

A REVIEW OF SBA'S 504/CDC LOAN PROGRAM

HEARING
BEFORE THE
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS
OF THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES
ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

HEARING HELD
JUNE 29, 2017



Small Business Committee Document Number 115-027
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PUBLISHING OFFICE

26-019

WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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CONTENTS

OPENING STATEMENTS

Hon. Dave Brat	Page 1
Hon. Dwight Evans	2

WITNESSES

Ms. Natasha Merz, Vice President, Langley Federal Credit Union, Newport News, VA, testifying on behalf of the National Association of Federally-Insured Credit Unions	3
Mr. Wayne Williams, Senior Vice President, Business Finance Group, Fairfax, VA	5
Ms. Barbara A. Vohryzek, President and CEO, National Association of Development Companies (NADCO), Washington, DC	6
Mr. Sherwood Robbins, Managing Director, Seedcopa, Exton, PA	8

APPENDIX

Prepared Statements:

Ms. Natasha Merz, Vice President, Langley Federal Credit Union, Newport News, VA, testifying on behalf of the National Association of Federally-Insured Credit Unions	21
Mr. Wayne Williams, Senior Vice President, Business Finance Group, Fairfax, VA	30
Ms. Barbara A. Vohryzek, President and CEO, National Association of Development Companies (NADCO), Washington, DC	35
Mr. Sherwood Robbins, Managing Director, Seedcopa, Exton, PA	38

Questions for the Record:

None.

Answers for the Record:

None.

Additional Material for the Record:

None.

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THURSDAY, JUNE 29, 2017

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:01 a.m., in Room 2360, Rayburn House Office Building, Hon. Dave Brat [chairman of the Subcommittee] presiding.

Present: Representatives Chabot, Brat, Kelly, Evans, Murphy, Clarke, and Chu.

Chairman BRAT. Good morning. Thank you all for being with us today. I call this hearing to order.

While our economy is showing signs of improvement, access to capital continues to be a major challenge for small businesses, startups, and entrepreneurs. Although we are working feverishly to rollback red tape, small businesses face an uncertain lending environment that is compounded due to their reliance on traditional bank borrowing to raise capital. This Committee is striving to create an environment where small businesses can expand and create jobs.

One program to bridge the funding gap that too often acts as a roadblock for small business is the SBA's 504/CDC Loan Program. The 504/CDC Loan Program, which is the topic of today's hearing, combines a partnership with community development companies, also known as CDCs. The program is uniquely structured to offer creditworthy businesses an opportunity to access capital.

First, to be eligible to participate in the loan program, the borrower or small business must meet certain job creation or job retention requirements. However, if these requirements cannot be achieved, the small business still has the ability to participate if community development or public policy goals are met, such as improving, diversifying, or stabilizing the local economy.

Beyond the economic development requirements, the 504/CDC Loan Program offers a distinctive finance structure where the private lender is responsible for 50 percent of the total cost of the project, the CDC is responsible for 40 percent, and small business borrower is responsible for 10 percent.

I look forward to hearing more about this program from our witness panel this morning, what is working, what is not working, where can there be improvements. As we work to assist small businesses, it is important to hear from those who have on-the-ground

experience with this program. I appreciate all the witnesses for being here today. I look forward to your testimony.

I now yield to Ranking Member Evans for his opening remarks. Thank you, Dwight.

Mr. EVANS. Good morning. Thank you, Mr. Chairman.

In order for small firms to play their traditional job-creating role, a number of factors must be in place. Perhaps the most important ingredient is the availability of capital. However, obtaining conventional credit can be particularly difficult for small businesses, making a Small Business Administration lending program critical to filling this gap.

As a result of the SBA programs, entrepreneurs are provided with greater access to capital through the extension of Federal guarantees on a long-term basis. Namely, the SBA 504 program helps small businesses obtain long-term financing for major assets, such as real estate and equipment. It gives them much-needed access to capital on par with their larger counterparts.

Most importantly, financing under this program is secured through a unique three-part structure, requiring as little as 10 percent put down by the small business borrower. The rest of the funds are provided by the banking partner at 50 percent, and 40 percent by a certified development company, a local nonprofit corporation.

The 504/CDC program was not only designed to assist small firms in obtaining necessary capital; it was meant to spur economic development and create and retain jobs. Since its inception, the program has supported over 2 million jobs. In fact, a 2-year study of the program concluded that two-thirds of the borrowers reported job growth within 2 years of receiving the loan and averaged nearly 12 million new jobs.

It should also be noted that the 504 program experienced three consecutive years of growth and grew nearly 7 percent to over 4.7 billion in the fiscal year 2016. Nevertheless, a few issues have been presented to the Committee that may point to ways that the program could operate more effectively.

For example, concerns have been raised about the decline in loan value since the program's peak, as well as the secondary mark in the use of 7(a) loans over 504 loans. And while the 504 loans were made through the United States and U.S. territories, they tend to be concentrated in very specific areas of the country. For instance, just over a handful of States accounted for over half of those approved loans. I applaud the great effort made by the lenders making these loans. Yet I am disappointed that just over a quarter of 504 loans are not going to minority firms, and that many lenders remain somewhat hesitant to approve more than a few of them each year.

I hope to hear from witnesses about finding solutions to improve the program and reach more underserved population.

Today's hearings provide us with an opportunity to hear experiences of 504 partners and what can be done better to facilitate the use of the program. Overall, we are seeking to ensure that the 504 program works for the CDC's banking partners, who in turn must make it work for their small business borrowers.

On that note, I would like to thank our witnesses for taking time to be here. Their views and experience will be valuable to this Committee as we best consider entrepreneurs' capital needs.

I yield back. Thank you, Mr. Chairman.

Chairman BRAT. Thank you Mr. Evans.

If Committee members have an opening statement prepared, I ask they be submitted for the record.

I would like to take a moment to explain the timing lights for you all this morning. You will each have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, at the end of your 5 minutes, it will turn red. I ask that you try to adhere to that time limit. If you go over a hair, it is okay.

Start off with introductions. Our first witness is Natasha Merz. Ms. Merz is the vice president of commercial lending at Langley Federal Credit Union in Newport News, Virginia. She has spent years working in the financial industry with both credit unions and community banks. In 2014, she was named a National Financial Services Champion of the Year by the Small Business Administration. Ms. Merz is testifying today on behalf of the National Association of Federally-Insured Credit Unions, and I appreciate you being with us here today. Thank you.

STATEMENTS OF NATASHA MERZ, VICE PRESIDENT, LANGLEY FEDERAL CREDIT UNION; WAYNE WILLIAMS, SENIOR VICE PRESIDENT, BUSINESS FINANCE GROUP; BARBARA A. VOHRZEK, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES (NADCO); AND SHERWOOD ROBBINS, MANAGING DIRECTOR, SEEDCOPA

STATEMENT OF NATASHA MERZ

Ms. MERZ. Good morning, Chairman Brat, Ranking Member Evans, and members of the Subcommittee. My name is Natasha Merz, and I am testifying today on behalf of NAFCU. I appreciate the opportunity to share with you my experience with the SBA's 504 Loan Program.

The SBA's 504 Loan Program helps lenders provide small businesses with long-term financing to acquire and improve major fixed assets such as owner-occupied commercial real estate and heavy machinery. The program helps businesses by giving them access to financing backed with as little as 10 percent owner equity. Under the program, a financial institution partners with the CDC, a specialized SBA-certified nonprofit corporation, to finance small businesses looking to expand. Each partner makes a loan to a qualifying small business. Typically, the lender's loan is secured by a first lien, covering 50 percent of a project's cost. The CDC's loan is secured by a second lien for up to 40 percent of the project's cost. The CDC loan is also backed by 100 percent SBA-guaranteed debenture. Participating with the CDC helps reduce risk for the lender.

The SBA's 504 Program has helped us meet some specific needs for our small business members at Langley. For example, we were able to help a successful hotel operator who needed to purchase office space and was declined by a conventional lender. The borrower

came to Langley asking for financing options. With the help of the 504 Program, the borrower was able to purchase an office building and lock in a great rate for 20 years.

There are many more stories like these of small business owners looking for that loan to enable them to start or grow their business. At Langley, we are pleased that we have been able to step up to meet this demand using the 504 Program.

Some of the benefits of the program for borrowers include low fixed interest rates for long terms and affordable down payments as low as 10 percent. Additionally, new businesses are eligible, and the CDC can help make the application and approval process seamless.

The program also has features that can make it attractive for lenders. These include: the CDC being responsible for determining SBA eligibility, meaning the lender does not need an in-house SBA expert. The lender treats their portion of the 504 as a regular commercial loan, which does not have SBA reporting requirements. There is a low loan-to-value on the lenders' loan after debenture funding, and lenders can participate out their portion of the 504. Additionally, the new debt refinancing option has created more opportunities for lenders to offer 504 loans.

While there are a number of benefits of the 504/CDC Program for lenders and borrowers, there are challenges in areas where we think it can be improved. These include: Partnering with the right CDC is critical for the lender as not all CDCs are consistent in their processes. The 10-year prepayment penalty makes it less attractive for the borrower. Construction loans in the 504 Program will not close with the SBA until construction is completed and the borrower has moved into the new facility. And lenders should be allowed to collect payments and remit to the CDC on a monthly basis, as some borrowers prefer not to make two payments.

Credit unions also have a special challenge with 504 loans as they have an arbitrary member business lending cap. Government-guaranteed portions of SBA loans do not count towards this arbitrary limit. However, a loan issued by a credit union in a 504 loan is a regular commercial loan that counts toward it, as it does not have a government guarantee. Congress should aid credit union SBA 504 lending by exempting SBA 504 loans made by credit unions from the cap.

In conclusion, the SBA's 504/CDC Program provides much-needed opportunities to established and fledgling businesses. Still, there are several relatively simple steps that could propel the program to its full potential. We would urge Congress to ensure credit unions can meet the needs of their small business members.

I thank you for your time and the opportunity to testify before you here today, and I welcome any questions that you may have.

Chairman BRAT. Great. Thank you, Ms. Merz.

Our next witness is Wayne Williams. Mr. Williams is a senior vice president for the Business Finance Group in Fairfax, Virginia. They also have an office location in Midlothian, Virginia, which is in my district. Mr. Williams has spent years working in the banking industry and has been with Business Finance Group since the late 1990s. He is a former chapter president of the American Institute of Banking and an instructor for the Risk Management Asso-

ciation. He was also a 2009 Financial Services Champion award winner. And so thank you very much for joining us today.

STATEMENT OF WAYNE WILLIAMS

Mr. WILLIAMS. Chairman Brat, Ranking Member Evans, and other distinguished members of the Committee, good morning, and thank you for inviting me to testify.

My name is Wayne Williams, and I am here on behalf of Business Finance Group, a nonprofit certified development company headquartered in Fairfax, Virginia. Our mission is helping small businesses succeed, strengthening our communities, and promoting economic development through job creation. The 504 Loan Program is vital to that mission.

We are one of 230 CDCs nationwide. And while our markets may be different and we vary in size, we all share a commitment to assisting small businesses and promoting economic development. Our story is their story.

Business Finance Group was originally certified in 1982 as Fairfax Local Development Company operating in a single northern Virginia county. In 1994, SBA designated us as the statewide CDC for Virginia. Regulatory changes in 2003 created local economic areas and statewide certifications, and we gradually expanded into Washington, D.C., Maryland, and the Panhandle counties of West Virginia. We have consistently been the most active CDC throughout our jurisdictions as our board and staff continues to earn the respect and trust of SBA, our lending community, and our small business owners.

Business Finance Group, like the other 230 CDCs nationwide, has assisted thousands of small business owners to access the capital they need to expand and create jobs. Since 1982, we have provided 504 loan approvals to over 2,800 companies, totaling \$1.6 billion. And, in turn, the small businesses in our loan portfolio have created and retained approximately 42,000 jobs.

In addition to 504, we became an SBA Intermediary Lending Pilot Program lender in 2013. Small loans for working capital and equipment are not readily available from traditional lending sources, but are essential for businesses to grow and create jobs and promote economic development.

Last month, I celebrated 20 years with Business Finance Group. During that time, we have grown from 8 to 26 employees. Many of my coworkers have also been with us a long time. But we all value that 504 lending not only helps small business owners, it also strengthens communities, communities like Midlothian, Virginia, where 504 assisted Adriana and Kent Lavvorn. Their business, VMEK Sorting Technologies, is a manufacturer of seed/grain counting machines for agribusinesses. The company has developed software that allows those machines to not only sort products based on shape and color, but machines can also provide analytical data on the sorted output, something their competitors' machines could not do.

So their business was exploding, but they had insufficient production capacity in their small leased space, and the owners couldn't tie up all their cash in a real estate purchase when their business was expanding rapidly. With 504's 90 percent financing,

it became a perfect solution. The company purchased the larger facility, had expansion space, and the owners had cash preserved for their business growth, and they added four new jobs.

Or in communities like Alexandria, Virginia, where 504 assisted Karen and Bill Butcher and their company, Port City Brewing Company. After a dozen banks turned them down in 2009, we were able to say yes, and they became the first production brewery to open in the modern era of D.C.-area breweries. And they have been a leader in the modern-era of D.C.-area breweries—I am sorry—been a leader in the expanding craft brewery market throughout the mid-Atlantic and the United States. Their award-winning brewery is now on tap from New York to North Carolina, and on the shelf at Wegmans and Safeway. They now employ 37 people and are in the middle of a major expansion funded with two new 504 loans, and State and local grant money, creating 26 additional jobs.

Beyond these specific examples, I will also share that I have seen 504's ability to help preserve jobs in rural communities like Tazewell, Virginia, or transform once-neglected urban corridors like 14th Street Northwest or H Street Northeast right here in Washington, D.C.

These were our stories, but they reflect an experience of my colleagues from around the country. The 504 Loan Program works. It creates jobs. It promotes small business. It promotes economic development, and it operates at zero subsidy. We take pride in that, and we accept responsibility to maintain it.

Thank you for inviting me to testify. I am happy to answer any questions.

Chairman BRAT. Super. Thank you, Mr. Williams.

Our next witness is Barbara Vohryzek. Ms. Vohryzek is president and chief executive officer for the National Association of Development Companies, also known as NADCO, which is the main trade association for Certified Development Companies. With vast expertise spanning decades, Ms. Vohryzek was the founder and executive director of the California Statewide CDC and a founder and director of Community Business Bank. Thank you very much for joining us today.

STATEMENT OF BARBARA A. VOHRZEK

Ms. VOHRZEK. Thank you, Chairman Brat, Ranking Member Evans, and the other distinguished members of this Committee. Thank you for asking me to testify. I appreciate it.

My name is Barbara Vohryzek, and I am here on behalf of the National Association of Development Companies, also known as NADCO. I represent—our association represents about 95 percent of those 230 CDCs. As have been mentioned, they are nationwide. They are largely nonprofit entities. I think we may have two for-profit, or three, out of the 230, that are grandfathered in from many years ago.

I understand the work of CDCs because, as was mentioned, I ran California Statewide for 21 years, founded and ran it. And, at the time, it was the only statewide when we founded it. Because, at one time, statewides were developed, originally, to be safety nets

for interurban and rural areas. And that is why California State-wide was created originally.

CDCs, as was mentioned, are here to support small business and economic development. There is one CDC covering each congressional district in the country, creating jobs and supporting small business owners and other community development activities. My colleagues here can speak at great length about what happens every day. But what really unifies us as an industry is the fact that we provide the 504 Loan Program.

I am not going to go over the 50-40-10. That was very well laid out. The number of jobs we have created, again, and the number of loans, has already been discussed. So I won't cover that again.

I will cover a couple of things related to that. The SBA, right now, we have a 10- and a 20-year debenture. The SBA has green-lighted—they are in the process of rolling out, hopefully within the next 12 months, a new instrument, a 25-year fully amortized 504 fixed-rate loan. The industry is very excited about that. That will enable small business owners to get lower payments on a monthly basis. And that is definitely needed by some of our small businesses.

But one of the main benefits of the 504 Program, beyond that fixed rate, is the fact there is no balloons. It is fully amortizing. And so it is a product that the business doesn't need to worry about having to refinance it in 5 or 10 or 15 years. Right now, we are 50-40-10. Our maximum loan is \$5.5 million. The average loan is much smaller than that, well under \$1 million.

It was mentioned that our program involves debentures. Just to make clear what happens there, they are federally guaranteed debentures. The reason we get low fixed rates—right now it is around 4.6 percent—to the borrower is because those are federally guaranteed debentures that are pooled and sold on Wall Street on a monthly basis. Any given month, we will sell between \$300 and \$400 million. And we get great rates. And, of course, right now, with the yield curve flat, we are getting incredible rates for our small businesses. We are very pleased about that. We know that because there are such low fixed rates right now, that those businesses can grow and create more jobs quicker, because they have more working capital available to them.

I did want to mention that while we help many neighborhood businesses, you know, the local—well, it used to be the local video store. That is kind of being phased out. But, you know, the grocer and different things that you find locally—that we also have been—and I think Wayne mentioned Port City. But another national brand many of you may have—and I can't tell you how often the OtterBox was a 504. Otter is a 504 borrower. And I would not have an intact iPhone that is 4 years old were it not for this OtterBox. I can't tell you how many times it has fallen from the StairMaster. But it just keeps on ticking.

Many of you may eat yogurt. Chobani yogurt is a 504 product. As well as if you are into music, South by Southwest is a 504 product.

So we do 504. We create jobs through that program. But we are also, as Wayne mentioned, involved in the Intermediary Lending Program. We also have other programs that our CDCs are involved

in through SBA, like the Intermediary Lending Program, as well as the Community Advantage program. But they also will often be engaged with the Small Business Development Centers, SCORE, other organizations that are devoted to small business and economic development in their communities.

With that, I will end. And Wayne was precise. I think you were almost just on 5. I will end slightly early. But I want to just finalize with a statement about how great the 504 Program is as a tool for small businesses and also for the communities in which those small businesses are growing. And thank you, again, for having me here.

Chairman BRAT. Thanks, Ms. Vohryzek. Very good.

And I will now yield to our ranking member for the introduction of the final witness.

Mr. EVANS. Thank you, Mr. Chairman.

Good morning. I am pleased to introduce Sherwood Robbins, managing director of the Southeastern Economic Development Company of Pennsylvania.

Seedcopa is the leading certified development corporation in the Commonwealth, approving over 325 loans over the last decade, and borrowers committed to creating more than 4,600 local jobs. Mr. Robbins is responsible for overseeing Seedcopa's menu of financing services, managing relationships and economic development agencies, and banking partners, expanding the organization's 504 Loan Program.

Prior to joining Seedcopa, Mr. Robbins spent over 20 years in the banking industry where he served most of those years as a government loan officer.

Welcome, Mr. Robbins.

STATEMENT OF SHERWOOD ROBBINS, MANAGING DIRECTOR, SEEDCOPA

Mr. ROBBINS. Chairman Brat, Ranking Member Evans, distinguished members of the Subcommittee, good morning, and thank you for the opportunity to testify the economic successes that our CDC has in Pennsylvania and the job creation that we facilitate through the SBA 504 lending program.

My name is Sherwood Robbins. I am the managing director of Seedcopa. And we were certified as a Certified Development Company through the SBA 34 years ago, and we are proud of that fact. We serve the SBA's Philadelphia district and beyond. While Seedcopa offers other Federal, State, and local loan programs, the SBA 504 continues as our flagship.

I joined Seedcopa as a loan officer in 2007, just as the Great Recession was approaching. In my time, I have witnessed dozens of examples where small businesses received higher-leverage funding and the security of a long-term fixed interest rate. In some instances, these 504 benefits saved the businesses from collapse. In others, it allowed the small business to expand and create additional jobs.

In the last 10 years, our dedicated small-business size staff of seven full-time employees have received 313 504 loan approvals, which resulted in borrowers committing to over 4,500 jobs over that time period. Over the life of our program, we have been part of

more than 644 loans across the Commonwealth, and created one full-time job for every \$30,150 borrowed that we have lent. And that far surpasses the SBA's minimum job requirement, and we are proud of that fact as well.

The 504 is, once again, an even more powerful economic lending tool through the reauthorization of 504 refinance provided by Congress in 2015. This program allows the borrower a financing opportunity to restructure existing conventional commercial mortgage debt, possibly including up to 18 months' worth of eligible future business expenses. This access to capital and comfort, knowing that a portion of their project will be fixed interest rate for the entire 20-year period, may be invaluable as those businesses and our economy continue to grow.

I would like to present two examples of small business owners who utilized the 504 Program to grow or expand their businesses.

A self-employed personal trainer in Bryn Mawr, Pennsylvania, had a vision to take personal training to a higher level by offering fitness services to large area employees and co-develop onsite wellness programs. However, he needed a building to operate and offer expanded services to the smaller businesses in his market. Although his cash flow was actually strong, he would struggle to inject the 20 percent conventional equity into the project and actually still maintain the capital to grow his business over time. And the 504 loan was a perfect solution for this borrower.

As per program requirements, the borrower was required to create five new jobs over the next 2-year period. And I am very happy to report that our borrower actually exceeded his requirement by 400 percent, creating 21 jobs rather than the five required, as business growth far exceeded even his expectation initially.

The second example I would like to give you is a manufacturer in Northampton County, a county formally known for its steel industry. This company is a very

traditional manufacturer, rolling, bending, pressing steel, to make commercial storage, racking, and mezzanine systems. They employed 104 local persons, and their history actually goes back to the early 1900s where they originally designed and manufactured motorcycle parts. And then at some point, they began manufacturing parts for the Ford Model T chassis. So we have got a long history on this borrower as well.

The company leased its current location for many years, and they had the first rights to buy the property. However, again, injecting that 20 percent traditional equity would nearly exhaust the company's necessary working capital. If the company needed to move, the cost of moving that heavy equipment was going to be drastic, over \$1.5 million.

Additionally, if the company moved out of the area, they had very much concern of those long-term, tenured employees having their ability to relocate, and they had employment issues, potentially, as well. The borrower really stated that without the 504 Program, the company might have folded. With his loan now approved by the SBA, the borrower is looking forward to closing on the debenture and locking in their 20-year fixed interest rate.

In these examples, there are benefits beyond the direct employment numbers. The employees at these businesses are earning liv-

ing wage income. With the prosperity of their employer and the confidence in this dependable income, their sense of financial stability increases. That confidence and their disposable income, in turn, stimulates the local economy.

The true impact of 504 lending goes beyond the job creation and the number of jobs, out to inferred job creation throughout the surrounding communities. The overall economic impact of the 504 Program, the SBA's continual willingness and effort to improve the lending process, and this Subcommittee's support of 504 lending, will continue to have a positive impact on small businesses, which are the backbone of our economy.

Thank you, once again, for accepting my testimony. I welcome any questions from the Subcommittee.

Chairman BRAT. Thank you all very much for your testimony today.

With that, we will go to questions.

And I will just throw out three quick ones. I will read off the questions first and give you all about 1-1/2 minutes, if you can squeeze it in there.

Let me ask the questions first, and I will give everyone a minute to think over their question.

For Mr. Williams, in your testimony, you touched on the refinancing policy change that recently took place. Can you talk to us today about this policy change? What has been your experience with the refinancing program, et cetera?

For Ms. Vohryzek, SBA's 7(a) Loan Program has experienced rapid growth over the last few years. However, the 504/CDC Loan Program has fluctuated somewhat. What is behind that pattern?

And then, also, if the project can't meet some of the requirements discussed, they can still obtain a loan if they meet a community development or policy goal. On average, how often does a project fail to meet the job creation or retention requirements and thus turn to those other policy goals?

And for Ms. Merz, I would like to ask you about the role lenders play in this lending program. And can you just walk us through, typically, what happens when a small business comes to you in search of a loan? Do they usually know about the 504/CDC Loan Program upfront?

And so, Mr. Williams, if you can start us off. And sorry for the rapid fire, but—

Mr. WILLIAMS. Thank you, Chairman Brat. Well, as you know, Congress made the program permanent in December of 2015, and SBA put forth the regulation changes in June of 2016. We don't have the final regulations—or the final is not out yet. SBA is still working on that, and we are expecting it soon.

But the program is working. I think loans are being done, albeit not at the pace that I think everyone was expecting. And a lot of that is, I think, because the program is permanent now, and there is no rush to—on behalf of the lending community to use it. And I think we are all hoping that that is going to correct itself.

Chairman BRAT. Thank you.

Mr. WILLIAMS. So I think that—and as we are working with SBA and I think working through some of the tweaks to the pro-

gram and the final rules coming out, I think we will see some improvement in those numbers.

Chairman BRAT. Great. Great. Thanks, Mr. Williams.

Ms. Vohryzek.

Ms. VOHRYZEK. So I start with the 7(a) question. Okay. Well, it is a complicated question. And I would say that the fact that the 504 Program has gone through fluctuations, I think one of the things we saw, the reason the program is not as high as it was during that period, somewhere around 2012-13, is that during that period, we had the temporary refinance program. And if you took those numbers out, the program would probably look a little bit more flat.

The 7(a) Program is a program that has a higher cap than it used to in the old days, which means that, you know, now they can go up to \$5 million. We see that they are doing a little bit more real estate. It is also a program that involves banks. And banks, coming out of the recession, were needing to book loans and they were needing to show profitability. I think there was a report yesterday about the ability to give dividends. It was announced where, okay, they get to give dividends. That is a big deal. And what it is talking about is the strength of the banking industry.

Part of that strength for many medium and small banks in the country can be the 7(a) Loan Program and the ability to book loans under that, long-term loans, and then sell them into the secondary market. So they don't have to hit a lending cap within the bank, they can actually lend and then get those loans off the books, long-term, through the secondary market.

The final aspect to that is because there is this secondary market in premiums, it does drop it to the bottom line.

So I would say there are dynamics that will drive lenders to move towards the 7(a) Program and away from the 504. But we do find in rising interest rates, inevitably, there will be a movement towards 504 because of the fixed interest rate.

And so we just have had a very long period of low interest rates. I think that is—it is puzzling everybody at this point, and globally, frankly, where there are some negative interest rates. And so at this point, we believe that, over time, we will see, as rates rise, that there will be more of a movement into 504. I am trying to stay on the 1-1/2 minute mark.

Chairman BRAT. We can go on another cycle.

Ms. VOHRYZEK. Okay. And then let me go on the second question. I don't have the data. Because you could have something that met the jobs and you had a public policy goal. So I could have a veteran-owned business that also met the policy goal—or rather, that met the job goal. So that it would be difficult to kind of carve that out.

Chairman BRAT. Yep.

Ms. VOHRYZEK. However, what I will tell you is, even if a CDC has to use public policy goals on a number of projects, they are held to the criteria to maintain their certification of one job per \$65,000. So as they move, if their CDC is moving towards—I think you said something about one per \$30,000. So he is fine. He is not anywhere close one per \$65,000. But in areas of the country where you may have much higher real estate prices, or equipment prices, for in-

stance California, you may start drifting. Because a \$1 million building in Oklahoma, if you go to the Silicon Valley, it could easily be \$7 million. And so you can see the job impact may be identical, but the real estate cost is significantly different.

And so what we find is in areas of high real estate cost, we will tend to have the drift towards \$150,000, \$160,000, and then in the areas of the country that have less pricey real estate and equipment, that we will see them lower. But I just want to make the point that, again, a CDC has to maintain within their standing 504 portfolio——

Chairman BRAT. Uh-huh.

Ms. VOHRYZEK.—one job per \$65,000——

Chairman BRAT. Thank you.

Ms. VOHRYZEK.—period.

Chairman BRAT. Ms. Merz, we will get to you in the second round.

I am going to defer to my ranking member, Mr. Evans, with your questions. You can go ahead. I will come back on round two. Thank you.

Mr. EVANS. Ms. Vohryzek, as you know, women-owned and minority-owned businesses often face more challenges to access credit. What steps are the CDCs taking to help with this issue?

Ms. VOHRYZEK. Thank you for that question. The CDCs have—one of the reasons that the pilot program Community Advantage was proposed was that CDCs wanted to be able to provide capital at different areas of the capital access curve. So that the 504 Program tends to keep—to be there for more mature, growing, larger businesses. That is what we find, in general, in the program.

The CDCs, in order to meet the needs of more underserved communities, needed to have the vehicle to do the smaller loans and to be able to do working capital and startup and things like that. And the Community Advantage program was designed—its cap is \$250,000. And it was designed as a program that probably would involve a lot of technical assistance and assist in moving people up the capital-readiness curve.

That is what its intention is, to take the minority and women-owned businesses were on that curve and try to bring them—move them along so that at some point in the future, as they grow, they would be able to access 504 product, meaning they would be ready to buy their own building or long-term equipment, and we would be standing ready to help them.

CDCs also work with the Small Business Development Centers to reach those communities. They have the Intermediary Lending Program, ILP. Some of them are IRP, Intermediary—the rural lending program through rural development, IRP. And so they look at different products. Ultimately, our goal is to grow these businesses, over time, women and underserved communities, in order that they will become 504 eligible and they will be able to access that financing.

So CDCs look at that continuum of capital readiness and say, how can we meet these people where they are and then grow them to the next level, and support them all during that continuum with either direct technical assistance, or they work with their partners in SCORE, or Small Business Development Centers, or women

business owned, veteran business assistance centers, to help them get there.

Mr. EVANS. Thank you.

Mr. Robbins, in your testimony, you mentioned SBA's efforts to work with CDCs to improve, streamline the 504 lending process. Do you believe that these efforts are adequate and that they are listening to your feedback?

Mr. ROBBINS. Thank you for the question. I do. We have found communication has been really effective, over the last number of years, where I have been participating at the level that we are able to talk about ideas. We are able to talk about questions, really looking for—and I think it is key as we have the refinance opportunity in front of us so long as we stay on the zero subsidy. It is making us put a focus on our documentation, our credit underwriting and overall credit quality. So I really do. I think we are at a position where we continue that conversation. We understand that fine balance, which is oversight and compliance, and the ability to offer this capital to the small businesses of our country.

Mr. EVANS. Let me do a followup. What specific ways could the lending experience be more improved? You gave an example, of one in Northampton as well as in Bryn Mawr, and I know the one in Bryn Mawr. Talk a little bit about how it can be improved.

Mr. ROBBINS. I would say it is awareness. I really believe it is awareness. We are talking a lot—I met with a manufacturer this week who is very conventional in nature, actually a very strong borrower, and has the ability to pay for a lot of expansion via cash. So we had a conversation. It was no longer than 45 minutes. He deemed it as a great opportunity. I deemed it as a great opportunity, even though the borrower is going to end up going conventionally. They liked the idea of the program, were unaware of it. We walked out. And I look at that as a true opportunity that the borrower is able to put the conventional lending offer as an apple, compared to the 504 loan as an apple, and compare them directly. And he made a strategic decision.

So what we are finding is the ability to talk to people, give them the choice, and at the end of the day, what is best for that borrower, for their financial needs, is a great opportunity. So for us, it is getting out and actually telling that story, working with partners as we had mentioned, working with partners to go in the communities that have not been served, going through SCORE or SBDC, working with strategic centers of influence or partners that we talk to, to understand who could really benefit from this program and telling of the story.

Mr. EVANS. Mr. Chairman, I yield back the balance of my time. Chairman BRAT. Great.

Next, we will go to Mr. Trent Kelly, who spent the entire night working on another committee and showed up early in the morning to be here. Thank you, Mr. Kelly.

Mr. KELLY. Thank you. I also want to recognize our chairman, our full Committee chairman, Chairman Chabot, on the end. I offered him my time and he did not take it. But let me tell you, we are just fortunate on this Committee to have a great chairman and ranking member. And all Subcommittee chairs and ranking mem-

bers, it is a great working relationship here. And I think it is about what we do.

I mean, America is small businesses. It is the American dream. It is taking a small idea in a garage and turning it into a—you know, a multinational, worldwide corporation, just based on a dream and the ability. And that is what you guys—or that is what the Small Business Administration, it funds those dreams, and especially these loan programs.

I want to start with you, Ms. Merz. And I am just going to go back—the chairman, Chairman Brat, asked a great question. He said—you discussed the 504 refinancing program. Can you describe for us how this policy change is impacting you in your area?

Ms. MERZ. This is a great question. So I think lenders, in general, are a critical partner to make the program a success. Any policy changes, such as the refinance, enables us to sell the program to more members and assist small businesses there. Previously, 504 loans did not fund working capital. With the help of refinance, there is a working capital component that can now be included. And that is actually in big demand with a lot of small businesses, because cash is everything for them.

So it provides more opportunities for us to continue to partner with this program.

Mr. KELLY. And this is kind of—I come from a very—my district is rural. But I come from an even ruraler area, where I grew up. And sometimes dreams are beyond what we know we can achieve or reach. And I think that is where having access to loans and capital and knowing that those—those resources are available to finance your dreams or help you to achieve those.

Can each of you talk about what we can do better to make sure that rural areas, okay—and that would include other—like, inner city is not rural, but it has some of the same issues. And so can you let me know what we can do better to let them know about the CDC Loan Program and how we can better implement it towards those areas, rural and inner city?

Ms. MERZ. Speaking from a lender's perspective, I would say that awareness and also specifically geared towards loan officers. Because loan officers are our feet out there. They are the ones that market the program to the borrower. They are the ones that match the borrower with the correct program. The right training of the loan officers and maybe more networking opportunities would be a great, great help.

But what we do at Langley, we keep up with the changes of the 504 Program. So we are aware how the program works and how we can—we can benefit.

Mr. KELLY. Mr. Williams?

Mr. WILLIAMS. Thank you for the question. It is a vital question.

And we, in our, you know, jurisdictions, have both. We have, you know, eastern shore of Virginia, far southwest Virginia, and, you know, inner city Washington, D.C. So we have experienced that. And I think, you know, the answer for us has been partnerships. And it is, you know, getting out and, you know, networking with your Small Business Development Centers, networking with your chambers of commerce, and spreading the word, and educating

those resource providers that are on the ground, you know, boots on the ground, in those local communities, but also taking advantage of technology.

There are rapid changes with technology you can take advantage of, you know, and use that, use social media. Because that can get you in those communities, you know, faster than you can get there yourself in many cases. And we are starting to take advantage of that as well.

Mr. KELLY. And I am going to get Mr. Robbins, because he hasn't had very much mike time. If you can answer just real quickly in these 37 seconds.

Mr. ROBBINS. Absolutely. I think I would like to mirror some of what Mr. Williams said, is that idea that it is really about leveraging the opportunities. So the groups that we try to talk to, we, as a regular calling effort, try to get out to the county or State-based economic development organizations who are going to touch these people maybe on a more daily basis than we have the ability to. We are a seven-person staff. We go out through trade organizations, if we have that ability. And then we go out also through chambers of commerce. So it really is about kind of leveraging our opportunities to get out there and talk about it.

I think whether we go back—it was a tough economic time. But we were getting media attention during and approaching and coming out of the recession about the SBA. So I think the SBA was in the news scene. It was being talked about for a tough economic time, but the SBA was out there. So I think as borrowers, or potential borrowers, hear about this program, know of the opportunity, have that confidence to say, I do have this dream, I need to ask who to talk to, and go out there. It is that communication that really makes us effective.

Mr. KELLY. And I have exceeded my time. I yield back.

Chairman BRAT. Thank you, Mr. Kelly.

We turn to Ms. Chu from California.

Ms. CHU. Thank you so much.

Ms. Vohryzek, it has been a pleasure to work with the NADCO and the national association of the CDCs. And thank you for your help in pushing for the CREED Act, the Commercial Real Estate and Economic Development Act, which I was the author. I was so thrilled when my bill was included in the 2016 Omnibus package and signed into law by President Obama.

And, of course, as you said, the 504/CDC debt refinancing program allows small businesses to refinance existing commercial debt with long-term fixed rate financing so that they can free up their capital. This had been a successful pilot program in 2012, but then had been allowed to lapse. And since then, we have been attempting to get it put back into law. But, finally, with the help of this Committee, we were able to get it into that Omnibus bill.

And since the refinancing program went into effect in June of 2016, CDCs across the country have approved 231 loans for small businesses. That amounts to 254 million in loans to help businesses grow and expand.

So, Ms. Vohryzek, do you expect that this trend in refinancing lending will increase?

Ms. VOHRYZEK. Absolutely. Oh. I forgot that last time, to turn on the talk.

Thank you for that question. Absolutely. I do believe it is going—and particularly as awareness. I think part of it is you go in and you educate banks. And I remember when I was running the CDC, I thought, okay, I have educated the banker about 504, and I can let it—you know, I can move on to the next bank. But what I found is if you didn't touch base with them pretty regularly, they forgot. And so they—often I would check in and say, hey, how you doing, Bill, you know, this is Barbara Vohryzek with California Statewide. Bill said, Oh, you know, I have got a deal on my desk, and, you know, it is a great thing you called.

So it very much is about continuing the education process, even when you think you already did it, and then following up. And I think both of them really talked about—both Sherwood and Wayne talked a lot about getting—and, actually, Ms. Merz also talked about education of the people who are actually on the ground.

And as this—we are watching an upward trend in the debt refi, and so we absolutely believe it is going to grow. And particularly as rates begin to rise and as balloons come due, we are going to see more and more small businesses coming in and taking advantage of it. But it is on us, as an industry, to make sure that we are calling those banks and credit unions and other lenders and reminding them, hey, we have got this great product for your small businesses, so don't forget we are out here. It is just a matter of communication and keeping that open all the time.

Ms. CHU. And another great thing that happened with the 2016 inclusion in the Omnibus bill is that it made the program permanent. Have you seen the benefits for your industry since then?

Ms. VOHRYZEK. I think knowing that it is permanent takes away a certain level of anxiety, quite frankly. And it is also much more helpful when you are going to discuss it with a bank or with other community partners that they know this isn't going to disappear and that this is a permanent program. And so, absolutely, permanency settles everybody.

And it also enables, over time, for there to be improvements over time. Because we know it is a permanent program and things will change. Markets change. Small businesses change. And the program has the ability to change as well.

Ms. CHU. Do you think there is more that we in Congress or perhaps the administration could do to help more small businesses take advantage of this program?

Ms. VOHRYZEK. I think just talking about it in your districts would be fantastic.

And also, remembering that you have got a whole network of CDCs nationwide that are more than happy to help you and bring you to visit some small businesses and just talk about it. And SBA has been doing its own form of marketing. And the Administrator has been out there. And so the more that we are talking about it, the more small businesses that will be aware of it. And lenders. We want to make sure the lenders are aware of it too.

Ms. CHU. And SBA has been attempting to streamline the 504 loan application process. But there are still some potential lenders

that argue that utilizing the program is too burdensome. How would you respond to this concern?

Ms. VOHRZEK. I would say that the SBA is in the middle of what I call the—or what we call the 504 modernization project. And it is being phased in as we speak. And so, for instance, E-Tran is going to be turned on—or is operating right now, a dual system, in that it will become the new system.

But, beyond that, the new Central Servicing Agent contract, the CSA contract, that was let recently, included in it technology budget, basically, for that contractor. And so they are going to be involved in what will ultimately be a birth-to-grave system of document management and data management. And so from so many aspects, it will enable a more, as the Administrator said, efficient and effective system. It absolutely will. Because for reviews or for a loan, you will just reach into the cloud and be able to access data and access documents related to that small business loan.

And so the SBA is currently moving towards a much more efficient and unified system for the 504 Loan Program. So lenders and small business borrowers are going to find it gets more and more streamlined over time.

And thank you for allowing me to go over.

Ms. CHU. Thank you. I yield back.

Chairman BRAT. Thank you, Ms. Chu.

Now we turn to the full chairman of Small Business, Steve Chabot, with some questions.

Mr. CHABOT. Thank you very much, Mr. Chairman.

Obviously, CDCs and the 504 Loan Program have been critical to an awful lot of small businesses all across the country. My first question, I would invite anybody who wanted to talk about this, would you comment on sort of the way urban areas traditionally have utilized CDCs and the loan program versus more rural areas? I would welcome that from really anybody who would like to comment.

Ms. MERZ. Well, speaking from a lender's perspective—first of all, thank you for the question—I think we see more participation in the 504 Program from an urban area versus a rural area. And I think that is simply because there is more awareness. There is more outreach in urban areas. There is also the lender's footprint tends to be more in urban areas. So we reach out to our members. Word-of-mouth is a huge component when we sell a commercial lending program to our members. And that tends, for us, from—you know, from a credit union perspective, that happens more in urban areas than rural.

Mr. CHABOT. Thank you.

Anybody else want to comment?

I will move on to another one. Relative to publicizing the availability of the 504 Loan Program, any recommendations that you would make? We have, obviously, a new administrator at the SBA. And she has really come in, I think, and trying to shake things up and make things better. And I am very encouraged, thus far, with what I have seen.

Any recommendations there as to how we can better publicize this? And even beyond that, any recommendations, overall, and

changes you would like to see at the SBA? And I will invite that from anybody.

Ms. MERZ. This is a great question. Thank you for that. I think there are some challenges when we are selling the 504 Program to our members. Where we would like to see improvements, a lot of our members don't quite know about different SBA programs. They know that the SBA is there to promote small businesses, there is government-guaranteed lending available. So it is the lender's job to pair the borrower with the right program.

Then it becomes a challenge to explain the process. Because, usually, it is one property, let's say commercial real estate. It is one property that the borrower is looking to purchase. And the common question that we get is, well, how come there is two agencies now, and will I be making two payments on one property? So we have to explain the process, maybe somewhat of a complex process, especially to a member that did not know about the 504 Program before.

So I think a big improvement would be for lenders to have the ability to collect the payments and then distribute to the CDCs so then it is one property, one payment.

Another improvement, I would say, would be the prepayment penalty. A lot of borrowers are hesitant about the 10-year prepayment penalty. I would say this is more of a psychological factor, from what we have seen. Buying a property and I have to commit to stay at the property for 10 years. So I think an improvement to kind of lower the prepayment penalty to, let's say, 5 or 7 years would be great.

Mr. CHABOT. Thank you. I have got about another minute on the clock. Any other members like to see some improvements?

Mr. ROBBINS. Thank you very much. I would say it is that conversation. What we find is that we just need to be out there every day. It does not keep me up at night, rather it wakes me up every morning to think, when I meet someone in at a chamber function or a business mixer or something, and they are talking about the idea that, I just bought the building, I wish I would have known about the 10 percent ability, that capital staying on my balance sheet would have been very powerful.

So, for us, it is really about getting out there, meeting people. And that is either leveraged through organizations. So I don't have the direct marketing channel and a game plan here today, but it really has that idea that if people know that this exists, and it is of benefit to them as they grow and expand, that is powerful. That is very powerful.

Mr. CHABOT. Yes, sir. Mr. Williams.

Mr. WILLIAMS. I will just offer that in terms of most of the changes that I think that we have seen that might be needed are minor tweaks in operational changes with the agency, and, you know, standard operating procedures, SOP. And I think the agency is working through that now. And they have been very receptive to working through that, because I know there is a big, massive rewrite that they are going through. And they have been welcoming of comments, and I think that has been a very good sign, and we have been very appreciative of that.

Mr. CHABOT. Thank you. My time has expired. I yield back.

Chairman BRAT. Thank you, Mr. Chairman.

We will turn to Mrs. Murphy from Florida. Thank you.

Mrs. MURPHY. Great. Thank you, Mr. Chairman.

So as was mentioned on the panel previously, there is a difference between the distribution of these loans between rural and urban areas. Do you also see a difference maybe from State to State or maybe geographically across the country? And then, my understanding is that there is some geographic restrictions on CDC entities as to how far their reach for their loans can be. And do you think that plays a role in creating some of the inequities in the disbursement of access to these loans? And then, what do you think can be done to ensure that these underserved areas have equal access to capital through the CDC? Anyone?

Ms. VOHRYZEK. Well, that is a multilevel question. Yes, we definitely do see concentrations in the country. Some of it has to do with just the nature of, if you look at the number of small businesses, the sizes of those small businesses, and the growth patterns, and the tendency to focus on real estate. So we will see concentrations in states like California or Florida. We definitely see some of that.

One of the things we have seen over time, and rural areas was brought up, has been brought up by a number of you, that in rural areas, and particularly before the Great Recession, we saw that banks would actually extend to very high loan to values for real estate. And even coming out of the recession as the recovery was getting stronger, we were seeing some banks that were going to 85 percent loan to value. And, of course, 504 is 90 percent loan to value. We don't see that as much in some of those territories where you see a great deal of 504 volume, where a bank will not go that high and, therefore, the 504 becomes, really, the critical vehicle for that business to be able to do 10 percent down.

And so I think the dynamics are different. And we see that across states. And we see that in rural versus urban areas. And the nature of the bank or the credit union of the lenders are different in those territories as well.

The second part of your question was relative to does the amount of CDC activity or—they are out of their geographic. All CDCs are statewide now. Some are multistate or have area extensions. I am not sure how much that actually factors into what you are speaking to. I am not sure if, you know, making a CDC a four-state entity instead of a two-State is necessarily going to increase volume. I think concentrated efforts and—where the agency or the public policy goals are pointing towards rural development are pointing towards downtown revitalization. Those kinds of things will, in fact, increase activity.

In California, when I was doing intercity, downtown redevelopment were part of the public policy goals under one broad—I think it was called business district revitalization. And so we saw a lot of activity, particularly in—I know it is—you know, we don't talk about it anymore, but enterprise zones. I did a lot of activity in the enterprise zones, and it really focused, particularly in L.A., in Pacoima in East L.A., in South Central L.A., we did a lot of volume, not just because of jobs, but also because of the public policy

goals related to downtown revitalization. And the same thing happens in rural.

And I forgot the third part of your question. I apologize.

Mrs. MURPHY. You covered the question. But thank you. I appreciate that.

Ms. VOHRZEK. Thank you.

Mrs. MURPHY. And, Ms. Merz, my next question is for you. In your testimony, you had suggested the need for greater flexibility for 504 funding for certain types of businesses. And you specifically cited the example of a loan made to a restaurant, but there were restrictions where they couldn't use the funds for items such as smaller furniture or equipment.

When a situation like that occurs, what other loan products are you able to offer the borrower?

Ms. MERZ. So Langley Federal, we are a partner with the SBA, and we offer a wide range of products. So in situations like this, we would be looking at an SBA product to see if we can do like, let's say, an SBA express loan to assist the borrower to purchase those assets.

Mrs. MURPHY. Thank you.

Thank you. I yield back the reminder of my time.

Chairman BRAT. Thank you very much.

I think with that round, we will conclude our testimony. So thank you very much, everyone, for being here today. I think it went very well. Very good witnesses and the information today.

As direct participants in SBA's 504/CDC Loan Program, your insights and ideas were very valuable to everyone on the Committee. In order to conduct proper oversight, it is important to take a step back. And so today, our conversation will be important as the committee continues to examine all of SBA's lending programs.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned. Thank you all very much.

[Whereupon, at 11:05 a.m., the Subcommittee was adjourned.]

A P P E N D I X



Testimony of

Natasha Merz

Vice President of Commercial Lending

Langley Federal Credit Union

On behalf of

The National Association of Federally-Insured Credit Unions

"A Review of SBA's 504/CDC Loan Program"

Before the

House Small Business Subcommittee on Economic Growth, Tax, and Capital Access

June 29, 2017

Introduction

Good morning, Chairman Brat, Ranking Member Evans and members of the Subcommittee. My name is Natasha Merz, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share with you my experience with the Small Business Administration's (SBA's) 504 Loan Program.

I currently serve as Vice President of Commercial Lending at Langley Federal Credit Union located in Newport News, VA. I joined Langley in June 2011, with over 16 years of experience in commercial and SBA lending with various lenders in New Jersey and Virginia. When I arrived at Langley, I helped create the infrastructure necessary to accommodate in-house commercial loan origination, underwriting, servicing and collection functions. Since then, Langley's member business loans (MBLs) have grown from \$7 million to nearly \$110 million. I actively pursue SBA Lending at Langley including SBA 7(a), Express and 504 loans. I was awarded a Financial Services Credit Union Champion of the Year award in 2014 and Langley was named a Top Credit Union in SBA Lending in 2014 and 2016 by the SBA Richmond District Office. I believe that the SBA's mission to promote small businesses closely resonates with any credit union's goal to support business members in their communities.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally-insured credit unions at the federal level. NAFCU is celebrating its 50th anniversary this year. NAFCU member credit unions collectively account for approximately 70 percent of federally-owned credit union assets. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the 504/CDC loan program under the Small Business Administration.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to such services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions continue to fill today for nearly 108 million Americans. Every credit union is a co-operative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 § USC 1752(1)). While over 80 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service, and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The nation's nearly 6,000 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they ave on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Credit unions also play an important role in the on-going recovery from the financial crisis. As widely recognized by elected officials in Washington, credit unions did not cause the financial crisis. Because they did not engage in the same risky practices as big banks, credit unions fared well during the crisis and, as a result, had the capital available to lend. Surveys of NAFCU-member credit unions have shown that many credit unions saw increased demand for mortgage loans and auto loans as other lenders were leaving the market. A number of small businesses who lost important lines of credit from other lenders turned to credit unions for the capital that they needed.

Our nation's small businesses represent 99.7 percent of all employer firms, employ nearly half of all private sector employees, pay more than 40 percent of total U.S. private-sector payroll, and have generated over 60 percent of net new jobs annually over the last decade. It is inarguable that the strength of the economy directly correlates to the health and well-being of America's small businesses. Many small business owners are members of credit unions around the country and rely on their services to help make their small businesses successful. Our nation's credit unions stand ready to help and, unlike some other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business

lending cap prevents credit unions from doing more for America's small business community.

Artificial Member Business Lending Cap at Credit Union Hurts Small Business

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L. 105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets.

CUMAA also established, by definition, that business loans above \$50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 18 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap in 1998, many of those that meet the needs of small businesses today are now included in the cap due to this erosion. To put this in perspective relative to inflation, what cost \$50,000 in 1998 costs \$74,500 today, using the most recent consumer price index data. That is close to a 50% rate of inflation change that is completely ignored by current law and greatly hamstrings a credit union's ability to meet its members' needs.

It should be noted that the government-guaranteed portions of SBA loans do not count toward the member business lending cap, but the non-guaranteed portions do. This could ultimately lead to a situation where a credit union may be an excellent, or even preferred, SBA lender and ultimately has to scale back participation in SBA programs as it approaches the arbitrary cap. This arbitrary cap can have its biggest impact on SBA 504 loans since the first mortgage issued by the credit union in a 504 loan is a regular commercial loan that counts toward the cap. Congress could aid credit union SBA 504 lending by enacting legislation to exempt SBA 504 loans from counting toward the credit union member business lending cap. Given the nature of the program, 504 loans should be treated differently than regular commercial loans when it comes to the credit union member business lending cap.

A 2011 study commissioned by the SBA's Office of Advocacy affirmed the important role of credit unions to small businesses. (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA study indicates that credit union business lending has increased in terms of the percentage of their assets both before and during the 2007-2010 financial crisis, while banks' lending decreased. This demonstrates not only the need for lifting the MBL cap in order to meet credit union members' demand, but also that credit unions continued to meet the capital needs of their business members even during the most difficult of times. One of the findings of the study was that

bank business lending was largely unaffected by changes in credit unions' business lending. Additional analysis in the study also found that credit unions' business lending can actually help offset declines in bank business lending during a recession.

We would urge the Subcommittee to support legislation to remove or raise the arbitrary cap on credit union member business lending.

Small Business Administration's 504/CDC Loan Program

The Small Business Administration developed the Certified Development Company (CDC)/504 Loan Program to promote economic development and create and retain jobs. The program helps lenders provide small businesses with long-term financing to acquire and improve major fixed assets, such as owner-occupied commercial real estate and heavy machinery. The program helps businesses by giving them access to financing backed with as little as 10 percent owner equity.

Under the program, a financial institution partners with a CDC, a specialized SBA-certified nonprofit corporation, to finance small businesses looking to expand. Each partner makes a loan to a qualifying small business. Typically the lender's loan is secured by a first lien covering 50 percent of a project's cost. The CDC's loan is secured by a second lien for up to 40 percent of the project's cost. The CDC loan is also backed by a 100 percent SBA-guaranteed debenture.

The program helps financial institutions attract and serve small business borrowers that need financing for plant and major-equipment acquisition that may not meet conventional underwriting criteria. Participating with a CDC can help reduce risk for the lender.

Investors purchase interests in the debenture pools and receive certificates representing ownership of all or part of the pool. The SBA and CDCs use various agents to facilitate the sale and service of the certificates and the orderly flow of funds among the parties. After a 504/CDC loan is approved and disbursed, accounting for the loan is set up at the Central Servicing Agent, not the SBA. The SBA guarantees the timely payment of the debenture. If the small business is behind in its loan payments, the SBA pays the difference to the investor on every semiannual due date. In FY2016, the SBA approved 5,938 504/CDC loans amounting to roughly \$4.74 billion.

504/CDC Lending at Langley Federal Credit Union

Langley currently has a total Commercial Loan Portfolio of nearly \$110 million, of which \$3.5 million is in various SBA programs: 504, 7(a) and Express. This represents a total of 114 commercial loans, of which 30 are SBA loans (over 26% of total loans). Without the SBA programs we would not have been able to service these members. When a small business comes to us at Langley, we work with them to place them in the right type of loan, whether a conventional loan or SBA product.

The SBA 504 program has helped us meet some specific needs for our small business members at Langley FCU. Some examples include:

- A member with a small information technology and telecommunications business was leasing an office space to use for their primary business operations. The initial lease term expired and the landlord was looking to raise the rent, which would have been a strain on the borrower's cash flow. The 504 program helped this borrower, who did not qualify on conventional terms, to purchase a building to move their operations into and reduce leasing expenses.
- The landlord of a member with a granite and tile contracting business was looking to sell the property the member's business was operating out of and offered it to the borrower. The borrower did not have the required 20% cash down in order to qualify for conventional financing. However, he was the perfect fit for the SBA 504 program. Furthermore, owning the building and taking advantage of the 20-year fixed rate on the SBA portion has resulted in other income opportunities and improved cash flow for our member.
- A successful hotel manager and operator who needed to purchase an office space for his operations was declined by a conventional lender who was not lending to hotels or hotel operators. The borrower came to Langley asking for financing options. With the help of the 504 program, the borrower was able to purchase an office building and lock in a great rate for 20 years on the SBA portion.

There are many more stories like these of small business owners looking for that loan to enable them to start or grow their business. The demand is out there. Unfortunately, in this current environment, many banks have scaled back their smaller dollar business lending that credit unions are readily able and willing to fill. At Langley, we are pleased that we have been able to help step up to meet this demand.

Benefits of the 504/CDC Program

Benefits of the SBA's 504/CDC program include:

1. Low fixed interest rates for 20 years on commercial real estate and 10 years on equipment for the SBA portion;
2. Down payments as low as 10%, thereby making 504 loans more affordable to borrowers;
3. New businesses are eligible for the program, even when they may not be eligible for conventional financing;
4. There is a simultaneous closing with the CDC which makes the process easy for all parties; and,
5. The right CDC partner can make the application and approval process seamless for the borrower as they can bring their expertise to assist with the loan.

The SBA 504 program also has features that can make it attractive for lenders. These include:

1. Determining SBA eligibility is the responsibility of the CDC. This makes it easier on the lender and a great program for those lenders that are looking to get into SBA lending and may not have in-house SBA expertise;
2. Since a lender does not need to have staff with specialized SBA expertise, they can save on the cost of hiring an SBA expert;
3. There is no need for monthly Colson reporting and SBA approved loan accounting processes—the lender treats the first mortgage (their portion of the 504) as a regular commercial loan;
4. There is a low loan-to-value (LTV) on the lender's loan after debenture funding;
5. Lenders can participate out the first mortgage (their portion of the 504) thus increasing their interest rate yield;
6. The new 504 refinancing option allows for existing debt refinance, financing of fixed assets and working capital;
7. The 504 loan can be assumed by the buyer if the borrower decides to sell; and,
8. In the event of liquidation—lender has the benefit of the low LTV and can follow their own processes and has no risk of SBA guaranty denial/repair.

Challenges and Recommendations

While there are a number of benefits of the 504/CDC program for lenders and borrowers, the program does present some challenges and have areas where we think it can be improved.

Challenges for lenders and borrowers include:

1. Partnering with the right CDC is critical for the lender. A poor lender-CDC relationship can make the process slow and inefficient for the borrowers and the lender—not all CDCs are consistent in their processes;
2. The 10-year prepayment penalty for the borrower is not attractive and harder to sell for a lender—a 5- or 7-year prepayment penalty would be a better option;
3. Construction loans in the 504 program will not close with the SBA until construction is completed and the borrower has moved in to the new facility. Construction monitoring is the lender's responsibility. This means that the lender needs to have a sophisticated and rigorous construction monitoring ability in order to have the project completed per the SBA authorization. Lack of expertise and resources, especially with lenders new to commercial lending, may compromise the project or halt the process. We have heard stories of lenders who have been hampered by this—they approved a loan for a new auto body shop, but the existing shop had to close during construction and revenues plummeted, leading to a deteriorated financial

situation, which led the CDC to decide on its own to back out citing a “material adverse change” to the project. It would be helpful for the CDCs to assist with the construction monitoring process;

4. Some borrowers prefer not to have to make two payments on one property. This could be amended if lenders would be allowed to collect payment and remit to the CDC on a monthly basis;

5. Other borrowers hesitate about additional legal expenses and closing costs that arise out of the need to have two closings; and

6. Some lenders may not know how to market an SBA loan to the borrower—better SBA or CDC outreach and support or networking opportunities for loan officers would be helpful in marketing SBA loans to borrowers.

With a 504 loan, the lender does not have a guarantee in place from closing—the CDC holds the guarantee. If a lender uses the 7(a) program, they hold the guarantee immediately on day one of the loan. On a 504 loan, the SBA issues an Authorization for Debenture which lists the financial institution to be paid off once the debenture funds. The SBA guaranty is issued to the CDC. The financial institution gets the promise that their lien will be paid off as long as there has not been a material adverse change to the borrower’s finances. With a 7(a) loan, the lenders are issued the SBA guaranty directly. If a problem arises, the lender has the control to manage its own credit and still maintain the SBA guaranty.

The 504 program has restrictions that do not allow lenders to use their underwriting standards. Some 504 loans will benefit the member if the financial institution has stricter underwriting standards, while some will not if a lender is comfortable with the credit criteria of the borrower but the 504 program or CDC is not. Giving financial institutions some greater flexibility in this area is something that should be considered.

With a 504 loan, the borrower pays a penalty if they pay off within 10 years. A 7(a) loan secured with commercial real estate has an imposed 3-year pre-payment penalty, while a 504 loan for commercial real estate has a 10-year pre-payment penalty on the CDC’s second lien. The CDC’s pre-payment penalty descends 1% every year. As noted above, dropping this window to 5- or 7-years could help the borrower.

There should also be some greater flexibility for use of 504 funding for certain types of businesses. For example, if a lender issues a 504 loan for a hotel, the proceeds can be used for bedding, equipment, etc. However, if the loan is made to a borrower with a restaurant, they cannot use the funds for smaller furniture, fixtures and equipment such as chairs, small equipment, working capital, etc. Greater flexibility for use of funds in this situation would be helpful.

The SBA is an Important Partner for Credit Unions

I am pleased that NAFCU signed a memorandum of understanding (MOU) with SBA in February 2015. The MOU formalized a joint-partnership that aims to increase the availability of small dollar loans by providing more outlets for entrepreneurs to access SBA products in their neighborhoods. The partnership also helps small business owners get capital for investments into their new or existing business they may have otherwise put on a high-interest credit card or a personal credit line. And finally, it makes the small dollar loans more accessible to underserved communities, including women and minorities.

Conclusion

Small businesses are the driving force of our economy and the key to its success. The ability for them to borrow and have improved access to capital is vital for the job creation that will lift our nation out of the economic malaise in which we find ourselves today. While the Small Business Administration's 504/CDC program provides much needed opportunities to established and fledgling businesses, there are several relatively simple steps that could propel the program to its full potential. We are confident this Subcommittee will do what is necessary to ensure that these programs are successful, while ensuring eligibility requirements and other qualifying criteria are not overly burdensome on the financial institutions that participate in them. We would urge Congress to ensure credit unions can meet the needs of their small business members.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's economy. I would welcome any questions that you may have.



Testimony of:
Wayne Williams
 Senior Vice President
 Business Finance Group Inc.
 Fairfax, Virginia

"A Review of SBA's 504/CDC Loan Program"
US House of Representatives
Committee on Small Business
 Subcommittee on Economic Growth, Tax & Capital Access
 June 29, 2017
 10:00 am

Chairman Brat, Ranking Member Evans, and other distinguished members of the Committee, good morning. I am Wayne Williams and I am here on behalf of Business Finance Group Inc., a certified development company headquartered in Virginia. Thank you for the opportunity to discuss the work that my colleagues and I do every day in pursuit of our CDC's mission of helping small businesses succeed; strengthening our communities, and promoting economic development through job creation. The 504 Loan Program has been vital to our local economic development mission.

Background on Business Finance Group Inc.

I'd like to begin by sharing a little background about our company and what we do in general. In 1982 the Fairfax County Economic Development Authority and the Fairfax County Chamber of Commerce partnered to create what was then known as Fairfax Local Development Company, a community-based non-profit charged with promoting economic development in the county. The goal was to become a SBA certified development company and participate in the SBA 503 loan program to assist the county's eligible small businesses.

A lot has changed over the last 35 years!

Now known as Business Finance Group, our CDC that started in 1982 in just Fairfax County had become the SBA-designated "statewide" CDC for Virginia by 1994, and has since 2006 been a multi-state CDC assisting small businesses in Virginia, Maryland, Washington, DC and the panhandle counties of West Virginia. The company has consistently been the top-producing CDC for SBA's Washington, Richmond, and Baltimore District Offices earning honors from SBA at the state and regional level. This is due to the hard work and dedication of our board, committee members, and our professional staff that has grown to 26 employees who serve our clients, lending partners and SBA, our federal oversight agency.

Business Finance Group maintains its headquarters in Fairfax, Virginia and has regional business development offices in Midlothian, Virginia; Gambrills, Maryland; Washington, DC and Hedgesville, West Virginia all strategically located to better serve our small business clients, lending partners and other resource partners.

While the 504 Loan Program continues to be our primary loan program, in recent years we have strategically invested in two complimentary loan programs, adding the SBA Intermediary Lending Pilot Program (ILP) in 2011 and the SBA Community Advantage (CA) Loan Program in 2013. We added these programs because our board felt that they both furthered our mission of promoting economic development throughout our area of operations. We believe that small loans for working capital and equipment are not readily available from traditional lending sources, but are essential for small businesses to grow and create jobs.

Business Finance Group's Economic Development Success Record

I'd like to share a little of our CDC's success record in meeting our mission of promoting economic development. We believe that the best measure of success combines loan activity generated on behalf of our small business borrowers with the economic impact of that activity on the community. Here are our results –

SBA 504 Loans	FYE 9/30/2016	Inception to FYE 9/30/2016
Borrowers Assisted	81	2,849
SBA 504 Financing	\$69 million	\$1.6 Billion
Jobs Created/Retained	5,359	41,978
Loans to minority-owned businesses	38%	22%
Loans to women-owned businesses	22%	19%
Loans to veteran-owned businesses	7%	4%

These results reflect the vision set by our Board of Directors, the leadership of our management team, the dedication and hard work of all our professional staff members, and the tenacious optimism and strength of our small business borrowers who open their doors in their communities every day.

I joined our CDC back in 1997 when we had 8 employees. My role as a loan officer was to meet with borrowers and referral sources to educate them about the 504 loan program and to generate loans. Borrowers in turn would share with me their plans and dreams for growing their businesses and making a difference in their communities. And for me has become one of the best things about CDCs and 504 lending – the feeling that our lending can and does make a tangible difference in our communities. It differentiates us from conventional financing. CDCs have a different mission from conventional lenders. But we are all part of the puzzle that makes our 504 loan program work.

Last month I celebrated my 20-year anniversary with Business Finance Group. It has been such a pleasure working with this company. Over the years I have personally assisted almost 700 small business owners with almost \$500 million in SBA 504 financing representing total projects of over \$1.3 billion – that's a lot of dreams and plans. I have seen up close how 504 lending can assist small business owners in rural communities like Southwest Virginia or the Eastern Shore of Virginia. I have also seen first-hand how 504 lending can be the catalyst for transforming neglected urban corridors like 14th Street NW and H Street NE in Washington, DC.

The 504 Loan Program works...it promotes small business, it promotes economic development. It creates jobs, and it can save jobs.

And it does all this while operating at zero subsidy. We are extremely proud of that fact, but we are fully aware of our resulting obligation to assure that the program stays on firm footing with sound underwriting and portfolio management.

Background Information on SBA 504 Loan Program

To provide just a little background on the 504 loan program, SBA developed the 504 loan program (also referred to as the CDC/504 Loan Program) to promote economic development in local communities by encouraging healthy businesses to expand and create jobs.

The program provides long-term, fixed-rate financing for the purchase of fixed assets, typically land, buildings, machinery and equipment. Refinancing existing debt is now allowed and can also include a limited amount of cash out for certain eligible business operating expenses. To be eligible a business must meet all regular SBA business eligibility requirements and size standards, and the project must meet an economic development goal specific to the 504 loan program – typically the project must create or retain one job for every \$65,000 in SBA financing; projects for manufacturers are adjusted to one job for every \$100,000 in SBA financing. If the project will not qualify based on jobs impact, there are 13 public policy and community development goals that can be used to qualify the project under certain conditions. These are outlined at 13CFR§120.862 and include items such as assisting businesses owned and controlled by women, veteran, or minorities or assisting businesses in rural areas or in enterprise zones.

The costs in a 504 project are typically split with a Third Party Lender (a participating bank, non-bank, or credit union) funding 50% and receiving a 1st lien on the project assets, the CDC/SBA 504 loan funding up to 40% of the costs and receiving a 2nd lien, while the borrower/applicant injects an equity contribution of as little as 10%. The 504 loan is funded from a 100% SBA-guaranteed debenture sold on Wall Street.

Success Stories

With that background on the 504 Loan Program, I would like to share with you a couple of successful entrepreneurs were able to pursue their dreams with the help of the 504 Loan Program through Business Finance Group –

VMEK Sorting Technologies – Midlothian, Virginia

Adriana and Kent Lovvorn had always wanted to own and operate their own business. So, in 2012, Adriana formed VMEK Sorting Technologies (<http://vmek.com/index.html>). Adriana serves as President and focuses on bookkeeping and financial planning, while Kent is the company's General Manager and handles product development, sales, and marketing. VMEK manufactures seed/grain counters for agribusiness applications as well as more advanced machinery.

The company's counter machines have the capability to not only sort products based on shape and color, but they can also provide analytical data on the sorted products. The company's Abacus High Counter is used in agriculture, processing, and manufacturing industries to count the quantity of small products such as seeds, beans, and corn. The Metrix Analytic Color Sorter can sort products into two categories based on color and/or shape. For example, it can be used to separate discolored or "bad" corn kernels for "good" kernels. In addition to separating the product, it also provided analytical data about number of pieces sorted. Multiple Metrix sorters can be attached to increase sorting capabilities into more than two categories. VMEK sells its products to sells to customers such as Monsanto and DuPont Pioneer

Since opening in 2012, VMEK had been operating out of a 1,550-sf leased space in Richmond, Virginia. But it had quickly outgrown this space based on its rapid growth and it was impacting its ability to add new business. Additionally, the manufacturing business was only 4 years old and its product lines were based on relatively new technology which added a higher level of risk for any conventional lender.

VMEK located an 11,520 sf building in nearby Midlothian, Virginia that Adriana and Kent felt would be perfect for the company's current and future needs. There was an existing tenant that would remain in 48% of the space, while VMEK could initially occupy 52%. And over time, as the tenant's lease expired and as VMEK's business kept growing, Adriana and Kent could expand VMEK into the rest of the building.

But in approaching their banker at Union Bank, the challenges were Adriana and Kent did not want to sink significant cash into the real estate project and deprive the business of the valuable working capital that was needed to continue to fuel its growth. Additionally, Union Bank perceived additional industry risk associated with a relatively young, growing company with product offerings in early stage development. But, operating results since 2012 were very strong and the outlook very promising.

So, VMEK and Union Bank turned to Business Finance Group and the SBA 504 Loan Program for assistance. The company was able to qualify for 90% financing and got a competitive, 20-year fixed rate. Adriana and Kent preserved their cash to support their future working capital needs, the business is projected to create 4 new jobs as it grows, and the project fulfills 3 SBA public policy/community development goals – assisting a women-owned business, a minority-owned business, and a manufacturer.

Success Story 2 - Port City Brewing Company -- Alexandria, Virginia

Bill and Karen Butcher began planning for Port City in early 2009 just as the Great Recession was hitting – a start-up, capital-intensive business in the middle of the greatest recession since the Great Depression. As you can imagine, most traditional banks were not interested. But Bill's long-time dream was to own his own craft brewery. He felt the timing was right, no one had done it yet in the region, he had all the connections from his 20+ year career in the beverage/spirits distribution business in the region, he had equity investors lined up, but most importantly, craft beer was (and remains) his passion.

By the summer of 2010, Bill had been rejected by a dozen bankers before he walked into the office Kerry Donley of Virginia Commerce Bank who also happened to be a board member of Business Finance Group. Using SBA 504 financing, Port City Brewing Company ultimately purchased \$1,000,000 in brewhouse equipment, leased its warehouse in Alexandria, Virginia and opened for business in January 2011. Port City became the first production brewery to open in the modern era of DC-area breweries and has been a leader in the expanding craft brewery market throughout the mid-Atlantic. The company has received critical national and international recognition winning numerous awards including the prestigious Small Brewing Company and Small Brewing Company Brewer of the Year awards at the 2015 Great American Beer Festival. Its individual beers have consistently won medals since 2012, including its highly acclaimed Optimal Wit, Monumental IPA, Ways and Means IPA, and Porter beers.

The original SBA 504 loan resulted in the creation of 23 jobs and met the SBA's public policy goal of assisting a manufacturer.

By the end of 2016, Port City had grown to 37 employees, and increased production to 17,000 barrels of beer annually, with distribution from New York to North Carolina to over 1,600 retail accounts – bars, hotels, restaurants, and grocery chains including Wegmans, Harris Teeter, Food Lion, and Safeway. The beer is on tap in locations from Manhattan to Charlotte. The company's Alexandria tasting room attracts 78,000 annual visitors and has become a local tourist destination.

The company has outgrown its existing space and its outdated bottling line could no longer keep up with demand limiting any expansion opportunities. Port City has now embarked on a 3-year, \$2.6 million expansion that will create 26 new jobs, increase workflow efficiency, and triple annual brewing capacity from 17,000 to 50,000 barrels. This includes the addition of a 6,000-square-foot leased, cold storage warehouse; the purchase of a new \$1.5 million bottling line that will replace the company's existing line and be energy efficient, improve workflow with a smaller physical footprint, and triple bottling capacity; and interior renovations to the existing brewhouse (including adding second tasting room).

Business Finance Group will be financing the new bottling line as a 2nd 504 Loan and the renovations to the existing brewhouse will be part of a 3rd 504 Loan.

It is important to note that additional funding for Port City's expansion project is coming from partner equity and from \$500,000 in state and local grant programs from the City of Alexandria and the Commonwealth of Virginia through a Governor's Agriculture and Forestry Industries Development (AFID) grant. The grants are specifically used for economic development projects that promote state farm and forestry products. Certain Port City beers use state-sourced red winter wheat and oysters. As a side note, part of the local grant money is funding a bikeshare station at the brewery to promote bicycle usage as a responsible alternative to driving when visiting the brewery.

The Port City Brewing Company 504 projects are excellent example of how multiple 504 loans can be provided to the same borrower as the business grows and how local and state funds/grants can be mixed into a project.

These are just a small sample of the work that Business Finance Group has been able to do with the 504 loan program. It is a truly valuable tool for economic development and job creation not only in our Mid-Atlantic region encompassing Virginia, Maryland, Washington, DC and West Virginia, but throughout the country.

Future Issues

As we look to the future, I am cognizant that there is always room for improvement with any program, particularly a government loan program, so I look forward to working with SBA and Congress on any suggestions that improve the usefulness of the program to the small business applicants and lenders or that helps advance the program's mission.

Thank you for inviting me to testify today. I am happy to answer any questions.



Testimony of:
Barbara A. Vohryzek
President and CEO
National Association of Development Companies (NADCO)

A Review of SBA's 504/CDC Loan Program
U.S. House Small Business Committee
Subcommittee on Economic Growth, Tax, & Capital Access
June 29, 2017

Chairman Brat, Ranking Member Evans, and other distinguished members of the committee. Thank you for inviting me to testify today.

My name is Barbara A. Vohryzek and I am here on behalf of the National Association of Development Companies, or as we're commonly known, NADCO. I serve as President and CEO and, in that role, represent more than 95% of the 230 Certified Development Companies in the country. These Certified Development Compa-

nies, or CDCs, are non-profit entities dedicated to economic development in their local communities. The work of a CDC is familiar territory to me—I founded and ran California Statewide CDC for over 21 years. There is at least one CDC covering each congressional district in the country, creating jobs and supporting small business owners. My colleagues on this panel can speak at great length about their CDC’s daily work, but while CDCs can be rural or urban, large or small, what unites them all is their participation in SBA’s 504 loan program.

The 504 loan program is an economic development tool that provides small businesses with long-term, fixed-rate loans to help them acquire major fixed assets for expansion or modernization of their businesses. These loans are most frequently used to acquire land, buildings, machinery, or equipment. A 504 loan can be 10 or 20 years, and SBA has recently announced it will also add a 25 year term, which is a beneficial addition for small business owners. Pairing the fixed rate aspect with these term options gives a small business owner stability, allowing her to budget, without concerns about rising rates or balloon payments.

A loan package that includes a 504 is made up of three parts, which we often describe in shorthand as “50-40-10.” First, a bank provides approximately 50% of the loan package. The 504 loan is the next portion. This can be up to 40% of the package total, up to a maximum of \$5.5 million for businesses that meet certain criteria, though most 504 loans do not come close to this cap. The 504 loan is guaranteed by SBA and funded through a debenture sale on Wall Street, not by funds from the government. CDCs “quarter-back” this part of the loan package by working with the borrower to get SBA’s approval, ensuring the loan is funded through the private markets, and servicing the loan after closing. The final part of the loan is funded by the small business borrower herself. Through the balance of this structure, fees, and rigorous SBA oversight of CDCs and the loan portfolio, the 504 loan program operates at zero subsidy. The fact that 504 requires no subsidy from the taxpayer is a point of pride, and we hope and work to ensure the loan portfolio continues to operate that way each year.

Beyond these structural aspects of the loan, the distinguishing feature of the 504 loan program is jobs. By law, each \$65,000 in financing through the 504 loan program must create or sustain one job, or meet one of several public policy goals. Job creation and retention is the primary metric of the 504 loan program if a CDC does not maintain this 1 to 65,000 ratio of jobs to loaned dollars, it cannot operate as a CDC any longer. 504 is a jobs program at its core, and every day CDCs work with borrowers to get financing that will help them hire new workers, or save jobs that would be lost but for the existence of the 504 loan they receive.

The statistics of this program speak for themselves. Since 1991, 504 loans have created or sustained 2.1 million jobs through 128,000 loans, delivering \$70 billion in financing to Main Street, according to SBA data. These businesses include the local toy store where you buy Christmas gifts and the animal hospital that does house calls to your farm. They are the pillars of the community

whose products you order online when you're homesick, and what make your current neighborhood special and unique. There are also some 504 loan recipients whose names are likely familiar to everyone in this room, regardless of hometown. If we all pulled out our cell phones right now, I bet we'd see the words "Otterbox" stamped across several cases, like mine. A few more of you may have had a Chobani yogurt for breakfast. For the music lovers in the room, a trip to South by Southwest is likely on your bucket list, and the foodies likely have dinner at The French Laundry on theirs. All of these products and places, and the jobs created through them, received 504 financing. Many of these businesses would not exist at all without it.

All CDCs pursue their economic development mission through SBA's 504 loan programs, the primary focus of our hearing today. However, I would be remiss if I did not highlight that CDCs often also participate in other federal, state, and local economic development programs. While 504 was designed to be the larger SBA loan and have a strong jobs impact through the small business' acquisition of real estate and equipment, many CDCs also look for opportunities to serve entrepreneurs who need smaller loans earlier in their development. Within SBA programs, CDCs are active participants in the Community Advantage pilot loan program, the Microloan program, and Intermediate Lending Pilot (ILP) Program. In addition, incubators, CDFIs, and EDA revolving loan funds are all represented by multiple CDCs in our community, among many other programs. Economic development is the watchword for the CDC industry, as this range of programs and the range of programs provided by the two CDCs at the witness table with me demonstrate.

The 504 loan is a wonderful tool for both a small business owner and for communities looking to grow and create job opportunities. Thank you again for the privilege of joining you today. I look forward to your questions.



"A Review of SBA's 504/CDC Loan Program"

**Testimony before the House Committee on Small Business Subcommittee
on Economic Growth, Tax and Capital Access**

June 29, 2017

Submitted by
Sherwood P. Robbins, Managing Director
Seedcopa
737 Constitution Drive
Exton, PA 19341

Chairman Brat, Ranking Member Evans, and distinguished members of the Subcommittee, good morning. I am Sherwood Robbins, here as Managing Director of South Eastern Economic Development Company of Pennsylvania, (Seedcopa). I am pleased to have the opportunity to discuss the economic development success that our CDC has in Pennsylvania and the job creation we facilitate with the 504 lending program.

Seedcopa was founded 1983 by the Chester County Economic Development Council as an affiliate, not-for-profit dedicated to SBA 504 lending as an SBA Certified Development Company (CDC). Seedcopa is primarily a 504 lending company covering the entire Commonwealth of Pennsylvania. Seedcopa utilizes other Federal and State economic development loan programs (such as the Pennsylvania PIDA program) when they are advantageous to Pennsylvania's start-up and expanding businesses, yet the SBA 504 program remains our flagship economic development tool.

I joined Seedcopa in 2007 as a loan officer, just as the onset of the great recession. During that time, and continuing through the present, I have witnessed dozens of examples of small businesses that received high leverage funding through the 504 program that either saved the small business or allowed the small business to expand and create additional employment. Even in today's stable economic climate, the 504 program continues to do the same, sponsoring growth in business revenue, economic stability, and living wage employment.

In just the last ten years since I have been a part of Seedcopa, our dedicated staff of seven full-time employees received 313 loan approvals under SBA's 504 lending program. As you are aware, SBA 504 loans require borrowers to create jobs to receive funding under the program. Seedcopa's loan approvals over the past ten years have resulted in borrowers committing to the creation of more than 4,500 local jobs. Over the life of Seedcopa's program, our 504 lending program has created one new fulltime job for every \$30,149 we have lent, far surpassing SBA's minimum job creation requirements.

Since inception, Seedcopa has collaborated with SBA to approve 644 loans that cover the landscape across Pennsylvania. It is near impossible to drive through our area and not see multiple borrowers that have been funded by the 504 program through Seedcopa. These borrowers are active, vibrant, and have become key employers and good corporate citizens, supporting jobs and much more.

As we continue expanding our reach with the 504 program, I am very excited about the re-authorization that Congress provided in 2015 of the 504 refinance program. There are a significant number of businesses in our region whose real estate has been financed through traditional commercial loans that are ballooning over the next two years. With real estate values still recovering from the great recession, renewal of these loans may be difficult for the current lenders due to their regulatory loan-to-value limitations. I anticipate that the 504 refinance will be very useful in assisting busi-

nesses in refinancing their high loan-to-value real estate debt, preserving their ability to operate and the people they employ.

I would like to take a few moments to reflect on three examples of small business owners who have utilized the 504 program to grow their businesses. A local entrepreneur from Bryn Mawr, PA located in Ranking Member Evans' District, was self-employed as a personal trainer. This gentleman had a vision to take personal training to a higher level by offering the services to large area employers and co-develop fitness and wellness programs at the employer's locations; however, he would need a building from which to operate the business and to offer expanded services to smaller employers who did not have readily available space onsite to accommodate the program for their employees. The owner's most significant problem was that he had limited resources. Although cash flow was strong, the constant need to reinvest in the business and expand training did not leave him in a position where he could afford to fund a 20% deposit on the new building and continue to fund the business' growth and reinvestment needs. The 504 Loan was the perfect solution for this borrower. The program's 90% financing of both the real estate and a large portion of the loan costs reduced the owner's cash investment by more than 50%, allowing the acquisition of the building and the continued, uninterrupted operation of his business at a high level.

This borrower closed on the 504 Loan in 2014 with a requirement to create five new jobs in the next two years. At the two-year anniversary date of the loan closing, the borrower reported that he had exceeded his job creation requirement by 400% and had hired 21 new employees due to the increase in demand for the business' services!

Another example of the impact of 504 lending in our area of operations is a local salon and day spa business with seven locations in southeastern Pennsylvania. The most recent locations is in Perkiomenville, PA in Congressman Fitzpatrick's District. Four of the seven locations have been financed by Seedcopa through the SBA 504 loan program. The owners utilize the 504 loan program's long term, 20-year fixed rate financing as a means to increase the financial stability of the business. In addition, the higher leverage financing enables the owners to maintain working capital in order to support growth and expansion of the business. The business growth facilitated through the SBA 504 loan program has seen this borrower develop from a small "Main Street" salon with only a few employees into a significant, woman-owned small business with 238 employees.

The last example is a manufacturer in Northampton County, PA, a county formerly known for its steel industry. This company is a traditional manufacturer, rolling, shaping and pressing steel to make commercial storage, racking and mezzanine systems, employing 104 local persons. The company's history goes back to the early 1900s as a designer and manufacturer of motorcycle parts, later manufacturing components for the Ford Model T chassis. The SBA 504 is very important for this borrower. The company has leased its current location for many years and had the first rights to pur-

chase the building. When the building was offered for purchase, the company's principal struggled with two issues. First, injecting the traditional 20% equity into the property would nearly exhaust the company's necessary working capital. Second, the cost and effect of moving to a new location would be drastic. The prohibitive cost to move the heavy equipment to a new location was estimated at over \$1,500,000! Additionally, if the company moved out of its current territory, the loss of employees who could not relocate was very concerning. The borrower stated that, without the 504 program, the company might have folded. With this loan now approved by the SBA and the bank funding minor improvements included in the project, the borrower is looking forward to closing on the SBA debenture to lock in their 20-year fixed interest rate very soon.

In each of the examples, it is important look beyond just the direct employment numbers. Traditionally, in the fitness and salon industries, the employees are hourly, 1099 independent contractors who are paid by the number of fitness classes they teach or the number of heads that they coif with no benefits. These two visionary entrepreneurs have leveraged the SBA 504 program to develop a new model of operations whereby the personal trainers and salon employees are now fulltime, regular employees with access to medical benefits and retirement savings. In the traditional manufacturer example, the 504 loan was the difference between employees losing their livelihoods and a community losing one of the few remaining manufacturer of the area's heritage industry—steel.

The employees in these examples have dependable, recurring income that increases not just their sense of financial stability, but also their disposable income which is in-turn spent at other small businesses throughout the area. The true impact of 504 lending, in these and many other examples, goes beyond the number of jobs created at a borrower site to include the inferred job creation that occurs throughout the surrounding community and the overall increase in consumer confidence that generates and maintains consumer spending across the economy. The overall economic impact of the 504 program, SBA's continual willingness and effort to work with NADCO and CDCs to improve and streamline the lending process, and this Subcommittee's understanding and support of SBA 504 lending will continue to have a strong and significant positive impact on small businesses, which are the backbone of our economy.

Thank you once again for accepting my testimony. I am happy to answer any questions the Subcommittee may have.

