

# REVIEW OF THE SBA'S 504/CDC LOAN PROGRAM

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## HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS,  
OVERSIGHT, AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

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## REVIEW OF THE SMALL BUSINESS ADMINISTRATION'S 504/CDC LOAN PROGRAM

TUESDAY, DECEMBER 10, 2019

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,  
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT,  
AND REGULATIONS,  
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Judy Chu [chairwoman of the Subcommittee] presiding.

Present: Representatives Chu, Burchett, and Spano.

Also Present: Representative Chabot.

Chairwoman CHU. I shall call this Subcommittee to order, and I thank everybody for joining us this morning. I especially want to thank the witnesses who have traveled from across the country to be here with us today.

On this Committee, we are focused on making sure that small businesses, whether in my district of California or in Ranking Member Spano's district in Florida and in every district across the America, can access the capital that they need to start, grow, and create new jobs. And we know that when capital is affordable and accessible, small businesses can do what they do best: strengthen our communities, create jobs, and fuel our economy.

This is something I have witnessed firsthand in my home State of California, where 4 million small businesses make up 99.8 percent of the businesses in our State and employ almost half of our workers. California is the fifth-largest economy in the world, and small businesses are the backbone of our thriving economy.

But accessing capital is one of the biggest challenges facing these small-business owners, and it can be even more difficult if that capital is needed to purchase or improve major fixed assets such as real estate, buildings, equipment, and heavy machinery.

Recognizing the additional barriers to capital faced by small businesses at this stage of growth, Congress enacted the 504 loan guarantee program to meet the long-term, fixed-rate financing needs of small businesses who need an injection to reach the next level.

The 504 program is a public-private partnership between the Small Business Administration; nonprofit certified development companies, also known as CDCs; and private-sector lenders, typically banks and credit unions that offer a unique financing structure for a small business. For most 504 loans, the structure works as follows. The private-sector lender provides 50 percent of the cost

of the project, the CDC provides 40 percent, and the small-business borrower provides 10 percent.

One of the primary purposes of the 504 loan program is job creation, and, to participate in the program, small businesses must meet certain job creation or retention requirements. If the small business is unable to meet these requirements, it can still qualify for the program if it meets one of several community development or public policy goals outlined in the Small Business Investment Act of 1958, such as expanding minority- or woman-owned business development, reducing energy consumption, or expanding exports.

The 504 program can be a powerful tool in helping small businesses achieve relief from high-interest commercial loans. Eligible businesses can refinance their loans through the 504 program and take advantage of lower interest rates, allowing them to reinvest more capital into keeping their businesses afloat.

I was proud to author the Commercial Real Estate and Economic Development, or what we call the CREED Act, which was enacted into law in 2015 and revitalized the ability for SBA to offer refinancing for those who had loans. And this is after this popular program had expired in 2012.

According to SBA, in 2018, the number of jobs supported by 504 was down slightly over previous years, which has raised questions regarding the program's performance and whether we need to modify and make improvements to the program.

As part of our congressional oversight of the program, today we will hear from various CDCs across the country about their views on the 504 program. The Committee would like to know what is working, what is not, and what we can do to improve the program.

I look forward to hearing from the witnesses today and working with my colleagues on both sides of the aisle to minimize the barriers facing our small-business owners when it comes to securing affordable capital.

Again, I want to thank the witnesses for being here, and I now yield to the Ranking Member, Mr. Spano, for his opening statement.

Mr. SPANO. Thank you, Madam Chairwoman. And thank you for holding this very important hearing today.

The Small Business Administration's 504/CDC loan program is one of the most important and unique access-to-capital tools available to small businesses. This public-private partnership involves a financial institution, a small business, and the CDC, also known as a certified development company. The program is a key tool for long-term financing of real estate transactions and small-business equipment purchases.

Going beyond just access to capital, economic development is one of the real drivers of the program. With job creation and job retention requirements, along with community development and public policy requirements, this program is transforming neighborhoods and communities from my home State of Florida, to Tennessee, and to Ohio.

In fiscal year 2019, the SBA approved 5,933 loans, for a total of \$4.9 billion. From a job perspective, the program has supported approximately 60,000 jobs over the last few years.

The program has many features, including a fairly new 25-year debenture. CDCs also have the ability to utilize SBA's Community Advantage Loan Program, which this Subcommittee held a hearing on this past May.

From a cost perspective, the 504/CDC loan program runs on fees built into the program. And because the fees have been sufficient over the last few years, the program enjoys zero subsidy from taxpayers, which is something I really like. I hope this trend continues.

Today, we will be examining the program's performance as well as its successes. We will also discuss how Congress can address challenges and how we can look to improve and strengthen the program, as Madam Chairwoman mentioned.

I am happy to have our witnesses joining us today. Thank you for being here and taking the time out of your busy schedules. I look forward to hearing your thoughts on many of the 504/CDC loan program features.

As with any government loan program, comprehensive and continuous oversight is required to ensure that the program runs effectively and efficiently, all while safeguarding taxpayer dollars.

Within my congressional district in Florida, which is just outside of Tampa, we have 12,000 small businesses that employ over 100,000 Floridians. And programs like the 504/CDC loan program are instrumental to growing and expanding operations and creating jobs all over the country, in California and in my home State of Florida.

Again, I thank all the witnesses. Thank you for being here, taking time away from your businesses and your families.

Madam Chairwoman, I yield back. Thank you.

Chairwoman CHU. Thank you, Mr. Spano.

The gentleman yields back.

And if Committee members have an opening statement, we would ask that they be submitted for the record.

I would like to take a minute to explain the timing rules. Each witness gets 5 minutes to testify, and members get 5 minutes for questioning.

There is a lighting system to assist you. The green light comes on when you begin, and the yellow light means that there is 1 minute remaining. The red light comes on when you are out of time, and we ask that you stay within that timeframe to the best of your ability.

I would now like to introduce our witnesses.

Our first witness is Ms. Mary Mansfield. Ms. Mansfield has been with the Bay Colony Development Corporation since 1985 and has served as president and CEO since 2016. Mary oversees day-to-day operations of the 504 and microloan programs for Bay Colony. Prior to that, she was closing manager and portfolio manager.

In addition to her responsibilities at Bay Colony, she served as Chair of the Board of the National Association of Development Companies, or NADCO, where she taught the introduction to 504 and the loan closing courses, both of which are required for all CDC attorneys closing 504 loans.

Welcome, Ms. Mansfield.

Our second witness is Mr. Wayne Williams. Mr. Williams has over 32 years of experience in commercial banking and small-business lending, including extensive expertise in SBA's programs.

His company, Business Finance Group, is a mission-driven CDC providing financing solution to small businesses. BFG is the number-one SBA 504 lender in the mid-Atlantic and a top CDC nationally. As their senior lending officer, Wayne supports a team of six business development officers who navigate SBA policies and promote the company and its products to clients and referral sources across its mid-Atlantic footprint.

Since 2015, he has served on the board of directors of NADCO.

Welcome, Mr. Williams.

Our third witness today is Ms. Elaine Fairman. Ms. Fairman began her SBA lending career at Catawba Regional Development Corporation in 1987. In 2012, Ms. Fairman became the executive director of Business Expansion Funding Corporation. With offices in Charlotte and Raleigh, BEFCOR was a top producer in North Carolina—and, in fact, still is—for 504 loans.

Her extensive expertise with the 504 program spans marketing, underwriting, loan packaging, closing, servicing, board relations, governance, compliance advocacy, and now executive management. Is there anything she has not done?

In addition to her management of BEFCOR, Elaine is a board member of NADCO. So we thank all the NADCO participation.

But welcome, Ms. Fairman.

And now I would like to yield to our Ranking Member, Mr. Spano, to introduce our final witness.

Mr. SPANO. Thank you, Madam Chairwoman.

Our next witness is Brooke Mirenda. Ms. Mirenda is president and chief executive officer of Sunshine State Economic Development Corporation, which is also known as SEDCO. SEDCO has multiple locations in my home State of Florida.

Ms. Mirenda has nearly 20 years of financial services experience. In 2016, she joined SEDCO as senior vice president and was quickly moved into the role of president and CDO.

You must have done something right there in that short, brief period of time. Ms. Mirenda, we appreciate you taking the time away from your business and from your community, from your CDC, to talk with us today.

Thank you very much, Madam Chair. I yield back.

Chairwoman CHU. Thank you very much.

Ms. Mansfield, you are now recognized for 5 minutes.

**STATEMENTS OF MARY MANSFIELD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BAY COLONY DEVELOPMENT CORPORATION, WALTHAM, MA; WAYNE WILLIAMS, SENIOR VICE PRESIDENT, BUSINESS FINANCE GROUP, INC., FAIRFAX, VA; ELAINE FAIRMAN, EXECUTIVE DIRECTOR, BUSINESS EXPANSION FUNDING CORPORATION, CHARLOTTE, NC; AND BROOKE MIRENDA, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SUNSHINE STATE ECONOMIC DEVELOPMENT CORPORATION, CLEARWATER, FL**

**STATEMENT OF MARY MANSFIELD**

Ms. MANSFIELD. Subcommittee Chairwoman Chu, Ranking Member Spano, and other distinguished members of this Committee, thank you so much for inviting me to testify here today.

Again, my name is Mary Mansfield. I am the president and CEO of Bay Colony Development. We are a certified development company in Waltham, Massachusetts, with offices in New Hampshire, Vermont, and Rhode Island. I started with Bay Colony back in 1985, and I was the company's third employee. I am proud to say that we now employ 15 people at Bay Colony.

Bay Colony is a nonprofit, mission lender. We do SBA 504 loans, microloans, and we also provide grants to community revolving loan funds. In 504 lending alone, we have helped over 1,500 borrowers that have created and retained over 13,000 jobs in New England.

As you know, 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 their expansion. These loans are most frequently used to acquire land, buildings, machinery, and equipment. A 504 loan can be either 10, 20, or now 25 years. The 504's long-term fixed-rate gives a small business lower loan payment stability without the concerns of rising interest rates or balloon payments.

A distinguishing feature of the 504 program is jobs. By law, each \$75,000 in financing through the 504 loan program must create or retain one job or meet one of several public policy goals. Job creation and retention is the primary metric of the 504 loan program.

Not only do we create jobs, the 504 loan program operates at zero subsidy—no cost to the government. The fact that the 504 loan program requires no subsidy from the taxpayer is a point of pride for our CDC community, and we work very hard to ensure that our loan portfolio continues to operate that way each year.

Some very famous, nationally known companies started off with 504 loans when their businesses were just getting started: Chobani yogurt, OtterBox, and Life is Good, to name a few.

We have helped many small businesses, but there are many more that we could help with modifications to these loan programs. I have listed several recommendations in my written testimony, including changes to occupancy rules, disaster assistance, and other areas. But let me mention one right now.

Currently, small businesses find the closing process inconsistent, uncertain, and lengthy. I know this both from my years of working with small businesses in New England and also because for many

years I was a CDC instructor for an industry-wide course on 504 loan closings.

At least two areas in that process can be streamlined to help small businesses. First, minor changes to a loan that do not increase the risk to the SBA should not have to go through a second round of SBA approvals. Rather, CDCs who have demonstrated reliability and quality when working with borrowers should be able to make these changes with their own authority. I do mean minor changes here, such as typos in names and addresses.

I think an example from one of my colleagues in the CDC industry may best demonstrate how these minor reviews can delay small businesses from receiving their funds. During the last government shutdown, when SBA was not open to do these approvals, one small business could not close on their loan because it needed SBA approval to add periods to the "LLC" in their company name.

Delays like this could result in our borrowers paying higher interest rates, forfeiting their deposits on properties, or completely losing the property if the sellers in these transactions are not accommodating. Allowing a CDC to perform a correction like this will help entrepreneurs move forward in their businesses without any additional risk to the taxpayer.

Second, provide consistent and clear rules on what documents need to be submitted to SBA for a loan closing and when those documents need to be submitted. Right now, this can vary depending on where the small business is located in the country. This leads to unnecessary delays, frustration, and this can impact the borrowers' interest rate.

I am happy to share more of our successes and suggestions for further improvement. And, again, thank you for having me today, and I look forward to your questions.

Chairwoman CHU. Thank you.

Mr. Williams, you are now recognized for 5 minutes.

#### **STATEMENT OF WAYNE WILLIAMS**

Mr. WILLIAMS. Thank you.

Chairwoman Chu, Ranking Member Spano, and other distinguished members of the Committee, good morning, and thank you for inviting me to testify.

My name is Wayne Williams, senior lending officer of Business Finance Group, a nonprofit, mission-based certified development company headquartered in Fairfax, Virginia, with additional offices in Maryland, West Virginia, and Washington, D.C.

As the Congresswoman mentioned, we are the number-one 504 lender in the mid-Atlantic and a top-20 CDC in the Nation out of over 200. Since 1982, we have assisted over 3,000 small businesses with \$1.8 billion in 504 loans, supporting over \$4.8 billion in total capital investment, resulting in over 41,000 jobs created and retained in the local communities that we serve.

By statute, 504 loans stimulate local economic development through job creation and retention. CDCs deliver that required measurable economic impact at zero subsidy. That differentiates us from other SBA and conventional loan programs. We are proud of this accomplishment and determined to preserve it with prudent underwriting and responsible portfolio management.

But CDCs do more than 504 lending. At Business Finance Group, we participate in SBA's Community Advantage and ILP loan programs. We view these as complementary to 504, allowing us to provide clients with access to affordable, responsibly underwritten capital along a continuum of credit, from start-up to growth and expansion.

Other CDCs offer SBA microloans, USDA loans, State and local loan programs, business incubators, and technical counseling services. CDCs must invest excess capital generated from 504 lending into other economic development.

As I stated, since 1982, Business Finance Group has assisted many successful small businesses, but I would like to highlight one for you today that was in my written testimony as well.

Greater Unity Adult Services is based in Richmond, Virginia, and is owned by Eugene Thomas, Jr. The company provides training, treatment, and support for adults with disabilities, including intellectual disabilities, mental illness, and physical challenges. The company runs a day support program facility and various assisted-living residential care homes.

When we started working with Greater Unity in 2012, they had 2 locations and 10 employees. Today, after 6 504 loans and 3 ILP loans, the company has 8 locations and 60 employees. They have been a true 504 success story for us.

Many small businesses like Greater Unity have successfully used 504 to fund growth and expansion, but even more could benefit from the program with modifications and streamlining to implement and adjust to changing market conditions, to increase program access, and improve speed, transparency, and certainty.

I listed several recommendations in my written testimony, including streamlining the closing process and improvements to 504 debt refi, but I will elaborate on my recommendation to reduce the owner-occupancy requirements.

Occupancy requirements are a challenge that prevent or limit the ability of small businesses to use the 504 loan program, particularly in more densely populated urban communities with multistory buildings and limited real estate inventory.

Current statute requires a borrower that purchases an existing building to occupy 51 percent or more of that building. In urban areas of the country, it is common to have multistory buildings where the small business may only need the first-floor space. Owner-occupancy is 50 percent for an evenly split two-story building and progressively drops with more than two levels. In these cases, these properties are not eligible for SBA assistance.

Relaxing the occupancy requirement across the board from 51 percent to 50 percent will increase small-business access to 504's attractive features.

Urban core markets, like Washington, D.C., and Baltimore in my region, are home to thousands of small businesses that can benefit from 504 if occupancy requirements are relaxed even further for those specific targeted areas. Indicative of this challenge, we have only approved 159 loans in Washington, D.C., in our 25 years of serving this particular market despite thousands of small businesses that operate here.

These changes would better position 504 to reflect today's business dynamics and real estate market.

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

Chairwoman CHU. Thank you, Mr. Williams.

Ms. Fairman, you are now recognized for 5 minutes.

#### STATEMENT OF ELAINE FAIRMAN

Ms. FAIRMAN. Good morning. I am Elaine Fairman of Business Expansion Funding Corporation, known as BEFCOR, in North Carolina. BEFCOR is a Certified Development Company that provides 504 loans and other small-business support throughout North Carolina and portions of South Carolina. In addition to the SBA 504 program, BEFCOR operates another program that provides much smaller loans in rural and hurricane-impacted areas.

Our 504 loans have created or retained 11,500 jobs through the nearly 1,000 loans that have been made, totaling \$519 million. These numbers have had a significant impact in our economy.

One of our successful borrowers is a catering business that began in 2010 and had offices and kitchens in multiple locations. In 2014, a 504 loan approval enabled this business to unite all operations under one roof, improving efficiency and quality. As a result of the 504 loan, this business's workforce tripled. Now the business is very successful, and its owner was named North Carolina's Small-Business Person of the Year in 2018. Without a 504 loan, that business would not have been able to grow as quickly or as strongly.

In addition to the program's successes, I would like to speak with you about strengthening the 504 program. There are many topics that would improve 504 loans and access to capital for small businesses. I would like to recommend several key areas—EPC/OC rules, occupancy percentages, and refinancing, among others in my written testimony. And I want to focus especially on the often-avoided EPC/OC rules.

EPC/OC rules impact regular applicants who seek 504 loans and form a separate corporation to own their own building. The active business that creates products and services is known as the OC. When the OC purchases a building, it forms a separate legal entity to own its real estate. That entity is known as the EPC. The EPC then leases its building to the OC, the operating company.

While the two companies often appear to operate as one, they are legally separate and distinct, and a written, formal lease agreement outlines certain legal requirements between the two entities. Reasons for having a separate EPC and OC are varied, with the three most common being: reducing liability risk to the OC, normal tax strategies, and normal business strategies. All of these reasons are legal, sensible, and responsible.

The EPC/OC structure is common in today's business practices and environment; it was not common, however, when the SBA rules were originally written.

When considering through a modern business lens the outdated rules on EPC/OC that were developed decades ago, there are many problems created: The rules are intrusive and overbearing. The rules do not appear to protect the SBA from losses or bad loans. The rules interfere with practical, basic business and management

financial decisions, and they dictate the details of the relationship between the EPC and OC. The rules exclude normal expenses from the lease that are generally tax-deductible for other non-SBA business owners. The rules potentially make the operating company more vulnerable to legal action by removing protections desired by the owner when the EPC is formed. And, finally, the rules adversely affect 504 borrowers who lease their unused space to another business.

CDCs often ask: If these rules do not protect the government and do not help small businesses, why are the rules still here? The time to repair this is now.

In addition to the EPC/OC rule issues, please consider simplifying occupancy and refinancing rules. Both limit the program's effectiveness, especially related to small-business expansions.

I wholeheartedly believe that when we approach a challenge with a common mission we have the opportunity to make improvements. Some would say we have an obligation. I believe we have both at this time.

Our four-person panel is committed to serving small businesses, and, collectively, we represent over 90 years of experience lending in the 504 program—**90 years**. So we respectfully seek your guidance in helping resolve some of these issues that impair the ability of small businesses to grow.

Thank you for your time.

Chairwoman CHU. Thank you, Mr. Fairman.

Ms. Mirenda, you are now recognized for 5 minutes.

#### **STATEMENT OF BROOKE MIRENDA**

Ms. MIRENDA. Representative Chu, Ranking Member Spano, and other distinguished Committee members, good morning. I am Brooke Mirenda, and I am here on behalf of Sunshine State Economic Development Corporation in Florida. I am pleased to have the opportunity to discuss the economic development work our CDC does and the jobs we help create, particularly with the 504 loan program, as well as discuss areas of opportunity.

Sunshine State Economic Development Corporation, also known as SEDCO, was born from the result of a merger of two 30-year-old CDCs in 2016. SEDCO is headquartered in beautiful Clearwater, Florida, and is one of four CDCs that operate within the State. We are considered a midsize CDC, and we have seen significant growth over the last several years.

While the 504 loan program is our primary focus, we also offer other loan programs to meet the demands of our small-business borrowers, which include the SBA ILP and CA loan programs. SEDCO also utilizes its own resources to offer financing to small-business owners through a women/minority/veteran loan program and SEDCO loan program. We believe that our coordinated lending alternatives are essential in helping small businesses grow and create jobs.

I joined the CDC in 2016 as senior vice president/business development officer after 15 years in the financial services industry, primarily in mid- and executive-level management. I have had the privilege of working with small-business owners around the State,

helping them access funds they needed to continue to grow their business and create more jobs.

In November of 2017, the board of directors appointed me as the president and CEO. As SEDCO president, I continue to be intimately involved in helping small businesses reach their maximum potential.

The SBA 504 loan program not only creates jobs in our economy, it also offers up competitive rates and terms for our small-business owners, which helps preserve capital and grow their businesses, while still operating at a zero subsidy.

I want to turn my attention to the work our CDC does with the 504 loan program in particular. We work with lenders throughout the State of Florida to offer a solution to small-business owners that is not only attractive but leverages them in a way conventional financing cannot.

I would like to take a brief moment and share one of our many successes of the 504 loan program.

A couple dreamed of owning their own business and being their own boss. They purchased a cafe in September of 2011 in Fort Myers. That cafe continued to grow and flourish over the years.

They were leasing their building until the owner of the building sold, and they had a very short time period to relocate. They did so, and right as they did, Hurricane Irma hit. They were faced with trying to relocate and dealing with a decline in diners and tourists which negatively impacted their business.

They had an opportunity to purchase a building on Fort Myers Beach perfect for their growing business. However, with declines in revenues due to the hurricane and the money they had to utilize for relocation, being able to purchase a building with 20 or 25 percent down just simply was not an option.

Along with a third-party lender, we were able to secure a 504 loan for these entrepreneurs. They were able to reopen as a full-service restaurant, creating seven new jobs.

I am proud that SEDCO can bring these resources to Florida entrepreneurs. However, during my time with the CDC, I have seen some policies that are not helpful to my small-business borrowers but also do not seem to protect the taxpayers' loan guarantee in a meaningful way. I hope Congress and SBA will review them and consider improving them to better meet the needs of our small-business owners.

One way to help small-business owners is to allow a more robust refinancing option in the 504 loan program. Thanks in great part to the leadership of this Committee, small-business owners can now refinance existing conventional loans using a 504 loan. That has been invaluable to many businesses and jobs.

However, there is an important exclusion from 504 refinance eligibility, and that is other small-business loans from government-guaranteed programs. A small-business owner that purchased their building with a government product is now barred from refinancing via the 504. This refinancing barrier does not exist for other government-guaranteed lending programs. As a result, this subset of small-business owners cannot take advantage of the 504 loan program with the low 20- and 25-year fixed rates.

These borrowers would still need to meet all of the eligibility requirements that any other small business would. Thus, the soundness and quality of the refinancing program would not change if they participated. Ensuring that 504 refinancing is an option available for these small-business owners would give them an additional tool when deciding what best meets their needs, while not increasing a risk to taxpayers.

Congress, SBA, and CDCs all have a shared goal of supporting small businesses while ensuring proper use of taxpayer dollars. The 504 loan program is a wonderful example of that. It creates jobs while at no cost to the taxpayer. The opportunities for change that I have outlined in my written testimony as well as illustrated today will help keep that proper balance, and I urge Congress to consider them.

Again, thank you for inviting me to testify today, and I am happy to do my very best in answering any questions that you have.

Chairwoman CHU. Thank you.

And thank you to all of our witnesses. We appreciate all that you have shared with us.

We will now begin the questioning, and I will begin by recognizing myself for 5 minutes.

Mr. Williams, I am the proud author of the CREED Act, which was enacted into law in 2015. It reinstated the ability for businesses to refinance their loans under the 504 program. So it is my priority to ensure that SBA is implementing this program effectively.

Under current regulations, the 504 program cannot be accessed to refinance any government-guaranteed loans, including other SBA loans. What are some types of government-backed loans that could be refinanced under the 504 program if this restriction were removed? And how would that change impact small businesses?

Mr. WILLIAMS. Thank you for your question. And I think it is a very important question, as this is a high priority for our industry and our trade association. And we also want to thank you for your leadership in getting this passed in the first place.

As my colleague Brooke mentioned, this is very important for small businesses, and it would open up all government loan programs to be eligible for refinance, just as all other loan programs can refinance our debt. So it would balance the equation as we look at it.

And provided it is in the best interest of the borrower and also not disadvantageous to the taxpayer, that is what is important for us. And, again, as mission-based lenders, it is our responsibility to make sure we are doing what is in the best interest of both of those parties. So we look at it as, you know, all programs will be eligible.

The other point I would like to make, Chairwoman, is that, under the existing 504 debt refi with the expansion that we have had longer than the 504 debt refi program, we can already refinance existing government-guaranteed debt. And that has been allowed for a while, you know, since 2009. It is just in this other program, the permanent refi program, that we cannot.

So, in some respects, the horse has already left the barn, you know, so it is time to, you know, kind of catch up, is the way I

think our industry looks at it, and simplify the discrepancies among the programs.

Thank you.

Chairwoman CHU. Thank you for that.

Ms. Mansfield, in places like my home State of California, rising real estate prices means that some small businesses struggle to secure the capital that they need to grow their businesses for their real estate.

Under current law, certain businesses like small manufacturers are eligible for a larger SBA-backed debenture than typical 504 applicants, which allows them to redirect more of their resources towards growth and employment.

How would increasing the debenture limit for real estate projects to at least match the limit for small manufacturers impact business in higher-cost States like California?

Ms. MANSFIELD. Well, coming from Massachusetts, I know a little bit about rising real estate prices, so I would be very excited to see this pass as well.

Any time we can help a small business by putting more funds through the 504 program, it is going to give them a longer term. It is also going to have the fixed interest rate for them. So we would be very excited to see they can utilize that program and save their funds for working capital purposes within their company.

Also, job creation. Again, as we mentioned, job creation is a big component to the 504 program. If we can get more money out there to that small business, it also means they are going to create more jobs for our economy.

Thank you.

Chairwoman CHU. And, Ms. Mansfield, I have heard from CDCs in California that the refinancing process for 504 loans can be onerous. For example, SBA requires that refinancing applicants provide copies of original purchase agreements, closing statements, promissory notes, and grant deeds.

For small businesses that have refinanced their debt previously, it is possible that the bank that originally issued the loan may no longer even be in business. So businesses in this position are then excluded from the 504 refinancing options.

So, based on your experience, how can SBA improve the documentation requirements for small-business owners in the 504 refinancing process?

Ms. MANSFIELD. Thank you.

Again, simplification of the documentation. As you said, it is quite possible that some of these banks are no longer in business or they have merged and it is actually impossible to get some of these original documents. And requiring a borrower who has had a loan out there for 10 or 15 years that they want to refinance be able to provide original documentation is a bit onerous for them. You know, they are not in the business of keeping all of that documentation from an original loan.

So anything we can do to eliminate that requirement would go a long way for helping more businesses be able to take advantage of the refi program.

Chairwoman CHU. Yeah, Mr. Williams.

Mr. WILLIAMS. I just wanted to add, it also kind of removes the barrier that small businesses see with SBA financing, the stigma associated with paperwork, you know, redundancy. And it simplifies that image and that reputational risk that the agency has.

And I know as my colleagues and I have discussed, the agency accepts certifications for a large number of things with respect to, you know, a loan transaction—certifications from borrowers, certifications from lending partners, certifications from CDC partners. This would be another way to help streamline, simplify, without adding undue burden to the taxpayer.

Chairwoman CHU. Thank you.

Well, my time has now expired, and the Ranking Member, Mr. Spano, is now recognized for 5 minutes.

Mr. SPANO. Thank you, Madam Chairwoman.

Interesting stuff. Thanks so much for your testimony.

I have a number of different things kind of bouncing around in my head, but, well, I will start with this. I mean, we have talked about, kind of, several areas where we think there might be some improvements, right, that could be implemented. What I would like to get from each of you, kind of without commentary, but just list for me, in each of your specific individual opinions, what is the single largest issue facing CDCs today.

Ms. Mansfield?

Ms. MANSFIELD. For me, I would think it would be streamlining the closing process—

Mr. SPANO. Okay.

Ms. MANSFIELD.—would be the largest.

Mr. SPANO. Mr. Williams?

Mr. WILLIAMS. Streamlining the closing process and improvements to debt refi.

Mr. SPANO. I only gave you one.

Mr. WILLIAMS. I am sorry.

Mr. SPANO. That is okay. I am just kidding. I was just kidding. I am just kidding.

Ms. Fairman?

Ms. FAIRMAN. Debt refi.

Mr. SPANO. Okay.

Ms. FAIRMAN. Barely.

Mr. SPANO. Ms. Mirenda?

Ms. MIRENDA. I would say streamlining the closing process, because that can affect borrowers and affect closings, and that is a pretty big deal for our small-business owners.

Mr. SPANO. All right. So three of the four of you agree that streamlining the closing process is the number-one issue.

Why is it that we have inconsistencies in the closing process, in your opinion? Honestly.

Ms. Mansfield?

Ms. MANSFIELD. Sure. I have been involved with 504 loan closings for quite some time, and we first talked about streamlining, I believe it was, back in 1997.

Mr. SPANO. Uh-huh.

Ms. MANSFIELD. And it seems that some streamlining has occurred, but it has not been for the benefit of the small business.

Mr. SPANO. Okay.

Ms. MANSFIELD. So I think we need to change the mindset and look at how the small business is impacted with all of this documentation and what would really affect them and help them out to get these closings done more smoothly.

Mr. SPANO. When you say “streamlining,” are we also referring to differences in the process in regions around the country? Inconsistencies in the various regions around the country? Is that one and the same?

Ms. MANSFIELD. That has been my experience, that closing alone, for instance, in the New England area is different than my CDC counterparts in other parts of the country. We have a very good process where we are, but I have heard that is not the case throughout the country.

Mr. SPANO. And, Ms. Mirenda, is there anything as it relates to the various regions around the country that would justify or warrant, potentially, the differences and the inconsistencies around the country?

Ms. MIRENDA. I wouldn’t say so. I, you know—only, you know—I know, Mary, you are a multi-State. So, you know, for us, we are just Florida, so we deal with certain district councils, and we deal with the same ones, so our closing process is streamlined, as far as that is concerned.

Where I come into play when I talk about streamlining is we are an ALP lender, which is Accredited Lender Program, which means we go through a pretty intensive process to be an ALP lender with the SBA, I mean, from financials, to governance, to looking at loans. And because of that, we would hope that we would have some leniencies when we decrease a loan by \$4 to not have to go to the SBA for approval for those types of things.

Mr. SPANO. Uh-huh. Uh-huh.

Ms. MIRENDA. So, you know, just some leniencies there by being an ALP lender.

Mr. SPANO. Can you walk me through, just very quickly, a typical closing process and what that looks like and how—I mean, you just gave me one instance, you know, but how, if there was a streamlined process, how that would positively impact—

Ms. MIRENDA. Sure. So you have, you know, from application, you then get an authorization. Any changes made to that authorization is called a 327 action. So when you are in that process where you are from authorization to 327, any time there is an outstanding 327, lenders will not close the loan, because they want SBA’s blessing to make sure we are all good to close.

Mr. SPANO. Uh-huh.

Ms. MIRENDA. Obviously, you know the lenders are holding sometimes 90 percent of financing for up to 2 years. So that is a risk to the lender. So they want to ensure that SBA says, yes, that we are going to get to the finish line. And so, you know, those 327s can hold up closing.

Now, once we get all those approved, we go to closing, we fund, and we move on, and, you know, it goes to funding, and then we go to debenture or sale. But that can be a pretty long process. And, you know, I would say banks, credit unions, and third-party lenders want to ensure, you know, they are not in any kind of, you

know, high-volatility commercial real estate by financing up to 90 percent.

Mr. SPANO. Uh-huh.

Mr. Williams, you look like you had a—

Mr. WILLIAMS. Yeah, I will just add that, you know, there are various district councils that SBA has around the country that are involved in this process that receive closing packages from the CDCs around the country. And each of those councils has the discretion to have a cut-off date to receive closing packages.

So, you know, there is variance around the country to receive those packages, to get them into a funding cycle for the next available bond sale for us. So, you know, borrowers are treated, you know, disparately around the country because of that.

Mr. SPANO. And, to your opinion, have you been offered any explanation as to why there are these variances?

Mr. WILLIAMS. Not publicly anything from SBA.

Mr. SPANO. Uh-huh.

Mr. WILLIAMS. And that is part of the challenge, is that borrowers are treated, you know, disparately in that process. And each district council can also add, you know, other things that they might want to see outside of a standard checklist.

Mr. SPANO. Thank you.

Madam Chair, I yield back.

Chairwoman CHU. Thank you.

The gentleman's time has expired, and I would now like to recognize a member of our Subcommittee, Mr. Tim Burchett.

Mr. BURCHETT. Thank you, Chairlady. You got my name pretty close, so I am just going to—

Chairwoman CHU. I have learned my lesson.

Mr. BURCHETT. Thank you. Thank you. My wife has told me to quit doing that to you all, so I am not going do it. Just not going do it.

Thank you, Chairlady and Ranking Member Spano.

I always wondered, though, when you say, "I am going to recognize myself," why you don't say, "Self?", and then you say, "Well, thank you," and then you recognize yourself but you really don't. I just—it is one of my pet peeves I just want you all to know about, okay?

But thank you all for being here.

The 504/CDC loan goes a long way towards helping folks grow and economic development, and it creates jobs and helps our small businesses across the country, and I realize all that, but the folks in my district in east Tennessee use this loan program to do just that. And, with that, I have a couple of questions.

Ms. Fairman, can you share with the Committee what a small business experiences when they walk through your CDC? And who do they meet with? Who is their point of contact?

Ms. FAIRMAN. We have a staff of 15, and the small-business owner is introduced to one of our business development officers, who goes through the program with them and explains the rules and requirements to them.

So they work with someone who handholds them through the process and puts them at ease and reassures them that they don't have to worry about the rules and the regulations, that that is

what our organization does on their behalf, and we advocate for that business.

Mr. BURCHETT. Yeah. I would say it is kind of a daunting task when they walk in, a little overpowering, so I appreciate that very much.

Ms. Mirenda, you mentioned a few different success stories of small businesses that you all were able to keep afloat due to the loan program in your testimony. Is that a common situation for all the borrowers of 504 CDCs, ma'am?

Ms. MIRENDA. I don't know if it is common. I would certainly say that there is definitely a need out there for our small-business owners, especially when they are trying to expand and grow their business. Commercial real estate is a good investment for small-business owners, and they see that value as something that they can utilize and be able to continue to grow their businesses.

So I would say it is, you know—it is not common to—you know, we sometimes will—we will save a business owner for sure, where there is a business owner that—I have one in my written testimony, if you will read that. It was a refinance, and without that refinance, they would not be in business today. So that does happen on occasion for sure, and we certainly try to do what we can to help them.

Mr. BURCHETT. Do you all—and I come from, sort of, the Dave Ramsey, sort of—

Ms. MIRENDA. Oh, yeah.

Mr. BURCHETT.—you know, paying off. You know, I tried to spread those values to my family, which my wife agrees, so we get out of debt.

But do you all, you know—and I hear folks come in and they say, “Oh, it is not bad debt; it is good debt.” Well, to me, it is all bad debt. It is a sucker's bet, is what it is. Because, you know, the Bible says, you know, you are a slave to the lender.

And I wonder, do you all push that, the getting out of debt? Or do you just refinance?

You know, because I have talked to folks all the time and they say, “Well, I got a great deal on this car.” And then I say, “Really? How is that?” “Well, I refinanced and I got my rates lower than my last car.” But they are going to be paying for it for, you know, 672 more payments and that little beauty is going to be all theirs.

So do you all encourage paying down, or do you go the other route?

Ms. FAIRMAN. We always encourage repayment. But—

Mr. BURCHETT. Well, I am sure, but, I mean—

Ms. FAIRMAN. But—

Mr. BURCHETT. But getting out of debt and getting off the—

Ms. FAIRMAN. We all want the money back. But I think that, unfortunately, debt is required in order for businesses to grow. And so the mission of the industry is to put responsible, reasonably priced debt into the hands of small-business owners so that they have that opportunity.

And by the way the program is structured, whenever we make that debt affordable to them, they are able to save other cash for growing and helping the economy. So debt is a necessary part of business growth.

Mr. BURCHETT. You don't think it would be saving their own money and reinvesting and being intuitive about things in the way to go with their money is a better route than debt, though?

Ms. FAIRMAN. I don't. I think that for businesses that are starting out it is so expensive to buy real estate, it is so expensive to buy machinery and equipment. It is an expensive business climate, and businesses can't save up \$5 million to buy a new building. If we make this money available to them in a responsible manner, then we allow them to grow faster, with some assurance that we are going to get our money back.

The industry monitors portfolios well enough to know that we are doing everything we can to help those small businesses repay those loans.

Mr. BURCHETT. All right.

My time is up. Thank you, Chairlady, Ranking Member.

Chairwoman CHU. Thank you.

And we actually have time for a second round of questioning, if any of you have more questions. I certainly do, so I would like to ask these questions.

Ms. Fairman, I would like to go to the 50-percent occupancy issue. The current law requires 504 borrowers who purchase an existing building to occupy at least 51 percent of the building. But this requirement prevents small businesses from ever buying buildings with two floors that are evenly split.

Ms. FAIRMAN. Right.

Chairwoman CHU. So could you expound on the implications of this rule and what kind of situations businesses have found themselves in and if lowering the occupancy requirements would benefit the 504 program?

Ms. FAIRMAN. So the easy answer is, yes, it would help many small businesses be able to occupy buildings that they currently are not able to finance under the 504 program.

Basically, businesses nowadays function differently than when some of these rules were written, and while they might have been reasonable in that time period, they are not reasonable now. Businesses that need to buy multistory buildings in order to get into an area where they can better perform their services and provide economic benefit are limited by these rules that are so old and outdated.

Chairwoman CHU. Ms. Mansfield, there is even a more difficult situation in the urban areas, because the 50-percent occupancy rule would prevent business owners from having mixed-use developments, which is very popular right now, where businesses occupy the ground-floor storefront and there are apartment units on floors above.

How would a special rule allowing small businesses to purchase mixed-use buildings benefit small businesses in those urban areas?

Ms. MANSFIELD. It would greatly benefit the small businesses in the Boston and surrounding areas. Before coming here, I took a look at our statistics, and over the history of Bay Colony since 1981, we have only done 53 loans in the greater Boston area. And I believe, because of that, there are small businesses that we just weren't able to help.

Again, we see a lot of these mixed-use businesses where you have a first-floor commercial property and the second floor is an apartment, and with the current 51-percent occupancy rule, we just can't help them. And it is a shame.

Chairwoman CHU. This question is for both Mr. Williams and Ms. Fairman. 504 regulations limit small businesses to refinancing up to 50 percent of a project's cost, but there is confusion because the same rules do not apply for banks, which, of course, can go above 50 percent.

So could you describe how this limit impacts the ability of small businesses to pursue financing under 504?

Ms. FAIRMAN. It causes us to get into numbers and evaluations that are not helpful whenever we are reviewing prospective clients and businesses that need financing. Banks have a lot more flexibility and can do things that the program will not allow us to do with 504.

Mr. WILLIAMS. And I think that, again, there is confusion because this limitation is in the 504 debt refi with the expansion, and the limitation applies that there is a 50-percent cap of the debt refi, and the 50 percent applies to the new project cost. So it is always difficult to explain to a borrower and a lending partner, because it is just not a calculation that is intuitive or easily available in the marketplace.

So, you know, if you have a project that is \$500,000 in new project costs, you are restricted to only refinancing \$250,000 in existing debt. If you have a half-a-million dollars in debt on that project and \$500,000 in new project costs, then you have a problem.

You know, so you want to help the borrower, but you have restrictions, and it just complicates things. And it is not what the marketplace does.

Chairwoman CHU. Yeah.

Mr. WILLIAMS. And it is not what the other debt refi program does.

Ms. FAIRMAN. And if I can add, the irony is that the program is based on business expansion and growth, and it is the expanding business that faces the restrictions in being able to access the program fully by these rules that are in place.

And so it is counterintuitive that we want businesses to expand but, when they try to refinance their existing debt, we tie their hands and make it more difficult for them.

Mr. WILLIAMS. And, again, pursuing the mission of assisting small businesses, we are nonprofit lenders. Our mission is to assist small businesses while preserving the taxpayer. And so there are much better ways of going about doing that.

Chairwoman CHU. Thank you so much.

My time has expired, and now I would like to recognize the Ranking Member, Mr. Spano, for 5 minutes.

Mr. SPANO. Thank you, Madam Chairwoman.

Just playing devil's advocate—I am an attorney, and so I like to do that—what was, potentially, the rationale in preventing borrowers from jumping from 504 program and refinancing with one of the other government loan programs? Any ideas as to what that rationale may have been?

I have one in my mind, but I wasn't here during the history of the passage of the legislation. Any ideas on why they would have prevented that, if any, or do you think it was an arbitrary decision?

Ms. FAIRMAN. I am not aware of any explanation for that.

Mr. SPANO. Yeah. One thing that occurs to me is that maybe they wanted someone else to have an opportunity to have a government loan. Right? So someone has already received the benefit of a 504 loan, and now we are giving them a second bite at the apple, whether they probably need it, and I am sure in many cases they do. It is helpful. But that keeps someone else, some other small business out there who might benefit from a small loan—that is just a thought.

I don't know if you have any opinions on that. Is that a possibility?

Okay. All right. Good enough. You can only ask, right?

The other thing, too, is, getting back to the occupancy requirement—so we can probably, I think, all agree that 50/50 certainly should happen. Right?

I think you, Mr. Williams, said, well, it should probably be lower than that. So what should that number be in the best-case scenario?

Mr. WILLIAMS. I think we are open—as an industry, I think we are open to discussions with the Committee and trying to come up with something that might work in urban areas. I don't think we have, you know, something hard and fast in mind.

Just in multistories, that percentage is going to start going down pretty dramatically as soon as you add another story. But the reality is, small businesses operate in these buildings because of scarcity of real estate and the highest and best use of property. It is just a fact of the marketplace. But these small businesses still, you know, deserve access to financing and access to ownership.

So I think we would like to work with the Committee to come up with something that would work and still fulfill the mission of the program without jeopardizing the taxpayer. But I don't know if we have a hard-and-fast rule right now—

Mr. SPANO. Yeah.

Mr. WILLIAMS.—but I think it is certainly something that we can have a discussion about.

Mr. SPANO. Uh-huh.

Does anybody else have anything to add?

Ms. MIRENDA. I would like to add something.

Mr. SPANO. Yes, Ms. Mirenda?

Ms. MIRENDA. So one of the things that we have to do when you underwrite a small-business owner, we have to look at cash flow, right? In a 504, we can't take any cash flow generated from any business—so if they are at 51 percent and they are leasing out 49 percent, it doesn't matter what they are paying that business for lease, we have to underwrite it. It is a rule. We cannot take that, you know, lease.

So it protects us. At the end of the day, even if it is 40 percent, that is what protects and, I would say, makes the program great, because we are not lending to investors. That is the big concern, I think, for SBA, is we are not lending to investors. We don't want to lend to people who are just out there buying real estate, com-

mercial real estate, and leasing the whole building out. And so our small-business owner, we have to—we do site visits. There are things that we have to do to be a CDC to ensure that we are maintaining the integrity of the program.

Mr. SPANO. Yeah. Thank you. That is very insightful. I wasn't aware of that. So they have to be able to justify their ability to repay the loan based on the business that they are actually operating—

Ms. MIRENDA. Correct.

Mr. SPANO.—not some type of a real estate investment.

Ms. MIRENDA. Correct.

Mr. SPANO. Got it. Thank you.

Madam Chair, I yield back.

Chairwoman CHU. Well, thank you all so much. I want to thank all the witnesses for taking time out of their schedules to be with us today.

And I would like to make my closing statement.

SBA's loan program, including the 504 program, is designed to fill the gaps left by the private markets, providing loans to small-business owners who cannot afford or obtain loans from conventional lenders. The 504 program takes this one step further by targeting small businesses with unique capital needs—the purchase of major fixed assets, such as land, buildings, and equipment.

Ensuring that this program is effectively reaching and serving small businesses at this critical stage of growth is a priority of this Committee, and this hearing has provided important information and testimony that will help us do just that.

I look forward to continuing to work in a bipartisan fashion to enhance the 504 program and ensure that small businesses have access to affordable capital.

I would ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

And if there is no further business to come before the Committee, we are adjourned. Thank you.

[Whereupon, at 10:57 a.m., the Subcommittee was adjourned.]

**A P P E N D I X**



**“A Review of the SBA’s 504/CDC Loan Program”**

**Testimony before the House Committee on Small Business Subcommittee on  
Investigations, Oversight, and Regulations**

December 10, 2019

Submitted by:

Mary K. Mansfield, President & CEO

Bay Colony Development Corp.

230 Third Avenue

Waltham, MA 02451

Subcommittee Chair Chu and other distinguished committee members, good morning. I am Mary Mansfield and I am here on behalf of Bay Colony Development Corp., a certified development company headquartered in Massachusetts. I'm pleased to have the opportunity to discuss the economic development work our CDC does and jobs we help create, particularly with the 504 loan program, as well as the challenges we face.

**Background on Bay Colony Development Corp.**

I'd like to begin by sharing a little background information about our company and what we do in general. Bay Colony Development was certified by the Small Business Administration in June of 1981 to serve the small businesses of Massachusetts. At that time, Bay Colony had just two employees, including the company's founder. Over the past 38 years, we've grown to a staff of 15 full-time employees, dedicated to assisting small businesses in our communities. Over the past four years we've expanded our territory to provide 504 loans throughout Rhode Island, New Hampshire and Vermont. We also serve the small businesses of Connecticut in counties contiguous to Massachusetts. In addition, we've grown our product line to include microloans and grants to community revolving loan funds.

**Bay Colony Development'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. Our Board and staff believe that the best measure of success combines both the loaned dollars to our small business borrowers with the economic impact of that activity on the community. Here are the results:

<b>SBA 504 Loans</b>	<b>FYE 9/30/2018</b>	<b>Inception to FYE 9/30/2018</b>
Borrowers Assisted	116	1,599
SBA 504 Financing	\$59,050,000	\$763,955,000
Jobs Created/Retained	242	13,378
Loans to minority owned businesses	11%	10%
Loans to women owned businesses	18%	20%

I joined our CDC back in 1985 as the Office Manager – I was the third employee. Over the past 34 years with the company, my responsibilities grew to Portfolio Manager, Closing Manager, Vice President, Executive Vice President and now President and CEO of the organization. Working in so many roles has given me the opportunity to interact with thousands of small businesses and to watch firsthand how their dreams of expansion have come true. I still enjoy going out to loan closings to see just how excited the borrowers are to be moving into their new properties and how appreciative they are of the SBA 504 loan program. Today, Bay Colony has four Business Development Officers covering 47 counties in five states working with small business borrowers and helping them access the funds they need to grow and create jobs. I'm proud to say last year alone we connected 117 business owners with financing through the 504 Loan Program. These are businesses and jobs that otherwise would not exist. Driving around the local area, I love pointing out to family and friends the businesses I've helped over the years that are now pillars of the community, so much so that my family gets tired of listening to me!

#### **Background Information on SBA 504 Loan Program**

To provide background on the 504 loan program, SBA developed the 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 also allowed and can also include a limited amount of cash out for certain eligible business operating expenses. To be eligible for a 504 or 504 refinance, 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 \$75,000 in SBA financing. Alternatively, there are 13 public policy and community development goals Congress set that can be used to qualify the project under certain conditions. These are outlined at 13 CFR §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 funds a small business receives to finance a 504 project are typically split. A Third Party Lender (a participating bank, non- bank, or credit union) funds 50% and receives a 1<sup>st</sup> lien on the project assets, the CDC/SBA 504 loan funds up to 40% of the costs and receiving a 2<sup>nd</sup> lien, while the borrower/applicant injects an equity contribution of as little as 10%. The 504 loan is funded from a SBA-guaranteed debenture sold on Wall Street, not tax-payer dollars.

**Let me share with you a successful entrepreneur - Circle Furniture of Acton, Massachusetts**

In 2015, Bay Colony Development was pleased to assist Circle Furniture in the construction of the store's seventh location in Massachusetts. The story of their entrepreneurial success began over sixty years ago, when Harvard University students on a budget trekked to Robert Tubman's store in Putnam Circle. That's where they bought quality used and unfinished furniture for their dorm rooms that lasted well beyond their college years. Today, Circle Furniture continues to thrive, thanks to Tubman's sons Richard and Harold, with locations in Acton, Boston, Cambridge, Danvers, Framingham, Pembroke and newly opened Middleton.

The Tubman family has also crafted a reputation for Circle Furniture that includes an eclectic, contemporary selection, fast delivery times for made-to-order items, corporate philanthropy, support of the regional economy, and most of all, fun. Circle Furniture offers unique, quality furniture for contemporary and traditional homes. Much of the furniture is not only made in the United States, but it's made **locally** in Massachusetts, New Hampshire, Vermont and Maine. Circle Furniture is a firm supporter of New England-based wood furniture manufacturers.

Bay Colony was first introduced to Circle Furniture in 1999 when we assisted the family with the purchase of the Framingham store. Revenues at that time were \$8.3 million, and today they are in excess of \$16 million with the company employing 53 people. In addition to expanding the number of stores, Circle Furniture is also expanding into the next generation. Jessica Tubman, Harold's daughter, is in charge of business development, e-commerce, and creating and maintaining the company's website. Jessica started with the company in 2004 and took some

time off to obtain her MBA from Sloan School of Management in 2007, before returning to the family business in 2012. Richard's daughter, Erica, started dusting furniture in the store at the age of four and then spent her summers in the delivery department during her high school years. After moving back from California last year with her husband, she is running the sales floor for the Boston location. Erica said she was anxious to get back to working for a company that gives so much back to the community. Circle Furniture partners with local businesses to host events and fundraisers, and they use local vendors and manufacturers as often as they can. Over the years, Bay Colony has provided four SBA 504 loans to Circle Furniture for various locations and we look forward to working with the next generation of Tubmans on more stores.

#### **Opportunities to Better Support Small Business Owners**

The 504 Loan Program is a truly valuable tool for economic development and job creation throughout the country. However, it will be more valuable to small businesses with some updates, streamlines, and simplifications of the program. Let me highlight four areas among many where those opportunities are.

First, the closing process for a 504 loan can be cumbersome, lengthy, and inconsistent from borrower to borrower. There are several ways that the SBA and Congress can consider addressing this. First, minor changes to a loan that do not increase risk to the SBA should not have to go through a second SBA approval process for the changes. Rather, CDCs who have demonstrated reliability and quality when working with borrowers should be able to make these changes with their own authority. Some of these very minor changes all CDCs can currently do. However, there are additional areas where CDCs could have authority to approve changes. For example, changing typos in the name of a borrower or company, correcting the bank name, or adding an additional guarantor to the loan. I know of many of my borrowers whose closing process would have been more efficient if they did not need to get a second round of government approval. I think an example from one of my other colleagues in the CDC industry may best demonstrate how these minor reviews can delay small businesses from receiving their funds. During the last government shutdown when SBA was not open to do these approvals, one small business could not close their loan because it needed SBA approval to add periods to the "LLC" in their company name. Delays like this could result in our borrowers paying a higher interest

rate, forfeiting their deposits on the properties, or completely losing the properties if the sellers in the transaction are not accommodating. Allowing a CDC to perform a correction like this will help entrepreneurs move forward in their business without additional risk to the taxpayer.

Another opportunity to make the 504 closing process more efficient for small business borrowers is to streamline the closing legal review process. When a 504 loan gets to closing, it has already gone through the full SBA process and been approved by the Agency as a sound loan. The small business has then closed with the bank (Third Party Lender) and the bank's attorney has reviewed title and they've completed construction on the property, since all building and construction must occur between approval and closing on a 504 loan. The closing is the end of a long process, sometimes multiyear, process. As part of the closing, the small business again must submit business and legal documents. While there is an official list of documents borrowers need to submit for closing, experience has demonstrated that numerous SBA district offices routinely requires different documents. If SBA believes there is a material risk to the taxpayer dollars in the loan, of course we support a thorough review. However, the inconsistency in which SBA reviewer requires which documents, especially if documents are not related to the risk of the loan, means small businesses do not know what documents they must prepare and when they will truly close their loan. The deadlines for borrowers to submit their closing documents to SBA can also vary depending on which area of the country a borrower lives in. Making sure there are clear, consistent documentation rules and timing for these small businesses is critical to give them certainty and reliability in their business planning. These are entrepreneurs who have already had their loan approved by SBA and invested time and money into constructing or modifying their real estate. This is not the moment when we should let them down.

Beyond closing, a second challenge that limits the 504 program from reaching small businesses is occupancy requirements. In densely populated cities, the real estate options are limited. Entrepreneurs often must consider buildings that are two or more stories, but their business would occupy only the first floor. Right now, a 504 owner must occupy the majority of their real estate. That means if there is a two-story building with equal footage on the top and bottom floor, the building is not eligible because the first-floor business would only occupy 50 percent,

not the majority. If it is a multistory building where the business only needs the first floor, it is even farther from 504 eligibility. Because of these occupancy challenges, in the decades of Bay Colony's work with the 504 Program in Massachusetts, we have only done 53 loans in Boston. Boston and the surrounding communities have thousands of successful business and has a huge market that would be a boon to many small business owners. However, the 504 program is almost never a viable option because so few buildings can meet SBA's occupancy requirements. Making occupancy requirements reflect the true nature of real estate in urban and suburban areas will help the 504 Program support those entrepreneurs and the mandatory job creation that comes with receiving a 504 loan.

A third area where reforms will help small businesses is in disaster assistance. While disaster assistance is a large topic that could fill many hearings of its own, there is one narrower part I want to raise today. CDCs are required by SBA, but are also very eager to perform, "other economic development" as part of our mission, and fulfilling this is part of our annual reviews by SBA. Since we are mission-based lenders, this is something we do not do to check a box but because we exist to support our communities. During a disaster, we want to provide support beyond our community as well, both to small businesses affected by the disaster as well as our fellow CDCs in the disaster area. Removing any barriers to this assistance and ensuring this work qualifies as "other economic development" by SBA will only help these communities recover faster.

Finally, I want to touch briefly on the 504 program's policies that I'll refer to as "EPC/OC" policies. I know some of my colleagues on this panel will go into more detail about these, but these policies are ones that affect my small business borrowers as well. Briefly, many small businesses, on the advice of their accountants and lawyers, structure their business as an operating company, or OC, and an eligible passive company, EPC. The EPC owns the real estate while the OC is the company itself. In a 504 loan, both the OC and the EPC are equally responsible for repaying the loan, so there is no additional risk to the taxpayer in this business structure. However, SBA has added additional rules to 504 small business that have an EPC/OC structure. These rules limit their tax deductions, increase their legal liability, and prevent an EPC from having any other business. In addition, they go against conventional real estate practices.

These rules should be modified to allow small businesses to follow best practices in their business structure at no additional risk to the SBA.

**Conclusion**

By solving these problems, we will help our small businesses and our economy grow. As I stated at the beginning of my testimony, 504 borrowers are statutorily required to create or retain jobs for every \$75,000 they receive. The easier it is for responsible small businesses to access this program, the more jobs our country creates. It's that simple. I ask for your leadership and assistance in addressing these challenges and growing our economy.

Again, thank you for inviting me to testify today. I am happy to answer any questions.



Financing Real Estate for Mid-Atlantic Businesses

## **Review of SBA's 504/CDC Loan Program**

Testimony before the  
**U.S. House of Representatives**  
**Committee on Small Business**  
Subcommittee on Investigations, Oversight, and Regulations

**December 10, 2019**

Submitted by:  
**Wayne Williams**  
Senior Vice President & Senior Lending Officer  
Business Finance Group Inc.  
Fairfax, Virginia

Chairwoman Chu, Ranking Member Spano, and other distinguished members of the Committee, good morning. Thank you for inviting me here today to provide my testimony regarding the SBA 504 Loan Program and the work that my colleagues and I do every day pursuing of our mission to provide entrepreneurs and small businesses with access to affordable, responsibly unwritten capital that in turn promotes local economic development through job creation.

My name is Wayne Williams, and I am here on behalf of Business Finance Group, a non-profit certified development company headquartered in Fairfax, Virginia with offices in Maryland, West Virginia, and Washington, DC. I have been involved in the SBA 504 Loan Program since 1989. I began my career in commercial banking in 1987 and was initially a bank partner in the 504 program. I joined Business Finance Group in 1997, transitioning to the CDC side of the 504 loan program. I currently serve as Senior Vice President and Senior Lending Officer. Throughout my 32-year career, I have been active in management, marketing, loan structuring, and credit underwriting. As you heard from my bio, I also currently serve on the board of directors of the National Association of Development Companies (NADCO), the 504 industry's national trade association, where I am on the Executive Committee and was the immediate past Vice Chair of Regulatory Affairs. I am also a national instructor for NADCO specializing in the statutes, regulations, and standard operating procedures that govern the SBA 504 Loan Program.

**Background on Business Finance Group Inc.**

Business Finance Group (BFG) was originally organized in 1982 as a joint effort of the Fairfax County Economic Development Authority and the Fairfax Chamber of Commerce with a mission to provide creative financing solutions to help small businesses succeed and strengthen local communities by promoting economic development through job creation. Since 1982, BFG has grown from our initial single county to become a multi-state CDC with a professional staff of 26 employees assisting small businesses in Virginia, Maryland, West Virginia, and Washington, DC. Likewise, our board of directors has grown to a large, diverse group that reflects our trade area.

While our headquarters remains in Fairfax, Virginia, we now have strategically located regional offices in the Richmond, Virginia metro area; Norfolk, Virginia; the Baltimore, Maryland metro area; Washington, DC; and Hedgesville, West

Virginia, all staffed with local employees. As a mission-based lender, it is important that we reflect our local communities to not only better serve our small business clients, lending partners, and referral networks but to also ensure local presence, outreach, and connection to all areas where we are authorized to make loans, especially rural and underserved markets.

BFG has also expanded our product offerings over the years to better serve our mission and our small business clients. While the 504 loan program continues to be our primary financing tool, BFG also participates in SBA's Intermediary Lending Pilot (ILP) Program (since 2011) and SBA's Community Advantage (CA) Pilot Loan Program (since 2013). Both programs principally provide small loans for working capital and equipment for businesses that are not readily available from traditional lending sources but are essential for small businesses to grow and create jobs. These complimentary loan programs provide affordable capital to our small business clients to help responsibly bridge their credit needs until they become bankable for the next level of growth. As an aside, I strongly urge the committee to support making the Community Advantage Loan Pilot a permanent program. These loans, earmarked for very small businesses, are crucial to helping the most underserved markets. By making this program permanent, these small and start-up businesses can continue to access critical, reasonably priced capital paired with critical technical assistance to better assure long term success.

#### **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.

Business Finance Group is the #1 CDC in the Mid-Atlantic and a top 20 CDC in the nation (out of over 200 CDCs). 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.

In Fiscal Year Ending September 30, 2019, Business Finance Group authorized 102 SBA 504 loans for \$83 million supporting total capital investment of \$219 million and that in turn is estimated to result in total jobs created/retained of 1,418 in our local communities. Since 1982, BFG has assisted 3,116 small businesses with

\$1.8 billion in SBA 504 Loans supporting total capital investment of \$4.8 billion and total jobs created/retained of 41,170.

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, and the tenacious optimism and strength of our small business borrowers who open their doors daily in local communities stretching from the rural farmlands of Virginia and West Virginia to the urban centers of Baltimore and Washington, DC. I have seen up close how 504 lending can bring jobs to rural communities and be a catalyst for transforming once neglected urban cores.

The ability and obligation to measure economic impact differentiates SBA 504 lending from other SBA loan programs and from conventional loan programs. It's what makes 504 work – the 504 Loan Program promotes small business, stimulates economic development, creates and saves jobs.... **all while operating at zero subsidy**. As an industry, CDCs are extremely proud of that fact, but we are fully aware of our resulting obligation to assure that the 504 Loan Program remains on firm footing with prudent underwriting and responsible portfolio management.

To further differentiate us from other SBA Loan Programs and conventional lenders, CDCs are non-profit, mission-based lenders connected to their communities both physically and financially. We use our excess capital to support economic development in every state in which we are authorized to conduct business. Beyond SBA 504, many of my CDC industry colleagues run a variety of other programs to assist small businesses, including – lending programs like SBA ILP, Community Advantage, Microloans, USDA IRP loans, state and local loan programs, small direct loan programs; business incubators and accelerators; grant writing services and grant funding; and counseling services in partnership with Small Business Development Centers and SCORE chapters.

#### **Background Information on SBA 504 Loan Program**

I'd like to take a few moments 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 \$75,000 in SBA financing; projects for manufacturers are adjusted to one job for every \$120,000 in SBA financing. If the project will not qualify based on jobs impact, there are 14 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, opportunity zones, labor surplus areas.

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 1<sup>st</sup> lien on the project assets, the CDC/SBA 504 Loan funding up to 40% of the costs and receiving a 2<sup>nd</sup> 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. The 504 Loan is not financed using funds from the government. The CDC works with the applicant small business borrower to get the SBA 504 Loan approved, closed, and funded, and then the CDC provides loan servicing to the small business for the life of the 504 Loan. Let me share with you how some stories of how our small business borrowers have successfully used the SBA 504 Loan Program.

**Success Story – Greater Unity Adult Services, LLC – Richmond, Virginia**

Business Finance Group has had the pleasure of working with Eugene Thomas, Jr. and Greater Unity Adult Services in Richmond, Virginia on multiple occasions. Greater Unity provides training, treatment, and support for adults with disabilities. The company provides skills training in the environments where the individuals will live and work. Individuals with intellectual disabilities, mental illness, or physical challenges utilize the company's Day Support Program facility to develop soft skills and become more independent in a structured classroom setting. The company provides long-term and temporary care for individuals with intellectual disabilities in a variety of assisted living residential care homes. And

the company is now offering employment services (recruitment and job screening and job training) ultimately placing individuals with disabilities in competitive employment integrated with non-disabled individuals.

Greater Unity is the quintessential SBA 504 story – a growing small business needing to preserve capital to grow and expand. Greater Unity has used the SBA 504 Loan Program to finance six of its facilities, and it has used the SBA ILP Loan Program three times for short term working capital needs. When Business Finance Group first started working with Eugene in 2012, he had two locations and 10 employees. Today, the company has 8 locations and 60 employees.

#### **Other Success Stories**

There are many 504 success stories. Local names that you might recognize – Schneider’s Liquors of Capitol Hill, Bourbon, Dolcezza, Nellie’s Sports Bar, Old Town Trolley Tours, Pizzeria Paradiso, Pacers, Ambar Capitol Hill, Bus Boys and Poets, Black Cat, and Silver Diner. Others are national successes such as Chobani Yogurt, Fat Boy Ice Cream, and the local Sunrise Senior Living and Port City Brewing Company that at one time could not find financing outside SBA 504, but because of the program, they are all now household names.

#### **Recommended Changes to the Program**

I applaud the Committee’s efforts to modernize SBA and keep it relevant to America’s entrepreneurs and small businesses. While the SBA 504 Loan Program is a valuable tool for economic development and job creation, small businesses who want to use the program face unnecessary challenges, and there is room for improvement with a goal to increase speed, transparency, and certainty for all stakeholders involved – the small business applicants, the CDCs processing the 504 Loans, and the Third Party Lenders partnering in the SBA 504 projects. The challenges and suggestions outlined below are focused on reducing overly burdensome and cumbersome regulation and modernizing the loan delivery system. All will improve program reputation, integrity, and usefulness to America’s small businesses while appropriately managing risk exposure to SBA and the American taxpayer.

1. **Reduction in Owner Occupancy Requirement** – Occupancy standards are a problem that prevent or limit the ability of small businesses to use the SBA 504 Loan Program particularly in more densely populated suburban

communities and urban cores with multi-story buildings and limited real estate inventory. Current statute requires a 504 borrower who purchases an existing building to occupy 51% of that building (not 50.9%, it must be 51% or more). In many suburban and urban areas, it is common to have 2-story buildings where the first floor may have commercial zoning, but the second floor is residential zoning. If the floors are of equal size, the commercial occupancy is 50%, and the project is not eligible for SBA 504. Even if the property is a live-work unit and the owner lives in the residential space, the project is still not eligible for SBA 504, as SBA only allows residential space to count toward the 51% owner occupancy requirement if the residential space is “essential” to the business – the business by its nature or my local jurisdiction code requires someone to be on sight at all times (i.e. a horse-boarding facility requires someone on premises at all times to care for the horses; many jurisdictions require resident managers for a bed and breakfast operation). And if the building is multi-story where the business only needs the first floor, the project is further removed from SBA 504 eligibility, as occupancy can drop to 20-30%. This becomes an increasingly larger concern for our urban core small businesses in areas such as Washington, DC; Baltimore, MD; Richmond, VA; and inner suburbs like Alexandria and Arlington in Virginia; and Bethesda in Maryland – particularly areas where the commercial space is restricted to the ground floor and upper levels are typically residential rental units. These buildings are ineligible for SBA financing, and their mixed use nature prevents them from qualifying for more traditional credit programs, making it very difficult for business owners to get financing of any kind when seeking to acquire their space and control their occupancy and overhead costs.

Our CDC has not historically tracked the number of small businesses that we could have helped purchase properties in these situations, as these projects have never been eligible for SBA 504 financing. Anecdotally, we know that there is a large pool of potential buyers who could benefit from the SBA 504 Loan Program if the occupancy requirement was relaxed. Our urban core markets like Washington, DC and Baltimore, MD and their inner suburbs are home to thousands of successful small businesses. Relaxing the occupancy requirement to 20% or 30% will better reflect the reality of real estate in urban core and inner suburban communities and the nature of how business is conducted in these areas, and it will expand CDCs ability

to support the credit needs of small businesses seeking long term capital to purchase these properties for their business use. We regularly see transactions that are 50%/50% evenly split 2-story buildings.

A relaxed occupancy requirement will create a couple of associated challenges that will need to be considered, as many of the issues here are intertwined. By their very nature, these properties will have more third party tenant rental space which will exacerbate the EPC-OC lease restriction concern (detailed below) which will need to be relaxed. Also, the SBA's credit standards require that the Small Business must support the debt service on the entire project without any contribution from third party rents. This will need to possibly be reevaluated considering a higher portion of the property will be dedicated to third party tenant space.

2. **Changes to Restrictions on EPC-OC** – Another policy unnecessarily harming small businesses is SBA's restrictions on the relationship between Eligible Passive Companies and Operating Companies, or EPCs and OCs. This business structure is common and provides benefits recommended by accountants and lawyers. However, EPC/OC relationships within the 504 program have their rent structures dictated by SBA, their lease structures dictated by SBA, and restrictions placed on other business activities outside of the 504 loan project. All of these are outside the norm of conventional commercial business practices and come at the detriment of the legal and tax advice these small businesses receive. A small business who structures their business this way should not be penalized by the SBA.
3. **Change to Small Business Ownership / Management Control percentage threshold to qualify for public policy goals for SBA 504 Loan Program from 51% to 50%** – This change will expand access to capital by allowing more small businesses to qualify for the 504 Loan Program under certain public policy goals when their project does not meet 504's job creation/retention goals, provided the CDC's loan portfolio meets its job opportunity average. Expanding access to capital to more economically and socially disadvantaged small businesses increases economic vitality, community development, and job creation throughout the country. Like Congress and SBA, Business Finance Group has a commitment to offering financing programs that promote the vitality and expansion of economically and

socially disadvantaged entrepreneur businesses, including women, minorities, and veterans. However, SBA's current minimum 51% ownership and management control benchmark may not always accurately capture the changing complexity of America's small businesses.

For example – a small business is owned 50% equally by two partners who are both active in all daily management; one is a Black female, while the other is a White/Caucasian male who happens to also be a veteran of the US Navy. The small business is 50% woman-owned, 50% minority-owned, and 50% veteran-owned, yet it does not meet any existing public policy goals for an SBA 504 Loan. Assuming the business does not meet the job creation requirement or any other policy goals, this business is not eligible for an SBA 504 loan. Surely this is a business we want to encourage lending for, not shut out based on a 1% difference in ownership.

4. **Streamline Closing Process** – My colleagues on the panel will be providing more detailed information on this recommendation, so I will keep my comments brief. In order to improve program delivery, speed loan closing and funding, and improve service quality to our small business borrowers, we recommend several improvements in the closing process –
  - a. Delegate authority to ALP CDCs (high performing CDCs who pass certain established competency and performance requirements and benchmarks) to approve specific minor changes to the SBA approval, eliminating the need for SBA personnel to review non-substantive changes, creating greater efficiency and cost savings for SBA, and avoiding delays in the debenture funding process that could be costly to small business borrowers
  - b. Streamline and Simplify the Legal Review Process by standardizing documentation as much as possible nationwide and removing all superfluous documents added by local SBA district counsel
  
5. **504 Debt Refinance** – Minor changes to the 504 debt refinance programs (with and without expansion) could increase the usefulness of the programs and allow more small businesses to benefit from the programs' below market, long-term fixed interest rate and unlocked trapped equity tied up in real estate to finance growth and expansion.

- a. **504 Debt Refinance with Expansion** – this program was our original debt refinance program authorized in 2009 where Congress allowed small businesses to refinance a limited amount of pre-existing debt not to exceed 50% of the cost of any new expansion project. This has always been a restrictive limitation that was difficult for small businesses and lending partners to understand and reduced utilization of the program. While there is a cap of the amount of debt that can be refinanced into a new 504 project, the program still allows any excess debt refinance above the cap to be refinanced by the bank partner and simply added to their final loan amount in senior lien position. So, the artificial cap is confusing to explain and implement, it restricts SBA's participation in a project, and it diminishes SBA collateral position relative to the senior lender. I would recommend a minor tweak in the program to allow the existing debt to be refinanced provided it does not exceed 100% of the costs of the new expansion project. This will significantly improve the usefulness of the program to small business applicants.
  - b. **504 Debt Refinance without Expansion** – Our CDC gets multiple calls every week from referral sources and potential borrowers who would like to use this program, but current restrictions prevent the program from helping as many small businesses as it could. To unlock the program's potential and assist small businesses get access to long-term, below market, fixed rate financing –
    - i. Allow SBA 504 to refinance any government guaranteed debt
    - ii. Reinstate the alternative job retention goal to assist more small businesses qualify and for and reap the benefits of the program
    - iii. Remove all restrictions on the number of refi loans that a CDC can provide; CDCs ultimately exist to serve small businesses, and providing appropriate lending options helps to fulfill that mission
6. **SOP Reform** – Many policies and procedures that govern the 504 Loan Program are part of SBA's Standard Operating Procedures (SOP). This document, over 400 pages, is updated and re-released almost every year. It contains almost every detail necessary to get a 504 loan to a small business. However, it does not go through the regulatory notice and comment

process, which means small businesses and CDCs like those at this table do not have a chance to share their perspective on these policies and the problems that changes can unintentionally cause, despite being the ones who are affected by them. This leads to unnecessary confusion for small businesses, and a switch in the “rules of the road” sometimes without an explanation from the Agency. I think there could be a more collaborative way to issue these policies while ensuring small business voices are heard. Below are a few ideas to start that discussion –

- In the brainstorming/drafting phase of a new SOP, SBA discusses key concepts and issues under review for change (ideally with trade associations who speak for those using the loan programs)
- SBA releases the SOP with a 30 day comment period
- At the end of the 30 day comment period, SBA has 30 days to make revisions and publish the final SOP
- The SOP implementation date is no less than 30 days from final publication
- Implement a requirement on how frequently SBA must update SOP so the opportunity for small business feedback and modernization of program policies occurs regularly

7. **Personal Resources/Credit Elsewhere** – SBA has recently reinstated a policy that means borrowers can be forced to take funds from personal liquidity held for children’s educational or family health savings and invest in a 504 project. Currently, SBA personnel are inconsistent and unpredictable in implementing this issue which can lead to loan screen outs and declines. This impacts the consistent delivery of the 504 Loan Program and the injures program’s reputation contributing to uncertainty with small business borrowers and third party lending partners. While there has been some improvement from time to time with SBA, there is no predictability to SBA’s concern over the issue.

From April 2014 to December 2017, SBA had a great policy on this issued through a “Final Rule” that eliminated the Personal Resources Test and made clear that in respect to funds otherwise available to support the project, only non-federal financing would be examined, not personal resources. It meant there were healthy borrowers who also of course contributed to the 504 Loan. SBA had no problems with any loans as far as

we know. We would like to return to that policy. However, SBA is now suggesting in a proposed rule (the "Express Rule"), that it wishes to reinstate a personal resources test to be applied to the 504 Loan Program that the agency specifically eliminated in 2014 and promised not to reinstate.

Reinstating this requirement would harm small business owners. The proposed regulation does not adjust for personal circumstances that require liquidity, such as cost of living (which varies significantly throughout the country), childcare, health care, and education needs (such as college tuition for children). The regulation also does not adjust for the variety of business needs, such as business development and training, other business opportunities that may arise, market changes, or increased competition, all of which require liquidity. As a result, the small business that must abide by this will lack the necessary capital required for growth, job creation, and continued economic development within its community and beyond. Finally, the proposed regulation disincentivizes prudent business practices and penalizes small business owners who are economically prudent and are reserving funds for future market changes, expansion, and growth.

Reinstating a requirement that SBA eliminated just 5 years ago promising in writing to never bring back, demonstrates SBA's inconsistency in delivering its loan programs and damages the 504 Loan Program's reputation with small businesses and third party lending partners. Also, in reinstating a personal resources test to 504 loan program, SBA appears to be extending to 504 a policy that specifically applies to one of its other loan programs and is not applicable to 504, a habit of theirs and one we have never supported. The 504 Loan Program is all about economic development and job creation.

Having the committee explicitly remind SBA through statutory language if needed, that in respect to funds otherwise available to support the project, only non-federal financing would be examined, not personal resources.

8. **504 Express Loan Program** – Modernization also means looking at ways to speed up low dollar, low risk loans to small business owners, to help keep them from predatory online lenders. These lenders charge exorbitant

amounts, but small businesses sometimes are trapped into accepting their help because no timely alternative exists.

9. **Community Advantage** – Although not a part of SBA 504, I wanted to add a few suggestions here for improvements to the SBA Community Advantage Loan Program to make the program more useful to small business applicants –
  - a. Make CA permanent loan program to improve consistency and reliability for small businesses and bank lenders
  - b. Add women and minorities to “underserved” communities to expand small businesses that can be served

Beyond statutory changes, SBA controls the 504 Loan Program and its usefulness to small business through its regulations, policies, and procedures. We all strive to be prudent, responsible lenders in assisting our small business clients. All lending involves risk. Our job is to properly assess, manage, and mitigate risk. We cannot eliminate or avoid risk and remain in the lending business. In our opinion, SBA through its recent actions with policies and procedures, has been pursuing more risk avoidance than risk management. The result is a decrease in the usefulness and effectiveness of the agency’s lending programs to small business and lending partners.

As we all strive to make SBA and its loan programs relevant to a dynamic, changing marketplace and business environment, I remain hopeful that we all share the same goal to better serve America’s small businesses with responsive, relevant, and innovative lending solutions. Reducing burdensome regulation and streamlining and modernizing program delivery will help improve the SBA 504 Loan Program.

Thank you for the opportunity to submit testimony, and I am available to answer any questions or provide additional information.



**Testimony before the House Committee on Small Business  
Subcommittee on Investigations, Oversight, and Regulations**

December 10, 2019

Submitted by  
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Business Expansion Funding Corporation (BEFCOR)  
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Representative Chu and other distinguished committee members, good morning. I am Elaine Fairman and am here on behalf of Business Expansion Funding Corporation, a CDC in North Carolina. I am pleased share with you the jobs and economic development we bring to many communities, particularly with the 504 loan program, as well as the challenges we face.

Business Expansion Funding Corporation, known as BEFCOR, was created by the City of Charlotte in 1982 to operate a city-wide CDC. Later, the organization became statewide, serving all of North Carolina and portions of upstate South Carolina. Today, we have a staff of 14, in 3 offices, and we have led the state in lending to 504 borrowers for 8 years. In 2016, we merged with another non-profit CDC and absorbed a portion of a third CDC, allowing us more resources and reach to better serve North Carolina's entrepreneurs.

In addition to the SBA 504 program, our CDC operates a Small Business Loan Fund, capitalized by a generous grant from the Golden LEAF Foundation. The SBLF program provides financing for businesses in rural and hurricane-impacted areas. In the last 18 months, we have loaned nearly \$500,000 in small amounts to emerging and expanding companies. We are currently seeking other loan program options to allow BEFCOR to serve even more small businesses.

As you know, 504 is SBA's economic development loan program. SBA 504 borrowers are required by statute to create or retain jobs, or meet certain public policy goals identified by Congress. The CDC industry is proud that we are currently assisting small businesses with this program at zero subsidy - this program is self-funded. CDCs assist numerous small businesses, including manufacturers, distributors, retailers, professional offices and many others. Both new and expanding businesses are generally eligible, and this program is the reason many businesses are able to grow.

I entered the SBA lending field in 1987, working with a small CDC in South Carolina as a loan officer. That CDC was affiliated with a Council of Government and I began my career knowing that small business lending was not just about lending – it was also about economic development. That attention to economic development formed the way I view SBA financing. I left that CDC in 2007 to join a large organization, Self-Help Ventures Fund, in their Charlotte, NC office. I left Self-Help in 2012 to become the Executive Director of BEFCOR. I have worked in nearly every facet of the SBA 504 world – marketing, packaging, underwriting, closing, servicing, governance, compliance, oversight, advocacy, and more. In addition to 504 loans, I have worked with EDA, USDA, and privately-funded loan programs. I am proud to be serving my second term as a Board member and the Treasurer for the National Association of Development Companies, the trade association that serves the CDC industry. Needless to say, I am passionate about my work – I truly believe this work matters. I consider it a privilege to work with small businesses and with others in my CDC who are deeply committed to making a difference for small business owners. When a business owner acknowledges the impact that BEFCOR has made on her business and future, I know that our efforts have succeeded.

I would like to share stories of two successful entrepreneurs assisted by BEFCOR through the 504 program. One is a catering business that began in 2010 and soon had offices and kitchens in multiple locations. In 2014, a SBA 504 loan approval allowed this young business owner to unite all business operations under one roof. This project improved efficiency and quality, and the company's workforce tripled. Because the business was relatively new, SBA 504 financing was needed. Now, not only is the business very successful, it is a community-minded company, offering discounts to help many non-profits in the area. The business owner

has been such a leader in our business community that BEFCOR nominated the owner for Small Business Person of the Year for North Carolina – we were elated when he won in April 2018.

Another example of the power of the 504 program is a minority female physician who started her practice in 2010. Her goal was to provide an array of therapy and counseling services to the underserved communities in the Raleigh-Durham area. As her practice expanded, she had to relocate every few years in order to accommodate the growth. Finding appropriate space and negotiating terms with landlords for her business' changing needs began to take too much of her time. And, her customers had to keep up with her new locations. A 504 loan allowed her to purchase her own office space, providing stability for both employees and clients. She learned that owning her own building was actually less expensive than paying rent. With her new office space, the physician has continued to grow her practice and she has hired additional staff to keep up with demand. Today, she has six employees on site, and eight outpatient therapists.

While the SBA 504 program has helped numerous businesses thrive, there are policies in place that prevent us from supporting even more businesses.

One of the issues adversely impacting 504 borrowers is what we call the “EPC/OC rules.” Initially included in the program’s parameters as a way to insure that 504 loans benefit operating businesses instead of developers or investors, the rules have not been updated to reflect common business practices. Often considered “too cumbersome” or “too confusing” to address due to the nuances, details, and complexity, EPC/OC rules are in dire need of revision. The fact that it is too difficult to explain is a clear indicator that it needs to be revisited. Yet we continue to pass opportunities to develop a simple fix to an old problem – I believe the time has come that we MUST address the EPC/OC rules for the benefit of small businesses. These rules are an

impairment to accessing SBA loans and unfairly restrict our borrowers' ability to write off expenses afforded to other businesses.

One EPC/OC rule is used to dictate the lease between an operating small business (the OC) and the separate legal entity formed to hold title for the real estate that business purchases (the EPC). Normally, both have similar or identical ownership, and the business uses this structure for business management purposes. The rule, originally designed to ensure that developers and investors do not benefit from SBA 504 loans, mandates unreasonable limits on the rent payments from the OC to its EPC. The control on rent forces small businesses to lose depreciation as a deductible expense and means that lease payments between the OC and its EPC are often determined by the loans that funded the building, instead of being determined by market rates.

The problem with this EPC/OC rule is not only that it dictates lease payments but it also creates ripple effects on basic business decisions that small business owners make. When SBA mandates how much rent can be charged under certain business formation structures, it is effectively interfering with tax strategies, management strategies, and advice of the business' advisors (such as CPAs and attorneys). So many entrepreneurs risk their own financial resources to make their businesses succeed, give up time away from families to launch their companies, and then they personally guarantee their business' debt. The EPC/OC policy, with so much control over the business, seems to be a grievous overstep.

Recently, a borrower that had previously used the 504 program to expand geographically and open additional locations requested financing for a new location. His early loans were very successful for the program's mission, creating jobs and providing services in his local community. However, when he applied for another 504 loan to continue growing, he reached the

EPC/OC hurdle. Because SBA believed the business had not complied with EPC/OC rules when it reviewed his previous loans, the borrower was told to either comply or be denied financing for the new project. This business is the very type of growing, job-creating business that communities want and we strive to serve. In fact, the business had already demonstrated a track record of success within the program, and not a record of risk.

Beyond the rent structure I just outlined, rules governing small businesses with an EPC/OC structure also dictate leasing agreements 504 borrowers have with third parties that are leasing space in their building. In addition, EPCs are prevented from holding other OCs beyond the single one involved in their 504 loan. Similar to the rent issue I already discussed, these requirements routinely go against the advice small businesses receive from their advisors such as accountants and lawyers and do not reflect standard business practices in the industry.

The EPC/OC structure does not impose undue risk on the 504 program. The rules were designed decades ago to address a “then-present” concern that investors or developers would exploit the program. However, over many years of working with the 504 program, it is clear that these fears are unfounded. In addition, when a 504 loan is made to a small business that is using an EPC/OC structure, both the EPC and the OC are obligated for the loan repayment. This is not a structure that allows either of them to avoid their obligation to responsibly manage their government-guaranteed loan. These rules present unnecessary barriers to our ability to serve more growing businesses.

In addition to the EPC/OC rules, the owner-occupancy rules impose additional challenges to small businesses who could benefit from the 504 program. They are inconsistent and have no clear reasoning. Currently, if a business **buys** an existing building using a 504 loan, it can lease up to 49% of the building to another business. However, if a business **constructs** a new building

using a 504 loan, it can only lease out 40% for a few years, and then 20% long-term. Once again, these rules are not based on risk mitigation or sound lending – they are arbitrary. Most business owners do not desire to be landlords long-term, so why does buying an existing building or constructing a new one change the amount or length of time they can lease? These occupancy percentages also do not reflect the reality of how existing buildings are laid out. If a business buys a building with two stories, each of which has the same amount of square footage, it cannot have a 504 loan for the purchase; however, if the downstairs has a few extra feet to allow the business to occupy 51% of the building, it can. These occupancy rules should be harmonized and reflect a maximum 50% owner occupancy requirement. In densely populated areas, the Committee could consider making the occupancy requirement even lower, given the limited real estate options and the many multistory buildings in these areas.

Another matter of concern for small businesses who want to access the 504 program is the onerous rules to refinancing existing debt. We appreciate the excellent work of this Committee from 2010 through 2015 to make refinancing permanently available to small business owners. However, some of the regulations implementing that statute have limited its effectiveness. Refinancing through conventional channels has long been a challenge for many small businesses – newer businesses, certain industry sectors, and during times of economic volatility. When reviewing whether a loan secured by fixed assets is eligible for refinancing with a 504 loan, CDCs are required to obtain certification that 85% of the debt was originally eligible for a 504 loan, that only 20% of the refinanced amount can be used as cash for the business, and other confusing percentages. Additionally, expanding businesses are limited by the 504 program to refinancing existing debt of no more than 50% of the cost of the new project. Refinancing is another example of seemingly arbitrary percentages that restrict growing, expanding businesses

that are the very foundation of our program – everything we do encourages businesses to expand – yet, the rules tie their hands when they are refinancing an expansion. Rules should be tied to the mission of this program and the risk to the government. Right now, these rules seem to be tied to neither.

Finally, I want to highlight one more issue that is a severe detriment to small business borrowers in the 504 program. The SBA 504 was designed to stimulate economic development and to ease access to capital for growing businesses. When I entered the world of SBA lending, the first thing I learned was why the program exists: job-creating businesses fuel the economic engine that allows people to buy homes, educate their children, and live productive and satisfying lives. While home ownership has often been dubbed the American Dream, it is not a sustainable dream if homeowners cannot find jobs in their communities. The 504 program was designed from inception to be an economic development boon to communities by easing the pain of borrowing money for small businesses. We know that low-cost, low interest rate, low down payment financing accelerates the growth trajectory for many businesses, allowing them to grow faster and on solid footing. However, recent rule changes in how loans are reviewed may raise questions about whether we have forgotten the principles of the 504 program.

CDCs are now required to evaluate the on-hand cash of the business, disregarding what it may need for operations. If a business owner has personal cash on hand for savings, instead of being able to invest those funds in an IRA, she may be required to use those funds in lieu of an SBA loan – in fact, savings for her children’s education can be required to be used for business purposes. We all tell children from an early age to make sure they have a rainy day fund for life emergencies that are inevitable. Why wouldn’t we want our small businesses to plan the same way? A business owner with no “cash cushion” or “rainy day fund” to help get her business

through the loss of a contract or a market fluctuation could receive a 504 approval while that same business that has some “cash cushion” savings might not be eligible. To say that we would fail to assist the business owner who has made better decisions and would be a better credit risk is most definitely counter-intuitive – perhaps, some would consider it a poor lending practice. To penalize a small business owner for caring about her business enough to sacrifice and reserve personal funds to support their business simply seems wrong.

Small business owners should absolutely use their funds as a down payment on a 504 loan, but not to the point that the financial health of their business is jeopardized. Any policy that requires that owners deplete their cash will harm the business, its employees, and the likelihood repayment on a 504 loan.

In all of the percentages, program improvements, statistics and definitions that are shared when the 504 program is discussed, I hope we can maintain clear sight of the extraordinary work the 504 program allows CDCs to perform on a daily basis in conjunction with the Small Business Administration as our partner. Small business are the lifeblood of our economy. At the core, small businesses are not inanimate objects – they are people taking ideas and solving problems, people providing meaningful jobs and advancement opportunities to others, people paying taxes to pay for services in our communities, and much, much more. If we are willing to improve the 504 program by working together, we can expand our reach and impact. I stand ready to assist in any way in finding improvements to the 504 program.

I thank you for your time today and welcome your questions.



Testimony of:  
**Brooke Miranda**  
 President & CEO  
 Sunshine State Economic Development Corp.  
 Clearwater, Florida

**"A Review of SBA's 504/CDC Loan Program"**  
**US House of Representatives Committee on Small Business**  
**Subcommittee on Investigations, Oversight, and Regulations**  
 December 10, 2019  
 10:00 am

Representative Chu and other distinguished committee members, good morning. I am Brooke Miranda and I am here on behalf of Sunshine State Economic Development Corporation in Florida. I'm pleased to have the opportunity to discuss the economic development work our CDC does and jobs we help create, particularly with the 504 loan program.

I would like to share a little bit of background on our company. In the early 1980s, two CDCs were established in the Tampa Bay area, GulfCoast Business Finance and Tampa Economic Development Corporation. In 2016, SBA approved a merger between these two CDCs, creating what is now known as Sunshine State Economic Development Corporation (SEDCO). SEDCO is headquartered in beautiful Clearwater, Florida and is one of four CDCs that operate within the State. We have business development officers strategically located in Orlando, Tampa and Miami who work closely with third party lenders, small business owners and other economic development organizations to meet the financial needs of small businesses.

SEDCO is considered a mid-size CDC and we have seen significant growth over the last several years. We have remained a top 50 CDC over the last couple of years and the most recent statistics have placed us in the top 20. While the 504 Loan Program is our primary focus, we also offer other loan programs to meet the demands of our small business borrowers. This includes the SBA Intermediary Lending Pilot Program (ILP) and the SBA Community Advantage Loan Program (CA). Outstanding loan balances in these programs are approximately \$650,000. SEDCO also utilizes its own resources to offer financing to small business owners through a Women/Minority/Veterans Loan Program and SEDCO Loan Program, with balances exceeding \$2.3MM. SEDCO believes that our coordinated lending alternatives are essential in helping small businesses grow and create jobs. Our successes are below, but the successes in economic impact from all these programs stretches even farther.

<b>SBA 504 Loans</b>	<b>FYE 9/30/2019</b>	<b>Inception to FYE 9/30/19</b>
Loan Approvals	37	1,102
Authorized Debenture Amounts	\$30,824,000	\$567,374,000
Loans Funded	24	920
SBA 504 Financing	\$14,912,000	\$465,442,000
Jobs Created/Retained	247	9,087

Through a combined effort of the Board of Directors, the leadership of our management team and our splendid staff, these results illustrate our vision in economic development, which strengthen and promote small business lending.

I joined the CDC in 2016 as Vice President, Business Development Officer after 15 years in the financial services industry, primarily in mid and executive level management. In the first two years at SEDCO, I was the highest performing Business Development Officer, generating 44 loan approvals totaling over \$33 million in loan authorizations. I had the privilege of working with small businesses owners around the state, helping them access funds they needed to continue to grow their business and create more jobs. In November 2017, the Board of Directors appointed me as the President and CEO. In 2018, I was named as The Coleman Report's SBA Woman Lender of the Year. As SEDCO President, I continue to be intimately involved in helping small businesses reach their maximum potential. The SBA 504 loan program not only creates jobs in our economy, it also offers up competitive rates and terms for our small business owners, which helps preserve capital and grow their businesses, while still operating at a zero subsidy.

I want to turn my attention to the work our CDC does with the SBA 504 loan program in particular. We have worked with banks, credit unions, and non-bank lenders throughout the State of Florida to offer a solution to small business owners that is not only attractive but leverages them in a way conventional financing cannot. Our business owners are able to retain capital and utilize their own resources for expanding their businesses and creating jobs. Let me share with you a couple of successful entrepreneurs whom SEDCO was able to help by securing commercial real estate with less money down and long-term fixed rates.

#### **Fort Myers Restaurant Success**

A husband and wife had a dream of owning their own business and being their own boss. They had experience in the restaurant industry and in September 2011, acquired a café in Fort Myers. Since then, they have grown the fledgling coffee shop into a popular full-service café. The original coffee shop was already well known for their delicious bagels, homemade Liege waffles, and gourmet coffees and beverages. They operated the café under a month-to-month lease at its original location in Fort Myers Beach, Florida until their lessor unexpectedly sold the property in the fall of 2017, giving them a short window to vacate their restaurant space.

They quickly identified a new restaurant space to rent, but unfortunately, Hurricane Irma hit the Southwest Florida coast as a category-3 hurricane before they could complete their relocation. Hurricane Irma was one of the costliest storms to hit Southwest Florida and the most powerful Atlantic hurricane in recorded history. An estimated 65,000 structures in West and Southwest Florida were damaged or destroyed. Our clients faced this destruction firsthand when the relocation to their new café was significantly delayed due to severe damage caused by Hurricane Irma. The sudden economic impact of a decline in diners and tourists also negatively impacted their business, as tourism to the Fort Myers Beach area halted and many of the local residents were recovering from the storm themselves.

SEDCO partnered with a third-party lender to offer them an SBA 504 loan that would allow them to complete their relocation and make the necessary repairs to their new, much larger restaurant space. With this loan, they were able to reopen as a full-service restaurant that began serving lunch and dinner in addition to their already popular line of bagels, Liege waffles and gourmet beverages. To accommodate this business growth, they created an additional 7 jobs.

Not only did this small business persevere in the wake of Hurricane Irma and the subsequent impact to the hospitality industry, they have prospered in their new location, thanks to the SBA 504 loan that the lender and SEDCO helped them secure.

#### **Refinancing Success**

A small, yet impactful, weight loss clinic in Florida was in jeopardy of losing its business property in early 2019. The owners suffered through a financial hardship in the years following the Great Recession and banks were reluctant to lend to them. This forced them to use non-bank lenders to finance the real estate for the clinic they operated. Non-bank lenders typically issue higher interest rate loans with shorter maturities and charge higher fees.

With a profitable business such as this weight loss clinic, a more expensive loan is not necessarily cost prohibitive. However, our borrower's problem was that their note was coming to maturity with a balloon payment (as is typical in commercial lending), but their lender was disinclined to refinance or extend the maturity even for only a few more years.

Our borrowers soon realized that they were faced with the possibility of imminent foreclosure. This meant the lender could take ownership of the property they used to conduct business and they would no longer have a place to earn a living, provide services to the customers that relied on them, and would have to lay off their employees. Four full time employees would be left without work, which would have an impact not just on them, but their families also. Our borrowers would also join this group of unemployed and be left to scramble to find some other income. The 700 customers for this small business would be left hanging to tackle their weight loss ailments on their own. In addition, the community would be left with a vacant building contributing nothing to the progress of the surrounding population.

With the 504 program, SEDCO was able to find a third-party lender to help this minority-owned small business attain long term fixed interest financing, allowing the clinic to further grow. Not only is its client base growing, it is expected to create three more jobs over the following two years. Furthermore, through the 504 loan program and this refinance project, our borrowers were able to save an excess of \$33,000 per year in debt service while paying down both principal and interest at about half the interest rate of their previous loan. Finally, since the 504 refinance took place the clinic has been able to use its savings to hire two part time employees which are due to turn into full time employees in 2020.

These successes are just a small sample of the great work being done by SEDCO in the beautiful state of Florida. It is a truly valuable tool for economic development and job creation throughout the country. As you know, the 504 program is statutorily required to create or retain a job for every \$75,000 it lends, so these businesses benefit their communities not just with their products, but with their employment.

#### **Opportunities for Improving the 504 Program**

As I have outlined above, the 504 program provides tremendous support for small businesses as well as their surrounding communities. I am proud that SEDCO can bring these resources to Florida entrepreneurs. However, during my time with the CDC, I have seen some policies that are not helpful to my small business borrowers, but also do not seem to protect the taxpayer's loan guarantee in a meaningful way. I hope Congress and SBA will review them and consider adjusting them to better meet the needs of small business owners. I have explained a few in detail below.

One way to help small business owners is to allow a more robust refinancing option in the 504 loan program. Thanks in great part to the leadership of this Committee, small business owners can refinance their existing loans using a 504 loan. That has been invaluable to many businesses and jobs, including the one I discussed above. However, there is an important exclusion from 504 refinance eligibility: small business loans from government guaranteed programs. A small business owner that purchased her building with a government product is now barred from refinancing via 504; this refinancing barrier does not exist for other government guaranteed lending programs. As a result, this subset of small businesses cannot take advantage of the 504 program that offers low fixed rate 20 or 25-year financing with payments and terms that enhance stability and certainty for businesses. These borrowers would still need to meet all the eligibility requirements that any other small business owner would, thus the soundness and quality of the refinancing program would not change if they participated. Ensuring that 504 refinancing is an option available for these small business owners will give them an additional tool when deciding what best meets their business needs, while not increasing risk to taxpayers.

Another set of policies currently in place that can be onerous for small businesses yet have a negligible effect on taxpayer risk, are policies with restrictions on small businesses that use real estate holding companies as part of their business structure. In the industry, we often call these "EPC/OC policies." Some small businesses form two entities: an operating company ("OC") and an eligible passive company ("EPC"). This is a common structure for businesses and small businesses may be advised by their lawyers to structure this way when they form their business. However, when a small business structured as an EPC/OC applies for a 504 loan, it faces additional restrictions that are onerous for the small business.

Second, SBA mandates what rent amount the OC can pay to the EPC as the owner of the building. Rent cannot be market rate, but instead only the cost of the mortgage and minor operating expenses. However, because the OC and the EPC are related parties, IRS rules require that the rents an EPC or holding company charge a related OC be at fair and reasonable rates. Because of this, accountants almost always recommend market rents be paid so that the business can avoid potential IRS problems. In addition, because rent can be a deductible expense, a lower-than-market rate prevents the OC from taking advantage of the available tax breaks afforded to small businesses. Finally, commercial real estate is valued partially on the rental income, so a below-market rental payment can reduce the overall value of the property and can harm the resale price if the small business ever sells the property. This rental policy should be changed to allow the small business to set a market rate rental payment and receive the appropriate tax treatment, as long as the rent is not detrimental to the operations of the small business.

There are two other EPC/OC policies that can cause problems for small business. One policy states that an EPC in the 504 program can only exist with a single OC and no others. This is inconsistent with standard business practices, and onerous on small businesses. A business owner will frequently create one EPC for all their OCs, because there is no reason to spend the time and money to have multiple EPCs. Another policy requires the OC to lease the entire property from the EPC, and all third-party leases for the property must go to the OC. This can expose the OC to unnecessary legal liability from those third parties, and as a result is often against the advice a small business receives from their lawyers.

These policies were likely created to ensure that the benefits of the 504 program go to true small businesses, not developers or investors. However, the 504 program has clear requirements for who can qualify, including the mandatory job creation and retention requirements I mentioned earlier. There are surely more effective ways of protecting the program than increasing the tax liability and decreasing the legal protection of these small business borrowers that are not developers or investors.

Another area where current policy may not match program intent is in the program's public policy goals. Beyond requiring job creation and retention, Congress alternatively allows for certain public policy goals to be met in the program. These allow 504 loans to go to businesses who may not meet the requirement of 1 job to \$75,000 lent, but nevertheless are important for economic development in other ways. These public policy goals include lending to majority owned businesses by women, minority, rural and veteran borrowers. The current ownership requirement for majority ownership is 51%. As a result, there are many owners who cannot qualify under these public policy goals due to only having 50% ownership. For example, a small business may be owned 50% equally by two partners who are both active in daily management; one is a female of Asian descent and the other is a male who is a US Army veteran. While the small business is 50% woman-owned, 50% veteran-owned, and 50% minority-owned, the business does not meet any existing public policy goals for SBA loan programs. However, it certainly meets the spirit of those goals. If the requirement were adjusted to 50%, a greater number of 504 loans would assist small businesses within these sectors.

An additional policy area in need of reform is the process small business owners go through to close a 504 loan. Currently the process is inconsistent, unpredictable, and lengthy—all characteristics that small business owners try to avoid. Right now, after a small business gets their 504 loan approved, it must go through an additional approval process for almost all changes, no matter how minor, before it can close. Allowing CDCs with a proven track record of accuracy and success to adjust loan documents for items such as typos in business address, business name, or bank name, as well as make small decreases to a loan amount, would benefit the small business and SBA. By reallocating this work, there will be a faster closing process for the small business, greater efficiency and cost savings for SBA, elimination of the need for SBA personnel to spend time approving non-substantive changes, and fewer delays in closing when SBA faces a backlog of these requests. To give you an idea of how allowing CDCs this authority will help small business, one CDC had a borrower that needed to decrease their loan amount by only \$2.00, but that small business could not close their loan without SBA approval.

Congress, SBA, and CDCs all have a shared goal of supporting small businesses while ensuring proper use of taxpayer dollars. The 504 program is a wonderful example of that—it creates jobs while at no cost to the taxpayer. The opportunities for change I have pointed to today will help keep that proper balance and I urge Congress to consider them. Again, thank you for inviting me to testify today. I am happy to answer any questions.



**U.S. House of Representatives Committee on Small Business  
Subcommittee on Investigations, Oversight, and Regulations**

**Review of SBA's 504/CDC Loan Program  
Hearing on December 10, 2019**

**Testimony for the Record Submitted by  
Tracy Ward, Director, SBA 504 Loan Program  
Self-Help Ventures Fund  
Durham, North Carolina**

Chairwoman Chu, Ranking Member Spano, and other distinguished committee members, thank you for the opportunity to provide written testimony for your review of the SBA 504/CDC loan program. I am Tracy Ward, Director of Self-Help Ventures Fund's SBA 504 Loan Program. In connection with your review of the SBA 504 program, Self-Help Ventures Fund appreciates the invitation to provide information gained through our more than 25 years of experience as a 504 Certified Development Company ("504 CDC").

Self-Help Ventures Fund is a 35-year-old nonprofit Community Development Financial Institution ("CDFI") with the mission of creating and protecting ownership and economic opportunity for all. Among other activities, we help small businesses grow and create jobs, we partner with other lenders to provide affordable mortgages to homebuyers, we support fair and affordable financial services, and we convert neglected buildings into community assets. One of the many programmatic tools we utilize to support our work with small businesses is the SBA 504 program. Self-Help Ventures Fund sought and received SBA approval to operate as a 504 CDC in our home State of North Carolina in 1993. Since that time, we've worked with more than 900 small business borrowers through our SBA 504 program. As a direct result of the affordable and responsible fixed asset financing provided by the SBA 504 program, these small businesses have been able to create jobs and meet other economic development and public policy goals, greatly benefitting communities throughout North Carolina.

As you are aware, the SBA 504 program was created by Congress to promote economic development by encouraging healthy businesses to invest in expansion and create jobs. The SBA 504 program does this by providing small businesses with long-term, fixed rate, responsible financing for buildings, machinery and heavy equipment. While SBA has other small business loan programs, the SBA 504 program is unique in several critical ways:

- Unlike other SBA loan programs, small businesses must meet a Congressionally mandated community development or public policy goal to be eligible. These goals include, among others, job creation (typically 1 job must be created for every \$75,000 of SBA 504 loan funding); assisting businesses owned by veterans, minorities, or women; increasing exports; assisting small manufacturers; increasing energy efficiency; and assisting businesses located in rural communities, Opportunity Zones, HUB Zones, and other defined areas in need of revitalization.
- The SBA 504 program is likewise unique from other SBA loan programs in that it requires private sector investment. For every SBA 504 loan, there is a private sector bank or lending partner that typically provides 50% of the total financing needed by the small business borrower. The SBA 504 program intentionally incentivizes private sector lenders to make these loans by allowing them to have a first lien position on the collateral, while SBA takes a second lien position and typically provides up to 40% of the total financing. Under this structure, healthy small businesses contribute only 10% to the project, leaving more of their cash for business operations and allowing them to expand and create jobs earlier than would otherwise be possible. Further, SBA 504 loan funds are raised from private sector investors, who purchase shares of pooled SBA 504 loans. Because the resulting debentures are 100% guaranteed by SBA, SBA 504 loans typically provide the lowest-cost responsible financing available to small business borrowers.
- Finally, the SBA 504 program is unique from other SBA loan programs in that each SBA 504 loan is originated, closed, and serviced by nonprofit, mission-based 504 CDCs like Self-Help Ventures Fund, who are connected to, located in, and invested in their local communities. All 504 CDCs across the country are required by the SBA 504 program not only to have a physical location in our lending territories, but also to make economic investments in the communities we serve. In large part due to this structure, 504 CDCs are excellent stewards of the SBA 504 program and of the small business borrowers we serve, with the result that the SBA 504 program operates with zero government subsidy. In short, the structure of the SBA 504 program is a model for encouraging job creation, economic development, business expansion, and private sector investment – all at no additional cost to the government or U.S. taxpayers.

To help illustrate how effective the SBA 504 program can be, I would like to share a few examples of SBA 504 loans Self-Help Ventures Fund has made, and the impact those loans have had on small business borrowers and the communities where they operate:

- Packrite, a woman-owned packaging manufacturer in High Point, North Carolina, obtained two SBA 504 loans in 2012. The small manufacturer, which had started operations in 2008, was unable to expand to meet market demand due to high debt payments on its equipment loans and high lease payments on its facility. Because of the responsible and affordable financing available under the SBA 504 program, Self-Help

Ventures Fund was able to finance Packrite's acquisition of its facility and refinance its equipment loans, saving the company a remarkable \$200,000 or more annually in debt payments. This savings allowed Packrite to invest in expansion, and within two years of funding, the company had hired approximately 40 more employees. Today Packrite employs well over 100 workers in its community. Instead of drowning in high debt and lease payments, the SBA 504 program was a lifeline that allowed Packrite not only to survive, but expand and thrive, creating jobs that Packrite notes would not otherwise have been possible.

- Skyrock Construction, an African-American-owned general contractor specializing in concrete construction, is another SBA success story. As a relatively new business in 2008, Skyrock obtained an \$8,000 SBA Microloan from Self-Help Ventures Fund. Successful repayment of that loan paved the way for Skyrock to obtain SBA 7(a) working capital loans over the following years, allowing the company to take on larger construction jobs as it grew. Like many small businesses that cannot afford to acquire their own facility, during this period of growth Skyrock invested funds to upfit leased space to meet its needs. When its landlord decided to sell the property in 2017, Skyrock did not have the extra cash reserves to purchase the building – conventional commercial loans often require a 20% to 30% equity injection. If not for an SBA 504 loan from Self-Help Ventures Fund, which allowed Skyrock to acquire its facility on affordable terms with only 10% down, the company would have faced the possibility of losing its upfit investment, as well as the cost and disruption of relocating. Acquiring its building gave the company the stability to continue its growth, and in the two years since the purchase, Skyrock has gone from 16 to 24 employees – an increase of 50%. At each stage of Skyrock's growth, SBA loan programs have provided the company with the appropriate type of financing to fit its needs, giving Skyrock the best opportunity to succeed.
- Farm Fresh Produce, whose owner was recognized by SBA as its 2019 North Carolina Small Business Person of the Year, is yet another great example of the benefit SBA 504 loans provide to small businesses and the communities where they operate. Contracting with and providing a revenue source to local growers in a rural, predominantly agricultural section of Eastern North Carolina, Farm Fresh Produce encourages sustainable practices such as water conservation and reduction in the use of pesticides. When the company wanted to bring curing, packing and storage capabilities in-house but was unable to obtain conventional financing on reasonable terms, an SBA 504 loan through Self-Help Ventures Fund helped finance the expansion. As a result, Farm Fresh Produce recognized considerable cost savings, significantly increased exports to the United Kingdom, Europe and Canada, added 15 jobs in just the first year following the expansion, and created a larger market for North Carolina farmers.

Self-Help Ventures Fund literally has hundreds of other small business and community success stories that are the result of the SBA 504 program, as do other 504 CDCs in every State across

the country. The SBA 504 program is a proven and effective tool for supporting small businesses and the communities where they operate.

While the SBA 504 program has been an effective tool for economic development, however, small businesses face unnecessary challenges accessing the benefits of this program. Self-Help Ventures Fund, like the other 504 CDCs who have provided testimony to this Committee, greatly appreciates your attention to modernization and improvement of this program so it can have even more impact in the future. Issues we would raise to your attention include:

- Personal Resources Test: After reviewing and eliminating it as recently as 2014, last year SBA effectively reinstated a personal resources test by adding new language in the Standard Operating Procedures ("SOP") for the SBA 504 program: "The CDC must include in its credit memorandum ... [a] determination that some or all of the loan is not available from ... liquidity of owners of 20% or more of the equity of the Applicant, their spouses and minor children, and the Applicant itself...." SBA has also issued a proposed rule (RIN: 3245-AG74) that would reinstate a personal resources test, requiring small businesses and small business owners to show they do not have personal or business resources that reduce their need for an SBA 504 loan. Reinstatement of a personal resources test is detrimental and damaging to the SBA 504 program, to small businesses, and to the community development objectives of Congress, for the following reasons:
  - A personal resources test is contrary to the purpose of the SBA 504 program and confuses *credit* with *savings*. Congress is clear in Section 120.101 that SBA business loan programs are limited to borrowers who can show they are unable to obtain the desired *credit* (*i.e.*, loans) without SBA assistance:

SBA provides business loan assistance only to applicants for whom the desired *credit* is not otherwise available on reasonable terms from non-Federal sources. SBA requires the Lender or CDC to certify or otherwise show that the desired *credit* is unavailable to the applicant on reasonable terms and conditions from non-Federal sources without SBA assistance, taking into consideration the prevailing rates and terms in the community in or near where the applicant conducts business, for similar purposes and periods of time. Submission of an application to SBA by a Lender or CDC constitutes certification by the Lender or CDC that it has examined the availability of *credit* to the applicant, has based its certification upon that examination, and has substantiation in its file to support the certification.

(13 CFR §120.101; *emphasis added*)

It is important to read Section 120.101 in tandem with the purpose of the SBA 504 program. Unlike other SBA loan programs, the SBA 504 program's purpose is "to foster economic development, create or preserve job opportunities, and stimulate growth, expansion, and modernization of small businesses." (13 CFR §120.800) To be eligible for a 504 loan, small businesses must create jobs or meet other economic development objectives set by Congress (13 CFR §120.860). As Congress recognized when it set low borrower contribution requirements for 504 loans (13 CFR §120.910), small businesses need liquidity to meet these mandated job creation and economic development objectives. Except in cases where 504 CDCs and SBA determine that additional equity is required to meet prudent lending standards, requiring eligible SBA 504 small business borrowers to inject additional personal funds over and above the contribution amounts set by Congress misreads Section 120.101, contravenes Section 120.910, and makes it significantly harder for small businesses to meet the objectives of the SBA 504 program set forth in Sections 120.800 and 120.860.

- Forcing a small business and its owner to contribute additional liquidity beyond mandated program requirements is not economically prudent. Businesses and business owners with liquidity are able to withstand economic downturns and adjust operations to meet business and market changes. If the business is a startup, it requires liquidity in order to survive an initial ramp-up period to stability. If the business is already established, it requires liquidity for continued growth and expansion. Depleting business and owner liquidity makes it more likely that a business that hits a difficult time will have to default on its SBA payment obligations and will fail to meet the SBA 504 program's job creation and economic development objectives.
- Personal circumstances that require liquidity, such as cost of living, childcare, health care, family and education needs (such as college tuition for children), vary greatly from business owner to business owner. Small business needs, such as business development, other business opportunities that may arise, market changes, or increased competition, likewise vary significantly among businesses. A requirement that small business borrowers with higher levels of liquidity inject more funds than the SBA 504 program's statutorily mandated borrower contribution results in depletion of the necessary capital required for small business growth, job creation, and legitimate personal needs of the small business owner and their family.
- A personal resources test unnecessarily disincentivizes prudent saving practices and penalizes small business owners who are economically frugal and reserve funds for future market changes, expansion, growth, family needs and retirement.

- SBA itself determined a personal resources test was ineffective and contrary to the SBA 504 program's mission, and eliminated it in 2014. There is no justification for reversing that determination now.
- SBA 504 Debt Refinance: To a small business, refinancing existing debt with an SBA 504 loan can mean the difference between shutting its doors or expansion and growth. Unnecessary regulatory limitations, however, make SBA 504 program debt refinance options inaccessible for some small business borrowers:
  - SBA allows debt refinance with expansion, but the amount of debt that can be refinanced is limited to 50% of the cost of the expansion project. This limitation is arbitrary, and to the extent the project collateral provides sufficient value to support it, the amount of debt small business borrowers can refinance should be increased to 100% of the cost of the expansion project.
  - SBA also allows debt refinance without expansion; however, the SBA 504 program does not allow for the refinance of government-guaranteed debt under this option. We recently worked with a small business that had received an SBA 7(a) loan from a lender who inexplicably funded the building acquisition, but not the needed renovations. Without additional financing, the business will not be able to operate in the building. Local lenders who are trying to work with the business are unwilling to refinance the 7(a) loan conventionally, yet we cannot offer the SBA 504 program to refinance the 7(a) loan and finance the renovations, because the relevant refinance option under the SBA 504 program does not allow refinance of government-guaranteed debt. Bizarrely, the SBA 7(a) program allows a lender to refinance an existing 7(a) loan with a new 7(a) loan, yet an SBA 504 loan may not refinance an SBA 7(a) loan if there is no corresponding business expansion project.

As was the case with Packrite, the North Carolina small manufacturer that was able to recognize savings of approximately \$200,000 annually with an SBA 504 debt refinance loan, debt refinance can result in savings that allow small business borrowers to create jobs and meet other economic development objectives. Debt refinance under the SBA 504 program is a powerful tool for economic development and should be expanded to allow access to more small businesses.

- Occupancy Requirements: SBA requires 504 small business borrowers to occupy at least 51% of existing buildings acquired with an SBA 504 loan. While we strongly agree the SBA 504 program should remain a tool for operating businesses, not passive investors, strict adherence to these occupancy rules excludes many operating businesses from accessing the program. The issue becomes especially apparent in urban centers, where many properties are multi-story. For those properties, an operating small business typically occupies the first floor and leases the remainder of the building to third-party

tenants. Those small businesses should not be excluded from accessing the SBA 504 program based on arbitrary percentages. Instead, in cases where the operating small business occupies and operates out of a meaningful portion of the building, the occupancy rule should be relaxed.

- EPC/OC Requirements: To be an eligible borrower for an SBA 504 loan, a small business must be an operating business (referred to as an operating company, or "OC"). When OCs acquire real estate, however, most tax, accounting and legal professionals advise the OC to set up a separate holding company (referred to as an eligible passive concern, or "EPC") to own the real estate. The OC then becomes a tenant of the EPC, and pays rent to the EPC, which the EPC uses to make the mortgage payments on the property. Current SBA requirements allow this arrangement (provided both the EPC and OC are fully obligated on the SBA 504 loan), but ignore the reality of the commercial marketplace and disadvantage SBA 504 small business borrowers in the following ways:
  - SBA requires the OC to create an EPC specifically for the 504 loan. In many cases, the OC may have an existing holding company to own other real estate, especially in situations where the business has more than one location. Requiring the OC to create a separate entity for the SBA 504 loan results in unnecessary expense and additional burden for SBA 504 borrowers. Because both the EPC and OC are fully obligated on the SBA 504 loan, it would present no additional repayment risk to SBA to allow EPCs to own multiple properties; indeed, in many cases it strengthens the loan because the EPC, which is obligated on the loan, has additional assets and income to support loan repayment.
  - SBA strictly limits the amount of rent paid by the OC to the EPC to the debt payments on the property and a reasonable amount for direct expenses of holding the property. This is problematic for small business borrowers because it prevents them from reflecting market rate rents, which in turn (i) prevents the small business from reducing taxable income with legitimate rent expense, and (ii) reduces the resale value of the building, since appraisers consider current rents as one method of determining the rental income potential, and thus the appraised value, of a property. Because both the EPC and OC are fully obligated on the SBA 504 loan, it would present no additional repayment risk to SBA to allow OCs to pay market rate rents.
  - SBA requires the EPC to lease 100% of the property to the OC, which may then sublease less than half the property (generally) to third-party tenants. This creates an unnecessary burden for SBA 504 borrowers, because existing leases to other tenants in the building must be rewritten, and in many cases renegotiated to the SBA 504 borrower's disadvantage, to meet SBA requirements. Because both the EPC and OC are fully obligated on the SBA 504

loan, it would present no additional repayment risk to SBA to allow the EPC to lease directly to third-party tenants.

- Steamline Closing Requirements: SBA 504 loans have a more cumbersome closing process than is necessary, causing delays to the closing and funding of the loan. This results in additional expense to 504 small business borrowers due to the reality of the marketplace. Not only do 504 borrowers face the extra costs that a longer timeline adds to any project, an overly long closing process often forces borrowers to negotiate costly extensions to property purchase contracts, and in some cases may result in losing the property altogether. Suggested streamlining includes:
  - Delegate authority to SBA-approved high-performing 504 CDCs to make non-substantive changes to the SBA 504 loan authorization. This not only would prevent the delay caused by sending each non-substantive change to SBA for review and approval; it would also free up time for SBA to review and approve substantive changes more efficiently and quickly.
  - Eliminate/limit review of the 504 closing package by SBA District Counsel. Before a 504 loan can fund (i) loan documents are prepared by trained, experienced 504 CDC staff, (ii) the loan is closed by the 504 borrower's legal counsel, and (iii) the complete executed closing package is reviewed by experienced, designated 504 CDC legal counsel who are required to attend SBA-approved 504 closing training courses bi-annually. Self-Help Ventures Fund's experience has been that SBA District Counsel are diligent, efficient, and are an incredibly knowledgeable resource; however, the extra step of review by SBA District Counsel of a loan closing package that has already been thoroughly vetted to ensure compliance with SBA regulations adds several days to an already lengthy closing process. Because SBA 504 loans fund only one day per month, these few added days often result in a full additional month's delay for funding of the small business borrower's SBA 504 loan.
- Prepayment and Borrower Equity: One of the benefits of a small business owning its building is that it allows the business to build equity – equity that can be used for future expansion, protect against future downturns, or for other business or family needs. In most circumstances, however, SBA does not allow small businesses to access that equity to meet those legitimate needs. As a result, small businesses are forced to prepay their SBA 504 loans to access any equity in the building. I have seen instances where small businesses are forced to pay prepayment penalties on the SBA 504 loan and to accept less advantageous loan terms from the lender refinancing their debt, because the only way they can access equity they have built in their property is to pay off the SBA 504 loan. To avoid placing small businesses in this untenable financial situation, SBA should allow a small business to refinance the senior loan on the building to access borrower equity; provided (i) the loan is well-seasoned, (ii) payments of the senior loan and the

SBA 504 loan have been current for at least the past 12 months, (iii) combined senior and SBA 504 debt service coverage ratios remain acceptable, and (iv) a current appraisal documents combined senior and SBA 504 loan-to-value no greater than what was approved by SBA at origination. This would allow successful borrowers to access equity they have built up over time and maintain the benefits of the fixed-rate, long-term SBA 504 financing, without increasing risk to SBA.

In addition to the regulations directly impacting small business borrowers noted above, SBA regulation of 504 CDCs also unnecessarily restricts small business access to the SBA 504 program when it becomes unnecessarily burdensome or adds excessive expense, liability and risk to 504 CDCs. SBA oversight and regulation of 504 CDCs is entirely appropriate and necessary for the continued integrity and performance of the SBA 504 program; however, regulations should be tailored to the SBA 504 program, which is unique among SBA programs, and to 504 CDCs, which are unique among SBA lenders. A one-size-fits-all approach to every SBA program is neither efficient nor effective. We appreciate changes SBA has promulgated over the past year to address some of the issues relevant to 504 CDCs; however, there are remaining issues yet to be addressed. One glaring example of a regulation that is unnecessary and burdensome is the receivership language added to the Code of Federal Regulations over industry objections at the end of 2016:

- Receivership Regulation (13 CFR §§120.1400, 120.1500, 120.1600): The Receivership Regulation permits SBA “to apply to any Federal court of competent jurisdiction for the court to take exclusive jurisdiction, without notice, of the [504] CDC, and SBA shall be entitled to the appointment of a receiver of SBA’s choosing to hold, administer, operate and/or liquidate the [504] CDC....” As more fully set forth below, this regulation is unnecessary, overly burdensome, will result in unintended adverse consequences, and ultimately will make the SBA 504 program less effective, and therefore should be eliminated in its entirety with respect to 504 CDCs.
  - It is unnecessary, given the enforcement tools already available to SBA. SBA already has the right, as it should, to completely shut down the SBA 504 operations of any 504 CDC that is not in compliance with SBA regulations. SBA has the authority (i) to suspend or terminate a 504 CDC’s authority to participate in any capacity in the SBA 504 program, (ii) to transfer a 504 CDC’s SBA 504 loan portfolio, including any pending 504 loan applications, and (iii) to withhold all SBA 504 program income due and payable to the 504 CDC (see 13 CFR §120.855). These existing provisions provide SBA with a broad array of effective, tailored tools to enforce regulations and protect SBA and public interests.
  - It is overly broad and overly burdensome. Self-Help Ventures Fund, like many 504 CDCs, offers multiple non-SBA programs to meet our community economic development mission – in fact, SBA requires 504 CDCs to engage in economic development outside of 504 program operations (see 13 CFR §120.823(d)). This

regulation would materially interfere with other federal programs. For example, Self-Help Ventures Fund's non-SBA commercial lending programs have included the U.S. Department of Treasury's New Markets Tax Credits program, the U.S. Department of Agriculture's various loan guarantee programs, the U.S. Department of Housing and Urban Development's Neighborhood Stabilization Program, the U.S. Department of Education's Credit Enhancement for Charter School Facilities program, as well as various State and local programs. Further, Self-Help Ventures Fund and many other 504 CDCs provide economic development programs outside the scope of commercial lending. By allowing SBA "to hold, administer, operate and/or liquidate the [504] CDC" in its entirety, including a 504 CDC's non-SBA operations, the receivership regulation puts the community economic development work of 504 CDCs at risk and is, without question, overly broad and overly burdensome.

- It will result in adverse unintended consequences. Because 504 CDCs offer community and economic development programs unrelated to the SBA 504 program (in many cases unrelated to any SBA program), the receivership regulation places 504 CDCs at risk of default under agreements with other regulatory bodies and funders. Federal and state agencies administering community and economic development programs through 504 CDCs have not consented to allow SBA to put those programs into receivership; therefore the regulation puts SBA directly at odds with other governmental agencies. The same is true of a 504 CDC's funders – the regulation could put 504 CDCs in default of their existing loan agreements and could impair a 504 CDC's ability to raise capital. As a lender, Self-Help Ventures Fund would not provide funding on market terms to a borrower who was subject to receivership on vague terms and without notice; no responsible lender would. Unintended consequences of the receivership regulation include severely impacting a 504 CDC's ability to provide non-SBA community economic development programs and its ability to borrow capital for operations.
- It may ultimately result in fewer 504 CDCs. As the impact of this new regulation becomes evident, rather than subject all of their operations and assets, community and economic development work, and ability to raise capital, to the broad risk of receivership and liquidation imposed by the receivership regulation, existing 504 CDCs may exit the 504 program; additional nonprofit lenders may not be willing to enter it. Fewer 504 CDCs necessarily results in less access to the SBA 504 program for small businesses. Especially in rural areas, the loss of 504 CDCs familiar with the local market lessens the impact of the SBA 504 program in the exact areas where this proven job creation tool is most critical.
- We note that SBA, acknowledging the overly broad language of the receivership regulation, implemented limiting language in its SOP. That language provides

that SBA will typically use its receivership authority as a remedy of last resort; will limit the scope of receivership to the 504 CDC's SBA-related assets (except where the 504 CDC's business is almost exclusively SBA-related); and provides that SBA will only seek receivership in cases of (i) fraud or false statements or (ii) refusal by the 504 CDC to cooperate with SBA enforcement actions or orders. (See SOP 50-10-5(K), Subpart A, IV.C.). We appreciate SBA's recognition of the issues with the overly broad receivership regulation and the adoption of limiting language in the SOP; however, the Code of Federal Regulations supersedes the SOP, and at a minimum, the receivership regulation should be modified to include these same limitations. Further, as part of any modification, the receivership regulation should clearly limit the scope of receivership to SBA-related assets. Regardless of whether a 504 CDC's non-SBA programs are a significant or insignificant part of its overall assets, SBA should not be permitted to take over any assets that are not clearly SBA-related assets – no 504 CDC should be forced to place any of its non-SBA community and economic development programs at risk in order to participate in the SBA 504 program. Self-Help Ventures Fund does not believe mere modification of the receivership regulation fully addresses its adverse impact, however, and instead believes the regulation as a whole should be statutorily eliminated with respect to 504 CDCs because it is unnecessary, overly burdensome, results in unintended adverse consequences, and ultimately makes the SBA 504 program less effective.

The above recommendations could all be implemented with statutory changes, and we in the 504 CDC industry urge you to thoughtfully consider these and the other items raised by the industry as you conduct your review of the SBA 504 program. In addition, we also urge you to consider providing regulatory guidance to SBA to encourage a more collaborative approach with 504 CDCs when making non-statutory changes. In large part, SBA controls access to the SBA 504 program through its policies and procedures for the program, both as implemented in its SOP and in its practices for reviewing and approving SBA 504 loans. In my experience, SBA leadership and staff work diligently to support small businesses, and I have seen SBA work with the industry to implement changes to increase access to the program (such as improving documentation requirements for debt refinance loans; updating job creation requirements; limiting some of the more onerous 504 CDC governance and oversight requirements; *etc.*). In many cases, however, SBA fails to collaborate with 504 CDCs prior to making changes to the SOP or to its practices, and once unnecessarily burdensome rules are implemented, all our hands are tied. Absent SBA and industry collaboration, regulations, practices and SOP rules fail to adequately balance the burden to small business borrowers against the likelihood and severity of the perceived risk to SBA. A few examples include:

- Insurance requirements: 504 CDCs, as prudent lenders, require small business borrowers to document and annually confirm maintenance of hazard insurance to protect the loan collateral, as well as any other type of insurance determined to be necessary for loan approval (which may include flood insurance, key person life

insurance, etc.). Earlier this year, SBA added new language to the SOP, requiring small business borrowers to additionally document annually that they maintain all other types of insurance required by State law. Under this new language, small businesses now need to spend additional time and energy each year to document for SBA that they have in place workers' compensation insurance, automobile liability insurance, and any other insurance required by State law. Requiring small businesses to supply proof annually for SBA of the maintenance of various types of insurance unrelated to the loan micromanages and adds unnecessary burdens on small businesses, with no equivalent reduction in risk to SBA.

- Language added to the SOP in 2018 effectively reinstated a personal resources test, which has resulted in confusion among the industry, our banking partners, and small business borrowers as to which small businesses are eligible to obtain SBA 504 financing. As noted above, a personal resources test unfairly limits access to the program without reducing risk to the program or to SBA.

Collaboration with 504 CDCs prior to changing the SOP and SBA practices would allow 504 CDCs, who are on the front lines working with small business owners, to help SBA assess the impact of proposed changes. While all 504 CDCs agree it is critical to lend prudently and minimize risk, all commercial lending involves risk. If it did not, there would be no need for SBA programs – the private sector would gladly make risk-free loans or investments. Prudent risk management, however, does not require SBA and 504 CDCs to micromanage small business owners. SBA and 504 CDCs are uniquely positioned to work together to balance prudent lending requirements against the likelihood and severity of potential risks, to ensure unnecessary and cumbersome burdens are not placed on small business borrowers. Providing guidance to allow SBA to work collaboratively with 504 CDCs prior to making changes to the SOP and SBA practices would go a long way towards making the SBA 504 program a more effective and accessible tool for small business success, job creation, and for meeting other community development and public policy goals set by Congress.

Addressing all of the issues raised above will help make the SBA 504 program more effective, more impactful, and easier for small businesses to access, thereby allowing small businesses to grow, create jobs, and support a strong economy. Self-Help Ventures Fund appreciates your leadership and assistance in addressing these challenges, and appreciates the opportunity to provide testimony to the Committee on this important issue. If it would be helpful to the Committee, I am happy to provide any additional information requested. Thank you.