FULL COMMITTEE HEARING ON LAYING THE GROUNDWORK FOR ECONOMIC RECOVERY: EXPANDING SMALL BUSINESS ACCESS TO CAPITAL

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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FULL COMMITTEE HEARING ON LAYING THE GROUNDWORK FOR ECONOMIC RECOVERY: EXPANDING SMALL BUSINESS ACCESS TO CAPITAL

Wednesday, June 10, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC. House of RepresentativesCommittee on Small BusinessWashington, D.C.

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [chairman of the Committee] presiding.

Present: Representatives Velázquez, Moore, Dahlkemper, Schrader, Bean, Altmire, Bright, Graves, Luetkemeyer and Coffman.

Chairwoman VELÁZQUEZ. The House Small Business Committee will come to order.

Whether you talk to the owners of a Silicon Valley start-up, a Mom and Pop restaurant or a hardware store on Main Street, entrepreneurs across the nation face a common challenge. They cannot find the capital necessary to sustain their businesses. For many firms, this can make the difference between staying open or going under.

During today's hearing we will examine what options are available to help small companies access capital. Lenders and entrepreneurs will share the real world challenges they face in today's tightened credit conditions, as well as their ideas for making things better.

In previous recessions, the Small Business Administration has filled the gaps in private capital markets. Today that is not the case. Loans funded by the SBA's flagship program have been double digit declines, meaning when we need the SBA to step in and help lift the capital markets, they are actually doing less. This is a result of poor policy decisions and a lack of funding at the agency over the last eight years finally taking its toll on the programs.

The American Recovery and Reinvestment Act has helped lay the foundation to start turning things around. The new law makes loans less expensive for borrowers, putting more money in the hands of small firms.

It also gives banks greater incentives to lend by increasing the percentage of a loan the government will guarantee. It is a start, but we have a long way to go.

Today the SBA has not implemented over half of the Recovery Act provisions that Congress passed and the President signed, but as more and more of these initiatives come on line, entrepreneurs should see an improved lending environment. Even with these steps, small businesses are still finding it difficult to secure credit. Overall lending is down over 50 percent. At this rate the SBA will make nearly $5 billion less in loans than it made in the previous year, demonstrating the serious difficulties in the credit market still exist.

How we overcome these challenges will be an important part of today's discussion. All options are on the table in finding a solution to these very real problems. Where we can enhance existing initiatives we should do so, but when programs no longer work, they must be replaced with measures that do meet small business' needs. No initiative should continue simply because of a special interest. The only measurements should be do these programs serve small businesses and do they help small firms access capital. If we cannot answer yes to both of those questions, then we have to ask why are they here.

Our goal must be to expand options for small businesses seeking financing. As with health care in many communities, entrepreneurs have only one or two options for lending. That is no real competition, and it does not give firms the flexibility they need to realize their potential to grow and create jobs.

Ultimately the full range of small business' capital needs must be met, from the micro borrower who needs a few thousand borrowers to the high growth company seeking equity investment. No such menu of choices exists today, and the options are becoming more limited. By the end of last year, venture capital was down 26 percent. Venture capital was instrumental to the role technology played in turning the economy around in the 1990s, and it will be just as important today as it was a decade ago.

In creating paths to capital for small firms we have our work cut out for us. If we have learned anything in recent years, it is that insuring the capital markets function smoothly requires a robust public-private partnership.

It is my hope that today's hearing begins a dialogue about how to renew that partnership. I have always said that access to capital is access to opportunity. In today's economy, the ability to tap into capital means a laid off worker can launch their own venture. It means companies who would otherwise close their doors stay open and keep providing jobs. It means that when the economy improves, small businesses can hire again and sustain our nation's recovery.

I thank our witnesses for taking time out of their busy schedule and companies to be here with us today, and now I yield to the Ranking Member, Mr. Graves, for his opening statement.

Mr. GRAVES. Thank you, Madam Chair.

I want to thank you for holding this important hearing on the ability of small businesses to obtain needed capital. Given the recent job numbers, the country will be relying on small businesses to help the American economy grow.

Although Shakespeare warned the people that the people should neither be a lender nor a borrower, he was unfamiliar with the modern American economy. Today the car-boat dealer needs financing to purchase inventory to resell. The home or commercial builder needs funds to buy land in the face of mortgage backed security debacles. The manufacturer needs funds for investing in the latest equipment to make it competitive in the global economy. Capital then is the life blood of the American economy.

There is no doubt that the current environment for raising capital is difficult even for the largest businesses with the AAA credit ratings when they have to compete against the voracious appetite of the most credit worthy borrower in the world, the United States government. So I can imagine how difficult it is for small businesses to find capital.

Since the end of the Korean conflict, the federal government has recognized that small businesses have a much harder time raising capital than their large business competitors. Programs overseen by the SBA provide small businesses with access to debt and equity financing. These programs have a number of restrictions and limitations that may reduce their utilization among small businesses.

In times of economic necessity, imposing unnecessary barriers to existing programs for providing capital seems counterintuitive. As a result, I am interested in hearing the opinions of our witnesses on the value of the SBA programs and what changes are needed to insure that America's small businesses can obtain the needed infusions of capital to keep the economy alive.

And, again, Madam Chair, I appreciate you having this hearing, and thank you to our witnesses for all coming a long way in many cases for being here.

Chairwoman VELÁZQUEZ. Thank you.

And I welcome our first witness, Ms. Cynthia Blankenship. She is the Vice Chairman and Chief Operating Officer of Bank of the West in Grapevine, Texas. Bank of the West was founded in 1985 and specializes in customer service and small business financing. She is testifying on behalf of the Independent Community Bankers of America. The ICBA represents more than 20,000 locations nationwide.

Welcome.

STATEMENT OF CYNTHIA BLANKENSHIP

Ms. BLANKENSHIP. Thank you, Chairman Velázquez and Ranking Member Graves.

I appreciate the opportunity to be here today and present the views of the nation's community banks on both capital markets and small business lending.

In addition to small business lending, Bank of the West has been a long time partner with the Small Business Administration and is strongly committed to helping our communities, using the SBA's 7(a) program and the 504 loan program. Bank of the West has more than $10 million in SBA loans in its portfolio, and we service these loans. This represents six percent of our total loans.

Notably, as of May, our total small business lending and SBA lending are running ahead of the amount last year in 2008. So we are doing our part and working hard to get capital out there to the deserving small businesses.

My bank's SBA loans create hundreds of jobs by financing the local preschool, health center, hardware store, and auto dealer.

Community banks represent the other side of the financial story. Community banks like Bank of the West experienced difficult economic times before, and like always, we stick with our communities and our small business customers.

As Chairman of the ICBA, I was recently honored to participate with President Obama and Treasury Secretary Geithner, as well as Chairman Velázquez and Ranking Member Graves, in advancing important policy initiatives to small business lending.

ICBA strongly supports the recent initiatives to bolster small business loan program included in the American Recovery and Reinvestment Act of 2009. SBA lending program must serve as a counterbalance during these challenge credit markets for small businesses.

Unfortunately, at a time when the economy is faltering, the sharp 2009 decline in the number of SBA loans is troubling. The recent uptick in SBA loans is a positive and welcome sign, but we still have a very long way to go before it reaches solid levels again.

Community banks are well positioned and willing to help get our economy back on track. While community banks represent 12 percent of all bank assets, they make 20 percent of all business loans and more than half of all business loans under $100,000. Some 48 percent of small businesses get their financing from banks with one billion dollars and less in assets.

Therefore, we encourage policy makers to be mindful and supportive of the community banking sector's important role in supplying credit to small business. To that end, ICBA supports strong SBA programs, fair regulatory treatment and tax policies that will foster robust community bank small business lending.

Specifically, ICBA appreciates your work, Chairman Velázquez, and the work of the Committee in enacting $730 million in ICBA-backed SBA-related funding in the American Recovery and Reinvestment Act. This included reduced fees for borrowers and lenders and increased guaranty levels, a new deferred payment program, and a secondary market initiative.

Given the prolonged length and depth of the recession, the credit crunch, ICBA encourages Congress to extend or make permanent the SBA fee reductions beyond 2009. We urge SBA to follow the statute and Congress' intent to give priority to small banks in implementing the 7(a) lender fee reduction.

ICBA is encouraged to see the SBA finishing the implementation of the ARC loan program. This program will allow existing small business bank customers to better service their debt and ride out the economic slowdown.

The SBA market must be restored. I know first hand that my bank would be able to make more small business loans if I was able to sell my existing inventory into the secondary market. ICBA offers several additional policy recommendations aimed at returning more community banks to SBA lending. These include insuring SBA makes good on their loan guarantees and provides more flexibility in small business size standards and market-based loan pricing.

ICBA also believes the bank regulatory pendulum has swung too far and is crushing many community banks' ability to lend to small businesses.

In conclusion, the need for affordable small business capital is greater than ever. Community bankers run small businesses themselves, live and work in the communities with their small business customers, and we will do everything we can to insure that we meet the credit needs of our local community.

Thank you.

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

Chairwoman VELÁZQUEZ. Thank you.

Our next witness is Ms. Jean Wojtowicz. She is the chair of the Board of Directors of the National Association of Development Companies. She is also founder of Cambridge Capital Management Corporation, a manager of nontraditional sources of capital for businesses in Indianapolis, Indiana. The National Association of Development Companies provides legislative and regulatory support for its members.

Welcome.

STATEMENT OF JEAN WOJTOWICZ

Ms. WOJTOWICZ. Thank you.

I am so pleased to be here, and I would like to thank the entire Committee for their continued support of the CDC industry and the 504 loan program.

First I would like to discuss the need to reduce the cost of this program. SBA has informed us that its 2010 budget increases the cost of 504 loans by 38.9 basis points per annum, and this is due to at least two factors in the SBA's econometric subsidy model: the national unemployment rate and the forecast of the 504 default rate.

With both of these factors being impacted by the current recession and their real effect expected to be shortlived, we ask the Committee to consider requesting an appropriation sufficient to offset this fee increase for the next two years as small businesses return to a growth mode and improve their cash flow.

This request needs immediate attention in order to negate the impact of this fee increase on our borrowers for fiscal 2010. It is inconsistent in this economy to offer small businesses fee relief through the stimulus bill in February of 2009 and turn around and increase their cost of borrowing in October of that same year.

Second, we need to reach out to more small businesses. Our industry thanks the Small Business Committees for their leadership role in adding key programs to the stimulus bill earlier this year that are beginning to impact capital access and job creation.

However, we believe that more should be done quickly to have added impact. Even as SBA works to implement new programs and fee reductions created in the stimulus bill, the loan eligibility and underwriting criteria to maximize the effectiveness of these programs are drifting toward more conservative and restrictive interpretations.

For example, SBA has moved to restrict borrowers from accessing their personal home equity in order to inject these funds into 504 expansion projects. NADCO has prevailed upon the agency to reconsider this policy while they collect additional data. We are hopeful that when SBA completes this analysis they will again allow business owners to inject capital in any way possible.

We believe that many small businesses either need access to larger loan amounts or have already reached their maximum availability under current law. This can be addressed in three ways.

First, increase the maximum 504 debenture beyond its current limit of $1.5 million.

Second, allow a borrower to maximize use of both 504 and 7(a) loan limits.

And, third, eliminate the regulation that restricts business owners with higher net work and liquidity from accessing these loans.

Next I would like to emphasize the need to reduce loan losses with more effort devoted to loan liquidation and recoveries. At Congress' direction several years ago, SBA created a new regulation that enabled it to take advantage of the recovery expertise within the CDC industry. Many CDCs already performed such tasks for other loan programs that they administer. They have simply not been given the ability and the freedom by SBA to do this on a broad scale for their 504 loans.

NADCO believes that losses can be reduced if CDCs are actively engaged in the loan recovery process. This will require cooperation with rather than dictation from SBA liquidation staff.

Further, NADCO proposes that SBA use its loan servicing contractor to speed up collection and payments for defaulted loans and we ask that this accounting information be made available to CDCs to assist them in their recovery efforts. Can you imagine trying to collect a loan without being able to tell the borrower what the balance is or in today's electronic age not being able to have a borrower wire a payment or send an ACH payment on a defaulted loan?

The SBA loan programs are over 20 years old, and an environment of restrictive and overbearing regulations has evolved within the agency. With this new administration and fresh thinking from senior policy makers, NADCO sees an opportunity to break out of the old program structure and bureaucracy. We see the chance to work with this new leadership team and with the new Congress to expand program benefits to more borrowers.

Like any maturing organization, SBA has to reevaluate its products to serve the changing needs of small businesses. NADCO urges Congress to collaborate with the new SBA management and with far sighted, market driven lenders to create the financing and economic development programs so vital to America's future. Nimble and forward thinking small businesses will lead us out of this recession. Let's help them do it sooner. Working together, we can get America working.

Thank you.

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

Chairwoman VELÁZQUEZ. Thank you.

And I welcome now Mr. Roger Heacock. He is the president and CEO of the Black Hill Federal Credit Union in Rapid City, South Dakota. The Black Hill Federal Credit Union has over 49,000 members with assets of more than $765 million.

Mr. Heacock is here to testify on behalf of the Credit Union National Association, the national trade association serving America's credit unions.

Welcome.

STATEMENT OF ROGER HEACOCK

Mr. HEACOCK. Chairwoman Velázquez, Ranking Member Graves, and members of the Committee, thank you so much for the opportunity to testify on behalf of the Credit Union National Association. I am honored to address the impact SBA lending has on our local economy, our credit union, and our members, and to suggest ways to improve SBA programs.

Black Hills was first authorized to do SBA lending in January 2003, and we truly value our partnership with the SBA. We wrote more SBA loans than any other financial institution in South Dakota during 2008, 29 loans for a total of $1.6 million. We are looking forward to working with new SBA Administrator Karen Hills and find working with the SBA beneficial to the credit union and our members for several reasons.

We have a number of members who started small businesses using SBA loan funds while continuing to work at their primary job as their main source of income. The SBA helped us be there for our members, and this has resulted in additional employment opportunities.

There is additional risk to these types of borrowers, and quite frankly, other lenders shy away from helping them because there is not a proven cash flow. We are able to do this type of lending because of the guarantee that SBA provides. The programs allow us to help the borrower who comes in and may not have the equity investment we would generally like to see but has a good business plan. The SBA helps us create an acceptable level of risk, and it is a win-win situation for all of us, the credit union, the SBA, and the borrower.

CUNA is a strong supporter of the 7(a) and 504 loan programs, essential tools for achieving our mission to serve the needs of members. However, several important factors discourage more credit unions from participating as SBA lenders.

First, the statutory cap on credit union MBLs restricts the ability of credit unions from helping their members even more. Even though the cap does not apply to SBA loans, it is a real barrier, keeping some credit unions from establishing an MBL program at all.

Not all loans fit SBA parameters, and credit unions are reluctant to initiate an MBL program when they may reach the cap in a fairly short order. CUNA is also aware that some lenders have not had a positive experience with the SBA, citing the application process, fees, and time of decision making.

In that vein, we think there are ways to improve the work that is done by the SBA. As the Committee reviews SBA programs, we encourage Congress to make additional funds available to the agency so that fees can remain low and the guarantees can remain sufficient.

We appreciate Congress setting aside $375 million for the temporary elimination of fees and raising the guaranty percentage on some loans to 90 percent as part of the Recovery Act.

In closing, credit union business lending represents just over one percent of the depository institution business lending market. Credit unions have about $33 billion in outstanding business loans compared to $3.1 trillion for banking institutions. We are not financing skyscrapers or sports arenas. We are making loans to members who own and operate small businesses.

Despite the financial crisis, the chief obstacle for credit union business lending is not the availability of capital. Credit unions are, in general, well capitalized. Rather, the chief obstacle is the statutory limits imposed by Congress in 1998. Under current law, credit unions are restricted from member business lending in excess of 12.25 percent of their total assets. This arbitrary cap has no basis in either actual credit union business lending or safety and soundness considerations.

And the U.S. Treasury Department found that delinquencies and charge-offs for credit union business loans were much lower than that for either banks or thrifts.

The cap effectively limits entry into the business lending arena on the part of small and medium size credit unions, the vast majority of all credit unions, because the costs and requirements, including the need to hire and retain staff with business lending experience exceed resources of many credit unions.

While we support strong regulatory oversight of member business lending, there is no safety and soundness rationale for the cap. There is, however, a significant economic reason to eliminate the cap. America's small business needs access to capital.

We estimate that if the cap on credit union business lending were removed, credit unions could safely and soundly provide as much as $10 billion for new loans for small businesses within the first year. This is an economic stimulus that would not cost the taxpayers a dime or increase the size of government.

Madam Chairwoman, thank you very much for convening this hearing and inviting me to testify. I look forward to answering the Committee's questions.

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

Chairwoman VELÁZQUEZ. Thank you, Mr. Heacock.

Our next witness is Ms. Hollis Huels. Ms. Huels is the Senior Vice President of Capital for Business in St. Louis, Missouri. Capital for Business is a national private investment firm focused on providing capital to middle market businesses.

Ms. Huels is testifying on behalf of the National Association of Small Business Investment Companies, the oldest organization of venture capitalists in the world.

Welcome.

STATEMENT OF HOLLIS A. HUELS

Ms. HUELS. Madam Chair, Ranking Member, members of the Committee, thank you so much for the opportunity to appear today and offer the National Association of Small Business Investment Companies' views on expanding small business access to capital.

I am a Senior Vice President and a partner with Capital for Business. We are a private equity fund headquartered in St. Louis, Missouri, and have been an active investor through the SBIC program for almost 50 years. I am also chair of our Board of Governors of NASBIC.

We appreciate the Committee's continued commitment to small business. We particularly appreciate the SBIC reforms that were included in the Recovery Act. Your actions have helped many of our small business partners.

SBICs are private equity funds that invest exclusively in domestic small businesses. While the bigger names in private equity and venture capital invest globally, SBICs invest locally in Main Street businesses. Many of SBA's greatest success stories, Federal Express, Intel, Outback Steakhouse, Whole Foods, Apple, Quiznos, and many, many more received their early funding through the SBIC program.

SBICs should be part of your approach to end the recession, grow the economy and create jobs. The SBIC program has been a successful, market-driven, collaboration providing over $55 billion of financing to over 106,000 U.S. businesses. While these are large numbers, the program is currently underutilized.

The program's design is simple and effective. Debenture SBIC fund managers raise private capital for investment in small business and are able to enhance these investment by borrowing periodically from the SBA. Currently, the SBIC debenture program has capacity to facilitate investments of about $4 billion a year in America's small business. However, currently only $1.5 billion are being utilized. Over the next four years, this is an opportunity cost of approximately $10 billion.

SBICs are needed now. Small business investment is in tight supply, but demand is strong. It is in times of economic stress that small business can be nimble and take advantage of growth opportunities, but they need access to capital.

We recently polled our NASBIC members found that 100 percent of the respondents reported that banks are pulling or reducing their senior lines of credit available. Seventy-five percent of the respondents reported less subordinated debt available for small business.

One of the most respected publications in the lower middle market, GF Data Resources, recently reported that "we are now in the throes of a dramatic slowdown in non-distressed private equity sponsored buy-out activity." While this year SBICs have invested in over 1,000 companies with an average investment of just over a million dollars, the impact of SBICs is hindered by the relatively low number of licensees. Imagine what could be done if the program were running anywhere near full capacity.

For seed and early stage companies the situation is even worse. Early stage and equity investing for small business has largely dried up. A recent survey by the National Association of Seed and

Venture Funds found that 90 percent of early stage entrepreneurial companies, some of the nation's best job creators, are having serious difficulty raising follow-on capital.

The SBA previously had an effective tool that was exceptionally successful at using the private market to steer equity investments into domestic small business with taxpayer money as an enhancement. While it lasted, this program invested over $13 billion and over 385,000 new jobs were created and hundreds of thousands of more were saved.

While almost 70 percent of venture capital goes to high tech and life science industries, this program invested in small business manufacturing.

Unfortunately for America's small business, the demand for the SBIC capital is increasing at a time when the SBIC program is at its nadir. Last year, only six SBIC funds were licensed. This is down over 90 percent from the peak. Licensing from the 1990s only took a few months, and in contrast, last year many SBICs had to wait well over a year.

The good news is that for Fiscal Year 2009, the SBA has already licensed nine SBICs, an increase of over 50 percent from the prior year. The SBA is openly trying to get licensing waiting periods down to four months. This is a great start, but we would be in a better place if 30 or 40 new funds were licensed each year.

There is evidence of a dramatic uptick in the number of fund managers interested in becoming SBICs. The program should welcome more funds and investors and thereby providing a market-based solution to the current capital crunch.

My written testimony details and explains the areas of improvement and reform, but I will briefly describe them. First, increase the number of SBICs. Keep the successful funds in the program. We need more SBICs in more places, particularly the West.

Insure that the SBICs that can raise private capital are not placed at a disadvantage and implement the energy debenture.

We also need to provide incentives for banks and others to invest in SBICs and create a stable equity option for early stage investment.

In conclusion, the Recovery Act it was projected to save or create four million jobs cost nearly 197,000 per job. The small business jobs can be created for far less, close to 11 to $33,000 per job. If we take advantage of the SBIC program we can have a real impact on small business.

Thank you.

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

Chairwoman VELÁZQUEZ. Thank you.

Our next witness is Mr. Michael McGannon. He is the Senior Vice President and Chief Lending Officer of Country Club Bank in Kansas City, Missouri. Country Club Bank was founded in 1953 and is based in Shawnee Mission, Kansas.

Mr. McGannon is testifying on behalf of the American Bankers Association, found in 1975. The ABA brings together banks of all sizes and charters into one association.

Welcome.

STATEMENT OF MICHAEL McGANNON

Mr. MCGANNON. Thank you, Chairwoman Velázquez, Ranking Member Graves and members of the Committee.

My name is Michael McGannon, Senior Vice President and Chief Lending Officer of Country Club Bank in Kansas City, Missouri.

Country Club Bank is a family owned community bank with over $650 million in assets.

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

The topic of SBA lending for small businesses is especially important and timely. The efforts that have been made by this Committee, the Congress as a whole, and the administration to improve the environment and opportunities for small businesses through changes to the SBA program have been needed for many years. These changes are particularly important in the difficult economic conditions which are affecting all businesses, including banks.

The SBA program has struggled over the last several years. SBA Fiscal Year 2008 loan volume figures showed a 30 percent decline year over year in the 7(a) loan guaranty program, and Fiscal Year 2009 figures would indicate a similar reduction in volume.

The economy is certainly playing a significant role in overall loan volume decline. However, many lenders are concerned that this decline is also due to SBA programs becoming too costly and difficult for lenders and small businesses who wish to access the program.

For this reason we recommend the following changes to the SBA program. First, SBA should work with trade associations like ABA to formulate SBA programs that are attractive to lenders of all sizes, and especially to community bankers. Most small community banks are intimidated by the amount of paperwork required for a regular SBA 7(a) loan. In the past the SBA had a product in which there was a two-page application for the bank to complete and had an 80 percent guarantee. This program has been eliminated.

Furthermore, the SBA needs to eliminate the financial and human resource burden on community banks created by SBA audits, particularly a concern with several new programs coming on line this year. These audits review loans already on the books that are already being scrutinized by other federal regulators, such as the FDIC or the OCC.

Worse, banks are required to pay for their own SBA audit even though it does nothing to correct or stabilize a loan or to assist if there is the need for a liquidation.

Second, SBA should reduce the time it takes for participating banks to collect on loan guarantees. In our own experience, we have been fortunate to collect on all guarantees submitted. However, the time frame for these collections is sporadic. There is a near universal agreement in the lending community that efforts to collect on the loan guarantee from SBA can be a time consuming and costly process.

Third, community banks need personal contacts with knowledgeable people who can answer our questions. Our bank has had the benefit of a very cooperative SBA office in Kansas City. This relationship has been vital in making sure we stay on track with new changes in SBA regulations.

However, banks in outlying areas do not have the benefit of a local SBA office that understands them, their clients or their town. Instead, they have to contact someone at a 1-800 number and get answers to questions.

As a community banker from Missouri, I take pride in knowing the business and the community that an entrepreneur is trying to serve. It is critical that SBA returns to a model of helping local small businesses and banks through off-site training programs that can tend to the needs of the lending partnership.

Thank you for your time and attention today.

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

Chairwoman VELÁZQUEZ. Thank you, Mr. McGannon.

Ms. Blankenship, I would like to address my first question to you, if I may. You mentioned a problem and Mr. McGannon also mentioned the same problem with the SBA either denying or delaying payment on guarantees. Can you talk to us about how serious this problem is, and if so, how does it affect the program's overall success?

Ms. BLANKENSHIP. Well, in my own experience at our bank, we have not been denied any of the guarantees when we have had to go back to SBA. However, I have heard through the association that there are banks. There is a grumbling that there are many delays and maybe they are just getting a little pickier on the paperwork and the appraisals.

And what that does is just foster an air of distrust with using that program. If a bank can be able to rely on that guaranty, then they feel very comfortable in using that program and it works to their benefit. But if they do not know that the government will stand behind the guaranty, then it will affect the program.

Mr. MCGANNON. The SOP manual from the SBA is over 400 pages long, and I think that if you are not a banker that is in the routine of making SBA loans, you get lost on dotting all of the Is and crossing all of the Ts.

My sense is that, and once again, we have never had a problem collecting on a guaranty. Sometimes it takes longer than we would like, but we have been paid in full. I think the concern with bankers that are not in the routine of making SBA loans would find that trying to follow the SOB, trying to be sure that disbursements are appropriate at the front end, I think a lot of bankers may have trouble documenting or remembering to document the use of proceeds on the front end of an SBA loan, and when it comes time to collect on a defaulted loan, they may not have the paperwork in place to step through the disbursement process on the front end.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Huels, one of the short comings of Government Investment Program is the emphasis placed on early results. Consequently, there is a tendency to prematurely terminate programs that do not achieve results immediately. In the case of patient equity investment, how long does it take for investment programs to bear fruit?

Ms. HUELS. That is a great question. When equity capital is invested into a company, there is an immediate impact as far as the ability to hire employees, which will reduce the unemployment rate or increase the employment. So those dollars and the resulting payroll taxes and things, you will see an immediate impact.

In the midterm, you see an impact. The company that receives equity capital is obviously buying goods and services from other companies so that capital is spent through the economy by buying goods and services.

I think what you are referring to is when do you see return on your equity capital, and most private equity funds have a ten-year life. They spend the first three to five years investing the capital. Then the companies need time to mature and to grow, and then those investments are typically harvested in a seven to ten-year time frame. It is patient capital. It takes quite a while.

Chairwoman VELÁZQUEZ. Okay. Thank you.

Ms. Wojtowicz, we are all aware that the current recession grew out of the collapse in real estate prices, and this has significant consequences for the 504 program, which is often used to finance real estate. Do you believe that the SBA and the CDC community have the tools to mitigate potential fallout from these conditions?

Ms. WOJTOWICZ. I certainly do. I actually think that the depression in the real estate prices will create some opportunities. We have certainly seen an uptick in our backlog of new transactions where borrowers who have previously been leasing facilities are now seeing clear and finding some bargains actually in the commercial real estate market.

As it relates to our existing portfolio, I think we have to be very cautious. We do have to find a way to be patient. This is not the time to be trying to liquidate or to force liquidation of real estate holdings if there is any changed of rehabilitating a borrower. Forcing a borrower, walking through a foreclosure and trying to sell commercial real estate in this market will only increase the losses to the program and the taxpayer.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Blankenship, today, and you were in the White House participating with President Barack Obama when he made that announcement for the use of money for a lending facility through Treasury for small businesses, but the Federal Reserve TALF program has only lent roughly $116 million back with small business loans. Meanwhile Treasury's $15 billion SBA loan purchase program has yet to make a single transaction.

Given these factors, do you think more should be done to restart the secondary market for SBA loans?

Ms. BLANKENSHIP. I certainly continue to say that the secondary market plays a very critical role because you understand that when we make those loans, our bank does not typically hold the loans. We sell those guaranteed portions back into the secondary market, allowing us to then re-leverage those funds into additional loans.

When there is no secondary market, then that is what causes the freeze of credit. We are seeing some recovery on the bank side in the secondary market. I think the dealer side is still suffering. The

TALF program, I think the challenges there were that you had to go through a primary dealer, and there were some issues about releasing your customers' names, and so that is an issue.

The White House plan, I am not sure what the holdup is there. So whatever we need to do, we need to make sure that we continue to look at the secondary market and continue to push initiatives that will restore that market and restore the confidence, and that is really what it boils down to is the confidence in that market.

Chairwoman VELÁZQUEZ. But you feel that the way the program was structured it will unlock the secondary market?

Ms. BLANKENSHIP. I think there is a ways to go yet. I think perhaps maybe a panel of bankers and broker-dealers could be brought in and maybe asked their opinion. Where is the freeze occurring? What is the holdup? Is it the paperwork? Is it the burden?

And, you know, with the TALF funds, there were additional restrictions placed on banks and brokers. So that is an issue.

Chairwoman VELÁZQUEZ. Mr. McGannon.

Mr. MCGANNON. I would certainly agree with Cynthia. As far as Country Club Bank goes, we have always held our SBA loans. I think that we just have never had reliance on the secondary market. If it is out of our control, I think that we feel like we need to try to take care of what we are funding.

But Cynthia is right. If the secondary market does open up, it does give every bank an opportunity to re-leverage those dollars into more SBA lending.

Chairwoman VELÁZQUEZ. Thanks.

Mr. Heacock, do you believe that the Small Business Administration is doing enough to encourage and train new lenders to participate in this program?

Mr. HEACOCK. I cannot say I have an answer to that.

Chairwoman VELÁZQUEZ. That is troubling.

Mr. HEACOCK. Well, whether they are doing enough because in our area we have had a great relationship with the district office, and we get all of the assistance we need as far as training. They have monthly teleconferences, and so we really do get adequate training.

Nationwide I cannot speak to that, but locally, excellent.

Chairwoman VELÁZQUEZ. Thank you.

Now I recognize the gentleman, Mr. Graves, Ranking Member.

Mr. GRAVES. Thanks, Madam Chair.

My first question is to Ms. Huels.

Has the economy changed as far as your investment practices go? With the downturn in the economy, have you changed your policies or practices or backed off or anything like that?

Ms. HUELS. We have not. We invest primarily in midwest based industrial manufacturing companies, and while many may think manufacturing has declined in this country, we find there are significant opportunities to invest in growing middle market, lower middle market manufacturing companies.

We have not changed our profile. If there is a profile that has changed, it is really the availability of senior lending available to us. So what we have done is we have had to write a little bit bigger check and provide more of the capital because the senior lenders are typically providing less.

Mr. GRAVES. When you talk about middle range, what is that range?

Ms. HUELS. For us the middle market is a company with seven to $100 million in revenues, relatively small companies in comparison to some of the large multinationals we read about.

Mr. GRAVES. And my next question is for the lenders out there, and we can start with Mr. McGannon, and it is the same question as far as your lending practices go in light of the economy. Have you all backed off? Have you increased?

I mean, are you requiring more from investors?

Mr. MCGANNON. We had a 12 percent increase in loan activity in 2008, and looking back at 2008 just briefly, we got off to a slow start, not unlike 2009 in terms of actual loan growth. We accelerated throughout the year, even through September into the end of the year of 2008, when obviously things started to cycle downward in the economy.

In 2009, we have had just moderate growth year to date, but I can tell you that our pipeline is growing in terms of pending loan requests. There was more activity in April in terms of new loans booked than we had since last September. So am encouraged by that.

Our loan requests are down. It is a quieter time. Without question I think there are a lot of borrowers that are reassessing whatever their business is. But having said that, we are gaining market share from other financial institutions in the Kansas City marketplace.

Our underwriting, I get that question asked a lot. Our underwriting really has not changed. We feel like we have had a strong credit culture in our bank for many years. Certainly we are more concerned about collateral values, and so we may, in fact, when you think about underwriting, we may well, in fact, require more money down on a particular project if it is real estate related, as an example.

But by and large, our underwriting remains unchanged.

Mr. GRAVES. How about the credit unions, Mr. Heacock?

Mr. HEACOCK. Thank you.

We have not backed off at all. As I said before, we wrote more SBA loans than any other lender in South Dakota last year, and it is continuing this year.

As far as non-SBA loans, we had a record year last year and it is continuing very, very strong. Credit unions nationwide, for the most part, have plenty of capital to lend, and we have had, I know, locally some financial institutions that are not willing to lend to some small businesses. Also, they are changing some terms and conditions. They are coming to us.

Oftentimes we can help them. Sometimes we cannot, but we are there and available and have the funding.

Mr. GRAVES. Ms. Blankenship.

Ms. BLANKENSHIP. Yes. Actually our loans increased just over ten percent from 2007 to 2008 as well, but interestingly, our SBA loan percentages have been running about two to two and a half percent per year of our total portfolio. This year it is running 6.38. So we have really gotten behind a push to use the SBA program because what banks are facing right now is kind of a double-edged sworn.

You hear Congress saying, “Lend, lend, lend,” but then the examiners are overreacting and they are coming in and we are getting stories of, you know, all commercial real estate being classified.

So, you know, in my opinion, this is an opportune time to use the SBA program because you can mitigate some of that because you have that guaranty. Because the overwhelming majority of SBA loans will include typically, at least in our portfolio, some type of real estate as collateral.

So we really need to mitigate the overreaction from the examining force. Again, I think it has been stated today there is an opportune time.

The only other thing that I think would make the program more accessible in these times is perhaps raising the limits that we currently have on the size of 7(a) loans, and I think also on the 504s. So I think that would help a lot.

Mr. GRAVES. Jean, how about the development side?

Ms. WOJTOWICZ. Well, if you take a look at our national statistics, we saw record years in 2006 and 2007. Two thousand eight fell off significantly, and 2009 is off again, at least in our own portfolio in the national statistics as well.

We cannot do a 504 loan unless we have a bank partner. I would say that when I look at my list of partners that are working with us on transactions, it does tend to be more of the community banks and fewer of the national lenders in that scope. The high point is starting to grow, but certainly not yet at a level to return us to where we were two years ago, and it is a significant concern.

Chairwoman VELÁZQUEZ. Mr. Moore.

Mr. MOORE. Thank you, Madam Chair.

And I would like to welcome Mr. McGannon, who is from our area in the Kansas City area, and I appreciate all of the witnesses who are testifying today.

The American Recovery and Reinvestment Act signed into law by President Obama in March included a number of provisions designed to increase small business lending through Small Business Administration programs. Specifically, the stimulus law increased to 90 percent the SBA guarantee on 7(a) loans, temporarily waived the guarantee fee on 7(a) loans, and provided incentives to restate the secondary market in which lenders sell portions of SBA loans to private brokers and investors.

What effect has the Recovery Act had on your ability to make SBA-backed loans? And I would ask that question to any of the witnesses who care to answer.

Ms. Blankenship.

Ms. BLANKENSHIP. Yes. Well, as I stated just earlier, our percentage of our total loan portfolio has been running about two and a half and now it is almost six and a half. And so we have really utilized that program, and just as of yesterday we had the local SBA office out of the Dallas area come in and talk to 20 of our lenders about the enhanced programs both on the 504 and the 7(a) because we, again, feel like this is the time to really maximize the use of this program.

Mr. MOORE. Very good. Any other witnesses? Mr. Heacock, and Mr. McGannon, you will be next.

Mr. HEACOCK. I know on a state level, the temporary elimination of fees has been very, very important. Apparently the volume declined quite a bit at the end of last year, last fall, but with the elimination of fees the volume has picked up considerably.

Mr. MOORE. Thank you.

Mr. McGannon.

Mr. MCGANNON. I would agree. I think that like any other product, it has to be competitive, and to eliminate the guarantee fee makes the product more competitive to other traditional bank financing vehicles.

I would also say that the ARC program is very timely, and I think that it will serve a direct purpose. I can think of three or four borrowers in our bank right now that would certainly qualify and benefit from a program like that.

Mr. MOORE. Thank you, Mr. McGannon.

Madam Chair, I had a second question on secondary markets, but you have already asked the question. So I will yield back my time and thank you very much to the witnesses.

Chairwoman VELÁZQUEZ. Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Ms. Blankenship, you made a comment a minute ago and during your testimony with regards to the impact of regulatory authorities coming into the bank. Can you elaborate on that a little bit more?

Ms. BLANKENSHIP. Certainly. What we have seen is just because of the past six months and the financial meltdown that we are all getting painted with the same brush, and while the big banks got bailed out and were given the TARP money, their primary intent for that was to lend money. But yet what we are hearing from small businesses is that they cannot get it.

This is a double-edged sword because the banks are willing to lend. They have capital to lend. We have heard that here today, and that continues to be true the community banks, but the examiners are painting us all with one brush. They are painting the small banks the same way they do the two big to fail banks.

And so when they come in and say, "Okay. If you have got commercial real estate," and we have heard stories like this, "we are going to classify it across the board," well, even if you are using an SBA program for our reporting purposes, that has to be reported as commercial real estate, and if you have a regional office, regardless of what the mandate is from Washington, sometimes the examiners in the field do not always carry the same operating procedures and practices as we hear out of the head offices in Washington.

So it can make banks hesitant to make those types of loans because at a time like this, we cannot afford for perhaps you are a well capitalized bank, and if you have certain classifications, your ratings go down and you fall into adequately capitalized. Then your FDIC assessment goes up, and all of our costs. There is a tremendous amount of cost being levied on the small banks right now.

Mr. LUETKEMEYER. You are a great witness. You answered the question perfectly. I do not have to do any more leading questions with you.

Mr. MCGANNON. May I add something? I am sorry.

Mr. LUETKEMEYER. Yes. You are next, sir.

Mr. MCGANNON. Okay.

Mr. LUETKEMEYER. Go ahead.

Mr. MCGANNON. Cynthia obviously is right about the regulatory environment. Examinations have never been tougher, and I have found myself on many occasions really working hard to defend in front of regulators good customers of the bank, good borrowers, performing loans. You know, maybe there is a shortfall from a collateral standpoint, but again, that is a secondary source of repayment, the primary source of repayment being their business and their income that they are generating, how they are stepping up to support their businesses.

And so it takes a few days to get over an examination and literally to get back into being upbeat about lending into your community. That is what we all want to do. That is what we are paid to do as a community bank. It is our duty to do that, but you almost have to really regroup after an examination.

Mr. LUETKEMEYER. It has been my experience in dealing with the banking community in my district and my state that there seems to be a disconnect from Washington and the local regulators. Is that what you are seeing?

In other words, Washington says we have not changed our criteria. We have not changed our examination procedures or the way we look at stuff, and yet when you have the examiners come in, it is a whole different world with the way they come in, and they, again, paint you with a broad brush, as Ms. Blankenship said.

Mr. MCGANNON. It is very true.

Ms. BLANKENSHIP. That is correct.

Mr. LUETKEMEYER. One of the questions that I want to have for you two again, as well, with regards to the TARP funds, did either one of your two institutions take any of those?

Mr. MCGANNON. No.

Ms. BLANKENSHIP. I did not.

Mr. LUETKEMEYER. Okay. One of the questions that has been posed to me with regard to the TARP funds is initially they were supposed to be for the banks that were in trouble, for the institutions that were in trouble, and as I have seen the funds dispersed, it seems like it has gone to more and more institutions that are not in trouble.

And in fact, I have found that some of the banks were asked to take the money so that they would go out and buy other banks rather than actually absorb weak assets.

Have you seen or heard of instances like that or are you aware that we have an opportunity maybe to help a weak bank with the TARP funds that we have not taken advantage of?

Ms. BLANKENSHIP. As I understand from Treasury Secretary Geithner was present at one of our meetings several weeks ago, and he indicated that there would be an initiative for some of the perhaps returned TARP funds to go to some of the banks that had applied and perhaps had missed the deadline or did not qualify the first time around.

I think just from my experience I am hearing that a lot of smaller community banks have opted not necessarily to use that program because of the regulatory burden associated with it, and typically those banks are well capitalized.

We did not use it. We would have considered possibly using it, and I think there are some opportunities for an additional program perhaps that would fund M&A activity of, say, a strong community bank to acquire a weak or a failing community bank with the assistance, but I do not know that under the current program a lot of banks would be willing to accept the terms associated with that.

But I think you could take those TARP funds and perhaps look at another initiative if you wanted to look at the M&A.

Mr. LUETKEMEYER. Very good. Thank you.

Thank you, Madam Chairman

Chairwoman VELÁZQUEZ. Ms. Bean.

Ms. BEAN. thank you, Madam Chairwoman, for holding the Committee and this hearing. It has been an important issue, access to affordable capital for our small businesses.

I want to thank our witnesses today for echoing the importance of the small business to our economic recovery and the importance of access to capital.

This week before I came out to Washington, I hosted in Illinois, which I represent with Senator Durbin a round table of small businesses who had been participating or were considering working with the SBA lending programs, and some had expressed past frustrations, but also like many of you today have expressed hopefulness about the new programs and some of the things that were done on the stimulus.

And we really did it to help get the word out. I know one of the questions from one of my colleagues was is the SBA getting the word out. I know in Illinois they were very helpful in trying to let people become aware of some of the new resources that are available.

And I know, Ms. Blankenship, you had been there with us at the press conference at the White House when the President had committed the $15 billion to try and get additional funding to get the secondary market moving, but I think that was following the AIG bonus fallout. So the press entirely did not cover it. So in an effort to let some of our community lenders and businesses know, we hosted a round table. It was very well received.

The good news that I was hearing from them, and I just want to get your thoughts, was that they are seeing from where particularly in the secondary market it had been up at about 325, 328 million per month, was the activity; so many of the community banks in our area were finding about roughly half of the SBA loans they would write they would then move quickly into the secondary market and, as you said, they could then recycle that capital back into new loans; that it dropped off after September with the credit crunch to a low point of only 85 million.

And so at a time when businesses needed even more access to capital, there was less available, but from what I have heard, and again, Ms. Blankenship mentioned it in your testimony, we have seen that now get closer to those levels back pre-September in recent weeks, and so that is a hopeful thing.

And I know they have also, in talking to Administrator Mills at the SBA, they have really worked to address some of the issues to get the 15 billion moving, and they are just getting training going on that.

I just wanted to see if you had any further thoughts about the ARC programs, which will be loans and increments of 35,000 that should start rolling out June 15th, to help. It is something that the Chairwoman and many of us on the Committee have long advocated for, is to allow businesses who have been longstanding, ongoing. profitable entities, sometimes businesses that have been around for generations, who have seen their credit lines dry up, either taken away or reduced significantly even without a late payment, and so in response to that they have had to find other higher cost avenues of credit.

This is going to allow them to restructure that debt, get zero interest loans, and increments of 35,000. What are your thoughts about that? Obviously there is limited funding. It is tied to the stimulus at this time.

And the other question I have is some of the programs that we have seen that are core within the SBA lending program are very targeted to new businesses or smaller entities who have less of a direct impact on the job growth in some of our middle market types of companies. Is there more that we can be doing there, to whomever wants to take this?

Ms. BLANKENSHIP. Well, I will start. Regarding the ARC loan program, you know, I think it is a great program to help some of those distressed small business customers, but one thing that we have to consider as banks, I think it was the OIG's office had an estimated default rate on those loans of 70 percent. So I think you are going to find some hesitancy on the part of banks to make a loan that has an estimated default rate of 70 percent because, again, when we are in this crushing regulatory environment, the last thing we need are more loans to be classified.

The second thing is it says that there is still no definition for the term "viable." It has to be a "viable" loan. So I think bankers just need some clarification there so they have some confidence when they make that loan that the SBA guaranty will stand behind the terms of that.

But outside of that I think it is a terrific program. I think we really just need to hold its hand and walk through it and make sure it is working the way it was intended.

Mr. MCGANNON. I would say on the ARC program specifically I think it is very important that the bank that has been the lender to that business also be the lender on the ARC loan. I do not think it is a good idea for that same borrower to go to another bank to get that loan.

And the reason why I say that is when we first heard about this program at our bank a month or so back, I had three different lenders come to me and say, "I think I have a borrower that would benefit from this program," and when we talked about each one of them, you could clearly see that they were existing customers of the bank, obviously, had been with us for a year or two or more, had proven themselves in terms of being resourceful, resilient borrowers, and that they had a clear temporary need to get through a cash cycle.

And so, again, the banker that knows the borrower and understands their business is the most appropriate banker to make that loan.

As far as the overall 7(a) program, I think it is critical to, if we can, extend the waiving of the guaranty fee to make that program competitive with other traditional bank financing vehicles. If that could be done, I think that there would be more and accelerated momentum for 7(a) loans to get back to where they once were and beyond.

The other part of this though I think is the outreach to smaller, maybe rural banks that just do not know enough about the SBA programs, are not confident enough in the SBA programs, not knowledgeable enough to implement and actually make some of these loans.

Chairwoman VELÁZQUEZ. Time has expired.

Mr. Coffman.

Ms. BEAN. Thank you.

Mr. COFFMAN. Thank you, Madam Chairman.

Mr. McGannon and Ms. Blankenship, I get complaints from my local bankers and from my small businesses, but particularly from my local bankers who say that, on one hand, the federal government wants them to lend and, on the other hand, I think just the regulatory scheme is such that it is kind of the zero defects, that you know, they had a 20 percent increase, I think, in their capital reserve requirements, if I am using the proper term, ten to 12 percent, and that has caused them to pull back on their lending.

I mean, have we gone too far on the regulatory side where we are not allowing bankers to exercise their own judgment in terms of the ability of the borrower to repay the loan? Could you address that issue?

Ms. Blankenship, we will start with you.

Ms. BLANKENSHIP. Certainly. Again, we cannot be painted with the same brush, and you know, yes, has the regulatory gone too far right now? Yes, it has because you find banks are hesitant to lend because of the increasing costs that I talked about. The FDIC, we are additionally being asked to put more money in loan loss reserve. So that takes the money out of loans, money available that could be leveraged back into loans.

So all of those are challenges right now. To make this program more effective, we have to continue, as I said, to look at the initiatives and what is working and get back to less paperwork and involving more banks in this program.

Additionally, you know, if we could get some Subchapter S reform, you would find that a lot of small businesses could raise their own capital. Right now they are restricted to one type of stock. If they could be allowed to issue preferred stock and increase their shareholders.

So I think there are many ways that we could approach this, but again, to really answer your question, the regulatory environment, until we can get some equity there and know that the way you supervise a too big to fail bank is not the way you supervise a small business bank, which is what we are.

Mr. COFFMAN. Okay.

Mr. MCGANNON. We realize the regulators are under a lot of pressure, and I will say that our examinations are more difficult, but I continue to think that they are fair. We spend more time discussing our borrowers, as I mentioned earlier. Even though they are performing well, they are going through several more layers, I think, in our portfolio, and again, I can only speak to our bank, but they are fair. They just want to learn as much as they can about what our borrowers are doing and how they are performing.

And, again, I certainly understand that.

Mr. COFFMAN. Would anyone else like to comment on that? Yes.

Mr. HEACOCK. I would just like to say from a credit union perspective, we have been heavily regulated for many years on business loans, a tremendous amount of regulation, but having said that, so far our examinations have been fair. I have heard from other colleagues that maybe there is not that kind of consistency. In other areas of the country the examinations are very difficult, and it is maybe kind of anti-business lending philosophy on the part of the examiner.

Mr. COFFMAN. Would anybody comment on the fact that I often hear that the other shoe is going to drop and it is the exposure to commercial real estate, and what will that do to lending? Is that going to further tighten it up?

What is your prognosis of the future here?

Mr. MCGANNON. We are concerned about commercial real estate, but I think just to make the distinction, commercial real estate covers a lot of different types of property. When we think about commercial real estate in terms of owner occupied commercial real estate where a business owner owns his or her building, we continue to have confidence because it all hinges on how his or her business is doing, how are they performing. So the collateral truly is secondary in nature.

The commercial real estate in terms of hotels and multi-family and those types of things, you know, we are concerned about where cap rates are going, where appraised values are currently, and certainly there is a watchful eye toward that part of the market.

Mr. COFFMAN. Thank you very much.

Chairwoman VELÁZQUEZ. Okay. I would like to ask Ms. Huels another question.

You made reference to the need for improving licensing functions and particularly for SBICs that have successfully operated funds that are simply seeking a license renewal. What changes would you tell us should be made to the licensing process to encourage the creation of new SBICs?

Ms. HUELS. Successful SBIC fund managers that are coming back for a second, third, or fourth license, there is no additional risk. If they are an SBIC in good standing, they have been examined; they have had no findings; and their management team is remaining the same or most of the management team is remaining the same, you know, with a background check because hopefully nothing has changed there, but I think a background check would be something prudent and the fund manager showing that they can raise additional private capital or new private capital, that fund ought to be formed and receive a license very quickly.

These are fund managers that are known to the SBA. They are in good standing and should receive a license quickly. We had an example of a second or a third fund licensee that took 17 months to receive a second or third license. It was just far too long of a process.

Chairwoman VELÁZQUEZ. For the creation of new SBICs?

Ms. HUELS. Creation of new SBICs should happen in a three to six-month time frame. I think we would prefer four months. The process is at this point too long. It can take longer than a year to receive a first time license, a process that is a little bit cumbersome, a lot of paper work and somewhat subjective.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Heacock, if a credit union has never made a 7(a) or 504 loan before, what resources does it need to become familiar with SBA's financing programs?

Mr. HEACOCK. That would be a pretty steep learning curve if you have never done one. Yes, you would need to work with your local office, if you have got a local representative, and of course with the state office, the district office to learn as much as possible because there are a lot of procedural steps that you need to take and you need to follow. If you do not follow those correctly, you can lose your guarantee.

Chairwoman VELÁZQUEZ. Mr. McGannon.

Mr. MCGANNON. Outreach is very important. I think that education is very important in all of these programs, and it is certainly lacking, and I do not know at what level we need to start, but we are fortunate to have someone in our office who has been an SBA lender for probably 15 years and just knows the ins and outs of the program very well. So when we have another lender even in our bank that is looking at an SBA loan, we make sure that she is on the front end of it and understands it and can make sure it is documented properly.

So there is definitely a learning curve involved here.

Chairwoman VELÁZQUEZ. Thank you.

Okay. Mr. Graves, do you have any other questions?

Well, let me take this opportunity again to thank all of you for being here today, and you are dismissed or excused.

Thank you.

I would ask the members of the second panel to please come forward.

We are going to proceed with our second panel. Let me welcome our first witness, Mr. Douglas Doerfler. He is the President and CEO of MaxCyte, Inc., Gaithersburg, Maryland. MaxCyte is s research and development company that concentrates on self-modification. He is testifying on behalf of the Biotechnology Industry Organization founded in 1993. Bio provides advocacy and services for more than 1,200 members worldwide.

Welcome. You will have five minutes to make your presentation.

STATEMENT OF DOUGLAS A. DOERFLER

Mr. DOERFLER. Thank you, and good afternoon, Madam Chair Velázquez, Ranking Member Graves, members of the Committee.

Thank you for the opportunity to testify in front of this Committee during a very, very difficult, time for the research and development based companies that I represent.

As mentioned, I am Doug Doerfler. I am founding CEO of MaxCyte in Gaithersburg, Maryland. We are a research and development company developing technologies to modify cells, make cells into drugs to treat diseases like pulmonary arterial hypertension, leukemia and brain cancer. We have products in clinical trials today.

We have about 20 people in the company. So we are clearly a small business.

I am also associated with Bio and on the board of directors, and of the 1,200 companies that are members of Bio, more than 90 percent are considered small companies. So the biotechnology industry is an industry with small companies.

We are small, and what is important about this is our inability to raise necessary capital to maintain the research and development programs that we have as companies at Bio.

A little bit about the industry. We employ directly about 1.3 million jobs in the U.S., and indirectly over seven million jobs, and these are particularly high paying jobs with the average employee making two-thirds more than the average private sector job.

According to the latest data, one-eighth of the U.S. biotechnology companies that were active in 2008 are either bankrupt today, they have winded down or become acquired. And since January of 2008, over 125 biotech companies have laid off over 10,000 scientists and employees. In doing so, they have dropped many important programs. These are clinical programs that we have data on involved in therapies for HIV, cervical cancer, multiple sclerosis, and diabetes.

Forty percent of the U.S. biotech companies have less than one year's worth of cash, and about a quarter have less than six months' worth of cash. And the total amount of capital that we raised sine 2008 has fallen 55 percent from 2008 to 2009.

We commissioned a study with biotech investors, and over 80 percent of investors in the biotech area have significantly altered their ways of investing. They now are no longer investing in high risk, high reward companies like those found in the biotech industry.

What is also disturbing is investments by angel investors in the life sciences industry has all but disappeared. There are just no angels out there to help support some of the earlier stage companies.

So there is little oxygen in this industry to survive, and once these companies fold up or we stop clinical programs, it is virtually impossible to revive these. So once we stop a program for a particular therapy, it is very difficult to get them back on their feet.

So the decline of the biotech industry jeopardizes not only the patient population but also our competitive edge in the 21st century global economy. Biotech is one of the few industries in the world that the United States is the predominant force in. This is for developing therapies. It is for developing alternative fuels and for developing alternative food sources.

So the question: how can SBA provide assistance to early stage, high risk, high reward small businesses like mine? This is a biotech focused discussion, at least from my perspective, but I have colleagues in the alternative fuels area and in the information and technology industries and they share some of the same concerns that I do.

First, the SBIR program has traditionally been enormously helpful to small biotech companies, and after the 2003 ruling which has prevented many of our small companies from participating due to their capital structure, there was a recent report issued by the National Research Council that stated that some of the most promising small companies, small, innovative companies were excluded from this program.

Until this is addressed and small U.S. biotechnology businesses are allowed to compete based on science and the potential to benefit public health and not on how many investors we have or how many minority investors we have, this program will not achieve its maximum impact, which is helping high risk, high reward companies to succeed.

Access to many of the SBA programs we heard about in the earlier panel that could help small, high risk, high reward technology businesses are unfortunately limited. Most of our companies, most biotech companies, do not have any revenue resources, and it usually takes about ten years for us to actually begin to bring in revenues.

So it is impossible for us to take advantage of the SBA premier programs such as Preferred Lender or the guaranty loan programs.

The SBIC programs also tend to focus on companies with revenue streams that are beyond the start-up phase. These companies are typically lower risk and lower gain companies, and Bio would like to work closely with the Committee and SBA to determine if there are ways in which this program can be improved to stimulate more investment in high risk, high reward industries like Biotech.

In order to develop programs to promote our innovative high growth sector, we need to talk about the business model for just a minute, and there are really four elements of this. One is there is a lengthy amount of time, lengthy time horizon associated with product development. That is number one.

Chairwoman VELÁZQUEZ. Mr. Doerfler, your time expired, and I will allow for you in 30 seconds to provide us with a closing. But you know, during the question and answer period you will have time to expand on any point that you have not mentioned.

Mr. DOERFLER. Okay. Thank you.

Our long time horizons; our collateral is not assets as intellectual property; and revenues are not significant for about ten years.

So what we are here to do is examine these potential opportunities with SBA and work closely with you to figure out ways for us to help in developing new fundings sources for our companies.

Sorry.

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

Chairwoman VELÁZQUEZ. Thank you.

Our next witness is Mr. Lawrence Cohen. Mr. Cohen is the President of DOC & Associates in Tomball, Texas. His firm is a franchisee of the Great American Cookie Company and Pretzel Tying.

Mr. Cohen is testifying on behalf of the International Franchise Association.

Welcome.

STATEMENT OF LAWRENCE "DOC" COHEN

Mr. COHEN. Good afternoon, Chairwoman Velázquez, Ranking Member Graves, and members of the Committee. My name is Doc Cohen, and I am grateful to have the opportunity to speak to you about the credit crunch and the strong measures that are needed to promote capital access for small business.

I will try to make three key points today. The first is fairly obvious. Credit is essential for small business.

The second, this is not a typical recession, and many more small businesses need the capital access programs of the SBA in order to obtain financing. I think policy makers should be willing to consider even temporarily further changes to the SBA programs, including sizable increases in the dollar amounts for the SBA 7(a) loan program, guarantees to accommodate the needs of small business.

And third, a compelling case exists that franchise businesses offer the best opportunity to promote job growth in a strong, sustainable recovery.

As you said, I am a franchisee at the Great American Cookie Company, and I am here on behalf of the International Franchise Association. According to a 2008 study conducted for the IFA educational foundation, there are more than 900,000 franchise businesses in the U.S. creating 21 million American jobs and generating 2.3 trillion in economic output.

I am proud to represent franchising. The business methods, training and support that I have received as a franchisee have been one of the keys to my success. From my first Great American Cookie Company store in Lafayette, Louisiana 30 years ago, I now operate 30 stores in the Houston, Texas area, and we employ almost 300 people.

I was very fortunate that when I began my career in franchising there was a functioning credit market, including the SBA programs. Availability of credit helped me succeed in franchising. Today's small business entrepreneurs, however, are not quite so lucky. Under normal circumstances small businesses tap financing from a number of different sources, including the SBA programs, but during this recession, lenders have dramatically curbed their willingness to assume risk.

Some credit might be available, but the terms and delays that entrepreneurs are encountering can be staggering. This leaves the SBA as virtually the only girl at the dance, sometimes not the best looking girl.

Last year I had the opportunity to add eight new locations. I had previously acquired a reducing line of credit from my lender of ten years, but it appeared that I would need additional funds in order to complete my expansion. The answer I was given by my bank was not quite no, but the terms being offered in late 2008 had become all too restrictive. I could borrow an additional $500,000 more only if I agreed to keep a million dollars in liquid assets with the lender. In other words, they would lend me my own money, but only half of it.

[Laughter.]

Mr. COHEN. My track record in business and my healthy balance sheet were not enough anymore. So I actually chose to forego the additional borrowing and finance the two new stores or the last two stores using cash generated from operations.

The eight stores that I eventually opened required a capital investment of $1.8 million and created 74 new direct jobs, but I will likely delay opening additional stores until the restrictions on credit are eased.

Lack of credit is keeping entrepreneurs on the sidelines and delaying our recovery, and the problem is even looking worse for those looking to get into business for the first time.

The findings of a recently released study, The Small Business Lending Matrix and analysis prepared for the IFA Educational Foundation, support the notion that an economic recovery and job creation will start with small business lending. In fact, the study determined that for every million dollars in new small business lending, the franchise business sector would create 34.1 jobs and generate $3.6 million in economic output.

Now, I would like to ask that this entire report be included with my statement if the Committee would approve that.[Study submitted by Mr. Cohen is included in the appendix.]

Chairwoman VELÁZQUEZ. Without objection.

Mr. COHEN. Franchise businesses are poised to help lead the economy on the path to recovery. Studies show that the franchise industry consistently out performs the non-franchise business sector creating more jobs and economic activity in local communities across the country. A 2008 IFA report, for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005. Franchise business output over this period increased 40 percent compared to 26 percent for all businesses.

The message is clear, Madam Chairwoman, provide small business entrepreneurs and franchisees with access to capital and we will create jobs. We are not looking for a bailout. What we need is functioning credit markets. If the commercial markets cannot function, Congress needs to figure out a way to use the SBA as a temporary alternative.

There are several steps that Congress could consider to make it easier for entrepreneurs to access capital, and I have detailed these recommendations in my prepared statements.

I have one final note. Unbelievably, the SBA has actually created new roadblocks for small businesses during this recession. In March it shifted policy on goodwill financing of transfers and acquisitions and placed a cap on the amount that can be financed under the guaranteed loan program. Since the true value of most businesses is tied to the cash flow rather than the value of the assets on the books, the policy has placed an arbitrary limit on the valuation of some businesses.

Finally, I would like to suggest the best solution for the struggles facing small business is more lending, not more government spending. As shown in my experience in the hundreds of thousands of small franchise businesses in every local community, lending leads to more sustainable renewable job growth and economic recovery.

Thank you for the opportunity to participate in today's important hearing on small business capital. I think you will agree with the franchise business community can play a vital role in this recovery.

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

Chairwoman VELÁZQUEZ. Thank you, Mr. Cohen.

Our next witness is Mr. Tim Watters. He is the President and CEO of Hoffman Equipment is Piscataway, New Jersey. Hoffman Equipment is a full service authorized dealer of heavy lifting and construction equipment.

Mr. Watters is testifying on behalf of Associated Equipment Distributors. AED has 700 distributor member companies and accounts for over $50 billion of annual sales.

Welcome.

STATEMENT OF TIM WATTERS

Mr. WATTERS. Good afternoon, Chairman Velázquez, Ranking Member Graves, and other distinguished members of the panel.

We are a family owned business headquartered in Piscataway, New Jersey. We sell, rent and service construction equipment. We represent about ten different manufacturers, including Case, Terex, Grove, Manitowoc and Doosan. We employ about 75 people from five locations in New York and New Jersey.

And just as an aside, Madam Chairwoman, our service territory includes the 12th Congressional District of New York.

We also have an export department, and about 20 percent of our volume is export related of U.S. equipment and parts.

As you mentioned, I serve on the AED board. AED is a national association of authorized independent distributors for construction, mining, forestry, and agricultural equipment, and the vast majority of AED's members are small, locally owned family businesses such as mine.

There are three ways the current credit crisis is hurting our industry. First is that as a distributor, my own cost of borrowing is increasing and in some cases credit may even be unavailable. Access to capital is critical to our industry. Distributors such as myself borrow money to finance equipment in our inventories and rental fleets and to operate our companies on a day-to-day basis. We generally utilize large banks and finance companies as sources for this lending.

Continued access to credit from sources such as these is absolutely necessary for our industry to exist, and the current crisis has made it difficult, increasingly difficult for dealers such as myself to find this capital.

The second way the crisis has hurt our industry is that our customers and the developers they work for cannot find financing for their jobs. You are all well aware of the current condition of the residential construction market. Essentially it is dead, and the commercial construction is slowing as well. Since developers cannot finance their projects, our customers have no work and so need no machinery, and we therefore have no business.

The lack of credit creates a chain of events, painful events, I might add, that ultimately lead to decreased business and employment throughout our entire industry.

The third way the credit crisis has impacted our industry is that we are unable to finance our customer's retail transactions. Contractors themselves rely heavily on credit when purchasing equipment. The most common sources of credit here again are finance companies and banks. These banks and finance companies have made access to their credit resources unavailable or, in the rare case when they are willing to finance a transaction, exceedingly expensive.

So the net result is if we as a distributor are lucky enough to find a customer that has work and is actually willing to purchase a new machine, we then have difficult to finding him financing to make that transaction possible.

In April, AED conducted a member survey to clarify what impact the credit crisis was having on our industry. The findings paint an ugly picture. Eighty-one percent of our respondents reported they had lost sales in the last year because qualified purchasers had been unable to get financing. Fifty-six percent of distributors reported increase in their own credit costs, and 44 percent of respondents said their companies had difficulty security credit.

The findings illustrate that the lack of access to capital is undermining equipment markets and increasing the cost of doing business for equipment distributors. The impact of all of this on our markets has been staggering. In some regions of the country the market for new equipment sales has fallen by as much as 85 percent from peak levels in 2006.

Our own company has experienced sales this year less than 50 percent of what we sold just last year. We have responded to this drop in business volume with layoffs and cutbacks of every type we can make, and we are still hanging on just hoping to survive this mess.

Having said all of this, I think there are some things that Congress and the executive branch can do to help ease our pain. First, Congress should put new multi-year authorization laws in place for federal highway, sewer and drinking water infrastructure programs and dramatically increase investment in these areas. We need to create infrastructure construction activity. Investing in our infrastructure speeds economic recovery, will help address the staggering 19 percent unemployment rate in construction workers and restore lending confidence in our industry.

This will also create demand for the thousands of products that are consumed on a typical construction project, including equipment sold by firms such as mine.

Second, the SBA should be directed to work with finance companies and banks serving our industry to develop loan products that meet our unique needs. SBA should also reexamine its size standards to determine whether they are preventing companies that otherwise fit the definition of small business from benefitting from SBA programs.

Once construction is reached and programs are in place, SBA should be encouraged to undertake aggressive outreach to lenders, contractors and distributors.

And finally, and I will go quick, Congress and the executive branch should continue to work to improve access to capital for the finest companies that serve all American industry because in spite of what the banks were saying earlier, which they are continuing to lend at previous rates, that is not what we are seeing from the business side of things.

Thank you.

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

Chairwoman VELÁZQUEZ. Thank you.

And our next witness is Mr. Dave Bofill. Mr. Bofill is the President of Dave Bofill Marine in Long Island, New York. His firm is the nation's second largest and third largest seller of Scout and Cris Craft boats, respectively.

Mr. Bofill is testifying on behalf of National Marine Manufacturers Association, which represents 1,400 companies that produce an estimated 80 percent of marine products used in North America.

Welcome.

STATEMENT OF DAVE BOFILL

Mr. BOFILL. Thank you.

Good afternoon, Madam chairwoman, Ranking Member Graves, and distinguished members of this Committee. Thank you for inviting me to testify today on the important topic of expanding affordable wholesale marine floor plan financing access to marine dealerships.

My name is David Bofill, and I am President and owner of Dave Bofill Marine. I come to you wearing three hats, one of my company, one of the National Marine Manufacturers Association, and one of being on the board of directors for the New York Marine Trade Association for the last eight years.

I sell Cris Craft and Scout boats from my two Long Island locations. I have been in the boating industry for 35 years, and my operation at its peak employed 20 people. I am a small business and, in fact, the majority of the boating industry is made up of small businesses and most boats are might right here in the United States. The brands I carry, Cris Craft and Scout boats, are made in Florida, North Carolina, and South Carolina.

Unfortunately, my story is being played out in both dealerships and manufacturing plants across the country. I have had a thriving business for over 35 years, but this credit crisis will force me to close my doors.

What frustrates me the most is that most of us in the boating industry are used to riding the ups and downs of the economy, but this downturn is different. Today I am dealing with a reluctant consumer, but more so the sudden loss of wholesale credit at anything close to reasonable rates to finance my inventory. Over the last year, the floor plan lenders to the boating industry, including Key Bank, Textron Financial, Wachovia, and several others, have abruptly stopped lending in the boating industry.

Some of these banks, as you know, received federal assistance under the TARP program, but severed their ongoing business relationships with the marine dealers anyway. Today, General Electric Capital has become the dominant lender with over 70 percent of the market. However, G.E. recently has informed all of us that they are radically changing loan terms resulting in doubling of interest payments and, in my case, my interest will go from 10,000 to $20,000 per month.

Lenders overall have scaled back lending, dramatically increased their rates, cracked down on curtailments and are not issuing loans or extending current lines of credit to enable marine dealers to finance any new inventory. The inability of dealers to finance current inventory or purchase new model inventory to display means that manufacturers now have shut down production by at least 60 percent.

With hundreds of dealerships being forced out of business as mine, 20,000 manufacturing jobs vanishing and 135,000 boating industry jobs that are now gone, something must be done. It is important that you know that these businesses like mine were not failing businesses or companies with flawed business models. We relied in good faith on lenders for typical business credit, and when the financial markets collapsed, we had nowhere to turn.

What we need to survive is access to credit at reasonable terms. What Congress could do to help many small businesses in the boating industry is to facilitate the creation of new credit market. Both dealers and manufacturers need to help in encouraging regional banks to create or reestablish floor plan lending departments.

The industry strongly supports the Small Business Administration's plan to establish a floor plan lending program for boats, motors and trailers. The industry has welcomed this program as a critical lifeline, but problems still remain. This Committee and Congress could help in three specific ways.

One, make the SBA dealer floor plan financing program permanent and do it quickly. As written now, this program only lasts one year. It will be hard to attract new lenders without the important certainty of this program.

Two, make the increased business size limits permanent. This is an important change that reflects the marketplace. The traditional standard for marine dealers is far too low to include dealers who sell high cost products but do so with such a small staff.

Three, increase the cap on SBA 7(a) loans. The current limits are too low to provide financing for the majority of small dealers and manufacturers. It is common for a small boat dealer to have inventory in the $5 million range.

Thank you for inviting me to testify today. The marine industry is suffering. It is an American industry of manufacturing and servicing that deserves support. The lack of reasonable credit is likely going to lead me to close my doors soon, and it will cause other dealers to shut down as well.

Thank you, and I am happy to answer any questions.

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

Chairwoman VELÁZQUEZ. Thank you, Mr. Bofill.

I just would like to address my first question to all the members of the panel. You were sitting there and you were listening to the previous witnesses, basically those representing financial services, banks and the credit unions, and what they are saying is that they have money to lend, and that by some metrics have actually increased their loans.

And what I hear from you today, from this panel, is that that is not the experience that you have had. My question is do you think that the SBA should play a more direct role in small business lending either by refinancing non-SBA loans or making direct loans that could be sold to lenders?

Any of the members of the panel, for any of the witnesses. Yes, Mr. Watters.

Mr. WATTERS. For sure, the environment we witness is different than that which was described by the preceding panel. There is definitely a lack of financing available for my industry, for construction, every link of the chain of the construction cycle, from the contractor right down to we, the equipment distributor, and I would just say yes, wholeheartedly. If the SBA involvement as you just described can increase financing and credit availability to our industry, absolutely that would be a great thing.

Chairwoman VELÁZQUEZ. Mr. Bofill.

Mr. BOFILL. I agree with Mr. Watters that in my industry credit has shut down completely. It is very, very difficult not only to wholesale finance a boat, but the retail financing as well.

In fact, between us when we were listening to statistics, it is like, boy, I will tell you what. That is not in my neighborhood, and it is not in anybody's neighborhood. So if there is anything that SBA can do to assist in any format, be it wholesale financing or retail financing, it certainly will be welcome because that is better than what we have now because what we have right now is almost nothing.

Chairwoman VELÁZQUEZ. Let me address this next question to Mr. Doerfler. A common failing in government investment programs is a tendency to focus on unrealistic metrics to determine a program's success. How should success in an investment program geared toward small, high growth companies be measured?

Mr. DOERFLER. Well, that is a great question. I mean, first off, this is a long-term bet, if you will. It is a long-term investment, and as I mentioned before, it takes about ten years for us to get to revenues and beyond that to really return what our investors expect from us.

So you are not going to see any finance return in the short term. But there are some metrics, and I think they are industry specific. Certainly the creation of new jobs, the creation of payroll taxes, the ability to spend money and have indirect benefits to the economy.

In my particular sector, it is the ability to use that investment as a catalyst for additional investment, which is very, very important. We are looking at issues, certain things like issue patents, clinical trials that have been started. All those things, I think, are industry specific. So I think that there are a lot of ways that we can identify these.

Certainly in my State of Maryland, we spend a lot of time doing just that because we want to make sure that these funds are being used and they are being used properly and they are returning something to those who are providing those.

Chairwoman VELÁZQUEZ. Mr. Cohen, in the current recession, businesses of all sizes have been squeezed by the contraction in credit. We hear that. You witness it, and many companies that previously did not have access to SBA financing have shown interest in these programs.

What steps should be taken to insure that these programs remain focused on the small businesses that they are originally intended to serve?

Mr. COHEN. That is also a great question. All of your questions are great questions. I am not an economist, but my sense is that so much of the money that is being pumped into the economy is going into the mortgage sector and into the real estate sector and not that much is going into the small business sector.

It seems to me that we need to find a way to dedicate a certain pool of funds to small businesses, especially small business start-ups and expansions of small businesses.

And if I might tag onto the question you asked about how you measure the success rate, in the franchise businesses, we have lots of historical data and proof that the franchising model works, and so when considering a start-up franchise, we do have evidence to show that a particular model will work, a particular concept will work. And I think we should rely on those statistics when we are looking at making those loans and not so much on a sector which is sometimes done. I think the SBA rates sectors and says, "Well, this sector is not as successful as others."

But I think if we pull out and say, "Well, gee, when that sector is franchised, it is far more successful."

Chairwoman VELÁZQUEZ. Thank you.

I have my last question to Mr. Doerfler. Much of the success of the SBIC debenture programs has come from the fact that losses in the program are low. If a new investment program were to focus on early stage and high growth companies, how can we manage the risk of losses and provide some assurance that government leverage will be repaid?

Mr. DOERFLER. So the debenture program is a loan program, and it is my understanding we are not part of that because I think it is toward revenue producing companies or companies that are relatively low risk.

If you are looking at something like the participating security program, the old SBIC program and trying to figure out something new to do with that, it is defunct now. We think that it could be very, very important. But I recommend, we recommend that we align ourselves with the really talented investors.

There is a group of investors out there that really know our sector extraordinarily well. They have been through many cycles. They are very experienced, and aligning ourselves, aligning SBA funds with those investors, either as limited partners or as grant mechanisms so that the companies that receive investments from these qualified investors can get grants from the government, and those grants can be paid back by royalties; they can be paid back by if the company is acquired or an IPO.

So there is certainly a number of ways to that, but, again, I think aligning it with smart investors who really do know the sector.

Chairwoman VELÁZQUEZ. Okay. Thank you.

Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Madam Chair.

Mr. Bofill, you had a lot of great examples of things that you felt we could do, improvements in the SBA program. Do you have any other ideas for what is existing in the program now? Do you have any ideas or suggestions of things we could add to it that would be important or could make it more beneficial?

Mr. BOFILL. The goal for me being here today was to back the decision of the SBA to get into marine floor planning. The way it stands right now as it is written is that it is only good for one year. So we need to expand that to permanency.

And the whole goal of the SBA backed loans or guaranteed loans is to attract banks, regional banks into the floor plan business, and that will only be done with permanency and with more dollars without the $2 million cap that is on there presently. And that will benefit both the banking industry as well as the dealerships.

Mr. LUETKEMEYER. Okay. Mr. Watters.

Mr. WATTERS. I guess I am not really sure of the exact process the SBA could do to solve the problem. I think part of the problem is that there is a pendulum, and we have had an era of loose credit, and now we are in this new era of tight credit, and I think the pendulum has swung way too far. It is overly tight, constricting all of these markets.

So I guess I would love to see a way that the SBA could entice banks to try and push the pendulum back a little more center. There are good quality credit, quality companies that are being denied credit or being forced to pay too much money for their interest rates. Is there a way that SBA could create a program that would encourage banks to be a little more realistic?

You know, that was also mentioned in the preceding panel, how the regulators who are going to be coming out and creating this environment, the culture of the banks to be very, very concerned and afraid about everything they are doing.

So some type of program that would encourage banks to become a little more reasonable.

Mr. LUETKEMEYER. Okay. Mr. Cohen.

Mr. COHEN. I keep coming back to the two points that are key to me, and one is the valuation of businesses and the treatment of goodwill, and just to give you an example of how that affects me as a small business person, if I want to acquire another outlet from another franchisee with the expectation that I can improve that business, I am limited in how much SBA money I can borrow because my business is not capital intensive in terms of the investment going in.

So if I have 100,000 or $150,000, to use the higher number, $150,000 in equipment, fixtures and furniture on the books, but the cash flow of this business is $200,000, and then I am going to use a multiple of cash flow to purchase or sell that business, which is very common in our sector, and the multiple in our sector would be four to five. So you would be conservative and say four. This business is worth $800,000. But I have only $100,000 or $150,000 in assets on the books. So the book value is low, but I have $650,000 difference that is going to go to goodwill.

I would not be able to use the SBA right now to qualify for that. The other part of it that would be important to me would be increasing the loan amounts because in franchise businesses we find that 50 percent of franchise businesses are owned by multi-unit franchisee. So I have an opportunity right now to acquire two other franchisees in my state, both of whom are ready to retire, neither of who wants to expand their business. I see great growth potential in both of those markets, but it will take my ability to borrow three to $5 million to do that.

So I cannot qualify under the current SBA standards to get those loans and get that assistance.

Mr. LUETKEMEYER. Thank you.

Mr. Doerfler.

Mr. DOERFLER. So valuations based on high growth, high return businesses are difficult because the normal measures, cash flow or hard assets just are not in these businesses. Again, we are looking at negative cash flows for a number of years, and we are looking at intellectual property which is very hard to value.

So, again, if SBA could align itself with private equity investors who have expertise in evaluating and valuing those assets and those assets are intellectual property and clinical programs, that would be a great benefit for the biotech industry.

Mr. LUETKEMEYER. Very good. Thank you.

Chairwoman VELÁZQUEZ. Mr. Schrader.

Mr. SCHRADER. Thank you, Madam Chair.

I do not guess I have a lot of questions. Both panels were very, very good. Sorry I could not be here the whole time, as Chair of the Subcommittee on Tax and Finance and the lending programs, in particular, we are very interested in the comments that have been and the juxtaposition between one panel and the other.

And to that end it would really be helpful for me and my Subcommittee if we could get a number of examples from members of your different associations, particularly that have had good credit, have been making payments, that now cannot get their loans or their credit lines or whatever reauthorized, you know, with various types of institutions because I have had somewhat the same feedback from my banking community, what seemed to be trying to do the right thing.

So some of it is the regulators, in deference to the banks. I mean, the regulators have come down pretty hard, I think, and made it very difficult for them with their reserve requirements that have gone up to do the right thing, but to me that is something that our panel, our Subcommittee, if you will, could get into and from the SBA aspect maybe create some new opportunities.

But I need some examples. So if that is a possibility, you know, several examples from each one of you would be very, very helpful for my staff, who has been here the whole time, to use and help create perhaps the right atmosphere to get things going back again.

So that's all I request. I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Watters, I would like to ask you. The Small Business Administration spent much of last month working on a new program to provide floor plan financing for title inventory. So will; this program have any appreciable effect on the ability of your business or your customers to access credit?

Mr. WATTERS. Probably not. It is really kind of a technical issue. Our equipment that we sell is non-titled. So if your program is directed at titled equipment only, titled vehicles only, then we would not be able to partake or benefit from that program.

Chairwoman VELÁZQUEZ. What about you, Mr. Cohen?

Mr. COHEN. I would be in the same category. It probably would not be of any benefit to me in my line.

Chairwoman VELÁZQUEZ. Mr. Bofill?

Mr. BOFILL. That is exactly what we are looking for because all boats, motors, and trailers are titled.

Chairwoman VELÁZQUEZ. Okay. Well, gentlemen, we are listening, and of course, this is the first step in the legislative process where we are assessing how can we improve the existing programs, especially the loan business program under SBA. How can we make the changes to make them more efficient and to respond to the new reality and the economic climate that you are all facing today.

With that I ask unanimous consent that members will have five days to submit a statement and supporting materials for the record. Without objection so ordered.

This hearing is now adjourned.

Thank you.

[Whereupon, at 3:00 p.m., the Committee was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

SAM GRAVES, MISSOURI
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0315

STATEMENT
Of the Honorable Nydia M. Velázquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: *"Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital"*
Wednesday, June 10, 2009

Whether you talk to the owners of a Silicon Valley start-up, a mom-and-pop restaurant, or a hardware store on Main Street, entrepreneurs across our nation face a common challenge – they cannot find the capital necessary to sustain their businesses. For many firms, this can make the difference between staying open or going under.

During today's hearing, we will examine what options are available to help small companies access capital. Lenders and entrepreneurs will share the real world challenges they face in today's tightened credit conditions, as well as their ideas for making things better.

In previous recessions, the SBA has filled the gaps in private capital markets. Today, that is not the case. Loans funded by the SBA's flagship program have seen double digit declines, meaning, when we need the SBA to step in and help lift the capital markets, they are actually doing less. This is a result of poor policy decisions, inept management and a lack of funding at the agency over the last eight years finally taking its toll on the programs.

The American Recovery and Reinvestment Act has helped lay the foundation to start turning things around. The new law made loans less expensive for borrowers, putting more money in the hands of small firms. It also gives banks greater incentives to lend, by increasing the percentage of a loan the government will guarantee. It's a start, but we have a long way to go. To date, the SBA has not implemented over half of the Recovery Act provisions that Congress passed and the President signed. But, as more and more of these initiatives come on line, entrepreneurs should see an improved lending environment.

Even with these steps, small businesses are still finding it difficult to secure credit. Overall, lending is down over fifty percent. At this rate, the SBA will make nearly $5 billion less in loans than it made in the previous year, demonstrating that serious difficulties in the credit market still exist. How we overcome these challenges will be an important part of today's discussion.

All options are on the table in finding a solution to these very real problems. Where we can enhance existing initiatives, we should do so. But, when programs no longer work, they must be replaced with measures that do meet small businesses' needs. No initiative should continue simply because of a special interest. The only measurements should be – do these programs serve small businesses? And, do they help small firms access capital? If we cannot answer yes to both of those questions, then we have to ask, why are they here?

Our goal must be to expand options for small businesses seeking financing. As with health care, in many communities, entrepreneurs have only one or two options for lending. That is not real competition and it doesn't give firms the flexibility they need to realize their potential, grow and create jobs.

Ultimately, the full range of small business capital needs must be met – from the micro-borrower who needs a few thousand dollars to the high-growth company seeking equity investment. No such menu of choices exists today – and the options are becoming more limited. By the end of last year, venture capital was down 26 percent. Venture capital was instrumental to the role technology played in turning the economy around in the 1990s and it will be just as important today as it was a decade ago.

In creating paths to capital for small firms, we have our work cut out for us. If we have learned anything in recent years, it is that ensuring the capital markets function smoothly requires a robust public-private partnership. It is my hope that today's hearing begins a dialogue about how to renew that partnership. I have always said that access to capital is access to opportunity. In today's economy, the ability to tap into capital means a laid off worker can launch their own venture. It means companies that would otherwise close their doors stay open and keep providing jobs. It means that when the economy improves, small businesses can hire again and sustain our nation's recovery.

U.S. HOUSE OF REPRESENTATIVES
SMALL BUSINESS COMMITTEE REPUBLICANS
REPRESENTATIVE SAM GRAVES, RANKING MEMBER

Opening Statement for Hearing on
Laying the Groundwork for Economic Recovery:
Expanding Small Business Access to Capital
Sam Graves
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC
June 10, 2009

I would like to thank the Chairwoman for holding this important hearing on the ability of small businesses to obtain needed capital. Given the recent job loss numbers, the country will be relying on small businesses to grow the American economy. Although Shakespeare warned that people should neither be a lender or borrower, he was unfamiliar with the modern American economy. Today, the car or boat dealer needs financing to purchase inventory to resell, the home or commercial builder needs funds to buy land in the face of the mortgage-backed security debacle, and the manufacturer needs funds for investing in the latest equipment to make it competitive in a global economy. Capital, then, is the lifeblood of the American economy.

There is no doubt that the current environment for raising capital is difficult even for the largest businesses with triple-AAA credit ratings when they have to compete against the voracious appetite of the most creditworthy borrower in the world – the United States government. So I can imagine how difficult it is for small businesses to find capital. Since the end of the Korean conflict, the federal government has recognized that small businesses have a much harder time raising capital than their large business competitors. Programs overseen by the SBA provide small businesses with access to debt and equity financing. These programs have a number of restrictions and limitations that may reduce their utilization among small businesses.

In times of economic necessity, imposing unnecessary barriers to existing programs for providing capital seems counterintuitive. As a result, I am interested in hearing the opinions of our witnesses on the value of the SBA programs and what changes are needed to ensure that America's small businesses can obtain the needed infusions of capital that keep the economy alive. Again, I would like to thank the Chairwoman for holding this hearing and yield back the balance of my time.

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

Cynthia Blankenship
Vice Chairman/COO, Bank of the West
Grapevine, Texas

On behalf of the
Independent Community Bankers of America

Before the

United States House of Representatives
Committee on Small Business

Hearing on
"Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital"

June 10, 2009
Washington, D.C.

Chairwoman Velazquez, Ranking Member Graves, and members of the committee, I am Cynthia Blankenship, Vice-chairman and Chief Operating Officer of Bank of the West in Grapevine, Texas. I am also the Immediate-Past Chairman of the Independent Community Bankers of America.[1] I am pleased to have this opportunity to present the views of the nation's community bankers on the credit markets and small business lending. Community banks are independently owned and operated and are characterized by attention to customer service and lending to small business.

ICBA represents 5,000 community banks throughout the country. Bank of the West is part of a two-bank holding company with assets of $300 million. We have eight locations in the Dallas/Fort Worth metroplex and banks in two rural locations in Vernon and Ponder, Texas. We serve the small business community with a strong focus on SBA lending and real estate.

Bank of the West has been a long-time partner with the Small Business Administration and has been strongly committed to helping small businesses in our communities using the SBA 7(a) and 504 loan programs. Bank of the West has more than $10 million in SBA loans in its portfolio, and we service these loans. This represents nearly 6% of our total loans. As Chairman of the ICBA, I was recently honored to participate with President Obama and Treasury Secretary Geithner in advancing additional policy initiatives to help small businesses lending. ICBA greatly appreciates the efforts of the Obama Administration and the Small Business Committees in Congress for working with us in advancing key policies to ensure our nation's small businesses have the access to credit they need.

Summary of Testimony

- The prolonged recession, turmoil in the financial markets, and pro-cyclical bank regulatory policies continue to jeopardize credit availability for many small businesses.

- Community banks support their communities in good times and in bad. Community banks are well-positioned and willing to lend to small businesses especially during these challenging economic circumstances.

- ICBA strongly supports President Obama's and Congress' recent initiatives to bolster small businesses loan programs included in the American Recovery and Reinvestment Act of 2009. ICBA will continue to work with policymakers to ensure these small businesses initiatives are properly implemented and succeed as intended.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. 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. With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and more than $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.*

- Small businesses will help lead us out of recession and boost needed job growth. Therefore, lawmakers must continue a constant focus on the policy needs of the small business sector during this economic slowdown. SBA lending must remain a viable and robust tool in supplying small business credit.

Overview
ICBA greatly appreciates the opportunity to present our concerns and recommendations before the Small Business Committee today. Like thousands of community banks across our nation, Bank of the West is doing its part to support our local economy with small business lending and is dedicated to the success of small business and the community. Bank of the West has facilitated more than $10 million in SBA loans in our local communities. These SBA loans create hundreds of jobs by financing the local preschool, health center, hardware store, or auto dealer.

We all know the economy is still suffering from massive job losses, declining real estate values, and tight credit markets. Additionally, declining credit ratings, increased risk, and a crushing financial regulatory environment has jeopardized banks' ability to lend. Many of the nation's largest "too-big-to-fail" financial institutions have been propped up with government programs and taxpayer funds and dramatically cut back their small business lending and lines of credit. But there is another side to the financial story. Many community banks like Bank of the West have experienced difficult economic times before and, like always, we will stick with our communities and small business customers.

Vital SBA Lending Role
Small Business Administration lending programs should serve as a counterbalance during times of challenging credit markets for small businesses. Unfortunately, at a time when the economy is faltering, the sharp decline in the number and dollar amount of Small Business Administration loans is troubling. In the first quarter of fiscal year 2009, the number of SBA 7(a) loans dropped 57% from first quarter of FY2008 and represents a 62% drop from first quarter of FY2007. The very recent uptick in SBA loans is a positive and welcomed sign, but we have a very long way to go before SBA lending reaches solid levels again. ICBA is encouraged to see the SBA report that weekly 7(a) loan volume recently increased by more than 25 percent and new SBA loans were made by nearly 450 lenders who had not made loans since October 2008.

SBA loans serve a unique niche since bank 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. Importantly, SBA lending allows longer 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. As small businesses do their best to weather the current economic climate, the longer loan term offered by an SBA loan would be a huge help.

Community Banks are Key SBA Lenders
Bank of the West strongly supports the work of the Small Business Administration and actively participates in the SBA's lending programs, specifically the flagship 7(a) and the 504 loan programs.

Community lenders like Bank of the West are proud to work with the SBA in helping supply needed capital to small businesses across our nation, especially now when the economy is weak and many large, money-center banks are cutting back sharply on small business lending. Community banks rely on relationship lending in their communities, not on relationships with investment banks or hedge funds. Common-sense community bank lenders largely did not trip up on toxic investments sub-prime loans, and off-balance sheet shenanigans. We are well-positioned and willing to help get our economy back on track. Therefore ICBA urges the Committee ensure the SBA programs work for the broad range of community banks and not become overly concentrated in only a handful of the nation's largest financial institutions.

Our nation's community banks are very much alive and willing to lend to small businesses. While community banks represent about 12% of all bank assets, they make 20% of all small business loans and more than half of all small business loans under $100,000. Some 48 percent of small businesses get their financing from banks with $1 billion and under in assets. Therefore, we encourage policymakers to be mindful and supportive of the community banking sector's important role in supplying credit to small businesses. To that end ICBA supports strong SBA programs, fair regulatory treatment, and tax policies that will foster robust community bank small business lending.

ARRA Success and Implementation

ICBA was proud to work with Congress and the Obama Administration in advancing new policies to bolster SBA lending to address the recession. Specifically, ICBA appreciates your work Chairwoman Velazquez and the work of the Committee in enacting $730 million in ICBA-backed SBA-related funding in the American Recovery and Reinvestment Act of 2009 (ARRA). This includes reduced fees for borrowers and lenders and increasing the guarantee, a new deferred-payment loan program to address small business' short-term debt expenses, and a SBA secondary market initiative. Where implemented, ICBA believes these "stimulus package" initiatives are already having a positive impact on SBA lending and encourages the SBA to ensure all of ARRA's provisions be fully implemented as Congress intended.

ICBA fully supports the temporary lender and borrower fee reductions applied to the 7(a) and 504 loan programs. Notably, we encourage Congress to extend or make permanent these fee reductions beyond 2009 given the prolonged length and depth of this recession and credit crunch for small businesses. Importantly, ICBA notes the ARRA put into statute that the resources to be used for lenders' 7(a) loan program fees must first go to small lenders (those with $1 billion or less in assets). We urge the SBA to follow the statute and Congress' intent to give priority to small banks in implementing the 7(a) lender fee reduction.

ARC Program

ICBA is encouraged to see the SBA finishing the implementation of the "ARC loan" program this month. This key program included in ARRA will allow existing small business bank customers to better service their debt and ride-out the economic slowdown. The ARC loan program will allow a viable small business up to six years to repay a $35,000 ARC loan with a 100% SBA guarantee. SBA will pay monthly interest to the bank lender. ICBA encourages the SBA to promote the new ARC program to all community banks in order to ensure the limited funds reach a wide geographic range of small businesses and lenders throughout the nation.

SBA Secondary Market

The largely frozen secondary market for small business loans continues to impede the flow of credit to small business. Many community banks find it difficult to make new SBA loans because they cannot sell off existing ones to investors through the secondary market. While it is encouraging to see some recent thawing in the secondary markets, they are nowhere near normal levels needed to expand the flow of SBA lending. Several ICBA-backed programs have been launched to help unfreeze the frozen secondary market for pools of SBA guaranteed loans, including the Term Asset-Backed Securities Loan Facility (TALF), a White House / Treasury announced $15 billion initiative and the new SBA secondary market facility called for in ARRA.

The TALF conducted through the Federal Reserve and U.S. Treasury, is intended to extend billions in nonrecourse loans to holders of high-quality asset-backed securities and small business loans in a bid to free up the frozen market.

ICBA greatly appreciates such ongoing program efforts to revive the secondary market for small business loans. Specifically, the TALF program for SBA secondary market loan pools is very close to success. Unfortunately, one program obstacle requiring third-party direct competitor primary dealers to be middlemen has completely stalled the program. SBA loan poolers will not turn over their customers to their direct competitors nor have the primary dealers engaged in the program to date. ICBA recommends either eliminating the primary dealer middlemen in the process or allowing the Federal Reserve Bank of New York to work as the intermediary with the existing SBA loan poolers.

Similarly, the ICBA believes the new SBA secondary market program called for in ARRA is close to success but the debate over potential additional fees to operate the program has stalled its launch. ICBA recommends the Office of Management and Budget consider using all available budget authority to run the program in combination with user fees so as not to kill the important program with unworkable double fees. ICBA also appreciates the ongoing work of the White House and Treasury to address obstacles in their $15-billlion TARP-funded announced program to buy SBA loans directly from interested lenders.

ICBA believes with minor adjustments, these targeted SBA secondary market programs will keep money flowing to consumers and small businesses providing the intended value and results.

Other SBA Program Considerations

Community banks do want to support more small business lending through the valuable SBA programs. Several additional policy recommendations are aimed at returning more community banks to SBA lending. These ICBA-backed initiatives include making the Rural Lender Advantage program permanent, ensuring SBA makes good on their loan guarantees, and providing more flexibility in small business size standards and market-based loan pricing.

Rural Lender Advantage

Many community banks that do not have dedicated SBA lending departments and are not Preferred lenders (PLP) still make SBA loans. With more than 8,000 community banks nationwide, additional community banks making SBA loans would have a tremendous impact on the credit availability to small businesses. When the SBA dropped the successful, streamlined "low-doc" program, hundreds of banks dropped out of doing any SBA lending at all. Fortunately, in January of 2008, the SBA launched a ICBA-backed initiative for the 7(a) program known as the Rural Lender Advantage initially targeted in just a handful of states. As always, community banks still do their own strict underwriting of these SBA loans but can rely on a less-onerous process to complete the loan through the SBA. Important features of the program include:

- A streamlined, simpler, and more user friendly 7(a) process for small loans ($350,000 or less);
- One page application for very small loans with key, but limited additional information required for loans above $50,000;
- SBA guarantees 85 percent of loans of $150,000 or less and 75 percent of loans greater than $150,000;
- Loans centrally processed through SBA's Standard 7(a) Loan Processing Center;
- Expedited SBA processing with routine loans processed within 3-5 days; and
- Training on SBA program requirements from local SBA offices.

ICBA fully supports this beneficial, streamlined program and recommends it be expanded nationwide and made permanent. Even with its limited launch and the economic decline, to date more than 600 Rural Lender Advantage loans have been made. ICBA encourages the Committee to ensure this program continues to help meet the small businesses' credit needs especially in small communities often facing population loss and higher unemployment levels.

Making Good on SBA Guarantees
ICBA has been hearing from a growing number of community banks lenders concerned with SBA not making good on loan guarantees. This includes long waiting periods to hear from SBA, refusal to pay the guarantee, or SBA applying substantial repairs. For community banks SBA loans provide a very small margin of profitability and the guarantee is critical. In order for community banks to engage in SBA lending they must have full faith in the SBA payment of the loan guarantee. When lenders are confronted with trouble in collecting on an SBA guarantee they cannot afford to continue in the program. ICBA recommends more upfront communication between the lenders and the SBA on the guarantee process and all requirements when the loan is approved by the SBA. Addition education and faster response times from the SBA would be helpful.

Small Business Size and Market-Based Pricing Flexibility
In these difficult economic times, the SBA loan programs need to be as flexible as possible to best meet the need of lenders and small businesses in getting credit flowing again. To that end, a greater range of small businesses should be eligible for SBA loans and lenders should have greater flexibility in pricing these loans based on market conditions and risk. ICBA wholeheartedly supports the recent SBA effort to temporarily allow alternative size standards for the 7(a) loan program through Sept. 30, 2010. As a result of the temporary change, some 70,000 additional small businesses could be eligible to apply for SBA 7(a) loan. The temporary 7(a) loan size standard will parallel the standard for the agency's 504 Certified Development Company loan, and will allow businesses to qualify based on net worth and average income. The net worth for the company and its affiliates can't be in excess of $8.5 million and average net income after federal income taxes

(excluding any carry-over losses) for the preceding two completed fiscal years can't be more than $3 million. ICBA recommends this new size standard be made permanent.

Additionally, ICBA believes consideration should be given to the current credit market realities and the pricing of SBA loans in this sharp economic downturn. Clearly credit risk has increased and banks' costs -- including the cost of raising bank capital, regulatory costs, and sharp increased in FDIC deposit insurance premiums -- have all dramatically diminished banks' margins. Every bank needs a reasonable, positive loan spread to do business and survive. Small businesses still need credit in this challenging financial environment. Small businesses often report they cannot get credit at any price. ICBA recommends the SBA consider alternative market-based pricing for SBA loans versus the set Prime-plus amounts to allow more flexibility and allow more small businesses to qualify for SBA loans.

Overzealous Bank Regulation Hurting Small Business Lending
Pro-cyclical bank regulatory policies continue to jeopardize credit availability for many small businesses. ICBA believes the bank regulatory pendulum has swung too far and is crushing many community banks' ability to lend to deserving small businesses. Community banks did not cause the current financial crisis fostered by the missteps of the too-big-to-fail banks. Unfortunately, bank regulators are often applying crippling regulatory exams and policies across-the-board.

Community bankers nationwide continue to report to ICBA about overzealous and unduly, overreaching examiners second guessing bankers and appraisers and demanding overly aggressive write-downs and reclassifications of viable and performing commercial real estate loans and other assets. Examiners are requiring write-downs or classification of performing loans due to the value of collateral irrespective of the income or cash flow of the borrowers; placing loans on non-accrual even though the borrower is current on payments; discounting entirely the value of guarantors; criticizing long-standing practices and processes that have not been criticized before; and substituting their judgment for that of the appraiser.

Other bankers are concerned that otherwise solid loans are being downgraded simply because they are located in a state with a high mortgage foreclosure rate. This form of stereotyping is tantamount to statewide redlining that is unjustified in today's economic climate and could ultimately lead to capital problems at otherwise healthy banks.

This examination environment is exacerbating the contraction in credit for small businesses as community bankers must avoid making good loans for fear of examiner criticism, write-downs, and the resulting loss of income and capital. While it is expected and understandable that examiners will be more thorough and careful during a credit downturn, excessively tough exams that result in potentially unnecessary loss of earnings and capital can have a dramatic and adverse impact on the ability of community banks to provide small business loans and the ability to support economic growth.

Nearly sixty percent of small business lending is backed by some type of real estate collateral. To prevent a downward spiral in small business credit, regulators should consider a more flexible and reasonable examination policy particularly with respect to real estate lending so that community banks can meet the credit needs of the communities they serve. When banks suddenly find themselves classified as "adequately capitalized" rather than "well-capitalized" because of these tough examinations their ability to fuel small business lending is dramatically curtailed. Community banks are ready to meet the objectives of lending to creditworthy households and businesses but they simply cannot meet those objectives without a change in the current regulatory environment.

Regulatory Restructuring Concerns
The Administration and Congress are also advancing proposals to restructure the financial regulatory system, causing community bankers great concerned about the potential impact. Any restructuring of our financial regulatory system should first recognize the fact that the current system that applies to community banks has worked appropriately and the highly-regulated community banking sector did not trigger the current financial crisis. Therefore, ICBA believes any plan to eliminate the state bank charter and the current federal structure is unnecessary and would disrupt community banking and small business credit.

ICBA believes reforms should focus on filling in regulatory gaps by regulating unregulated institutions and instruments, such as credit default swaps, off balance sheet schemes, and providing more effective regulation of under-regulated entities in the financial services sector, such as non-FDIC insured mortgage companies and mortgage brokers. Regulatory restructuring should address the systemic risk taxpayers just witnessed caused by the nation's largest too-big-to-fail institutions and focus efforts on eliminating future systemic risk.

Important Beneficial Small Business Tax Reforms

For many small businesses, taxes are the second highest cost after labor costs. Therefore, ICBA strongly supports a number of small business tax relief measures to assist small businesses in attracting and preserving capital in these difficult economic times.

Flexibility for S Corporations
S corporations continue to be the most prevalent type of corporation in our nation. More than four million small businesses are structured as Subchapter S corporations including one-third of all banks. For small businesses, raising capital is critical to the start-up, survival, and growth of the business. However, arbitrary and restrictive limits on Subchapter S businesses are jeopardizing their ability to raise capital. Specifically, current tax law restricts the number and types of individuals or entities that may own S corporation stock. S corporations may not have more than 100 shareholders, new IRA shareholders, and can only have one class of stock outstanding. ICBA believes these restrictions should be immediately reformed to spur more private sector solutions for small businesses to attract capital as Treasury is injecting taxpayer funds as capital into banks. In order to increase the options for small businesses to raise capital from the private sector, ICBA recommends:

- Increasing the maximum number of allowable S corporation shareholders to 150 from 100;
- Allowing IRAs as eligible S corporation shareholders; and
- Permitting the issuance of preferred stock for all S corporations.

Small businesses including community banks are dealing with frozen capital markets and the near-impossibility of raising new capital. Immediate adoption of the reforms listed above would go a long way in creating addition private sector capital-raising options.

Expand Loss Carryback to Five Years or More
One-third of banks nationwide or more than 2,657 reported a loss in the latest FDIC quarterly banking profile. Allowing community banks and small businesses with $10 billion in assets or less to simply spread out their current losses to preserve capital to leverage for lending would help entire communities weather the deep recession. Expanding the current Net Operation Loss Carryback (NOL) period to five years or more from two years will help free up small business resources now to help support investment and employment at a time when capital is needed most. Expanding the NOL to a five-year carryback simply allows businesses to accelerate the use of allowable NOL deductions that can be claimed in future years under current law anyway.

Preserve 35% Top Marginal Tax Rate on Subchapter S Income
Maintaining cash flow is vital to the ongoing survival of any small business and taxes are typically the second highest expense for a business after labor costs. As pass-through tax entities, Subchapter S taxes are paid at the individual income tax level. Marginal income tax rates do play a critical role in a small business' viability, entrepreneurial activity, and choice of business form. Today more than half of all business income earned in the United States is earned by pass-through entities such as S corporations and limited liability corporations.

ICBA believes it is important to consider maintaining parity between the top corporate and individual income tax rates in the Code. Additionally, during this difficult economic period, at a minimum, the current top tax rate of 35% should be preserved on both small business Subchapter S income and C corporation income, not increased. This will afford lenders and investors more confidence in extending small business capital.

Conclusion
The need for affordable small business capital is greater today than ever. Community bankers run small businesses themselves, live and work in the communities with their small business customers, and will do everything possible to ensure they can support the credit needs in these difficult economic times.

Small business credit needs and helpful SBA lending programs should remain front and center. The ICBA pledges to work with the Small Business Committee to ensure our Nation's small businesses have the access to capital they need to invest, grow, and to provide jobs and economic growth. Thank you.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program

Expanding Small Business Access to Capital

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Jean Wojtowicz
Chair
NADCO Board of Directors
&
Executive Director
Indiana Statewide CDC

McLean, Virginia

June 10, 2009

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business about our concerns on the need to improve access to capital by small businesses.

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

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

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

NADCO will provide comments today on the critical needs of the 504 program as we seek to increase access to long term capital by small businesses during and immediately following this recession.

Reduce 504 Program Costs for Small Businesses:

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

Since FY 1997, the 504 program has been at zero subsidy; that is to say, fees paid by small business borrowers, CDCs and first mortgage lenders have covered the entire cost of the program. No taxpayer funds have been appropriated for the program in over ten years. While we have requested a more detailed discussion with SBA's subsidy experts, an analysis of the OMB Federal Credit Supplement reveals that SBA is projecting that loan defaults for 504 will increase from 3.5% for FY 09 to over 7.3% for FY 10. Together with the unemployment rate increase, these two factors may well account for the majority of the fee increases over the next two years.

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

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

The result will be that, just as occurred in FY 1997 when OMB grossly overestimated the defaults and cost thousands of small businesses millions in inflated guarantee fees, for FY 2010 we will see borrowers paying unnecessarily high program fees at the worst time: when they need access to affordable 504 loan capital so they can preserve their cash for working capital to undertake their company expansion and create jobs. With inflated guarantee fees for both FY 2010 and 2011, almost 20,000 small businesses will pay millions in extra fees to SBA over the entire twenty years of their 504 loans.

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

Reach Out to More Small Businesses With New Capital:

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

However, our industry believes that more should be done quickly to have even more impact. Even as SBA worked to implement new programs and fee reductions created through the stimulus bill, the loan eligibility and underwriting policies set forth by SBA that are so critical to maximize the effectiveness of these programs were drifting towards more conservative interpretations on numerous issues.

For example, even with a history of successful lending and no data demonstrating unusual loan losses, SBA has moved to restrict 504 borrowers from accessing their personal home equity in order to inject these funds into their new 504 expansion projects. NADCO and the banking industry have prevailed upon SBA to reconsider this policy and collect data to mitigate its negative impact on business borrowing. We are hopeful that SBA will reverse the planned implementation of this potentially highly restrictive policy.

SBA has also moved to interpret the energy-saving project financing changes passed by Congress in ways that are unusual and inconsistent, to say the least. NADCO is working with SBA to try to maximize the impact of these program enhancements and provide financing that will incent businesses to become much more energy efficient as they expand their plants.

Our discussions with member CDCs and banks lead us to believe that there are many small businesses eager to expand that either need access to larger guaranteed loan amounts, or have already used up their allocated maximum for 504 under current law. Sometimes these are larger businesses that can create many more new jobs with a new plant; other times they may be successful entrepreneurs that have one or two stores today and want to add more sites based on their current (and profitable) business models. NADCO believes that these restrictions can be addressed in three ways: first, increase the maximum 504 debenture beyond its current limit of $1.5 million, second, allow a borrower to maximize use of both 504 and the 7(a) loan limits for a single project, third, eliminate the regulation that restricts business owners with higher net worth from participating in 504 projects. These are the very business owners that can create the most jobs as their businesses expand, and do so with the least risk of future loan default.

Our industry is concerned about the potentially catastrophic damage to the nation's entrepreneurial sector as a result of the current capital markets and banking sector crisis. The commercial mortgage backed securities industry remains frozen and banks are failing, or failing to lend, in spite of historic efforts by this Congress and Administration to get these markets moving. One area where this is having very adverse effects is in situations where companies own their own buildings, but have financed these buildings with conventional financing which often has 5 year call provisions. As the banks for these companies fail or substantially tighten their lending standards, performing loans to good companies are being called, causing historically good small businesses with performing loans to be put into foreclosure and causing jobs to be lost. Because of the CDC industry expertise in providing optimally structured fixed asset financing to small business, we believe 504 should be made available refinance this badly structured conventional debt and save these good companies and the jobs they have created.

NADCO is also concerned that many small businesses that urgently need working capital to fund salaries, raw materials, inventories, and everyday expenses are being hamstrung by their inability to gain access to needed working capital from their substantial commercial real estate equity. This equity is locked up in the current capital markets and banking crisis, with many banks simply unwilling to renew even good loans as federal and state regulators force major adjustments in bank balance sheets and loan portfolios. We believe that SBA and our industry can work together to craft means to assist in these situations and provide fresh capital to these small businesses, while retaining sufficient real estate collateral to protect the taxpayer. We urge Congress and SBA to work with NADCO to develop and pass legislation to make regulations more flexible, especially during this recession in which businesses are collapsing due to lack of working capital, even as they sit on substantial real estate equity that they cannot access due to a crisis in the nation's capital markets.

Reduce Loan Losses by Focusing More Effort on Liquidation:

Clearly, loan defaults and charge offs within the 504 portfolio are increasing. However, NADCO believes that the net losses for the program do not have to increase at the same rate. At Congress' direction several years ago, SBA created a new regulation that enabled it to take advantage of the recovery expertise within the CDC industry to increase the labor effort focused on liquidating collateral from defaulted loans, and going after guarantors of those loans at the local level. All agreed that this was especially difficult for SBA, as it has only two small and extremely overworked liquidation staffs, located in Little Rock and Fresno, with no local recovery specialists able to do this work in every city and town. They are simply too far away from the projects and too small of a staff to maximize recoveries on the growing number of loan defaults.

This work is highly specialized and invariably requires staff work in local courts, as well as local contractors to maintain collateral property and negotiate settlements with local guarantors. Many, if not most, CDCs already perform such tasks for other loan and grant programs they administer. They have simply not been given the ability and freedom by SBA to do this on a broad scale for 504. Nor, have they, as set up in the SBA's own regulations, been given the expense reimbursements for the costly work of their staff efforts to maximize recoveries.

NADCO believes that the charge off losses for the 504 program can be reduced over time if CDCs are given the freedom to perform recoveries and seek settlements from loan guarantors of 504 projects. This will require cooperation with, rather than dictation from, SBA liquidation staff, who sometimes have far less experience that CDCs at this work. It will also require greatly improved and accurate collections of payments and loan accounting systems. NADCO continues to make proposals to SBA regarding use of its centralized loan servicing contractor to improve this process and speed up collections and payments for defaulted notes that are renegotiated with borrowers or guarantors, with access to this information provided to the CDC industry to assist them in their recovery efforts.

The Need to Make SBA Programs more Relevant and Productive:

Loan volume for both the 504 and 7(a) guarantee programs has improved slightly since passage of the stimulus act, but many of those benefits are just now being implemented by the SBA. However, in spite of the Stimulus bill, both programs are still down over 50% from their highest levels two years ago.

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

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

Working together, we must become more creative and flexible in serving the needs of these new industries. We can't finance just hotels and C-stores and create the kinds of jobs that Americans will move into in record numbers to create new wealth. Working together, we must tear down the walls of arcane, irrelevant and restrictive regulations or policies that create unnecessary barriers to reaching the industries of the 21st century's economy.

Further, neither SBA nor our CDC industry should shy away from working with other lending industries or other federal credit agencies such as EDA, HUD, USDA or Treasury to create new financing tools that will maximize job growth and economic development for our nation. Instead, we should embrace the concept of change for our program in order to respond to new small business needs.

In the end, SBA should recognize the expertise and the broad financing knowledge of its lending partner industries. CDCs are not just loan packagers; they are versatile and skilled economic developers that have the well-being of their communities as their number one goal. SBA can leverage this industry's skills and contacts to expand its own programs and re-make itself into a more relevant agency whose impact can be so much more substantial and be felt by thousands of additional small businesses.

Conclusion:

In its fifty-six years of existence, SBA has become the most efficient and certainly the most successful small business economic development agency in the Federal government. By leveraging its guarantee authority and lender industries, SBA has directly assisted in the creation of over five million jobs through more than $200 billion in 504 first mortgages, 504 second mortgages and 7(a) bank loans. Many hundreds of thousands of small businesses have been assisted. Every State has seen the job growth and business success achieved by the capital brought to them by SBA programs. SBA has touched the lives of millions of business owners and employees in its short existence. Few agencies can claim this record of accomplishment and impact on our economy.

But like any maturing organization, SBA has to re-evaluate its product lines, and strive to serve the changing needs of America's small businesses. With fresh leadership bringing extensive market and financing knowledge to the agency, and with the twin pains of plummeting loan volume and increasing loan defaults, we have the "fiery cauldron" of opportunity from which new and revolutionary programs can evolve tomorrow.

Failure to respond to the new needs of 21st century small businesses will make both the SBA and its programs less and less relevant in the next 56 years, and even in the next decade. Success in changing its programs and throwing off the burden of its increasing regulatory bureaucracy will keep it in the forefront of small business assistance. This will certainly lead to the creation of another five million new jobs at a time when solid, well-paying American jobs will be precious indeed for our economy.

NADCO urges the Congress, through the two Small Business Committees, to collaborate with the new SBA management and with far-sighted, market driven lenders to tear down those unneeded and overly restrictive regulatory walls and create the financing and economic development programs so vital to America's future in a competitive new world.

"By working together we can help get America working."

Thank you.

CUNA & Affiliates

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WRITTEN TESTIMONY

OF

ROGER HEACOCK
PRESIDENT AND CEO
BLACK HILLS FEDERAL CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE COMMITTEE ON SMALL BUSINESS
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"Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital"

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"Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital"

JUNE 10, 2009

Chairwoman Velazquez, Ranking Member Graves, and Members of the Small Business Committee, thank you very much for the opportunity to testify at today's hearing on "Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital" on behalf of the Credit Union National Association (CUNA). CUNA is the nation's largest credit union advocacy organization, representing over 90% of our nation's approximately 8,000 state and federal credit unions, their State credit union leagues, and their 92 million members.

My name is Roger Heacock, and I am President and CEO of Black Hills Federal Credit Union in Rapid City, South Dakota. Our field of membership includes businesses located in and individuals, who live, work, worship, or attend school in Pennington, Custer, Fall River, Lawrence, or Meade Counties in South Dakota.

I am honored to be here to speak to you about the impact that SBA lending has on our local economy, to our credit union and most importantly to our members, and to suggest ways to improve SBA programs.

I would also like to note that CUNA President Dan Mica appreciated being among those at the White House March 16 when President Obama announced his Small Business Lending Initiatives, and we are looking forward to working with new SBA Administrator Karen Mills, who has already undertaken steps to revitalize the agency.

Black Hills FCU's Experience with the Small Business Administration

Black Hills FCU was first authorized to do SBA lending in January 2003, and we truly value our partnership with the SBA. In May 2009, Black Hills FCU received the District Director's Leadership Award from the South Dakota SBA. Black Hills FCU wrote more SBA loans in the state of South Dakota than any other financial institution during 2008—29 SBA loans for a total of $1,644,400, which is an average of $56,703 per loan.

We find working with the SBA beneficial to the credit union and our members for several reasons.

SBA Programs Are Particularly Helpful for Start-up Businesses

First, our relationship with the SBA gives us the opportunity to serve our members who are interested in starting their own businesses. We have a number of members that started small businesses, using SBA loan funds, while continuing to work at their primary job as their main source of income. Many of these businesses started out in their home or garage, and as their small business slowly began to grow, they were able to move their business to a bigger location and were able to quit their job. The business matured and we were able to help them out. The SBA helped us be there for our members.

There is additional risk to these types of borrowers and, quite frankly, other lenders shy away from helping them because there is not a proven cash flow with these borrowers. We are able to lend to this type of borrower because of the guarantee that SBA provides. The programs allow us to help the borrower who comes in and may not have the equity investment we would generally like to see, but has a good business plan. We looked to the SBA to help us create an acceptable level of risk and it was a win-win situation for all of us – the Credit Union and the SBA and the borrower.

As a result of our ability to make these small loans to start-up businesses, we have seen these businesses grow, and that has resulted in additional employment opportunities, even during these difficult economic times.

Excellent Support from Small Business Development Centers and Our District Office

We find we receive excellent support from the Small Business Development Center, an affiliate of the SBA. When someone comes into the credit union inquiring about an SBA loan, we often refer them to the SBDC because they have people with expertise that can work with the borrower to develop the business plan, complete cash flow projections, as well as pro forma income statements and balance sheets. We accept documents from the SBDC as part of our review plan, and it facilitates the application process and increases the member's probability of being approved for a loan.

In addition, we also have an excellent relationship with the South Dakota District Office in Sioux Falls. We can generally call or e-mail them with a question or a concern and they get right back to us. And, if there is a question that they cannot answer, they will refer it to the national level. They give us direction and guide us on certain programs processing and servicing issues. This level of service is ultimately advantageous for the borrower. They are just very supportive. I cannot say enough about the SBA District Office here in South Dakota on the SBA and how supportive they have been for us.

SBA Supports the Borrower

The SBA seems to approach its mission from a similar perspective as we approach our lending—with the borrower as the primary focus. When there is a problem, the SBA, in our experience, has been open to work-out solutions. They do not pressure us to liquidate the borrower. They want to work with us and the borrower on a solution to bring the business back to a state of financial health. In many respects, the approach we have found the SBA takes with problem loans is consistent with the credit union spirit. Instead of asking, "What's the best way to cut our loss," they ask, "What's the best solution?"

CUNA is aware that some lenders, including some credit unions, have not had such a good relationship or positive experience with the SBA. In addition to the barriers presented by the statutory credit union member business lending cap, credit unions also identify the application process, fees, timeliness of decision-making and difficulties with SBA district and central offices as reasons that they either do not participate in SBA programs, or do not do more SBA lending. In that connection, we think there are ways to improve the work that is done by the SBA.

Maintain or Lower Fees

CUNA strongly supports legislative initiatives to reduce the SBA fees and has advocated for the highest possible appropriation in order to keep SBA programs even more beneficial to small business and accessible to credit unions. CUNA believes that the greater the number of available sources of credit to small business, the more likely a small business can secure funding and contribute to the nation's economic livelihood.

We encourage Congress and the SBA to maintain or lower fees because cost has become a major obstacle for the small entrepreneur. We greatly appreciate Congress setting aside $375 million for the temporary elimination of fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent, as part of the American Recovery and Reinvestment Act of 2009. This additional assistance is available until the end of the year or whenever the funds are exhausted, whichever comes first.

As the Committee reviews SBA programs, we encourage Congress to make additional funds available to the agency so that fees can remain low and the guarantees can remain generous. SBA fees have a direct impact on small businesses' ability to borrow under SBA programs. A 3% fee on a $200,000 SBA loan is $4,500 that the business must pay either at origination or over the course of the loan. The fees can become an obstacle for us as a lender when we are working with a borrower.

Improvements to the SBA's Electronic Communication and Application Systems

We encourage the SBA to develop an email notification system for lenders in order to improve communications regarding procedural changes. Currently, we are not notified when the SBA makes procedural changes to its programs. Lack of notification opens us up to exposure because we are operating under a certain set of rules that has changed without our knowledge—if we do not follow the proper procedure, we may not get the guarantee if the loan goes bad. This could be avoided if lenders were made aware of changes in procedure at the SBA.

While this certainly is not a suggestion that requires a legislative fix, we would also encourage the SBA to continue to make improvements to the agency's website aimed at making it more user-friendly to both lenders and borrowers. Many of the forms that we are required to use are not up-to-date on the website.

Additionally, we encourage the agency to find ways to improve its E-Tran system. While we appreciate the goal to make the application process more efficient, as it has currently been implemented, we find it to be more time consuming. The application pages are difficult to complete, and errors on the application are easier to make and harder to correct using the system.

The Size of Eligible Business

The SBA has adopted an interim final rule that will revise the size criteria for a small business eligible for a 7(a) loan; the rule took effect on May 5, 2009. In addition to the current size limit, the new rule will allow a small business to be eligible if it has a tangible net worth of up to $8.5 million and average net income after federal taxes of up to $3 million. SBA estimates about 70,000 businesses would meet the new criteria. While the new size standards will end September 30, 2010, we support this initiative as a very positive step to help boost the small business community and the broader economy.

Credit Union Involvement in SBA's 7(a) Loan Program

CUNA is a strong supporter of the 7(a) loan program, which provides America's 26 million small business owners with the capital and technical assistance needed to start and expand their businesses. We view the 7(a) program as an essential tool for achieving the credit unions' mission of serving all the credit needs of members, particularly low-to middle-income individuals and groups living in communities that are not adequately served by other traditional financial institutions.

CUNA strongly encourages our members to make use of the 7(a) program. Yet, while the number of credit unions participating has increased, currently, less than 3% of all U.S. credit unions offer SBA loans to their members. Larger credit unions are more likely to be involved with SBA loans, and with business lending generally. About 28% of credit unions with more than $500 million in assets offer 7(a) business loans. And, while the number of credit union 7(a) loans has grown steadily since 2003, such loans represent only a small portion (1.6%) of all business lending to credit union members.

Several important factors discourage larger numbers of credit unions from participating as 7(a) lenders. First the statutory cap on credit union member business lending (MBL), which is discussed in detail below, restricts the ability of credit unions offering MBLs from helping their members even more, and discourages other credit unions from engaging in business lending. Even though the cap does not apply to SBA loans, it is a real barrier to some credit unions establishing an MBL program at all. That is because not all loans fit SBA parameters and credit unions are reluctant to initiate an MBL program when they may reach the cap in fairly short order.

A second factor limiting credit union participation has been SBA policies that, until 2003, limited credit union eligibility to participate in the 7(a) program only to credit unions with geographic or community charters. Since the number of credit unions with community charters still represents a small percent of all credit unions, this severely limited credit union access to the program. Fortunately, SBA issued a revised legal opinion on February 14, 2003, removing restrictions on the types of credit unions eligible to participate as 7(a) lenders.

While SBA's 2003 policy change was good news for credit unions, it may prove to be even more important for small businesses. In 2005, an SBA research publication noted that large bank consolidation is making it more difficult for small businesses to obtain loans.[1] Given the fact that the average size of a credit union member business loan is approximately $216,000, and the average credit union SBA 7(a) loan is approximately $73,000, this is a market that credit unions are well suited to serve. And this is a market that credit unions are eager to serve.

[1] Small Business Administration. The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks. March 2005.

business lending. However, please allow me to paint a picture of the member business loan (MBL) activity of credit unions.

As noted above, member business loans that credit unions provide their members are relatively small loans. Nationally, credit union business lending represents just over one percent (1.06%) of the depository institution business lending market; credit unions have about $33 billion in outstanding business loans, compared to $3.1 trillion for banking institutions.[2] In general, credit unions are not financing skyscrapers or sports arenas; credit unions are making loans to credit union members who own and operate small businesses.

Despite the financial crisis, the chief obstacle for credit union business lending is not the availability of capital—credit unions are, in general, well capitalized. Rather, the chief obstacle for credit unions is the arbitrary statutory limits imposed by Congress in 1998. Under current law, credit unions are restricted from member business lending in excess of 12.25% of their total assets. This arbitrary cap has no basis in either actual credit union business lending or safety and soundness considerations. Indeed, a subsequent report by the U.S. Treasury Department found that business lending credit unions were more regulated than other financial institutions, and that delinquencies and charge-offs for credit union business loans were "much lower" than that for either banks or thrift institutions.[3]

The cap is overly restrictive and undermines public policy to support America's small businesses. It severely restricts the ability of credit unions to provide loans to small businesses at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks.

The cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but also discourages credit unions who would like to enter the business lending market. The cap effectively limits entry into the business lending arena on the part of small- and

[2] All financial data is March 2009. Credit union data is from NCUA; Bank data is from FDIC.
[3] United States Department of Treasury, "Credit Union Member Business Lending." January 2001.

medium-sized credit unions—the vast majority of all credit unions—because the startup costs and requirements, including the need to hire and retain staff with business lending experience, exceed the ability of many credit unions with small portfolios to cover these costs.

Today, only one in four credit unions have MBL programs and aggregate credit union member business loans represent only a fraction of the commercial loan market. Eliminating or expanding the limit on credit union member business lending would allow more credit unions to generate the level of income needed to support compliance with NCUA's regulatory requirements and would expand business lending access to many credit union members, thus helping local communities and the economy.

While we support strong regulatory oversight of member business lending, there is no safety and soundness rationale for restricting credit union member business loans as the law currently does. There is, however, a significant economic reason to permit credit unions to lend without statutory restriction, as they were able to do prior to 1998: America's small businesses need the access to credit. As the financial crisis has worsened, it has become more difficult for small businesses to get loans from banks, or maintain the lines of credit they have had with their bank for many years.

A growing list of small business and public policy groups agree that now is the time to eliminate the statutory credit union business lending cap, including the Americans for Tax Reform, the Competitive Enterprise Institute, the Ford Motor Minority Dealer Association, the League of United Latin American Citizens, the Manufactured Housing Institute, the National Association of Mortgage Brokers, the National Cooperative Business Association, the National Cooperative Grocers Association, the National Farmers Union, the National Small Business Association, the NCB Capital Impact, and the National Association of Professional Insurance Agents.

We hope that Congress will eliminate the statutory business lending cap entirely, and provide NCUA with authority to permit a CU to engage in business lending above 20% of assets if safety and soundness considerations are met. We estimate that if the cap on credit union business lending were removed, credit unions could—safely and soundly—provide as much as $10 billion in new loans for small businesses within the first year. This is economic stimulus that would not cost the taxpayers a dime, and would not increase the size of government. We also support revising the statutory floor on what constitutes an MBL from the current $50,000 to a more realistic level of $250,000.

Madame Chairwoman, thank you very much for convening this hearing and inviting me to testify. I look forward to answering the Committee's questions.

NASBIC
America's Small Business Partners

Statement
of
Hollis A. Huels

National Association of Small Business Investment Companies
Suite 750
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Before The

United States House of Representatives
Committee on Small Business
June 10, 2009

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Madam Chair, Ranking Member and Members of the Committee:

Thank you for the opportunity to appear today to offer the National Association of Small Business Investment Companies' (NABSIC) views on the important issue of how to lay the groundwork for economic recovery by expanding small business access to capital. My name is Holly Huels and I am the Senior Vice President of Capital For Business (CFB) in St. Louis, MO. I am also Chairwoman of the NASBIC's Board of Governors.

While much of the attention has been paid to the General Motors, AIG, and other ailing behemoths, the plight of millions of small business owners and entrepreneurs has not received the same media attention. We appreciate this Committee's continued commitment to small businesses and efforts to keep small businesses as part of the Congressional agenda. We particularly appreciate the reforms that were incorporated into the Recovery Act. Your actions have helped many of our small business partners.

CFB is a private equity firm focused on providing capital to small businesses with proven management teams and a high potential for growth. Founded fifty years ago as one of the first SBICs, we have invested in over 80 companies across a wide range of industries including consumer, commercial, distribution, manufacturing, and service companies throughout the US. CFB's goal is long-term growth and the creation of value by bringing unique financial, operational, and industry expertise to help management teams grow their businesses. We do not purchase companies with the intention of reducing employees or selling off key assets in order to realize short-term profits. We invest, in cooperation with exceptional management teams, to improve companies and increase long-term shareholder value for all investors.

CFB has invested in companies from Pennsylvania to California. Today much of our portfolio is in the Central US. The difficult economy has impacted our current 20 portfolio companies just as most companies in America have been affected. Revenues and profits have declined. However, CFB as well as most SBIC investors take a long-term view toward investing in US-based companies. We have continued to support our investments by working with our management teams and commercial banks and providing additional capital from our own funds, when appropriate. Many of our companies are not currently growing due to the difficult economy. However, over CFB's long history, our portfolio investments have typically grown, increasing their employee base and paid taxes.

Over this 50 year period, the SBIC program has provided over $55 billion of financing to over 106,000 U.S. based businesses. While these are large numbers, I assure you the program is underutilized. The U.S. credit markets have experienced a significant contraction especially to small companies. SBIC financing is the one program available to US small business that remains available when other financing sources have retracted.

SBICs are private equity funds that invest exclusively in domestic small businesses. While the bigger names in the private equity and venture world invest globally, SBICs invest locally in the main street businesses that employ your constituents. Many of SBA's greatest success stories – Federal Express, Intel, Outback Steak Houses, Whole Foods, Apple, Quiznos, and PeopleSoft – received their early funding from SBICs. SBICs are the right partnership for policy makers and the private sector to work together to end this recession, grow the economy, and create jobs.

Since 1958, the SBIC program has been a successful, market-driven collaboration. The program design is simple and effective: debenture SBIC fund managers raise private capital for investment in small businesses and are able to enhance these investments by borrowing money periodically from SBA. Currently the SBIC Debenture program has the capacity to facilitate investments of about $4 billion dollars a year into America's job creators. However, only about $1.5 billion dollars a year is currently being facilitated by the SBIC program. Over the next four years that is an opportunity cost of approximately $10 billion dollars – 100% of which would otherwise be invested in job creating domestic small businesses. This is particularly troublesome because the existing SBIC Debenture program fully pays for itself and often returns a profit to the government. For example, the SBIC Debenture program has returned over $340 million dollars to SBA in excess of the costs of running the program and this number does not include any of the increased tax revenues from the small businesses that benefitted from the program. As the champions of small business, we are asking this Committee and SBA to emphasize the SBIC program and fully utilize its potential. Please reform the program to help today's small business become tomorrow's icons of the American economy.

Current State of the Market

Small Business Access to Capital

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

NASBIC polled its members and found that 100% of the respondents reported that they had experienced banks pulling or reducing senior lines of credit for investments that normally would have no difficulty. 75% of the respondents reported less subordinated debt available for small businesses. One of the most respected publications for the lower and middle markets, GF Data Resources, recently reported that we "are now in the throes of a dramatic slow down in non-distressed private equity sponsored buyout activity."[1] However, unlike the rest of the market, SBICs are still investing in small businesses. SBICs have provided approximately $1.3 billion to small businesses in 2009. These funds were invested in over 1900 transactions in 1068 companies. The average amount of investment in each company is slightly over $1 million. These may sound like small numbers by Washington standards, but to small businesses every one of these dollars is a very big deal. The SBIC Debenture program expands access to critical capital to the nation's small businesses. This effort is hindered by the relatively low number of licensed SBICs. Imagine what could be done if the program were running anywhere near full capacity.

For seed and early stage companies the situation is even worse. Early stage and equity investing for small business has largely dried up. The SBA previously had an effective tool that was exceptionally successful at using the private market to steer equity investments into domestic small businesses with the taxpayer money enhancing the effect. The SBIC Participating Securities program needed reforming, but instead of being reformed, it was deactivated and now lies dormant. While it lasted, this program had an Internal Rate of Return of almost 11%, invested over $13 billion in small businesses, created over 385,000 new jobs and saved hundreds of thousands more. While almost 70% of venture capital dollars go to high tech and life science industries, this program invested heavily in small business manufacturing. More than half of VC investments are made in California and Massachusetts, but the SBIC program invested more than 70% in other states that are often starved for investment capital. SBICs are still a source of capital for early stage companies, investing in almost 300 so far this year, but there has been over a 30% decline since the mothballing of SBA's equity option.

Meanwhile the debenture program provided over $800 million over the same period. The demise of an early stage and equity option from SBICs has contributed to the dearth of early stage capital and is a road block to our economic recovery. These SBICs were the most reliable source of equity capital for U.S. small businesses dealing with the fallout of the recession that began in 2000. All venture capital investments fell 83% between 2000 and 2003 according to Venture Economics. SBIC investments during that period—a total of $5.25 billion—fell just 23%. A recent survey by the National Association of Seed and Venture Funds found that over 90% of early stage entrepreneurial companies, some of the nation's best job creators, are having serious difficulty raising follow on capital.

[1] GF Data Resources May 2009

Unfortunately for America's small businesses, the demand for SBIC capital is increasing at a time when the SBIC program is at its nadir. Last year only six SBIC funds were licensed. This is down by over 90% from the peak of over 60 a year in the late 1990s. Licensing in the 1990's took only a few months. In contrast, last year many SBIC licensees had to wait over a year. Without new SBIC licenses, small businesses are being denied funds that could be providing growth capital. The good news is that in FY 2009 SBA has licensed nine SBICs – a 50% increase from the nadir of 2008 – with SBA openly trying to get licensing waiting periods down to four months. This is a good start, but a better target would be 30 to 40 new funds a year.

New Capital for SBICs Means More Capital for Small Businesses

There is a dramatic uptick in the number of funds that are interested in becoming SBICs. With fewer limited partners investing in private equity, limited partners feeling the stress of the market downturn, and institutional investors holding onto capital, the SBIC program can be a win-win-win for private equity funds, small businesses, and policy makers. SBIC informational seminars were recently held by some of our industry partners in New York, Chicago, and Charlotte and with attendance so large that some rooms had to be expanded. As interest in the program grows, more of these seminars are being planned across the country.

NASBIC partners with SBA to provide regulation training for applicants to the SBIC program. The next class was expanded twice and is sold out. Our next class is scheduled for October and is nearly sold out. The private equity world is taking a fresh look at the SBIC program. We urge Congress and the Administration to seize the opportunity to bring in new partners and dramatically increase the investment capital available for small business. Now is the time for Congress and the Administration to fully utilize the SBIC program.

Renewable Energy

There is a lot of interest in renewable energy and other technologies. While SBICs invest in small business across almost all industry sectors, SBICs are not yet able to utilize the "energy debenture" that was passed by Congress. We do not yet know if the energy debenture will be successful in expanding small business investment in these areas, but until SBA implements this new debenture we do not know what the effect will be on these small businesses of the future. Some major market participants are actively reviewing ideas for a new debenture model to promote energy efficiencies. With your help, SBICs can make sure that the green economy will be open to innovative small businesses and not just the biggest multinationals. These regulations need to be put in place quickly and more green investing options should be authorized.

Bank Investments in SBICs

Banks are important investors in many SBICs. Banks receive excellent returns on their investments and many also get CRA credit. However, since the passage of Gramm-Leach-Bliley the number of bank SBICs and amounts invested in SBICs has dropped dramatically. Currently, banks are under intense pressure to maintain or increase capital reserves so the outlook for bank investments is not promising. As more pressure is being placed on banks to get capital out to small businesses, the SBIC program should be an attractive public policy option for both banks and policymakers.

Laying the Groundwork for Economic Recovery

The SBIC program must be used to its full potential. Small businesses need growth capital and they need it now. Capital for small businesses must not be a handout or bailout. The program should be market driven and protective of the taxpayer's money and trust. To achieve its full potential the SBIC program must attract and accept only qualified partners. Policymakers should remove barriers to entry and create incentives to partake in this socially conscious form of investing that provides profits for investors and jobs for Americans.

Maximizing the Impact by Keeping Successful SBICs in the Program

Proven and successful SBICs are often "graduated out" of the program because the relicensing process is too slow and cumbersome and the leverage limits for "family of funds" becomes constraining. The loss of these established funds must be stopped. The program benefits from keeping funds that have developed expertise in the small business sector. To correct this problem we recommend that SBA create an "expedited relicensing process."

Every three years any licensed SBIC should be automatically eligible for a new additional license subject to the following restrictions: the SBIC must be financially sound, have no major negative audit findings, have no major examination findings, have 2/3 of the same management team, and be in regulatory compliance. To be granted an expedited relicense, the SBIC must have a new background check, proof of private capital raised, pay all appropriate fees and submit a declaration that their new business model is similar to their previous model. Successful SBIC management teams are well known to SBA and there is no taxpayer protection added by an expensive, duplicative, and year long process. New or troubled funds should not be eligible for expedited relicenses.

If we are to keep successful SBIC funds in the program, raising the leverage limit for a family of funds is also very important. The normal life cycle of a single SBIC fund is ten years with a maximum $150 million leverage limit. With expedited relicensing a new license could be granted every three years and therefore a higher leverage limits will be needed to accommodate the capital needs of multiple funds. Under this scenario for a family of SBIC funds, one fund might be just getting started with $50 million in leverage. A second fund might be at its investment peak with $150 million in leverage. A third fund might be winding down with $75 million in leverage outstanding. The current limit of $225 million was a dramatic improvement for successful repeat funds, particularly in this time of economic crisis. However, if we are to truly lay the groundwork for keeping more successful funds in the system then even the current family of funds limit should be increased or eliminated.

There is one option that could release large amounts of capital nearly immediately - extending the investment period for current SBICs. Many successful SBICs are in the wind down phase, but do not have to be. If existing, successful SBICs were allowed to extend their investment period by two years and access the program's leverage, then many more small businesses could be funded within a matter of days or weeks. There would be no increased risk to the taxpayer because only successful and currently licensed funds could access the extended investment period. Small businesses need capital now and are not served by an arbitrary investment period that cuts off the best SBICs when they are needed most.

A National SBIC Program

The SBIC program provides capital in areas of the country often overlooked by the rest of the private equity and venture capital community. Despite this fact, there are areas of the country that need more SBIC coverage. A concerted effort should be made to publicize this program and to welcome new licensees, particularly from the western United States. Policymakers should also make it easier to raise capital for SBICs by allowing a higher percentage of capital to come from state sources. There are a number of funds that have attempted to become SBICs who were either delayed or rejected for a SBIC license because of the current state limit of 33%.

Welcoming Banks to the SBIC Program

Banks are being asked to hold more capital while increasing lending and investment. Policy makers should encourage and incentivize banks for investing in SBICs. Banks get CRA credit for providing capital to SBICs, but this credit is sometimes done on a case by case basis. A strong public statement from bank regulators would provide an incentive to partner with SBICs. Moreover, if banks are welcomed and incentivized to become leveraged SBICs they could then triple the amount of capital they invest in small businesses. This could be done in a way that does not cost the taxpayer while minimally reducing their regulatory capital.

Prevent Regulatory Disincentives to Becoming an SBIC

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

Following the scandals in several of the mega private equity funds, there have been calls to regulate private equity, including SBICs. SBICs are already highly regulated and screened to levels that the SEC has never matched and likely never will. Additional regulation by the SEC or other bodies would just increase the regulatory burden for being an SBIC. SBA's reporting requirements are already out of sync with GAAP and will be out of sync with the SEC too. SBA's requirements are stricter. Adding SEC regulation would only add cost – not taxpayer protection. SBICs and the entire lower and middle markets pose no systemic risk and should not be punished for the sins of a few scandalous mega funds.

Revive an Equity Focused Program

We are in a recession. This fact makes the availability of equity capital, or lack thereof, even more important to America's small businesses. Equity capital is the foundation upon which any company is built. A company's ability to raise senior debt and lines of credit—absolutely essential to business success—relates directly to its ability to raise equity capital. Congress and the Administration should review proposals that establish tools for SBICs to invest equity in a manner that protects the taxpayer and provides capital to worthy businesses.

Conclusion

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

SBIC Financings
2004 - 2009

State	$ Fin. 2009	$ Fin. 2008	$ Fin. 2007	$ Fin. 2006	$ Fin. 2005	$ Fin. 2004	Total $ Financed 2004 to Present
AL	16,682	9,256,173	9,084,571	4,217,827	13,900,006	30,207,292	**66,682,551**
AK	0	0	0	0	0	0	**0**
AZ	34,233,277	60,834,429	30,249,147	41,756,290	24,741,694	29,235,389	**221,050,226**
AR	1,970,000	331,518	10,144,777	13,281,992	7,057,425	12,623,615	**45,409,327**
CA	133,410,976	347,448,553	408,174,810	456,952,045	487,038,915	608,630,860	**2,441,656,159**
CO	48,018,000	77,032,486	93,579,760	112,208,179	77,097,953	73,448,469	**481,384,847**
CT	19,807,846	47,496,128	38,643,462	81,834,822	46,167,518	49,889,435	**283,839,211**
DE	1,051,425	3,082,572	3,290,301	2,838,033	14,925,469	10,100,510	**35,288,310**
DC	1,286,257	12,354,065	749,815	2,112,500	9,199,404	7,431,663	**33,133,704**
FL	65,954,736	48,663,606	113,672,922	166,502,105	106,081,810	50,761,621	**551,636,800**
GA	21,680,087	64,992,086	75,400,958	54,279,480	89,465,544	97,935,960	**403,754,115**
HA	0	0	0	4,620,000	0	0	**4,620,000**
ID	150,000	6,106,029	10,040,000	550,000	6,894,802	891,346	**24,632,177**
IL	38,723,687	109,205,506	168,606,212	100,002,022	144,566,449	121,597,340	**682,701,216**
IN	17,195,591	57,380,088	33,556,133	31,284,392	30,495,242	10,419,756	**180,331,202**
IA	2,789,000	6,200,000	8,018,937	9,246,254	10,187,412	21,941,093	**58,382,696**
KS	3,311,000	21,249,878	27,393,333	21,039,245	8,821,068	3,644,988	**85,459,512**
KY	14,765,360	25,344,897	36,161,066	1,665,000	24,879,978	17,317,543	**120,133,844**
LA	12,946,962	8,852,878	8,844,411	18,844,289	26,884,982	11,004,500	**87,378,022**
ME	625,000	9,564,640	8,700,000	20,550,000	16,375,000	25,350,000	**81,164,640**
MD	13,116,317	48,271,099	51,677,197	89,662,842	53,500,990	60,699,195	**316,927,640**
MA	106,441,506	166,991,540	175,394,349	139,807,267	207,468,130	158,037,274	**954,140,066**
MI	31,952,378	34,882,568	47,389,763	50,520,778	38,762,993	34,137,201	**237,645,681**
MN	28,292,995	25,545,227	45,244,101	62,331,432	66,505,800	35,548,394	**263,467,949**
MS	608,294	14,185,403	2,161,208	4,486,500	11,150,861	9,101,500	**41,693,766**
MO	39,274,195	36,689,539	49,318,000	68,604,335	48,240,293	47,239,828	**289,366,190**
MT	500,000	495,000	1,305,000	123,000	0	0	**2,423,000**
NE	2,150,000	4,483,302	17,441,663	2,625,000	17,853,252	1,300,000	**45,853,217**
NV	9,646,793	12,187,996	18,488,000	14,859,948	9,539,805	5,270,000	**69,992,542**
MH	11,181,178	22,364,351	18,581,756	32,050,896	30,674,852	15,905,393	**130,758,426**
NJ	45,328,952	109,023,126	128,064,464	93,742,234	116,199,476	127,345,863	**619,704,115**
NM	297,706	3,703,120	9,400,595	11,468,225	18,347,988	9,761,741	**52,979,375**
NY	142,400,223	361,499,241	325,956,487	447,987,904	377,053,148	397,312,616	**2,052,209,619**
NC	38,067,960	80,512,684	69,606,180	67,940,758	46,466,092	38,282,741	**340,876,415**
ND	0	0	0	1,670,000	0	0	**1,670,000**
OH	21,790,551	31,936,167	40,360,705	75,817,454	47,962,311	38,044,078	**255,911,266**
OK	9,000,000	10,525,170	13,594,439	3,396,232	14,378,540	10,924,965	**61,819,346**
OR	2,000,437	6,491,767	36,234,991	36,815,319	22,538,250	35,873,604	**139,954,368**
PA	56,495,731	51,526,249	119,209,618	112,966,543	142,820,692	99,457,210	**582,476,043**
PR	1,260,000	807,500	727,600	5,791,028	13,664,736	3,295,000	**25,545,864**
RI	450,042	11,876,260	4,256,286	11,240,000	26,383,539	6,291,282	**60,497,409**
SC	21,994,248	28,073,788	14,733,056	47,546,022	28,999,250	16,403,600	**157,749,964**
SD	115,014	0	689,700	9,342,599	1,500,000	7,608,209	**19,255,522**
TN	15,125,607	38,449,479	57,392,395	39,305,762	70,134,322	49,725,786	**270,133,351**
TX	59,883,553	219,106,162	127,888,822	167,493,034	142,584,386	229,932,391	**946,888,348**

UT	40,239,533	33,588,481	26,631,312	38,577,559	37,765,890	48,496,900	**225,299,675**
VT	594,000	6,320,446	6,264,705	1,098,000	7,225,000	4,420,746	**25,922,897**
VA	49,435,504	56,596,756	48,399,139	34,162,186	61,252,683	67,259,349	**317,105,617**
WA	14,141,667	55,697,154	56,470,405	59,219,349	62,337,653	46,765,697	**294,631,925**
WV	37,500	10,415,118	1,894,173	2,664,878	4,177,611	13,276,867	**32,466,147**
WI	11,774,738	29,715,128	48,761,020	18,308,039	24,829,487	36,642,689	**170,031,101**
WY	0	0	0	1,833,336	0	0	**1,833,336**
	1,191,532,508	**2,427,355,353**	**2,647,847,744**	**2,897,242,934**	**2,895,098,701**	**2,836,791,499**	**14,895,868,739**

Testimony of

Michael McGannon

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Small Business

United States House of Representatives

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June 10, 2009

Chairwoman Velázquez, Ranking Member Graves and members of the Committee, my name is Michael McGannon, Senior Vice President and Chief Lending Officer of Country Club Bank in Kansas City, Missouri. Country Club Bank is a family owned community bank with over $650 million in assets. I am pleased to be here today on behalf of the American Bankers Association (ABA), which brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

The topic of SBA lending for small businesses is important and timely. The efforts that have been made by this Committee, the Congress as a whole, and the Administration to improve the environment and opportunities for small businesses through changes to the SBA program have been needed for many years. These changes are particularly important in the difficult economic conditions which are affecting all businesses, including banks. The core business of banking is lending. That is what banks do. Banks will continue to be the source of financial strength in their communities by meeting the financial needs of businesses and individuals in both good times and bad. Banks in every state in the country are actively looking for good loan opportunities. Even in a weak economy, there are strong borrowers.

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

I would like to focus on three points today:

- Banks continue to lend, even in this difficult economic environment.
- Changes in the SBA program have the potential to create opportunities for small businesses.
- Further examination of SBA's mission and purpose is needed.

I will address each of these points in turn.

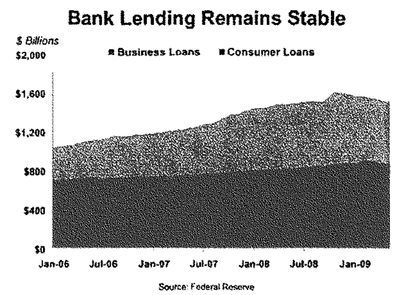
I. Banks continue to lend, even in this difficult economic environment

Against the backdrop of a very weak economy, it is only reasonable and prudent that all businesses – including banks – exercise caution in taking on new financial obligations. Both banks and their regulators are understandably more cautious in today's environment. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they examine. This means that some higher-risk projects that might have been funded when the economy was stronger may not find funding today.

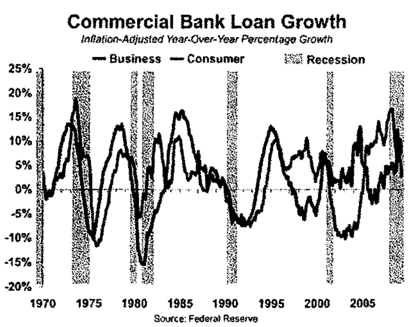
In this environment, we sometimes hear from individual businesses and developers that banks are not lending money. While overall bank lending continues to grow, that does not mean much to an individual borrower having difficulty obtaining financing. In many of these individual cases, however, upon further investigation, it appears that the primary reason for not receiving funding was either that the borrower's financial condition was vulnerable (perhaps weakened by local economic conditions), or the borrower expected to borrow money at pre-2008 terms when the risk of lending was considerably lower and funds available for lending were more accessible. Of course, every loan application is unique and must be evaluated that way. One thing that has clearly happened is that banks are looking carefully at the risk of a loan and re-evaluating the proper pricing of that risk. This is a prudent business practice and one expected by our bank regulators.

Even with the economy faltering and individuals and businesses reducing their borrowing, banks continue to lend. This is, in fact, in sharp contrast to the lending trends during other recessions.

History shows that during a recession, several forces typically combine to reduce the volume of loans outstanding: loan demand declines as businesses experience slowdowns, financial shocks make it hard to repay existing loans, and banks tighten lending standards as regulators caution banks about lending in this environment.



As the chart and table below show, loan growth shrinks during a recession as loan demand falls. During the ***current*** recession, business loans have ***expanded*** by 12 percent and consumer loans by 9 percent; in contrast, for the previous six recessions, median business loans ***declined*** by 0.7 percent and consumer loans by 5.1 percent.



Change in Bank Lending During Recessions[1]

Recession	Business Lending (%)	Consumer Lending (%)
Dec 1969 - Nov 1970	-0.9	-1.2
Nov 1973 - Mar 1975	5.7	-6.3
Jan 1980 - Jul 1980	-0.5	-12.8
Jul 1981 - Nov 1982	9.0	-4.4
Jul 1990 - Mar 1991	-6.6	-5.9
Mar 2001 - Nov 2001	-8.0	1.9
Median of Past Recessions	**-0.7 %**	**-5.1 %**
Dec 2007 - ?	**12.2 %**	**9.0 %**

In the case of Country Club Bank, our bank continues to be an active lender in our community, but we have certainly seen a slowdown in loan requests. Although our loans were up 12 percent in 2008 we have seen year-to-date growth in 2009 of only around 1 percent. We still remain optimistic that our loan demand will pick up as evidenced by the fact that our pipeline for new loan requests is beginning to pick up. We have money to lend and a strong desire to do so but with a watchful eye toward prudent underwriting and proper overall risk management.

Capital is critical to support additional lending. It enables banks to raise deposits to fund loans, and it absorbs unexpected losses when businesses and individuals fail to repay their debt. Currently, $1 of capital can support up to $7 in loans. Capital is the money that owners invest in banks to provide the financial security to weather economic downturns.

Banks entered this current recessionary period with much higher capital compared to other recessions (see the table on the right). Loan losses have increased as the economy weakened; as capital absorbed these losses, capital ratios began to fall somewhat.

Under normal circumstances, banks would go to the private capital markets for additional capital. With markets frozen, this has been extremely difficult to do. In fact, banks in the last 12 months have ***raised only one-third of capital typically raised during a recession,*** according to the Federal Reserve. Without additional capital to back more loans, banks might not be able to grow lending; others might even be forced to shrink lending in order to boost their capital-to-assets ratio. The Capital Purchase Program investments has provided capital to support lending and made it easier for banks to raise capital directly as investors will have more confidence in the overall financial underpinning of the bank. However, the changes made to the program and the constant mixed messages banks have received, have hindered the usefulness of the program and encouraged banks to repay the capital more quickly than the plan envisioned.

Change in Bank Capital During Recessions[1]

Recession	Average Capital-To-Asset Ratio (%)	Change in Capital-to-Asset Ratio (Basis Points)[2]
Dec 1969 - Nov 1970	N/A	N/A
Nov 1973 - Mar 1975	4.7	20
Jan 1980 - Jul 1980	5.0	-134
Jul 1981 - Nov 1982	5.4	205
Jul 1990 - Mar 1991	8.2	52
Mar 2001 - Nov 2001	9.6	86
Median of Past Recessions	**5.4 %**	**70 bp**
Dec 2007 - ?	**10.5 %**	**-104 bp**

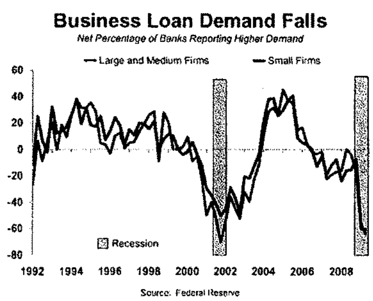
1. Twelve-month change from the month prior to the official start of the recession.
2. One basis point equals 1/100th of a percentage point
Source: Federal Reserve, H.8, Assets and Liabilities of U.S. Commercial Banks; capital values based on estimates derived from Federal Reserve's asset and liability survey data.

Naturally, banks are following prudent underwriting standards to avoid losses in the future, and bank regulators demand that they do so. One-third of the banks surveyed by the Federal Reserve in its April 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices noted a decrease in the size of business lines of credit. About one-third of banks have decreased credit limits on business credit card accounts. Of those banks surveyed, more than 65 percent said that the "less favorable or more uncertain economic outlook" was a "very important" reason for tightening credit standards or loan terms (and 20 percent said it was "somewhat important"). "Worsening of industry-specific problems" was cited by 33 percent as a "very important" driver of these changes (with another 33 percent saying it was "somewhat important").

But in spite of the difficult economic environment, only 8 percent of small businesses (according to a May 2009 survey by the National Federation of Independent Businesses, NFIB) reported problems in obtaining the financing they desired. The report noted that: "The credit worthiness of potential borrowers has also deteriorated over the last year, leading to difficult terms and higher loan rejection rates, even with no change in lending standards."

Borrowers are also being more careful, and, as would be expected in this economy, the overall demand for loans is declining, although this varies by market. (See the chart on Commercial and Industrial Loan Demand on the right.) The NFIB reports that "33 percent [of businesses] reported regular borrowing, typical of the past 20 years." This combination of ***increased*** bank lending in 2008 at the same time that loan demand was ***shrinking*** underscores the increased prominence of banks in meeting the credit needs of borrowers.

It is almost certain that loan demand – including the demand for SBA loans – will continue to decline in this economy, and there is evidence that the volume of traditional bank credit is now marginally declining. With fewer customers, businesses experience a reduction in the need to finance inventory, buy equipment or expand operations. However, as the economy starts to grow again and loan demand increases, the ability of banks to meet these needs will be stunted if adequate capital is not available to back increased lending.



II. Changes in the SBA program have the potential to create opportunities for small businesses

The SBA program has struggled over the last several years. SBA fiscal year 2008 loan volume figures showed a 30 percent decline year over year in its flagship 7(a) loan guarantee program, and fiscal year 2009 figures would indicate a similar reduction in volume. The economy is certainly playing a significant role in overall loan volume decline. However, many lenders are concerned that this decline is also due to SBA programs becoming too costly and difficult for lenders and small businesses who wish to access the program. This Committee has consistently worked to maintain the integrity of the

7(a) program and we applaud your efforts on the Recovery Act to enact the small business provisions. Already, the SBA is making progress to implement these provisions.

First, SBA has made $375 million available to make access much easier for the two most popular lending programs. The act temporarily increases the guarantees to up to 90 percent on SBA's 7(a) loan program, which will help provide banks with the greater confidence they need to extend credit during the recession. It also temporarily eliminates fees for borrowers on 7(a) loans and eliminated fees for both borrowers and lenders on 504 Certified Development Company loans. According to testimony for the Senate Small Business Committee by SBA Administrator Karen Mills last month, average weekly loan volume was up 28 percent in the 7(a) program and 22 percent in the 504 program immediately following passage of the Act, and that participation among banks had likewise increased. We hope these provisions will be reevaluated as the deadline approaches, to determine whether they should be extended to continue to help with the economic recovery.

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

Third, a whole new category of loan will be available through the America's Recovery Capital (ARC) program. This program provides funding of up to $35,000 for six months to help small businesses facing immediate financial difficulty. These loans are interest-free to the borrower, and are 100 percent guaranteed by the SBA. In addition, the loans have no fees associated with them and repayment will not begin until 12 months following the final disbursement. Many businesses will be able to get on their feet with this assistance, however the dollar amount allocated for this program is very small and it is anticipated that the ARC program will be fully funded in a matter of months of when banks are able to start using this program.

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

III. Further examination of SBA's mission and purpose is needed

The recent legislative changes have the potential to create opportunities for small businesses and lenders. Practically, however, it will be difficult for our bank to take advantage of these opportunities unless SBA makes some changes to address some important challenges we face:

- ***The challenge to find programs that are right-size for our bank.***
- ***The challenge of collecting on a loan guarantee.***
- ***The challenge of finding answers to our questions.***

First, SBA should work with trade associations like the ABA to develop SBA loan programs that are attractive to lenders of all sizes, and especially to community bankers. The United States has over 8,000 banks, but only slightly over 2,500 of these financial institutions participate in SBA's 7(a) loan guaranty program. Most small community banks are intimidated by the amount of paperwork required for a regular SBA 7(a) loan. In the past, the SBA had a product in which there was a two page application for the bank to complete and had an 80 percent guaranty. The SBA has since eliminated their Low-Doc program and has offered their SBA Express product as a substitute. However, the SBA Express guaranty is only 50 percent of the loan amount. Community banks would be more inclined to participate in the SBA program if a regular guaranty was offered for a loan of $150,000 or less. The ARC loan program may fit this bill; however, as this program was outlined by Congress in February, the implementation of the program is still being drafted by SBA. More importantly, the funds allocated for the program will be expended in a matter months, if not weeks.

Furthermore, the SBA needs to eliminate the financial and human resource burden on community banks created by SBA audits. These audits review loans already on the books that are ***already being scrutinized by other federal regulators*** such as FDIC or the OCC. Worse, banks are required to pay for their own SBA audit, however it does nothing to correct or stabilize a loan or to assist if there is the need for a liquidation.

Second, SBA should reduce the time it takes for participating banks to collect on loan guarantees. In our own experience, we have been fortunate to collect on all guaranty purchases submitted. However, the time frame for these collections is sporadic. In every case, the items needed were submitted in a complete package, but, as the process continued – far away in Herndon, Virginia – sections of the package were lost. Thus the bank had to resubmit documentation and lost time in the process. There is a near universal agreement in the lending community that efforts to collect on the loan guarantee from SBA can be a time-consuming and costly process.

Third, community banks need personal contacts with knowledgeable people who can answer our questions. Our bank has had the benefit of a very cooperative SBA office in Kansas City. These SBA loan specialists know the area and know the economic environment better than anyone from a 1-800 number. This relationship has been vital in making sure we stay on track of new changes in the SBA regulations and answering questions regarding some of the grey areas of the Standard Operating Procedure. However, banks in outlying areas do not have the benefit of a local SBA office that understands them, their clients, or their town. Instead they have to contact someone at a 1-800 number and get answers to questions. As a community banker from Missouri I take pride in knowing the business and the community that an entrepreneur is trying to serve. A 1-800 number cannot help me through that process. It is critical that SBA returns to a model of helping local small businesses and community banks through off-site training programs that can tend to the needs of the lending partnership.

Conclusion

The initiatives and new programs launched by the Administration and by Congress have great potential to help thousands of small businesses. The SBA, however, must be given the human resources to implement these initiatives, many of which are new to SBA.

Thank you for your time and attention today.

BIOTECHNOLOGY
INDUSTRY ORGANIZATION

HEARING TESTIMONY

DOUGLAS A. DOERFLER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
MAXCYTE, INC.

ON BEHALF OF THE

BIOTECHNOLOGY INDUSTRY ORGANIZATION

BEFORE THE HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

"LAYING THE GROUNDWORK FOR ECONOMIC RECOVERY: EXPANDING SMALL BUSINESS ACCESS TO CAPITAL"

June 10th, 2009

Good morning Chairwoman Velázquez, Ranking Member Graves, and Members of the Committee.

Thank you for the opportunity to testify before you today on how the Small Business Administration and its programs could assist innovative, research and development focused, small businesses bridge funding gaps and overcome other barriers that affect their ability to succeed.

My name is Doug Doerfler and I have been President and Chief Executive Officer of MaxCyte, Inc. in Gaithersburg, MD since 1999. Currently, I serve on the Biotechnology Industry Organization's (BIO's) Board of Directors and its Executive Committee, and am co-chair of the Capital Formation Committee. I am here to today representing BIO's more than 1,200 members - the vast majority of which are small emerging biotechnology companies.

I have led the development of global biotechnology companies and products for more than 25 years. MaxCyte currently has approximately 20 employees who are developing novel therapeutics using cells that have been modified by our process to treat serious diseases. We have one product in Phase I/II clinical human testing for the treatment of Pulmonary Arterial Hypertension and additional products in pre-clinical development for the treatment of cardiovascular disease, cancers and infectious disease. These programs are partnered with commercial partners and major universities, including Baylor, the University of Pennsylvania, Duke University and Stanford University.

Biotech companies are, by and large, small companies. Recent survey data by BIO indicates that 93% of their core R&D members have fewer than 500 employees. The topic of this hearing is very timely given the current economic environment which has severely limited the ability of small biotechnology companies to raise the capital necessary to continue to research and develop new treatments and therapies. According to the latest available data:

- 16% of the 394 public US biotech companies that were active at the beginning of 2008 ended the year either in bankruptcy, restructuring, or suspended operations (9%), or were acquired (7%).
- Since January 2008, over 125 biotech companies have laid off more than 10,000 employees to save cash and over 35 companies have shelved promising development programs with positive clinical data. These programs include therapies for HIV, cervical cancer, Multiple Sclerosis and diabetes.
- 40% of the currently active 330 public U.S. Biotechs have less than 1 year of cash
- 23% of the currently active 330 public U.S. Biotechs have less than 6 months of cash.

The total capital raised by industry in 2008 has seen a steep decline (down 55 percent compared to 2007). A recent joint study by BIO and Thompson Reuters found that the current economic crisis has forced over 80 % of biotech investors to change their investment approaches. They can no longer afford the high risk that is characteristic of investment in biotech. And lastly, engagement by angel investors in the life science industry has all but disappeared over the last year. The decline of the biotech industry jeopardizes not only America's patient population, but also America's competitive edge in the 21st century global economy.

Small biotechnology companies always have a long and difficult path in researching and developing treatments and therapies. Developing cutting-edge treatments and therapies takes anywhere from 8-12 years due to the intensive research and extensive regulatory requirements that must be overcome in order to provide safe and effective treatments to patients. In addition to being a lengthy process, it is an extraordinarily capital intensive endeavor generally costing over $1 billion to bring a single FDA-approved product to market.[1] The typical small biotechnology company has one lead product and 5 other early-stage research projects in the pipeline. However, while these projects tend to be high-risk they are also high-reward both economically and socially.

The total employment impact of the biosciences sector is 7.5 million U.S. jobs, taking into account the additional jobs created in the economy as a result of the sector's 1.3 million direct jobs. [2] These are high-paying jobs that are on average 68% higher than the average private-sector job.[2]

As you know, it is imperative that we find better ways to treat chronic diseases. A 2007 study by the Milken Institute found that the U.S. could save about $900 billion in indirect costs (lost productivity) by 2023 by reducing the rate of chronic disease through improved prevention and disease management.[3] Innovative treatments are an important component of reaching this goal. Currently there are more than 252 FDA approved biologics and 400 biotech drug products and

[1] Tufts Center for the Study of Drug Development.
[2] Technology, Talent and Capital: State Bioscience Initiatives 2008, Battelle/BIO study, June 2008
[3] De Vol R, Bedroussian A, et al. "An Unhealthy America: The Economic Burden of Chronic Disease-Charting a New Course to Save Lives and Increase Productivity and Economic Growth." The Milken Institute. October, 2007.

vaccines currently in clinical trials targeting more than 200 diseases including various cancers, Alzheimer's disease, heart disease, diabetes, multiple sclerosis, AIDs and arthritis.

The topic of this hearing is to explore ways in which the SBA can better provide assistance to early-stage high-risk, high-reward small businesses. As we have testified previously, SBA's Small Business Innovation Research (SBIR) program has traditionally been enormously helpful to small biotech companies - with the best science and most potential to commercialize their products - by providing an opportunity to compete for funding to develop early-stage, high risk research projects. These funds serve to bridge the funding gap for early stage research projects and help companies reach critical milestones, thus helping these companies attract the significant private sector capital required to develop that project into an FDA approved treatment or therapy.

However, the SBIR program is currently limited in that a significant number of companies have not been able to apply to the program since a 2003 SBA ruling that determined that small companies, with multiple venture capital firms with minority ownership, failed the "51% majority ownership by individuals" test, if collectively the minority venture capital investors own more than 51%. In fact, the recently released National Research Council Report, *Venture Funding and the NIH SBIR Program*, states that restricting access to SBIR funding from firms that benefit from venture investments risks disproportionately negatively affecting some of the most promising small innovative firms. Further, the complex financial structure of multiple venture capital investors can cause a company to be rendered ineligible – even if they meet the current 51% individual ownership criteria – due to broadly applied affiliation rules that often count employees of an investor's portfolio companies against the SBIR applicant. This is done even when the only thing the SBIR applicant shares with these other companies is an investor. Until these issues are addressed and small U.S. biotech businesses are allowed to compete based on science and the potential to benefit public health - and not on how many investors with minority ownership they have - this program will not achieve its maximum potential in helping high-risk, high-reward companies to succeed.

The SBA has many programs that help small businesses but programs that provide assistance to biotech and other high-risk, high-reward technology industries are unfortunately limited. Small biotech firms. which do not have any revenue resources for often times more than a decade, are normally unable to take advantage of SBA's premiere programs, such as the preferred lender or guaranteed loan programs. Most biotech companies do not take on debt, as their lack of revenue means that any loan proceeds would be used in part to pay down the interest. As a result, most biotech companies do not generally utilize loans for which guarantees could be useful.

SBA's Small Business Investment Company (SBIC) program is designed to stimulate the flow of private equity capital and long-term loans to small businesses (companies with a net worth of less than $18 million and an average after tax net income for the prior two years less than $6.0 million). This program allows SBICs to receive up to 300% additional leverage on their private capital from SBA guaranteed debentures. According to a recent BusinessWeek article (June 5, 2009) SBICs tend to focus on companies with revenue streams that are beyond the start-up phase. These companies are generally lower-risk but lower-gain companies. SBICs on average invest less than $1 million in each of their companies which may be too low to have an impact on the life sciences industry as an investment funding resources. While this program is for investors, BIO would like to work with the Committee and the SBA to determine if there are ways in which the program could be improved to stimulate more investment in high-risk, high-reward industries such as biotechnology.

In addition, the numerous programs that assist small businesses procure contracts, while valuable, are not applicable to the life sciences industry. There are helpful programs, such as the Small Business Development Centers Program, which works with educational institutions and other federal and state government agencies to provide information on how to create a startup and early-stage businesses. However, the funding mechanisms, aside from SBIR, are for the most part not applicable to the life science industry.

The SBA does have links to several resources and programs (facilitated by SBA) that assist small early stage companies in attracting venture capital and angel financing. Some examples include ACE-Net and BusinessPartners.com which assist investors in identifying investment opportunities and small businesses in identifying potential investors. BIO would like to work with SBA to determine if these efforts could be improved in order to maximize outreach to small emerging biotech companies and life science investors.

I believe it would be a worthwhile endeavor for the Committee, SBA and organizations representing high-risk, high-reward industries to examine ways to tailor current programs, or develop a new program, that would serve to foster small research and development-intensive companies that are high-risk and high-reward. In order to develop a program to promote America's innovative and high-growth – yet cash-starved – industries, such as biotech, it will be important to take into account their business models. Unique attributes of many of these industries' business models include: a lengthy time horizon associated with product development, the fact that collateral in the form of fixed assets is not available where investments are based on intellectual property, and more capital-intensive research and development requiring larger investments. It may be feasible to develop a program whereby grants could be repaid by future positive cash flows or proceeds from the sale of the business. BIO looks forward to working with the Committee to examine ways in which the SBA could increase efforts to support and foster the growth of high-tech industries. Supporting these small businesses is critical to developing a robust 21st century innovation economy in the United States.

In closing, I would like to again thank the Committee for holding this hearing to discuss how the Unite States Small Business Administration can develop or improve programs to ensure that 21st century industries such as biotechnology are fostered and allowed to reach their maximum potential in improving public health and strengthening our nation's economy.

IFA Franchising
INTERNATIONAL FRANCHISE ASSOCIATION

Statement of Lawrence "Doc" Cohen
President, DOC & Associates, Ltd.
Past Chairman, International Franchise Association

Before the House Committee on Small Business

Hearing on *Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital*

June 10, 2009

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Statement of Lawrence "Doc" Cohen
President, DOC & Associates, Ltd.
Franchisee of Great American Cookie Company
Past Chairman, International Franchise Association

United States House of Representatives
Committee on Small Business

June 10, 2009

Good afternoon Chairwoman Velázquez, Ranking Member Graves and members of the committee. My name is Doc Cohen, and I am grateful to have the opportunity to speak to you today about the credit crunch facing small business entrepreneurs and the need for strong measures to promote capital access. During my statement, I will make three key points:

1. Credit is the lifeblood of small businesses;
2. While SBA programs typically support borrowers who cannot obtain financing through commercial sources without the SBA guarantee, this is not a typical recession and many more small businesses need the capital access programs of the SBA in order to obtain financing. This means that policymakers should be willing to consider, even temporarily, further changes to SBA programs including increases in the dollar amounts for SBA 7(a) loan guarantees to accommodate the needs of larger- and intermediate-sized small businesses; and,
3. The fastest way to kick start the American economy into a sustainable recovery will be to target categories of businesses that can create and sustain the most jobs. I believe a compelling case exists that franchised businesses offer the best opportunity for policymakers to promote a strong and sustainable recovery.

I am the Founder and CEO of DOC & Associates, based in Tomball, Texas, and a leading franchisee of the Great American Cookie Company. I have served as the Chairman of the Board of Directors of the International Franchise Association (IFA) and was the first franchisee to earn the designation of "Certified Franchise Executive" given by the IFA Educational Foundation. As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted for the IFA Educational Foundation, there are more than 900,000 franchised establishments in the U.S., creating 21 million American jobs and generating $2.3 trillion in economic output. I am proud to represent franchising. The business methods, training and support I have received as a franchisee have been one of the keys to my success.

My franchise, Great American Cookies, began in 1977 when the first store location opened in Atlanta's Perimeter Mall. Founded on the strength of a generations-old family chocolate chip cookie recipe, the company eventually set the standard for gourmet cookie sales in shopping centers nationwide. From one store and one recipe, Great American Cookies expanded in malls across the country and developed a complete line of cookies and brownies, including our signature Cookie Cake product. Currently, there are over 300 Great American Cookie locations in the United States.

Today, I sit before you an experienced entrepreneur. From my first Great American Cookie Company in Lafayette, Louisiana thirty years ago, financed with help from my sister and brother-in-law, I now operate 30 stores in the Houston, Texas area, employing almost 300 people. I was fortunate that when I began my career in franchising, there was a functioning credit market, including the SBA loan guarantee program. I can say that the SBA loan programs helped me and my business succeed in franchising. After my first store, I came to the Agency three times to finance subsequent expansion. Today's small business entrepreneurs are not so lucky. Under normal circumstances, small businesses can tap financing from a number of different sources, including the SBA loan programs. During this recession, however, most commercial lenders have dramatically curbed their willingness to assume risk. Some credit might be available, but the terms and delays that entrepreneurs are encountering can be staggering.

Last year, I was presented with opportunities to add eight new locations. I had previously acquired a reducing line of credit with a major bank in the amount of $1.5 million. In early 2008, I had approximately $1 million available on the line. By the end of 2008, and with two locations remaining to be built, it appeared that I would need an additional $500,000 and asked to increase our credit line back to the original $1.5 million. The answer I was given by my lender wasn't quite "no;" but the terms being offered in late 2008 had become extremely restrictive. I was told that I could borrow the additional $500,000 that I needed, but only if I agreed to keep $1 million in liquid assets on deposit with the lender. Fortunately, I no longer need my brother-in-law; but even with an extensive track record of successfully opening new units and a relatively healthy balance sheet, my lender was unable to provide the financing under acceptable terms. Facing unacceptable credit terms, I chose to forego the additional borrowing, take a personal risk and finance the two new stores on my own, using cash generated from operations. The eight stores that I opened required a capital investment of $1.8 million and created 74 new direct jobs. It is unlikely, however, that I will consider opening additional stores until the restrictions on credit are eased and until small business regains its ability to access the capital necessary to fuel expansion and growth.

The current crisis is keeping America's entrepreneurs on the sidelines and the negative impact this is having on our country's economy could not be more real. Small businesses are struggling to access the capital needed to stay open, pay debts, maintain payroll and expand operations. The problem is even worse for those looking to get into business for themselves for the first time.

Capital investments in small businesses create jobs, and according to the SBA, small businesses have created 60 to 80 percent of new jobs annually over the last decade. The findings of the recently released study, *Small Business Lending Matrix and Analysis*, prepared for the IFA Educational Foundation, support the notion that meaningful economic recovery and meaningful job creation will start with small business lending. In fact, the study determined that for every $1 million in new small business lending, the franchise business sector would create 34.1 jobs and generate $3.6 million in economic output.

Franchised businesses play an important role in the economic health of the U.S. economy, and they are poised to help lead the economy on the path to recovery. IFA Educational Foundation reports show that the franchise industry consistently outperforms the non-franchised business sector, creating more jobs and economic activity in local communities across the country. Released in February, 2008, *Volume 2 of the Economic Impact of Franchised Businesses,* for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses. The message is clear, Madam Chairwoman, provide small business entrepreneurs and franchisees with access to capital, and we will create jobs.

Earlier this year, Congress and the new Administration worked quickly to address the current economic crisis. The stimulus plan authorized the spending of nearly $800 billion, including more than $650 million targeted at small business lending. The recovery bill made important changes to SBA programs such as a temporary increase in the loan guarantee from 75 percent up to a maximum of 90 percent, and the bill suspended loan fees for borrowers that can add up to 3.75 percent to the cost of a loan. These are crucial steps, but far more needs to be done to support small businesses.

Since passage of the American Recovery and Reinvestment Act, the Administration has announced further action to address the availability of credit. In March, President Obama and Treasury Secretary Geithner announced that the federal government would use $15 billion to purchase SBA guaranteed loans from the secondary market in order to help new loans flow. Unfortunately, the rollout of this initiative stalled when financially healthy industry partners refused to abide by the intrusive terms of the federal bailout. As a result, franchised businesses and prospective franchise investors with strong credit histories remain in limbo and loan applications continue to be denied or delayed.

The franchise business community believes that there are several steps that Congress should consider to make it easier for entrepreneurs to access capital and create jobs. Congress should increase the standard 7(a) maximum loan limit from $2 million to $4 million and increase the maximum guarantee amount provided to $3.6 million. The economic downturn has resulted in borrowers having less collateral due to declining home values and reduced investment and savings accounts. Increasing the loan limit will allow more individuals and businesses to take advantage of the 7(a) program, expanding the job creation potential of the program.

I would urge you to also consider examining a market-based loan pricing model for the SBA loan programs. The real issue for many small business borrowers is not so much the cost of funds as it is the basic availability of funds. When SBA programs cap the interest rates that can be charged by lenders, the rules create a competitive disadvantage for small business borrowers. Despite the best intentions of policymakers, capital will not flow to markets that offer below market rates, and guarantees and borrower discounts alone will not change the dynamics of a bank's simple risk versus return analysis. Smaller, thinly capitalized firms cannot compete for scarce capital resources with larger firms paying market rates, and financial institutions are more likely to lend money to a better capitalized firm offering an opportunity for a greater return. In my view, this is a major market breakdown that has blunted the impact of changing the guarantee rate and reducing fees and Congress should respond.

In April, the General Accounting Office reported that SBA lending activity has begun picking up pace. While that may be true, many franchised businesses continue to report that they are still struggling to find capital. Do not mistake the increased activity of mortgage refinancing for the start-up financing that small businesses need. Mortgage refinancing in the small business sector is not going to promote the kind of job creation and recovery that Congress intended. Therefore, the IFA strongly recommends that this Committee look at new ways to stimulate small business lending so that funds are available for business start up and expansion. One recommendation would be to reserve a portion of the available loan proceeds solely for business start-ups and expansion. This would ensure that the SBA guarantee programs are supporting real job creation.

While we are here to examine steps to improve the climate for small business lending, I must note that, unbelievably, the SBA has actually created new regulatory roadblocks for small businesses. On March 1st, the SBA published a new version of its Standard Operating Procedure (SOP) that included a significant change regarding goodwill financing of business transfers and acquisitions. In a departure from long-standing practices, the SBA opted to place a cap on the amount of "goodwill" that can be financed through the SBA's guaranteed loan program. Since the value of many small businesses is based primarily on the cash flow it can generate rather than the value of the assets it has on its books, the new policy has had the impact of placing an arbitrary limit on the valuation of some businesses. In franchising, this change also threatens to curb the valuation of all franchisees in a system, not just a store that is being transferred to a new owner.

The SBA has indicated that it will grant exceptions on the policy while it collects data on loans involving goodwill submitted after March 1, 2009. The agency has also said that it will reconsider the policy for revision in September. The IFA would recommend that in order to adequately analyze transactions that involve goodwill financing, the SBA should entirely rescind the newly established cap of $250,000 on goodwill financing while the data is gathered. Keeping in place an arbitrary rule will continue to undermine the Agency's ability to effectively evaluate the policy.

Finally, I would suggest that the solution to adequately addressing the economic struggles facing small businesses is for the federal government to promote more lending—not more federal government spending. As shown my experiences and the hundreds of thousands of small franchised businesses in every local community, lending leads to more sustainable and renewable job growth and economic recovery.

I want to again thank the members of the Committee for the opportunity to participate in today's important hearing on laying the groundwork for economic recovery and expanding small business access to capital. I think you will agree that the franchised business community can play a significant role in these efforts.

Thank you.

AED Associated Equipment Distributors

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THE IMPACT OF THE CREDIT CRISIS ON EQUIPMENT DISTRIBUTORS AND THEIR CONTRACTOR CUSTOMERS

STATEMENT OF TIMOTHY WATTERS, PRESIDENT & CEO, HOFFMAN EQUIPMENT CO., PISCATAWAY, NEW JERSEY
ON BEHALF OF THE ASSOCIATED EQUIPMENT DISTRIBUTORS
BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

JUNE 10, 2009

Good afternoon Chairwoman Velazquez, Ranking Member Graves, and other distinguished members of the House Small Business Committee. My name is Tim Watters and it is my pleasure to come before you today both in my capacity as a small business owner and as a spokesman for my industry.

Executive Summary:

- **Construction equipment distributors rely on credit to operate their companies and the vast majority of equipment purchases are financed.**
- **Tightening credit has taken an enormous toll on equipment distributors and their customers. The overwhelming majority of AED members report that they have lost equipment sales over the past year because customers have been unable to get financing. AED estimates the value of those lost sales at more than $700 million.**
- **While the construction industry credit crisis is reflective of the problems plaguing the broader economy, Congress and the executive branch could alleviate some of the pain by quickly reauthorizing federal infrastructure programs, tailoring SBA loan programs to the construction industry, and improving access to capital for the captive finance companies that serve our industry.**

I am the president and CEO of Hoffman Equipment Co., a family-owned business headquartered in Piscataway, New Jersey. Hoffman sells, rents, and services Case, Liebherr, Terex, JCB, Grove, Manitowoc, and other leading brands of construction equipment from five locations in New Jersey and New York. Our distribution territory includes New York's 12th congressional district.

I am also the northeast region director for the Associated Equipment Distributors (AED) and serve on AED's Board of Directors. AED is the national trade association representing authorized, independent distributors of construction, mining, forestry, and agricultural equipment. AED has more than 1,000 members, the overwhelming majority of which are small businesses. Approximately 48 percent of our distributor members report annual revenues of $10 million or less.

I appreciate the opportunity to come before the Committee to discuss how equipment distributors are being affected by tighter credit and to suggest ways to improve access to capital for small, construction industry firms.

Credit and the construction equipment industry

The construction equipment industry runs on credit. Distributors borrow to finance equipment in their inventories and rental fleets, and to operate their companies on a day-to-day basis. Credit is also critical for equipment purchasers.

Contractors seeking to acquire a piece of equipment may choose to buy it, lease it, rent it, or rent it with an option to buy. When buying equipment, contractors generally pursue one of three financing or payment strategies. The first is to simply write a check and buy the machine outright. However, given the relatively high cost of construction equipment, this is the least common approach. The second (and slightly more common) option is for the purchaser to independently seek financing (e.g., through a local bank or other third party lender). The third and most common way to buy equipment is to borrow funds for the purchase from a captive finance company affiliated with a manufacturer that the dealer selling the equipment represents (e.g., CNH Capital, CAT Financial, Volvo Financial Services, John Deere Credit, Volvo Financial, Doosan Capital, etc.) Captives provide distributors and their customers with more flexibility than third party lenders. As a general proposition, captives owned by manufacturers are willing to accept more risk than independent banks because the manufacturer can (at least to a certain extent) offset potential losses on the lending side with profits from the sale of equipment.

Impact of the credit crisis on the construction industry

With the foregoing in mind, it is no surprise that the construction equipment industry has been hit hard by the global credit crisis. AED members report that it has become considerably more difficult for customers to get financing to buy equipment and for the dealers themselves to get credit to run their companies.

This spring, AED conducted a member survey to, *inter alia*, clarify what impact the credit crisis has had on equipment distributors and their customers. The 2009 AED Government Affairs Survey was conducted over a four-week period from mid-March to mid-April. Multiple e-mails inviting participation in the survey were sent to primary AED contacts at dealer member companies. Respondents were representative of AED's overall membership: 46 percent had between 20 and 99 employees and 57 percent had between $5 million and $75 million in revenues. Ultimately, 107 distributors (approximately 17 percent of AED's dealer members) completed the survey, resulting in a survey margin of error of 8.6 percent.

Key survey findings were as follows:

- Eighty-one percent of survey respondents reported that they had lost sales in the last year because qualified purchasers had been unable to get financing.
- Survey respondents reported losing more than $120 million in sales because qualified customers were unable to get credit. When the survey results are projected across the association's entire membership, AED calculates distributors have lost more than $720 million in sales because credit was unavailable.
- Fifty-six percent of distributors who responded to the survey reported an increase in their own credit costs. And,

- Forty-four percent of respondents said their companies had difficulty securing credit.

The findings illustrate that the lack of access to capital is undermining equipment markets and increasing the costs of doing business for equipment distributors.[1]

The staggering value of lost sales is particularly vexing considering current industry market conditions. Given the well documented drop-offs in housing and commercial construction, in some regions of the country the sales market for new equipment has fallen by as much as 85 percent from peak levels in 2006. Dealers are struggling to keep their heads above water and credit issues are in some cases preventing the only people who want to buy equipment from doing so. As one AED member recently put it, "It's hard enough to find a deal, then a whole new fight begins in trying to get it financed. It's brutal."

What's behind the credit crisis?

The credit woes plaguing the industry are apparently the result of a number of factors. First, given that the construction industry has been among the hardest hit by the economic downturn, in an effort to minimize risk, some of the large, independent, asset-based lenders have reduced construction lending or simply stopped writing loans for the industry. At the same time, captive finance companies have found it more difficult to raise money. Wall Street currently has a dim view of asset-based lending and the cost of money for captives has therefore gone up in many cases. The captives are passing the cost increases along to customers and, in some cases, are quoting interest rates for equipment purchasers at well above ten percent.

Dealers also report that the finance companies still serving equipment markets have raised their creditworthiness standards. While a tightening of credit terms is not surprising given the recent subprime meltdown, some dealers have suggested that lenders have over-corrected and told us that it has become difficult to find financing for equipment purchases even for credit-worthy borrowers. As one dealer put it, we've swung from "easy credit" to "no credit". Other AED members suggested that what we are seeing in the marketplace is simply a return a more sustainable level borrowing after an extended period of loose credit. However, the availability issue aside, AED members have expressed near universal concern about the high cost of credit for the construction equipment distributors and customers at a time when interest rates in general are so low.

Easing the pain. What can the federal government do?

We recognize that the challenges that our industry is facing are symptoms of economic problems plaguing the broader U.S. and world economies. However, the following actions by Congress and executive branch could help speed the industry's recovery and alleviate some of problems we are facing:

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[1] Construction equipment distributors are not the only ones who have lost sales as a result of lack of access to capital. Forty-eight percent of the respondents to a spring 2009 survey of members of the North American Equipment Dealers Association, a trade association primarily representing farm equipment distributors, reported they had lost retail sales because customers had been unable to get financing.

- **Quickly reauthorize and increase funding for federal infrastructure programs.** Numerous government and private studies[2] suggest that the federal government is spending less than half of what it should be to maintain our current, woefully inadequate surface transportation infrastructure. Traffic congestion resulting in large part from inadequate capacity costs the U.S. economy $78 billion per year in wasted time and fuel. Our sewers and drinking water systems are in equally deplorable shape. The pending reauthorization of federal highway, sewer, and drinking water programs provides an opportunity for Congress to address this national crisis. The reauthorization of water programs is many years past due. Additionally, all signs suggest that the highway reauthorization will not be completed by the end of Fiscal Year 2009 and that the Highway Trust Fund will run out of money this summer. Given the massive impact that federal infrastructure programs have on the construction industry, the uncertainty surrounding reauthorization is contributing to instability in construction markets. Contractors and distributors are caught between the proverbial rock and hard place. Lenders are avoiding the construction industry because of current volatility and Congress is only making matters worse by dragging its feet. One of the surest ways to speed recovery in the construction industry, address the staggering 18.7 percent unemployment rate among construction workers, and restore lender confidence in the construction industry is to reauthorize the federal highway program and ensure the long term solvency of the Highway Trust Fund.

- **Tailor Small Business Administration loan underwriting to better serve the construction industry.** A widely-held perspective in the construction equipment industry is that loans underwritten by the Small Business Administration (SBA) take too long to get approved and that there is too much "red tape" attached. As one dealer put it, "Buying a piece of equipment is an event; SBA involvement would turn it into a process." Our interviews indicate that captive finance companies generally do not offer loans underwritten by SBA. This is likely attributable in part to the fact that captives are sometimes willing to bear higher risk to facilitate a sale and that those borrowers might not meet SBA requirements. Even so, we suggest that SBA work with captive finance companies and banks serving the industry to develop loan products that meet the unique needs of small construction contractors, particularly those perceived as high-risk borrowers. As one industry finance expert pointed, just because a potential construction industry borrower is "subprime", does not mean the company will not pay its bills on time, it just means they are a higher risk. Unfortunately, it seems that credit is effectively unavailable for smaller, higher risk companies. Additionally, SBA should reexamine its size standards to determine whether they are preventing companies that otherwise fit the definition of small business from benefiting from SBA programs. If so, the standards should be adjusted. If appropriate SBA products and programs already exist, our research suggests that the industry is largely

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[2] *See, e.g.,* the most recent report on the economic impact of congestion from the Texas Transportation Institute (http://mobility.tamu.edu/ums/), the National Surface Transportation Policy and Revenue Study Commission's report explaining the need to double investment in highway infrastructure (http://transportationfortomorrow.org/final_report/), and the National Surface Transportation Infrastructure Financing Commission's report explaining the need for a gas tax increase (http://financecommission.dot.gov/).

unaware of that fact and SBA should conduct aggressive outreach to the construction industry.

- **Investigate allegations of SBA bias against non-titled vehicles.** Some in the industry perceive that SBA underwriting requirements are biased against construction equipment because, unlike motor vehicles, equipment is generally not titled. However, the Uniform Commercial Code (UCC) filing system for liens against movable assets is actually superior in some ways to motor vehicle titling because there is reportedly less variation in registration rules from state to state. The Committee should inquire into whether SBA's loan programs are biased against non-titled assets and, if necessary, clarify the applicability of the SBA underwriting to loans for those types of assets.

- **Improve access to capital for captive finance companies.** While the credit crisis has eased somewhat on Wall Street, looser credit has not necessarily trickled down to Main Street (or "Industrial Boulevard" where many equipment dealers are located). While we expect conditions to improve as the economy recovers and financial markets correct themselves, Congress and the President should look for ways to further assist the commercial and asset backed paper markets to help lower the cost of funds for the captive finance companies. As one distributor told AED, "The Fed has set the prime rate at near zero. So we somehow need to have a contractors' finance rate that is reasonable. Fourteen percent is not reasonable, and thus, not stimulative."

Conclusions

In sum, tight credit is making it more difficult for equipment distributors to sell equipment and to operate their businesses. While much of the problem is attributable to broader economic problems that are beyond the control of government, there are steps that Congress and the president can take to help alleviate some of the pain. We appreciate you organizing this hearing to focus attention on the small business credit crisis. AED and its members stand ready to work with the members of this committee in a bipartisan manner to find solutions that promote rapid economic recovery.

For more information regarding this statement, please contact:

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STATEMENT
OF

DAVID R. BOFILL
PRESIDENT AND OWNER OF DAVE BOFILL MARINE, LONG ISLAND, NY

ON BEHALF OF
NATIONAL MARINE MANUFACTURERS ASSOCIATION

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

JUNE 10, 2009

ON
"LAYING THE GROUNDWORK FOR ECONOMIC RECOVERY: EXPANDING SMALL BUSINESS ACCESS TO CAPITAL"

Good afternoon Madam Chairwoman Velázquez, Ranking Member Graves and distinguished members of the Committee. Thank you for inviting me to testify before your Committee today on the important topic of expanding small business access to capital.

Background

I am David R. Bofill, the President and Owner of Dave Bofill Marine, and sell Chris Craft and Scout Boats at both of my Long Island, New York sales locations. I have been in the boat service and dealer business for 35 years and my operation at its peak employed over 20 people. I am the 2nd largest Scout dealer nationwide and the 3rd largest nationwide Chris Craft Dealer. I am a small business. In fact, about 80 percent of the boating industry is made up of small business with the vast majority of boats sold in the U.S. having been made in this country. The National Marine Manufactures Association (NMMA) asked me to explain to the Committee the impact of the current credit crisis on the recreational boating industry. The boat brands that I sell, Chris Craft and Scout Boats, are active members of NMMA's Boat Manufacturing Division Board. In addition, I have served on the Board of the New York Marine Trades Association for the past eight years.

Marine Industry is in a Severe Credit Crisis

Unfortunately, my story is being played out in boat dealerships and manufacturing plants across the country. I have had a thriving business for over 35 years, but this credit crisis will force me to close my doors. What frustrates me the most is that those of us in the boating business are used to riding the ups and downs of the economy. It is typical for our boat sales to track with consumer confidence, which is why many boat dealers diversify with marinas and boat service departments. Since 1974, when I started in the boating industry, I have always been able to tighten my belt and rely on good customer service and a solid diversified business plan to weather the storm. This downturn is different.

Today, I am dealing with a reluctant consumer and the sudden loss of wholesale credit at anything close to reasonable rates to finance my inventory. Over the last year, the floor plan lenders for the boating industry, including KeyBank, Textron Financial, Wachovia, National City, and several others have abruptly stopped lending in the boating industry, as well as in other industries. Some of these banks as you know received federal assistance under the TARP program, but severed their ongoing business relationships with marine dealers anyway. GE has become the dominate player with approximately 70 percent of the market. GE has recently informed me that they are radically changing my loan terms, resulting in a doubling of my interest payment per month. They have changed the instrument for calculating interest from Prime rate to LIBOR, and have added a substantial percentage that has driven up my rate from under 4% to just under 8% on new inventory and over 10% on aged inventory. GE has also added a 2.1% surcharge to all new boat invoices as a service fee. Overall, these actions have increased my monthly bill from $10,000 to over $20,000.

My story is playing out across the country. GE has scaled back lending, dramatically increased interest rates, cracked down on curtailments, and is not issuing new loans or extending current lines of credit to enable marine dealers to finance any new inventory. The inability of dealers to finance current inventory or purchase new model inventory to display means that manufacturers have shut down production by about 60 percent, and much higher in some cases. Boat manufacturers are also being hit hard. Manufacturers must "buy back" or repurchase inventory of dealers driven out of business by the yanking of their credit. This trickle down effect drains much needed capital from manufacturers, leaving them responsible for buying back inventory, but without marine dealers to sell these boats. It is a vicious circle. Boat dealers and manufacturers have and will continue to face lay-offs, furloughs, plant closures as well as liquidations and bankruptcies.

The credit crisis has forced the closure of many otherwise solid dealers who could have made it through this rough spot and would have been ready to rebuild their businesses in the recovery if they could keep their hands on reasonable credit. These were not failing businesses or companies with flawed business models—they relied in good faith on lenders for typical business credit, and when the financial markets collapsed, my company and others had nowhere to turn. What I need to survive, just like any other American business, is access to credit at reasonable terms.

Boating Industry Needs Help Through this Transition

There has been a fundamental shift in the lending environment. What Congress could do to help the many small businesses in the boating industry is to facilitate the creation of a new credit market. The exit of lenders in the last few months has convinced me that the boating industry needs help to transition from relying on just a few large national financing companies to a network of regional and national banks that complement larger lenders and provide some competition. Boat dealers and manufacturers need help in encouraging regional banks to create or re-establish floor plan lending departments. The industry has overwhelmingly supported and eagerly awaited the Small Business Administration's (SBA) plan to establish a floor plan lending program for boats, motor, and boat trailers. The industry has welcomed this program as a critical lifeline, but problems remain. It will be very difficult to attract a lender to develop a floor plan program when the program is only slated to last a year. A new permanent program will be much more effective in attracting new lenders. The SBA lending program can serve as an important transition. Waiting a year to authorize the program as permanent, will do little to encourage new lenders when we need them so badly now. We will know that this is a success when new regional lenders are established and competition has again returned to boat inventory lending.

The terms of the SBA program are very conservative and will require boat dealers to make significantly more financial assurances than was typically required. This is going to be difficult for some dealers, but we understand the need to be cautious with government guarantees. It is the industry's view that an 80% loan guarantee with adequate inventory management controls will protect the SBA from incurring unreasonable losses.

Temporary Change in Business Size Standards are Welcome and Should be Permanent

In addition to making the SBA floor plan program permanent, we also support the changing of the size standards for all businesses. This is an important change that reflects the marketplace. The traditional standard for marine dealers (receipts of $7 million or less a year) is far too low to include dealers who sell high-cost products, but do so with a small staff. Selling a couple of larger yachts would put many dealers over that limit and yet there is no question they are small businesses. We urge that these temporary size standards be retained.

Loan Limits Should be Increased

Currently, SBA 7(a) loans are capped at $2 million. This level is not enough to provide financing for the majority of small dealers and manufacturers. Typically, in the marine industry one dealer will carry multiple types and lines of boats. It is common for a small boat dealer to have inventory in the $5 million range. In addition, boat manufacturers would need far more than $2 million to build a new manufacturing facility or to purchase specialized equipment. We urge the Committee to track the 7(a) program more closely with the U.S. Department of Agriculture Business and Industry Guaranteed Loan program which caps out at $25 million.

Conclusion

I appreciate the opportunity to testify before you today. The marine industry has been hit extremely hard by the economic downturn and even more so by the meltdown in the credit markets. Already, industry observers have noted that the marine industry stands to lose one third or more of its boat dealers due to the financial crisis. Nearly 20,000 manufacturing jobs have already vanished and roughly 135,000 jobs related to the marine industry are gone. The lack of reasonable credit may very well lead me close my doors soon. I urge the Committee to support in every way possible the rehabilitation of the credit markets, particularly for the small businesses on Main Street that are the real engine of the American economy. We cannot have a healthy credit market, nor can we have healthy companies, if conditions make it so that there is only one option for wholesale or floor plan credit. I urge you to make sure that the Small Business Administration has the resources and authority it needs to continue its efforts to help affected small businesses.

NAFCU
National Association of Federal Credit Unions
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(703) 522-4770 • (800) 336-4644 • Fax: (703) 522-0594

B. Dan Berger
Senior Vice President
Government Affairs

June 10, 2009

The Honorable Nydia Velazquez	The Honorable Sam Graves
Chairwoman	Ranking Member
Small Business Committee	Small Business Committee
U.S. House of Representatives	U.S. House of Representatives
2361 Rayburn House Office Building	1415 Longworth House Office Building
Washington, DC 20515	Washington, DC 20515

Dear Chairwoman Velazquez and Ranking Member Graves:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU) the only trade organization exclusively representing the interests of our nation's federal credit unions, in regards to today's House Small Business Committee hearing entitled "Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital."

NAFCU would like to thank you for holding this very important hearing and would also like to offer some possible recommendations that would help promote an economic recovery of America's small business community.

As you are aware, our nation's small businesses represent 99.7 percent of all employer firms, employ half of all private sector employees, pay more than 45 percent of total U.S. private payroll and have generated 60 to 80 percent of net new jobs annually over the last decade. Therefore, NAFCU believes that the strength of the economy is strongly influenced by the health and well being of the small business community. Many small business owners are members of credit unions around the country and rely on our services to help make their small businesses a success. Our nation's credit unions stand ready to help in this time of crisis and, unlike many institutions, have the assets to do so.

Unfortunately, there are legislative and regulatory hurdles impeding the ability of credit unions to do more. First, an antiquated and arbitrary member business lending cap (12.25% of assets) is prohibiting credit unions from assisting American businesses during the current credit crunch. This cap was placed on credit unions in 1998 and has remained unmodified since then, despite a 2001 Treasury Department report that indicated that

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The Honorable Nydia Velazquez
The Honorable Sam Graves
June 10, 2009
Page 2 of 2

credit union business lending meets the needs of America's small businesses that other institutions are unable to serve. With the current credit crisis, we believe that sentiment rings even more true today, which is why NAFCU supports removal of this cap. Doing so will allow credit unions to lend millions more capital to our nation's small businesses and help stimulate the economy, all the while not costing the American taxpayer a penny.

NAFCU also strongly supports the re-introduction of the *Credit Union Small Business Lending Act* from the 110^{th} Congress. This bill would have exempted credit union participation in Small Business lending programs from the arbitrary MBL limits currently in place, provided a higher guaranty of SBA loans made by credit unions and instructed the SBA to create an outreach program to credit unions to help more get involved in SBA lending. Enactment of these provisions would help many small businesses throughout the nation to have greater access to capital at a time when it is most needed.

We thank you for holding this important hearing and look forward to continuing to work with the Small Business Committee in finding ways to increase opportunities for America's small businesses in these trying times. Please do not hesitate to contact me or NAFCU's Director of Legislative Affairs Brad Thaler, at 703-522-4770, if you have any questions regarding how credit unions can help America's small businesses.

Sincerely,

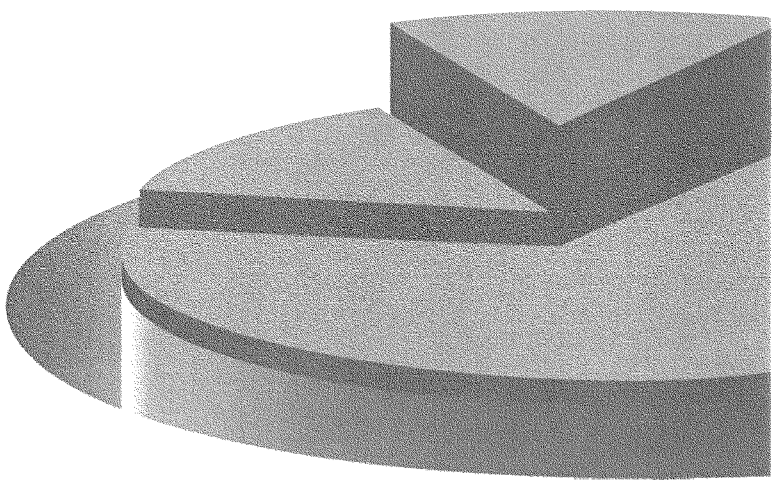
B. Dan Berger
Senior Vice President, Government Affairs

cc: Members of the House Small Business Committee

Small Business Lending Matrix and Analysis

The Impact of the Credit Crisis on the Franchise Sector

May 2009



FRANdata

Source Material

Information for this report is based on SBA data, the Economic Impact of Franchised Businesses Study (Volume 1 and 2) and additional third-party data. Additional information in this report was compiled from FDDs received and registered by state franchise examiners. Franchisors are required under state and federal laws to produce and deliver FDDs to prospective franchisees. As part of this disclosure process, certain state regulatory agencies require complete and updated FDDs to be filed and approved before a franchisor is permitted to sell franchising rights within their jurisdictions. These documents must be accurate by law.

More information concerning FDD disclosure guidelines is available at the North American Securities Administration Association (NASAA) website:

http://www.nasaa.org/Industry___Regulatory_Resources/Corporation_Finance/588.cfm

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Contents

OVERVIEW

Small business is a powerful and important driver of economic expansion. The current recession and the corresponding reduction in lending have placed a burden on small business and its ability to grow and to help the economy. The purpose of this report, prepared for the IFA Educational Foundation, is to show the relationship between lending to the franchising industry and the industry's capacity to develop new businesses and expand existing businesses, which in turn creates more jobs and produces more economic growth. This report examines a number of factors which enhance or constrain franchise business growth. However, the primary focus of this report deals with the amount of lending available to franchise businesses and its impact on franchise growth and the economy as a whole.

A typical franchised small business with initial investment requirements greater than $50,000 directly creates an average of 10.8 jobs and an additional average of 9.8 indirect jobs. It also creates an average of $828,000 in direct annual economic output and another $1.3 million in average indirect annual economic output (all excluding the Lodging Industry).[1]

Franchising as a business model has been extremely resilient to economic slowdowns in the past. For example, between 1999 and 2006, the number of franchised units grew at an annual average rate of almost 6%. During the 1999-2002 Tech Bubble, the new unit growth continued at 5%.[2] During past recessions this growth has helped spur the pace of economic recovery and has provided alternatives to individuals who were down-sized or displaced by other businesses or sectors of the economy. However, the present recession presents new challenges. Between 2000 and 2002, lender willingness was constrained but capital was not. This time, the recession has been exacerbated by banks having limited capital to lend with significant implications for small business.

The relationship between lending, franchise small business jobs and economic output can be summed up by the following: For every million dollars of lending obtained by franchised small businesses, 34.1 jobs are created and $3.6 million in annual total economic output is realized.[3]

The current capital access issues affect franchising and the economy in the following ways:

- Even with lowered expansion expectation in 2009, franchisors, franchisees and prospective franchisees are faced with capital access challenges that will constrain their growth further.
- Franchising will require an estimated $8.4 billion dollars in financing to meet 100% of demand in 2009.
- Based on the current conditions, it is possible there will be a 40% reduction in franchise lending in 2009 which would limit the total number of unit transactions to 10,781 new units and 16,912 transfers. This amounts to 25,547 lost direct jobs and another 22,992 indirect jobs, or a total of 48,539 jobs. The economy as a whole would lose $1.9 billion in direct annual economic output and another $3.2 billion in indirect economic output, or a total of $5.1 billion.
- Without the current capital constraints, FRANdata projects that in 2009 there will be 12,965 new units and 20,338 transfer units. This equates to 151,660 direct jobs and 126,566 indirect jobs either created or protected, for a total of 278,226 jobs. Total direct annual economic output would be $11.6 billion and indirect annual economic output of $18.5 billion, for a total of $30.1 billion of economic output.

[1] Direct jobs and direct economic output refers to the employment and business activity that is created directly by the franchise business. Indirect jobs and indirect economic output occurs when a franchised business and its employees acquires products and services from other businesses.
[2] For purposes of this report a "unit" is one business format franchisee-owned establishment. This report does not include product distribution franchises and company-owned establishments.
[3] Combination of both direct and indirect jobs and economic output.

EXECUTIVE SUMMARY

DEMAND

In 2009, FRANdata projects that franchise systems across all industries excluding Lodging[4] will require total capital of $12.7 billion and total borrowings of $8.4 billion. These projections are based on the following factors:

1. Average initial investment for a unit transaction
2. The number of unit transactions defined as both new units and transfers
3. Distinctions between prospective franchisee and experienced operator franchisee willingness and ability to start new units and acquire existing units
4. Bank loan terms

The projected average initial investment for 2009 was calculated by analyzing the average initial investment for all brands across industries. Franchises that require an average initial investment of less than $50,000 were excluded. It was assumed that franchises with initial costs under $50,000 typically would be financed through non-institutional sources, such as family and friends. Based on historic data, the average initial investment for brands with a minimum requirement of $50,000 was $390,152. This number was reduced by 2% to $382,349 to account for expected declines in initial investment costs in 2009 as franchisors try to reduce such costs whenever possible.

To determine the number of unit transactions requiring financing, FRANdata considered new units and transfers since both transactions involve new financing. FRANdata estimated that franchise systems would try to maintain — but not attempt to increase — their historic growth levels to calculate the number of unit transactions. In 2008, excluding Lodging, there were an estimated 22,547 new units and 22,916 transfers, adding up to 45,463 unit transactions. Consequently, FRANdata assumes that in 2009, unit transactions would be at the same level.

Potential new unit owners were divided into two groups, first time owners and experienced franchisees. FRANdata took into consideration possible changes in both the ability and the willingness to invest in a unit transaction for each group separately. It is assumed that both have decreased due to the effects of the economy on housing prices (down 18% from 2006 to 2008), an unemployment rate of 8.1% in February 2009 (up from 4.5% in February 2007) and 401k portfolio losses (down an average 30%). FRANdata projects that unit transaction investments by experienced franchisees will decrease by 33% and those by first time owners will decrease by 21%. Investments by experienced franchisees are expected to decrease more than those of new franchisees because they are generally leveraged by their current units and the equity in their businesses has not allowed for a significant amount of new leverage. FRANdata estimates that of the 45,463 unit transactions that would require new ownership, excluding Lodging, only 33,302 units will be applying for financing, a reduction of 27% from 2008 estimates.

FRANdata further projects that based on 33,302 unit transactions, excluding Lodging, with an adjusted average initial investment of $382,349, franchisees will have total capital requirements of $12.7 billion in 2009.

Lending from banks follows two basic programs, SBA guaranteed loans and conventional bank loans (private placements, securitizations, and public company franchisee activities were deemed to be not

[4] Lodging was excluded from the overall analysis because of its capital intensity. The Lodging industry will be examined separately in the last chapter.

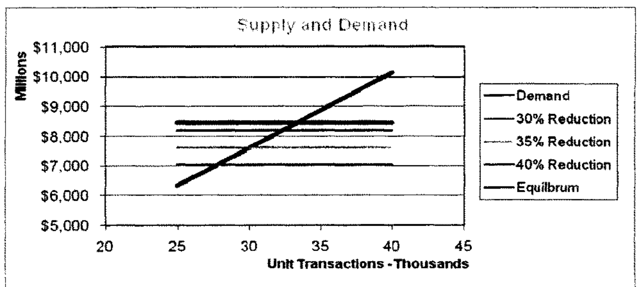
material to this analysis because of the capital market disruptions in 2008). Each type of loan requires different equity levels for borrowers to meet. In 2008, an SBA loan typically required borrowers to put in at least 20% cash while conventional loans typically required 30%. In 2009, these requirements are projected to increase to 30% for SBA and 35% for traditional loans. In 2008, franchisees received about 16% of all SBA guaranteed loans, according to FRANdata estimates. This share is projected to increase in 2009 because the government has more tools to influence SBA lending as it tries to add liquidity to the capital markets. Based on FRANdata's assumption of an increase to 26%, the average overall debt-to-equity required by banks is projected to be 66% in 2009.

FRANdata projects that based on capital requirements of $12.7 billion, excluding Lodging, and a discount debt-to-equity ratio of 66%, the projected total lending institution borrowing demand for 2009 will be $8.4 billion.

SUPPLY

While it is impossible to know how the economic downturn will affect bank ability to lend at this time, several scenarios can be used to understand the impact on franchise unit capital needs. Using the estimated nearly $12 billion loaned to franchisees in 2008 as a base, a lending contraction of no more than 28% would still allow enough capital availability to meet franchise unit transaction borrowing requirements.

This relationship is displayed in the graph below.



Based on the current banking environment, FRANdata believes lending could be reduced as much as 40% from 2008 estimates.

ECONOMIC RAMIFICATIONS

Each unit transaction has an impact on the economy as a whole. Based on the Economic Impact of Franchised Business Study, the average franchise unit employs 10.8 directly (excluding Lodging) and creates $828,353 of direct economic annual economic output (excluding Lodging). These units also create 9.8 indirect jobs and $1.3 million in indirect annual economic impact. Therefore, every new unit not opened costs the economy 20.6 jobs and $2.2 million of annual economic output.

Transfer units that are unable to get financing will likely continue in business thus not affecting the economy as a whole. FRANdata assumes that 5% of all transfers that fail to get financing will close. These 5% are taken into consideration in the calculations below.

The table below provides to information about the constricted lending scenarios:

Scenario	New Units	Transfer Units	Total Jobs	Total Economic Output
Equilibrium	12,965	20,338	288,153	$30,112,041,484
30% Reduction	12,577	19,731	279,549	$29,212,864,832
35% Reduction	11,679	18,321	259,581	$27,126,231,630
40% Reduction	10,781	16,912	239,613	$25,039,598,427

Based on the equilibrium scenario under which unit growth is not constrained by financing, the 12,965 new units and the 20,338 transfer units will create, or protect, 288,153 total jobs and create a total annual economic output of $30.1 billion.

To calculate the number of total jobs lost under each scenario, FRANdata multiplied the difference between the equilibrium point and the individual scenarios. The result equals the number of new units not developed and transfers not financed. For example, at a 35% reduction from equilibrium, 1,286 fewer new units will be developed and 2,017 transfer units will not find financing.

The new units that are not being built can be multiplied by the average direct (10.8) and indirect (9.8) number of jobs in order to come up with a total number of jobs not created. For the transfers, only 5% should be taken into consideration to calculate the number of jobs not protected since the other 95% are assumed to continue their operations.

In summary, if lending is restricted by 35%, or $837 million short of the equilibrium point, the economy will lose 28,572 total jobs and suffer lost economic output of $3 billion dollars. Another way to say this is that for every million dollars in lending not obtained by franchises, 34.1 jobs and $3.6 million in output will be lost.

Demand

The demand for franchise unit debt capital was determined by using 2008 estimates as a baseline and adjusting these estimates for 2009. Three main factors affect borrowing demand: the number of unit transactions, the average initial investment and the bank lending rate. For this analysis, Lodging is removed as an outlier. The Lodging industry is highly capital intensive and its financing comes primarily from capital markets activities that are not often available to other franchise segments. For this reason, the Lodging industry will be examined on its own in the chapter on Industry Break Out and has been removed from the overall calculations.

Franchisor Capacity

One factor that will determine the number of unit transactions is franchisor capacity to grow franchised unit numbers. It is assumed that all brands will want to grow at 100% of their 2008 capacity but in the face of the current economic conditions would not be adding new capacity for growth. Uncertainty about consumer behavior is likely to deter franchisors from implementing aggressive growth plans. In addition, decreased demand for products and services offered will make most franchisors more cautious and protective about their brand image. While some brands will add capacity, any such capacity increase is likely to be offset by brands that decide to curtail capacity.

To determine 2009 unit growth capacity, FRANdata examined a population of 1,630 franchise brands across all industries and sectors. From 2005 to 2008, these brands grew their units on average by 22%, with brands in NEC growing the fastest. Gasoline Services experienced the largest decrease. It should be noted that these latter two NAIC segments had the fewest number of brands and units and thus do not have the same weight as the other larger segments.

It should also be noted that not all franchise brands have provided 2008 unit numbers. Whenever 2008 data were not available, average historical growth rates were used to estimate the expected number of units in 2008. This assumption is based on franchisor feedback stating that for most franchisors the recession started affecting unit growth in the second half of 2008.

Industry	Growth Rate between 2005 and 2008
Automotive	1.23%
Business Services	21.70%
Commercial & Residential Services	20.53%
Food Retail	26.16%
Gasoline Service Stations	-1.90%
Lodging	10.98%
NEC - not elsewhere classified	79.64%
Personal Services	33.17%
Quick Service Restaurants	13.18%
Retail Products & Services	15.57%

These percents were then applied to the 2008 unit numbers to project the maximum number of units franchisors could add in 2009.

Based on these estimates, 2009 could see 48,560 unit transactions of which 22,741 would be new units and 25,819 would be transfer units. When Lodging brands are removed, the number falls to 22,547 new units and 22,916 transfers.

Franchisee Demand

To determine franchisee demand, FRANdata considered several factors. Demand for a new unit is largely driven by a buyer's ability and willingness to invest. Considering the level of willingness is important for the calculations because a new owner can have the ability to invest in a unit transaction due to access to credit and personal assets. However, investment decisions are also driven by less tangible factors such as willingness to invest.

Demand is also influenced by the type of prospective investor. FRANdata distinguishes between new owners and experienced franchisees who wish to add another unit to their existing one(s). For these two types, ability and willingness to invest will differ.

Another factor affecting the number of new franchisees is the recent weakening of the job market. People who lose their jobs may seek out franchising as way to guarantee their future job security. However, even if the potential pool of new franchisees would thus increase, it is not certain whether this would also significantly increase the number of qualified applications. For this reason, FRANdata did not include this as factor in overall new unit demand.

Franchisee Ability

First time buyers have had their personal ability to invest considerably affected in the past 24 months. According to recent economic figures, housing prices have declined by 18% from 2006 to 2008 and 401k balances are down an average of 30% from 2007 to 2008. These declines in private assets will negatively impact the ability of new franchisees to provide the necessary cash portion of an investment because the equity position of a franchise unit investment is traditionally financed through a mix of home equity debt, personal savings and other assets.

The second group, experienced franchisees, has often already leveraged their homes or 401k plans to purchase their first unit and thus use equity in their existing business to purchase additional units. In a period of decreased consumer sales, many existing franchisees have experienced decreases in operating margins and therefore in company equity. As a consequence, experienced franchisees are exposed to a decline in private assets and business equity and may face even more restrictions on their ability to invest in a unit transaction than new franchisees.

Franchisee Willingness

While it is difficult to assess emotional and psychological factors that influence willingness, some assumptions are possible. Uncertain economic times, a projected 1.6% decrease in consumer spending in 2009 and lower severance packages for employees are all likely to decrease willingness to take on entrepreneurial business risks. Based on past patterns of business activity during economic downturns, experienced franchisees will try to ride out the economic storm by slowing further development plans. However, past patterns also show some increased willingness on the part of experienced franchisees to acquire existing units, particularly from franchisees that have more recently entered franchising.

Considering how these factors could impact the ability and willingness to invest in a unit transaction for each of the two groups of potential buyers, FRANdata created the following matrix. It is assumed that new franchisee willingness to invest in a unit transaction would be lower than that of existing franchisees because of their lack of franchise experience. The table presents the percent decrease for each transaction type in 2009.

Decrease in Investment Ability and Willingness by Investor Type

	Decrease in Willingness to Invest	
Franchisee Type	New Unit Transactions	Transfer Transactions
Existing Operator Willingness	50%	10%
Existing Operator Ability	60%	10%
New Franchisee Willingness	20%	15%
New Franchisee Ability	40%	10%

Based on the above analysis, the matrix shows the most affected group will be existing operators. The majority of these operators will be the most constricted due to declining personal net worth and greater financial restrictions imposed on their businesses. Also, the bulk of unit transactions will consist of transfers rather than new units. An investment in a transfer is likely to be more attractive because new units that do not have a sales history represent greater investor risk. Transfer unit prices are more affected by future cash flows and not the value of existing assets. A demonstrated performance history makes valuation more certain.

In addition, buying an existing unit will also be an attractive proposition for experienced operators confident of their ability to streamline operations, cut down on expenses and increase profit margins. Units that underperform due to inefficient operations typically are among the first to be put up for sale during economically difficult times.

Given that credit availability and decline in private assets has been significant, FRANdata projects that the ability to purchase a new or existing unit will be a more limiting factor than the willingness to do so.

Estimated Unit Transactions

Based on the estimated new units of 22,547 (excluding Lodging) and transfers of 22,916 (excluding Lodging), FRANdata projects a maximum of 45,463 unit transactions in 2009. Following recent trend statistics, it is assumed that there will be about an equal number of new franchisees and existing operators involved in unit transactions in 2009. The effects of decreases in ability and willingness result in 12,965 new units (down 43% from estimates for 2008) and 20,338 transfers (down 11% from estimates for 2008) for a total of 33,302 unit transaction in 2009.

Estimated Average Initial investment

To calculate an average initial investment for each individual business line, FRANdata took a sample of over 1,960 brands and removed all brands with initial investment levels of less than $50,000 leaving a population in excess of 1,700 concepts. The concepts with initial investment levels below $50,000 were removed on the assumption that they would finance through non-institutional sources or would not require any debt to start.

Based on the aggregation of franchise brands into eleven NAIC categories, the average initial investment breaks out as follows:

Industry	Average Initial Investment	Standard Deviation
Automobile & Truck Dealers*	$212,933	$230,291
Automotive	$386,188	$653,719
Business Services	$185,779	$192,532
Commercial & Residential Services	$179,112	$402,337
Food Retail	$366,318	$550,361
Gasoline Service Stations**	$854,000	N/A
NEC - not elsewhere classified	$92,001	$50,669
Personal Services	$274,872	$395,885
Quick Service Restaurants	$417,326	$358,754
Retail Products & Services	$240,206	$191,673
Table/Full Service Restaurants	$1,082,941	$871,773
Average Initial investment	**$390,152**	**$389,799**

*Automobile & Truck Dealers were rolled up into Automotive because of a limited sample size.
**There is no standard deviation because of a small sample size.

As the table shows the average initial investment across all industries is $390,152 (Lodging was removed as an outlier). Each industry average initial investment was calculated independently as was the total average initial investment. One challenge for the estimate is the high standard deviation in average initial investment. In each industry there was a wide array of different types of companies and each of these had very different initial costs associated with starting the business. Also, franchisors disclose initial investment levels for each brand as average initial investment, which is based on a range of new unit costs.

FRANdata assumed that transfer unit purchase prices would be similar to the creation of a new unit while any difference in price would be based on individual sales performance, which cannot be measured.

A second factor affecting average initial investment is an expected decrease in prices. In late 2008, price indexes began to fall, driven by lower fuel cost and decreased demand. FRANdata projects prices to decrease by approximately 2% in 2009. As a result, the average initial investment will fall from $390,152 to $382,349.

FRANdata used a flat average instead of a weighted average for the overall industry average in an attempt to limit the number of assumptions made about unit growth. The number of factors impacting growth projections varies by industry. Also, additional unknowns would have increased the number of necessary assumptions for this calculation. A flat average avoids such additional assumptions.

Using the adjusted average initial investment of $382,349 and the total unit transactions of 33,302, FRANdata projects that franchisees will require total capital of $12,733,166,682 in 2009.

Advance Rates

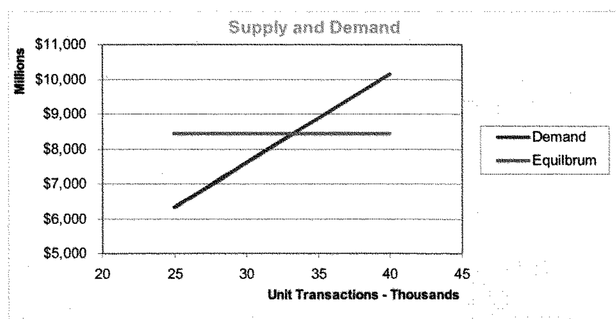
Of the calculated $12.7 billion in required capital, only a portion will come from lenders because borrowers need to provide a portion of the capital themselves. The advance rate banks expect on franchise transactions is based on the type of transaction. Since SBA loan transactions have a government guarantee protecting the bank from default, they often have a higher advance rate than conventional loans. This means franchisees have to come up with a smaller cash piece to qualify for a loan. In 2008, the SBA debt-to-equity ratio was nearly 80% and for conventional loans it was about 70%. Also, potential new legislation may increase the SBA loan guarantee to 95% of the loan value, which would further decrease the franchisee's cash portion.

In 2009, FRANdata predicts both these ratios will decrease due to the current credit challenges that are likely to continue in 2009. Experts in the lending industry expect that debt-to-equity ratio for SBA loans will be closer 70% in 2009 and conventional loans will have a debt-to-equity ratio of approximately 65%.

In 2008, SBA guaranteed loans represented approximately 16% of total borrowing by franchisees. This percentage is likely to increase. As conventional bank lending decreases, the new administration will look into various ways to ensure capital access for small businesses. According to the Office of Advocacy, small businesses represent over 90% percent of all firms and create more than half of the private non-farm US gross domestic product. FRANdata projects regulatory pressure to increase SBA Loan guarantees to help unfreeze the credit markets. In February of 2009, legislation was passed to increase the SBA loan guarantee to 90% on 7(a) loans. In 2009, FRANdata expects SBA guaranteed loans to represent 26% of the total loan pool or a blended SBA/conventional basis; the average bank advance rate will be 66% in 2009.

Using this ratio, FRANdata projects that total borrowings in 2009 will be $8,442,089,510.

This is presented below as part of a Supply and Demand graph at the estimated economic equilibrium point.



The equilibrium point represents the amount of funding required to meet the needs of all the franchise unit transactions in 2009. At this point all 12,965 new units and 20,338 transfers, or a total of 33,303 unit transactions, would be able to receive financing.

Franchising Economic Impact in 2009

Based on the Economic Impact of Franchised Business Study, the average franchise unit provides 10.85 direct jobs and 19.5 indirect jobs (excluding Lodging) and creates $828,353 of direct economic output and $2.2 million in indirect economic output (excluding Lodging)[5].

The following table breaks out the averages by NAIC code per unit:

NAIC Code	# of Direct Jobs per Unit	# of indirect Jobs per Unit	Direct Economic Output per Unit	Indirect Economic Output per Unit
Auto	4.94	4.45	$710,355	$1,136,568
Business Services	6.98	6.28	$780,574	$1,248,919
Commercial and Residential	5.76	5.19	$603,725	$965,960
Lodging	18.99	17.09	$1,599,254	$2,558,806
NEC	4.57	4.12	$775,811	$1,241,298
Personal Services	12.21	10.99	$1,250,911	$2,001,458
Quick Service Restaurants	18.82	16.93	$907,637	$1,452,219
Retail Food	12.76	11.49	$770,000	$1,231,999
Retail Products	6.84	6.16	$464,253	$742,804
Table Service	24.74	22.26	$1,191,912	$1,907,059

*Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Combining this information with FRANdata's estimates shows that the projected 12,965 new units for 2009 would create 267,195 new jobs and account for $27.9 billion in total annual economic output[6]. Transfer units do not generate new jobs or economic output because at existing units all employees have been hired and are already creating output. However, some units that are looking to transfer ownership might not find a buyer. While some franchisors may re-acquire these units and ensure continued operations others might be closed. FRANdata assumed that 5% of transfer units will be closed for this reason. Thus, the 20,338 transfers that would occur without the limitation of lending sustain 20,958 total jobs and protect $2.2 billion of annual economic output.

In total, FRANdata estimates that unit transitions seeking capital in 2008 would account for 288,153 total jobs and $30.1 billion in total annual economic output.

[5] Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.
[6] Jobs are defined as positions filled by part-time and full-time employees or by self-employed individuals. Economic Output is defined is the gross value of the goods and services it produces.

Supply

FRANdata used estimates for the amount of lending in 2008 as the basis to estimate lending in 2009. An estimated $11.7 billion went to franchisees for unit transactions. Of that amount, $1.9 billion[7] — or 16% — was SBA guaranteed while $9.8 billion came from conventional loans.

In 2009, banks willingness to lend will be restrained. According to the Federal Reserve October 2008 Senior Loan Officer Opinion Survey on Bank Lending practices[8], banks are tightening their credit policies in response to the current economic climate. Of the banks surveyed, 85% are tightening lending for commercial real estate and 60% mentioned tightened credit policies for consumer lending. Based on this data, it can be assumed that commercial lending policies will also be tightened considerably. This will make obtaining franchise loans more difficult.

The amount of money banks are able to lend to franchisees is also likely to be constrained. In 2008, a number of large financial institutions have announced plans to reduce the available amount for small business lending which will also limit the funds available to franchisees. In both, SBA and conventional lending markets, a handful of national lenders had a significant percentage of all the franchise lending activity in recent years. Even if regional and local banks increase the commercial lending activity, as early evidence in 2009 suggests, it will be very hard to replace the large volume that the big financial institutions represented.

Based on these data and interviews with experts and professionals in the banking field, FRANdata projects that overall bank lending would decrease by 30% to 40% from last year. FRANdata projects that in the 30% reduction scenario there will be $8.2 billion available for banks to lend. In the 40% reduction scenario, banks will only have $7 billion to lend for franchise unit transactions.

The graph shows the relationship between supply and demand based on FRANdata's estimates. The equilibrium point is above the 30% scenario line meaning that at best there will be a short-fall of $252,089,510 in requested funds from franchisee transactions and 994 fewer unit transactions.

The following table breaks out the numbers for each scenario:

Scenario	Units	Unit Shortfall	Dollars	Dollar Shortfall
Equilibrium	33,302		$8,442,089,510	
30% Reduction	32,308	994	$8,190,000,000	$252,089,510
35% Reduction	30,000	3,302	$7,605,000,000	$837,089,510
40% Reduction	27,693	5,610	$7,020,000,000	$1,422,089,510

[7] The SBA estimates its lending to franchises at $1.2 billion. FRANdata assumes this is an underreported amount caused by bank keying errors in SBA applications.

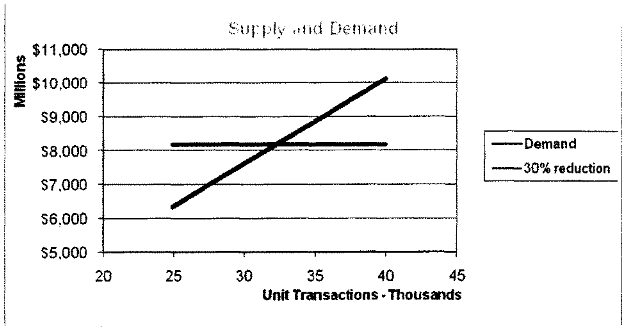
[8] http://www.federalreserve.gov/boarddocs/snloansurvey

Lending's Impact on Franchising and the Economy in 2009

To put this information into perspective, the following section describes how each scenario will affect jobs and economic output.

Scenario I: 30% Reduction in Lending

In the first scenario, lending is constrained by 30% of last year's amount.

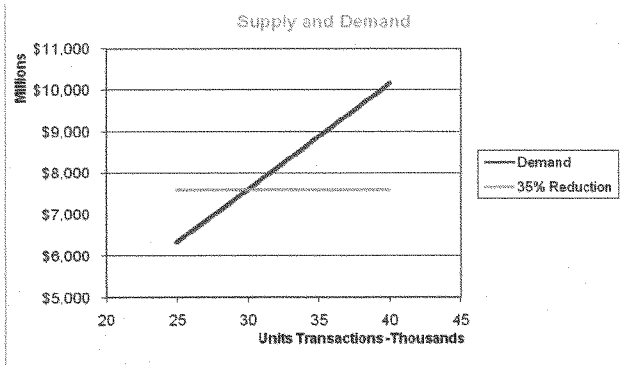


In this scenario, due to reduced bank lending there will be $8.2 billion dollars available for franchises in 2009, instead of the $11.7 billion in 2008 and the $8.4 billion required at equilibrium. This reduces the number of new units created from 12,965 units at equilibrium to 12,577 new units. This equates to 4,199 direct jobs not created and 4,076 indirect jobs from new units not opened. This in turn equates to $320 million in lost direct annual economic output and $513 million in indirect annual economic output from these new units not being opened.

In this scenario, transfer units receiving financing will decrease from 20,338 to 19,731. FRANdata assumes that 5% of these 19,731 units will not be able to complete transfer transactions and will be required to close. This reduction in transfer units decreases total jobs from 288,153 to 279,549 and total annual economic output decreases from $30.1 billion to $29.2 billion, a drop of approximately 3% for equilibrium for both employment and economic output.

Scenario II: 35% Reduction in Lending

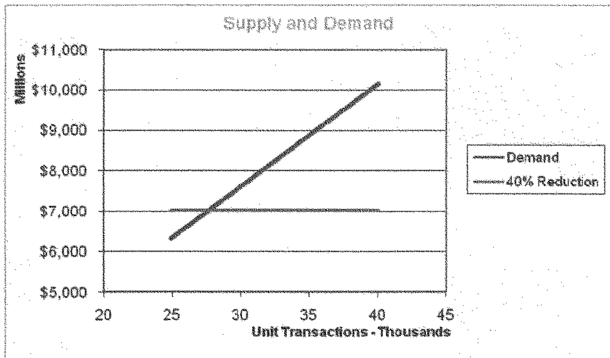
In the second scenario, lending is reduced by 35% from 2008 levels. This equates to an estimated lending pool of $7.6 billion dollars for franchising verse the $8.4 billion required at equilibrium.



At this level of lending, the number of new units opened is reduced from 12,965 to 11,679 or a 10% decrease from equilibrium and the number of transfer units is reduced from 20,338 to 18,321, also 10% of equilibrium. Using the same assumptions from above, this will result in 13,944 direct jobs not created and 12,550 indirect jobs not created from new units and 1,094 direct jobs and 984 indirect jobs lost from incomplete transfer units for a total of 28,572 jobs lost. These lost units and jobs total $3 billion in lost economic output.

Scenario III: 40% Reduction in Lending

In the third scenario lending is reduced by 40% from 2008 levels. This equates to an estimated lending pool of $7 billion dollars for franchising vs. the $8.4 billion required at equilibrium.



In this case the number of new units is reduced from 12,965 to 10,781, or a 17% decrease from equilibrium and transfer units are reduced from 20,338 to 16,912. This equates to 45,010 total jobs not created from new units and another 3,530 total jobs lost from transfers not completed, summing up to a total of 48,540 total jobs either lost or not created and economic output lost or not created of $5.1 billion.

Table below summarizes all scenarios:

Scenario	New Units	Transfer Units	Total Jobs	Total Economic Output
Equilibrium	12,965	20,338	288,153	$30,112,041,484
30% Reduction	12,577	19,731	279,549	$29,212,864,832
35% Reduction	11,679	18,321	259,581	$27,126,231,630
40% Reduction	10,781	16,912	239,613	$25,039,598,427

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Another way to put it is that for every one million dollars in lending lost to franchises cost the economy 34.11 total jobs and $3.6 million in economic output.

Unit Growth in the Past Recession

Enabling franchisees to access capital is all the more crucial during a recession, particularly given that franchising has always been a resilient business strategy. Companies that grow through the franchising business model have weathered many serious economic storms in the past and have always done well. In fact, franchises continued to grow units in the face of recessions. From 2000 to 2002, the U.S. economy suffered through the tech bubble recession. The table provided below shows unit growth by industry during the recession and immediately after. As the table shows, franchises maintained an average yearly unit growth of 5.9% in spite of the harsh economic conditions.

Industry	1999 to 2000	2000 to 2001	2001 to 2002	2002 to 2003	2003 to 2004	2004 to 2005	2005 to 2006
Automotive	4%	-4%	-4%	3%	-1%	2%	4%
Business Services	12%	5%	6%	-3%	4%	8%	13%
Commercial & Residential Services	6%	5%	2%	3%	2%	4%	6%
Food Retail	4%	6%	5%	3%	4%	2%	3%
Lodging	12%	5%	3%	1%	0%	2%	3%
NEC - not elsewhere classified	5%	12%	13%	7%	8%	42%	27%
Personal Services	6%	11%	15%	17%	11%	7%	3%
Quick Service Restaurants	10%	4%	5%	6%	5%	5%	4%
Retail Products & Services	1%	3%	2%	3%	2%	1%	4%
Table/Full Service Restaurants	13%	6%	5%	5%	6%	5%	4%
Average	7%	5%	5%	5%	4%	8%	7%

The franchise business model has proven to be resilient through previous recessions.

Industry Break Down

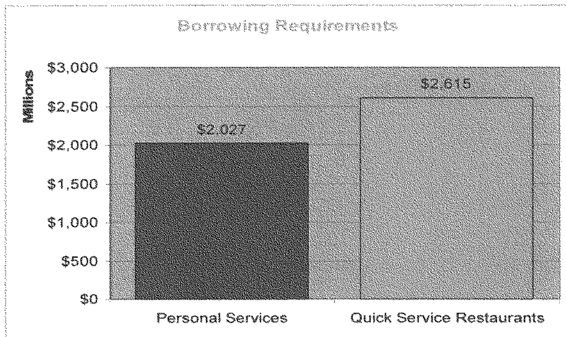
For a more granular approach, FRANdata examined the estimated borrowings by ten different industries. To attain the expected borrowing requirements FRANdata assumed unit percentage growth would be consistent form 2008 to 2009 and that each industry would suffer the same percentage decrease in demand for new unit transactions. The debt-to-net worth was also held consistent for all industries. Each industry average initial investment was applied to calculate the estimated requested borrowings in 2009. It should be noted that the industry totals do not sum back to the overall estimated borrowings. The reason for this is that a flat average was used to estimate the overall required borrowings and not a weighted average[9].

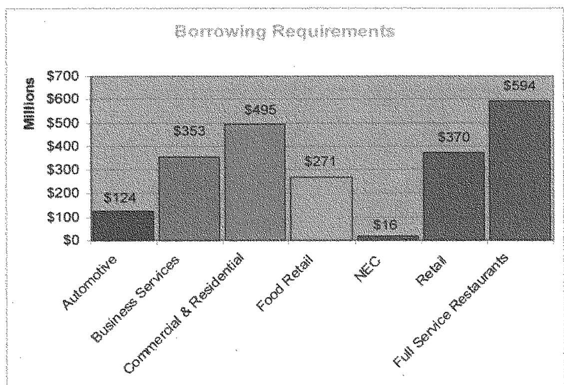
The table below breaks out total estimated borrowings by ten industries.

Industry	Estimated Borrowings
Automotive	$123,673,800
Business Services	$353,358,652
Commercial & Residential	$495,248,923
Food Retail	$271,294,824
Full Service Restaurants	$593,618,707
Gasoline Service Stations	$206,845
NEC	$16,477,605
Personal Services	$2,027,224,848
Quick Service Restaurants	$2,614,843,586
Retail	$370,321,633

[9] As mentioned above, the calculations were based on flat averages rather than weighted averages in order to avoid additional assumptions. Mathematically this means that applying an industry average to the following calculations leads to a different total as opposed to using the total average.

Presented graphically:





*Gasoline Service Stations were removed as an outlier

Automotive	
New Units	192
Transfer Units	301
Total Unit Transactions	493
Bank Lending Rate	66%
Industry Average Initial Investment	$ 386,188
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 123,673,680
Required Borrowings (based on Overall Average Initial Investment)	$ 124,943,161
Average Number of Employees per unit*	4.94
Average Output per unit*	$710,355
Average Number of Indirect Jobs created per Unit*	4.45
Average Indirect Economic Output per Unit*	$1,136,568

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Business Services	
New Units	1,140
Transfer Units	1,788
Total Unit Transactions	2,927
Bank Lending Rate	66%
Industry Average Initial Investment	$ 187,779
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 353,358,652
Required Borrowings (based on Overall Average Initial Investment)	$ 742,083,113
Average Number of Employees per unit*	6.98
Average Output per unit*	$780,574
Average Number of Indirect Jobs created per Unit*	6.28
Average Indirect Economic Output per Unit*	$1,248,919

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Commercial & Residential Services	
New Units	1,657
Transfer Units	2,599
Total Unit Transactions	4,256
Bank Lending Rate	66%
Industry Average Initial Investment	$ 179,112
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 495,248,923
Required Borrowings (based on Overall Average Initial Investment)	$ 1,078,781,525
Average Number of Employees per unit*	5.76
Average Output per unit*	$603,725
Average Number of Indirect Jobs created per Unit*	5.19
Average Indirect Economic Output per Unit*	$965,960

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Food Retail	
New Units	444
Transfer Units	696
Total Unit Transactions	1,140
Bank Lending Rate	66%
Industry Average Initial Investment	$ 366,318
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 271,294,824
Required Borrowings (based on Overall Average Initial Investment)	$ 288,946,576
Average Number of Employees per unit*	12.76
Average Output per unit*	$770,000
Average Number of Indirect Jobs created per Unit*	11.49
Average Indirect Economic Output per Unit*	$1,231,999

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Gas Stations*	
New Units	-
Transfer Units	1
Total Unit Transactions	1
Bank Lending Rate	66%
Industry Average Initial Investment	$ 854,000
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 206,845
Required Borrowings (based on Overall Average Initial Investment)	$ 94,498

NEC - not elsewhere classified	
New Units	107
Transfer Units	168
Total Unit Transactions	276
Bank Lending Rate	66%
Industry Average Initial Investment	$ 92,001
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 16,477,605
Required Borrowings (based on Overall Average Initial Investment)	$ 69,877,339
Average Number of Employees per unit*	4.57
Average Output per unit*	$775,811
Average Number of Indirect Jobs created per Unit*	4.12
Average Indirect Economic Output per Unit*	$1,241,298

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Personal Services	
New Units	4,419
Transfer Units	6,932
Total Unit Transactions	11,351
Bank Lending Rate	66%
Industry Average Initial Investment	$ 274,872
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 2,027,224,848
Required Borrowings (based on Overall Average Initial Investment)	$ 2,877,428,580
Average Number of Employees per unit*	12.21
Average Output per unit*	$1,250,911
Average Number of Indirect Jobs created per Unit*	10.99
Average Indirect Economic Output per Unit*	$2,001,458

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Quick Service Restaurants	
New Units	3,754
Transfer Units	5,889
Total Unit Transactions	9,643
Bank Lending Rate	66%
Industry Average Initial Investment	$ 417,326
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 2,614,843,586
Required Borrowings (based on Overall Average Initial Investment)	$ 2,444,580,142
Average Number of Employees per unit*	18.82
Average Output per unit*	$907,637
Average Number of Indirect Jobs created per Unit*	16.93
Average Indirect Economic Output per Unit*	$1,452,219

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Retail	
New Units	942
Transfer Units	1,449
Total Unit Transactions	2,373
Bank Lending Rate	66%
Industry Average Initial Investment	$ 240,206
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 370,321,633
Required Borrowings (based on Overall Average Initial Investment)	$ 601,491,029
Average Number of Employees per unit*	6.84
Average Output per unit*	$464,253
Average Number of Indirect Jobs created per Unit*	6.16
Average Indirect Economic Output per Unit*	$742,804

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Full Service Restaurants	
New Units	328
Transfer Units	515
Total Unit Transactions	844
Bank Lending Rate	66%
Industry Average Initial Investment	$ 1,082,941
Overall Average Initial Investment	$ 390,152
Required Borrowings (based on Industry Average Initial Investment)	$ 593,618,707
Required Borrowings (based on Overall Average Initial Investment)	$ 213,863,548
Average Number of Employees per unit*	24.74
Average Output per unit*	$1,191,912
Average Number of Indirect Jobs created per Unit*	22.26
Average Indirect Economic Output per Unit*	$1,907,059

* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Lodging

Lodging has been removed from the previous calculations of the totals for several reasons. First, because of its capital intensity, the industry often accesses capital in different ways. Lodging has the highest average initial investment of all industries, which would have highly slanted the estimate used for the calculations. Second, new units take a longer time to be built than most other franchise units, and to operate which makes Lodging likely to lag behind other industries. Third, the larger capital amounts required for a unit in the Lodging industry make the industry more susceptible to economic downturns.

For these reasons Lodging is presented here as an independent industry. FRANdata used the same estimates to determine unit growth and bank lending rates.

Lodging	
New Units	3
Transfer Units	65
Total Unit Transactions	68
Bank Lending Rate	66%
Industry Average Initial Investment	$ 11,691,871
Overall Average Initial Investment*	$ 1,331,962
Required Borrowings (based on Industry Average Initial Investment)	$ 516,573,986
Required Borrowings (based on Overall Average Initial Investment)	$ 58,849,171
Average Number of Employees per unit**	18.99
Average Output per unit**	$1,599,254
Average Number of Indirect Jobs created per Unit**	4.12
Average Indirect Economic Output per Unit**	$1,241,298

*The Average Initial Investment was adjusted to include Lodging
** Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

FRANdata

About FRANdata

Founded in 1989, FRANdata is the franchise industry's number one source for objective information and analysis. FRANdata receives no advertising or other fee arrangements that might influence its objectivity. Using its proprietary software to access data from various sources, including its library of more than 15,000 Uniform Franchise Offering Circulars, FRANdata supports the research and competitive intelligence functions of franchisors, helps franchisees evaluate different concepts, provide information and analysis for legal and financial organizations, and provide marketing access to franchisors and franchisees. FRANdata also is the exclusive contractor for the SBA Franchise Registry.

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