FULL COMMITTEE HEARING ON INCREASING ACCESS TO CAPITAL FOR OUR NATION'S SMALL BUSINESSES

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FULL COMITTEE HEARING ON INCREASING ACCESS TO CAPITAL FOR OUR NATION'S SMALL BUSINESSES

THURSDAY, MARCH 1, 2007

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. Nydia M. Velázquez [Chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Shuler, Bean, Cuellar, Altmire, Braley, Clarke, Sestak, Chabot, Fortenberry, Westmoreland, Gohmert, Fallin, and Buchanan.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

Chairwoman VELÁZQUEZ. The House Small Business Committee is called to order. Today, we will hold a hearing entitled, "Increasing Access to Capital For Our Nation's Small Businesses," and it is the intent to examine the challenges faced by entrepreneurs in securing affordable financing and propose solutions to meet those challenges.

Let me start off by thanking everyone for being here today. Welcome to all the witnesses.

While small businesses are the country's economic drivers and job creators, accessing the capital they need to successfully grow a business is always challenging. As most of us know, many entrepreneurs just starting a firm cannot qualify for traditional bank loans and rely heavily on borrowed money from friends, family or credit cards.

In the past, this is where the SBA has stepped in to help businesses in need of financing. There is no question that its loan programs have been a great source of capital for entrepreneurs, providing 40 percent of all long term financing and putting $25 billion into the economy annually. The partnership between small business lenders and the government has allowed entrepreneurs from all walks of life to secure affordable capital.

For all of the good that these initiatives are doing they could clearly be doing more. SBA's access to capital programs are a necessary tool for small firms; however, we need to find a way to decrease costs and increase access to these services especially in underserved areas. With veterans returning from Iraq, and the increasing number of women and minority entrepreneurs, affordable financing is more important now than ever.

One thing we cannot forget is why these programs were created in the first place, to provide long-term capital to this nation's small businesses. This was its original purpose and this is its true potential. For these initiatives to live up to their original intent, we need to make them affordable for small businesses.

What has always set SBA's loan programs apart from other financing means are the local ties to the community. Many are combined efforts, working with the SBA and private sector lenders in a public-private partnership to provide capital to small firms. In helping small business owners, they are also contributing to the economic development in their local communities.

The SBA's financing programs are essential for many entrepreneurs to get started or expand their businesses. for the programs to best serve small firms they must have the tools needed to provide affordable capital. With small firms creating three out of every four new jobs and comprising over half of the nation's gross domestic product, it is a big problem when they do not have much needed funds. A small business owner should not be left with the difficult choice of either scaling back plans to expand their firms or risking the failure of their business.

Today, we will be hearing from small businesses advocates who will tell you what entrepreneurs are experiencing. Also in today's hearing, we will look at how the SBA loan programs can be improved to meet the needs of small businesses. This is an opportunity for us to listen and to take action so that we can create an environment that small firms can succeed in.

It is crucial that our nation's 26 million entrepreneurs have the ability to secure capital and to continue to spur economic development. We need to ensure SBA's loan programs are the premier lending tool for entrepreneurs. Access to capital is access to opportunity and by putting capital back into the hands of our small businesses we give entrepreneurs a chance to compete in today's marketplace.

And now, I am very pleased to yield to the Ranking Minority, Mr. Chabot, for his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr. CHABOT. Thank you, Chairwoman Velázquez, and I want to thank you for holding this hearing, and I want to thank all the witnesses for participating here today, particularly, Mike Schmitt, who is the President of the Metalworking Group for my district in Cincinnati, Ohio, in Corine Township, but we want to thank all of you for making the trip here today.

In my view, today's hearing on improving small businesses' access to capital is one of the most important hearings this Committee will hold during this session of Congress. While many challenging issues confront small businesses—excessive litigation, burdensome regulation, affordable healthcare, high taxes, and contract bundling, just to name a few—none of these issues matter if small businessmen and women cannot borrow the seed money they need to start, and improve, their businesses.

The 7(a) and the 504 lending programs, administered by the SBA, are critical for the success of many small businesses in this country. These programs allow entrepreneurs, who may not otherwise have the opportunity, the chance to start their own business or to make improvements in their businesses.

Unfortunately, many small businesses have experienced difficulty in obtaining this much needed capital of late. After a 25 percent increase in the number of 7(a) borrowers in 2005, there was a 37 percent decline in borrowers during 2006 which some attribute to the rising fees paid by borrowers and lenders.

Over the last few years, the 7(a) and 504 programs have been self-sustaining, operating at zero-subsidy and no appropriations, which eliminates the funding shortages the program experienced in the past. In my view it's the most desirable way to fund the program since it is paid for by those who use it. That said, we must make sure the lending programs continue to be used by those who need them and I know that we plan to take a close look at the programs' recent fee increases.

This hearing is the first step toward reauthorizing the SBA and its programs—a process that hasn't been completed, unfortunately, since 2002. It's important that the SBA and its programs be thoroughly reviewed and evaluated to improve what's working and to fix what isn't.

I look forward to working with Chairwoman Velázquez to ensure that the SBA's loan programs operate as efficiently and effectively as possible.

And, once again, we want to thank all the panel members for coming out here today to testify before the Committee.

I yield back the balance of my time.

Chairwoman VELÁZQUEZ. Thank you, Mr. Chabot.

Chairwoman VELÁZQUEZ. And now, I will call on Ms. Janet Tasker. She's the Deputy Associate Administrator for Capital Access at the United States Small Business Administration. The Office of Capital Access manages the administration business loan programs, and performs lender oversight function at the SBA.

Ms. Tasker, you will be recognized for five minutes.

STATEMENT OF JANET TASKER, DEPUTY ASSOCIATE ADMINISTRATOR FOR CAPITAL ACCESS, U.S. SMALL BUSINESS ADMINISTRATION

Ms. TASKER. Thank you, Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee, for inviting me to testify about SBA's reauthorization and the Fiscal Year 2008 budget for capital access.

I am Janet Tasker, SBA's Deputy Associate Administrator for Capital Access. The Office of Capital Access manages the guaranteed business loan programs, the investment programs, the surety bond program, international trade programs, and the lender oversight function at SBA. I am proud to discuss our Fiscal Year 2008 budget, which reflects the President's commitment to America's small businesses and supports Administrator Preston's new reform agenda to expand the Agency services and make our programs more customer driven, while ensuring fiscal restraint and responsible stewardship of taxpayer dollars.

The Small Business Administration plays an important role in supporting America's entrepreneurs and small business community. Each year, we are reaching more small businesses at an extraordinary rate, and doing so at no subsidy cost to the taxpayer. Fiscal year 2001, the loan program served about 48,000 small business borrowers. Fiscal Year 2006, this number had doubled to more than over 100,000, in both the 7(a) and 504 loan programs.

The President's Fiscal Year 2008 proposal will support a total of more than $28 billion in SBA financing for small businesses. The proposal requests authorizations of $17.5 billion for the 7(a) program, $7.5 billion for the 504 program, $3.0 billion for the SBIC debenture program, and $25 million for the Microloan program.

The 7(a), 504, SBIC and Microloan program levels build on the continuing success that SBA has achieved in its loan programs over the past five years. in 2006, we served more small businesses than ever before. In our major loan programs, we increased the gross number of loan approvals by 99 percent, from 50,233 in Fiscal Year 2002 to over 100,000 loans in Fiscal Year 2006. Likewise, 7(a) lending to minorities and women have increased dramatically, more than doubling since Fiscal Year 2002 in terms of the number of loans funded. These record numbers are possible in part because of the zero subsidy policy that was adopted at the beginning of Fiscal Year 2005.

We are pleased that the 2008 budget proposes a number of fee reductions in our business lending programs, due to outstanding portfolio performance, enhanced lender oversight, and positive economic projections. The 7(a) program, SBA is seeking to lower the ongoing annual fee on lenders from 55 basis points in 2007 to 49.4 basis points in 2008, resulting in a savings of $657 over the lifetime of an average loan of $145,000.

The budget proposes elimination of the 50 basis point up-front fee on loans in the 504 CDC program, initially saving the borrower nearly $3,000 on the average loan of $582,000.

SBA also requests a reduction in the ongoing annual fee for the SBIC Debenture program, from 90.6 basis points in 2007 to 71.7 basis points in 2008, representing a savings of nearly $359,000 over the life of an average guarantee. These fee adjustments are significant, and we are pleased that they will help the participants in our program access the capital necessary to establish and grow small businesses across the country.

One specific area of the 7(a) program, we are requesting authority to charge a fee on pools of loans sold in the secondary market. This will enhance the ability of SBA to properly manage our programs by covering more of our expenses through fee authority, rather than taxpayer subsidy. We are not proposing to charge a fee at this time, but believe that the statutory authority to charge a fee in the future under certain circumstances, such as interest rate changes that affect the program, is appropriate. Borrowers would not be affected at all, as the fee would be paid by investors in secondary market certificates.

Another key priority of SBA's 2008 budget will support our new Administrator's commitment to maximizing the effectiveness of Agency resources by building on the improvements of the past several years in centralized lending functions. By centralizing our 7(a) loan liquidations, we saved taxpayers approximately $18 million in Fiscal Year 2006, even while our portfolio was growing markedly.

Administrator Preston is committed to better monitoring and management of performance metrics through centralization, ensuring consistent application of SBA's policies and procedures. While SBA has successfully improved customer service, efficiency and accountability, with reduced staffing levels in recent years, this year's budget requests a staffing increase of 28 new FTEs to support the Agency's oversight and portfolio management functions. Efficient infrastructure to manage our risks is more important now than ever before, due to tremendous growth in our loan program, and we believe that new FTEs are necessary to strengthen and support these critical functions.

We are also pursuing several measures to minimize the potential for fraud in our loan programs, including the leveraging of data analysis techniques to identify portfolio trends that may be indicators of fraud, as well as meeting with fraud experts in the public and private sectors. We continue to refer evidence of potential fraud to the Inspector General for investigation in a timely manner, and have incorporated the referral process into our SOP for lender referrals.

Administrator Preston placed a high priority on better targeting SBA's programs and services to under-served markets, when he was sworn in as head of SBA in July, 2006. We have made notable progress in this area.

In October, the Agency launched the New Markets Tax Credit Pilot Loan Program to provide capital to small businesses and economically distressed urban and rural areas, or "New Markets." This pilot program allows certain Community Development Entities to purchase up to 90 percent of the gross loan amount of SBA Express or Community Express 7(a) loans to "qualified" businesses in low-income communities.

Additionally, the Fiscal year 2008 budget request includes a proposal to expand the potential reach of the Microloan program to under-served communities, by moving the program to a zero subsidy. In past years, SBA has proposed eliminating the Microloan program because under current structure it is very costly to the taxpayer, relative to the amount of capital it lends.

However, SBA will be able to offer loans to virtually any eligible intermediary by changing the rate at which the intermediaries borrow from 3.77 percent, which is below the Government's cost of funds, to 5.99 percent, which is 1 percent above the Government's cost. Intermediaries will continue to receive a better than market rate of interest, and businesses in under-served markets will have expanded reach through non-bank microlenders.

The Agency is also seeking to vastly expand the number of outlets providing training to Microlenders by utilizing our technical assistance resource partners, including the Small Business Development Centers and Women's Business Centers located throughout the country. By shifting Microloan technical assistance to our extensive network of existing resource partners, SBA has the potential of tripling the potential outlets for microenterprise lending and will save almost $13 million in Fiscal Year 2008.

In conclusion, we are very proud of the growth in the business lending programs, and our efforts to ensure that this growth is managed in a reasonable and prudent manner.

Today, SBA is helping more small businesses meet their financing needs than ever before, especially in our Nation's under-served markets.

Thank you for your time today, and I would be happy to answer any questions.

[The prepared statement of Ms. Tasker may be found in the Appendix, on page 33]

Chairwoman VELÁZQUEZ. Thank you, Ms. Tasker.

And now our next witness is Mr. David Schroeder. he is the President of the American Enterprise Bank in Buffalo Grove, Illinois. He is here on behalf of the Independent Community Bankers of America, which represents nearly 5,000 community-based financial institutions nationwide.

Mr. Schroeder, you will be recognized for five minutes.

STATEMENT OF DAVID G. SCHROEDER, INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. SCHROEDER. Thank you very much, Chairwoman, Ranking Member Chabot, and Members of the Committee. My name is David Schroeder. I am the President of American Enterprise Bank, a locally-owned, $325 million community bank in Buffalo Grove, Illinois. I'm pleased to appear today on behalf of the Independent Community Bankers of America and its nearly 5,000 members nationwide. The community banking industry thanks you, Chairwoman Velázquez, for holding this important hearing. I know this Committee has a history of working well and on a bipartisan basis to focus on the needs of small businesses.

Community banks serve a critical role in financing small businesses. In Illinois alone, there are 549 community banks that have made a total of 194,000 small business loans or $21 billion in small business lending. Community-based banks forms the building blocks of our Nation's communities, providing the needed small business capital and credit to all geographic regions of the country, both large and small.

First of all, I want to make it very clear that the SBA Guaranteed Loan Programs are unique and extremely valuable, in providing needed long-term capital to small business borrowers. The SBA loan programs truly represent a success story of how the Federal Government, working with private sector lenders, can fund small businesses that otherwise would not have access to capital.

Community lenders, like American Enterprise Bank, are proud to work with the SBA in helping supply needed long-term capital to small businesses across the Nation. Last year, American Enterprise Bank facilitated $25 million in 7(a) loans, and $28 million in 504 loans, in our local communities. American Enterprise recently earned the distinction of being named "Lender of the Year' by SomerCor 504, a Chicago-based Certified development Corporation.

With small business development, one of the fastest-growing segments of our changing economy, the demand for small business capital will only increase. However, ICBA believes recent changes to the budget and loan programs are causing the SBA to fall short of its ability to facilitate affordable small business capital. Recent budget cuts, sharp fee increases on both lenders and borrowers, and the elimination of the successful "LowDoc" program have undermined the full potential of SBA lending programs.

We have witnesses a disturbing decline in the number of community lenders actively participating in SBA loan programs. While the number of SBA loans has increased, the number of participating lenders, and the size of loans, continues to fall. The shrinkage of average loan size has left many small businesses with less capital to grow their businesses and create jobs.

Given the growing demand for small business capital, one would expect the number of lenders actively participating in lending—SBA lending programs to grow. Unfortunately, this is not the case.

In recent years, many community banks have found it much harder, and not easier, to provide needed capital to small businesses through the SBA loan programs. Notably, the number of lenders that have made at least one SBA 7(a) loan has dropped almost in half since 2001. This is a very disturbing trend.

The majority of our Nation's commercial banks are, indeed, community banks. However, today, just the top ten SBA lending banks do nearly 60 percent of all SBA loans. SBA lending should not be allowed to morph into a one-size-fits-all, cookie-cutter program that works only for a limited number of big bank lenders in limited small business needs. The SBA loan programs should be allowed to work well for lenders making ten loans, as well as 10,000 loans.

ICBA supports the SBA loan programs, and respectively proposes several recommendations that will address problem areas. Our recommendations include:

1. Restoring a reasonable 7(a) loan program appropriation to allow the sharp increases on lenders and borrowers to be scaled back.
2. Boosting the SBA budget, which has been cut nearly in half in the past six years.
3. Reinstating the successful "LowDoc" program with an 85 percent guarantee for loans up to $250,000.
4. Reinstating the availability of "piggyback" financing to help serve businesses with larger borrowing needs.
5. Allowing $19 billion in 7(a) lending authority and $9 billion in 504 lending authority, up from last year's budget.
6. Applying additional SBA budget resources to better staff and support regional SBA offices.

The ICBA believes the growing demand for small business loans only validates the importance of ensuring a more robust Small Business Administration. Financing more small businesses in turn creates more jobs, and provides revenue back to the Federal Government.

In conclusion, the ICBA urges the SBA programs be allowed to work for as many interested lenders as possible, in many geographic areas, to best meet the needs of small business borrowers. Providing needed capital resources to small business through broad community bank participation in SBA lending will help strengthen economic growth and foster greater job creation.

ICBA sincerely appreciates this opportunity to testify today. Thank you very much.

[The prepared statement of Mr. Schroeder may be found in the Appendix, on page 38]

Chairwoman VELÁZQUEZ. Thank you, Mr. Schroeder.

Our next witness is Mr. David Bartram. he is the President of the SBA Division of U.S. Bank, a large banking institution that operates SBA lending centers in 24 states. Mr. Bartram is Chair of the National Association of Government Guaranteed Lenders, a trade association of approximately 700 lenders participating in the Small Business Administration's loan programs.

Welcome.

STATEMENT OF DAVID BARTRAM, CHAIR, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS (NAGGL)

Mr. BARTRAM. Thank you very much, Chairwoman Velázquez, Ranking Member Chabot, and Members of the Small Business Committee. My name is David Bartram, and I am the President of the SBA Division of U.S. Bank. Our division operates SBA lending centers in 24 states, and we are one the largest SBA lending partners. Last year, U.S. Bank provided $542 million in long-term SBA loans to over 4,700 firms nationwide. U.S. bank is a committed small business and has an ongoing, or an outstanding, SBA portfolio of approximately $1.6 billion.

Prior to joining U.S. Bank, I was the Chief Operating Officer of Bank of Commerce, where I worked for 15 years. This bank was a small community bank that specialized in SBA and 7(a) lending and 504 lending.

I'm also currently serving as the Chairman of the Board for the National Association of Government Guaranteed Lenders. This trade association has approximately $700 lenders, participating in the loan programs that comprise over 80 percent of the loans that are made through the programs. Our members include regional banks, non-bank lenders, large nationwide banks, certified development companies, credit unions, and small community banks, which comprise the largest membership.

We appreciate the opportunity to testify today on the effectiveness of the SBA loan programs. The SBA 7(a) and 504 programs fill a significant gap for small businesses that need access to long-term capital. In fact, 40 percent of all long-term capital provided to small business is done through the SBA loan programs. This means that SBA is the single largest producer of long-term capital to small businesses. While it is true that commercial banks make many small business loans, these conventional loans typically have maturities of three years or less, since short-term deposits fund commercial banks. Therefore, by bridging the credit gap, the SBA fills a critical need for small businesses, especially for start-up and early stage companies.

While the program has worked well, we believe they can be improved. NAGGL has proposed 7(a) program changes that we judge will increase access to capital, reduce costs to many small business borrowers, and improve the economics to retain and grow the number of lenders in the program. Our suggestions will be delivered to you next week, in the form of a legislative proposal, but they will include the following:

1. Increase the maximum 7(a) loan size to $3 million with a maximum guarantee of $2.25 million. Since 2002, the volume of loans of $250,000 or more has been generally flat. These larger loans pay

disproportionately higher fees, thus, subsidizing the costs of smaller loans. This is especially true for loans with guarantee portions over $1 million, since this fee is by far the largest of all fees charged to 7(a) borrowers. A request to increase the maximum loan size of $3 million is the most requested program change by our 700 members, particularly, small banks.

2. Allow the use of alternative size standard, currently sued in the 504 and the SBA program. This change will remove one more hurdle for lenders' participation in the program.

3. Allow 7(a) and 504 combination loan packages where a borrower could utilize the maximum guarantee amounts available under each program.

4. Allow the use of a rate index rather than "the lowest prime rate as published in the Wall Street Journal." This use of a longer-term rate index could lead to lower cost of borrowings for small businesses.

5. Allow the use of weighted average coupon loan pools for secondary market sales. This will allow the secondary market to become even more efficient.

6. Extend the prepayment penalties for loans with maturities of 15 years or longer to five years, as opposed to the current three year. The five year prepayment penalty would then be on a sliding scale of 5 percent in year one, to 1 percent in year five. The current prepayment fees are extremely high, and this proposed change could reduce fees for future SBA borrowers.

We believe these changes will increase the access to capital for many small businesses, and will also decrease the cost of the loan programs.

Many of our proposals should have a positive subsidy impact, meaning fees to the program could be reduced in the future. The SBA, under the new leadership of Administrator Preston, has appeared receptive to these suggestions.

Chairman Velázquez and Ranking Member Chabot, this concludes my comments, and thank you very much for the opportunity to testify today, and I'd certainly be glad to answer any questions.

[The prepared statement of Mr. Bartram may be found in the Appendix, on page 47]

Chairwoman VELÁZQUEZ. Thank you, Mr. Bartram.

Our next witness is Ms. Marilyn Landis. She's the Owner and President of Basic Business Concepts, Inc., a consulting and financial management company in Pittsburgh, Pennsylvania. Ms. Landis is the First Vice Chair of the National Small Business Association, a volunteer-led association that advocates on behalf of small businesses.

Welcome.

STATEMENT OF MARILYN LANDIS, NATIONAL SMALL BUSINESS ASSOCIATION (NSBA), SMALL BUSINESS OWNER

Ms. LANDIS. Thank you.

Good morning. My name is Marilyn Landis, and I'm please to be here on behalf of the National Small Business Association. I would first like to thank Chairwoman Velázquez for holding this very important hearing, and for being such a strong and outspoken advocate for increased access to capital opportunities for U.S. small businesses. I also would like to thank Ranking Member Chabot for his long-time support for entrepreneurs. The entrepreneurs of the National Small Business Association look forward to working with you on the House Small Business Committee.

I am proud to serve as the first Vice Chair for NSBA as we celebrate our 70th year of small business advocacy, and continue our longstanding tradition of working in a non-partisan manner to promote pro-small-business policies. In addition to my leadership role within NSBA, I am the owner of Basic business Concepts, a consulting and financial management company serving small businesses primarily in Pennsylvania and Ohio.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest SBA lenders in the country—marketing, originating and underwriting SBA loans—and have continued working with my clients on securing SBA loans as well as myriad other sources of capital. Small-business owners face many obstacles in trying to garner capital. Many small and start-up businesses lack the assets necessary for traditional bank loans. Smaller loans are generally less profitable for banks and typically have a higher default rate. The increased usage of personal credit ratings for business owners further exacerbates the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks, fewer character-based loans, and more difficulty for small-business owners.

One of the biggest barriers to small business financing is debt secured by equity and fixed assets. Many small business owners do not have the kind of equity required by banks to acquire a sizeable loan. This gap in debt equity financing primarily hinders both start-up businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership [if the entrepreneur owns a home] rarely meets the equity requirements for receiving a larger commercial loan. Small business owners seeking to expand his or her business, or hire additional employees, faces the same equity challenges.

Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan request. Rapidly growing businesses, like mine, that are not traditional brick and mortar, have neither. We are forced to use bank credit lines which, if not security with equity in a home, are increasingly credit card accounts. As such, these loans are subject to credit card regulations which permit significantly higher and more volatile rates and payment structures. Rapidly growing service and technology companies do not want to rely on credit card debt—they are forced to.

Additionally, too many banks rely solely on the personal credit score of the business owner, and neglect to evaluate the owner's business experience or the long-term viability of the business. Individuals with high credit scores and/or equity in a home can secure a loan, whereas an experienced entrepreneur may not. Lower credit scores may only reflect the presence of both personal and business debt on the business owner's credit report, not a poor credit history. We firmly believe that in time the unintended consequences of the over-reliance on credit scoring, and lack of emphasis on the actual viability of the business, will increase small business defaults by over-extending credit to the inexperienced and denying credit to viable functioning businesses.

NSBA also strongly supports efforts to allow small businesses to earn interest on their checking accounts, and SBA thanks Chairwoman Velázquez for introducing the Business Checking Fairness Act, and urges the Full Committee to support this important piece of legislation.

Banking practices that restricted access to capital were a key catalyst in the creation of the SBA's flagship 7(a) loan program. The goal under the generally accepted premise that small business growth is a good thing was to encourage greater lending to smaller, potentially riskier clients. As you can see, however, imperfections within the market still exist, and SBA loan programs are as important now as ever.

As everyone in this room can attest, the 7(a) loan program has had a bumpy ride over the past five years. The program has faced loan caps, a complete shutdown, and a zero budget. The 7(a) loan program is now running on a zero subsidy, which requires no appropriations but has led to higher increased fees on lenders and borrowers.

While some have argued that the zero subsidy and lack of appropriations has led to stability in the program, we would argue that stability and funding the 7(a) program are not mutually exclusive. Hindering the 7(a) program and placing the financial burden on small business owners, because Congress has been unable to enact appropriation measures, is simply unfair.

When the program first went to zero subsidy rate in 2005, lenders and borrowers were hit twice by increased fees. While the number of loans being made has steadily increased, both loan volume and loan size has decreased since the new subsidy rate went into effect.

Perhaps, the most worrisome numbers, however, are the number of banks involved in the 7(a) program. Higher fees are not only pushing business borrowers toward credit card reliance, they are driving banks out of the program. The number of lenders registered that actually made at least one loan between 2001 and 2005 has decreased dramatically, almost 50 percent. SBA Administrator Preston has stated that in keeping with the Agency's efforts to run a more efficient agency, the goal is to fold the Microloan program in with the 7(a) loan program and have small business development centers assume the technical assistance responsibilities currently provided through the Microloan program. We do not believe that this is in the best interest of the Microloan program or the aspiring entrepreneurs it strives to assist.

In conclusion, Congress must recognize that the majority of small businesses in today's economy are not fixed asset intensive, and should have the lead in ensuring that traditional financing practices do not restrict small business growth. NSBA urges Congress to examine the benefits of reforming the current limitations placed on banks in lending to small businesses, and fully supporting and funding existing SBA loan programs.

I thank you for your time, and welcome any questions you may have.

[The prepared statement of Ms. Landis may be found in the Appendix, on page 56]

Chairwoman VELÁZQUEZ. Thank you.

Now I recognize Mr. Chabot for the purpose of introducing his witness.

Mr. CHABOT. Thank you, Madam Chair.

I'd like to welcome Mike Schmitt from my district in Cincinnati, Ohio, where he is President of the Metalworking Group, which is in Corine Township. Mr. Schmitt's business, Metalworking Group, employs 70 people, and they do sheet metal fabrication, robotic welding, machining and other things.

He used the 504 loan to help finance the business which is now generating about $9 million in annual revenues. He's a graduate of the University of Notre Dame, with a B.S. in Mechanical Engineering, and he received his MBA from Xavier University, which is also in Cincinnati.

He's a member of the Tristate Tooling and Machining Association, and was President of that organization from 2001 to 2003, and we would all like to welcome you here this morning.

Mr. Schmitt, we look forward to your comments.

STATEMENT OF MICHAEL SCHMITT, PRESIDENT, METALWORKING GROUP INC., SMALL BUSINESS OWNER

Mr. SCHMITT. Thank you. Good morning.

I'd like to thank Chairperson Velázquez, Ranking Minority Member Chabot, and the entire Committee, for giving me the opportunity to provide remarks concerning the benefits small businesses receive using the SBA's 504 program.

Moreover, I would like to personally thank the leadership in the Committee for steadfastly championing small business issues, including those of the 504 program, and for introducing legislation that will improve the 504 loan program for future small business borrowers.

I purchased the Metalworking Group in 2000, after having worked there for ten years. A t that time, the company had approximately 70 employees with $9 million in annual revenues.

Our primary business is contract manufacturing focusing on sheet metal fabrication, robotic welding, machining, painting, and metal stamping. Our competitive advantage is the ability to offer our customers the most diverse range of manufacturing solutions in the Midwest. We serve many industries including medical, machine tools, consumer products, and defense.

In 2004, we needed to invest in the company to continue growth. The real estate lease under which we were operating was a burden to the cash flow and investment opportunities for the Metalworking Group. We needed to purchase capital equipment in order to continue our strategy of automating and offering our customers a high-tech solution to their manufacturing needs.

To maximize our potential, we contacted Horizon Development Corporation to explore the 504(a) SBA loan program. The Economic Development Office of our locality, with whom we initiated a relationship regarding a tax abatement program in 1999, recommended Horizon CDC. The 504 loan program was the most attractive way for Metalworking Group to free up resources and allow us to invest in our future. We were able to save significant dollars, which could then be used towards the purchase of new equipment such as laser cutters, robotic welders, and CNC machining centers.

The assistance Horizon provided in obtaining the 504(a) funding was professional and invaluable. Although the 504(a) was not the only financing in which we participated, it was the catalyst for all future investments because it allowed us to save valuable cash reserves.

The 504(a) loan is critical to companies like Metalworking for a number of reasons. First of all, the loan structure requires the participating banks to offer favorable terms in the loan package, such as the length of amortization. For planning purposes, it is especially helpful to have a long and uniform payout schedule. Secondly, the program offers a better interest rate due to the participation of the SBA.

Metalworking Group was able to put less money down for the transaction. This saved us at least $130,000 of cash reserves. Another benefit to the borrowers is that the loan structure, at 20 years fixed interest, required the participating banks to conform to the same structure. Without that, we would have had a significant interest rate risk in as little as five years.

With the favorable financing we were able to obtain through our 504 loan, Metalworking Group has experienced some success. Today, we currently have 150 employees and we have doubled our annual revenues to nearly $18 million.

Horizon is an integral part in bringing these loans to fruition. They have the incentive to help businesses and educate clients on the availability of these programs. Banks are certainly willing to participate in these loans, but I feel they would prefer conventional lending in order to control the terms and rates.

Horizon provided important and specific professional help throughout the loan process. Without Horizon, we would have been hard pressed to obtain these loans. Since these programs are not our expertise, the services Horizon offered were indispensable. Negotiating the legalities and conditions with the banks would have been nearly insurmountable without their help. Without this assistance, we would not have access to capital available to larger companies.

Horizon CDC was able to provide the 504 loan at an extraordinarily low cost to our company. The beneficiaries of this low cost are not only our company, but include our many new employees, other companies with whom we conduct business, and as a result, the local area and community as a whole.

I also want to stress that Horizon CDC played a critical role in balancing the interests of our company, the SBA and the bank. Horizon provided assistance at every level of the project—offering advice, support and expertise critical to our success. Horizon has also helped other small businesses obtain 504 financing; they have approved over $229 million in financing to over 900 small businesses that have generated over 8,000 jobs since they were formed in 1982.

In short, having Horizon as our advocate in the project, having them provide optimally structured 504 financing at the lowest possible cost and in a professional and expeditious manner, was critical to maximizing the benefit to our company and our community.

In conclusion, I understand that through 504, SBA provides the largest and most successful small business economic development financing program the Federal Government has today. I hope I have shed some light on its real value to small businesses and to the American economy. Its significance reaches far beyond the statistics of numbers and dollars of lending done each yea; the jobs and community development alone helps to create and the business growth it fosters, the benefits to our employees and their families, and, ultimately, our community, are all a result of the 504 loan program. from a small business perspective, 504 and CDCs are a critical component in securing reasonable financing for growing small businesses in America. I know that without the staff at Horizon CDC, we would not be as successful as we are today—we would not have created as many new jobs or accomplished as much for our company or our community.

Many people are fond of saying that "small business is the engine that drives the United States economy," an idea in which I deeply believe. With your continued support and hopefully legislation for the enhancement of the 504 program, this will sure continue to be the case.

Again, I thank the Leadership, Committee Members and Committee staff for its tireless work in support of SBA and the 504 program. I am available for any questions you might have. Thank you.

[The prepared statement of Mr. Schmitt may be found in the Appendix, on page 65]

Chairwoman VELÁZQUEZ. Thank you, Mr. Schmitt.

Ms. Tasker, I listened to your testimony quite carefully, and, basically, you talked to us and gave an overview of the same information that Administrator Steven Preston gave to us when he appeared before this Committee. And, I was struck by the fact that in all of your testimony there is not a single recommendation to improve the SBA's business finance program.

Clearly, small businesses have a lot of needs out there, as you listened to the rest of the testimony provided by the witnesses here. The Agency ranks among the lowest on consumer satisfaction, so I believe that there is room for improvement.

So given that, why haven't you come up today with any recommendations as to how can we improve the business loan programs?

Ms. TASKER. Congresswoman Velázquez, we are continually working to improve our business loan programs, both in terms of the way we offer our services. It's at the cornerstone of Administrator Preston's reform. He wants us to be customer centric, transparent, and outcome focused, and all of our efforts are really designed to make improvements in those areas.

Chairwoman VELÁZQUEZ. Can you tell me how you are going address the fact that lenders participation is down, loan volume down 3 percent for the first time in four years, fees are at an all-time high, consumer satisfaction was ranked among the lowest in the Federal Government?

Ms. TASKER. Let me just speak to a couple of those points. In terms of less lenders being involved in our programs, if you are relying on some of the data that we provided you, the way we count the number of lenders in our programs we've adjusted. Before we counted all of our — all of the various branches, so one large national lender might be counted 35 times, if they had a presence in 35 different states. We've tried to consolidate it so we can understand exactly who our lenders are, and so that is part of the result of it.

Part of it is the result of just the general consolidation in banking itself. So, we believe that we are reaching more small businesses every day and every year, so we don't really see it as an issue, in terms of the banks' participation.

That said, we do significant outreach through our district offices to bring in, particularly, the smaller local community banks, and we do a lot of work in terms of training them and bringing them up to speed.

Chairwoman VELÁZQUEZ. Well, maybe it might not be the outreach the answer, but maybe it might be a recommendation as to how to address legislatively, maybe?

My next question to you, I want to ask you about one proposal to increase the maximum limit on the 7(a) loans beyond the current $2 million limit. Based upon trends that the Agency has observed in the 7(a) program, do you believe there is adequate demand from borrowers to justify the increasing of the maximum loan size beyond the current limit?

Ms. TASKER. Congresswoman Velázquez, we haven't evaluated the demand for that since we don't offer loans in that area. We certainly know that lenders are interested in increasing their loan size to $3 million.

Chairwoman VELÁZQUEZ. Do you think that the proposal is a good idea?

Ms. TASKER. We would have to evaluate it, we don't have enough experience with that. Our real issue would be around, one, making sure we are serving—truly serving small businesses, and, two, what the impact on the subsidy rate would be.

Chairwoman VELÁZQUEZ. Well, we have been talking about this for the last two years, and you still have time to evaluate it?

Ms. TASKER. we haven't made any loans in that range, so we can't — we don't know what the performance would be, Congresswoman.

Chairwoman VELÁZQUEZ. Mr. Bartram, most of your proposals seem to be on initiatives that are focused on mostly high-volume 7(a) lenders. What in your proposal will help the small lender?

Mr. BARTRAM. Well, if you go to the first proposal, and small banks would certainly benefit, I believe, more from this, and is being asked by our small bank membership for this, is the larger loan size.

A small bank, small community bank, has issues with legal lending limits, has liquidity issues, and being able to have a larger SBA 7(a) loan with a guarantee that that small lender could sell into the secondary market, would, basically, allow them to help a larger customer need and would also allow them to get the liquidity back through the sale in a secondary market.

Our second proposal, the alternative size standard, presently there's about 38 different size standards that a lender has to go through to calculate if a business is deemed to be small. The 504 program and the SBIC program have a net worth and a net profit test. This would be much simpler for all lenders to use. It will also allow those customers that get a 504 loan may now be eligible to get a 7(a) loan.

Chairwoman VELÁZQUEZ. Mr. Schroeder, you heard NAGGL's legislative proposal, do you think that it is something that you, as the small banker, can use?

Mr. SCHROEDER. Quite honestly, Congresswoman, we are interested in having an SBA program that has a wide variety of programs that can meet a number of different small business needs. There is definitely not a one-size-fits-all program that is going to satisfy, not only all of the different bankers' needs, but all of the different lender needs.

So, the greatest variety of programs is something that we would be looking for, not only for our bank, but also for our association.

Chairwoman VELÁZQUEZ. Well, do you think that the legislative proposal is a one-size-fits-all?

Mr. SCHROEDER. I believe that the SBA is gravitating towards a one-size-fits-all program. So, yes.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Bartram, in your view, what is the role for the small non-PLP lender, who makes only a handful of loans in the program? Would you support initiatives that encourage small lender participation, even if it has a positive impact on the subsidy rate?

Mr. BARTRAM. Well, presently, the SBA is consolidating out of the district offices into a one centralized processing center for non-PLP loans. Basically, it gives the benefits that the LowDoc program gave prior, and, in fact, the center is in Hazard, kentucky, where the LowDoc center was.

So, the smaller lender will have a more consistent processing time, will be able to get much more expertise to guide them through that process, so I think that the smaller lender that does five loans or less will be served under this new process.

Chairwoman VELÁZQUEZ. Sir, do you think that centralizing is a good idea?

Mr. SCHROEDER. It's been our experience in the lending community that the further away the decision makers are from the community and from the actual situations, the more difficult it is to get a quick decision and a decision that's most appropriate for the bank, as well as the borrower.

I would, as a result, caution and have some concerns with the consolidation of the offices in small areas, or, I'm sorry, into larger offices in, you know, just a single geographic region of the country.

It's been our experience that having a regional office is positive, because you have someone there that knows the area, knows your community, and you can have a greater, to me, have greater impact in getting a positive decision.

Chairwoman VELÁZQUEZ. Mr. Schroeder, we have heard the arguments that higher loans fees have actually benefitted the program, and that this is reflected in the 7(a) program's increased lending volume since moving to this zero subsidy rate. My concern, however, is that by focusing on volume we are missing the true intent of the program, to help those who cannot otherwise secure capital. With higher fees, do you think that some of the deserving borrowers are being pushed from the program in favor or borrowers that the program was not originally intended to serve?

Mr. SCHROEDER. Definitely. I think it is clear and irrefutable that the number of SBA loans are up, the number of dollars are up. It's also clear, however, that the number of lenders are down, and community banks are, in terms of active participants, in other words, one SBA loan or greater, is half of what it was several years ago. And, as I mentioned in my testimony, this is a very disturbing trend for us.

I think two things happen at this—and have happened as a result of the fee increases. First, on the lender side, second on the borrower side. On the borrower side, I think what you said is correct, I think that the lenders—sorry, the borrowers that are at the margin just, you know, perhaps, you know, just qualifying for an SBA loan, are the ones that are not going to be granted those loans, or be able to afford those loans because of the higher fees.

I think also, looking on the bank side, when you have higher lender fees some of the banks that do not make a number of SBA loans, that haven't made a real solid commitment to the program, but may want to do one, two, five, ten a year, these lenders, as a result of the higher fees, are dropping out of the program, and I think the numbers speak for themselves.

So, I think it's really a two-fold impact on the borrower, as well as on the banks.

Chairwoman VELÁZQUEZ. Thank you, Mr. schroeder, and I recognize the Ranking Minority.

Mr. CHABOT. Thank you, Chair.

Let me start out with Mr. Schmitt, if I can. Mr. Schmitt, would you discuss, I know a lot of small business nowadays struggle with being competitive with some of our overseas competitors, and there's an emphasis on modernizing, and actually being able to compete, or, perhaps, the pay rates are lower, perhaps, in other countries. Could you tell us, how did this enter into your ability to be more competitive and modernize your business, how did that play into that?

Mr. SCHMITT. That's a great issue, something we face every day. You know, we lose parts to overseas competitors on a regular basis, but they tend to be lower-tech parts and higher volume. And, the way for small manufacturers to stay competitive, and to increase their business, is to do higher precision work, to invest in technology, to automate so, you know, you are hiring higher-skilled people, but less of them, but with the ability to do, you know, computer-controlled machinery.

So, one of the things that we needed to do when we decided to try to grow and try to invest in the company, is to free up capital and money so we could buy that type of equipment, in order to compete, you know, in order to be more efficient and be able to produce more parts per hour, versus somebody who is not doing it as competitively.

So, that's what drove, you know, our decision to use a 504 program and to use lower-cost capital, and to free up money to invest in automation, because you have to, I mean, because, you know, we are fighting that every day.

Mr. CHABOT. So, having access to the 504 loan was important and enabled you, among other things, to increase your employees from 70 up to 115, was it?

Mr. SCHMITT. One hundred fifty.

Mr. CHABOT. One hundred fifty employees.

Mr. SCHMITT. Yes, absolutely. You know, we saved substantial money on the down payment, you know, in the loan. We saved—not only do we have a good interest rate, but our lease payment was so much higher than our mortgage payment. We saved a tremendous amount of money for that, which we rolled over into equipment purchases for some of the high-tech laser cutting equipment from Cincian, Incorporated, also, you know, right in Cincinnati.

Mr. CHABOT. Thank you very much.

Ms. Tasker, let me move to you next, if I can.

Several of the witnesses on the panel stated that the move to zero subsidy is causing some problems, most notably higher costs for lenders and borrowers, and fewer lenders participating in the program.

I'm sure that you've heard these concerns before. Could you explain in greater detail as to why moving to a zero subsidy system is a positive move for the future of the SBA?

Ms. TASKER. Certainly, Congressman.

We believe the zero subsidy definitely provides stability to the market, and allows us to have an uninterrupted stream of capital available for loans to small businesses.

When we are subject to appropriations, and appropriations are, you know, held up over time for a variety of reasons, we are faced frequently with having to place caps on the program, or even shutting the program down if we don't have appropriations to allow us to reach the level of lending that there's demand for in the market.

With regard to fees, I am somewhat confused, because from our perspective, and the numbers that we look at, the fees are really, basically, at the same level that they were ten years ago. There was a period during 2003 and 2004 where the fees were reduced by Congress, but if you take that anomaly out we are really at a very stable level in terms of fees, and, in fact, our proposal for Fiscal Year '08 is to reduce the ongoing fee.

Mr. CHABOT. Okay, thank you very much.

Mr. Schroeder, if I could turn to you next.

What, specifically, can be done to increase lender participation in the SBA programs?

Mr. SCHROEDER. One specific thing that can be done is to reinstate the LowDoc program. You know, I'm very familiar with the letter that this Committee, as well as your Senate counterpart, sent to the SBA back in June of '05, regarding not considering, not terminating the LowDoc program, which was terminated.

Our bank participated in the LowDoc program. I don't recall any losses or delinquencies that we had with that program, and, quite honestly, we genuinely miss that program.

And, I would like to make the following point, and I reiterate this point, it's critical to have a variety of programs to meet the needs, the individual needs, of businesses. There is no one program that you can sits well for every single borrower. You really need a basket of products and services, and be able to choose from among those to best meet the needs of each individual borrower.

So, really, no one financial structure works well for every borrower, and there's really no one size fits all.

So, the LowDoc program would be one that we would like to see reinstated.

Mr. CHABOT. Thank you.

Mr. Bartram, of the borrowers from USA Bank, under the guaranteed loan programs, what's the typical reason that they would not have qualified for a commercial loan from the USA Bank, your bank?

Mr. BARTRAM. Well, from US Bank, our experience, and if we can kind of separate the kind of requests that we would see, we have an SBA Express Program that we utilize quite a bit, and so a customer would come in, and usually these are for the smaller loan requests, they would ask for $50,000, let's say, on a conventional loan, and these are credit scored types of requests, so they may not meet certain credit scored criteria. So, we could shift them into the SBA program.

For other SBA loans, it's, typically, because the company is either a start-up or is a younger company, maybe less than five years old, where it doesn't have the proven track record of cash flow for us to make a conventional loan. So, that customer could go into the SBA program.

And lastly, it might be that the company, like Mr. Schmitt here, where they are looking to buy a long-term asset, commercial real estate, large piece of equipment, the SBA program affords us to provide longer terms. So, the company could save the cash flow to hire more people, let's say.

So, those are the typical reasons and why we use a program.

Mr. CHABOT. Thank you.

And finally, Ms. Landis, you brought up the need for greater transparency in small business credit scoring and/or loan approval requirements. Could you give us an example as to what, specifically, is lacking in this regard?

Ms. LANDIS. Sure. What happens with the business of the credit scoring the way it has evolved to today, is only 30 to 35 percent of the credit score is based on actual payment history. The rest of it is based on how much credit is outstanding.

These are things that I have learned in working in industry and being around it, the type of that credit, how new it is, think about the typical business owner, my business credit score, for example, because I personally signed for all my credit my business credit that's grown my company rapidly, my personal credit resides on the same credit report, my business is six years old, so my credit is relatively new, because I am service provider without the hard assets to be able to borrow against, much of that tends to be credit card type debt. So, that brings my credit score down.

I know this clearly, because I'm in the industry. Many SBA lenders do a first pass on the lending using their credit score, and in some cases they don't give them an alternative if they fall below the credit score, they simply don't get the financing.

Most of the public is unaware of that. The credit scoring process does not distinguish between personal and business debt, and it puts us at a disadvantage.

Mr. CHABOT. Okay, thank you very much.

I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Sure, thank you, Mr. Chabot.

Before I recognize Mr. Sestak, Ms. Tasker, you said that you were confused regarding the fact that the levels of the fees today are as high as they were ten years ago. Well, I'm not confused, because I know why, the fact that they were too high ten years ago, and that they are too high today.

You know why they were reduced, because they were too high.

Ms. TASKER. My point, Congresswoman, was that people are talking about fee—significant fee increases, and from other than where the fees were reduced by Congress for that two-year period, they are at a stable level, and that was the point I was trying to make.

Chairwoman VELÁZQUEZ. They were reduced because they were too high, this is why we reduced the fees.

Mr. Sestak, you are recognized for five years—for five minutes.

Mr. SESTAK. I went over time last time.

Thank you, Madam Chairwoman.

I hope I am not asking a question, and I'm sorry I had to step out and missed some of the testimony, which I did go over, I am curious about the trends, and, ma'am, if I might, Ms. Tasker, what's the profile now of the lenders? Has it changed since 7(a) has moved to a zero subsidy program?

Ms. TASKER. I don't want to speak incorrectly, and I haven't actually looked at the number, you know, compared based on the zero subsidy.

I do know that our portfolio operates, you know, generally, around the 80/20 rule, and it has consistently, which means that about 20 percent of our lenders generate close to, you know, 80 percent of our volume, but that means we've got several thousand lenders that are doing businesses in their local communities.

Mr. SESTAK. Do you know if the profile of the borrowers has changed, since we went to zero subsidies?

In short, I'm curious, have there been changes in the communities that are being served? Are we missing what we should be getting to, not how much? What's inside whatever how much is? What's the profile on the borrowers?

And, if you don't know, is it possible to find it and get back?

Ms. TASKER. We can certainly give you some additional information. We do know that the loan size has gone down significantly over the last several years, and the average loan size is about $140,000, which means we are reaching more small businesses. We know we are actually seeing increases in certain areas.

Mr. SESTAK. Does your data—can you better assess, are you able to with your database, because I'm really taken with data and modeling, are you able to figure out, you know, the profiles and what types of small businesses at all, if this has any implications, as compared to '04, '03?

Let me just ask, if you could—if anyone could get back on that and the 504 lenders, the same type of profile that might have been impacted, is there any changes in trends that might be, you know, how do we compare the snapshot back then with the trends now?

Ms. TASKER. We can get you, perhaps, not everything you would like, but we can look at the data that we have, and we can certainly give you industry, you know, types of loans, and geography.

Mr. SESTAK. The other question I had was the LowDoc program, as we discontinued it, you know, we used to give access to $150,000 for a shorter period of time and less, and I think we've moved—I think that guaranteed 80 percent, correct?

Ms. TASKER. It depended on the size of the loan. I mean, it was an 85 percent guarantee after—

Mr. SESTAK. Have there been any implications of moving to SBA Express, where we are only guaranteeing 50 percent, and that's by the private lender, isn't it, or is it still by—it's primarily run privately now, correct? I mean, there's kind of been a shift, right, from LowDoc to SBA Express.

And, I'm curious again, are there any ramifications. or any profiles, or trends, having made this fairly dramatic shift, I would think?

Ms. TASKER. We have seen a significant increase in our SBA Express program. It is, all of our loan programs are delivered by our lenders and funded by our lenders. We guarantee the loan. For the SBA Express program, it is a 50 percent guarantee, not the typical 75 percent guarantee for our program.

LowDoc itself, though, did not perform well for us, and as we indicated, and that actually was a centralized program, too, it was centralized in Kentucky and in Sacramento.

Mr. SESTAK. And performing well means?

Ms. TASKER. We had a high level of defaults, and it affected our performance of the portfolio overall.

We are centralizing as has been stated. We will have centers again in Sacramento and in Hazard, Kentucky, where we believe that a lot—and we are looking for a more streamline process for smaller loans, which would be consistent with LowDoc, we just need to put more controls around it.

Mr. SESTAK. The reason I'm curious is, my district, and it's adjacent to Philadelphia International Airport, 85 percent of—we lost 607 small business in three years, one out of five manufacturing establishments. I'm very curious about, I've watched what's happened over the years with SBA's programs, if there's any data to indicate, you know, who is being impacted, some might say harmed. But, I think the focus has to be that we shifted something as we moved loan making and administrative processes to private commercial partners, I can't believe we are just straight sticking this profile out, and there must be something in there to show, is SBA really doing what—you know, focusing upon who it should be focusing upon, as you've made this shift, at least my understanding of the shift over the last few years. Is that all right?

Ms. TASKER. We can certainly try to get you some information, and you may want to follow up to make sure we get you what you are looking for.

But, lenders have been delivering our programs for 15 years, there hasn't been a shift recently.

Mr. SESTAK. Right, but we've shifted, you know, the subsidies, I mean, some of that cost is now being borne by others than it was before, am I correct?

Ms. TASKER. We went to a zero subsidy program in 2005.

Mr. SESTAK. Yes.

Ms. TASKER. And—

Mr. SESTAK. There may be no correlation, but I'm just trying to get a grip, why 607 small businesses, the national level of education is higher than—the level of education in my district is above the national median for number of high school graduates and college graduates, yet, 607 small businesses disappeared.

I'm sure there's no correlation, but I'd sure like to see if there was, you know, what the profile is, and thank you very much.

Sir?

Mr. SCHROEDER. Congressman, if I could just dovetail off of— onto your comments. I think the observations that you made are, you know, very, very correct. There is a concentration—there's a concentration in the larger banks doing a much greater percentage of the SBA loans.

There's also a trend in terms of community banks not participating in the programs, and dropping out of the program, and there is also a trend in having a smaller dollar size, average dollar size, of the SBA loans.

I think our bank is a little bit different, our community bank is a little bit different. We tend to do a smaller number of larger SBA loans, and in addition to that, in terms of marketing, I think we market our programs a little bit different, perhaps, than some other banks. We take a more traditional approach. We mine our opportunities through more traditional sources, attorneys, accountants.

Mr. SESTAK. Right.

Mr. SCHROEDER. CPAs, insurance professionals.

Chairwoman VELÁZQUEZ. Time.

Mr. SESTAK. Sir, I am out of my time. But, the reason I am curious is, I've watched in Head Start, as they want to take these programs, and large non-profits come in, and the little local communities—no longer are able to focus and be, not just advise, but focus, and I'm curious if that's happening as bigger banks come in over smaller banks. Don't know, but that's the trend.

Sorry.

Chairwoman VELÁZQUEZ. Thank you.

Mr. SESTAK. Thank you very much.

Chairwoman VELÁZQUEZ. Thank you, your time is expired.

Mr. Fortenberry.

Mr. FORTENBERRY. Thank you, Madam Chair.

Thank you all for appearing today.

I have a smaller or more minor issue, Ms. Tasker, I'll get to after discussion of the larger issue here. Some of this ground has already been covered, but I think it's worth repeating.

The underlying tension in the hearing is, the good news is we have more loans and a larger loan portfolio. Your concern, Mr. Schroeder, about increased concentration, though, in the industry.

And, I would like, let's unpack that. You've done a good job unpacking it from your perspective, and what are some of the potential causes.

Mr. Bartram, perhaps, you can address that issue, given that you seem to be one of the beneficiaries, given your larger loan portfolio size, or your larger dealings with the SBA. Is this a result of economies of scale, efficiencies that are leading to, again, increased loans in the market, increased opportunities? How do you balance that with Mr. Schroeder's concern that we do have an obligation to ensure that the more participants, or the more banks, or other potential lenders that participate, will provide more access to larger numbers of people?

If both of you would address that, I'd appreciate it.

Mr. BARTRAM. Certainly, I would appreciate that.

There are really two reasons, I think, for that. First of all, the SBA Express program, which provides a 50 percent SBA guarantee, and the tradeoff for that is that the lender gets to use their own processes and their own loan documentation, so they can do it in a very efficient manner, and they can dovetail that in with their conventional process.

And, because of the larger banks have a lot larger flow of credit requests, they have done a very good job, US Bank being one, of utilizing the SBA Express programs, and those, typically, are very small loans. The average size of our SBA Express loan is $33,000. These are made to customers that we wouldn't have serviced before, because it acts as a default program. So, we pick up a client that we would have, absent the SBA Express product, not served.

So, the growth in units in the SBA is attributable to the SBA Express program, and because, as I mentioned, larger banks have utilized this program, and that's why if you look at the top ten SBA lender in units today it is comprised mostly of large banks. Ten years ago it was non-bank lenders and community banks.

The second issue is that some time during the 1990s, and I was the Chief Operating Officer of a small community bank, big banks made the decision that small business lending was profitable venture to get into. And so, many of the large banks really did focus on small business lending.

We used to get our transactions, when I was a community banker, from the larger banks that didn't want to provide a half million dollar credit to a customer, because it was too small for them to deal with. Today, big banks want that business. So, the bigger banks are doing a very good job in servicing small business clients. So that, too, has impacted that shift.

Mr. FORTENBERRY. Can I interrupt you one moment? Do you have agreements with smaller banks, even community banks, to act as, in a certain sense, retail brokers, the storefront that allows you to pass through, or allows them to pass through loans to you?

Mr. BARTRAM. We certainly do. We are the sixth largest bank in the country, and we do correspondent banking, providing other services for small community banks, and one that we also provide is that if you have an SBA loan, and you don't want to do it, we can go ahead and do it, and we can then go ahead and compensate you for that. The deposits and other services would stay with that bank.

Mr. FORTENBERRY. Thank you. Time is limited, thank you.

Mr. SCHROEDER. Again, I can only speak to my experience in our community bank, and we really mine our SBA lending opportunities, as I mentioned before, through more traditional sources, professionals, financial consultants, attorneys, CPAs and the like.

Once we've identified those opportunities, we do a thorough job of underwriting those potential opportunities, if they are approved fund them, and that's—you know, that's really the way we have developed in terms of our own bank.

Mr. FORTENBERRY. Thank you.

And, Ms. Tasker, I need more information on the New Markets Tax Credit Pilot Program.

Ms. TASKER. What kind of information are you looking for?

Mr. FORTENBERRY. Well, who is going—where is it going to be piloted, and who, primarily, is it going to be targeted to, or give me some examples of where it has worked. I've heard of a circumstance in Milwaukee.

This is just a request to your agency, you can work—you can get back to our staff.

Ms. TASKER. All right. Thank you.

Mr. FORTENBERRY. Thank you.

Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Altmire.

Mr. ALTMIRE. Thank you, Madam Chair, and I want to say hello especially to my constituent, Marilyn Landis, who has been a friend for a long time, and an advocate for small business, and a champion to small business. Welcome today, and thanks to the rest of the panel.

I'm Chairman of the Oversight and Investigations Subcommittee, so I have an oversight-related question, that in order to keep costs low under the 504 program, it's vital that defaulted loans be properly liquidated. In many cases, when a 504 program borrower defaults, it's the SBA that takes the required liquidation and foreclosure actions.

So, how, aggressively, has the agency pursued liquidation and stemmed losses on defaulted 504 loans?

Whoever is most appropriate to answer.

Ms. TASKER. I will take a shot at it, Congressman.

We have, our liquidations are centralized. We issued, right now, and handled—not centralized, but handled through SBA, and we work with the CDC locally to liquidate the loans, we issued a proposed regulation to allow the CDCs to do more of the liquidation, and we hope to have that completed shortly.

But, generally, we believe that liquidations are effective. The losses in the program are insignificant, and resulting in, fees today are really at a record level, and, you know, fees, really, are driven by the defaults in the program.

Mr. ALTMIRE. How many personnel work, and are currently at work, liquidating defaulted 504 loans?

Ms. TASKER. I would have to get you that number, I'm sorry, I don't have it here.

Mr. ALTMIRE. But, do you feel confident that these are folks who are trained and have the experience necessary, and committed to that task?

Ms. TASKER. Yes. We have been in the process of centralizing that away from the district offices, although we are still going to use local counsel in that area, and so, as we are centralizing we are making sure that we have talented and experienced people working on that, and those that are being trained, you know, at a less experienced level are partnered with people that have experience, so that we ensure an effective job is done.

Mr. ALTMIRE. Thank you.

Second question. Lending in the 504 program is expected to increase this year, but the SBA has not proposed to increase the program level funding from the amount that was requested for FY '07. What is the SBA's management plan to process the significant increase in 504 loans?

Ms. TASKER. We believe that the $7.5 billion that we proposed is adequate for this year. We didn't reach that level last year, so we believe we are in good standing. We do track it year to day, and we are consistent with last year.

Mr. ALTMIRE. Do you expect in future years there will be any added employees to process, or do you think that the level is sufficient?

Ms. TASKER. Certainly staffing has to be driven by production metrics, and if production increased we would have to accommodate it through either improved processes and/or increased staffing, depending on the best way to approach it.

Mr. ALTMIRE. Great, thank you.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Schroeder, today over 60 million Americans live in a community that has been designated with a shortage of health professionals. If the 7(a) program were adapted to provide loans to medical professionals, located in under-served areas, what would be necessary to encourage more lenders to market these loans?

Mr. SCHROEDER. I think, certainly, a mission of the SBA is to identify areas where their programs can address the needs of the communities. If this is identified as a legitimate need within either a community, group of communities, or geographic area, as far as I'm concerned they should have the available programs to be able to serve those needs. And, that would include, certainly, what you have said in terms of SBA loans related to the health care professionals.

Chairwoman VELÁZQUEZ. Thank you.

Last year, on a bipartisan basis, Mr. Schroeder, many members of the Small Business Committee urged the Small Business Administration to preserve the LowDoc program. We have heard various arguments as to why the program was eliminated, but there has been little analysis conducted by the SBA to support elimination of the program.

What are your observations on the reasons why LowDoc program was terminated?

Mr. SCHROEDER. Again, I don't have specific inside knowledge, you know, from within the SBA, as to why those—why that program was terminated.

My feeling, however, is that the LowDoc program would be best suited for banks that do a smaller number of SBA transactions, and those, you know, may very well be in smaller communities, in rural communities.

And, I believe by preserving or reinstating that program, we would legitimately increase the number of banks, particularly, the smaller banks and banks that don't do large volumes of SBA loans to get back into the program, which I think is really a stated intent of the SBA.

Chairwoman VELÁZQUEZ. Ms. Tasker, I would like for you to submit in writing the matrix that you used to conclude that the program was too costly.

Ms. TASKER. Yes, ma'am.

Chairwoman VELÁZQUEZ. Ms. Bean, you will be recognized for five minutes. Are you ready? I'm sorry, no, let me go to Mr. Chabot first.

Mr. CHABOT. Thank you, unless Ms. Bean would like to go, I just have a couple of quick questions.

Okay, thank you.

Very quick questions, relative—I think Mr. Larson raised the issue about liquidation rates, I think we only get back about .20 cents on a dollar, if I'm not mistaken, which is pretty low rate. And, it's my understanding that it's being looked into, kind of a better alternative. Perhaps, allow the certified development companies, either by themselves or through the retention of liquidation experts, to liquidate their own loans, and, hopefully, this would increase returns, thereby reducing the subsidy costs and the fees that lenders and borrowers must pay to maintain the zero subsidy rate in the program.

Is that accurate, Ms. Tasker? Is that my understanding of what's being considered, or could you shed any light on that?

Ms. TASKER. Yes, Congressman.

As I indicated, we actually issued proposed regulations last fiscal year that would allow the community development companies to liquidate their own loans, under certain conditions that indicate, you know, the qualifications to do so.

We anticipate issuing that guidance that would give them that opportunity.

Mr. CHABOT. And, I assume you would agree that .20 cents on a dollar is something that certainly needs to be improved upon, and that's what the goal of this is.

Ms. TASKER. Yes, although I would need to verify for you that that's an accurate number.

Mr. CHABOT. Okay.

Ms. TASKER. I do just want to point out that in the 504 program we eliminated the up-front fee in the Fiscal Year '08 budget, and then the annual ongoing fee increased slightly from, what, .018 percent to .021 percent, which is really to accommodate some of the fee we would need by eliminating the entire up-front fee. So, it's a very, very low fee, which indicates it's a good performing portfolio, and that we haven't had significant losses.

Mr. CHABOT. And then one other point I just wanted to make, if you could clarify, there's been, you know, considerable discussion here this morning, and this has been an ongoing issue, and I think it's important for us to address the issue, and that's relative to the rates which were at one level, and then for a couple years went to a lower level, and now they are back up to where they were initially, etcetera.

The two years that they were lower, my understanding is, is that had to do with a challenging economy, and a recession or whatever, and that was the reason for lowering them until we could kind of kick start the economy, get it moving again, and you are back up at something that over time, when you are dealing with budgets and how much money you are going to spend in all areas, this is one that's factored into that.

Is what I said accurate, and do you want to expound upon that in some manner?

Ms. TASKER. No, that's correct, and again, the fees are at the same level, the issue really is now whether or not, you know, who is paying for it, the person that's getting the benefit by virtue of the loan, as opposed to the taxpayer.

Mr. CHABOT. All right, thank you very much.

Chairwoman VELÁZQUEZ. Ms. Bean?

Ms. BEAN. Madam Chairwoman, thank you for recognizing me. I do apologize to all here for not being here earlier. We had a financial services mark-up that I was in, and I do apologize, but glad to see you all here. Thank you for your advocacy of the small business community and for helping them grow, by providing access to capital.

I also want to acknowledge Mr. Schroeder, who is from Illinois, and right near my district, and maybe I'll direct this question to him, as being in the community banking business, one of the issues that's been very important to me is the 7(a) loan program, particularly, that the fees continue to be going up, and that becomes, not only unhelpful to the borrowers, but to the lenders themselves.

Can you speak to how important it is to you to see those fees be reduced, to give you the flexibility to use some of the funding so that you can keep those fees reduced?

Mr. SCHROEDER. Definitely. Again, from our perspective, the increase in fees have had several undesirable results within the SBA loan programs.

Obviously, when you increase fees something has to give, and as we have discussed in our testimony, written testimony, as well as the oral testimony, really, I think two things have happened.

I think there's been, as a result, a reduction in the number of lenders that are active in the program, particularly, community bank lenders, and in terms of the borrowers, particularly, the borrowers at the margins, I think are the ones that are suffering the most as a result of these fee increases.

So, we would certainly encourage the SBA To roll those back, to make them as reasonable as possible.

Ms. BEAN. Well, I'm glad to hear you confirm that. I know Ranking Member Chabot and I are working on some legislation to address that and provide for that flexibility. But, your real-world perspective I think helps support our understanding of what we've been hearing from our districts. I know my district has really benefitted from the 7(a) program. There are a number of folks across all three counties that I represent in Cook, Lake and McHenry, who have been able to grow.

Some people think of the loans as the sort of incubator for new businesses. What I've seen more of is, as people are ready to take on that next plant and expand into new services or new products, that loan funding makes all the difference to allow them to continue to grow their business, which certainly has a very positive effect on our economy in terms of jobs, but also for those smaller businesses around them that are part of their supply chain in their growth model.

And so, I'm going to continue to support that.

And, I yield back.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Chabot?

Okay, well, let me take this opportunity again to thank all the witnesses for the insightful information that you have provided us, and the type of concerns and issues that have been addressed throughout the hearing.

And, let me just say that in the next week or so we'll be moving legislation that will address, and will take seriously, some of the issues and concerns that have been raised this morning.

I will ask unanimous consent for any statement that wanted to be submitted to the record be submitted, and I want to, for the record to reflect that this hearing is adjourned.

Thank you.

[The hearing was adjourned at 11:32 a.m.]

STATEMENT
of the
Honorable Nydia M. Velázquez, Chair
House Committee on Small Business
Access to Capital
10AM, March 1st, 2007

Let me start off by thanking everyone for being here today.

While small businesses are the country's economic drivers and job creators, accessing the capital they need to successfully grow a business is always challenging. As most of us know, many entrepreneurs just starting a firm cannot qualify for traditional bank loans and rely heavily on borrowed money from friends and family or credit cards.

In the past, this is where the SBA has stepped in to help small businesses in need of financing. There is no question that their loan programs have been a great source of capital for entrepreneurs, providing 40% of all long term financing and putting 25 billion into the economy annually. The partnership between small business lenders and the government has allowed entrepreneurs from all walks of life to secure affordable capital. For all of the good that these programs are doing they could clearly be doing more.

SBA's access to capital programs are a necessary tool for small businesses however, we need to find a way to decrease costs and increase access to these services especially in underserved areas. With veterans returning from Iraq and the increasing number of women and minority entrepreneurs affordable financing is more important now than ever.

One thing we cannot forget is why these programs were created in the first place, to provide long-term capital to this nation's small businesses. This was its original purpose and this is its true potential. For these programs to live up to their original intent, we need to make them more affordable for small businesses.

What has always set SBA's loan programs apart from other financing means are their local ties to the community. Many are combined efforts, working with the SBA and private sector lenders in a public-private partnership to provide capital to small firms. In helping small business owners they are also contributing to the economic development in their local communities.

The SBA's financing programs are essential for many entrepreneurs to get started or expand their businesses. For the programs to best serve small business owners they must have the tools needed to provide affordable capital. With small firms creating three out of every four new jobs and comprising over half of the nation's gross domestic product, it's a big problem when they do not have much needed funds. A small business owner should not be left with the difficult choice of either scaling back plans to expand their firms or risking the failure of their business.

Today, we will be hearing from small businesses advocates who will tell you what entrepreneurs are experiencing. Also in today's hearing, we will look at how the SBA loan programs can be improved to meet the financing needs of small businesses. This is an opportunity for us to listen and to take action so that we can create an environment that small firms can succeed in.

It is crucial that our nation's 26 million entrepreneurs have the ability to secure affordable capital and to continue to spur economic development and create employment opportunities. We need to ensure that SBA's loan programs are the premier lending tool for entrepreneurs. Access to capital is access to opportunity and by putting capital back into the hands of our small businesses we give entrepreneurs a chance to compete in today's marketplace.

Opening Statement	
Hearing Name	Hearing on Small Business Access to Capital
Committee	Full Committee
Date	3/1/2007

Opening Statement of Ranking Member Chabot

"I want to thank Chairwoman Velazquez for holding this hearing and I thank all of our witnesses for participating today -- particularly Mike Schmitt, President of the Metalworking Group from my district in Cincinnati, for making the trip.

"In my view, today's hearing on improving small businesses' access to capital is one of the most important hearings this committee will hold during this session of Congress. While many challenging issues confront small businesses – excessive litigation, burdensome regulation, affordable healthcare, high taxes, and contract bundling to name a few – none of these issues matter if small businessmen and women cannot borrow the seed money they need to start, and improve, their businesses.

"The 7(a) and the 504 lending programs, administered by the SBA, are critical for the success of many small businesses. These programs allow entrepreneurs, who may not otherwise have the opportunity, the chance to start their own business or to make improvements to their businesses.

"Unfortunately, many small businesses have experienced difficulty in obtaining this much needed capital lately. After a 25 percent increase in the number of 7(a) borrowers in 2005, there was a 37 percent decline in borrowers during 2006 which some attribute to the rising fees paid by borrowers and lenders.

"Over the last few years, the 7(a) and 504 programs have been self-sustaining, operating at zero-subsidy which eliminates the funding shortages the program experienced in the past. In my view it's the most desirable way to fund the program since it's paid for by those who use it. That said, we must make sure the lending programs continue to be used by those who need them and I plan to take a close look at the programs' recent fee increases.

"This hearing is the first step toward reauthorizing the SBA and its programs – a process that hasn't been completed since 2002. It's important that the SBA and its programs be thoroughly reviewed and evaluated to improve what's working and to fix what isn't.

"I look forward to working with Chairwoman Velazquez to ensure that the SBA's loan programs operate as efficiently and effectively as possible."

Testimony of Janet Tasker
presented to the
House Committee on Small Business
Thursday, March 1, 2007

Chairwoman Velazquez, Ranking Member Chabot, and members of the Committee, thank you for inviting me to testify about SBA's reauthorization and the FY 2008 budget for Capital Access programs.

I am Janet Tasker, Deputy Associate Administrator for Capital Access. The Office of Capital Access manages the business loan programs, the investment programs, the surety bond program, international trade programs, and the lender oversight function at SBA. I am proud to discuss our FY 2008 budget, which reflects the President's commitment to America's small businesses and supports Administrator Steven Preston's new Reform Agenda to expand the Agency's services and make our programs more customer-driven, while ensuring fiscal restraint and responsible stewardship of taxpayer dollars.

Since 2001, SBA has achieved major growth in our programs while simultaneously streamlining processes and developing more cost-effective budget strategies. We have significantly increased our loan volume, more than doubling the number of 7(a) and 504 loans funded. Each year, we are reaching more and more small businesses at an extraordinary rate – and doing so at no subsidy cost to the taxpayer. In FY 2001, the loan programs served about 42,000 small business borrowers. In FY 2006, this number jumped to over 100,000 in the 7(a) and 504 loan programs.

The new management team at SBA, led by Administrator Steven Preston, will continue to pursue this expansion in services to the small business community while aggressively working to ensure that all of the Agency's programs are fiscally responsible and sound, customer-focused, and outcome-driven. The Agency also has a renewed focus on ensuring that its products and services are accessible to entrepreneurs in the nation's most underserved markets – those with higher rates of unemployment and poverty and lower rates of economic progress.

Highlights of the Budget Request

The President's FY 2008 proposal will support a total of more than $28 billion in lending authority for small business financing, which represents a potential 40 percent increase over actual business lending for FY 2006, through the 7(a), 504 and SBIC debenture programs. The proposal requests authorizations of $17.5 billion for the 7(a) program, $7.5 billion for the 504 program, $3.0 billion for the SBIC debenture program, and $25 million for the Microloan program.

The 7(a), 504 and SBIC program levels build on the continuing success SBA has achieved in its loan programs over the past five years. In 2006, we served more small businesses than ever before. In our two major loan programs, the numbers of gross approvals has increased by 99%, from 50,233 in FY 2002 to over 100,000 loans in FY 2006. 7(a) lending to minority-owned small businesses increased from 13,485 loans in FY 2002 to 31,958 loans in FY 2006 – an increase of 137 percent. Women-owned business 7(a) lending experienced similar growth, from 10,364 loans in FY 2002 to 21,887 loans in FY 2006 – a 111 percent increase. These record level lending numbers are possible, in part, because of the zero subsidy policy that was adopted at the beginning of FY 2005.

The zero subsidy policy has allowed the Agency to continue to meet the financing demands of small businesses without the need for subsidy, saving taxpayers, in effect, $100 million or more each year. This policy has enabled SBA to stabilize the 7(a) loan program and provide financing without the need for loan caps or temporary suspensions of program availability due to appropriations shortfalls, such as those which occurred in 2003 and 2004. With zero subsidy, adequate loan levels are established to meet the demands of the lending and small business communities. In addition, agency resources can be focused on enhanced oversight of the portfolio in order to maintain a zero subsidy rate and fees that are the same or lower than they were in FY 2004 and 2005.

We are pleased that positive portfolio performance and economic projections have enabled the SBA's FY 2008 budget proposal to include a number of reductions in fees on our business lending programs. SBA is seeking to lower the ongoing annual fee on lenders for the 7(a) program from 55.0 basis points in 2007 to 49.4 basis points in 2008, resulting in a savings of $657 over the lifetime of the average loan of $145,000. The Agency proposed a fee reduction for the lender, rather than the borrower, because lowering the ongoing annual fee on lenders in the 7(a) program provides a more stable fee calculation that both lenders and borrowers have indicated is important to them. Additionally, this fee change allows SBA to provide relief to lenders, who have experienced fluctuating fees while borrower fees have stayed the same since 1995.

In the 504 CDC program, the budget proposes the elimination of the 50 basis point upfront fee, initially saving the borrower $2,910 on an average 504 loan. When combined with a related proposal to increase the ongoing annual fee on 504 borrowers from 1.8 basis points in 2007 to 2.1 basis points in 2008 – a cost to the borrower of $205 over the life of the average loan - the net savings to an average borrower with the lower upfront fee is $2,705. This is a significant adjustment which will help 504 borrowers, who are typically in underserved markets, access the capital necessary to establish and grow their small businesses.

The SBIC Debenture program budget also includes a reduction in the ongoing annual fee from 90.6 basis points in 2007 to 71.7 basis points in 2008. This represents a savings of nearly $359,000 over the life of an average guaranty. We believe this excellent portfolio performance of these lending programs is due to changes allowing for more diversification, enhanced lender oversight and the improved economy.

In order to cover more of our expenses through fee authority that will enhance the ability of SBA to properly manage our programs, we are requesting authority to charge a fee which would apply to pools of Section 7(a) loans sold in the secondary market. We are not proposing to charge a fee at this time, but believe that the statutory authority to charge a fee in the future under certain circumstances, such as interest rate changes that affect the program, is appropriate. Borrowers would not be affected at all, as the fee would be paid by investors in secondary market certificates.

To provide SBA the means to ensure that pooled 7(a) loans are self-financing in the future, we are requesting fee authority that will enhance the ability of SBA to properly manage the Secondary Market program. The ability to charge nominal fees to the purchasers of pooled loans will enable SBA to stabilize the program and prevent necessary annual programmatic changes that currently allow the program to be self financing. Borrowers would not be affected, as the nominal fee would be paid by investors in the secondary market. The secondary market program is a critical component in providing liquidity to the small business market. In most years, 40% to 50% of the 7(a) loans made are sold into the secondary market.

Compliant and Accountable Organization

Managing agency resources devoted to SBA's lending activity is another key priority. Many improvements have been made over the past several years by centralizing lending functions. We have centralized 7(a) loan guaranty purchase and liquidation functions as well as 504 loan processing. As a result, 7(a) loan liquidations cost approximately $18 million less in FY 2006 than in FY 2003 even while our portfolio has grown markedly. Centralization allows for more consistent application of SBA's policies and procedures. It also allows the Agency to better monitor and manage its performance metrics.

As we continue to grow the loan portfolio, currently at $78 billion, the need to provide sufficient infrastructure to manage our risk is more important than ever before. As such, we want to continue to strengthen and support the lender oversight and risk management functions of the Agency. While SBA has successfully improved customer service, efficiency and accountability with reduced staffing levels over recent years, the proposed staffing increase of 28 new FTEs, included in this year's budget is necessary to support critical oversight and portfolio management functions, resulting from the success of our programs and subsequent growth in the Agency's portfolio.

In addition, we are pursuing several measures to minimize the potential for fraud in our 7(a) and 504 loan programs. The Office of Lender Oversight is looking at ways to leverage data analysis techniques to identify portfolio trends that may be indicators of potential fraud. Data developed from this effort will be referred to OIG for further investigation. Further, the Office of Capital Access is meeting with fraud experts in both the private and public sectors and with federal financial regulators to explore how SBA can improve its fraud detection capabilities.

Additionally, we have replaced the old, primarily manual processes for reviewing lender and loan performance with automated, quantitative risk-based methods, enabling SBA to prudently manage its growing loan and guaranty portfolio using more sophisticated tools. The Agency is requesting $4.1 million in S&E (to be complemented by about $4.2 million in disaster funding) to continue the loan operations system upgrade, in order to replace our current loan information system for both regular loan programs and disaster loan servicing.

Collecting on the large amount of outstanding defaulted equity investments in the SBIC program continues to be of great concern. SBA is seeking $1.5 million to help maximize recoveries on the $1.5 billion in the Office of Liquidation, and minimize losses on the $10.4 billion in outstanding leverage and commitments in the Office of Operations. The staff has developed a comprehensive strategy for liquidating this portfolio of investments, and several pilot initiatives for liquidating SBIC assets are being considered to ascertain the most cost efficient means of disposing of this significant portfolio.

Customer-Focused

Administrator Preston has placed a high priority on focusing SBA's projects and services on underserved markets. In October, the Agency launched the New Markets Tax Credit (NMTC) Pilot Loan Program to provide financial assistance to small businesses in economically distressed urban and rural areas, or "New Markets." The pilot program allows certain Community Development Entities to purchase up to 90 percent of the gross loan amount of SBAExpress or CommunityExpress 7(a) loans up to $150,000 made to NMTC "qualified" businesses in low-income communities.

This new pilot will provide additional access to loans and technical assistance to both start-up and existing small businesses in New Markets. Under the program, CommunityExpress lenders will assist CDEs to provide small business borrowers with a package of services including mentoring, coaching and counseling.

In order to expand critical capital to certain sectors of our economy in underserved communities, the Agency has also proposed a zero subsidy Microloan program. In past years, SBA has proposed eliminating the Microloan program because, under the current structure, it is very costly to the taxpayer relative to the amount of capital it lends.

By changing the rate at which intermediaries borrow from 3.77% (below the government's cost of funds) to 5.99% (1% above the government's cost), intermediaries will continue to receive a better-than-market rate of interest and SBA will be able to offer loans to any eligible intermediary. This is particularly beneficial for businesses in those markets that can be reached best through non-bank microlenders.

The Agency is also seeking to vastly expand the number of outlets providing training to Microlenders by utilizing our technical assistance resource partners, including the Small Business Development Centers and Women's Business Centers located throughout the country. By shifting Microloan technical assistance to our extensive network of existing resource partners, SBA has the potential of tripling the potential outlets for microenterprise lending and will save almost $13 million in FY 2008.

Conclusion

In conclusion, we are very proud of the growth in the programs and our efforts to ensure that this growth is managed in a reasonable and prudent manner. Today, SBA is helping more small businesses meet their financing needs than ever before.

Thank you for your time today, Madame Chairman, Ranking Member Chabot and members of the Committee. I would be happy to answer any questions.

INDEPENDENT COMMUNITY BANKERS *of* AMERICA

Testimony of

David G. Schroeder
President, American Enterprise Bank

On behalf of the

Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Small Business

Hearing on
"Increasing Access to Capital for Our Nation's Small Businesses"

March 1, 2007
Washington, D.C.

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"Increasing Access to Capital for
Our Nation's Small Businesses"

March 1, 2007
Washington, D.C.

Good morning. My name is David Schroeder and I am President of American Enterprise Bank in Buffalo Grove, Illinois. Chairwoman Velazquez, Ranking Minority Member Chabot, I appreciate the opportunity to testify today on behalf of the Independent Community Bankers of America[1] on the Small Business Administration guaranteed lending programs. The ICBA represents nearly 5,000 community-based financial institutions nationwide. Community banks are independently owned and operated and are characterized by personal attention to customer service and lending to small business.

Summary of Testimony

The SBA loan programs are a success story of how the federal government, working with private sector lenders, can fund thousands of small businesses that otherwise would not have had access to capital. However, recent budget cuts, sharp fee increases on both lenders and borrowers, and the elimination of the successful LowDoc program have undermined the full potential of the SBA loan programs. These and other negative changes have caused a disturbing decline in the number of community lenders actively participating in the SBA loan programs. Today, just the top 10 SBA lending banks do nearly 60 percent of all SBA loans. This in turn jeopardizes the ability of interested community lenders to reach a wide variety of deserving small business borrowers and geographic areas with affordable and flexible SBA loan programs.

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

ICBA fully supports the SBA loan programs and respectfully proposes several recommendations that will address problem areas and enhance the effectiveness of SBA lending for lenders and small business borrowers alike. ICBA recommendations include:

- Restore a reasonable 7(a) loan program appropriation to allow the damaging sharp fee increases on lenders and borrowers to be scaled back.
- Boost the SBA budget which has been cut nearly in half in the past six years.
- Reinstate the successful SBA "LowDoc" program with an 85% guarantee for loans up to $250,000 to better meet the needs of small business borrowers.
- Reinstate the availability of combination ("piggyback") financing to help serve small businesses with larger borrowing needs.
- Support $19 billion in 7(a) lending authority and $9 billion in 504 lending authority, up from the stagnant $17.5 billion and $7.5 billion proposed in the FY 2008 federal budget.
- Apply additional SBA budget resources to better staff and support regional SBA offices to serve the thousands of non-PLP, non-CLP community lenders available to deliver SBA loans to deserving small businesses nationwide.

The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation. ICBA members represent more than 18,000 locations nationwide and employ more than 268,000 Americans. ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community.

Community Banks are Strong Supporters of SBA Lending

American Enterprise Bank is a locally-owned community oriented bank located in Buffalo Grove, Highland Park, and Schaumburg, Illinois. Since 1995, we have grown to over $325 million in assets and we currently serve more than 8,700 account holders. We strongly support the work of the Small Business Administration and actively participate in the SBA's lending programs, specifically the flagship 7(a) loan program and the 504 loan program.

Community lenders like American Enterprise Bank are proud to work with the SBA in helping supply needed capital to small businesses across our nation. Whether located in small towns, suburbia or big city neighborhoods, community banks grow our towns and cities by funding small business using local dollars. Community banks are one of the key sources of credit and other financial services to small business, the most prolific job creating sector of our economy.

In Illinois there are 549 community banks that have made a total of 194,000 small business loans or $21 billion in small business lending. Community-based banks form the building blocks of our nation's communities by providing the needed small business capital and credit to all geographic regions of the country, both large and small. They have played a vital role in the stability and growth of each of the fifty states by facilitating a decentralized source of capital and lending. This wide dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness, and stability of our entire financial system.

SBA Lending is a Proven Success

First of all I want to make it very clear that the SBA guarantee loan programs are unique and extremely valuable in providing needed long-term capital to small business. The SBA loan programs truly represent a success story of how the federal government, working with private sector lenders, can fund small businesses that otherwise would not have had access to capital. The SBA 7(a) loan program provides 30 percent of all the long-term small business lending.

Lenders need to match short-term deposits with short-term small business loans. While the typical commercial small business loan has a maturity of one to three years, SBA 7(a) loan maturities average 12 or more years. SBA lending allows loan terms up to 25 years. This lowers the entrepreneur's loan payments and frees up needed cash flow to start or grow the small business.

The SBA 7(a) and 504 guaranteed loan programs serve a unique role in providing an alternative means for entrepreneurs to access needed capital where funding is not available through conventional lending methods. A total of more than 100,000 7(a) and 504 loans were facilitated in 2006, double the number of loans made in 1996. The ICBA believes this growing demand for SBA loans only validates the importance of ensuring a more robust Small Business Administration with affordable and workable loan programs for a wide range of lenders and borrowers. Thriving small businesses in turn provide greater payroll and business income tax revenue back to the federal government.

American Enterprise bank is proud to help small businesses through the SBA programs. Last year, American Enterprise bank facilitated $25 million in 7(a) loans and $28 million in 504 loans in our local communities. American Enterprise Bank recently earned the distinction of being named Lender of the Year by SomerCor 504, Inc., a Chicago based Certified Development Corporation (CDC).

With small business development one of the fastest growing segments of our changing economy, the demand for small business capital will only increase. The demand for SBA 7(a) and 504 loans will increase as well and it is critical to ensure these programs are best suited for meeting the needs of small business. However, ICBA believes recent changes to the budget and loan programs are causing the SBA to fall short of its ability to facilitate affordable small business capital.

Disturbing Decline in the Number of Active SBA Lenders

Given the growing demand for small business capital, one would expect the number of lenders actively participating in SBA lending to grow. Unfortunately, this is not the case. In recent years, many community banks have found it much harder, not easier, to provide needed capital to small businesses through the SBA loan programs. Notably, the number of lenders that have made at least one SBA 7(a) loan has dropped almost in half, from 5,288 in 2001 to less than 2,700 today. This is a disturbing trend.

Also troubling is the fact that just a handful of lenders are now absorbing the lion's share of the SBA loan programs. The majority of our nation's commercial banks are community banks. The geographic dispersion of community banks around the country fosters a financial system where money and resources are made available not only in large urban areas, but in suburban and rural areas as well. That is why it is perplexing to note that the top 25 SBA lenders now represent two-thirds of the SBA's 7(a) loans with just 10 big lenders doing more than 55 percent of the loans. ICBA does not believe Congress intended the SBA loan programs to be functional for only a handful of the biggest lenders. ICBA urges the SBA programs be allowed to work for as many interested lenders as possible in many geographic areas to best meet the needs of small business borrowers.

During his Congressional confirmation hearings, the new SBA Administrator Steven Preston stated:

> *Ultimately, the SBA must serve its constituents in a way that is responsive to their needs and responsible to taxpayers. If nonparticipation from smaller and community banks in SBA programs results in small businesses not being able to benefit from its programs, it will be critical for me to get to the heart of the issue and address it.*

Chairwoman Velazquez that is why your hearing today is so important. ICBA wants to help identify ways to have more interested lenders be able to successfully leverage the SBA loan programs to serve a wide range of small businesses in as many geographic locations as possible.

SBA Programs Hurt in Recent Years

The sharp drop-off in active SBA lenders has been the result of a combination of discouraging factors that has undermined the community banking industry's ability to participate. These damaging changes include sharp SBA budget cuts, the elimination of any appropriations for SBA 7(a) loan programs, increased lender and borrower fees, the elimination of combination or "piggyback" financing, reduced staffing and service from local SBA offices, lower loan guarantee levels, as well as the elimination of popular loan programs such as "LowDoc."

Therefore we sincerely appreciate your leadership and efforts, Chairwoman Velazquez, in holding this important hearing to help address the genuine concerns many lenders have with the SBA loan programs. We are optimistic and encouraged by your actions to make the successful SBA loan programs work even better. We know that under the new leadership of SBA Administrator Steven Preston, there is a genuine desire to improve the SBA and its loan programs to benefit our nation's small businesses. The ICBA looks forward to working closely with you and Administrator Preston to ensure a strong Small Business Administration with robust loan programs.

Small Business Access to Capital is Key to Economic Growth

As small businesses represent a large and growing share of our economic well being, the ICBA has been dismayed by the sharp budget cuts the SBA has suffered in recent rears. Small businesses now employ more than half of the private sector workforce and produce more than 50 percent of the nonfarm private sector Gross Domestic Product. Small businesses are responsible for two-thirds of all the net new jobs being created. Given the significance of small business growth to our economy, this is no time to shortchange the SBA and its loan programs. The need for affordable small business capital is greater than ever.

However, we have witnessed sharp SBA budget cuts in recent years. The SBA budget proposed for fiscal year 2008 is a tiny 0.02 percent of the federal budget. In fact, the SBA's non-disaster program budget is about half of what it was in 2001. While there are efficiencies with new technology that can be achieved, when an agency's budget is nearly cut in half, the service and functionality of its programs will suffer. This was most evident in the troubled SBA disaster lending response after the Gulf-coast hurricanes. If supporting our nation's small businesses is a priority in the federal budget, we urge that more, not less, budget resources are allocated for the SBA and its beneficial lending programs.

Restore 7(a) Appropriation and Lower Steep Fees

A major concern of the community banking industry has been the elimination of the long-running appropriation for the SBA 7(a) loan program that was as much as $115 million in FY2001. As a result of the elimination of any appropriation for 7(a), the lender and borrower fees have been increased sharply, community lenders have dropped out of the program, and a greater concentration of SBA loans have gone to a handful of the nation's biggest banks.

With higher fees, many deserving entrepreneurs that were on the margin of obtaining a 7(a) loan are no longer able to afford such financing. This has the effect of shifting the delivery of SBA 7(a) loans further away from the fundamental mission of reaching deserving small businesses in greatest need of inexpensive, guaranteed financing. While the number of 7(a) loans has increased, the number of participating lenders and the size of loans continue to fall. The shrinking of average loan size has left many small businesses with less capital to grow their businesses and create jobs.

For smaller SBA loans, higher fees can translate into nearly $1,500 to $3,000 more in upfront closing costs for entrepreneurs. The added costs from today's higher fees can grow to up to $50,000 for larger small business loans. Higher fees only discourage the exact types of small business borrowers the SBA guaranteed loan programs were intended to reach from accessing needed capital.

Notably, under your leadership Chairwoman Velazquez, the House of Representatives has repeatedly acted to address the higher SBA loan fees by restoring an appropriation for the 7(a) program. On a *bipartisan* basis, the House has successfully passed an appropriation several times to help offset higher fees, only to be thwarted by a lack of a final budget for SBA loan programs. The appropriation for 7(a) had the support of some 20 small business groups nationwide and was not opposed by any small business group.

In order to help improve the SBA 7(a) loan program, ICBA again urges Congress to consider restoring an appropriation for the 7(a) loan program. Any appropriation should be applied proportionally to reduce the lender and borrow fees. This will help bring back a greater number of community bank lenders into the SBA loan programs and deliver more SBA loans to deserving small businesses in local communities across America. There should be absolutely no reason to shut down the 7(a) loan program as SBA has done in the past due to the timing of any Congressional appropriation. The existing program fees can continue to fund the program and any subsequently appropriation can be applied to adjust these existing fees.

Restore "LowDoc" Program

With the fallout from slashed SBA budgets, the elimination of any 7(a) appropriation, and higher loan fees to compensate, something had to give. Unfortunately, the popular and successful low documentation or "LowDoc" program was eliminated in an attempt to contain sharply rising fees under a system without any 7(a) appropriation. Frankly, the name "LowDoc" may be a misnomer. While the SBA LowDoc application may be streamlined, bank regulators would strongly criticize the bank if its loans were not adequately and thoroughly documented. Lenders still had to perform due diligence and approve all LowDoc loan requests prior to the SBA's additional review and approval. So despite the streamlined application, lenders will still require enough data to fulfill their need to thoroughly evaluate a loan request based on their own credit policy.

The LowDoc program worked extremely well for many small business borrowers and served an important niche for lenders doing a small number of SBA 7(a) loans. The LowDoc program especially enabled small and rural-based lenders to participate in the 7(a) program. LowDoc worked well for community banks that were not in the Preferred Lender Program (PLP) or Certified Lenders Program (CLP) yet had considerable small business lending experience. In many towns served by community banks, where the population may be under 3,000, a small number of SBA LowDoc loans made a big difference in the local economy.

Notably, last Congress, the Chairs and Ranking Members of both the House and Senate Small Business Committees specifically urged the SBA to work with Congress to strengthen the LowDoc program rather than terminate it. Unfortunately, as fallout from the elimination of any 7(a) appropriation and the resulting pressure on increasing fees, the beneficial LowDoc program fell victim.

Terminating the successful LowDoc program eliminated an important choice for small businesses seeking affordable capital. The end of LowDoc further pushed SBA lending into a one-size-fits all program. The SBA Express program, often touted as a substitute for LowDoc, provides only a 50 percent guarantee verses the LowDoc's 80 percent guarantee. SBA Express is a solid program for certain borrower needs but is not a viable substitute for LowDoc. The 50 percent guarantee under an Express loan is often not enough to rely on for a new start-up business to qualify for financing, so in the end, entrepreneurs suffer the fallout. SBA 7(a) lending should not be allowed to morph into a one-size-fits-all, cookie cutter program that works only for a limited number of big bank lenders and limited small business needs.

The end of the popular LowDoc program in turn is leading to the greater concentration of SBA loans in the largest lenders. The top ten lenders now account for nearly 60 percent of all SBA loans. ICBA believes the small business borrowers are best served if the loan programs are workable for a broad array of lenders and in many geographic areas across America, both urban and rural. The SBA 7(a) loan program should be allowed to work well for lenders doing 10 loans or 10,000 loans.

As the senior members of the House and Senate Small Business Committees requested last Congress, ICBA urges the SBA to restore the LowDoc program or a similar streamlined application for loans under $250,000 which allows an 85% guarantee. This will create a reasonable and needed SBA program choice, allow a greater numbers of lenders to participate in SBA financing, and improve the dissemination of SBA loans to reach small businesses in many more areas of the country, including rural America.

Reinstate "Piggyback" Financing

The ICBA requests that the successful use of combination ("piggyback") financing be restored as an option for SBA lenders. SBA suspended this valuable lending option in 2004. Piggyback financing provided lenders with greater flexibility in meeting the financing needs of small businesses, especially small businesses in need of greater financing levels.

Once again, adding more flexibility to SBA lending will avoid the one-size-fits-all problem that prevents deserving small businesses from accessing affordable capital. Ironically, this combination loan structure is quite similar to the loan structure provided in the successful SBA 504 program on mortgage lending. Reinstating piggybacking financing will prevent the unfortunate result where many small businesses with larger loan needs are being completely shut out from accessing financing through the 7(a) program.

Proposed FY 2008 SBA Budget

While the SBA budget has been dramatically reduced over the past six years, the ICBA is encouraged by the newly proposed fiscal year 2008 budget. We are hopeful the policy thinking is finally beginning to shift in a more positive direction -- from slashing SBA in recent years to supporting SBA. We support the proposed $17.5 billion authorization level for the 7(a) guaranteed loan program and the $7.5 billion authorization level for the 504 loan program. However, if needed changes are made, such as reducing fees, restoring LowDoc, enacting an appropriation for 7(a), then ICBA estimates the demand for SBA loans will exceed these authorized levels, which have remained the same as last year's. Therefore, ICBA would encourage Congress to authorize $19 billion for 7(a) and $9 billion for the 504 program to ensure growing SBA loan demand is met without any fear of the programs being abruptly curtailed or terminated as has been done in the past.

The ICBA is especially pleased that the new FY 2008 budget recognizes the steep fee levels and calls for a small reduction in both 7(a) and 504 loan program fees. However, more must be done to lower fees on both borrowers and lenders that have doubled in recent years. This would allow the program to better reach the borrowers it was meant to serve.

Additionally, ICBA is pleased to see the request to increase agency staffing and to increase the number of satellite SBA offices. SBA budget cuts and the elimination of regional offices and staffing are why many lenders have found the SBA program less responsive and more difficult to navigate. Having huge SBA processing offices in Fresno or Sacramento California may serve the needs of some lenders. However, if SBA programs are to work best and minimize risk it is also important that SBA officers be located closer to where lending is taking place to be familiar with local business conditions.

ICBA recommends that additional budget staffing resources requested for FY 2008 in part be targeted to assisting the thousands of non-PLP lenders serving small business needs. This can help reverse the decline in SBA participating lenders and help meet the needs of many more businesses seeking SBA funding nationwide.

While the proposed FY 2008 SBA budget is a moving in the right direction in several areas, it falls far short of reversing the dramatic budget cuts the SBA has suffered in recent years.

Conclusion

The ICBA pledges to work with the Small Business Committee to ensure our Nation's small businesses have the access to capital and credit they need to invest, grow, and to provide jobs and continued economic growth. ICBA will continue to urge Congress and the Administration to adequately fund the Small Business Administration and the successful 7(a) and 504 loan programs. These important SBA programs are widely used by many community banks to provide needed capital and credit to thousands of small businesses nationwide. High fees associated with the SBA loan program in recent years must be scaled back since they have made such loans less affordable and less attractive for banks and borrowers alike.

In our changing economy, small businesses will continue be the engine for new job creation and economic growth. This is a time to strengthen small business resources and build upon the successful SBA loan programs. Providing needed capital resources to small businesses through broad community bank participation in SBA lending will help strengthen economic growth and foster greater job creation. ICBA sincerely appreciates the opportunity to testify today on the important issue of available small business capital and lending. Thank you.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"Increasing Access To Capital for Our Nation's Small Businesses"

Testimony Before the
House Committee on Small Business

Thursday, March 1, 2007

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NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee, my name is David Bartram. I am the president of the SBA Division of U.S. Bank. Our division operates SBA lending centers in 24 states, and we are one of SBA's largest lending partners. Last year, US Bank provided $542 million in long-term SBA loans to over 4,700 firms nationwide. U.S. Bank is a committed small business and SBA lender with an outstanding SBA portfolio of approximately $1.6 billion.

I also currently serve as Chairman of the Board of the National Association of Government Guaranteed Lenders (NAGGL), headquartered in Stillwater, Oklahoma. NAGGL is a trade association of approximately 700 lenders participating in the Small Business Administration's loan programs. Our members include small community banks (the largest membership category), large regional and national banks, non-bank lenders, certified development companies, and credit unions. Our members are dedicated to providing the capital critical to our nation's small businesses—the capital that allows them to grow, hire more employees, and contribute to our nation's economic vitality. NAGGL members generate approximately 80% of the annual SBA 7(a) loan volume, as well as most of the lender portion of SBA 504 loans.

We appreciate the opportunity to testify today on the effectiveness of SBA's loan programs. The SBA 7(a) and 504 programs fill a significant gap for small businesses that need access to long-term loans. In fact, SBA, through private-sector lenders who use the 7(a) and 504 loan programs, accounts for about 40% of all long-term small business loans made in America. This means SBA is the single largest provider of long-term capital to U.S. small businesses. While it is true that commercial banks make many small business loans, these conventional loans typically have maturities of 3 years or less, since short-term deposits fund commercial banks. Therefore, by bridging the credit gap, the SBA fills a very critical need for small businesses, especially for start-up or early stage companies.

Let me briefly explain how the program works. The SBA has delegated most loan making authority to 7(a) lenders, while the agency retains regulatory and oversight of the program. A significant percentage of the lenders participating in the program today are preferred lenders who hold the delegated authority to attach a federal guarantee to a loan. Less active lenders—those generally making only a few loans per year—participate in the program with SBA having the final authority to attach a federal guarantee to a loan. The latter is now accomplished through centralized SBA loan processing centers.

The 7(a) loan program is self-funding. It receives no federal appropriation. Instead, fees paid by borrowers and lenders keep the 7(a) subsidy rate at zero. In fact, according to the administration's fiscal year 2008 budget submission, over the last 10 years fees paid by borrowers and lenders have been excessive—more than $800 million dollars in excess fees have flowed into the federal treasury beyond what was needed. In short, the 7(a) program has been a moneymaker for the U.S. government, not only through this fee income, but also in the tax revenues paid by the small businesses, their owners, and their employees.

A good question would be, "How does the small business borrower benefit from the program?" Certainly many small businesses can access the conventional capital market for their short-term needs. That is, they could perhaps get a short-term bank loan. However, the key is the terms and conditions of that loan. Typically, according to bank regulatory statistics, small business borrowers get conventional loans with maturities of 3 years or less, with the bulk of those maturities less than one year. Again, this is in keeping with the lending industry's view that they should make short-term small business loans based on short-term deposits.

Contrast this situation with the fact that the federal guarantee changes the terms and conditions of a conventional loan to make the federally guaranteed loan much more borrower-friendly. The guarantee allows a small business to appropriately finance a long-term asset with a long-term loan. Again, according to federal statistics, the typical 7(a) loan has a 12-year term (versus a 3-year term). This translates into the borrower having significantly lower monthly payments, approximately a 40% lower payment for a 12-year loan than the borrower would with a 3-year loan. Cash is like gold to small businesses and the federal guarantee allows the borrower to avoid becoming cash-strapped by loan terms.

The effectiveness of SBA loan programs is proven by their growing utilization. Over the past five years, while the government has been harvesting borrower and lender fee overpayments, the 7(a) program has grown by more than 66 percent. The 504 program has also experienced significant growth, 50% in just the last two years. There are countless numbers of small businesses that simply would not be in business today if not for the SBA loan programs.

Just last fiscal year, more than 100,000 small businesses received financing through the SBA 7(a) and 504 programs. These loans totaled approximately $25 billion. For the current fiscal year, it is estimated that the combined 7(a) and 504 loan totals, which includes the first lien on a 504 project, may reach $30 billion. No appropriations are provided for credit subsidies – meaning that program user fees cover the cost of the programs. Over the last several years, SBA has worked to streamline the lending process, helping to reduce the indirect costs of its lending participants. The results are clear – record lending levels in both the SBA 7(a) and 504 programs were realized in FY 2005 and 2006, with new records expected in FY 2007. This public-private partnership has been—and still is—a shining example of what can be achieved when private sector lenders and the federal government work together.

But while the programs are working well, we believe they can be improved. NAGGL has some suggested 7(a) program changes that we judge will increase access to capital, reduce costs to many small business borrowers, and improve the economics to retain and grow the number of lenders in the program. Our suggestions will be delivered to you next week in the form of a legislative proposal, but will include:

- Increasing the maximum 7(a) loan size to $3 million and the maximum guarantee to $2.25 million;
- Allowing the use of the alternative size standard, currently used in the 504 program, to be used in the 7(a) program;
- Allowing 7(a) and 504 combination loan packages where a borrower could utilize the maximum guarantee available under each program;
- Allowing the use of a rate index other than "the lowest prime rate as published in the Wall Street Journal";
- Allowing the use of "weighted average coupon" loan pools for secondary market sales; and
- Extending the prepayment penalty for loans with maturities of 15 years or longer to a 5-year penalty using a 5-4-3-2-1 sliding scale.

Maximum Loan Size and Guarantee: The number one requested program change from NAGGL members of all sizes is the increase of the maximum loan size to $3 million and the maximum guarantee to $2.25 million (keeping the 75% maximum guarantee rate). Since 2002, the volume of loans with amounts of $250,000 or more has been flat to down slightly. The larger loans pay disproportionately higher fees, thus subsidizing the cost of smaller loans. This is especially true for loans with guaranteed portions over $1 million, since the fee is, by far, the largest of all 7(a) fees. Many of our larger small business customers have financing needs that exceed $2 million, and they cannot be served through the 7(a) program. If they do not qualify for the 504 program, their financing needs go unmet.

Alternative Size Standard: In order to be eligible for an SBA loan, the borrower must meet the definition of a small business. Pursuant to the Small Business Act, SBA has promulgated size standards by industry utilizing the North American Industry Classification System (NAICS). Because many small businesses engage in more than one industry, utilizing the NAICS codes can be a very complicated process. As an alternative to these size standards, SBA permits the 504 and SBIC programs to use a simple size standard based upon the net worth and net income of the small business. It is a much easier process, and one we believe should be available to the 7(a) program. It would also eliminate the conflict where a small business can qualify as small for a 504 real estate loan, but cannot qualify for working capital financing under the 7(a) program.

Combination Loans: Many small businesses have physical plant and equipment needs that can be sizeable, especially when you consider real estate prices on the east and west coasts. Allowing combination loans would mean that a borrower with a sizeable loan in the 504 program could still receive working capital financing under the 7(a) program.

Alternative Rate Index: The current SBA requirement to use "low Wall Street Journal Prime" as a rate index has been in place for over 25 years. The banking industry has evolved since then. Now, many other rate indexes are commonly used. The Prime Rate is a short-term rate that can very volatile. Many financial institutions now use other indexes that match the terms of the credits extended to their customers. For instance, a 25-year SBA loan could have a variable rate that adjusts only every seven years, so a lender would use a 7-Year Treasury Swap rate index to match the terms of the note. Many of these indexes are published daily in the Wall Street Journal. The use of alternative indexes would lead to a lower, more stable borrowing cost to the small business.

Weighted Average Coupon – WAC - Pools: The Small Business Act permits lenders to sell the guaranteed portion of 7(a) loans to a secondary market broker/dealer who typically forms "pools" of loans and then sells shares in the pools to investors. This permits lenders to replace the capital they have committed in small business loans and then to make even more loans. Current regulations limit the pools to loans with "identical interest rates". To accomplish this, broker/dealers have to "strip" off interest pieces, so that all loans entering the pool have the same interest rate. The strips are then dealt with separately. This is an expensive and risky process for the broker/dealer, and impacts the marketability and value of some loans. Allowing the use of WAC pools should increase the marketability of 7(a) loans and make the SBA pool product more attractive to investors.

Enhanced Prepayment Penalty: A growing number of small businesses use a long-term 7(a) loan as a "bridge loan" and prepay it within two to three years. Since SBA estimates that these loans will be on the books longer than two to three years, it is losing subsidy dollars from the lack of the collection of the ongoing lender fee. In addition, lenders incur substantial costs to originate an SBA loan, costs that are recovered out of the interest margins over a period of time. We propose increasing the current 3-year prepayment penalty on loans with maturities of 15 years or longer, to a 5-year prepayment penalty. As it is today, SBA can continue to collect any prepayment fee dollars to use for subsidy recoupment purposes. A 5-year prepayment period will provide a more reasonable period of time for a flow of payments from the borrower. It will also provide the lender an economic incentive to continue offering the longer-term 7(a) product. And lastly, it will help keep future borrower fees lower as it would provide either a continued source of subsidy revenue from the ongoing lender fee or from the additional prepayment fees that would be collected.

We believe these changes will increase the access to capital for many small businesses, and will also decrease the costs of the program. Many of the proposals should have a positive subsidy rate impact, meaning fees to program users could be reduced. The SBA, under the new leadership of Administrator Preston, has appeared receptive to these suggestions, and we believe they are actively considering those suggestions that would not require a change in statutes (i.e., change in the rate index).

Like never before, the SBA 7(a) and 504 loan programs are vitally important to tens of thousands of small businesses annually, and these loan programs merit continued bi-partisan support in Congress.

Chairwoman Velázquez, this concludes my prepared statement. Thank you for the opportunity to testify about these programs that are so critical to many small businesses. I would be pleased to answer any questions.

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NSBA
National Small Business Association

TESTIMONY FROM

Marilyn Landis, Owner
Basic Business Concepts, Inc.

On behalf of the

NATIONAL SMALL BUSINESS ASSOCIATION

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing:

"Increasing Access to Capital for Our Nation's Small Businesses"

March 1, 2007

Good morning. My name is Marilyn Landis and I am pleased to be here on behalf of the National Small Business Association. I would first like to thank Chairwoman Velazquez for holding this very important hearing and for being such a strong and outspoken advocate for increased access to capital opportunities for U.S. small businesses. I also would like to thank Ranking Member Chabot for his long-time support of entrepreneurs. The entrepreneurs of the National Small Business Association look forward to working with you on the House Small Business Committee. I also would like to thank both of you for sharing members of your staffs with us during our recent Small Business Congress. Let me assure you that they represented you very well.

I am proud to serve as the first vice chair for NSBA as we celebrate our 70th year of small-business advocacy, and continue our long-standing tradition of working in a nonpartisan manner to promote pro-small-business policies. In addition to my leadership role within NSBA, I am the owner of Basic Business Concepts, a consulting and financial management company serving small businesses primarily in Pennsylvania and Ohio.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country—marketing, originating and underwriting SBA loans—and have continued working with my clients on securing SBA loans as well as myriad other sources of capital. After 36 years of working with small business, the one thing I can tell you without hesitation is that it's tough out there. Small-business owners face many obstacles in trying to garner capital—obstacles that illustrate the very significant need for and importance of the SBA's lending programs.

Small-Business Challenges in Financing

Many small and startup businesses lack the assets necessary for a traditional bank loan. Smaller loans are generally less-profitable for banks, and typically have a higher default rate. The increased usage of personal credit ratings for business owners further exacerbates the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks, fewer character-based loans, and more difficulty for the small-business owner.

One of the biggest barriers to small-business financing is debt secured by equity in fixed assets. Many small-business owners do not have the kind of equity required by banks to acquire a sizeable loan. This gap in debt-equity financing primarily hinders both startup businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership (if the entrepreneur owns a home) rarely meets the equity requirements for receiving a larger commercial loan. The small-business owner seeking to expand his or her business or hire additional employees faces the same equity challenges. The old adage, "You've got to have money to make money" has morphed into "You've got to have equity to get money"—which just does not make sense.

A new capital issue has come to the forefront for small businesses, and that is the increased reliance on credit cards. Many small-business owners were forced to turn to credit cards as their primary source of working capital in the early years of this decade when a multitude of banks tightened their lending standards. In fact, only 20 percent of the respondents to a 2006 NSBA membership survey relied on traditional bank loans as their primary source of financing. Eleven percent exclusively used credit cards to finance their business operations. The high interest rates typical of most credit cards continue to adversely impact U.S. small businesses.

Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan request. Rapidly growing businesses, like mine, that are not traditional brick and mortar, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit card accounts. As such these loans are subject to credit card regulations which permit significantly higher and more volatile rates and payment structures. Rapidly growing service and technology companies do not want to rely on credit card debt—they are forced to.

In order to address the access to capital barriers that continue to hinder the economic development of the small businesses that form the backbone of the U.S. economy, NSBA supports the following banking reforms:

Address the use of personal credit scores in processing loans

Too many banks rely solely on the personal credit score of the business-owner and neglect to evaluate the owner's business experience or the long-term viability of the business. Individuals with high credit scores and/or equity in a home can secure a loan, whereas an experienced entrepreneur cannot. Lower credit scores may only reflect the presence of both personal and business debt on the business owner's credit report, not a poor payment history. We firmly believe that, in time, the unintended consequence of the over-reliance on credit scoring and lack of emphasis on the actual viability of the business will increase small business defaults by over extending credit to the inexperienced and denying credit to viable, functioning businesses.

Require greater transparency in credit-scoring and/or loan approval requirements

While great strides have been made in regard to personal credit transparency and the finance worthiness of an individual, small-business financing remains cloudy at best.

Allow small businesses to earn interest on their checking accounts

Currently, large businesses have a significant advantage over small businesses in their ability to earn interest on their checking accounts. Most large banks have established "sweep" accounts which enable a business to set up a separate interest-bearing account into which the balance of their primary checking account can be transferred or "swept" up to 24 times per month. The transferring allows money to be placed into interest-bearing accounts at the close of business and then put back into the primary account at the next opening business day, providing for interest accrual overnight.

Due to the complexity of "sweep" accounts and the significant cost in administering them, these interest-bearing accounts are not an option for most small businesses. Chairwoman Velazquez has introduced legislation that would clarify and repeal certain regulations that have served to disadvantage small businesses in this regard. The legislation would enable small businesses to participate in these sweep-accounts and increase the allowable number of transfers per month while requiring that the fees for such transfers not be prohibitive to smaller accounts.

NSBA thanks Chairwoman Velazquez for reintroducing *The Business Checking Fairness Act of 2007 (H.R. 41)* and urges the full committee to support this important piece of legislation.

Eliminate the credit card industry's universal default practice

Starting in 2000, credit card issuers began increasing a credit card holder's interest rate if the cardholder was late on an unrelated payment to a different credit card, a utility company, or a mortgage lender, to name a few. This practice, known as "universal default," raised eyebrows and in 2004, the Office of the Comptroller of the Currency (OCC) issued a guidance to banks urging them to disclose this practice in promotional materials. This guidance, which included language warning of the risks of using a universal default policy, was successful in motivating the six largest U.S. credit card issuers to cease the practice.

According to a new report by the Government Accountability Office (GAO), however, three of the 28 most popular cards still employ a universal default policy. This GAO report also found that four other of the most-popular 28 cards are seeking to reinstate universal default, but are trying to do so under the auspices of a "change-in-terms", which unlike the automatic increase previously done with universal default can require prior notification.

Due to small business' reliance on personal credit cards, this practice is creating undue pressure on many small-business owners whose personal and professional finances are tied together. NSBA urges Congress to codify language preventing banks and credit card issuers from using universal default increases on credit cards unrelated to a particular late payment.

SBA Loan Programs

First, I would like to state for the record that NSBA is very pleased to be working with the new administrator of the SBA, Steven Preston. Administrator Preston who attended NSBA's recent Small Business Congress, is truly a breath of fresh air within SBA; and while we may not always agree with him, Mr. Preston's openness and willingness to work with a range of small business groups is to be commended.

Banking practices that restricted access to capital were a key catalyst in the creation of the SBA's flagship 7(a) loan program. The goal, under the generally-accepted premise that small-business growth is a good thing, was to encourage greater lending to smaller, potentially riskier clients. As you can see, however, imperfections within the market still exist and SBA loan programs are as important now as ever.

7(a) Loan Guarantee Program

As everyone in this room can attest, the 7(a) loan program has had a bumpy ride over the past five years. The program has faced loan caps, a complete shutdown, and a zeroed-out budget. The 7(a) loan program is now running on a zero subsidy, which requires no appropriations but has led to increased fees on lenders and borrowers. NSBA has worked with Chairwoman Velazquez and her staff in the past two years to push for funding, only to have the measure taken out in conference committee negotiations.

While some have argued that the zero subsidy and lack of appropriations has led to stability in the program, we would argue that stability and funding the 7(a) program are not mutually exclusive. For the record, I am confident that the program can be stable and receive appropriations at the same time. Hindering the 7(a) program and placing the financial burden on small-business owners because Congress has been unable to enact appropriations measure is simply unfair.

When the program first went to a zero-subsidy rate in FY 2005, lenders and borrowers were hit twice by increased fees. The new subsidy rate requires higher fees, and the expiration of PL 107-100 required a 100-percent increase in guarantee fees for loans less than $150,000, and a 20-percent increase in guarantee fees for loans between $150,000 and $700,000. Additionally, all annual service fees increased from .25 percent to .5 percent. The interest rates are now at their statutorily highest allowable level.

While the number of loans being made has steadily increased, both loan volume and loan size has decreased since the new subsidy rate went into effect. According to statements from the SBA, 7(a) loan volume decreased in FY 2006 to $13.46 billion from $14 billion in FY 2005. Additionally, the loan size has decreased from $157,459 in FY 2005 to $148,767 in FY 2006. The average 7(a) loan size in FY 2000 was $240,437. This represents a 61-percent decrease in loan size in only six years.

Perhaps the most worrisome numbers, however, are the number of banks involved in the 7(a) program. Higher fees are not only pushing business borrowers toward credit card reliance, they are driving banks out of the program. At first glance, it appears that there has been a moderate decrease in the number of lenders participating in the 7(a) loan program. This does not seem particularly alarming, as it could be explained by bank consolidation or a number of other issues. When you dig deeper, however, you discover that the number of lenders registered that actually made at least ONE loan in FY 2001 was 5,228, and that by FY 2005 the number had decreased dramatically, almost 50 percent, to 2,751.

The SBA has made a concerted effort to expand its operations, and we support the goal of broadening SBA's reach—but not at any cost. The decreasing loan size and number of participating banks is worrying, and could be signaling systematic shortcomings. The shriveling loan size is particularly troublesome as smaller loans do not typically create as many jobs as large loans. Since smaller loans generally present less risk for banks anyway, it would appear intuitive that the SBA should focus on increasing incentives to banks to make large loans. Shrinking bank participation could mean that because of bank consolidation, large corporate banks are distributing the bulk of loans or it could mean that the administrative costs of the program are too great for many banks. Sadly, whatever the explanation, the burden of diminished bank participation will most likely fall on the already overloaded shoulders of America's entrepreneurs, especially rural entrepreneurs.

NSBA continues to urge Congress to fully fund the 7(a) program, which remains the largest source of public or private small-business financing in the country—providing 30 percent of all long-term small business lending. The 7(a) program is not only important, however, it is effective. For every $33,000 spent in the 7(a) program, one job is created or retained. The merits of the 7(a) program are too great for Congress to continue to ignore.

Microloan Program

President George W. Bush's FY 2008 budget proposal includes a restructured and zeroed-out Microloan program. SBA Administrator Preston has stated that in keeping with the agency's efforts to run a more efficient agency, the goal is to fold the Microloan program in with the 7(a) loan program and have Small Business Development Centers assume the technical assistance responsibilities currently provided through the Microloan program. We do not believe this is in the best interests of the Microloan program or the aspiring entrepreneurs it strives to assist. A very important component of the Microloan program is the intensive, hands-on technical assistance it offers. This technical assistance is quite different from what is currently offered through the SBDC program, and given the continued flat-funding for SBDCs, it is both unfair and unrealistic to expect them to assume this new and different responsibility.

Although the incredibly low cost of the Microloan program makes it a tempting target during a budget crunch, this temptation must be resisted—the vital assistance provided by the Microloan program to the smallest and most vulnerable entrepreneurs in the country, oftentimes individuals who have been displaced, must be both ideologically and financially supported by Congress.

Access to capital for small companies that export is especially challenging. This is a particularly critical issue with the U.S. trade deficit at record levels. Exporters that cannot sell for cash need such financing, but the problems they encounter are: (1) asset-based lenders almost always reject transactions in which the collateral is shipped to a foreign country, where it would be difficult to foreclose for nonpayment; and (2) foreign risks differ from domestic risks, requiring a lender to have staff with specialized training. In practice, lenders will occasionally take a chance on underwriting an export by a large company; but they almost never will on a small-company exporter—unless the transaction is backed up by a government guarantee or insurance policy. This is why small exporting companies in the U.S. depend so much on government guarantors like the Small Business Administration, the Export-Import Bank, and the Overseas Private Investment Corporation. (OPIC).

Each of these agencies offers reasons for small-business optimism. With a field staff of only 16 export-finance professionals and an agency-wide budget of only $4.3 million, SBA's Office of International Trade financed more than $2.1 billion in exports in FY06. This translates into about $500 in export sales for each $1 the taxpayers invested in this program—and these exports supported the creation of nearly 30,000 new, high-paying American jobs in FY06, the taxes from which more than covered the cost of the program.[1] *There is no better return on export promotion anywhere in the federal government.* The real question here is why a capital access and export financing program this successful— both in addressing the U.S. trade deficit and in helping small business—continues to be starved for funds. As recently as FY2000, the program had 22 export finance professionals in the field and a much larger travel budget to allow them to visit banks and exporters across the large territories they cover. Today, huge areas of the country—even those with critical needs, like the Gulf Coast—lack access to these export finance professionals and the economic development that they can provide.

Thanks to the work of Chairwoman Velazquez and others, Congress recently directed the Export-Import Bank to create a permanent small business division, staffed by underwriters dedicated solely to small business, and headed by a senior vice president answering directly to the Bank president. These and other recent changes at Ex-Im should help the Bank build on recent progress by its new president, James Lambright. In FY06, the Bank met the mandate requiring them to devote 20 percent of its financing dollars to small businesses. We thank Chairwoman Velazquez for her excellent work on this important capital access issue, and we encourage this Committee and the Financial Services Committee to commend Ex-Im Bank as it shows continuing progress in this area.

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[1] Based on the Department of Commerce index of 14,000 new jobs, paying 18% higher wages than non-trade-related jobs, per $1 billion in exports, and IRS *Statistics of Income*.

The Overseas Private Investment Corporation (OPIC). is the federal government's most remarkable recent success story in financing small businesses in international trade. With the creation of its Small and Medium Enterprise Finance (SMEF) Department and the strong backing of the agency's current and former presidents (Dr. Peter Watson and Rob Mosbacher, Jr.), OPIC went from handling $6 million in small-business financing in FY01 to handling over $500 million in FY06. Today, it stands poised to do even more, through its new Enterprise Development Network that will delegate more front-end authority for small-business financing to commercial banks and brokers. OPIC is up for reauthorization this year, and it deserves the strong support of all in Congress that believe U.S. small business can play a vital role in international trade.

NSBA believes that increasing the amount of federal research and development invested in U.S. small businesses is another important access to capital goal. Small technology firms with less than 500 employees now employ 54.8 percent of all scientists and engineers in U.S. industrial research and development. Yet, these nearly 6,000 scientists and engineers are able to obtain only 4.3 percent of extramural government research and development dollars. This must change. NSBA urges Congress to build upon the successes of the Small Businesses Innovation Research (SBIR) program—which has delivered more than 50,000 technology patents and is now doing so at the rate of seven patents a day—during SBIR's reauthorization process and to increase the percentage of agencies' research and development funds reserved for small businesses

NSBA strongly encourages both the administration and Congress to fully support small businesses as the true centers of growth in the U.S. economy. Congress must recognize that the majority of small businesses in today's economy are not fixed asset-intensive and should take the lead in ensuring that traditional financing practices and new credit-card policies do not restrict small business growth. NSBA urges Congress to examine the benefits of reforming the current limitations placed on banks in lending to small business and fully supporting and funding existing SBA loan programs.

I thank you for your time and welcome any questions you may have.

STATEMENT

By

Metalworking Group Inc.

On

<u>Benefits of the</u>

<u>Small Business Administration</u>

<u>504 Loan Guaranty Program</u>

Submitted to the

COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

By

Mr. Michael F. Schmitt
President & CEO
Metalworking Group Inc.
Cincinnati, Ohio
March 1, 2007

I am Mike Schmitt, President and owner of Metalworking Group Inc, in Cincinnati, Ohio. I am here to represent my company and believe that our company is representative of all of the small businesses that have prospered with the assistance of a 504 loan.

I would like to thank Chairperson Velazquez, Ranking Minority Member Chabot and the entire Committee for giving me the opportunity to provide remarks concerning the benefits small businesses receive using the SBA's 504 program. Moreover, I would like to personally thank the leadership and the committee for steadfastly championing small business issues, including those of the 504 program, and for introducing legislation that will improve the 504 loan program for future small business borrowers.

The Metal Working Group Inc Story

I purchased The Metalworking Group, Inc. in 2000, after having worked there for ten years. The company had approximately 70 employees with approximately $9 million in annual revenues.

Our primary business is contract manufacturing focusing on sheet metal fabrication, robotic welding, machining, painting, and metal stamping. Our competitive advantage is the ability to offer our customers the most diverse range of manufacturing solutions in the Midwest. We serve many industries including medical, machine tools, consumer products, and defense.

In 2004, we needed to invest more in the company to continue growth. The real estate lease under which we were operating was a burden to the cash flow and investment opportunities for MWG. We needed to purchase capital equipment in order to continue our strategy of automating and offering our customers a high-tech solution to their manufacturing needs.

To maximize our potential, we contacted Horizon Development Corporation to explore the 504(a) SBA loan program. The Economic Development Office of our locality, with whom we initiated a relationship regarding a tax abatement program in 1999, recommended Horizon CDC. The 504 loan program was the most attractive way for MWG to free up resources and allow us to invest in our future. We were able to save significant dollars, which could then be used towards the purchase of new equipment such as laser cutters, robotic welders, and CNC machining centers.

The assistance Horizon provided in obtaining the 504(a) funding was professional and invaluable. Although the 504(a) was not the only financing in which we participated, it was the catalyst for all future investments because it allowed MWG to save valuable cash reserves.

The 504(a) loan is critical to companies like MWG for a number of reasons. First of all, the loan structure requires the participating banks to offer favorable terms in the loan package, such as the length of amortization. For planning purposes, it is especially helpful to have a long and uniform payout schedule. Secondly, the program offers a better interest rate due to the participation of the SBA.

Metalworking Group Inc. was able to put less money down for the transaction, which saved at least $130,000 in cash. Another benefit to the borrower is that the loan structure, at 20 years fixed interest, required the participating banks to conform to the same structure. Without that, MWG would have had a significant interest rate risk in as little as five years.

With the favorable financing we were able to obtain through our 504 loan MWG has experienced some success. We currently have 150 employees and we have doubled our annual revenues.

Horizon is an integral part in bringing these loans to fruition. They have the incentive to help businesses and educate clients on the availability of these programs. Banks are certainly willing to participate in these loans, but I feel they would prefer conventional lending in order to control the terms and rates.

Horizon provided important and specific professional help throughout the loan process. Without Horizon, we would have been hard pressed to obtain these loans. Since these programs are not our expertise, the services Horizon offered were indispensable. Negotiating the legalities and conditions with the banks would have been insurmountable without their help. Without this assistance, MWG would not have access to capital available to larger companies.

Horizon CDC was able to provide the 504 loan at an extraordinarily low cost to our company. The beneficiaries of this low cost are not only our company, but include our new employees, other companies with whom we conduct business, and as a result, the local economy and community as a whole.

I also want to stress that Horizon CDC played a critical role in balancing the interests of our company, the SBA and the bank. Horizon provided assistance at every level of the project --offering advice, support and expertise critical to our success. Horizon has also helped other small business obtain 504 financing; they have approved over $229 million in financing to over 900 small businesses that have generated over 8,000 jobs since they were formed in 1982.

In short, having Horizon as our advocate in the project, having them provide optimally structured 504 financing at the lowest possible cost and in a professional and expeditious manner, was critical to maximizing the benefit to our company and our community.

Conclusion
I understand that through 504, SBA provides the largest and most successful small business economic development financing program the Federal government has today. I hope I have shed some light on its real value to small businesses and to the American economy. It's significance reaches far beyond the statistics of numbers and dollars of lending done each year; the jobs and community development the loan helps to create and the business growth it fosters, the benefits to our employees and their families, and ultimately, our community, are all the direct result of the 504 loan program.
From a small business perspective, 504 and CDCs are a critical component in securing reasonable financing for growing small businesses in America. I know that without the staff at Horizon CDC, we would not be as successful as we are today - we would not have created as many new jobs or accomplished as much for our company or our community.
Many people are fond of saying that "small business is the engine that drives the United States economy", an idea in which I deeply believe. With your continued support and hopefully legislation for the enhancement of the 504 program, this will surely continue to be the case.

Again, I thank the Leadership, Committee Members and Committee staff for its tireless work in support of SBA and the 504 program. I am available for any questions you might have. Thank you.

America's Community Bankers Shaping Our Future

SUBMITTED TESTIMONY OF AMERICA'S COMMUNITY BANKERS BEFORE THE HOUSE SMALL BUSINESS COMMITTEE REGARDING INCREASING ACCESS TO CAPITAL FOR OUR NATION'S SMALL BUSINESSES

March 1, 2007

America's Community Bankers (ACB) appreciates the opportunity to submit the following statement to the House Small Business Committee on the topic of increasing access to capital for small businesses. ACB thanks Chairwoman Velazquez and Ranking Member Chabot for holding this very important and timely hearing to examine the various programs designed to provide capital for the estimated 20 million small businesses that have relied on the support offered through the Small Business Administration (SBA) since 1953.

ACB is a national trade association representing the nation's community banks of all charter types and sizes, including state and federally chartered savings institutions and commercial banks. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities. Our members are both stock and mutually owned.

At a time when the outsourcing of jobs overseas is becoming more and more common among large corporations, small businesses continue to be job incubators on main street America. These jobs are crucial to the financial well-being of our economy, and they allow the United States to compete with its global economic competitors. Access to capital must continue to be robust, and it is incumbent on Congress to keep this a priority. ACB member institutions are community-oriented banks, and small businesses are the cornerstone of many of our lending operations.

Many small business owners indicate that the single biggest obstacle to entry or expansion of their business is securing access to affordable capital. Because of the inherent risk in small business loans, banks need help in sharing the risk posed by making intermediate or long-term capital loans to small businesses. Without this crucial safety net, many small businesses would be unable to secure sensible financing on reasonable terms. In the past, the SBA has been an important partner in providing loan guaranty programs needed by community banks to provide the appropriate capital to their small business customers. The two SBA loan guaranty programs used by community banks today are the 7(a) and 504 programs.

The SBA 7(a) and 504 loan programs have successfully served as the premier small business government loan programs for emerging small businesses across the nation. These loans are a catalyst for economic growth, and they spur job creation in underserved areas. 7(a) loan proceeds can be used for a number of business purposes, including working capital, machinery and equipment, land and building, leasehold improvements, and debt refinancing. The loan maturity is up to 10 years for working capital and generally up to 25 years for fixed assets. An important concept of the 7(a) guaranty loan program is that the loan comes from a commercial lender – such as an ACB member institution – not the government. 504 loans provide small businesses with the necessary long-term, fixed-rate financing needed to acquire real estate or equipment for expansion or modernization. These programs are also a steady source of reliable capital for small businesses wishing to expand their business model and effectively plan for the future.

The 7(a) and 504 loan programs are sterling examples of effective public/private partnerships, which promote sound financial private sector entrepreneurship. ACB opposes any law or regulation that would handicap the ability of the SBA to provide community banks with ongoing, cost-effective and easily accessible, government-guaranteed loan programs for small businesses.

We are at a time when the federal budget is in deficit, and the Administration and Congress is forced to make difficult decisions regarding program funding. Over the last 7 years, funding for the SBA has been at a steady decline. Between the FY2002 and the FY2008 budget proposals, SBA has seen a 45 percent decrease in funding. For the FY2008, the budget would authorize $17.5 billion for the 7(a) loan program, and $7.5 billion for the 504 loan program. Although it calls for reducing fees in these loan programs, there is no direct loan funding, requiring them to continue on the self-funding basis.

The SBA loan program is the largest and most successful economic development program in the federal government, and Congress cannot allow budgetary or statutory impediments to create disincentives for the tens of thousands of lenders who currently assist the SBA in providing capital to our nation's small businesses. Because these programs operate at "zero subsidy," it is funded completely by user and lender fees. While we applaud the Administration for reducing the fee structure in their FY2008 budget proposal, ACB strongly supports Congress working to fully maximize the program's benefits and to safeguard against some of the unintended consequences associated with the program's reauthorization. ACB is concerned that increasing program costs will continue to make the program prohibitively expensive for both small businesses and lenders. Such consequences could ultimately inhibit participation by smaller lenders, which on the surface is counter-intuitive to the program's overall mission. We urge Congress to find a way to allow small lending institutions to overcome the hurdles they face when competing for SBA lending business with the larger banking enterprises.

Strengthening 7(a) and 504 Loan Guaranty Program will bring stability to the program and will reduce the burden on borrowers and lenders, since it will eliminate the potential for cost-shifting to offset program fees. ACB is encouraged by the Committee's examination of this very important issue today, and we appreciate the opportunity to offer comments for the hearing Record. We look forward to working with the Committee to actively promote awareness on the need to enhance small business access to capital, and to continue to share ACB's ongoing work to improve the economic health of our nation's small businesses.