sizeable increase in their budget allocation to implement and carry out these programs. Yet, the number of staff assigned to carry out the old and new programs has not been increased and, in fact, the program responsibilities of these employees have increased. SBA has thousands of partners and many more that desire to establish or reestablish a relationship with the agency. Without adequate levels of personnel to meet the needs of these partners, the small businesses that they serve will suffer.

Conclusion

The initiatives and new programs launched by the Administration and by Congress have great potential to help thousands of small businesses. These programs should be improved further and given the time to work. In addition, the SBA must be given the human resources to implement these initiatives, many of which are new to the SBA. ABA is prepared to work with this Subcommittee on finding ways to improve the SBA program, with the goal of enhancing credit availability to small businesses throughout our nation.

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Written Testimony of

Carol E. Wayman

Federal Policy Director, CFED

Submitted to the House Small Business Committee

Finance & Tax Subcommittee Hearing on
"Legislative Proposals to Reform the SBA's Capital Access Programs"

July 23, 2009
2360 Rayburn House Office Building

Thank you Chairman Schrader, Ranking Member Buchanan and members of the Subcommittee for the opportunity to testify on behalf of the Corporation for Enterprise Development (CFED) regarding improvements to the SBA Microloan Program. We would also like to thank Chairwoman Velázquez for her continued leadership on microenterprise. She has demonstrated an ardent commitment to ensure that low-income entrepreneurs are not excluded from accessing capital for their small businesses. Lastly, we would like to thank the Administration for recognizing the economic importance of microenterprise and the SBA Microloan Program.

Microenterprise is a critical component of our nation's economy. According to CFED's Assets and Opportunity Scorecard, there are 24,905,573 microenterprises in the United States in 2006 (most recent Census data); 16.5% of the labor force owns a microenterprise. According to the Federal Reserve, 3% of families in the lowest income quintile own a business asset. Microenterprise is supported at the federal and state level: approximately 33 states provide funding for microenterprise.

CFED, the Corporation for Enterprise Development, is a nonpartisan national nonprofit organization that celebrates our 30th anniversary this year. We collaborate with diverse partners across the field of microenterprise, including the Association for Enterprise Opportunity, the Center for Rural Affairs, Aspen Institute's FIELD program, State Microenterprise Associations such as the Oregon Microenterprise Network, SBA Microloan Intermediaries and other microenterprise practitioners. CFED also chairs the Microenterprise Anti-Poverty Coalition (MAP), and is a leader in promoting the expansion of economic opportunity to include all people. We strongly believe that this will bring greater social equity, alleviate poverty and lead to a more sustainable and inclusive economy.

Our mission is to bring together community practice, public policy and private markets in new and effective ways. We combine the innovation of a think tank with the "on-the-ground" insight of practitioners to:

- Identify ideas that make the economy work for everyone. We focus on communities that have traditionally been excluded from or limited by the mainstream economy. We conduct rigorous research, seeking ideas that have potential for practical application.

- We also work with economic development practitioners to pilot programs and provide funding to design and modify effective strategies to be successful in different cultures, regions and economic conditions.

- Lastly, we develop and advocate for federal and state policies that move the nation toward a more equitable and inclusive economy. We publish reports, convene working groups and provide information to help partners participate in the policymaking process.

Along with homeownership and continuing education, CFED focuses on microenterprise as a key asset-building tool for low-income entrepreneurs. We strongly support the SBA Microloan Program, which provides capital, training and technical assistance to disadvantaged entrepreneurs.

The Microloan Program was first authorized as a demonstration program in 1991, with the goal of reaching microentrepreneurs that were being served neither by mainstream financial institutions nor SBA's credit programs. Research and reporting by the Aspen Institute shows that approximately 10 million microentrepreneurs experience difficulty accessing capital from traditional lenders, and that half of these entrepreneurs are women.

Our current economic realities are undoubtedly pushing these numbers even higher, as job losses, tight credit markets and stringent readings of consumer credit reports make accessing business capital all the more difficult. Low-income entrepreneurs, minorities and women especially experience difficulty in obtaining business financing; even when they are highly skilled service workers, they do not have the business experience or training to make them mainstream credit-worthy.

The ultimate goal of the SBA Microloan Program is to provide resources for entrepreneurs who are ready to go from business curious to business capable, move into the financial mainstream and create jobs. A study of 25 microenterprise programs by the Aspen Institute found that the number of jobs (not including the owner) at the businesses assisted more than doubled after these businesses received microenterprise services.

Despite historically strong bipartisan support in Congress, the Microloan Program suffered years of neglect under the previous Administration. During this time, the program was continually targeted for elimination, severely understaffed, had no Standard Operating Procedure, did not collect or report on outcomes-based data and made public very limited information. In addition, funding was cut so severely that as early as 2003, the SBA Office of the Inspector General noted that these cuts made it nearly impossible to expand the field of Microloan Intermediaries.

We very much look forward to working with the Subcommittee and the Administration to improve this important program, and ensure that it reaches its full potential. We believe that the draft legislation under discussion today provides an excellent start to this discussion. Many of the reforms contained in today's draft bill have been requested for years by Microloan Intermediaries. It is our hope that these provisions will provide a long overdue update to the Microloan Program.

First, we are pleased to see that the Subcommittee has included language that allows Microloan Intermediaries to offer more flexible credit terms to entrepreneurs. This will allow Intermediaries to develop responsible financial products that meet the specific needs of their borrowers. This is especially true for entrepreneurs that provide seasonal services, and those whose business needs fluctuate according to other markers. For example, a home air conditioning repair service will typically experience a spike in demand during the hot summer months and might request a small revolving line of credit that would meet their cash flow needs more adequately than a three-year loan. Ultimately, our goal is for these entrepreneurs to benefit from responsible innovations in microlending.

Second, we agree with the Subcommittee and the Administration that increased program participation is necessary to meet the needs of underserved low-income entrepreneurs. We welcome language that expands eligibility requirements for prospective Microloan Intermediaries. We agree that SBA should have discretion to determine the type of experience necessary to become an Intermediary.

Third, we are pleased to see that the Subcommittee recommends increasing the cap on borrowing by Intermediaries, and increasing the maximum loan size of an SBA Microloan. Many of the highest-performing, most capable Intermediaries in the Microloan Program have met their loan limit, and are unable to make additional Microloans despite heavy demand. Increasing the cap from $3.5 million to $7 million will provide a much-needed injection of capital for these Intermediaries. We suggest that SBA be given the option to increase the cap further, to $10 million, for Intermediaries that meet certain criteria to be determined by SBA. We are also pleased to see an increase in the maximum loan that an Intermediary can make to a borrower, from $35,000 to $50,000. While the majority of Microloans are very small, and the average Microloan hovers around $13,000, this increase reflects a key market reality: the investor return on a $50,000 loan is deemed too small for most mainstream financial institutions. We believe that this change will enhance an Intermediary's ability to meet the capital needs of qualified microborrowers.

Lastly, we are happy to see that the Subcommittee proposes an increase in the percentage of technical assistance grants that may be used for providing information and technical assistance to prospective borrowers, as well as the increase in percentage that Microloan Intermediaries can use for third-party technical assistance.

We also recommend that the Subcommittee consider more extensive changes to the Microloan Program in the near future. After years of neglect, it is possible that further reforms may need to be implemented to optimize program performance. We suggest the following revisions:

- Lowering the loan loss reserve requirement: the required 15% loan loss reserve fund that Intermediaries must maintain results in unnecessary levels of passive capital. The SBA Microloan Program has made loans that no bank would dare take on, and yet has the lowest default rate of any SBA lending program, even as it operates without a guarantee. In fact, for FY 2009, the Microloan program is projected to have a default rate (net of recoveries) of 0.37 percent. Contrast that with the assumption for 7(a) at 3.42 %, or the CDC program at 1.79 %. While SBA regulations allow this requirement to be lowered to 10%, we are dismayed that this is the only SBA lending program that requires a loan loss reserve fund. This limitation forces the SBA to lower its risk on its best-performing program, even while it provides guarantees of 80% and higher through its other loan programs. Data collected by the Aspen Institute on 37 microenterprise lenders showed that in 2007, the median loan loss rate was 3.6%. The average loan loss rate was 5.8%, and only three of the 37 lenders had loss rates above 10%.

- Allowing for the one-time use of SBA Microloan loan dollars for Microloan Intermediary capital improvement projects: the market crash and recession have created an untenable environment for accessing capital. Many Intermediaries find themselves with rising demand and the need to expand or improve facilities to meet the demand. Enabling Intermediaries to borrow loan funds to improve their own facilities creates jobs and strengthens the economy at this time without any loss in access to funding for entrepreneurs.

- Expansion of operations: the advent of highly capable, highly successful microlenders in the United States leads us to ask the SBA and the Subcommittee to study closely whether it is time to eliminate the requirement that Intermediaries not be allowed to operate in more than one state. To this end, we believe that the Microloan Program can balance economies of scale with a sharp focus on community training and technical assistance needs. In fact, some microlenders already operate in more than one state, but this restriction means that they must use their Microloan dollars in some or part of the regions they serve. Permitting multi-state use of Microloan dollars will facilitate regional economic development, something that is much needed in many parts of the nation.

- SBA reporting requirements: unfortunately, very little information is available on the Microloan Program. This drought of data makes it difficult for the microenterprise field to focus on areas of improvement and efficiency. We would ideally like to see yearly SBA reporting requirements, include such information as individual loans made and loan dollar volume per Intermediary, as well as other key information such as credit score and jobs created related to borrower success.

I would like to thank the Subcommittee once again for the opportunity to testify today. CFED looks forward to partnering with Congress and the Administration to enable low-income entrepreneurs to start and grow businesses to achieve financial self reliance in vibrant communities. I look forward to answering any questions that you may have.

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Statement of the National Association of Home Builders

"Legislative Proposals to Reform the SBA's Capital Access Programs"

House Small Business Committee
Subcommittee on Finance and Tax

July 23, 2009

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the House Small Business Committee on ways to improve the utility of Small Business Administration (SBA) capital access programs to businesses struggling in the present economic crisis. Approximately sixty percent of NAHB's 200,000 members build less than 25 homes per year and eighty percent of them have less than $5 million in annual receipts. Ours is an industry dominated by small business.

This statement addresses the following areas:

1. The current conditions in the housing market and the long term outlook.
2. Two specific issues that especially impact the bottom lines of home builders – appraisals and financing of Acquisition, Development and Construction (AD&C) loans.
3. The historical experience of home builders generally with Small Business Administration (SBA) programs.
4. Proposed changes to the 7(a) and 504 programs at SBA.
5. Proposals to create a new lending program out of SBA to aide struggling businesses.

We applaud the Committee's continued efforts to help small businesses. Since the onset of the economic crisis NAHB has urged Congress to take steps to respond. Congress took several important steps as part of the *Housing and Economic Recovery Act (HERA)*, the *Emergency Economic Stabilization Act* (EESA) and the *American Recovery and Reinvestment Act (ARRA)*. Unfortunately, the crisis wears on and more resources are needed to ensure the survival of small businesses across the country, including home builders. We welcome the opportunity to comment on how to potentially expand the role of the SBA in this effort and look forward to working with Congress as the legislative process advances.

Housing Conditions and Outlook

The current housing recession is the worst since World War II. Total starts have fallen 80% from their peak in January 2006-- from 2.3 million starts to a low point of 454,000 starts in April. Virtually every housing indicator (starts, permits and sales) reached all time record lows within the past two quarters. The drop in single family construction alone has resulted in more than 3 million lost jobs in construction and the related industries supplying materials and goods to housing construction.

Glimmers of hope, however, suggest that the three plus year decline in housing may have stabilized. Existing and new home sales appear to have bottomed. Existing single-family home sales hit a low of 4.05 million in January 2009 improved to 4.25 million sales at a seasonally adjusted, annual rate in May. Meanwhile, new home sales bottomed in January 2009 at 329,000 and have since shown a modest recovery to 342,000 in May.

The inventory of unsold new homes continues to fall from a peak of 572,000 in July 2006 to 292,000 in May 2009. The decline has reduced the month's supply of unsold homes but not as dramatically because sales continue at a very slow pace. The NAHB Housing Market Index (HMI) languished at a single digit rate for five straight months from late 2008 through the first quarter 2009, but has since picked up to 15 at the latest reading in June. Single family housing starts rose the last three months, likely in response to the first time home buyer tax credit enacted as part of ARRA. Multifamily starts have fallen over the same period and will likely continue to fall in the face of a large overhang of apartments and single family homes on the market.

These "buds" of growth notwithstanding, a number of housing specific headwinds will continue to buffet any significant housing recovery:

- A large inventory of vacant homes and apartments on the market
- A pipeline of foreclosures feeding the inventory
- Continuous downward price pressures from too much supply and not enough demand
- Tight mortgage underwriting and low appraisals making it difficult for a willing buyer to complete the sale
- Extremely difficult financing terms and availability for builder AD&C credit

All these data suggest that residential construction is now bouncing along a bottom. We forecast that housing starts face a long, slow recovery that will take several years. NAHB forecasts 525,000 housing starts for 2009 and 650,000 for 2010.

Appraisals

The home building industry is facing a crisis in the use of inappropriate appraisal methods. A frequently mentioned problem is the use of foreclosed properties as comparables in appraising the value of new homes. We have been told by representatives of the Appraisal Foundation and the Appraisal Institute that foreclosure sales should only serve as comps if they represent reasonable alternative options for the buyer of a new home. However, builders are reporting, almost daily, where properties in poor repair are being used in the appraisal process for new communities without any adjustment whatsoever.

A recent NAHB survey of more than 500 builders found that nearly 60 percent reported serious problems with appraisals on their homes coming in well below sales prices, primarily because comparables are based on foreclosures and distressed sales in their communities. Of those who are reporting appraisal problems, 54 percent said that the appraisal amount was actually less than the cost of building the home, including land, labor and materials. When the appraisal is below the sales price, it is between 15 – 20 percent lower. Finally, twenty-five percent of the builders surveyed said they are losing sales because the appraisal is coming in below the contract sales price.

The appraisal environment was further complicated on May 1, when Fannie Mae and Freddie Mac implemented the Home Valuation Code of Conduct. The Code establishes standards for appraiser independence and is intended to eliminate undue pressure on appraisers to induce them to report certain values on home appraisals. Unfortunately, the Code has brought negative unintended consequences in its heavy emphasis on the use of appraisal management companies. These companies tend to use out-of-area appraisers and have a motivation to seek the lowest cost provider. Both of these factors are damaging appraisal quality.

NAHB is calling on Fannie Mae, Freddie Mac as well as the housing and federal financial regulators to adopt clear, concise regulatory guidance that will allow appraisers to develop realistic valuations based on sales that are truly comparable. In neighborhoods where the comps include a large number of short sales or foreclosures, appraisers should have the option of expanding the geographic area or extending the time frame for eligible sales to get a more representative picture of the value of homes sold in the area.

Builder AD&C Financing Issues

Another key aspect to the crisis facing home builders is the financing of AD&C loans. AD&C financing is the industry's most pressing problem. We continue to hear from NAHB members that it is virtually impossible to get AD&C loans. This is a major impediment to the housing recovery and an increasing threat to the ability of many home builders to survive the economic downturn.

Latest results from ongoing NAHB surveys on the availability and cost of AD&C credit show that conditions remained unfavorable in the first quarter of this year:

- 71% of respondents stated that the availability of credit for new single-family construction loans worsened in the first quarter compared to the fourth quarter of 2008.

- 82% of those seeking land acquisition loans, or construction funds for multifamily housing, reported worse credit availability.

- 40 % of the respondents reported tighter loan terms for outstanding single-family construction and land development loans.

Appraisals are a major contributing factor to the current AD&C credit crisis. Falling appraised values for land and subdivisions under development have led some financial institutions to stop lending to developers and builders, to demand additional equity, and even to call performing loans.

An increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan. AD&C loans are entirely dependent on collateral (the project being financed) for repayment of principal. In other words, sale of the lot or home is required to provide funds to retire the AD&C loan. Most home building companies are small businesses and do not have the capacity to meet significant equity calls. The result is often foreclosure on a loan that had been performing. Such actions can result in a cut-off of loans on other projects a builder is undertaking and can also have severe adverse consequences for other AD&C loans in the bank's portfolio. Foreclosure on such loans is not in the best interest of the lender or the builder.

Banks are increasingly refusing to modify AD&C loans or to provide builders more time to complete their projects and pay off these loans. Calling performing loans or forcing partially complete developments into foreclosures can result in unnecessary losses for a financial institution and significant losses for the local economy. Ultimately, all of this can lead to bankruptcy for the builder.

Home Builder Historical Experience with SBA

Historically, NAHB members have not accessed SBA loan programs. We understand this to the case for two primary reasons. First, the loan programs themselves do not serve the primary need of most builders – access to AD&C credit. SBA-guaranteed loans cannot be used to finance real estate development activity. Secondly, and this was especially true during the relief efforts after hurricane Katrina, the regulatory requirements for businesses to access relief programs were so onerous as to be a disincentive to participation.

More recently, however, NAHB was pleased to see a new, short-term program created with the SBA as part of the American Recovery and Reinvestment Act (ARRA) of 2009. The America's Recovery Capital (ARC) loan program, began on June 15 and offers small businesses guaranteed deferred-payment, interest-free loans of up to $35,000 that they can use to pay principal and interest on existing loans; qualifying small business debt, including mortgages; term and revolving lines of credit; capital leases; credit card obligations; and notes payable to vendors, suppliers and utilities. The program is funded at $255 million and continues through Sept. 30, 2010 or until the funding is exhausted.

SBA-approved lenders, who are being encouraged to make the loans, will disburse each loan over a six-month period. Borrowers will not be required to begin repaying the loans until 12 months after final disbursement and will have five years to repay the loan. While the loans are available interest-free to small businesses, SBA will pay the lenders the prime rate plus 2% for the loans.

SBA classifies companies as small businesses based on their annual revenue thresholds or their number of employees. Home builders are considered a small business if their annual revenues do not exceed $37.5 million, while the annual revenues of contractors are capped at $14 million. For manufacturers, those who make components used in home construction, are limited to 500 or fewer employees, while wholesalers may employ up to 100 persons.
NAHB members can begin the loan process by first contacting local banks. Because the program is new, many lenders may not be aware of it and, in fact, NAHB members have already experienced this first hand.

For some builders, the ARC program can provide critical resources in this time of need. To maximize the impact of this program, NAHB would recommend substantial additional funding and an increase in the loan size. This will help reach thousands of additional businesses nationwide, including home builders; providing a greater critical mass of resources to meet the need.

Proposed 7(a) and 504 Program Changes

7(a) Program Improvement Act

NAHB applauds the proposed improvements to the SBA 7(a) program. They would make certain temporary programs permanent, assists lenders who have not previously participated to become SBA lenders, expand lender eligibility, and promote non-traditional lenders to become participants of SBA programs. However, the proposal could be improved by more specifying more clearly borrowers who are eligible to participate. As noted above, home builders have been unable to participate in SBA loan programs in the past and more directly identifying potential uses of the program for home builders, remodelers and building materials suppliers, as well as other related businesses, would increase the impact of the program.

One especially interesting aspect of this proposal is the Capital Backstop Program (Sec. 112) which allows applications to be submitted directly to SBA who will attempt to get a lender to fund the loan. If there is no lender interest, SBA will fund the loan and attempt to sell it into the secondary market. SBA has the ability under this proposal to ultimately own and service the loan itself. This program could be very helpful to NAHB members; however, again, more specificity about eligible applicants is needed.

504 Program Improvements

NAHB cannot comment on the proposed improvements to 504 Programs as these are related to Certified Development Companies (CDCs) which are typically reflected in NAHB's membership.

Proposal for New SBA Lending Program

We understand that the Committee is also considering a new supplemental loan assistance program to complement the lending initiatives currently administered by the SBA. Its primary objective would be to assist businesses with capital needs that are higher than those served through the 7(a) and 504 programs. Maximum loan sizes could be as high as $15 or $20 million and would be targeted to businesses in the manufacturing or construction industries as well as those on the larger side of the small business community as well as those that generate or retain a significant number of jobs. A secondary objective, as we understand it, would be helping ensure liquidity for these loans when the private sector does not serve the market for these loans. In this scenario, basic credit decisions would be under the purview of the SBA or in concert with a nonprofit lending partner.

NAHB supports the objective of this proposal to increase the size of SBA loans for businesses with higher capital needs and ensuring greater liquidity in the provision of these loans. Many home builders would find greater benefit from an option like this than they perhaps would with the smaller SBA lending programs provided AD&C loans are eligible. Additionally, NAHB members that are involved in the modular and other specialty housing sectors could potentially benefit if their financing qualified under the manufacturing category in the proposal. In short, to have the greatest positive impact for home builders, the proposal should include the traditional financing methods used in home building. NAHB would urge the Committee to consider the inclusion of these methods as it further develops the proposal. As well, we suggest the committee examine closely whether or not the non-profit lending sector has the capacity to undertake transactions such as these to ensure that they can truly provide liquidity when needed.

Conclusion

Again, thank you for giving NAHB the opportunity to comment on proposals to improve the provision of services at the SBA for the nation's small businesses. We applaud the Committee's continued efforts and look forward to working collaboratively to enact these and other proposals that can help sustain the nation's small business community during this time of trial. While SBA has not traditionally been a ready resource for home builders, programs like ARC and other improvements proposed by the Committee could change that dynamic. We look forward to working with the Committee to make that a reality.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program

Expanding Small Business Access to Capital

Submitted to the

SUBCOMMITTEE ON FINANCE & TAX

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Zola Finch
Past Chair
NADCO Board of Directors
&
Vice President
RMI CDC

Jefferson City, MO.

July 23, 2009

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Subcommittee on Finance and Taxation about our proposals to improve access to capital by small businesses.

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

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

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

NADCO will provide comments today on the proposals we have made to the Subcommittee to improve the 504 program in order to increase access to long term capital by small businesses during and following this recession. Our industry thanks the Subcommittee for including in its legislation these program enhancements to expand access to long term, low cost capital for small businesses.

Reducing 504 Program Costs for Small Businesses:

NADCO has just been informed that the FY 2010 SBA budget increases the cost of access to the 504 program for small businesses by 38.9 basis points per annum. Further, with the nation's unemployment rate being a major factor in the SBA's "econometric" subsidy model, it is almost a certainty that the borrower fee for FY 2011 will also increase. For the average 504 borrower, this represents an increased interest cost of almost $50,000 for the life of their loan. For FY 2011, this figure may far more than double. These cost increases will hit our new borrowers just at the time our national economy needs these companies to expand, create jobs and help pull the country out of the recession. These fee increases will clearly negate the benefits of the benefits of the stimulus bill. We reduced the cost to borrowers in March 2009 and then will significantly increase the cost in October 2009, and likely increase the costs again in October 2010.

Since FY 1997, the 504 program has been at zero subsidy; that is to say, fees paid by small business borrowers, CDCs and first mortgage lenders have covered the entire cost of the program. Until passage of the stimulus bill in February of this year, no taxpayer funds have been appropriated for the program in over ten years. While we have requested a more detailed discussion with SBA's subsidy experts, an analysis of the OMB Federal Credit Supplement reveals that SBA is projecting that loan defaults for 504 will increase from 3.5% for FY 09 to over 7.3% for FY 2010. Together with the unemployment rate increase, these two factors may well account for the majority of the fee increases over the next two years.

NADCO is concerned about this forecast of the program default rate. Surveys of our CDC membership and information on bank credit underwriting lead us to a very different conclusion than the SBA has drawn for this critical factor. In fact, both bank's AND SBA's own underwriting of 504 loans have become far more conservative during this recession. The "credit box" has become much tighter, and only the strongest small businesses are now qualifying for new loans. Further, with most businesses more carefully husbanding their cash, demand for fixed plant expansion is coming from only the stronger small businesses. Finally, appraisers have become much more conservative in their valuations of commercial real estate, making expansion capital of any kind much more difficult to obtain.

Combining all these factors, it is clear that the FY10 loans we make to small businesses may be among the best and most conservatively underwritten in the twenty-two year history of 504 lending. NADCO strongly believes that loan defaults for the 2010 loans will substantially <u>decline</u>, not go up, as now forecasted by SBA's subsidy modelers.

If nothing is done by Congress, the result will be identical to what occurred in FY 1997 when OMB grossly overestimated the defaults and cost thousands of small businesses millions in inflated guarantee fees. In FY 2010 we will see borrowers paying unnecessarily high program fees at the worst time: when they need access to affordable 504 loan capital so they can preserve their cash for working capital to undertake their company expansion and create jobs. With inflated guarantee fees for both FY 2010 and 2011, almost 20,000 small businesses will pay millions in extra fees to SBA over the entire twenty years of their 504 loans. The 504 program will become less and less effective for small businesses creating new jobs.

We ask the Subcommittee to consider the impact of these increased guarantee fees on the very small businesses that are the job creators that will lead America out of this recession. NADCO believes that the only way to restore the fairness of this subsidy process is for Congress to step in and appropriate sufficient federal funds to offset these fees. We request this be taken up by Congress as soon as possible in order to negate the impact of this subsidy fee on our borrowers for FY 2010.

<u>Reaching Out to More Small Businesses With New Capital:</u>

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

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

<u>Increase the maximum 504 loan size</u>: In order to reach more borrowers, the limit for a regular 504 loan should be increased from $1.5 million to at least $3.0 million (and possibly more), and the limit for

critical public policy loans should go from $2.0 million to at least $4.0 million. Commercial real estate construction costs have increased substantially in the last five years, and the program benefit must keep up with these costs for small businesses.

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

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

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

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

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

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

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

Controling and Reducing Loan Losses for the 504 Program:

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

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

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

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

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

Making SBA Programs More Relevant and Productive:

Loan volume for both the 504 and 7(a) guarantee programs has improved since passage of the stimulus act, but many of those benefits are just now being implemented by the SBA. However, in spite of the stimulus bill, both programs are still down as much as 40% from their highest levels two years ago.

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

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

In order to begin a "re-thinking" of the program, its ability to serve small business, and an expansion of its benefits, NADCO believes that there must finally be established the organizational parameters and control guidelines for Certified Development Companies that deliver the 504 program to the nation.

The very definitions of our industry and its financing services should not be left to the sometimes arbitrary evolution of regulations that are designed to control the "lowest common denominator" of the program.

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

Certified Development Company structure: Low cost program delivery is at the core of 504's benefits for small business borrowers. As SBA and our industry seek to grow the delivery organizations for 504, the program should continue to be delivered by not-for-profit, community-based organizations that are focused on economic development in their local areas. NADCO has created a series of recommendations that address this goal, and through codification, make it an absolute requirement for all new CDCs. Some of these recommendations mirror beneficial SBA rules, while others are completely new requirements that will maintain the advantages of today's low cost delivery of 504.

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

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

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

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

CONCLUSIONS:

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

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

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

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

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

NASBIC
America's Small Business Partners

Statement
of
Steve Swartzman

National Association of Small Business Investment Companies
Suite 750
1100 G Street, NW
Washington, DC 20005

Before The

United States House of Representatives
Committee on Small Business
Subcommittee on Tax and Finance

July 23, 2009

"Legislative Proposals to Reform the SBA's Capital Access Programs"

Thank you for the opportunity to appear today to offer the National Association of Small Business Investment Companies' (NASBIC) views on the important issue of reforming SBA's Capital Access programs. My name is Steve Swartzman. I am a partner at C3 Capital, which manages two Small Business Investment Companies (SBICs) located in Kansas City, Missouri.

We appreciate this Committee's continued commitment to keeping SBICs as an important part of the Congressional agenda. As the champions of small business, we are asking this Committee and SBA to emphasize the SBIC program and fully utilize its potential. As someone who works closely with small businesses every day, I can tell you that the country needs this program, particularly at a time like this. NASBIC and its members ask you to reform the SBIC program to help today's small businesses become tomorrow's icons of the American economy. We specifically ask that as the SBA is being reauthorized that these reforms be included.

SBIC Program Overview

SBICs are private equity funds that invest exclusively in American small businesses. SBICs raise private capital and then get licensed by the Small Business Administration as an SBIC. Once licensed, debenture SBICs can draw leverage and thereby multiply the amount of money available for investment in small businesses. SBA is paid back with interest and thus there is no net cost to the taxpayer for the SBIC debenture program. Since this program's inception in 1958 over $55 billion dollars have been invested in American small businesses. Some of the bigger names that received early SBIC investments include: Apple, Intel, Callaway Golf, Outback Steakhouses, PeopleSoft, Staples, and Quiznos.

I co-founded C3 Capital where we manage two SBIC funds. Since 2003, we have invested $137 million in 33 small businesses, which have created many thousands of jobs and promoted economic development in communities throughout the country. Our investments have included: American Apparel, where we were the first institutional investor in a company that became the largest domestic apparel manufacturer in the U.S. and which grew retail stores from eight at the time of our investment to over 200 stores worldwide today (one of the fastest retail rollouts in American history); Electronic Transaction Consultants, a software developer and integrator that has grown into one of the most successful and innovative companies in its field, deploying the country's first electronic only toll road in the U.S. and providing the software that manages toll roads in the cities of Chicago, Dallas, and Houston; and a wide variety of niche manufacturing, services and distribution businesses throughout the U.S.

Need to Reform and Utilize the SBIC Program

Recently, NASBIC's Chairwoman of the Board testified that despite having a 50 year record of successfully growing American small businesses and providing over $55 billion of financing to over 106,000 U.S. based businesses, the SBIC program is being underutilized. This underutilization is leaving billions of dollars unused that would otherwise be invested in domestic small businesses. When both credit and investment has evaporated, it does not make sense to leave an effective small business tool unused, particularly because the SBIC Debenture program fully pays for itself. Because of its stability and partnership with SBA, the SBIC program is countercyclical and is one of the few programs that remains available to U.S. small businesses when other financing sources have dried up, as they have over the past year.

American small businesses and taxpayers need the SBIC program to live up to its potential. Without reform, we expect that over the next four years there will be about $10 billion of available SBIC capital that will not be invested in domestic small businesses. This opportunity cost is tragic because the cost to the taxpayer for providing the $10 billion in investments via the SBIC Debenture program is effectively zero. The SBIC debenture program pays for itself with fees and carries no subsidy rate. Zero cost to promote $10 billion of investments in small businesses is the kind of deal that taxpayers can respect.

Thankfully, this Committee is working on legislation to fix the problem. While there is not a single major problem with the SBIC program, there are a number of issues that are limiting utilization. We encourage you to include all of these issues in any legislation

Keeping Successful Small Business Investors

One of the bitter ironies for small businesses is that successful SBICs have been pushed or "graduated" out of the program. It is simply bad public policy to have disincentives for your best small business investment companies to continue operating. There should be incentives for good funds to continue to partner with SBA and to make all of their investments in domestic small businesses. Keeping successful SBICs in the program will ensure that there is ever more capital available for small businesses and that we are not losing some of the best small business experts.

Expedited Relicensing

Currently the licensing process at SBA is slow, opaque and subjective. It is the number one complaint of SBICs. For example, despite the success of our first SBIC fund, getting a second license took over a year, countless hours of paperwork, and expensive legal bills. Legislation should provide a transparent process, with clear standards, and a reasonable timeline for applicants. If a fund has already been fully vetted, licensed by the SBA at least once, proven itself successful financially, complied with federal regulations, passed annual examinations by federal regulators, and wants to continue to invest in small businesses, then it should be able to receive a new SBIC license quickly. To ensure continued taxpayer protection, new background checks and proof of private capital raised should be the only updates needed. Funds that are capitally impaired, have major regulatory problems, or that are unable to raise private funds should not be able to get an expedited repeat license. Further, the Administrator should have the authority to put the brakes on any application that she or he thought posed a risk to the taxpayer. Without a better relicensing system the amount of capital available for small business investment will continue to wither.

An expedited licensing procedure would have four positive benefits. First, it would provide more capital to domestic small businesses because there would be a greater number of SBICs. Second, it would create a strong incentive for existing SBICs with established track records and a wealth of investment experience to stay in the program. Third, it would allow the very limited resources allocated to the licensing division at SBA to focus its efforts on vetting new funds, with which SBA does not yet have a long-standing relationship. Fourth, it would create a strong incentive to remain in full regulatory compliance.

Letting Funds Grow to Provide More Capital

Success is rewarded by growth. Successful SBICs often start new funds that are larger than their previous fund. The problem is that successful funds can grow too large for the SBIC program. They still want to invest in the small business sector, but the family of funds limit effectively forces out repeat funds as they become successful and get larger. These would-be repeat SBICs that became larger funds are solid investment vehicles with a wealth of experience and significant infrastructures that should be kept in the program. Again, we should not force funds out because of successful small business investing.

The individual fund limits are adequate, thanks to the increases included in the stimulus bill. The increase in the family of funds limit that was included in the stimulus bill was urgently needed and it met that urgent need. **We appreciate this Committee's efforts to include these important** provisions in the bill. However, if we are truly to keep the best funds in the program and to provide billions in capital to small businesses, then we need to allow a continuum of investment funds. With a higher leverage limit and expedited relicensing, a successful fund could have a series of SBIC funds that run the 10 year life cycle of the funds. One fund could be winding down, another could be at peak, and another could just be ramping up. Under this scenario, good SBICs can constantly be providing funds to small businesses without having to "graduate out" and suffer for success by hitting a leverage-limit ceiling. Funds that were in distress would not be eligible for new leverage or expedited re-licensing.

Providing Capital to Veterans

Under the current SBIC program there are a number of incentives that apply to investments in low and moderate income areas (LMI). SBICs invest in many LMI and other underserved areas, not because of a mandate, but because they are good investments for the SBIC and for the taxpayer. One incentive that has been discussed is to allow investments in veteran-owned or run companies to count towards the LMI calculations. This would be a market-based incentive for investing in those who have served this nation.

Prevent Regulatory Disincentives to Becoming an SBIC

Following the scandals in several of the mega private equity funds, there have been calls to regulate private equity, including SBICs. SBICs are already highly regulated and screened to levels that the SEC has never matched and likely never will. Additional regulation by the SEC or other bodies would just increase the regulatory burden and cost for being an SBIC. For example, **SBA's reporting requirements are already out of sync with GAAP and will be out of sync with** the SEC too. **SBA's requirements are stricter than the SEC's standards.** Adding SEC regulation would only add cost – not taxpayer protection. SBICs, which are by their nature are small in size and cater to the lower and middle markets, pose no systemic risk and should not be punished for the past sins of a few unrelated mega funds. Adding duplicative and expensive regulation to SBICs would discourage funds from becoming SBICs and thereby drive capital away from small businesses.

SBICs compete in a free and open market as they invest in small business transactions. If the number of SBICs is to increase and thereby grow the amount of capital available for small businesses, then disincentives should not be placed on becoming an SBIC. For example, SBA currently limits the interest rates that SBICs earn if equity warrants are part of the investment package. SBA also limits enforcement of default rates. Both of these provisions need reforming **because they limit taxpayer protections for being paid back and risk the SBIC's bottom line** compared to non-SBICs. There should not be a penalty for partnering with SBA to invest exclusively in domestic small businesses.

Small Business Desperately Needs Equity Investment

Capital for small business investment is in very tight supply, but demand is strong. In times of economic stress, small businesses must be nimble to take advantage of growth opportunities, but they need access to capital. Right now, seed and early stage investment has shriveled to exceptionally low levels. Growth and buy out capital is hard to come by. Senior lending by banks has pulled back dramatically.

The SBA previously had an effective tool that was exceptionally successful at using the private market to steer equity investments into domestic small businesses, with taxpayer money enhancing the effect. The SBIC Participating Securities program needed reforming, but instead of being reformed, it was deactivated and now lies dormant. While it lasted, the program invested over $13 billion in small businesses, created over 385,000 new jobs and saved hundreds of thousands more. While almost 70% of venture capital dollars go to high tech and life science industries, this program invested heavily in small business manufacturing. More than half of VC investments are made in California and Massachusetts, but the SBIC program invested more than 70% of its capital in other states that are often starved for investment capital. SBICs are still a source of capital for early stage companies, investing in almost 300 so far this year, but there has **been over a 30% decline since the mothballing of SBA's equity option.** Meanwhile the debenture program provided over $800 million to small businesses over the same period. The demise of an early stage and equity option from SBICs has contributed to the dearth of early stage capital and is a roadblock to our economic recovery. These SBICs were the most reliable source of equity capital for U.S. small businesses dealing with the fallout of the recession that began in 2000. All venture capital investments fell 83% between 2000 and 2003, according to Venture Economics. SBIC investments during that period—a total of $5.25 billion—fell just 23%. A recent survey by the National Association of Seed and Venture Funds found that over 90% of early stage entrepreneurial companies, some of the nation's best job creators, are having serious difficulty raising follow-on capital.

We are in a deep recession. This fact makes the availability of equity capital, or lack thereof, even more important to America's small businesses. Equity capital is the foundation upon which any company is built. A company's ability to raise senior debt and lines of credit—absolutely essential to business success—relates directly to its ability to raise equity capital. Congress and the Administration should review proposals that establish tools for SBICs to invest equity in a manner that protects the taxpayer and provides capital to worthy businesses. The SBIC platform, with its experienced SBA personal and an established private sector network, is the best and fastest government tool available to resuscitate private sector equity investing.

Renewable Energy

There is a great deal of interest in renewable energy and other technologies. While SBICs invest in small businesses across almost all industry sectors, SBICs are not yet able to utilize the energy debenture that was passed by Congress in 2007 because SBA has not produced any regulations to implement them. We would encourage Congress to act to ensure SBA makes these tools available. We would also ask that a technical correction be made to make the energy saving debenture available to all the SBICs, and not just the 11 licensed since last year. Further, some major market participants are actively reviewing ideas for a new debenture model to promote energy efficiencies. With your help, SBICs can make sure that the green economy will be open to innovative small businesses and not just the biggest multinationals. These regulations, reforms, and new options need to be put in place quickly.

Bank Investments in SBICs

Banks are important investors in many SBICs. Banks receive excellent returns on their investments and many also get CRA credits. However, since the passage of Gramm-Leach-Bliley, the number of bank SBICs and amounts invested in SBICs has dropped dramatically. Currently, banks are under intense pressure to maintain or increase capital reserves so the outlook for bank investments is not promising. As more pressure is being placed on banks to get capital out to small businesses, the SBIC program should be an attractive public policy option for both banks and policymakers. A strong public statement from bank regulators would provide an incentive to partner with SBICs. Moreover, if banks are welcomed and incentivized to become leveraged

SBICs they could then triple the amount of capital they invest in small businesses. This could be done in a way that does not cost the taxpayer, while minimally reducing their regulatory capital.

A National SBIC Program

The SBIC program provides capital in areas of the country often overlooked by the rest of the private equity and venture capital community. Despite this fact, there are areas of the country that need more SBIC coverage. A concerted effort should be made to incentivize this program and to welcome new licensees, particularly from the western United States. Policymakers should also make it easier to raise capital for SBICs by allowing a higher percentage of capital to come from state sources. There are a number of funds that have attempted to become SBICs who were either delayed or rejected for an SBIC license because of the current state limit of 33% of regulatory capitol. Some of these rejected funds were from states that do not have any resident SBICs.

Conclusion

American small business is the unsung workhorse of our economy. A fully utilized SBIC program can provide billions in capital to domestic small businesses that will create more jobs than any other part of the economy. The Recovery Act was projected to save or create four million jobs at a cost of nearly $197,000 per job. It only costs between $11,000 and $33,000 to create a job via small business investment. If the existing SBIC program were fully utilized, it could create between 300,000 and 900,000 jobs over the next four years and could do so at zero net cost to the taxpayer. Please reauthorize, reform, and expand this successful partnership of 51 years. Now more than ever, the economy and the American worker need this program to be fully utilized.

AMERICAN ACADEMY OF
FAMILY PHYSICIANS
STRONG MEDICINE FOR AMERICA

Statement of the American Academy of Family Physicians

Before the House Small Business Subcommittee on Finance and Tax

Regarding
"Legislative Proposals to Reform the SBA's Capital Access Programs"

Presented By
Sterling N. Ransone, Jr., MD

July 23, 2009 – 10:00 AM

AAFP Headquarters
11400 Tomahawk Creek Pkwy.
Leawood, Kansas 66211-2680
800 274 2237
913 906 6000
fp@aafp.org

AAFP Washington Office
2021 Massachusetts Avenue, NW
Washington, DC 20036-1011
202 232 9033
Fax 202 232 9044
capitol@aafp.org

Chairman Schrader, Ranking Member Buchanan and members of the Small Business Subcommittee on Finance and Tax. I am Sterling Ransone, Jr., MD, representing the 94,600 members of the American Academy of Family Physicians (AAFP). I am pleased to be here today to discuss the *Small Business Health Information Technology Financing Act*.

Background

Founded in 1947, the AAFP is the only medical society devoted solely to primary care. Nearly one in four of all office visits are made to family physicians. That is 208 million office visits each year – nearly 83 million more than the next largest medical specialty. Today, family physicians provide more care for America's underserved and rural populations than any other medical specialty.

In the increasingly fragmented world of health care where many medical specialties limit their practice to a particular organ, disease, age or sex, family physicians are dedicated to treating the whole person across the full spectrum of ages. Family medicine's cornerstone is an ongoing, personal patient-physician relationship focused on integrated care.

Due to the number of patients family physicians see each year and the wide range of medical services they provide to their patients, the AAFP is committed to health information technology as one means to improve quality and cost-effectiveness of health care delivery in the US.

Support for the Small Business Health Information Technology Financing Act

On behalf of the AAFP, I am pleased to support HR 3014, the *Small Business Health Information Technology Financing Act*. Your bill, which would help make it easier for eligible physicians to acquire loans to purchase health information technology, would be a superb adjunct to the provisions contained in the American Recovery and Reinvestment Act (ARRA).

The AAFP worked closely with Congress to craft the *Recovery Act* provisions on health information technology. We appreciate the funds provided to encourage the adoption of HIT by Medicare and Medicaid providers during the next five years and the direct funding for the nation's HIT infrastructure. The *Recovery Act* makes an unprecedented investment in health information technology and reflects an understanding of HIT as a critical component in a reformed health care system.

As a result of our deep commitment to having appropriate HIT available to family physicians, the AAFP supports those provisions that would allow our members, and other physicians, to purchase and optimally use these HIT systems. Your bill is a significant step in that direction.

While we support the *Recovery Act* funding provided to physicians, and applaud the use of outcomes to frame "meaningful use," that legislation does not contain a crucial piece that your bill provides: access to up-front capital for to physicians seeking to purchase HIT, particularly those in small or medium-sized practices.

We appreciate that your legislation includes these key provisions:

- Guarantees of up to 90 percent of loans up to $350,000 for individuals and $2 million to a group of affiliated professionals to purchase HIT that supports "meaningful use;"
- Helps providers using HIT to enhance continuity of care and communication; improve quality measurements; further evidence-based decision support and boost consumer and patient empowerment.

Capital Constraints

We thank you for recognizing that solo, small and medium-sized physician offices still find it difficult to afford health information technology. Ironically, while everyone benefits from these systems, it falls to the physician to make the initial purchase and incorporate it into the practice. Unfortunately, declining reimbursements and increased operating costs in primary care offices have severely restricted access to capital for HIT investment.

The AAFP is proud of the fact that approximately one-half of family physicians already are using commercially available EHR systems in their ambulatory practices to improve care quality, patient safety and practice efficiency. Though many of these HIT systems are not as easily useable or affordable as we would like, our education and advocacy efforts over the last six years have enabled our members to adopt HIT solutions at rates higher than almost any other specialty.

Nevertheless, we still have a significant number of members who have not purchased HIT, with almost half, based on an August 2008 survey of our members, identifying cost as the most important reason for their reluctance to adopt these systems.

Let me give you a personal example. I have a friend in solo practice who employs only one nurse and one administrator in his three exam room office. Since my physician friend is highly aware of the benefits of HIT, he undertook a serious review of the available EHRs to find one that was both affordable and appropriate for his practice. Unfortunately, despite his due diligence, he came to the reluctant conclusion that, at this time, he simply could not afford to make this investment. My friend is precisely the individual this bill would target: a physician with a keen interest in adding HIT to his office, but one that also must face the realities of running a small business. Passage of this bill could help him purchase HIT and take advantage of its benefits.

Uncertainties with ARRA Remain

While family physicians applaud the incentive payments in the *Recovery Act* for the "meaningful use" of HIT, they are hesitant to act due to a high level of uncertainty that remains around the specifics of the law. The AAFP has received dozens of calls from members asking which HIT systems to purchase at this time.

Loans such as those included in the legislation could, at a minimum, reduce the level of uncertainty surrounding how to pay for HIT, as soon as this information becomes clear.

Making Meaningful Use Work

As stipulated in the law, providers must prove "meaningful use" of their HIT systems. While we appreciate the requirement for "meaningful use," we also realize that meeting these goals will mean more investment, both in time and money, than simply implementing any EHR on the market. Additionally, staying current with meaningful use requirements likely will mean incremental updates in EHR software and interfaces, which will be ongoing costs to practices.

In addition, most family physicians lack not only the money, but also the time to successfully prepare their practice for an EHR and then select, implement, maintain and "meaningfully use" a system.

Consulting and training costs must be considered in addition to the pure hardware and software costs and issues. The workflow redesign required to realize the true benefits of EHR adoption and meaningful use are foundational changes within the organization that take careful planning, focused effort and active management. Physicians will need to use these loans to engage experienced, successful and truly independent consultants to help them chart this course.

Last, a streamlined application process that requires minimal paperwork will be key to attracting busy physicians in solo, small or medium sized practices already facing a weighty administrative burden. We understand that the loan application would be the one provided by the individual lenders and want to urge the other witnesses at this hearing to require applications that are as simplified as is possible.

Conclusion

Health care is a significant component of our economic system. The efforts of other committees in Congress to pass health care legislation this year showcases the steadily increasing cost of healthcare and the critical need for reform.

While health information is only one portion of this highly complicated industry, Investment in HIT at the practice level is critical to improving health care for our patients, will reduce costly medical errors, can help patients manage their health care more efficiently, and will contribute to the nation's economic recovery.

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