THE PRESIDENT'S FISCAL YEAR 2006 BUDGET REQUEST: WHAT DOES IT MEAN FOR SMALL BUSINESS?

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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THE PRESIDENT'S FISCAL YEAR 2006 BUDGET REQUEST: WHAT DOES IT MEAN FOR SMALL BUSINESS?

THURSDAY, FEBRUARY 10, 2005

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The committee met, pursuant to call, at 10:24 a.m. in Room 311, Cannon House Office Building, Hon. Donald Manzullo presiding.

Present: Representatives Manzullo, Velazquez, Musgrave, Bradley, Fitzpatrick, Westmoreland, Millender-McDonald, Lipinski, Bordallo, Grijalva

Chairman MANZULLO. The Committee will come to order. We welcome you to the Committee's first hearing for the 109th Congress.

This room, 311 Cannon, is the first Committee room in the entire Capitol Hill complex to be restored to its original grandeur. Everything here has been restored to what it was originally with the exception of the carpet on the floor, and the floor is solid marble. The picture on the back wall of the ships was restored also, even to the extent that no one knew there were ships in the background, just a ship up front.

This restoration took place over a period of about a year, and during the process of it, it was the culminating effort of two of the people from the House woodworking shop, who took countless hours and days and weeks to fastidiously restore the wood that you see here. We removed a lower group of seats that had been put up but was not there, according to original plans.

So 311; this is a beautiful room, and the sound here is actually better than in boring Rayburn. So welcome to the first full Committee hearing in 311.

Let me applaud the fact that our first witness on the first panel, Hector Barreto, was one of the longest-serving administrators of the SBA. He serves not because this is a position on its way to another position, unless it is president, but he serves because of his passion and his zeal and his love for small businesses.

Let me also state this at the opening, that the 51-year tradition of Manzullos being in the restaurant business came to an end on December 31st. Those of you from the SBA who came out always would stop by and have a great opportunity there. My brother was honored to have a member of the president's cabinet come and to officiate over numerous small businesses coming to visit. It is one of those things where he decided to close up the family restaurant business. I wept for seven days straight. It was also the home where we were raised as children. But fortunately, he is holding onto the recipes and the family name. He sold the buildings, and a lady bought the family home, and she is going to have a quilting shop, and she is dedicated to restoring the old family home to its Victorian grandeur.

So it is one of those things; but, in passing, my brother decided to sell the restaurant for many reasons, but, frankly, he just got tired of paying the high insurances. It simply reached the point where he said, All I am doing is working for insurance companies.

I know Mrs. Velazquez shares that same concern, especially in the area of health and accident insurance, and, I think, the first hearing besides this is going to be in the area of what we can do to curb those costs.

So that is how we start the year. Frank will probably be out to testify sometime about his experience in running that family restaurant for 41 years.

[Chairman Manzullo's statement may be found in the appendix.]

Chairman MANZULLO. So I will now yield to the ranking Committee member, Congresswoman Velazquez of New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Chairman, before I make my opening statement, I just would like for the administrator to clarify to me what is the administration policy regarding requests from the members of this Committee because, two weeks ago, in preparing myself for this important budget hearing, I requested from your office, and you did not provide the information that was requested from me, and I think it is a lack of respect.

Chairman MANZULLO. I would like that question to be held in abeyance until the administrator has finished his testimony, and then you can ask that question during the regular course.

Ms. VELAZQUEZ. Well, that is my question.

Chairman MANZULLO. Okay.

Ms. VELAZQUEZ. Sure, Mr. Chairman. I am using the only venue that I have to make my views known in this Committee.

Mr. Chairman, every year, when I think the budget cannot get any worse for the Small Business Administration, the administration turns around and proves me wrong. This budget is a failure to America's small businesses. It is nearly half of what it was when President Bush took office, and at least $100 million has been cut each year.

What was once a cabinet-level agency that had a seat at the table, a $1 billion budget, and a large role in the decision-making process has sadly become the shell of an agency. It was not long ago that SBA was creating new, innovative programs to help entrepreneurs across the country start and grow their businesses. However, it is quite a different story today. This agency is failing to ensure that small businesses are receiving federal contracts and increasing the cost for entrepreneurs to access capital.

SBA seems to have fallen off the path here. They are no longer helping small businesses to start and expand their dreams. Time and time again, SBA has not been shy about voicing all-time records for programs and loans, but, in reality, what SBA should be voicing today is an all-time record for cutting and terminating the most programs over the past four years.

Let us go through the list of these programs. Cuts have been made to the Women's Business Centers, HUBZone, and SCORE, among others. Some of the small business programs that either were eliminated or slated for termination include Business Link, SBIR Rural Outreach, SBIR FAST, PRIME, New Markets, Venture Capital, and the flagship lending program, 7[a], all of which help to create jobs.

Of more concern is the fact that SBA proposed to eliminate the Microloan Program again, a program that serves a unique role by providing small loans to low-income communities. So much for compassionate conservatism.

In addition, by failing to request any program effort for the Small Business Investment Capital Participating Securities program, SBA's largest venture capital program, it has closed the book on this initiative, too.

I want to make one thing clear. These are all valuable programs that have contributed to some of the greatest entrepreneurial success stories in this country. They have formed the foundation for millions to pursue and achieve their business venture. The real problem today is not the programs themselves. Their successful clientele and the economic gain they have generated over the years speaks for itself. The real problem is the fact that they are underfunded and mismanaged.

This administration has a very unusual way of showing their support for small businesses. When the federal government cannot meet its contracting goal, instead of accepting accountability and working to fix it, they start counting large businesses towards a small business goal and flood the government tracking system with so much bad data that no one can really determine what has or has not been done.

Capital is not flowing to small businesses like it should be. Rather than putting money into the lending programs, this agency gutted their staff in towns across the country that do outreach to small businesses and created cost burdens for lenders. Afterwards, the agency claims they have improved the process.

This administration would also claim that these cuts are fine, and entrepreneurs simply need to do more with less, yet, at the same time, SBA has not been able to balance their books for the past four years. They have not had one clean audited opinion since these cuts began. If Mr. Barreto was the CEO of a corporation with this track record, he should be removed by stakeholders.

The bottom line here is that our small businesses deserve better than this, yet we are facing a massive budget deficit now, and we are involved in a war on terror. These entrepreneurs are some of the most patriotic people out there. They will do anything to help out. However, it is not fair that we expect them to bear the burden of these cuts once again.

I will say to my colleagues on the other side of the aisle and in the administration, if you do not believe in these programs, and if you think they deserve to be cut, that is fine; just say it. Let us have that debate. I have no problem standing up for these programs. I do believe in them, and I know they are valuable, but do not cut these programs year after year, mismanage them into the ground, and then come to the Committee and claim things are better than ever before. That is simply wrong. Our nation's entrepreneurs know this, and they deserve better than that. They deserve to be told the truth about where people stand on these programs. Let us give them that much. Thank you, Mr. Chairman.

[Ranking Member Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much.

Mr. Barreto?

STATEMENT OF THE HONORABLE HECTOR BARRETO, SMALL BUSINESS ADMINISTRATION

Mr. BARRETO. Thank you, Mr. Chairman, Ranking Member Velazquez, and members of the Committee. Thank you for inviting me here today to discuss the president's budget request for the SBA for Fiscal Year 2006.

The past year was not without its challenges for SBA. However, I am proud to say that last year was a great success for both the administration and this Committee. We were faced with several critical issues, and we worked together to reach agreements that benefitted both America's small businesses and America's taxpayers.

When 7[a] loan demand exceeded its budget authority, SBA and the Committee were able to come together with our lending industry partners to provide an additional $3 billion in lending for the 7[a] program at no expense to the taxpayers. This allowed the agency to lift the loan caps and guarantee a record $12.7 billion in small business loans in 2004.

At the beginning of Fiscal Year 2005, SBA began operating the 7[a] program at a zero-subsidy rate. This trial period showed that a zero subsidy would not hinder access or delivery of the 7[a] program. As a result, SBA, the Committee, and the lending industry came together to craft legislation that ensured long-term stability in the program.

Since October 1st, SBA has guaranteed over $4.4 billion in loans, and our lending partners have shown renewed support for the program. In addition, we are making more loans than ever to minorities, to women, to veterans. At this time last year, SBA's program under the Small Business Act had not been reauthorized for over four years, and the agency and the Committee seemed to be deadlocked in the negotiating process. However, persistence and diligence in pursuit of this goal produced a compromise, two-year SBA reauthorization which the 108th Congress approved.

Chairman Manzullo, I would like to compliment you and your staff on ensuring that this compromise was part of the Fiscal Year 2005 Omnibus Appropriations Act and for your support of SBA's efforts to become more efficient. This legislation allows the agency to better serve more small businesses at less cost. Our Fiscal Year 2006 budget submission reflects a continued commitment to this goal.

Small business customers are taxpayers and understand the need to cut unnecessary costs and to keep up with an ever-changing marketplace. Last year, I stressed to you that SBA's goal was to do more with less. I know that in Washington, D.C., it is difficult to imagine supporting a program without continually increasing its budget, but SBA has proven that it can be done. Since I became SBA administrator in 2001, the agency's annual appropriation has decreased, yet SBA's programs have reached more and more American entrepreneurs year after year.

Last year was a great example of this kind of success at the SBA. The agency provided a record $21.3 billion in loan guarantees and related financing for nearly 88,000 small businesses. Out of that $21.3 billion, nearly one-third went to women-owned and minority-owned businesses, more than in any prior year. Over $500 million went to African-Americans. Approximately $2.8 billion went to women, over $1.2 billion went to Hispanics, and over $115 million went to the Native American community.

These figures represent the administration's continued commitment to ensuring that SBA's loan programs serve those businesses that would otherwise have a difficult time accessing capital from the lending world. SBA's core infrastructure of technical-assistance programs—SBDCs, SCORE, Women Business Owners, and district offices—provided their services to record numbers of small businesses in Fiscal Year 2004. SBA's Entrepreneurial Development programs provided expertise and guidance to entrepreneurs who have the drive and the idea but need a little help putting all of that together into a working business plan.

SBA continued to support the federal government's statutory commitment to provide a fair share of contracting dollars to small businesses. Small businesses received a record number of federal contract dollars in Fiscal Year 2003, $65.5 billion, and exceeded the 23-percent, government-wide goal.

SBA has also been innovative in creating contracting opportunities for small businesses. For example, the Business Matchmaking program has given small businesses around the nation a better opportunity to obtain government and private contracts by introducing them to procurement officials who otherwise would be very difficult to meet.

The program stimulates jobs and growth for small businesses by taking advantage of opportunities that are normally confined to distinct geographical areas, such as Washington, D.C., or a city where a major corporation is located. Since the program started two years ago, 23,000 one-on-one appointments between small business owners and federal and corporate procurement officials have been conducted. This allowed small business firms to learn about and bid on procurement opportunities in their areas of expertise.

As a result, $29 million in federal and private contracts have already been awarded.

SBA has been active in other areas of contracting as well. I am proud of the hard work done to implement the provisions of Public Law 108-183 in record time, providing contracting officers with a powerful tool to award contracts to those who have given so much to our country: service-disabled veterans.

In December, the agency implemented a new policy to more accurately monitor contracts when a small business is purchased or merged with a larger business. The new policy requires the business to recertify itself as small when federal contracts are transferred to it in order to continue to be counted as a small business contract.

For years to come, victims of the worst hurricane season on record will remember how SBA helped them to get back on their feet. During Fiscal Year 2004, SBA's Disaster Assistance program provided more than $884 million in low-interest loans to over 28,000 homeowners and businesses. The supplemental appropriations allow SBA to increase these numbers to over 100,000 loans for up to $4 billion. This will enable the local economies to recover as quickly as possible.

President Bush understands the vital role of America's small businesses and the role that they play in creating opportunities. He also recognizes that small businesses generate approximately two-thirds of all of the new private sector jobs. The president's plan for economic growth and job creation, along with his Small Business Agenda, has been successful in creating an environment in which entrepreneurship can flourish.

Health care continues to be one of the largest burdens a small business owner must bear. Time and again, as I meet with entrepreneurs around the nation, they talk to me about the cost of health insurance, and it is only getting worse. We will continue to support the use of Health Savings Accounts and urge Congress to pass association health plans. We also plan to make the President's tax proposals permanent to help small businesses and their employees keep more of what they earn and reinvest that money in their families and their businesses.

Recognizing these successes, we look toward the future with renewed dedication to serving America's small businesses in a financially responsible manner.

Now, I would like to lay out the specifics of our Fiscal Year 2006 budget request. SBA's total request is $592.9 million. This request provides for a strong, active SBA that can effectively and efficiently meet the demands of its customers, America's entrepreneurs, while minimizing the cost to the taxpayer. Through improved management and program reforms, SBA will better serve small businesses.

SBA requests $16.5 billion in lending authority for its 7[a] loan program. This record amount of lending authority will provide the loans small businesses need in a timely manner and without disruption due to the stability of a zero-subsidy rate policy. This request will also give SBA the authority to provide $5.5 billion in loans through its 504 Certified Development Company program, also at no cost to the taxpayers.

SBA continues to support venture capital for small business. SBA requests $3 billion in authority for the SBIC debenture program. For 50 years, this program has provided venture capital success stories, such as Nike, Intel, Calloway Golf, just to name a few. However, we are not proposing to reinstate the Participating Securities program. In 10 years of operation, this program has resulted in reestimated losses of $2.7 billion.

Through a more flexible budget structure, SBA is seeking increased efficiency and quality of services. The request proposes that the agency work through its nationwide infrastructure of Women's Business Centers, Veterans Outreach Centers, SCORE chapters, SBDCs, and district offices.

This budget also includes continued funding for the agency's Disaster Loan program. As you are aware, the SBA is a major part of the government's mechanism to help disaster victims get back on their feet.

Some of the heaviest burdens borne by small businesses in America are the result of federal regulation and red tape. That is why I am pleased that the SBA's budget includes $9.1 million for the Office of Advocacy. This funding will allow Advocacy to fulfill its mission. In Fiscal Year 2006, the Office of Advocacy expects to save small businesses $5.6 billion in potential regulatory costs. Mr. Chairman, that is a substantial amount of savings for America's entrepreneurs.

All of us are quite proud of the agency's legacy of achievement. Many of today's most successful businesses received SBA assistance in their formative stages. Who knows which of tomorrow's industry leaders are today receiving their 7[a] or their 504 loans, their government contracting opportunities, or their counseling through SBA's programs and services?

However, we at the SBA cannot rest on our laurels. We must be forward thinking. We must anticipate changes in the marketplace and adjust our programs based on the realities of today's small business environment.

SBA's Fiscal Year 2006 request is good for America's small businesses and taxpayers. We ask for your support for our budget request. Thank you for the opportunity to appear here today. I am happy to answer your questions.

[The Honorable Barreto's statement may be found in the appendix.]

Chairman MANZULLO. Thank you, Administrator Barreto.

By SBA's own analysis, participating securities funds licensed between the years of 1994 through 2000 have performed as well as non-SBIC venture funds of the same vintage years that CalPERS invested in. Over $2.5 billion in leverage was invested in the three years, 1998 to 2000, immediately before the collapse of the economy. Thus, my question to you is, is it fair to ask how much of this loss is attributed to the recession, and how much to a flawed program?

Mr. BARRETO. Well, Mr. Chairman, as you mentioned, there are a variety of reasons why this has happened. Some of it has to do with the downturn in the whole venture capital industry over the last couple of years. Some of it has to do with the way that the Venture Capital program was structured and the profit participation in that structure. Some of it has to do with the funds that were chosen to invest in.

I cannot give you an exact number. I would be happy to go back and research this for you, but I think there is a combination of reasons why we have seen this downturn. I do not think we can say it is just one reason.

Chairman MANZULLO. Would you be willing to commit to working towards a solution of this problem and the participating securities?

Mr. BARRETO. Absolutely, Mr. Chairman. As you know, we have been in a dialogue all last year with the industry, with this Committee, and we are committed to continue those dialogues and stay in a relationship with all of the stakeholders to determine the best approach for the Participating Securities program.

Chairman MANZULLO. Could you provide the detail on the changes made in the 7[a] subsidy rate and reestimate models? These changes have caused an increase in lender fees. What will you do to stem further increases in lender fees?

Mr. BARRETO. Well, one of the things I want to do is put this into perspective. Obviously, the fees are still within the framework that we negotiated last year. It is going to be 54.5 basis points. We had a max of 55 basis points. We think that this change is incremental. It is a nominal change and should not affect the small businesses. Obviously, these are the fees for the lenders, the lender fees.

Chairman MANZULLO. If I may interrupt,—

Mr. BARRETO. Sure.

Chairman MANZULLO. —if the fees get too high for the lender, then they will drop out of the program. So we are willing to work with the SBA on a zero subsidy because that is our goal, and so I do not have to go to the well every year to get 77 to $100 million, but I would just advise the administrator that if the fees increase too much on the lender side, then the whole program will collapse.

Mr. BARRETO. I completely understand, Chairman.

Chairman MANZULLO. Okay. Did you have more that you wanted to talk about on the 7[a]?

Mr. BARRETO. I brought several charts to kind of give you an idea of where we have been with regards to the subsidy rate. It is really incredible what we have been able to accomplish—

Chairman MANZULLO. Why don't you go ahead because I cut you off?

Mr. BARRETO. —with this Committee. If you will notice, this chart on the far left is the 7[a] subsidy rate from 2001 to 2006, and what you see here is a line that has precipitously gone down. I remember the first time I testified before this Committee, I was told that we had a severe problem with the subsidy rate for the 7[a] loan program, and that had been a chronic problem for years and years. As you see, working together, we have been able to take that subsidy rate down from where it was, almost 1.2 percent, down to zero.

The other thing I wanted to mention is that I also understood from our lenders that this was a critical issue for them, and what they explained to me is that they needed to have consistency in the program, that they could not afford for this program to shut down for one day, that they have millions of dollars invested in this, and what has happened by us working together and getting to zero subsidy, we have been able to avoid that. We have been able to increase the budget authority. We are not going to have to put caps on these loans anymore. We are not subject to the fact that we have not had a budget at the beginning of our fiscal year.

So we believe that the zero-subsidy solution that we have come up with has been very positive for our lenders, for our small businesses, and obviously we are seeing the fruits of that. Right now, our loans at the beginning of this year are up double digits again, well in excess of 20 percent in the 7[a] loan portfolio, so we are building on an historic year that we already had last year, and this will be the best year in our history in terms of 7[a] loans, not only numbers but the dollars that we will guarantee for every community.

Chairman MANZULLO. Thank you. Ms. Velazquez?

Ms. VELAZQUEZ. Wow, Mr. Barreto. That is a lot of loans. That is great.

Mr. Barreto, can you tell me how many lenders are in SBA's loan program?

Mr. BARRETO. Well, in total, it is approximately 6,000 lenders. These are not branches. These are 6,000 different lending companies.

Ms. VELAZQUEZ. I think it is closer to 10. Barely 25 percent of these 10,000 lenders made a loan last year. Why? Do you think it could be due to industry consolidation?

Mr. BARRETO. No, ma'am, I do not. What happens a lot of times is that there is somebody that has been signed up for the SBA program, and they may not have done a loan with us for years, and some of that just has to do with education. You know, what happens out there is a lot of times they believe that they understand the SBA program, but they do not understand all of the changes that have occurred in the SBA program and how this can be a good business opportunity for that bank.

So the training and outreach that we do to lenders of all sizes is critically important, not only to attract new lenders but also to maintain lenders.

Ms. VELAZQUEZ. You do not understand my question, Mr. Barreto, and I do not have much time, and I have a lot of questions to make. I do not want to leave the impression that there are not any lenders that love the program. There certainly are. In fact, one lender makes nearly 20 percent of all 7[a] loans, 20 percent, Mr. Barreto, and 0.2 percent of the lenders account for almost 70 percent of the entire 7[a] program's lending. Is this level of concentration something that SBA is proud of?

Mr. BARRETO. Well, obviously, we want to work with as many lenders as we possibly can, and also we understand that one size does not fit all. We have some large lenders that do a lot of loans, but we also have some community lenders and rural lenders that make very few loans as a percentage but are critically important to the communities they serve.

Ms. VELAZQUEZ. No. That is not the case, Mr. Barreto, because maybe this is not a problem because lenders are geographically dispersed, but that does not seem to be the case. The majority of the lenders are concentrated along the East and West Coasts, leaving middle America without adequate access to the program. What are you doing to reengage the smaller community lenders in this part of America?

Mr. BARRETO. As you know, we have a responsibility to serve every community in America. That is why—

Ms. VELAZQUEZ. But it is not happening.

Mr. BARRETO. That is why we have 70 major program offices in every state. I would tell you that we work very closely with our district directors, and we make sure that they are reaching out to all of the lenders in their community. In fact, I have personally been involved in this outreach effort. When I go into the a community, oftentimes what will happen is we will set up business roundtables for lenders in that community.

Ms. VELAZQUEZ. Okay, Mr. Barreto. Is SBA providing more localized outreach and education to lenders and working one-on-one with these smaller lenders? Are you doing that?

Mr. BARRETO. Absolutely. You know, I would like to share with you—

Ms. VELAZQUEZ. Let me ask you another question. You said "absolutely."

Mr. BARRETO. Yes, ma'am.

Ms. VELAZQUEZ. The agency has fired, relocated, or forced into retirement much of the district staff that was responsible for working with lenders, mainly smaller banks that do not have the resources to fully operate the 7[a] lending program. Is the agency looking to draw more out of the program by making the processes smoother for lenders?

Mr. BARRETO. Well, first of all, let me make sure that we characterize this correctly. We are not forcing anybody out of the agency, firing anybody, et cetera, and some of the individuals that you mentioned that retired actually did not—

Ms. VELAZQUEZ. Didn't you send a letter to staff saying either you relocate, or you will be fired?

Mr. BARRETO. Again, in that particular instance, these were for people that were liquidating loans, not generating loans. These are the individuals—

Ms. VELAZQUEZ. Let us move on here. What is it that you are doing to make the program smoother?

Mr. BARRETO. Can I share with you this chart right here? This is our 7[a] loans to lots of communities that you mentioned, and what you see here is almost a stair step of progress over the last four years. What you see here, these are loans to minorities.

Ms. VELAZQUEZ. Sir, answer my question. What is it that you are doing to make the program smoother?

Mr. BARRETO. Well, you know, when I was in business, Congresswoman, I used to say that you learn a lot more by listening to your customers than you do by talking at them. What we have done is we have brought those lenders in, of all sizes, and asked them how the SBA could be a better partner. That is why you have seen so many changes to the program.

Ms. VELAZQUEZ. Okay, sir. Let us talk about small businesses now.

Mr. BARRETO. Okay.

Ms. VELAZQUEZ. During the fourth quarter of Fiscal Year 2004, the last quarter before SBA raised fees on small businesses, the SBA did nearly $4 billion in 7[a] loans. When compared to the most recent quarter that you are so proud of,—you were just talking about all of the numbers—this shows a decline of nearly half a billion dollars in 7[a] lending. What impact has the SBA fee increase on small business owners, which added between $1,500 to $3,000 for each loan, had on this decline in SBA lending?

Mr. BARRETO. First of all, let me make sure that we characterize it correctly. The SBA did not raise the fees on lenders. Those fees went back to previous levels because legislation that this body put forward expired. So SBA did not raise those fees; those fees just went back to a normal level.

Ms. VELAZQUEZ. Sir, you have the flexibility to lower the fees if you want.

Mr. BARRETO. I would like to answer the question in terms of what effect it has had. The effect that it has had is that so far this year we are up 27 percent on the 7[a] loan, we are up 16 percent on 504 loan, we are up 55 percent to African-Americans, we are up 49 percent to women, 15 percent to Hispanics, 285 percent to other minorities. We are on track—

Ms. VELAZQUEZ. We are talking about 7[a]. We will talk about loans to minorities later because I am going to stay here until I ask you the question.

Mr. BARRETO. Yes, ma'am.

Chairman MANZULLO. The gentlelady's time has expired.
Mrs. Musgrave?

Ms. MUSGRAVE. Mr. Chairman, I apologize. I had a radio program to do. I hope this has not been asked, but could you please comment on the HUBZone program and any changes that have been made to it? Much of my district is rural, and so this is very important to me.

Mr. BARRETO. Well, as you well know, Congresswoman, the HUBZone program has been a very successful program over the last couple of years. Procurement levels inside of that program have been consistently rising.

One of the things that we have done is we have wanted to make sure that we have gotten more firms who are interested in this program registered in this program, and we have had great success there as well. I want to say that we have over 7,000 firms now that are part of the historically Underutilized Business Zone program. We work very closely with the industry, the HUBZone national organization, and Ron Newlan, and we participate in a lot of their activities. We are also inviting lots of HUBZones to participate in our procurement events, the Business Matchmaking events that we do.

So as we do with all of our programs, we are wanting to make sure that we are capitalizing on every opportunity, and some of this is just getting the word out. A lot of times people do not realize that they could register for a number of different programs. In other words, they could be an 8[a] firm, they could be a HUBZone firm, they could be a small disadvantaged business firm, they could be certified as a woman-business-owner firm, and that just gives them more opportunities to access those federal contracts.

Ms. MUSGRAVE. Thank you, Mr. Administrator.

Mr. BARRETO. Thank you.

Ms. MUSGRAVE. That is all, Mr. Chairman.

Chairman MANZULLO. Congresswoman Bordallo?

Ms. BORDALLO. Thank you very much, Mr. Chairman, and thank you for your testimony, Mr. Barreto. What I got out of it was cuts are more efficient, but, you know, Mr. Barreto, cuts have far-reaching effects on people.

I am very concerned to hear about all of the cuts in the domestic programs across our nation. I really am very concerned, particularly in the area of the small business. I know the ranking member here mentioned the fact that some people were asked to relocate.

Well, I am from Guam. We have a very small program there, but it was a very important program. We had 12 to 15 employees, and I guess they received your letter, and, you know, it is rather difficult to relocate when you are 10,000 miles away. So now we are down to three, with one employee on loan from Hawaii. So we are not in very good shape, and I have a few questions to ask you.

First of all, on the 7[a] loan program, you have terminated or transferred over 100 district and branch office loan program staff as part of its workforce transformation. Now, that means that the Guam branch office has been practically decimated, and with the loss of these employees, the district offices are having problems bringing new lenders into the program. How is SBA ensuring that there will be adequate staff out there to help? What are your specific plans?

The other one, and I want to bring them all together because they are all basically the same, if you terminate the 7[m] Microloan program, completely terminate it, there is a void in the provision of technical assistance to low-income entrepreneurs. Do you plan to add SBA district staff to reach out to serve this particular community?

And then on the Women's Business Centers, once again, the budget request for the WBCs has remained the same as last year, yet you would like to expand the clientele served by this program. How do you think this is going to happen?

Mr. BARRETO. Thank you for the questions, Congresswoman. I will be happy to answer those in the order that you presented them.

First of all, you are referring to what the SBA, and not just the SBA, but government, has been going through over the last couple of years. We need to continually look for ways to be more efficient to do the right things and to do them better. Any business has to do that all of the time. We are not a business, but we also have to be concerned with efficiencies and the effectiveness that can come from those efficiencies.

The individuals that you mentioned were liquidators; in other words, folks that were responsible for liquidating a loan after it had gone bad. These were not the individuals that were out there generating new loans. We did not terminate them, but we terminated the functions that they performed inside of those district offices.

What was happening to us was a lot of the lenders said to us; look, we cannot have 70 different ways of doing it. You have got to centralize this so that we can have a better situation, we can save time, and obviously we will make more money by doing that. And so that is what has happened. We offered those individuals an opportunity to move to another location to be able to continue the work that they did, and obviously it had some impact on individuals that decided that they did not want to move. But these are things that happen, again, in every organization and in every business.

With regards to the Microloan program, and I would like to ask that we put up our Microloan chart, you know, the thing that has happened for us there, and we have been aware of this for a long time, is that we do not do a very good job on Microloans. It costs us a dollar for every dollar that we lend out. We did 2,400 of these loans over the last year. At the same time, I did 10 times that many loans of the same type and size, loans under $35,000, inside the flagship loan program.

At the same time, there are other entities that are making these loans. There are 600 nongovernment microlenders that do a phenomenal job, so it is not like small business does not have other places to go. But we have determined that this is a program that we can much better deliver those kinds of services to those communities in our regular programs, our regular network of providers.

This map right here shows you a depiction, and you have a copy of this in front of you, of all of the resource providers that we have across the United States. It is one of the things that makes SBA so strong.

With regards to Women's Business Centers, I guess, this is another conversation that we have had over the last couple of years. We understand very clearly that the fastest-growing segment of small business in the United States are women business owners, but the purpose of Women's Business Centers was for us to give these organizations a hand up, not a handout, but a hand up, to allow them to get started and, over a period of five years, to become self-sufficient.

What we have seen with Women's Business Centers, those centers that are being successful, that have been around for five years, are oftentimes in partnership with another organization. In other words, they are leveraging their resources. They may be working with a chamber of commerce or a business association. At the same time, we are concerned that there are large segments of the United States that do not have an opportunity to get a Women's Business Center because we continually invest all of the money in the existing centers instead of what the program was intended to do.

An example, and something that Congresswoman Millender-McDonald knows, is that up until recently, we did not have a Women's Business Center in Los Angeles. One of the cities with the most small businesses in the United States did not have a Women's Business Center. That is impossible to believe, but that was the fact. There are other areas around the country that fall into the same situation.

We are committed to Women's Business Centers. We are committed to women. We are excited about the results that we have seen for women over the last couple of years. Loans are at historic highs, contracts are at historic highs, training is at historic highs, and we are going to continue that commitment this year and in the years to come.

Chairman MANZULLO. Thank you.

Ms. BORDALLO. Mr. Chairman, if I could just make a concluding remark, I appreciate your answers to the—

Chairman MANZULLO. I understand, but other members have—I have gone over one and a half minutes.

Ms. BORDALLO. I am just going to invite Mr. Barreto to come out and observe our Guam office. It is the greatest complaint I have as a public official.

Mr. BARRETO. Yes, ma'am.

Chairman MANZULLO. Thank you. I am coming if I get a chance. I am coming. You know that.

Mr. Bradley?

Mr. BRADLEY. Thank you very much, Mr. Chairman. Mr. Barreto, always a pleasure to see you here. Mr. Chairman, I know you have taken a bit of a tongue lashing this morning, so I want to thank you for your advocacy on behalf of an American—

Chairman MANZULLO. If the gentleman would yield, I have a great relationship with Mrs. Velazquez. Her passion for small business is unsurpassed, and I respect her. She is a great member of Congress, does a tremendous job, and whatever she says comes from her heart,—

Ms. VELAZQUEZ. And the truth and the facts.

Chairman MANZULLO. That is correct. Thank you. I am doing fine, thank you.

Mr. BRADLEY. I would like to talk about the facts of how you helped a company in my district enforce the provisions of the Buy America Act, and were it not for your advocacy and your willingness to hold a hearing, my company would not have been able to expand its workforce by 10 percent.

And Hector—excuse me—Mr. Barreto, I just received an e-mail yesterday or this week from a gentleman whose 7[a] loan program was caught up in a lack of funding perhaps a year ago, and you and I talked on the phone about that, and he told me the success of his company.

I truly think, when I look at your budget numbers, going from a budget authority of about $800 million as recently as 2003 to what is being proposed now, just slightly under $600 million, juxtaposed with those graphs that you have shown us today, show that you have been able to do more with less, that you have run a government agency the way a business should be run, doing more with less, more efficiency, better use of technology, all of the things that the productivity of our economy has improved. You have made your government agency do that, and you have been able to increase your overall capacity to make these loans and to get them out there to the people that need them the most.

So I salute you for that and look forward to continuing to work with you. I would yield back the rest of my time, because you have not had a lot of time to talk about the charts that you have had up there, and allow you to, you know, go into them in further depth. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you, Congressman.

Congressman Grijalva from Tucson?

Mr. GRIJALVA. Thank you, Mr. Chairman and Ranking Member. I am very glad to be part of this Committee.

Mr. Administrator, I do not have the specificity in the questions at this point, but as I get acclimated, I will. If I may just ask for a comment on something. In reading your submitted remarks, you mentioned the importance of SBA, the agency that you administer, supporting the President's agenda for small businesses. No point of difference there. Then you talk about health plans and the cost impact on small businesses, and I agree. I think this Committee should explore all options in terms of how we provide relief there.

You mentioned the 800-pound gorilla in your comment, which was social security. If I am not mistaken, as part of the comment, and I think the ranking member mentioned social security as an issue that maybe this Committee should talk about, as it is going to be a primary area of debate for Congress in the coming days and months.

Let me ask you a question. We can debate the size of that 800-pound gorilla. We can debate the issue of whether it is a crisis or a challenge, and we will do that, but let me ask you another part of a gorilla that I see, and that is the deficit, the debt ceiling, the trade imbalance, and the impact that that is having on small businesses across this country. And one of the obvious impacts, to me, is the more-with-less mantra that we are hearing more and more about in domestic programs because you do have less, regardless, in an effort to try to deal with that deficit that has been created in the course of the last four years.

So respond for me or have a dialogue regarding how you see this other gorilla I see and its impact on small businesses: the deficit, the debt, and the trade imbalance that this country has.

Mr. BARRETO. Sure. Thank you, Congressman Grijalva, and welcome to this Committee. I am looking forward to working with you and providing any information that you might need on any of these programs.

I did not mention social security in my remarks. I have spoken about it before, but anything that affects the economy is definitely going to have an effect on small business. You know, we say all the time that small business is the engine that fuels the economy, and it is true. Fifty-two percent of the gross output—in other words, of all of the products and services that are produced in the economy—comes from small business.

Small businesses also are creating most of the net new jobs, and we talk about that, but a lot of times small business does not get the credit for creating those jobs. A lot of times, people do not realize that small business also creates a lot of the innovation and technology. Small business has 14 times more patents for products than large businesses do, but you would think that all of the great inventions come from big business. They do not; they come from small business.

So we need to do everything that we can—the President talks about this all of the time—to create the right environment. That is why I am proud of this budget because this budget is fiscally responsible. The President wants to cut the deficit in half over the next five years. With regards to trade, that is a huge opportunity as well for us. Ninety-seven percent of all companies that do international trade are small businesses, 225,000 companies, but they only represent 30 percent of all of the trade that is going on. So any time, and I know this is very important in your state, any time that you create more opportunities, grow the pie, you are helping those small businesses to grow their opportunities, as well.

But small businesses need a lot of things. They need permanent tax relief. They need regulatory relief. They need tort reform. They need an energy policy. They need access to affordable health care. They need new markets. All of those are part of the president's small business agenda. So we not only work at providing them the tools in the SBA, but we also work hand in hand with the administration and this Committee to create an environment where small businesses not only can start their business, but where they can be successful over the long term.

Mr. GRIJALVA. I appreciate it. Thank you, Mr. Chairman. I have no other questions.

Chairman MANZULLO. Thank you, Mr. Grijalva.

Mr. GRIJALVA. I appreciate that.

Chairman MANZULLO. Thank you. Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Mr. Administrator, for taking the time to be here with us today and for your professionalism. You obviously have great knowledge of not only the programs of SBA but what is going on in small business. This has been very helpful to me as a new member of Congress.

I have been a public official for 10 years before coming to Washington. Over the course of those years, I have referred quite a few members of the small business community of Bucks County, Pennsylvania, southeastern Pennsylvania, to the SBA, and I have been very happy with the responsiveness and the programs of the SBA, as have those small business persons. But one of the issues I hear from time to time has to do with the length of time in loan processing. I was wondering if you have any ideas, whether it be creative staffing of the processing center, something that could be done to reduce the loan processing time.

Mr. BARRETO. Thank you very much for that question, Congressman. You are absolutely right. You know, I referenced that when we sat down with those lenders, and, by the way, we just do not sit down with them once; we sit down with them on numerous occasions, and I meet with them all across the country, but they are constantly asking us to streamline our processing. I think I was talking to Congressman Westmoreland about this, that they said to us, you know, time is money. We are not philanthropic organizations. If you can save us time, we can make more money, and we can make more of the loans that you want to make.

So we have implemented a lot of the recommendations that the lenders wanted us to do. For example, on the SBAExpress Portfolio, we allow the lenders to use their own form, not our form. We allow them to transfer information to us electronically now through eTrans. So this is happening almost real time now. We allow them to make their own decisions. They do not have to go back and forth to the SBA and negotiate a buying decision on an SBAExpress loan. So all of those things have helped speed up the time.

On top of that, I have referenced some of the transformation efforts that we have been undergoing over the last couple of years. We have literally been able to shave down the amount of time it takes us to actually process the loan, once we receive it, from weeks down to days now on both the 7[a] loan portfolio and our 504 loan portfolio. That has been one of our big successes, as well. And so we continually stay committed to finding ways that we can even squeeze more efficiencies out, and I believe that we still can. The chairman referenced using technology even more to be able to cut out a lot of that time.

You know, when I was in business, small businesses like to say, "I can take a yes, and I can take a no, but those maybes kill me." So we are removing a lot of the maybes out of doing business with the SBA.

Mr. FITZPATRICK. That is good news. Congratulations.

On the 7[a] program, I noticed one of your previous graphs was talking about the subsidy going from one-point-something, I think, to zero. I suspect that that must have resulted in a net savings to the American taxpayers.

Mr. BARRETO. That is absolutely correct, Congressman, and I think that is one of the points that gets lost. When we talk about the funding differentials, we are really not talking about that much difference in terms of what we have been spending on these programs over the last couple of years. There will be some differences, but when you are at zero subsidy, you are able to save the American taxpayer well in excess of $80 million that we used to need to be able to provide these loan programs.

This program now is self-sufficient, the way that our 504 portfolio has, the way that the venture capital program has, so we have history, we have precedent here, and it is one of the things that is really allowing us to be much more efficient than we ever have been, but you are right. We have saved the taxpayers about $80 million just by going to zero subsidy.

Mr. FITZPATRICK. Thank you, sir. I appreciate it.

Mr. BARRETO. Thank you.

Chairman MANZULLO. Congresswoman Millender-McDonald?

Ms. MILLENDER-MCDONALD. Thank you so much, Mr. Chairman, and good morning, good morning. It is great to see you, Mr. Barreto. It was great to be with you on the "McLaughlin Show."

Mr. BARRETO. Thank you for being part of that.

Ms. MILLENDER-MCDONALD. It is great to have you, as a Californian.

Mr. BARRETO. Thank you.

Ms. MILLENDER-MCDONALD. At the time that you and I were on that show, I mentioned to you that if the President was really for small businesses, he would have authorized your budget. We have yet to see that, and by your own admission this morning, you say that we did not get that authorization.

When we look at the 2006 budget that he is proposing, we are still looking at an anemic budget proposal for the Small Business Administration. It appears to me that if he has this cognition of knowing that small businesses are the engine that drives the economy, and you know that, Mr. Barreto, he would not do the cuts that we are seeing proposed in his budget.

So my question to you is, and hopefully I will send a letter myself to the President asking him, why is it that he is cutting so much from SBA budget when he wants to create this environment of more jobs, helping Women Business Centers, which has really no money, and as you said by your own admission, Los Angeles did not have one initially; Long Beach—that one was taken away. We are talking about some of the largest cities in the State of California not having even the technical assistance that would help drive the women.

But as I look at this notion of the President terminating nine of 25 top SBA programs, can you identify what those nine are because we cannot continue to say that the President really does embrace small businesses when he is cutting at this type of rate? And, again, the proposed budget is nearly half of what it was when President Bush took office. So when we are talking about the 2006 budget and the President wanting to create this type of positive climate for small businesses, it is not identified in his proposals of the small business cuts.

So I just want you to talk about that, and you did a litany of the loans to minorities and Native Americans, and yet the Native Americans with the highest unemployment, that program, the Native American Outreach program, has been zeroed out. Please tell me what is it that this President is trying to say to us when we are trying to tell small businesses that this President wants them to flourish?

Mr. BARRETO. Thank you for the question, Congresswoman. Let me see if I can put some of this into perspective. You know, I mentioned to Congressman Fitzpatrick that you could start right away with the $80 million-plus that we saved on the 7[a] appropriation that we used to need. That is going to be a differential that we saw in previous budgets; we are not going to see it in this budget.

You could look at monies that we used to request for disaster loans, but, as you know, we got a tremendous amount of resources through the supplemental, and we still have a lot of that money left over. You could look at, for example, something that we might see in the future is some of the money that is going to be added for congressional initiatives. We did not ask for any money for congressional initiatives. That is going to have a differential.

But when you look at the money that we spend on all of our major programs and services, for example, the money that we put out into the district offices; that money is still there. The money that we put into GC/BD programs; that money is still there. The money that we have for all of our key programs is still maintained.

Ms. MILLENDER-MCDONALD. May I just interrupt you for a second to say that you were speaking about the total amount that you are putting into advocacy,—

Mr. BARRETO. Yes.

Ms. MILLENDER-MCDONALD. —which was a small amount, really, given that a lot of folks do not know about the money that you are talking about in these various districts. The advocacy program must be enhanced, and we must see that, equivalent to the money that the President should be proposing in his 2006 budget, and it is not.

Mr. BARRETO. Just to give you an example, in the 2005 appropriation line item, we are looking at in excess of a million dollars. In 2006, with all of the monies that we intend to spend on it, it will be over $9 million that we will be spending in the advocacy program. When you add in everything that we will provide for advocacy, we have allocated $9.13 million for the advocacy program. Now, just to clarify, it does not mean that we went from $1 million to $9 million because even though that $1 million was delineated as a separate line item. We also invested more, and we will in 2005, than just that $1 million. Significantly more.

Chairman MANZULLO. Let me cut you off. Let me move to Mr. Westmoreland to get in as much as I can.

Ms. MILLENDER-MCDONALD. Mr. Chairman, hopefully, the next time, we can have more time.

Chairman MANZULLO. Yes. Okay. I understand. Thank you.

Mr. WESTMORELAND. Mr. Barreto, thank you for being here today. You know, I want to thank you for small businessmen across the country, and I happen to be a small businessman, and I applaud you in the way you have handled yourself here today and also in the way that you have run your agency.

Mr. BARRETO. Thank you.

Mr. WESTMORELAND. You know, sometimes people believe that the amount of money that you have or that you spend correlates with the efficiency of your business or your agency, and that may be a syndrome up here, and that is the reason that we spend so much money on so many of these agencies. We try to throw money at everything.

I want to commend you on being able to do more for small business with a less amount of money. I think that is a great attribute to you, and I know that coming into the office in 2001 after eight years of being under a different administration. From an entrepreneur's standpoint, it is easier to start a business than it is to come in and take over a business. I think you have done a wonderful job in coming into a situation where you have had to trim fat. You have had to put the administration on a diet, so to speak, but not cutting any muscle, and still providing and increasing the loans for the people who do it.

And the other comment is I want to commend you also, from when we talked yesterday, about making it easier for lenders to operate with the Small Business Administration. You know, you can have 10,000 lenders, you can have 20,000 lenders, but you cannot make them do business. You can just make it as easy for them to do business, and that is really the government's responsibility. It is not to make it harder. It is not to make it more complicated. It is to make it simpler so our citizens know how to interact and companies know how to interact with government, and I think you have done a wonderful job with that.

So I just want to thank you for what you are doing, for the job that you took on, coming in and being able to do what you have with the amount of money that you have had to do it with. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you. Mr. Lipinski?

Mr. LIPINSKI. Thank you, Mr. Chairman. I look forward to working with you and with Ms. Velazquez on this Committee. I think we all share the desire to help out small businesses. I know I have hundreds of small businesses in my district, and I look forward to doing what I can to help them on this Committee.

And Administrator Barreto, I have no doubts about your commitment and your expertise in this area. I do have concerns—I share concerns with some of my colleagues—about the budget for this year, but I do believe that you are certainly committed to small business, and I look forward to also working with you and seeing what we can do, and hopefully maybe we could get a little bit of help. Maybe we could get a better budget, get some more help for our small businesses in that budget. I look forward to working on the Committee and working with you.

Mr. BARRETO. Thank you very much, Congressman.

Chairman MANZULLO. Thank you. We have got to go vote. Mr. Barreto, if you would not mind sticking around. In the interest of fairness, I have acquiesced to Mrs. Velazquez's request for five more minutes of questioning.

Mr. BARRETO. Sure.

Chairman MANZULLO. Okay.

Ms. VELAZQUEZ. Thank you for your kindness.

[Whereupon, at 11:28 a.m., a brief recess was taken.]

Chairman MANZULLO. If the other witnesses could be seated, as soon as we are done with the additional five minutes from Mrs. Velazquez with Hector Barreto, then he will be excused, and we can move immediately into the opening statements of the second panel.

The gentlelady from New York is recognized for five minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Barreto, let us see if we can do this again. Let us talk about small businesses and access to capital.

During the fourth quarter of Fiscal Year 2004, the last quarter before SBA raised fees on small businesses, the SBA did nearly $4 billion, in fact, $3.95 billion. When compared to the most recent quarter that you are so proud of, this shows a decline of nearly half a billion dollars in 7[a] lending. Again, I ask you, what impact has the SBA fee increase on small business owners had on this declining SBA lending?

Mr. BARRETO. First of all, Congresswoman, let me also put that in perspective. We had a tremendous fourth quarter of last year, and I believe that a lot of that was in anticipation of us coming to a zero-subsidy-rate program this year. In other words, lenders were taking advantage of the fee structure in the fourth quarter, so we got a tremendous amount of volume that we normally do not see in a fourth quarter. Having said that, our first quarter is doing phenomenally well.

Ms. VELAZQUEZ. Let us talk about January of this year. This January, the 7[a] loan volume average, $47 million per day, this is 16 percent below last January when it was shut down and even averaged $56 million per day.

Mr. BARRETO. Well, what we believe is happening is a lot of the loans that we would have seen in January in a normal course of business, we saw those at the end of—

Ms. VELAZQUEZ. Can you answer, if the $3,000 fee has anything to do with this decline?

Mr. BARRETO. We do not believe that it does, and part of the reason why I say that is because every month so far, we have seen incredible increases.

Ms. VELAZQUEZ. So you do not think $3,000 is much for any small business person in this country.

Mr. BARRETO. We were averaging, in January of 2004, 42.6, and this year we are averaging 46.9, an increase on our daily average from a year ago.

Ms. VELAZQUEZ. Well, I guess we have a problem with the numbers that you have and the numbers that have been given to us, and you know what? The problem is that you have always had a problem with the numbers. They do not add up. When it comes to Medicare legislation and prescription drugs, it did not add up, and one more time it does not add up.

Let us go to minority businesses. There is a picture being painted by you that small business opportunities are increasing in the federal marketplace. In Fiscal Year 2002, SBA claimed that the small business achievement was 22.62 percent. Recently, the Office of Advocacy published a report contending that the $2 billion counted toward the small business accomplishment in Fiscal Year 2002 was miscoded and should not be included. If we subtract this $2 billion from the Fiscal Year 2002 small business achievement, the actual accomplishment was 21.62 percent, a full percentage point lower. Can we agree that the small business achievement in Fiscal Year 2002 is 21.62 percent rather than 22.62 percent?

Mr. BARRETO. Well, actually, Congresswoman, we actually believe it was 23.61.

Ms. VELAZQUEZ. So is Advocacy lying?

Mr. BARRETO. Well, first of all, I think we are talking about two different things.

Ms. VELAZQUEZ. Oh, are they wrong?

Mr. BARRETO. Well, if I may, I will describe the Advocacy study and also the—

Ms. VELAZQUEZ. Sir, I just want for you to answer my question. My question is about 2002, not 2003.

Mr. BARRETO. Right. That is absolutely correct. We are dealing with 2002 data, and obviously what we depend on is the FPDS, and that is where all of the agencies of government, 60 agencies of government, are responsible for putting their information in there.

Ms. VELAZQUEZ. My question is, 2002 goal was not achieved.

Mr. BARRETO. That is correct.

Ms. VELAZQUEZ. Correct. Okay. So let us move on.

After the mistakes in Fiscal Year 2002, SBA claimed that the small business achievement was 25.37 percent in 2003. What did SBA do from 2002 to 2003 to ensure that those large business contracts counted in 2002 would not be miscoded again in 2003?

Mr. BARRETO. You are referring to the Advocacy study, and one of the things that we did, even before the Advocacy study came out, is that we put a rule forward as our novation, rule that basically requires a small business—

Ms. VELAZQUEZ. And I know that, sir. I know about the rule. This is my five minutes' questioning, Mr. Chairman.

The rule is not regressive. Basically, nothing was done between 2002 and 2003 to fix it.

Chairman MANZULLO. We will let Mr. Barreto answer the question.

Mr. BARRETO. I think that one of the things that I want to make very clear is that we do not have a trend in the federal procurement environment where large contracts are being taken away from the small businesses on a wholesale basis. In fact, what we found when we looked at those, Congresswoman, is there are two main reasons that that happens. One is that a small business gets a contract when they are a small business, and we want these businesses to be successful, and then, over time, they fall out of the size standard because they have grown.

The other issue that we found is that sometimes small businesses, because they have been successful, are taken over by a larger business. In other words, they sell to a larger business. Those are the primary examples that we found in the advocacy setting, not that there are large businesses that on a wholesale basis are misrepresenting their size and taking contracts away from small businesses.

Ms. VELAZQUEZ. You are being dishonest with the numbers, and you have been cooking those numbers.

Mr. BARRETO. No, ma'am.

Chairman MANZULLO. You do not call the Administrator dishonest. All right? You may disagree with him.

Ms. VELAZQUEZ. Those numbers are dishonest.

Chairman MANZULLO. You are out of order.

Ms. VELAZQUEZ. General Accounting Office—

Chairman MANZULLO. The numbers may be dishonest, but do not call the Administrator dishonest.

Ms. VELAZQUEZ. This is my five minutes, and I am telling him—

Chairman MANZULLO. All right. Your five minutes have ended, Mrs. Velazquez.

Mr. Barreto, thank you for coming. I appreciate it very much and look forward to again working with you. Okay?

Mr. BARRETO. Thank you, Mr. Chairman.

Chairman MANZULLO. You are excused.

Mr. BARRETO. Thank you very much.

Chairman MANZULLO. Tony, if you guys could just shift down one, and our goal is to end at 1 o'clock because we have a series of votes coming up there, so please keep your opening remarks to five minutes or under. Tony, you are up first.

Mr. Wilkinson is the President and CEO of the National Association of Government Guaranteed Lenders, and, Tony, we look forward to your remarks. Thank you.

STATEMENT OF ANTHONY R. WILKINSON, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS, INC.

Mr. WILKINSON. Thank you, Mr. Chairman. I appreciate the opportunity to come before the Committee again.

As you know, last year at this time, I testified about the many challenges facing the 7[a] program, and thanks to the efforts of this Committee and our counterpart in the Senate and Mr. Barreto and his staff, that problem that we encountered in 2004 has been resolved. We finished Fiscal Year 2004 setting records with both numbers and dollars loaned. Fiscal Year 2005 is also off to a record pace, with almost $3.6 billion lent in the first fiscal quarter. As part of the compromise that we worked out at the end of the 108th Congress, the 7[a] program received a $16 billion program level for this current fiscal year, which should be sufficient to meet the net lending demands of small business.

A couple of comments on the Fiscal Year 2006 budget. The administration has requested a 16-and-a-half-billion-dollar program level. Some have already forecasted that all $16 billion available for this year will be used, and given the growth rate we are experiencing in the program, we respectfully request that this Committee support a $17 billion program for Fiscal 2006. That $17 billion level would match the authorization level that was passed in the Omnibus Appropriations Bill just this past December and would lessen the risk of any future program caps or restrictions. So please support a $17 billion program level.

There is also an increase in fees in the 2006 budget. From the start of Fiscal 2004 to the start of Fiscal 2006, lender fees will have increased 116 percent if the increase proposed in the 2006 budget is put into effect. Although the latest increase would be within the compromise we worked out in the 108th Congress, the trend of higher and higher fees must be reversed. It is disturbing that the 7[a] program faces further fee increases, considering that this compromise deal establishing fee levels was signed into law just a couple of short months ago.

It is also disturbing to see that the administration reports that the Fiscal Year 2004 subsidy rate has been reestimated downward by some 70 percent, which causes us great concern that, in one short year, we would see that kind of shift in the subsidy calculation for Fiscal 2004.

Chairman MANZULLO. Would the gentleman yield for a second? Tony, could you give me a letter setting that forth, and I will get it immediately to the administration to get an answer back ASAP?

Mr. WILKINSON. I will do that.

Chairman MANZULLO. Thank you.

Mr. WILKINSON. I appreciate your help in getting this clarified. We would simply like to see what has changed in the model and why, and to have an understanding about what is included in the subsidy model. We will get you that letter.

The Administration is also requesting the authority to charge a fee for loans sold into the secondary market. According to the 2006 budget in Table 6 of the Federal Credit Supplement, the administration shows that the projected subsidy rate for next year is zero, so there really is not any need yet. So we are opposed in granting authority to the SBA right now for this secondary market fee, and would urge the Committee, again, to review the subsidy calculation. We would like to see the subsidy calculation on the secondary market fee, as well.

As part of the compromise deal reached this past December, this Committee, the Senate Committee, and the Administration all agreed to a national Preferred Lenders program, and it was to be included in the Omnibus Appropriations Bill. Unfortunately, due to a clerical error, that provision was not included, so we would ask that that provision be included in the near future in any appropriate legislative package, particularly in any technical corrections bill which SBA will probably submit. We would like to see that national PLP program authorized.

Lastly, we still have a prohibition against piggybacks, or combination financing loans. We have submitted a proposal to SBA, which they are reviewing. Hopefully, we can come to some sort of agreement on the reinstitution of piggyback loans. With the piggyback prohibition now, many applicants have no solution to their needs of larger loan packages, so we would request your assistance as we continue to work on getting piggybacks reinstituted.

Mr. Chairman, that is my testimony. Thank you for having me today.

[Mr. Wilkinson's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much.

Our next witness is Chris Crawford, President and CEO of the National Association of Development Companies and Development Funding Corporation, from McLean, Virginia. I look forward to your testimony.

STATEMENT OF CHRISTOPHER L. CRAWFORD, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Mr. CRAWFORD. Thank you. Good morning, Mr. Chairman. My name is Chris Crawford.

Chairman MANZULLO. Chris, you have got to talk into the microphone there.

Mr. CRAWFORD. I am pleased to provide a statement on the 2006 504 budget and a couple of other 504 issues.

First, I would like to comment on the 504 2005 authorization situation. Certified Development Companies provided $4 billion in 504 financing last year, and when you add our First Mortgage Partners loans, this totaled $9 billion in long-term capital to small businesses. This represented an increase of 26 percent over 2003 and is truly a tribute to the growing demand for the 504 program to meet the capital needs of small businesses.

However, despite this Committee's efforts, a hard cap was placed on the 504 program for 2005 of only $5 billion. We project the demand will exceed $5 billion, and this does not include any forecast at all of the impact on the debenture increases nor the new manufacturing debenture that Congress passed last December. We plan to provide the Committee with a request to increase the authorization within a month as we assess loan demand. We will ask the Committee to sponsor an amendment to increase the 2005 cap.

Now, on to 2006. The Administration is requesting only $5.5 billion for 2006. For a loan program growing at an average of over 20 percent for the last five years, this is certainly going to be insufficient. We ask the Committee to approve an authorization level of at least $6.5 billion for 2006. With 504 at zero subsidy since 1997, there is absolutely no cost to the taxpayer and, therefore, no downside to this program level.

We congratulate the Administration on its success in centralizing both 504 loan processing and portfolio servicing. These changes have resulted in decreased program costs for 504 while substantially improving the service to both small businesses and to lenders. However, we are concerned that the Sacramento Loan Processing Center may have insufficient staff to keep up with the demand for 504 loans. We urge the Administration to both continue to streamline loan operations and to consider the need for added staff at that critical processing center.

There is one area of loan operations that needs increased attention by the Administration, and that is 504 liquidation and recovery. While SBA has reorganized to improve its other loan program liquidation activities, we are very concerned that 504 defaults are not being addressed sufficiently to maintain the OMB forecasted recovery rate of 42 percent in this year's subsidy model. Failure to address this critical issue will lead directly to increased loan fees for all future 504 borrowers.

SBA abandoned its asset sale program over two years ago while downsizing its portfolio management staff. That is what the administrator referred to as the "loan liquidators." They downsized the staff in order to centralize both 7[a] and disaster loan liquidations. Unfortunately, 504 appears to have gotten lost in the mix.

Since the last asset sale, there have been over 800 504 loan defaults, since the last asset sale in 2002. While the default rate has not increased, we are gravely concerned about the limited SBA efforts to recover on these existing defaulted loans. We ask the Administration and this Committee to work with our industry to increase the effort to recover on 504 defaults and to immediately publish for comment the liquidation regulation that is already drafted within the SBA. The sooner 504 defaults are addressed, the greater the recoveries will be for these projects.

Our industry recognizes both the leadership of this Committee and the administrator for strongly supporting 504, and we look forward to working with you to grow this no-cost program in the future. Thank you very much.

[Mr. Crawford's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Steve Vivian with the National Association of Small Business Investment Companies. Steve?

STATEMENT OF STEPHEN VIVIAN, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. VIVIAN. Thank you, Mr. Chairman, for inviting me to Washington today. It is an honor to testify on behalf of the National Association of Small Business Investment Companies and, specifically, to have an opportunity to express my personal disappointment that the participating securities program, a program which I have been involved with for six years and a program that works, has not been included for consideration in the Administration's Fiscal 2006 budget.

I request that my testimony be included in the record, and I will summarize it here, to the best of my ability, for you.

Chairman MANZULLO. The written statements of all of the witnesses will be included as part of the record. Proceed.

Mr. VIVIAN. Thank you.

First, we would like to acknowledge and thank the Administration for its continued strong support of the Debenture program, with a $3 billion recommended authorization for Fiscal 2006. However, as I indicated, we are confused, disappointed, and concerned for America's small businesses that the Administration proposes no participating security leverage in Fiscal 2006, particularly given the proposed $4 billion authorization level in Fiscal 2005.

I respectfully disagree with Administrator Barreto that the Debenture program alone will support America's venture capital needs. The Debenture program serves a critical role in the nation's economy but does not, and should not, be expected to incent debenture managers to serve the nation's smallest and youngest businesses across diverse industries and geographic with true equity venture capital. In fact, the genesis of the Participating Securities program in 1994 was a direct result of the government's belief that the smallest and youngest companies in our country cannot, and should not, be served by the Debenture program.

The Participating Securities program accounts for roughly half of all SBIC investment dollars and, since inception in 1994, has infused nearly $9 billion into U.S. small businesses. That $9 billion has been estimated to have created over 240,000 jobs and over $40 billion of portfolio revenue. The majority of those jobs and revenue were created during the recession while the rest of the venture capital industry was effectively in hibernation. Thirty-five percent of that $9 billion, or over $3 billion, went into small and growing U.S. manufacturing companies. That dwarfs anything coming out of the traditional venture capital industry into mainstream, rustbelt manufacturing.

This program works. It serves overlooked niches of this country's businesses which are avoided by the traditional venture capital community due to their size, their location, or their industry. These biases are understandable if one understands the traditional venture capitalist's mindset. However, these biases are amongst the key reasons why there is a need for this program.

Once again, I believe this program works. It works across the country. It works in the Midwest, and it works in Illinois, where over $240 million has been invested out of the $9 billion. In our small, Chicago-headquartered firm alone, our $50 million Participating Securities SBIC has invested in 14 companies. Six of those are headquartered in Illinois; ten of those are headquartered in the Midwest.

We have supported manufacturing and companies like Banner Service Corporation, which was a second-generation, family-owned business under consideration for liquidation and winding down by its owner. Together with another Chicago-based Participating Securities SBIC, we supported an entrepreneur who purchased the $17 million, Carol Stream, Illinois-based, manufacturing concern, and we are now going about the business of growing the company.

As a result of our investment and support of strong management, in a little more than a year, the business has increased revenue and profitability substantially and has added 12 percent to its manufacturing workforce.

In another situation, our investment was used to open a Paxton, Illinois, manufacturing facility for a consumer water-bottling company. That plant now employs 30 people during peak bottling season in a small town in central Illinois.

These investments could not have been made out of the Debenture program. Mr. Chairman, this program works across the country. It works in the Midwest, and it works in Illinois. At Prism alone, our active portfolio companies have created over 100 jobs in Illinois and nearly 250 jobs in the Midwest and approximately 1,000 jobs across our portfolio since our inception in 1999.

In conclusion, we acknowledge that the program has experienced losses, many of which can be attributed to the recession, but some of which are a direct result of structural flaws in the original Participating Securities program.

Mr. Chairman, I believe I speak for the NASBIC Board of Governors and much of its membership when I say that the industry stands ready to work with you, your Committee, and the Administration in a collaborative effort to restructure this program and to ensure that it remains in place, serving its crucial role: fertilizing the roots of America's small businesses and its manufacturing base.

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

[Mr. Vivian's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much.

Our next witness is Don Wilson, President and CEO of the Association of Small Business Development Centers. I look forward to your testimony.

STATEMENT OF DONALD WILSON, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

Mr. WILSON. Mr. Chairman, we appreciate very much the opportunity to be with you representing the nation's Small Business Development Center program.

One of the things that we have heard so much today is the discussion of doing more with less. When we look at the significant increase in the last five or six years in domestic discretionary spending, and then we look at the downward spiral in the budget for the SBA, it does seem a signal is going out that there are higher priorities in the domestic sector, and that troubles us if we all agree that between 75 and 80 percent of jobs come from small business.

The economic data are particularly disturbing. We know that we are in a recovery, but we are much later, in terms of growing this economy, than in any previous recession since World War II. The labor force participation rate is the lowest since 1988. So what it means is that, yes, we went down from 5.4 to 5.2 in unemployment figures, but what it basically means is we went down because people quit looking for jobs.

The GDP in the last quarter of last year was the lowest in the past 24 months. So the recovery that we are hoping for is not moving along at the rate we want. You know that so very well because you are concerned in manufacturing. For the last five months in a row, manufacturing jobs have declined after having a meaningful increase in the first half.

Now, these statistics indicate that all is not well with small business. The charts that were up here earlier talking about how much SBA loans have gone up; I am not sure that that is a good sign. If small businesses cannot get conventional loans, it means their balance sheets are not healthy enough, and they are having to turn to government loans. The conventional loans; they just will not make them because you are not healthy enough.

So I am not sure it is a positive sign that we are increasing the number of SBA 7[a] loans, and I think somebody ought to look at that really closely. Yes, SBDCs have trained and counseled more people in 2004 than at any time in history. Now, you can say we are doing more with less, but there is a very disturbing thing that happened last year. The hours per client went down. We are pushing people through faster. If you did that in a medical office, you would not go back to that doctor.

Our counselors indicate to us, we need five to 12 hours of counseling. We are going backwards in the hour per client ratio. We are seeing more people, but we are not providing them the depth and quality of service that we were three or four years ago, and that is the reason job creation is not happening like we need it to.

The most staggering statistic, Mr. Chairman, is despite the fact that we have finally reached the point, in January, where we had as many jobs as we did when the recession ended, the fact is that private sector employment in January was six-tenths of a percent below what it was 46 months ago. So the growth in jobs in this country is government jobs, local, state, and federal level; it is not private sector jobs.

So, clearly, small business is suffering, and the reason they are suffering is they need help in hard times with how to manage their business better.

We are trying to be innovative. We are trying to work with the new group of people who are coming in. A 23-percent increase in about the last five or six years in people over 50 who are starting new businesses. Why is that happening? People over 50 are being laid off in enormous numbers as a result of acquisitions and mergers and downsizing. These people should be at the peak of their earning power, and, unfortunately, they are on the unemployment lines. So they are turning to self-employment, and they are turning to the SBDCs, women's centers, and so forth, and we do not have the resources to serve them.

Small states have 17 percent less in real-dollar terms than they did in 1998. Large states, like your state and Ms. Velazquez's state, in 2006, despite the President giving us about a $150,000 increase, for which we are deeply grateful—I mean that as sincerely as I can say it, but your state, Pennsylvania, New York, Indiana, Ohio, Michigan all have less resources than they did in 2001. So we cannot do the job for these small businesses and get jobs created and bring revenues back into the Treasury if we continue this trend. Thank you, Mr. Chairman.

[Mr. Wilson's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is with the Association for Enterprise Opportunity, Daniel Betancourt. I look forward to your testimony.

STATEMENT OF DANIEL BETANCOURT, COMMUNITY FIRST FUND

Mr. BETANCOURT. Thank you, Mr. Chairman. Thank you, Ranking Member Velazquez.

Chairman MANZULLO. You have to press the button on your—

Mr. BETANCOURT. Thank you, Mr. Chairman. Thank you, Ranking Member Velazquez. I am representing the Association of Enterprise Opportunity here today. I am also a board member, and I am also a practitioner for Community First Fund in Pennsylvania.

Just a couple of things about AEO. We represent over 500 members-micro-enterprise organizations across the U.S. Of the four main programs that micro-enterprises use, three of the four are actually being recommended for cut, and I really want to talk to you about those programs.

Just a few facts about myself. I work, as I said, at Community First Fund. We cover a 10-county area in Pennsylvania. We are an SBA microlender. We are an SBA technical assistance provider. We are also a Women's Business Center. About half of AEO's members are involved in these programs that we are talking about.

What the AEO is requesting is that we continue funding at a $20 million level for lending capital for the Microloan program, at a $17 million level for the TA program, at $5 million for the PRIME, and $16.5 million for the Women's Business Centers.

The funding that we are talking about is unique, at least in two ways. One is that it is helping entrepreneurs, small, micro-entrepreneurs, and generally the sales are $100,000 and less than five employees. We believe that the private sector, in many respects, is unable to reach this market. The 7[a] program, while you hear that it is doing well in many respects, it is unable to reach the market that we are serving. In our particular case, 90 percent of our borrowers are people of color. Forty percent are women. I think that if you look at the 7[a] numbers, you are going to find that those numbers will not correspond.

As a matter of fact, the Administrator indicated that these programs are expensive, the TA program itself. Well, let us talk about that for a moment. We are spending, in some cases, 20 to 40 hours with our entrepreneurs, and, in many respects, our loans might get, at best, $1,000 in interest. The other thing is that there is a less-than-one-percent default rate on the SBA Microloan program. The SBA gets its money back, and so do the organizations that we work for. What we are talking about is very intensive training for these entrepreneurs.

The Administrator also talked about that these services could be provided by other organizations across the nation. He said about 600 organizations, or CDFIs. I represent a CDFI in Pennsylvania, and I can tell you that we use SBA Microloan money so that we can provide technical assistance, and I will say that again. We are a CDFI, a community development financial institution. We do get money from other programs, but this is the only federal program that we use for technical assistance. So while you may say that there are other organizations that provide this to micro-entrepreneurs, if you eliminate the SBA Microloan program and Technical Assistance, and PRIME, you are going to eliminate the services that are being provided by those CDFIs.

Another point that was said today, in terms of geographic scope, was that the 7[a] program is dominated by many of the larger banks. The SBA micro-organizations are represented across the nation. We are in rural areas. We are in urban areas. We are in suburban areas. And I think that you will notice that about, as I mentioned earlier, 40 percent of our loans are in rural areas.

Many of our borrowers have credit issues that would not qualify for 7[a]. Forty percent of our borrowers are start-ups, and you will note that in the 7[a] program generally they are one to three years in terms of years in business. Our borrowers are not necessarily in business for one to three years.

So I would say, in conclusion, we are asking you to keep in your budget views and estimates the $20 million for the Microloan program, $17 million for technical assistance, $5 million for the PRIME, $16.5 million for the Women's Business Centers. Thank you very much.

[Mr. Betancourt's statement may be found in the appendix.]

Chairman MANZULLO. Thank you. I just have a couple of questions.

One of the problems, at least from the Administration perspective, is the overlapping and redundancy of programs. I guess my question is, the technical assistance that comes from the Microloan Technical Assistance and SCORE and SBDC and, in many cases, Women's Business Centers because I have a Women's Business Center and an SBDC in the district I represent; do these services overlap?

Mr. WILSON. Mr. Chairman, that is a huge question. OMB has maintained that for the last 10 years.

Chairman MANZULLO. OMB does not like small business.

Mr. WILSON. SBA commissioned a study this past year of all of their ED programs.

Chairman MANZULLO. "ED," Don?

Mr. WILSON. Entrepreneurial development. That is the section at SBA that covers SBDCs, Women's Centers, SCORE, and so forth.

The study has just been concluded, and the results are in, and what it shows unmistakably is that these programs are not duplicative. The Women's Centers serve businesses with about $60,000 in sales and about one to one-and-a-half employees. SCORE serves businesses with about $125,000 in sales, on average, and three employees. SBDCs, on average, serve businesses with $250,000 in sales and six to seven employees.

They are clearly, clearly, addressing different market segments. And so SBA has got the data. I feel certain they will share it with this Committee, but it absolutely refutes the long-held claim that these technical assistance programs duplicate each other's work. They are serving completely separate market segments.

Chairman MANZULLO. Mr. Betancourt, somebody cheerleading for your program there. He left out what Microloan Technical Assistance serves compared to the four programs he mentioned?

Mr. BETANCOURT. Yes. The Microloan Technical Assistance, you will note, is tied to the loans that we provide. It requires that we follow up when we provide the loans. The reason why there is a one-percent default rate is because we are following our borrowers. I can tell you that the average for non-SBA microlenders in the nation for Microloans is a 10- to 15-percent default rate, and the reason is because there is no technical assistance provided.

In our particular case, our organization, we have a less-than-one-percent default rate, and we do about 100 loans a year. We are one of the largest lenders in the nation when it comes to Microloans. Now, a subset of that is SBA Microloans.

Let me just be clear. We provide about 30 SBA Microloans a year. We do another 75 on our general fund. We are able to leverage your dollars, raise another 75 percent beyond that, and provide these services. It is just a small portion of what we are able to do in these communities.

More to your point about duplication, we work very closely with the SBDCs and the SCORE, and the gentleman is right. When we have tough cases of intensive training of very small businesses of women and people of color, they are always referred to our organization because that is what we specialize in.

Chairman MANZULLO. Is your default rate a lot less than the rest of the nation on the Microloans? You said you are only one percent?

Mr. BETANCOURT. The industry as a whole has a one-percent default rate under the SBA Microloan program.

Chairman MANZULLO. Is that the amount of dollars or the number of participants?

Mr. BETANCOURT. It is number of dollars. In other words, when you take the aggregate number and what is charged off, it is one percent.

Chairman MANZULLO. Okay. I do not have any further questions. Mrs. Velazquez?

Ms. VELAZQUEZ. Mr. Vivian?

Mr. VIVIAN. Yes.

Ms. VELAZQUEZ. Do you think that by SBA not requesting any program level for the participating securities, that this closes the book on the program?

Mr. VIVIAN. I hope not. We are certainly willing and able and ready, as we tried last year, with the strong support of this Committee and the hard work that you all put in, to resolve the problem. Our hope is that it is not.

Ms. VELAZQUEZ. Okay. Why has NASBIC continued to support a zero-subsidy-rate program for participating securities? It clearly has not worked for the industry and has not produced the desired stability.

Mr. VIVIAN. We believe that the program can support a zero-subsidy rate. The reason that it has not in the past worked is, as I suggested in the testimony, there are some structural flaws in the existing Participating Securities program, and we are actually in the process right now of preparing to come to the Committee with some proposals on how to solve that problem to be able to maintain a zero-subsidy rate.

Ms. VELAZQUEZ. Thank you.

Mr. Wilkinson, I know that SBA is focused on making smaller loans largely because they believe that they are better at creating jobs, but also because they believe that they are less expensive. What is your opinion of SBA's focus on smaller loans?

Mr. WILKINSON. Well, they came up with a new program called SBAExpress a few years back to try to get the large banks back involved with the SBA. It is a different kind of product, and that program has taken off, and that is where they are getting large numbers of smaller loans. But we still have what I call the "regular 7[a] program" in existence, and it continues to grow, but that is really a long-term loan. It is a niche product. So SBA's numbers have increased primarily because of Express, but the regular 7[a] program is doing just fine.

Ms. VELAZQUEZ. And what is the 7[a] program's subsidy rate?

Mr. WILKINSON. For the current fiscal year, it is zero.

Ms. VELAZQUEZ. So, then, why is there a cap on its program level? It does not make any sense. There is no cost to the government. Why do we not stand behind these estimates?

Mr. WILKINSON. First of all, we are seeing some unprecedented growth that we have not seen in previous years. It looks like we are going to do about $16 billion this year. We did $12.7 billion net last year. Our belief is that since it is now at a zero subsidy, there really should not be a limit on what we are doing. That is why we have supported the $17 billion estimate for next year, Fiscal 2006, to match the authorized level.

Ms. VELAZQUEZ. Mr. Wilkinson, can borrowers of the Microloan program secure loans through the Community Express program?

Mr. WILKINSON. I am not a Microloan expert, so I really do not know much about their clientele. What I have heard from my members is that, based on the credit scores that they are using for their loans in the Express program, those are credit scores that are higher than the credit scores of borrowers in the Microloan, so, based on that, I would say they are a different clientele.

Ms. VELAZQUEZ. Mr. Betancourt?

Mr. BETANCOURT. The credit scores in our case, in many cases, are less than 550; in some cases, bankruptcies.

Ms. VELAZQUEZ. And Community Express, SBAExpress loan; what will be the score, 700?

Mr. BETANCOURT. I would say 700, 650 or more. I am not an expert in that area.

Mr. WILKINSON. I think, from some of my members that are here, they are saying their minimum is around 630 for an SBA 7[a] loan.

Ms. VELAZQUEZ. But the SBA continues to say that borrowers of the Microloan program can get loans through the 7[a] program. Is this true?

Mr. WILKINSON. Again, our members, with their Express loan programs, seem to have minimums in the 630 to 650 range. A borrower would have to fit that range to be approved through the regular 7[a] program.

Ms. VELAZQUEZ. So what we are saying is that the clientele that will get loans through the Microloan program would not be able to get loans through the Express program because the score that is required, they might not meet. Correct?

Mr. BETANCOURT. I would agree with you, Ms. Velazquez, but I would also say, they would not even get to the table or at application without the technical assistance that is provided.

Ms. VELAZQUEZ. Mr. Crawford, the message NADCO gave to Congress last year was that they wanted the larger Debenture. Less emphasis was given to the cap on the 504 program. Why?

Mr. CRAWFORD. I am sorry, ma'am. Could you repeat the question? Less emphasis—

Ms. VELAZQUEZ. —has been given to the cap on the 504 program. Why?

Mr. CRAWFORD. I am not really sure, given the point that you just made, we are at zero subsidy. I would have hoped, as this Committee passed last year in its own reauthorization bill—you endorsed, I believe, $6 billion for 2005. We certainly supported that figure because we thought that figure would take care of the larger Debenture as well as the manufacturing debenture promoted by the chairman.

Ms. VELAZQUEZ. What would happen if 504 lending exceeded the cap?

Mr. CRAWFORD. I would presume, at some point, the agency will move to some sort of credit-rationing scheme, which is what they have had to do with 7[a] on two or three occasions over the past several years. I would hope that would not be the case. As you saw the disruption in the 7[a] program, it will certainly disrupt our program.

Ms. VELAZQUEZ. Do you think that is possible?

Mr. CRAWFORD. Do I think it is possible?

Ms. VELAZQUEZ. Uh-huh.

Mr. CRAWFORD. I assume, without increasing the cap from $5 billion, they will not have much alternative except to move to some sort of credit rationing.

Ms. VELAZQUEZ. Mr. Betancourt, do you see demand for the Microloan program increasing or decreasing and why?

Mr. BETANCOURT. In terms of their budget, the 2006 budget?

Ms. VELAZQUEZ. Demand for the program.

Mr. BETANCOURT. Oh, demand. I did not hear you.

Ms. VELAZQUEZ. Demand.

Mr. BETANCOURT. In our case, we doubled our volume from last year in the SBA Microloan program.

Ms. VELAZQUEZ. Okay. So can you tell us the profile of a borrower in the Microloan program?

Mr. BETANCOURT. I think it was said earlier, and it was a good profile, we are talking about businesses with less than $50,000 in sales. About half of our clients are start-up. In many cases, this is a part-time business they are trying to start off the ground. They might work and then build this up. Not a lot of collateral, credit is not great, but, you know, with a good business plan and the character of the borrower, we are able to provide the seed funding, follow-up, and then things work out.

Ms. VELAZQUEZ. If the program is terminated, where do you think the clients will go to get loans?

Mr. BETANCOURT. I think it is going to be a hardship for a lot of organizations in a lot of small, rural communities, some urban areas. I know, for example, in Washington County in Pennsylvania, they only have an SBA Microloan program. There are very few banks. If you eliminate this, I kind of doubt they are going to be able to offer it.

In our particular case, it is going to hinder a lot of what we can do. We will just have to cut back some services.

Ms. VELAZQUEZ. So how is the technical assistance provided by the Microloan program different from the Community Express program?

Mr. BETANCOURT. Well, I think that this is a partnership that the SBA has with the banks, in terms of Community Express, where the banks provide the funding, and the SBA is providing the guarantee. You have my resume there. I am a former vice President of a bank, 15 years, and I know how it works at a bank. It is a bump and run. If the deal works, you get a guarantee, and you move on, but you do not have the time to provide technical assistance. You would not have your job. It is a for-profit business.

Chairman MANZULLO. Okay. Thank you for coming. We appreciate it. We have got a lot of work to do. I think, on the subsidy rate of the 7[a], we probably should have a preemptive hearing within the next 60 days because this is a 70-percent increase. SBA is going to have to justify that, and on the Participating Securities, you know, lack of capital is the biggest problem that we have.

Don, you are right on the manufacturing. The largest city in our district, Rockford, Illinois, we are somewhere around nine and a half to 9.8 percent unemployment. It is double the rate. We have lost 29 percent of our manufacturing base, and the Secretary of the Navy has just awarded a $1.7 billion contract for Marine One to the Europeans. I hope he is proud of that.

Mr. WILSON. I would like, Mr. Chairman, if I could,—I mentioned it in my written testimony—I would like to get it to you. We had Dr. Chrisman do three studies over the last six years of what SBDCs are doing for manufacturers, and it is very, very significant.

Chairman MANZULLO. Well, obviously, we would not spend a lot of time working on that, but we look forward to working with all of you. The budget estimates have to be in—February 23rd, we will be getting that document in and making our statements and observations on it. Thank you for coming.

Ms. VELAZQUEZ. Mr. Chairman?

Chairman MANZULLO. Yes.

Ms. VELAZQUEZ. Can I have one more question?

Chairman MANZULLO. Sure, of course.

Ms. VELAZQUEZ. Mr. Crawford, how has the decline of local SBA staff affected CDC's ability to liquidate and service defaulted loans?

Mr. CRAWFORD. Well, the problem we have with CDC's liquidating defaulted loans is that we are not empowered yet by the Administration to do that. We have been crying for the regulation they have had in draft for more than six months to move towards liquidations. If we do not do something about that, the subsidy costs of this program are actually the borrower fee because they will keep us at zero. The borrower fee will skyrocket.

Ms. VELAZQUEZ. And, in your opinion, does SBA need to increase staffing at the 504 processing center and by how much?

Mr. CRAWFORD. I am not sure. I could hesitate a guess for that. I certainly would not advocate doubling the staff, but it is clear that those folks out there are working as hard and as fast as they can work, and I personally believe that there is a staff increase needed there.

Chairman MANZULLO. Thank you. The meeting is adjourned.

[Whereupon, at 12:35 p.m., the Committee was adjourned.]

House Committee on Small Business

The President's FY 2006 Budget Request: What Does It Mean For Small Business?

February 10, 2005

Prepared Remarks of Chairman Donald Manzullo (IL-16), Chairman
U.S. House Small Business Committee

Good morning and welcome to the Committee's first hearing for the 109th Congress.

Let me first applaud those parts of the President's budget that emphasize national defense, homeland security, and economic security. A key part of economic security is creating jobs and revitalizing the economy. Small businesses have always led this nation out of economic downturns and they continue to lead the way. The question becomes what can the federal government do – or, in many cases, not do – to foster a better economic climate for small businesses to grow?

Key provisions in the President's budget will help small businesses revitalize the economy. They include:

- Passage of Association Health Plans, allowing small businesses to band together and purchase insurance at lower rates;
- Providing a refundable tax credit for contributions of small employers to employee Health Savings Accounts;
- Making permanent the tax cuts previously passed by Congress, including killing the "death tax" for good;
- Making permanent the research and experimentation tax credit; and
- Continued progress on regulatory and litigation reform.

The President deserves our full support in making sure that America is secure. Of course, Americans can feel very insecure if they are worried about their jobs and their economic future.

This Committee can play a key role in achieving economic security by ensuring that the federal government and America's small businesses work together in a sound partnership to spur growth in the economy, in jobs, and, most importantly, in wages.

The President has developed a clear small business agenda – one that I fully endorse. Removing unnecessary regulatory burdens on small businesses through compliance with the Regulatory Flexibility Act is vital. Assisting small businesses in paying for health care will help them attract and keep employees. Eliminating bundling of contracts so that small businesses get a fair share of federal contracting dollars is not only good for the small businesses but is good for the taxpayer because small businesses provide better service at lower costs. Finally, tax relief will help spur investment by small business owners.

The Small Business Administration plays an important role in assisting small businesses throughout the country. With a few exceptions, most notably with regard to the Small Business Investment Company participating securities program, I am generally pleased with the President's Fiscal Year 2006 budget request for small business initiatives and the SBA. We must recognize the fact that the SBA can continue to do more with less. With the high budget deficit, tough choices needs to be made and we can't fund every program that we'd like. We must keep in mind that the overall FY 06 budget request for other non-security discretionary spending was cut in real terms, too. But that doesn't mean less service to small businesses. The President's FY 06 budget request expands access to credit through expanded budget authority for the 7(a) and 504 loan programs and aims to reach more entrepreneurs through electronic means.

I believe that the SBA can be an even stronger mechanism to help all of America's entrepreneurs, including our struggling small manufacturers. I look forward to working with the President and the Administrator to enhance our small business base. I have a few concerns that I'll bring up during the question and answer period, including the assumptions that went into the subsidy rate calculation in the 7(a) loan program that caused lender fees to go up again when they probably should have left alone.

Now I will recognize the ranking Democrat member of the full committee, the distinguished gentlelady from the Empire State, for her opening statement.

STATEMENT
of the
Honorable Nydia M. Velázquez, Ranking Democratic Member
House Committee on Small Business
Hearing on FY 2006 Proposed Budget
February 10, 2005

Thank you, Mr. Chairman.

Every year when I think the budget can't get any worse for the Small Business Administration (SBA), the administration turns around and proves me wrong. This budget is a failure to America's small businesses. It is nearly half of what it was when President Bush took office – and at least $100 million has been cut each year. What was once a Cabinet level agency that had a seat at the table, a $1 billion budget, and a large role in the decision making process – has sadly become the shell of an agency. It wasn't long ago that SBA was creating new, innovative programs to help entrepreneurs across the country start and grow their business.

However, it is quite a different story today. This agency is failing to ensure that small businesses are receiving federal contracts, and increasing the cost for entrepreneurs to access capital. SBA has seemed to have fallen off the path here – they are no longer helping small businesses to start and expand their dreams.

Time and time again, SBA has not been shy about voicing all time records for programs and loans. But in reality, what SBA should be voicing today is an all time record for cutting and terminating the most programs over the past four years.

Lets go through the list of these programs – cuts have been made to the Women's Business Centers, HUBZone and SCORE, among others.

Some of the small business programs that either were eliminated or slated for termination include BusinessLINC, SBIR Rural Outreach and SBIR Fast, PRIME, New Markets Venture Capital, and the flagship lending program – 7(a) – all of which help to create jobs.

Of more concern is the fact that SBA proposed to eliminate the Microloan program again – a program that serves a unique role by providing small loans to low-income communities. In addition, by failing to request any program level for the Small Business Investment Capital (SBIC) Participating Securities program – SBA's largest venture capital program – it has closed the book on this initiative too.

I want to make one thing clear – these are all valuable programs that have contributed to some of the greatest entrepreneurial success stories in this country. They have formed the foundation for millions to pursue and achieve their business ventures.

The real problem today is not the programs themselves – their successful clientele and the economic gain they have generated over the years speaks for itself. The real problem here is the fact that they are under-funded and mismanaged.

This administration has a very unusual way of showing their support for small business. When the federal government can't meet its contracting goal – instead of accepting accountability, and working to fix it – they start counting large business toward small business goals and flood the government tracking system with so much bad data that no one can really determine what has or hasn't been done.

Capital is not flowing to small businesses like it should be. Rather than putting money into the lending programs – this agency gutted their staff in towns across the country that do outreach to small businesses, and created cost burdens for lenders. Afterwards, the agency claims they have improved the process.

This administration will also claim that these cuts are fine, and entrepreneurs simply need to do more with less. Yet, at the same time, SBA hasn't been able to balance their books for the past four years – they haven't had one clean audited opinion since these cuts began. If Mr. Barreto was a CEO of a corporation, with this track record, he would be removed by stakeholders.

The bottom line here is that our small businesses deserve better than this. Yes, we are facing a massive budget deficit now, and we are involved in a war on terror. These entrepreneurs are some of the most patriotic people out there. They would do anything to help out. However, it is not fair that we expect them to bear the burden of these cuts once again.

I will say to my colleagues on the other side of the aisle and in the administration, if you don't believe in these programs, and if you think they deserve to be cut – that is fine – just say so. Let us have that debate. I have no problem standing up for these programs – I do believe in them, and I know they are valuable. But do not cut these programs year after year, mismanage them into the ground, and then come to the committee and claim things are better than ever before.

That is simply wrong. Our nation's entrepreneurs know this, and they deserve better than that. They deserve to be told the truth about where people stand on these programs. Lets give them that much.

Thank you.

STATEMENT OF
HECTOR V. BARRETO
ADMINISTRATOR
U.S. SMALL BUSINESS ADMINISTRATION
SBA'S FISCAL YEAR 2006 BUDGET REQUEST

Mr. Chairman, Ranking Member Velazquez, and members of the Committee, thank you for inviting me here today to discuss the President's Budget Request for the U.S. Small Business Administration (SBA) for Fiscal Year (FY) 2006.

As the Committee is aware, the past year was not without its share of challenges for the SBA. However, I am proud to say that last year was also one of great success for both the Administration and the House Small Business Committee. We were faced with several critical issues, but we were able to work together and reach agreement in ways that proved beneficial to both America's small businesses and America's taxpayers.

In FY 2004, when the 7(a) loan program's demand exceeded its budget authority, the SBA and the Committee were able to come together, and with the assistance of our partners in the lending industry, to provide an additional $3 billion in lending for the 7(a) program, at no additional expense to the taxpayers. This allowed the Agency to lift the loan caps and operate the program at full capacity for the remainder of FY 2004. As a result, the Agency guaranteed a record $12.7 billion in small business loans in FY 2004.

At the beginning of Fiscal Year 2005, under the continuing resolution, the SBA began operating the 7(a) program at a zero subsidy rate. This "trial period" showed that a zero subsidy rate would not hinder access to and delivery of the 7(a) program. As a result, the SBA, the Committee, and the lending industry came together to craft legislation that allowed the program to operate without appropriations from Congress and ensure long term stability in the program.

This change significantly reduced the potential for future program disruptions and uncertainties, and allowed the Agency to reduce its budgetary needs while continuing to service America's small businesses.

I know some have expressed concern that the resumption of the 2002 fee levels would harm small businesses. However, since October 1, SBA has guaranteed over $4.4 billion in loans, an increase of over 11 percent over last year, and our lending partners have shown renewed support for the program. In addition, we are making more loans than ever to minorities, women and veterans.

At this time last year, the SBA's programs under the Small Business Act hadn't been reauthorized in over 4 years, and the Agency and the Committee seemed to be deadlocked in the negotiating process. However, persistence and diligence in pursuit of this goal of reauthorization finally produced a compromise in the form of a two-year SBA reauthorization that passed at the end of the 108th Congress.

Chairman Manzullo, I would like to compliment you and your staff on ensuring that this legislative compromise was included as part of the FY 2005 Omnibus Appropriations Act and for your support of SBA's efforts to become more efficient. This legislation allows the Agency to better serve more small businesses at less cost. Our FY 2006 budget submission reflects a continued commitment to that goal. Small business customers are taxpayers and understand the need to cut unnecessary costs and to keep up with an ever-changing market place.

Last year, I stressed to you that SBA's goal was to do more with less. I know that in Washington, D.C., it's difficult to imagine strongly supporting a program without continually increasing its budget, but SBA has proven that it can be done.

Since I became SBA Administrator in 2001, the Agency's annual appropriation has continued to decrease, yet SBA's programs have reached more and more American entrepreneurs year after year.

Last year was a great example of this kind of success at the SBA. The Agency provided $21.3 billion in loan guarantees and related financing for approximately 87,800 small businesses in FY 2004; these being record levels.

Out of that $21.3 billion, nearly one third went to women-owned and minority–owned businesses, which is more than any prior year; over $500 million went to African Americans; approximately $2.8 billion went to women; over $1.2 billion went to Hispanics; and over $115 million went to the Native American community. These figures represent the Administration's continued commitment to ensuring that the SBA's loan programs truly serve those small businesses that would otherwise have a difficult time accessing capital from the lending world. I am proud of the successes documented by these efforts.

Our administrative transformation efforts have also produced similar results. As this Committee knows, the Agency has been going through a transformation process designed to realign some of its dated infrastructure to meet the changing face of the 21st century business world. The needs of the SBA's customers remain paramount, and modernizing and realigning the Agency's human capital resources, operations, and organizational structure to match those needs is crucial to the Agency's continued relevance. Last year, the SBA began consolidating administrative servicing functions, allowing field office staff to work more closely with their clients in the small business community. The Agency's field offices are using technology, outreach, marketing, and customer relationship management to better meet small business needs. Through these modernization efforts, more SBA employees will be in more locations providing direct assistance to the small business community at a lower cost.

The SBA has also been effective in streamlining processes on the loan finance management side of the organization. Currently, over half of SBA's 7(a) loans are made through SBAExpress, which is processed electronically in a 36 hour timeframe. Centralization has reduced the 7(a) program guarantee and purchase liquidations timeline to an average of less than 45 days. The 504 program reduced loan application processing time to just two days, five times faster than the prior national average of ten business days. These dramatic improvements directly affect the

SBA's partner lenders, and ultimately, the Agency's customers, America's small business owners.

SBA's core infrastructure of technical assistance programs----SBDCs, SCORE, WBCs, and district offices----provided their services to record numbers of small businesses in FY 2004. SBA's Entrepreneurial Development programs provide much needed expertise and guidance to those entrepreneurs who have the drive and the idea, but may need a little help putting all of that into a working business plan.

The SBA also continued its mission to support the Administration in meeting its statutory commitment to provide a fair share of contracting dollars to small businesses. Small businesses received a record number of Federal contract dollars in FY 2003 - $65.5 billion – and exceeded the 23% government wide goal. I am also proud to say that Federal contracting dollars increased for women-owned businesses, 8(a), SDB, HUBZone and Service-disabled veteran-owned firms. In FY 2004, the SBA provided procurement assistance to over 37,000 small businesses.

The SBA has also been innovative in creating additional contracting opportunities for small businesses. For example, the Business Matchmaking program has given small businesses around the Nation a better opportunity to obtain government and private contracts by introducing them to procurement officials who, otherwise, would be very difficult to meet. The program's goal is stimulate jobs and growth for small businesses by taking advantage of opportunities that are normally confined to distinct geographical areas such as the Washington, DC area or a city where a major corporation is located. Since the program started two years ago, 23,000 one-on-one appointments between small business owners and Federal and corporate procurement officials have been conducted. The program has allowed small firms to learn about and bid on procurement opportunities in their areas of expertise. As a result, $29 million in Federal and private contracts have been awarded. More than 50 percent of the small businesses that have received contracts through this initiative are women-owned or minority-owned businesses.

SBA has been proactive in other areas of contracting as well. I am proud of the hard work done by my staff last year to implement the provisions of P.L. 108-183 in record time, providing contracting officers with a powerful tool to award contracts to those who have given so much to our country: service-disabled veterans.

Additionally, the Agency recently published a rule clarifying the responsibilities of prime contractors and giving contracting officers a tool to ensure that small business subcontractors are treated fairly when doing work on Federal contracts – an issue plaguing many small businesses. In December, the Agency also implemented a new policy that enables the Federal government to more accurately monitor contract dollars awarded to small business concerns that are subsequently purchased by large business concerns. The new policy requires a business to recertify itself as small when a change-of-name or novation agreement has been executed if the contract is to continue being counted as a small business contract.

In the past year, the SBA has moved to a completely automated electronic application process for both the 8(a) and Small Disadvantaged Business (SDB) Programs. As a result, the average time to process an 8(a) application has fallen from over 100 days to 45 days, and for SDB, the drop is from 110 days to 40 days. Consequently, time and government resources are being used more efficiently, and at the same time better customer service is being given to small businesses.

While I am always more than pleased to talk about the active role that the Agency plays in the small business world, I really couldn't be more proud of the humanitarian assistance provided by SBA's Office of Disaster Assistance.

For years to come, people will remember the tremendous work the SBA did in 2004 to help disaster victims recover from the worst hurricane season on record. During FY 2004, the SBA Disaster Assistance program approved low-interest loans to over 28,500 homeowners and businesses grossing over $884 million. The supplemental appropriations allow the Agency to increase these numbers to over 100,000 loans for up to $4 billion. The direct public benefit of these SBA loans is that the businesses and local economies in disaster areas will be able to recover much more quickly than would have otherwise.

While we can enjoy the successes of the last year, we must continue to look towards the future with renewed dedication to serving America's small businesses in a financially responsible manner. In fact, the Disaster Assistance program has begun its transformation to electronic processing, simplifying the process for disaster victims and providing them with faster responses while reducing costs to administer the program.

President Bush understands the vital role that America's small businesses play in creating opportunities. He also recognizes that following times of economic downturn, small businesses play a leading role in economic recovery, and that it is small businesses that generate approximately two-thirds of all new private sector jobs. The President's plan for economic growth and job creation, along with his Small Business Agenda, has been successful in creating an environment in which entrepreneurship can flourish.

Health care continues to be one of the largest burdens our small businesses must bear. Time and again, as I meet with entrepreneurs around the nation, they talk to me about the cost of health insurance, and it is only getting worse. We also plan to make the President's tax proposals permanent to help small businesses and their employees keep more of what they earn and re-invest that money in their families and their businesses.

Finally, we want to help the President repair the Social Security system. Some people have claimed that the system is not in need of repair, that the crisis is fifty years away, but I believe it is our responsibility to those in their teens and twenties now to fix the program for their future rather than waiting until the problem becomes acute and unmanageable. I also believe that acting now is the best and fairest way to craft a solution that will not result in unfair costs on small business employers and employees or benefits cuts to those who have paid into the system in good faith. It is time for us to take this 800 pound gorilla out of the picture and remove its unwelcome presence from the plans and futures of small business owners and their employees who are paying the taxes that feed it.

Now, I'd like to lay out the specifics of our FY 2006 budget request. The SBA's total budget request is $592.9 million. This budget request provides for a strong, active SBA that can effectively and efficiently meet the demands of its customers, America's small business entrepreneurs, while minimizing the cost to the American taxpayer. Through improved management and program reforms, the SBA will better serve America's small businesses.

The SBA requests $16.5 billion in lending authority for its 7(a) loan program – a $500 million increase over the enacted level for FY 2005 and almost a 25 percent increase over FY 2004 levels. The 7(a) subsidy rate for FY 2006 remains at zero, meaning the 7(a) program can guarantee $16.5 billion in small business loans without requiring a taxpayer subsidy.

This Budget Request will give SBA the authority to provide $5.5 billion in loans – also a $500 million increase over the FY 2005 enacted level – through its 504 Certified Development Company (CDC) program with no cost to the taxpayers. The 504 program, which was established to increase small businesses' access to real estate and other long-term fixed asset financing, continues to have job creation as an important program goal. The SBA is continuing to take steps to increase small businesses' access to 504 loans by increasing competition among CDCs and streamlining the application process.

SBA is asking for $3 billion in debenture authority for the Small Business Investment Company (SBIC) program. This program has continued to operate with expectations, providing benefits to recipient firms and within financial projections. The Administration's budget does not propose reinstating the SBIC Participating Securities program in 2006. In ten years of operations this program has resulted in reestimated losses of $2.7 billion, $1.7 billion of which are realized cash losses.

I am continuing my advocacy for greater efficiency and more and better quality of services to small businesses by consolidating delivery of services to small businesses through the Agency's core non-credit programs. As we discussed last year, SBA does not need restrictive line-items placed in its budget in order for the Agency to reach more small businesses.

The HUBZone program is an excellent example of this. In FY 2004 and FY 2005, Congress mandated that the SBA spend $2 million on the HUBZone program. Congress expanded access to this program in the recent SBA reauthorization bill. While SBA is not asking for a special line item, the SBA fully intends to support this program from within our Salaries and Expenses account. As you can see from the Agency's FY 2006 budget, SBA plans to provide $7.3 million in support for the HUBZone program, providing resources that keep the program strong without hampering our ability to meet challenges and serve all of our customers' needs.

Further, SBA is working to enhance the HUBZone program and its other government contracting programs through monitoring and assessing the effectiveness in reaching their target audience. Results of this analysis will help SBA better use its resources in reaching these businesses. Through the Business Matchmaking Initiative, SBA will put more small businesses in touch with procurement officers at all levels of government and those at large businesses. The one-on-one meetings facilitated through these events provide small business owners with an opportunity to speak directly with the decision makers.

SBA will also be working more closely with other Federal agencies, ensuring that their contracting practices maximize opportunities for small businesses while still providing a good deal for the taxpayer. Through ePCR and the ESRS systems, the SBA will have more tools to monitor prime and subcontracts to ensure small businesses are given adequate opportunities to contract with the Federal government.

The SBA also believes it can provide a full range of technical assistance more effectively by using its core national delivery programs. The Budget Request proposes that the Agency work through its primary infrastructure of 104 Women's Business Centers, 4 Veterans Outreach Centers, 389 SCORE chapters, 1163 SBDCs, and 68 district offices. They can reach more customers and offer higher levels of service to targeted constituencies and, by eliminating the duplication and bureaucracy that is inevitably created by a large number of smaller programs, they can do it far more effectively.

The Budget Request also includes continued funding for the Agency's Disaster Loan Program. The SBA works very closely with the Federal Emergency Management Agency to assist those small businesses and individuals directly affected by disasters such as tornadoes, floods and hurricanes. As you are aware, the SBA is a major part of the government's mechanism to help disaster victims get back on their feet.

As the Committee is well aware, some of the heaviest burdens borne by small businesses in America are the result of unnecessary federal regulation and red tape. That is why I am pleased that SBA's budget includes $9.1 million for the Office of Advocacy. This funding will allow Advocacy to fully staff its regional operations; to continue training Federal agencies on how to comply with the Regulatory Flexibility Act; and to research, document, and report to Congress on small business matters.

In FY 2006, the Office of Advocacy expects to save small business $5.6 billion in potential regulatory costs. Mr. Chairman, that is a substantial amount of savings for America's entrepreneurs.

Another crucial area where the SBA continues to make progress is in lender oversight. Since the Loan and Lender Monitoring System (L/LMS) became operational in 2003, it has provided the SBA and the Federal government with an exceptional level of oversight of SBA's guaranteed-loan program operations. L/LMS is a risk-based approach to oversight that provides the Agency with greater insight into SBA's lenders. It is more streamlined and efficient, allowing us to better deploy our resources to those areas where the SBA has the greatest exposure while being less intrusive to the lenders.

Specifically, L/LMS has improved SBA's lender oversight by directly increasing our loan portfolio and lender monitoring capability. The result is SBA's first database combining future credit risk analysis with past performance. L/LMS also enables the SBA to use historical business loan level data when assessing risk levels.

The impact of L/LMS has been profound. For example, in previous years, the Kansas City Review Branch and District Offices reviewed most of the SBA's lenders. Preferred 7(a) lenders were reviewed onsite every year and other lenders were reviewed once every three years. L/LMS now provides non-disruptive off-site monitoring capabilities that consider both the performance and credit risk of every loan the lender makes and funds.

The SBA is committed to continuously reassessing and improving the potential impact of L/LMS for the Agency and its customers. We are constantly evaluating new ways in which we can improve our own operations to meet the full potential of L/LMS.

All of us at the SBA are quite proud of the Agency's legacy of achievement. Many of today's most successful businesses received SBA assistance in their formative stages. Who knows which of tomorrow's industry leaders are today receiving their 7(a) or 504 loans, their government contracting opportunities, or their counseling through the SBA's programs and services?

However, we at the SBA cannot rest on our laurels. We must be forward thinking, anticipate changes in the marketplace, and adjust our programs based on the realities of today's small business environment.

The SBA's FY 2006 request is good for America's small businesses and American taxpayers. It offers an opportunity for us to work together with our Congressional partners to ensure that the SBA continues to assist small businesses. We ask for your support for our Budget Request. Thank you for the opportunity to appear here today. I am happy to answer your questions.

Committee on Small Business
U.S. House of Representatives

"The SBA FY 2006 Budget"
February 10, 2005

Prepared Remarks of Mr. Anthony R. Wilkinson
President & CEO
National Association of Government Guaranteed Lenders, Inc.
Stillwater, Oklahoma

The National Association of Government Guaranteed Lenders, Inc. (NAGGL) is a trade association for lenders and other participants who make approximately 80% of the Small Business Administration (SBA) section 7(a) loans. Commonly called SBA's "flagship" program, the 7(a) program has proven to be an excellent public/private sector partnership. Over the last decade, the SBA has approved roughly 500,000 loans for approximately $100 billion. We thank the Committee for the opportunity to testify on the SBA FY 2006 budget request and other current issues facing the SBA 7(a) program community.

One Year Later

Last year at this time, the 7(a) lending program was in the middle of a crisis. Lack of adequate funding at the start of FY 2004 led to a variety of problems, including an unprecedented "lending holiday" and subsequent program caps and limitations. Thanks to the efforts of the Small Business Committees and SBA Officials, that problem was resolved and FY 2004 lending set records for both numbers and dollars loaned. FY 2005 is also off to a record pace, with almost $3.6 billion lent in the first fiscal quarter. As part of the compromise worked out at the end of the 108th Congress, the 7(a) program received $16 billion in lending authority for FY 2005, which should be sufficient to meet the net lending demands of small businesses.

Statistics

The SBA loan programs are the largest source of long-term capital for small business in this country. Based upon bank "call" reports, the SBA Office of Advocacy reports there are $485 billion in outstanding small business loans. From FDIC data, only about 20% of those loans (approximately $95 billion) have an original maturity over 3 years. The average original maturity of an SBA 7(a) loan is about 14 years, and the SBA 504 average is even longer. The balance of the outstanding 7(a) portfolio is approximately $40 billion or a significant percentage of all outstanding long-term small business loans. Small businesses rely upon the SBA 7(a) program to be a major source of long-term debt capital.

FY 2006 Budget

FY 2006 Loan Demand

The Administration has requested a $16.5 billion program level in FY 2006. FY 2004 usage was approximately $14.5 billion, and some forecast that all $16 billion of available lending authority will be used this fiscal year. Given the growth rate in the program, NAGGL requests that this Committee support a $17 billion program for FY 2006. A $17 billion program would match the authorization level passed in the Omnibus Appropriation bill in December 2004, and would lessen the risk of future program caps or restrictions.

More Fees

On October 1, 2004 through October 1, 2006, lender fees will have increased 116% if the increase proposed in the FY 2006 budget is put into effect. Although the latest increase would be within the compromise worked out in the 108th Congress, the trend of higher and higher fees must be reversed.

It is disturbing that the 7(a) program faces further fee increases considering that the compromise deal establishing fee levels was signed into law just 2 short months ago. In addition, the Administration reports, in table 8 of the Federal Credit Supplement to the FY 2006 Budget (on page 54), that the subsidy rate established for FY 2004 was excessive. The original subsidy rate for FY 2004 was 0.78% but this has now been re-estimated and reduced to 0.24%, the difference, coincidentally, being exactly the amount of the lender fee. Thus the Administration is now recognizing that the fee increases which they demanded be imposed upon lenders and borrowers to lower the subsidy rate to zero should have actually lowered the rate to a substantially negative number. We believe that given the downward subsidy re-estimate for FY 2004, the subsidy rate should have actually declined in FY 2006, resulting in a lowering of the lender fee.

NAGGL encourages this Committee to ask the Administration for a thorough explanation of the changes made in the subsidy and re-estimate models.

Secondary Market Fee

The Administration also is requesting authority to charge lenders a fee for loans sold in the secondary market. In the FY 2006 budget, in Table 6 on page 23, the Administration does not provide any income from a proposed fee. Thus the proposed fee must be zero and is unnecessary. NAGGL is opposed to granting the authority to impose secondary market fee, which the budget shows is not needed. We urge the Committee to conduct a thorough review of the credit subsidy model for both the lending side and the secondary market side of the 7(a) program.

National PLP Authority

As part of the compromise reached in December, a national Preferred Lenders Program or PLP should have been included in the legislation. Today, lenders who lend in multiple districts spend an inordinate amount of resources dealing with the multitude of district offices in establishing or renewing their PLP status. The new program would have established guidelines for the SBA to grant national PLP status to those lenders meeting the benchmarks. Unfortunately, due to a clerical error, the provisions were not included in the final legislative package, which was enacted as Division K of the Omnibus Appropriations Act (P.L 108-447). NAGGL requests that this provision be included in the near future in any appropriate legislative package, particularly in any technical corrections bill, which SBA has said it will submit.

Piggyback Restriction Still In Place

A lender generally utilizes the 7(a) program because an applicant has a credit deficiency or needs a longer term loan than could be provided without the 7(a) program. In other instances an applicant has a need that is larger than the maximum loan size allowed under the 7(a) program. To accommodate this higher financing need, a lender historically has utilized a piggyback structure or a combination loan to meet the borrowers' financing needs.

For example, assume an applicant needs to borrow $2.5 million, or $500,000 more than the 7(a) limit. A lender could have provided a $500,000 conventional loan in a first lien position, and a $2,000,000 SBA 7(a) loan in second lien position. Unfortunately, however, SBA administratively prohibits the use of piggyback financing and the statutory provisions permitting combination loans expired at the end of fiscal 2004. Thus the financing needs in excess of the 7(a) program limit cannot be met.

Ironically, this piggyback or combination loan structure is similar to the loan structure provided in the SBA 504 program, with two key differences. With a 504 loan the SBA has 100% of the credit risk on the second mortgage loan. With a 7(a) loan, under the piggyback structure, the originating private sector 7(a) lender has at least a 25% pro-rata share of the second lien loan, and thus the lender is sharing in the credit risk. The second difference is that the government collects substantially more fees on a 7(a) loan than it does a 504 loan.

With the piggyback prohibition, many applicants have no solution to their need to find larger loan packages. We request that this Committee work with the Administration to reinstate the use of piggyback loans so that lenders again would have a vehicle to serve those small businesses that need larger loan packages.

Conclusion

In conclusion, NAGGL requests that this Committee:

1. Support a $17 billion program for FY 2006;
2. Conduct a thorough review of the 7(a) credit subsidy model changes in the FY 2006 program estimate;
3. Support the reinstatement of piggyback or combination loans, through legislation if necessary;
4. Support the establishment of a National PLP Lender approval and renewal process through legislation; and
5. Oppose granting SBA the authority to levy an unneeded secondary market fee.

Thank you for the opportunity to testify before the Committee.

Table 6.—LOAN GUARANTEES: ASSUMPTIONS UNDERLYING THE FY 2006 SUBSIDY ESTIMATES—Continued

(in percentages, unless noted otherwise)

Agency, Bureau, Program and Risk Category	Subsidy rate	Composition of Subsidy				Loan Characteristics								
		Defaults, net of recoveries	Interest	Fees	All other	Loan maturity (years)	Bor-rower rate	Grace period (years)	Upfront fees	Annual fees	Other fees	Default rate [1]	Recov-ery rate [2]	Percent guaran-teed
Department of the Interior														
Bureau of Indian Affairs:														
Indian Guaranteed Loan Program	4.75	3.10	3.45	−1.80	....	16	9.00	....	2.00	....	....	4.29	10.52	90.00
Indian Insured Loan Program	4.75	3.10	3.45	−1.80	....	16	9.00	....	2.00	....	....	4.29	10.52	90.00
Department of Transportation														
Office of the Secretary:														
Minority Business Resource Center	1.85	1.85	....	....	....	2	6.56	....	....	....	....	2.00	....	75.00
Federal Highway Administration:														
TIFIA Loan Guarantees	3.67	3.92	....	[9] −0.26	....	37	5.32	5	0.30	0.01	....	26.18	60.00	100.00
Department of Veterans Affairs														
Benefits Programs:														
Housing Guaranteed Loans	−0.32	1.44	....	−1.75	....	30	6.71	....	1.78	....	0.50	7.21	73.65	25.00
Guaranteed Loan Sale Securities	4.12	5.05	....	....	−0.93	30	6.57	....	....	....	....	6.64	14.31	100.00
International Assistance Programs														
Agency for International Development:														
Development Credit Authority	3.90	5.24	....	−1.34	....	8	4.91	5	0.75	0.50	....	13.29	....	50.00
Loan Guarantees to Israel Program	....	5.10	....	−5.10	....	23	5.50	....	5.10	....	....	....	....	100.00
Overseas Private Investment Corporation:														
OPIC Loan Guarantees	0.80	6.42	....	−5.62	....	7	4.61	4	0.50	1.32	....	12.00	50.00	100.00
OPIC Investment Funds and Structured Finance	−17.33	0.29	....	−17.62	....	13	6.03	6	0.50	1.62	....	14.82	10.00	100.00
Small Business Administration														
General Business Loan Programs:														
7(a) General Business Loans	....	3.52	....	−3.52	....	15	7.17	....	3.17	0.54	....	7.21	51.11	68.20
Section 504 Certified Development Companies Debentures	....	3.13	....	−3.50	0.38	20	6.23	....	1.20	0.34	....	5.95	41.91	100.00
SBIC Debentures	....	8.97	....	−9.05	0.07	10	5.24	....	3.00	0.94	....	34.41	71.15	100.00
Secondary Market Guarantee	....	....	....	....	....	20	4.47	....	....	....	....	....	....	100.00
Other Independent Agencies														
Export-Import Bank of the United States:														
Short, Medium, and Long Term Guarantees and Insurance Program	2.91	13.13	....	−10.22	....	8	2.88	2	11.27	0.12	....	15.93	....	100.00
Presidio Trust:														
Presidio Trust Loan Guarantee Program	0.08	0.58	....	−0.50	....	20	....	....	0.50	....	....	0.75	....	75.00

[*] Nonzero amount rounds to zero, based on units for this column.
[1] Lifetime defaults as a percentage of disbursements.
[2] Recoveries as a percentage of lifetime defaults.
[3] Stafford loans include a six-month grace period.
[4] Recoveries include interest and penalties.

Table 8.—**LOAN GUARANTEES: SUBSIDY REESTIMATES [1]—Continued**

(in percentages, unless noted otherwise)

Agency, Bureau, Program, Risk Category, and Cohort Year	Characteristics of Subsidy Reestimates: Original Subsidy Rate	Current Reestimated Rate	Percentage point change due to interest rates	Percentage point change due to technical assumptions	Current reestimate amount [2] ($ thousands)	Net lifetime reestimate amount [3] ($ thousands)	Net lifetime reestimate amount, excluding interest ($ thousands)	Total disbursements to date ($ thousands)
FY 1994	....	−0.70	(4)	−0.70	−16,557	−22,012	−10,982	1,563,000
FY 1995	....	−1.24	(4)	−1.24	−6,821	−30,012	−15,994	1,250,000
FY 1996	....	−1.47	(4)	−1.47	−10,897	−44,123	−26,372	1,751,300
FY 1997	....	−1.70	(4)	−1.70	−6,709	−34,306	−21,834	1,250,000
FY 1998	....	−2.23	(4)	−2.23	−9,514	−45,155	−32,232	1,411,868
FY 2003	....	−2.53	1.13	−3.66	−65,354	−45,842	−38,788	1,600,000
FY 2004	....	−0.94	−0.12	−0.82	−17,254	−17,254	−16,396	1,750,000
Overseas Private Investment Corporation:								
OPIC Loan Guarantees								
FY 1992	0.52	−8.94	(4)	−9.46	−8,760	−44,690	....	272,702
FY 1993	1.92	−7.58	(4)	−9.50	−49,519	−52,370	....	308,878
FY 1994	2.45	−8.00	(4)	−10.45	−2,256	−96,837	....	647,388
FY 1995	1.91	3.97	(4)	2.06	−84,231	11,058	....	1,009,806
FY 1996	3.72	−4.75	0.57	−9.04	−80,401	−76,374	....	741,176
FY 1997	0.32	−3.19	0.18	−3.69	−98,885	−46,292	....	652,136
FY 1998	−15.38	62.83	−0.71	78.92	16,352	48,707	....	60,000
FY 1999	−12.18	−9.99	−0.09	2.28	−85,592	−66,678	....	516,364
FY 2000	−2.33	(5)	....	....	....	....	....	....
FY 2001	1.18	(5)	....	....	....	....	....	....
FY 2003	−7.98	(5)	....	....	....	....	....	....
FY 2004	−3.81	(5)	....	....	....	....	....	....
NIS — Guaranteed Loan program								
FY 1994	4.81	5.90	....	1.09	13,933	7,294	4,293	393,842
FY 1995	4.19	23.93	(4)	19.74	78,741	70,646	42,637	215,994
FY 1996	9.60	−14.38	(4)	−23.98	....	−5,167	−3,597	15,000
FY 1997	4.93	−12.15	(4)	−17.08	1,266	−25,345	−19,813	116,000
Small Business Administration								
General Business Loan Programs:								
7(a) General Business Loans								
FY 1992	4.85	2.34	0.53	−3.04	71,538	−146,637	−123,536	5,225,979
FY 1993	5.21	1.64	0.22	−3.79	104,166	−221,710	−196,837	5,925,592
FY 1994	2.15	0.57	0.04	−1.62	−73,619	−164,212	−108,636	7,190,942
FY 1995	2.74	2.39	0.23	−0.58	71,038	11,038	−4,417	7,141,980
FY 1996	1.06	1.07	*	0.01	36,797	18,655	−276	6,610,988
FY 1997	1.93	0.65	0.30	−1.58	47,032	−77,586	−94,590	7,884,516
FY 1998	2.14	0.47	−0.91	−0.76	−9,938	−128,606	−121,015	7,618,236
FY 1999	1.39	1.12	−0.50	0.23	52,226	−10,380	−20,336	8,593,952
FY 2000	1.16	1.42	−0.07	0.33	108,096	45,679	25,475	8,899,298
FY 2001	1.16	1.00	0.05	−0.21	62,143	−8,976	−10,866	8,449,435
FY 2002	1.07	0.31	0.14	−0.90	−9,226	−80,306	−75,818	10,375,693
FY 2003	1.04	1.26	....	0.22	2,928	20,506	19,656	9,274,097
FY 2004	0.78	0.24	....	−0.54	−42,248	−42,248	−40,728	7,498,037

Table 8.—LOAN GUARANTEES: SUBSIDY REESTIMATES [1]—Continued

(in percentages, unless noted otherwise)

Agency, Bureau, Program, Risk Category, and Cohort Year	Characteristics of Subsidy Reestimates: Original Subsidy Rate	Current Reestimated Rate	Percentage point change due to interest rates	Percentage point change due to technical assumptions	Current reestimate amount [2] ($ thousands)	Net lifetime reestimate amount [3] ($ thousands)	Net lifetime reestimate amount, excluding interest ($ thousands)	Total disbursements to date ($ thousands)
7(a) General Business Loans—DELTA								
FY 1995	2.73	([5])	....	....	....	....	....	1,220
FY 1996	3.15	([5])	....	....	....	....	....	21,115
FY 1997	3.47	([5])	....	....	....	....	....	27,309
FY 1998	3.36	([5])	....	....	....	....	....	27,495
FY 1999	2.08	([5])	....	....	....	....	....	35,028
FY 2000	1.83	([5])	....	....	....	....	....	13,508
FY 2001	1.87	([5])	....	....	....	....	....	2,470
FY 2002	1.73	([5])	....	....	....	....	....	803
FY 2003	1.58	([5])	....	....	....	....	....	150
7(a) General Business Loans — STAR								
FY 2002	1.67	−0.29	−1.67	−0.29	−12,576	−33,895	−11,028	1,621,148
FY 2003	1.04	0.25	−1.04	0.25	−485	−10,840	−445	1,366,602
Section 504 Certified Development Companies Debentures								
FY 1992	0.49	3.57	....	3.08	−3,638	11,166	16,334	562,596
FY 1993	0.54	1.99	....	1.45	−6,921	−3,161	9,476	723,343
FY 1994	0.51	6.08	1.68	3.89	76,524	85,998	65,873	1,135,379
FY 1995	0.57	4.13	2.40	1.16	19,054	41,989	40,356	1,314,744
FY 1996	....	2.51	−0.01	2.52	1,768	41,184	45,914	2,084,215
FY 1997	....	−1.74	−0.07	−1.67	19,052	−13,647	−19,335	1,205,638
FY 1998	....	−0.98	−1.35	0.37	52,600	−2,418	−11,847	1,470,304
FY 1999	....	0.12	0.30	−0.18	26,002	10,769	3,322	1,597,116
FY 2000	....	0.39	0.05	0.34	25,063	7,761	5,819	1,489,887
FY 2001	....	−0.07	0.06	−0.13	444	−2,106	−1,647	1,888,574
FY 2002	....	−1.18	0.01	−1.19	−25,866	−26,329	−23,539	1,980,782
FY 2003	....	−2.04	0.02	−2.06	−47,334	−45,091	−44,077	2,149,448
FY 2004	....	−1.34	....	−1.34	−14,087	−14,087	−13,552	1,012,325
Section 504 Certified Development Companies—DELTA								
FY 1996	0.57	([5])	....	....	....	....	....	8,463
FY 1997	1.01	([5])	....	....	....	....	....	1,727
FY 1998	0.72	([5])	....	....	....	....	....	5,278
FY 1999	1.29	([5])	....	....	....	....	....	1,725
Section 7(m) Microloan Guaranty								
FY 1996	11.95	([5])	....	....	....	....	....	1,579
FY 1997	8.21	([5])	....	....	....	....	....	2,702
FY 1998	8.21	([5])	....	....	....	....	....	3,654
FY 1999	7.97	([5])	....	....	....	....	....	1,757
FY 2000	8.32	([5])	....	....	....	....	....	1,150
FY 2001	7.95	([5])	....	....	....	....	....	2,000
SBIC Debentures								
FY 1992	14.29	22.97	0.19	8.49	19,471	14,111	5,300	60,060
FY 1993	15.40	12.82	0.07	−2.65	12,002	619	−1,331	63,350
FY 1994	16.25	1.11	−0.46	−14.68	−7,528	−22,780	−14,594	100,000
FY 1995	14.65	−16.95	0.41	−32.01	−45,315	−59,060	−32,524	104,430

Table 8.—LOAN GUARANTEES: SUBSIDY REESTIMATES [1]—Continued

(in percentages, unless noted otherwise)

Agency, Bureau, Program, Risk Category, and Cohort Year	Characteristics of Subsidy Reestimates: Original Subsidy Rate	Current Reestimated Rate	Percentage point change due to interest rates	Percentage point change due to technical assumptions	Current reestimate amount [2] ($ thousands)	Net lifetime reestimate amount [3] ($ thousands)	Net lifetime reestimate amount, excluding interest ($ thousands)	Total disbursements to date ($ thousands)
FY 1996	15.46	−22.85	−0.02	−38.29	−74,133	−70,040	−41,437	108,570
FY 1997	3.19	−9.54	−0.01	−12.72	−34,539	−28,613	−17,688	138,725
FY 1998	1.94	9.85	−2.89	10.80	−16,066	34,674	28,361	382,035
FY 1999	1.38	7.79	−2.36	8.77	24,463	23,044	18,408	292,750
FY 2000	....	1.11	(4)	1.11	18,409	6,749	4,312	292,155
FY 2001	....	2.15	(4)	2.15	24,391	12,329	9,226	355,970
FY 2002	....	0.44	(4)	0.44	10,854	2,563	1,961	318,070
FY 2003	....	2.99	(4)	2.99	6,402	7,607	7,078	240,150
FY 2004	....	1.20	(4)	1.20	1,412	1,412	1,357	112,730
SBIC Participating Securities								
FY 1994	9.00	[10] −3.58	−0.41	−12.17	35,051	−15,911	−17,270	149,660
FY 1995	8.90	[10] 24.58	0.18	15.50	89,057	80,525	34,879	219,940
FY 1996	9.00	[10] 15.55	−0.02	6.57	42,403	40,573	15,362	231,230
FY 1997	3.29	[10] 43.92	−0.10	40.73	79,347	147,244	92,216	232,830
FY 1998	2.20	[10] 21.41	−0.93	20.14	−46,253	165,566	122,157	677,825
FY 1999	2.19	[10] 62.04	−1.03	60.88	128,312	668,872	530,644	930,450
FY 2000	1.80	[10] 56.86	0.26	54.80	127,987	683,103	580,673	1,090,860
FY 2001	1.31	[10] 40.08	....	38.77	224,180	596,398	520,875	1,410,790
FY 2002	....	[10] 31.75	(4)	31.75	139,814	252,284	230,721	754,855
FY 2003	....	[10] 26.80	(4)	26.80	84,965	104,932	100,262	379,475
FY 2004	....	[10] 28.24	(4)	28.24	17,610	17,610	16,850	59,670
SBIC New Market Venture Capital								
FY 2002	14.47	(5)	....	....	....	....	....	1,150
FY 2003	15.46	(5)	....	....	....	....	....	1,950
FY 2004	16.05	(5)	....	....	....	....	....	12,260
Secondary Market Guarantee								
FY 2004	....	[11] 0.39	....	0.39	43,818	149,085	147,029	38,008,032
Other Independent Agencies								
Export-Import Bank of the United States:								
Short, Medium, and Long Term Guarantees and Insurance Program								
FY 1992	4.95	4.02	0.60	−1.53	−13,778	−630,445	....	8,102,397
FY 1993	4.00	−2.06	−0.02	−6.04	−104,823	−660,303	....	10,187,672
FY 1994	4.52	−2.04	0.25	−6.81	11,224	−1,392,855	....	9,439,964
FY 1995	5.62	−3.80	0.57	−9.99	−47,804	−931,234	....	5,489,677
FY 1996	7.50	0.36	0.09	−7.23	6,051	−791,528	....	6,449,940
FY 1997	7.51	−1.92	0.22	−9.65	−72,765	−1,383,308	....	8,412,789
FY 1998	6.82	1.75	−0.34	−4.73	−88,835	−962,809	....	6,922,799
FY 1999	5.13	−0.06	....	−5.19	−12,794	−1,265,202	....	11,373,918
FY 2000	7.90	0.26	....	−7.64	−157,702	−1,424,539	....	9,691,465
FY 2001	8.77	1.36	....	−7.41	−116,876	−1,006,876	....	9,966,407
FY 2002	7.18	1.48	....	−5.70	−204,285	−192,567	....	8,293,852
FY 2003	3.06	−0.65	....	−3.71	−26,826	−26,826	....	5,442,442

Christopher L. Crawford
President & CEO

National Association of Development Companies
&
Development Company Funding Corporation
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Chris Crawford has managed the National Association of Development Companies and the Development Company Funding Corporation for fourteen years. NADCO is the trade and professional organization for Certified Development Companies, who provide long term economic development loans to small businesses through the SBA 504 loan guarantee program. DCFC is responsible for the funding of the 504 guaranteed bonds for CDCs. 504 provided $4 billion in guaranteed funds and over $5 billion in private first mortgages to more than 8,300 small businesses during FY 2004.

Mr. Crawford is responsible for direct coordination with the SBA Offices of Capital Access, Financial Assistance, and Lender Oversight in Washington, D. C. He works with the SBA senior staff on technical issues, overall program policy, 504 program marketing, and staff education and training programs. He also is responsible for management of Congressional and political issues, communications to appropriate Members and the Small Business Committees in Congress, and direction of lobbying firms contracted to NADCO.

During the 1980's, Mr. Crawford was a Group Director at the American Bankers Association, the national trade organization for the commercial banking industry. He was responsible for more than ten major industry conferences each year, including the largest trade show in the banking industry. Additional responsibilities included payment systems, securities & trust operations, professional schools, industry newsletters, association marketing programs, and service on several industry boards and councils, including the CUSIP Board of Trustees. He also coordinated banking industry policies on payments and bank operations with the Federal Reserve System Conference of First Vice Presidents.

During the 1970's, he was employed by two regional banks: The First National Bank of Atlanta, and American Security Bank of Washington, D. C. Responsibilities included computer systems design and installation, check and ACH processing, securities processing, federal funds trading, wire transfer operations, and the commercial loan collateral and customer securities safekeeping.

Mr. Crawford is experienced in the management of small businesses, having owned two during the past eighteen years. Prior to entering banking, he served in the U. S. Army as a combat construction engineer, with a tour of duty in Viet Nam.

Mr. Crawford holds an Industrial Engineering and Computer Systems degree from Auburn University, and an MBA in Finance from Georgia State University. His spouse is a senior official with the U. S. Postal Service in Washington.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program Status

& Proposed FY 2006 SBA Budget

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Mr. Christopher L. Crawford
President & CEO

February 10, 2005

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business concerning the SBA budget proposed by the Administration for FY 2006. NADCO is the trade association for SBA 504 Certified Development Companies (CDCs). We represent 250 CDCs and more than 200 affiliate members, who together provided more than 99% of all SBA 504 financing to small businesses during 2004. NADCO's mission is to serve as the key advocate for the 504 program, and to provide program technical support, marketing assistance, strategic planning, and professional education to our membership.

504's objective is economic development and specifically job creation by funding the expansion of successful, growing small businesses. No other Federal economic development program can claim to have created over 1,300,000 jobs, as the 504 program has done. 504 is a critical economic stimulus program designed to assist growing businesses create jobs and invest in their communities.

NADCO would like to thank Chairman Manzullo, Ranking Member Velazquez, and the entire Committee, for continued support of the 504 program. Your Committee has worked closely with the Congressional leadership, SBA, and our industry to ensure the availability of capital to small businesses through the 504 program through the years. We would especially like to thank the Chairman and Ranking Member for their strong support for many program enhancements through HR 4818 last year. It will bring the benefits of 504 to numerous small businesses that otherwise might not have had access to the program.

I would like to address three topics:

1. 504 authorization need for the remainder of FY 2005
2. SBA's proposed 504 authorization for FY 2006
3. 504 loan processing and liquidation issues.

504 FY 2005 Authorization:

The omnibus spending bill passed in December 2004, H. R.4818, contained substantial 504 program enhancements long endorsed by this Committee. With support by both the Chairman and Ranking Member, Section K of that bill provided an authorization ceiling of $6.0 billion for FY 2005 and $7.5 billion for FY 2006. Our industry appreciates the Committee's support, as these program levels would have enabled 504 to add many more thousands of jobs to our economy.

However, other language in that bill placed a "hard cap" on 504 authority of $5 billion for FY 2005, which overrides the authorization ceiling passed by this Committee. With loan volume up by 24% year to date over last year, we believe that demand will exceed $5 billion. Furthermore, the increased debenture sizes and the new Manufacturing Debenture approved by Congress in December will certainly lead to even greater demand. We ask the Committee to carefully watch program usage and seek additional authorization for 504 if it proves necessary during the remainder of this year. Given the zero subsidy of 504, there is no cost to the taxpayer and no appropriation required for the program. If an increase is needed, 504 will add many more jobs this year. If authority runs out, we expect SBA to be forced to either shut 504 down during the year, or implement a credit rationing plan, as has been done to 7(a) in the past.

504 FY 2006 Authorization:

The Administration proposes a hard program cap of only $5.5 billion for 2006. If $5 billion proves to be insufficient for 2005, then $5.5 billion will be grossly insufficient for 2006. Demand by small businesses for 504 loan guarantees has grown by more than 20% per year over the past three years. With a statutory requirement to add or retain one job per $50,000 for 504 projects, this demand translates to more than 110,000 jobs added per year. All this is accomplished at zero subsidy. We believe that there is no Federal economic development program that is more effective in creating new jobs for America.

We ask this Committee to approve an authorization ceiling for FY 2006 of at least $6.5 billion. With the impact of last year's program enhancements and debenture increases yet to be measured, it is imperative that there be sufficient program authority to avoid running out of loan funding late in FY 2006. As with our potential predicament during 2005, this would lead to a shutdown of 504 during FY 2006 if the authorization were exhausted.

504 Centralized Loan Processing:

In an effort to both reduce operating costs to meet budgets, and improve 504 loan processing, SBA embarked last year on a pilot to bring all loan underwriting and approvals into one center in Sacramento. This was initiated when annual 504 demand was running at about $3 billion. The pilot was very successful, and we thank the Administration for its hard work to improve loan processing. This has resulted in a great improvement of service to small business borrowers.

However, today 504 demand is at least $5 billion, and will certainly exceed $6 billion next year with the endorsement of this Committee. This demand has put enormous pressure on the staff of the Loan Processing Center, with the result that the expected performance levels may be in jeopardy. I know of no more qualified and motivated Federal employees and managers than those in the SBA's Office of Financial Assistance and the Loan Processing Center. But these employees may be reaching their breaking point.

It appears that program demand may be outpacing SBA's ability to grow its processing capacity at existing staff levels. SBA and NADCO are working furiously together to streamline the center's workflows, and we think this will help improve capacity to a limited extent. But we believe that SBA must provide relief to those dedicated employees immediately by considering the need for staff increases. Otherwise, we foresee the inevitable outcome of staff burnout and sinking morale that will lead to turnover of these highly qualified individuals, resulting in lower service levels by SBA.

Through productivity improvements, SBA has been able to substantially downsize the labor required to both underwrite and process 504 loan applications. This has enabled SBA to shift its field office personnel to outreach and direct small business assistance tasks. Unfortunately, neither SBA nor NADCO foresaw the continued expansion of demand for 504, and SBA may have cut too deep in the capacity to handle future loan volume.

We urge the Administration to quickly evaluate the current and future staffing needs for 504 loan processing in order to maintain the high level of performance of this critical center well into the future. The result will be enhanced service to small business borrowers.

504 Loan Liquidation & Recovery:

504 is a loan guarantee program for which the primary operating cost is that of the losses on any defaulted loans. However, with all projected loan losses covered by fees paid by the small business borrower, our first mortgage lender, and by CDCs, the program operates at a "zero subsidy".

In order to keep these fees acceptably low, substantial efforts must be made by SBA to minimize the actual loss, or charge off, attributed to each defaulted loan.

Failure to improve the liquidation and recovery efforts for 504 defaulted loans will result in increased fees for all future 504 small business borrowers.

With every 504 loan being secured by both fixed assets (land, buildings, heavy equipment) and personal guarantees, it is expected (and actually forecasted by the OMB 504 subsidy model) that there will be a reasonable rate of recovery of any outstanding loan balance through either a workout with the borrower, or through liquidation of the loan collateral. For FY 2006, the forecast is for about 42% recovery on every default.

If the liquidation process fails, then the loan balance must be charged off, and there is a zero recovery for the project. In effect, the borrower walks away with no repayment of his debt, and the SBA must pay off the 504 debenture out of the guarantee fees that all other borrowers, our bank partners, and CDCs pay.

Alternatively, diligent workout or recovery efforts by SBA field staff may result in a partial or even a complete recovery of the outstanding loan balance from the borrower or guarantors. In fact, this occurs most of the time when recovery is actively pursued by SBA or qualified CDC recovery specialists, as detailed below.

Over the last several years, the actual number of 504 defaults has been very low for a Federal guarantee program. SBA's own forecast of defaults for FY 2006 is 5.95%. It is clear that defaults have been kept at very reasonable levels, even as demand increased substantially, or our economy sunk into recessions over the past eighteen years. This is a tribute to CDC and SBA loan underwriting and to continuing loan servicing to manage payments and collections.

However, it is another story when it comes to actual recoveries from these defaulted 504 loans. Shortly after 2000, SBA began a pilot to liquidate defaulted loans (disaster, 7a, and 504) through a series of "asset sales". These were apparently not very successful, and the Administration ceased these periodic sales of pools of loans. The last sale occurred in December 2002.

Since that time, SBA staff has been responsible for recovering proceeds on almost all 504 loan defaults through liquidations. Data from our program Trustee bank reveals that from 12/2002 through 12/2004, there have been just over eight hundred 504 debenture involuntary accelerations. We assume this to be the actual number of borrower loan defaults. Clearly, it is imperative that all these defaults be addressed by responsible SBA staff to maximize recoveries and avoid increasing the program guarantee fees charged to small businesses.

At about the same time that the asset sale process was abandoned, SBA initiated a project to centralize at least 7(a) loan liquidations and recoveries in a new center in Herndon, Virginia. It was also apparently decided to eliminate all "portfolio management" staff from all SBA District Offices, which resulted in a number of layoffs or forced retirements of PM employees. A small number of these PM staff were relocated to Herndon to build the new 7(a) liquidation center capacity. Any remaining staffs were assigned other tasks in the District Offices.

Unfortunately, and apparently lost in this transition, was the question of just who was responsible for handling the 504 loan defaults and liquidations. As NADCO and the Committee watched this process unfold, a pilot loan liquidation program for CDCs, created under direction of the Committee in the late 1990s, was demonstrating that CDCs, even though small community-based non-profits, were fully capable of successfully recovering outstanding funds from defaulting borrowers. Even today, about fifteen pilot CDCs continue to perform workouts and recoveries on their own loan defaults with a high level of recovery.

As the 7(a) liquidation center became a priority for SBA attention, it appears that 504 liquidation became a "catch as catch can" effort. Most of the 800+ loan defaults have apparently been returned to the various SBA District Offices for resolution and liquidation. However, it is not clear how many, or even whether any District Offices have remaining expertise or staff time to perform liquidations. We believe this capacity is sorely lacking today in most SBA offices due to downsizing of the field staff.

The result is that we don't know WHO is working these 800+ loan defaults, or what their actual recoveries are. We don't know how many have been simply charged off by the District Offices due to lack of expertise or staff time, leaving the defaulted borrower to walk away from his Federal obligation to repay his loan.

To avoid the certainty of substantial guarantee fee increases, the situation must be addressed quickly. With little real expertise remaining in SBA's field offices to recover 504 loan defaults, SBA must go in a direction it just did with the 7(a) program: centralize liquidation administration, and shift the actual field work of recoveries to the program's lenders: CDCs.

Throughout the last five years of the 504 liquidation pilot, we have been urging SBA to move in this direction. Now, with few or no remaining SBA PM field staff, it is imperative that this be done quickly. Eight hundred loans are sitting somewhere, with an unknown amount of effort by SBA to recover the outstanding balances. Further, as each year goes by, another four hundred loans default and must be dealt with. This uncertainty of collection must not continue.

We urge this Committee to work with SBA and with our industry to quickly reconfigure the process of liquidating 504 defaulted loans. We also urge SBA to issue for public comment its draft liquidation regulation as soon as possible. The alternative is that we will see recoveries decline, while borrower fees will go up. We stand ready to meet with the Committee and SBA management at any time to focus on addressing this critical issue.

Conclusion:

Through 504, SBA provides the largest and most successful dedicated economic development program the Federal government has today. Its real value to America is immeasurable. Through the jobs it creates and the business growth it fosters, 504 benefits employees, business owners, and government at all levels. Our borrowers pay Federal payroll and income taxes, State sales, payroll and income taxes, and local income and property taxes. All this takes place with no cost for the loan program to the U. S. taxpayer.

For this reason, we cannot understand why the Administration or the Congress would want to restrict access by growing small businesses to 504 for either FY 2005 or FY 2006. We urge Congress to ensure that the program is available to all businesses that need access to this long-term capital by increasing its no-cost authorization immediately.

To keep its fees low for borrowers, the process of liquidation and recovery of defaulted loans must be addressed quickly. We want to work with this Committee and SBA to meet their budgetary requirements, yet expand the recovery of loan balances. Given the number of outstanding loan defaults, there is no time to lose, and we urge quick action by the Administration to complete its regulations enabling CDCs to support the liquidation and recovery processes for 504.

NADCO thanks Chairman Manzullo, Representative Velazquez, and Administrator Barreto for their long-standing support of 504. We look forward to a very successful 2006.

Christopher L. Crawford
President & CEO

National Association of Development Companies
&
Development Company Funding Corporation
McLean, Virginia
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Chris Crawford has managed the National Association of Development Companies and the Development Company Funding Corporation for fourteen years. NADCO is the trade and professional organization for Certified Development Companies, who provide long term economic development loans to small businesses through the SBA 504 loan guarantee program. DCFC is responsible for the funding of the 504 guaranteed bonds for CDCs. 504 provided $4 billion in guaranteed funds and over $5 billion in private first mortgages to more than 8,300 small businesses during FY 2004.

Mr. Crawford is responsible for direct coordination with the SBA Offices of Capital Access, Financial Assistance, and Lender Oversight in Washington, D. C. He works with the SBA senior staff on technical issues, overall program policy, 504 program marketing, and staff education and training programs. He also is responsible for management of Congressional and political issues, communications to appropriate Members and the Small Business Committees in Congress, and direction of lobbying firms contracted to NADCO.

During the 1980's, Mr. Crawford was a Group Director at the American Bankers Association, the national trade organization for the commercial banking industry. He was responsible for more than ten major industry conferences each year, including the largest trade show in the banking industry. Additional responsibilities included payment systems, securities & trust operations, professional schools, industry newsletters, association marketing programs, and service on several industry boards and councils, including the CUSIP Board of Trustees. He also coordinated banking industry policies on payments and bank operations with the Federal Reserve System Conference of First Vice Presidents.

During the 1970's, he was employed by two regional banks: The First National Bank of Atlanta, and American Security Bank of Washington, D. C. Responsibilities included computer systems design and installation, check and ACH processing, securities processing, federal funds trading, wire transfer operations, and the commercial loan collateral and customer securities safekeeping.

Mr. Crawford is experienced in the management of small businesses, having owned two during the past eighteen years. Prior to entering banking, he served in the U. S. Army as a combat construction engineer, with a tour of duty in Viet Nam.

Mr. Crawford holds an Industrial Engineering and Computer Systems degree from Auburn University, and an MBA in Finance from Georgia State University. His spouse is a senior official with the U. S. Postal Service in Washington.

NASBIC
America's Small Business Partners

Statement
of
Stephen Vivian

Prism Capital
Suite 1910
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Before The

United States House of Representatives
Committee on Small Business

February 10, 2005

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Chairman Manzullo, Ranking Member Velázquez, and members of the Committee:

It is an honor to testify on behalf of the National Association of Small Business Investment Companies regarding the Administration's FY 2006 budget proposal for the Small Business Investment Company (SBIC) program. By way of introduction, my name is Stephen Vivian. I am a partner with Prism Capital, a team of six professionals managing two SBICs: Prism Opportunity Fund, a Participating Security SBIC licensed in 1999, and Prism Mezzanine Fund, a Debenture SBIC licensed in 2003. In total, we have approximately $175 million under management. Our main office is in Chicago, Illinois. We have satellite offices in Seattle, Washington; Englewood, New Jersey; Minneapolis, Minnesota, and Milwaukee, Wisconsin.

As to my background, I have worked across a range of companies: from a Fortune 100 company to a small technology consulting firm I started myself. Immediately prior to joining Prism, I was an associate with BancAmerica's leveraged finance group, serving as both a senior lender and investment banker for the placement of subordinated debt. With Prism Capital, I am involved in finding, closing, and monitoring both debt and equity investments and serve on the boards of directors of several of our portfolio companies. In addition, I serve as a member of the Executive Committee of NASBIC's Board of Governors and as Chair of that board's committee charged with finding a solution that will revive the Participating Security program.

At Prism, the investment opportunities I focus on are growing small businesses, including traditional manufacturing companies. In the latter, we look for small manufacturing companies that have good potential for growth, both internally and by way of acquisitions. We are committed to backing exceptional entrepreneurs who have the vision, drive, talent, and business models to be leaders within their industries. We understand the enormous effort required to create a successful business and stand ready to provide our portfolio companies with assistance in strategic planning, customer acquisition, business management, executive recruiting, and raising additional capital. We understand that growing an exceptional business is a lengthy, complex process that more often than not includes many unexpected developments along the way. Thus, we are a patient investor, investing with a horizon of between three and seven years depending on the requirements of the small businesses we invest in. We also invest with the mindset that growth requires additional capital and reserve for follow-on investments. We maintain an extensive network of contacts in the private equity community and can assist small companies by bringing additional investors into a transaction.

We also focus on investing in the Midwest. In our first fund, the 1999 Participating Security fund, we have invested in 14 small businesses. Of those, six are headquartered in Illinois, eight are headquartered in the Midwest and eleven have a presence in the Midwest. As an example of the program at work, one particular portfolio company used our investment to fund the opening of a bottling plant in Paxton, Illinois which now employs 30 people during the peak summer bottling season. Our active portfolio companies have created in excess of 100 jobs in Illinois alone and nearly 250 jobs in the Midwest. And we are but one of the 206 licensed Participating Securities SBICs across the country.

With that introduction, I will turn to issues related to the Administration's FY 2006 budget proposal. I will summarize my remarks, but ask that my full testimony be included in the record.

The Administration's Budget Proposal

1. We are happy to see the Administration continue its strong support of the Debenture program at the $3.0 billion level. As you know, Debenture SBICs primarily make subordinated loans to small businesses with sufficient cash flow to cover the interest payments. The subordinated nature of the loans makes them an important part of the balance sheet insofar as attracting senior bank debt that is so important for business operations.

   While $500 million less than the authorized level for FY 2006, the amount should be sufficient to meet the projected demand for new Debenture leverage during that year. We are also pleased to note that the FY 2006 interest rate adjustment required to maintain a zero subsidy rate for appropriation purposes is virtually unchanged, increasing by less than seven one hundredths of one percent.

2. We are very disappointed that the Administration failed to propose any new Participating Security leverage in FY 2006. As you may remember, the Administration had requested a $4.0 billion program for this year (FY 2005) if the program could be restructured in a way to produce a "zero" subsidy rate for appropriation purposes. Unfortunately, we were unable to come to an agreement with the Administration last year—despite the best efforts of this committee—as to how that restructuring should be accomplished. We treat it as an open issue that we hope will be resolved through further negotiation. However, the budget proposal indicates that the Administration wants to close negotiations altogether. We are not certain why that is the case. Clearly the need for equity capital of the type provided U.S. small businesses by Participating Security SBICs can not have fallen from the $4.0 billion proposed by the Administration last year to the $0 proposed this year. Nor can it be that the industry is trying to spend scarce government resources: we acknowledge program losses under the current structure—even if a substantial percentage of those losses can be attributed to the recent recession—and we agree that the program must be restructured to run at a true zero subsidy rate requiring no appropriation and no program wide losses that would increase the deficit. We hope that the Administration will reconsider its position during the course of the next few months so that, collaboratively, we can revive this segment of the SBIC program—the segment that provides more than half of all SBIC investments annually.

3. The Administration's refusal to ask for any new Participating Security leverage in FY 2006 has two major consequences, both negative. First, it continues the break in the pipeline of new funds that we are experiencing this year. Participating Security funds, like most venture funds, are formed as 10-year partnerships that make original investments during the first five years and then support those investments with follow-on rounds over the last five years. If new funds are not being formed every year, the capital available to small businesses that have not already received some will dry up quickly. And it is not easy to turn the flow back on quickly. It can take as long as one and one half to two years for a management team to both raise the capital and go through the SBA licensing process. Further, once experienced management teams leave the program, they are unlikely to return in the future. Thus, failure to "fix" the problem will result in less money for small business and fewer experienced management teams to call upon to run the program if the government tries to reinstate the program sometime in the future.

4. The second and equally negative consequence of the Administration's proposal is its abandonment of existing Participating Security SBICs that will need leverage in FY 2006 to operate in accordance with the business plans that SBA approved in the licensing process. Although Participating Security SBICs hold over $5.0 billion in commitments as a group, individual Participating Security SBICs in good standing do not hold commitments sufficient to meet their leverage requirements as approved by SBA in the licensing process. Based on a survey of all Participating Security SBICs, NASBIC estimates this requirement to equal approximately $80 million per year for the years FY 2006 through FY 2010. If unable to draw the leverage when needed, the effected funds will have less diverse portfolios (increasing risk of fund failure) and less money to invest in existing portfolio companies (increasing risk of failure for the very companies the program is designed to support). Failure to solve this problem will constitute a breach of the implicit promise made in the licensing process that leverage sufficient to fund approved businesses plans would be available so long as those funds remained in regulatory compliance. We look forward to working with the Committee this year to determine how the problem might be addressed without the requirement for a substantial appropriation.

5. We pose the following two questions with respect to the future of the Participating Security program. First, is there a need for the program and the equity capital it provides to U.S. small businesses not generally supported by non-SBIC venture funds—whether with respect to size of investment required, or the industry of which the small business is a part, or its geographic location? Second, is there a structure that can be developed that will produce the desired zero subsidy rate and still keep the program attractive to private investors who must lead with their capital commitments? We think the answer to both questions is "yes."

   With respect to the first question, we hope to provide the Committee with a report by the end of March from the Amos Tuck School of Business Administration at Dartmouth College that we believe will be persuasive with respect to the "capital gap" faced by U.S. small businesses. We hope that the Committee will hold a hearing at that time to consider the very important question of the "need" for the Participating Security program. In addition to the report, we would be happy to suggest the names of several small business entrepreneurs who would be happy to testify concerning the importance of the program for their businesses.

   With respect to the second question, we are hard at work designing a new proposed economic structure that would apply to Participating Security funds licensed after the date of its enactment. We would like to work collaboratively with the Administration, but if that is not to be, we will create the new model on our own. We will submit the new model to the Committee as soon as it is ready and, at that time, ask the Committee to consider its merits and request a scoring of the proposed structure for subsidy rate purposes.

6. In conclusion, I refer you to three documents attached to my testimony. The first is the September 9, 2004 letter from the National Venture Capital Association to the President outlining the unique and important role played by the Participating Security program in the universe of private equity. The second is a Participating Security program impact statement prepared by NASBIC that addresses many issues of importance to this Committee. The third an example of data available on the "Equity Gap" faced by U.S. small businesses. We

believe that the facts set forth in these documents, to be supplemented by others and validated by the Tuck School report provide a strong foundation that supports the continuing need for the Participating Security program. We look forward to working with the Committee during the months ahead to restructure the program in a manner that will meet that small business need while at the same time running at a true zero subsidy rate based on reasonable economic assumptions.

Thank you for your attention. I would be pleased to answer any questions you have.

NVCA
National Venture Capital Association

September 9, 2004

President George W. Bush
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Mr. President:

We have recently learned that there is now a debate within the Administration concerning the economic justification or "need" for SBA's Participating Security SBIC program. NVCA believes strongly that this program fills a void which non-SBIC venture funds are unable to fill. We request that our views be taken into consideration when you formulate the Administration's final position on this issue.

NVCA is the only organization that represents the overall venture capital and private equity industries in the U.S. As such, we believe NVCA is uniquely qualified to address the "need" question relative to the SBIC program. As part of our mission we track the flows of venture capital throughout the country on an quarterly basis and publish our findings so that government and industry leaders can better understand and appreciate the critical role venture capital plays in U.S. job creation and economic growth. In addition, reports such as, "Venture Impact 2004," issued July 20, 2004 demonstrate that venture capital continues to play a critical role in encouraging growth of the U.S. economy and contributing to job growth and technical progress.

With that brief background, let me turn to the three reasons we believe there is a role that the SBIC program fills within the private equity universe for the Participating Security SBIC program:

1. First, Participating Security funds make equity investments in smaller increments than do the large majority of non-SBIC venture funds. This is of critical importance to very small companies, particularly those not in high-technology industries, which require equity financing rounds in the $1.0- to $5.0 million range. That range of investing is generally not attractive to major non-SBIC venture funds, but one that is critical to help grow the business to a level that will eventually attract the interest of non-SBIC funds.

2. Second, SBICs, including Participating Security funds, make investments in areas of the country that are generally not served by the large majority of non-SBIC venture funds. For example, companies in California and Massachusetts received 52% of all venture capital invested during the period FY 1994 – FY 2002. During the same period, SBIC's invested 71% of their capital in companies outside of California and Massachusetts. Since there is no way to tell in advance which small companies will grow to tomorrow's large public success stories or simply important regional employers, nurturing companies in all segments of the country is important.

3. Third, SBIC's support a much more diverse segment of small businesses than do non-SBIC venture funds. In recent years, non-SBIC funds have concentrated their

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investments in the NAIC fast growing critical sectors of "Communications & Computers" and "Life Sciences." In contrast, SBIC's have invested approximately 50% of their funds in NAIC sectors "Manufacturing" and "Consumer Related." While there is overlap, it is clear that the SBIC program addresses the capital needs of many small businesses that are in industry sectors generally not attractive to non-SBIC funds.

In conclusion, the Participating Security program is a small but important part of America's overall capital structure. We urge the Administration to support continuation of the program and to work with all the program's stakeholders to secure the legislation necessary to achieve that result.

Thank you for your consideration of our views. We are available at your convenience to discuss the points made above or to address other issues the Administration believes are relevant to make a final decision on the future of the Participating Security SBIC program.

Sincerely,

Mark Heesen
President

cc: Hector Barreto
Joshua Bolten
Daniel Heath
Hon. Donald Manzullo
Hon. Olympia Snowe

NASBIC
America's Small Business Partners

The Impact Of The Participating Security SBIC Program

- Participating Security SBICs account for over 50% of all SBIC investments and are a major source of seed capital in the U.S.
- 35% ($3.0 billion) of the $8.5 billion in Participating Security investments made since the program's inception in FY 1994 have been made in small U.S. manufacturing companies.
- The Participating Security program was the most reliable source of equity capital for U.S. small businesses during the recession. All venture capital investments fell 83% between 2000 and 2003 according to Venture Economics. Participating Security investments—a total of $5.25 billion—fell just 23%.
- Raising equity capital in the SBIC target range of $1.0- to $5.0 million is the most difficult for a small company to secure. The average VC "deal" size in the 2nd quarter of 2004 was between $7.5- and $10.0 million. The disparity is particularly important in the area of "seed" financing. According to SBA, SBICs provided 64% of seed capital during FY'94 – FY'02.
- Non-SBIC venture capital is concentrated in a very few states. For FY'94 – FY'02, companies in California and Massachusetts received 52% of all venture capital. During the same period, SBIC's invested only 29% of their capital in companies in those states.
- $8.5 billion in Participating Security investments since 1994 have led to the creation of an estimated 228,000 new jobs and $39 billion in portfolio company revenue. Sixty percent of that growth—137,000 jobs and $23.4 billion in portfolio company revenue—occurred during the period FY'01 – FY'04.

  (Estimate based on a 2001 National Venture Capital Association study that found that one sustainable job is created for every $36,000 in venture capital invested in a small business and every $1.00 in venture capital leads to $4.75 in portfolio company revenue.)
- Participating Security investments have resulted in approximately $8.3 billion in employee compensation per year.

  (Estimate based on 2001 average U.S. compensation of $36,214 per full-time job.)
- Participating Security investments have resulted in approximately $1.33 billion in income and social insurance taxes per year paid to the federal government.

  (Estimate based on an August 2003 Congressional Budget Office report that found the effective federal tax rate for middle quintile households in 2000 to be approximately 16%. The average effective tax rate for all quintiles was approximately 23%.)

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The Small Business Equity Gap

The following is taken from a November 2, 2004 article by Daniel Sandler of the University of Western Ontario titled Incentives and Angel Capital: Federal & State Incentive Review and Commentary."

Of the 500 fastest growing companies in the United States (the "Inc. 500") in 2002 (measured by revenue growth over five years), 41 percent started business with $10,000 or less and 14 percent started with less than $1,000. In contrast, only 22 percent started with more than $100,000. Only 2 percent of the 2002 Inc. 500 list received seed capital from venture capitalists.

The formal venture capital industry, comprised of professionally managed venture capital funds, tends to reject small deals because they are simply not worth the costs associated with their assessment and monitoring. Furthermore, as the size of private venture capital funds has increased, the size of the average investment per round of financing and, perhaps more important, the size of the average first-round investment, has increased significantly. Table 1.1 shows the size of first-round financing by industry group and overall in the formal venture capital industry over the period 1980 to 2003. ***While there has been some softening in recent years, the average first-round investment in the formal venture capital industry remains significant and has exacerbated the equity gap at the earliest stages of a business's development.*** [Emphasis added] As a consequence, government venture capital policy and programs often focus on angel financing generally as well as seed and start-up financing because early-stage financing has the potential to generate the greatest social returns through job creation and product innovation and because financing at these stages is not adequately addressed by the formal venture capital industry.

Table 1.1
Average First Round Investment 1980-2003

Industry Sector	**Average First Round Investment ($millions)**											
	1980	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003
Communications	0.7	1.9	4.2	5.0	3.8	4.1	5.9	9.7	12.3	7.9	5.7	4.4
Computer Hardware and Services	1.1	1.5	2.8	3.0	3.9	3.5	4.4	7.3	8.5	5.7	6.6	4.9
Computer Software	0.9	1.3	2.1	2.6	2.7	3.1	3.6	4.8	7.0	5.6	4.1	4.4
Retailing and Media	0.6	2.2	3.3	4.8	4.8	3.6	5.5	6.1	7.8	4.4	4.2	6.2
Biotechnology	1.1	1.2	1.0	2.7	3.5	4.2	3.5	4.9	7.4	7.9	6.8	6.5
Healthcare Related	1.2	1.2	2.2	4.9	3.3	3.8	4.0	4.5	5.9	4.3	6.0	4.4
Semiconductors and Electronics	1.1	1.6	2.5	2.9	4.5	4.1	5.0	6.0	9.4	7.4	6.3	6.7
Industrial/Energy	1.4	1.5	1.9	6.2	3.8	4.0	10.2	9.7	8.9	6.4	7.8	6.0
Business/Financial	0.6	2.8	4.3	4.4	6.1	3.5	5.7	6.5	8.3	5.8	4.5	7.6
Overall	**1.1**	**1.7**	**2.5**	**4.1**	**3.8**	**3.7**	**5.1**	**6.5**	**8.6**	**6.3**	**5.5**	**5.3**

Source: Thomson Venture Economics, 2004 National Venture Capital Association Yearbook (Arlington, VA and New York, NY: Thomson Venture Economics, 2004), Figures 4.02, 4.11, 4.20, 4.29, 4.38, 4.47, 4.56, 4.65 and 4.74 for industry sectors; the overall figure is extrapolated from Figures 3.13 and 3.15.

Council on Competitiveness National Innovation Initiative Report
December 2004

The Council on Competitiveness (www.compete.org) was established in 1986 to address issues associated with the loss by the United States of its preeminent position in the world economy. Of particular concern to the founders was the decline in U.S. leadership in technology development and commercialization and the loss of market share to international competitors. To help meet this challenge, two-dozen industrial, university, and labor leaders joined together to create the Council to serve as a forum for elevating national competitiveness to the forefront of national consciousness. The Council's mission is to set an action agenda that drives economic growth and raises the standard of living for all Americans. The Council describes itself as the only national organization whose membership is comprised exclusively of CEOs, university presidents, and U.S. labor leaders.

In December 2004, the Council issued a report titled "Innovate America." Among the findings of the report related to the availability of risk capital are the following:

1. "Thousands of inventions lie dormant in the hands of universities, research centers and private companies. For those ideas that are pursued commercially, only seven out of every 1,000 business plans receive funding." (Page 33)

2. Entrepreneurs "lack risk capital ... [and] regions often lack the institutional ... mechanisms to direct existing capital assets to entrepreneurial activities." (Page 35)

3. "Recently, [the "funding gap'] has been widening as VC firms are shifting investments to focus on more mature firms with larger capital needs. Entrepreneurs report difficulty in raising money between $2 million and $5 million." (Page 36)

Stephen Vivian

Stephen Vivian is a Partner of the private equity firm Prism Capital in Chicago, Illinois, having joined the firm in 1999. Prism Capital manages two Small Business Investment Companies: Prism Opportunity Fund, a Participating Security SBIC licensed in 1999, and Prism Mezzanine Fund, a Debenture SBIC licensed in 2003. In total, Prism has approximately $175 million under management and focuses on both debt and equity investments in lower middle-market companies. Prism's main office is in Chicago, Illinois. Satellite offices are located in Seattle, Washington; Englewood, New Jersey; and Milwaukee, Wisconsin.

Prior to joining Prism, from 1997 to 1999, Mr. Vivian was an associate in BancAmerica's leveraged finance group serving as both a senior lender and investment banker for the placement of subordinated debt. In this role, he evaluated, structured, negotiated and executed senior loans for the bank's portfolio as well as syndicating bank loans and raising high yield bonds. From 1991 to 1995, Mr. Vivian was a territory manager for Parker Hannifin Corporation.

Mr. Vivian has been active on the boards of directors of several portfolio companies, including Fitzroy Dearborn Publishing, LLC, and Fieldglass, Inc., ClearSource Corporation, Banner Service Corp., and HighBeam Research. In addition, Mr. Vivian has served as President of the Midwest Regional SBIC Association and is a current member of the Executive Committee of the Board of Governors of the National Association of Small Business Investment Companies (NASBIC), the national association representing the interests of the SBIC industry.

Mr. Vivian received both a Bachelor of Science degree in General Engineering and an M.B.A. degree from the University of Illinois.

ASBDC Association of Small Business Development Centers®

Statement of

Donald Wilson

President, Association of Small Business Development Centers

February 10, 2005

Before the

U.S. House of Representatives Committee on Small Business

Regarding the FY 2006 SBA Budget

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Chairman Manzullo, Ranking Member Velazquez, and Members of the House Small Business Committee; I am Donald Wilson, President and CEO of the Association of Small Business Development Centers (ASBDC). ASBDC's members are the sixty-three State, Regional and Territorial Small Business Development Center programs comprising America's Small Business Development Center Network. SBDC programs are located in all fifty-states, the District of Columbia, Puerto Rico, The Virgin Islands, Guam and American Samoa. The SBDC network is the federal government's largest small business management and technical assistance program with over 1,000 service centers nationwide serving more clients than all other federal management and technical assistance programs combined.

Mr. Chairman, I would like to thank you and the House Small Business Committee on behalf of ASBDC, and the nearly 6,000 dedicated men and women who are a part of America's Small Business Development Center Network, for inviting the Association to testify at this important hearing on the Administration's FY 2006 budget for the U.S. Small Business Administration. We commend the committee Mr. Chairman for holding a formal public hearing on the Administration's budget request for the SBA for FY 2006. It is important to look at the Administration's budget figures for the SBA in light of the current economy and the needs of the small business sector. We should also look at those numbers in light of historical trends in budget support for the small business sector of the economy.

I would also like to take a moment Mr. Chairman to thank you, Ranking Member Velazquez and the members of this committee for all of your efforts on behalf of small business throughout the 108th Congress. In particular Mr. Chairman, we would like to thank you and Ranking Member Velazquez for your efforts along with your counterparts in the Senate for finalizing an SBA reauthorization bill in the last days of the 108th Congress. We are deeply grateful for including in that important legislation the long needed confidentiality protections for SBDC clients nationwide.

ASBDC would also like to commend you Mr. Chairman for your efforts to try and stabilize the SBA's 7(a) loan program. We recognize that fees to borrowers will go up under the agreement worked out late last year. We do not know how that will impact borrowers, although the number of loans approved in the first quarter of FY 2005 appears to be significant. Most importantly, the agreement worked out will apparently avoid the catastrophe that occurred in December 2003 when the 7(a) program was effectively shut down by SBA.

Mr. Chairman, in the last Congress, this committee reported favorably to the full House and the House overwhelmingly approved HR 205, the Small Business Regulatory Assistance Act. Unfortunately, despite the Senate Small Business Committee having approved this important legislation in the 107th Congress, the Senate's schedule last year did not permit action on this important legislation. Your former committee colleague Congressman Sweeney has reintroduced the Small Business and Regulatory Assistance Act this year as HR 230. We very much hope that this committee will schedule action on this important legislation early in this Congress to enhance the likelihood that the Senate will find time to act on this legislation during the 109th Congress. Similarly, Congressman Brady of Pennsylvania has reintroduced the Vocational and Technical Entrepreneurship Development Act, HR 527. This legislation was approved in the 108th Congress by this Committee as HR 1387. That legislation was subsequently approved by the full House. We would encourage this committee to again act favorably on this legislation.

I would like at this time to direct the Committee's attention to the state of the nation's economy, the Administration's proposed SBA budget for FY 2006, and the contribution of the nation's small business sector to our overall economy. I will then focus my remaining remarks on the Administration's proposed funding for the SBDC national program

The Bureau of Economic Analysis at the Department of Commerce reported twelve days ago that the nation's Real Gross Domestic Product increased by 4.4 percent in 2004. This compared to a 3% increase in 2003. It was also the best increase since 1999. However, the fourth quarter increase was at an annualized rate of 3.1%. This was the smallest quarterly increase all year and the lowest since the first quarter of 2003. We are grateful that the economy has continued to expand for the third year in a row. Congress needs to allocate federal resources in such a way as to maximize the chances of keeping the current expansion going.

The federal government must allocate resources in a way that will help insure that we increase the number of job opportunities for those being laid off as many large corporations continue to downsize and as corporate mergers increase. December 2004 was the busiest December *in history* for mergers and acquisitions, according to Thomson Financial. We need look no further than the merger of SBC and AT& T or Gillette and Procter and Gamble to see the impact that corporate mergers have on jobs. The P & G / Gillette merger is expected to result in a loss of 6,000 jobs. The merger of SBC and ATT is expected to result in the loss of 13,000 jobs. And we are not expected to know for a while what the job losses will be from the merger of Sears and Kmart or Citicorp and J. P. Morgan. We can be relatively confident that the layoffs will be substantial. And it is not just mergers that are resulting in substantial job loss. In mid December, Delphi, the nations largest auto parts maker announced it was cutting 3,000 U.S. jobs. Who will create the new jobs to compensate for the job losses I have just described? We will look to small businesses for new job creation just as we have for the last decade or more. The question is, will there be enough new small businesses being formed and existing small businesses expanding to generate the nearly 160,000 new jobs we need every month simply to provide jobs for new workers seeking to enter the workforce? That will depend in part on whether the government modifies the discouraging and counterproductive downward trend in the real level of resources as well as the downward trend in the percentage of federal resources allocated to assist small businesses.

Let's take a serious look at the nation's overall jobs picture. 2004 was the first year since 1999 that saw job growth in every single month, and it was also the first year since 2000 that the jobless rate declined. The nation's unemployment rate in January of 2004 was 5.6 percent. The jobless rate last month fell to 5.2%. On the surface, that would be very encouraging news. However, it would appear that the decline in the unemployment rate was primarily due to a fall in the Labor Force Participation Rate (LFPR) from 66.0% to 65.8%. **This represents the lowest Labor Force Participation Rate since May 1988**. The LFPR is currently 1.5 percentage points below its most recent peak of 67.3% achieved in April 2000. In other words, the unemployment rate declined last month because hundreds of thousands of Americans gave up looking for work in January. Specifically, unemployment fell because the labor force fell by 224,000, while employment grew by only 85,000.

The number of jobs created since the last recession ended in November 2001 has been the lowest of any economic recovery in the United States since World War II. The total number of jobs in the economy last month was only 62,000 more than existed in March of 2001. Currently private sector employment remains approximately 700,000 jobs below what it was in March 2001. Government entities may be creating new jobs but the private sector is not. **Private sector employment in January was 0.6% below what it was 46 months ago.** This is a particularly disturbing statistic. Overall, we have fewer people employed today than the President's Council of Economic Advisors predicted in January of 2002 that the nation would have in January of 2003.

Clearly, this has been an unusual recovery. Virtually every prediction in recent years relating to job growth has been missed. When the President's tax package was approved, the Council of Economic Advisors (CEA) projected 5.5 million new jobs would be created from July 2003 through the end of 2004. As of December 31 of 2004, it became apparent that those projections would fall short by nearly 3 million jobs. Fortunately, 2.2 million jobs were added during this past year, thereby bringing the year-end employment levels to 132.3 million employed.

In January, manufacturing employment, which we know is of particular concern to you Mr. Chairman, declined by 25,000 jobs. **That is the fifth consecutive monthly decline in factory jobs**. From March 1 through August of 2004 the economy created 85,000 new manufacturing jobs. From September 1,2004 to February 1, 2005 the manufacturing sector has lost 61,000 jobs.

The economic data which we have seen coming from The Department of Commerce and the Department of Labor continue to give mixed signals about the future of the economy. We are relatively confident that the overall economy will continue to expand throughout FY 2005 but at a slower pace than in FY 2004. The real economic issue that faces us all is job creation. Can this economy produce the number of jobs necessary to provide older Americans caught by downsizing and young Americans graduating from high school and college with the employment opportunities they must have to provide for themselves and their families? Can we create enough jobs to ensure that consumer spending will continue to drive economic growth? What will be the impact of higher interest rates on housing starts, consumer spending and in turn job creation?

The robust growth of 2004 is not likely to be repeated. Consumer spending will likely be unable to continue to fuel growth if inflation increases, wages remain relatively stagnant, and energy prices increase. And private sector job creation will be uncertain if we do not pay more attention to the well being of our nation's small businesses. One measure of whether we are paying attention is resource allocation. Resources for SBA have declined roughly 40 percent since 2000. This budget continues that downward spiral. ASBDC believes the economy has paid a price over the last four years as resources for management and technical assistance to small business owners and aspiring entrepreneurs has declined, certainly in real dollar terms.

Administrator Barreto has done the best he can do with what he has. We commend him for that. However, his field staff is strained, his resource partners are strained and small business owners are not getting the depth of service and adequate access to service that they need and deserve in light of the fact that over 40% of Treasury receipts come from small businesses.

ASBDC is not unmindful of what is occurring in the world and the responsibilities throughout the world that our nation is trying to meet. We recognize that we are fighting a worldwide war against terrorism and that we are engaged in nation building in Iraq, and Afghanistan. We fully appreciate that nation building does not come cheap and that we must provide for our troops abroad.

ASBDC understands that to meet these new worldwide obligations requires resources. That is why we have voiced concern about the lag time of this recovery in comparison to earlier post recession recoveries, the slow growth in business startups and the slow growth in employment. These factors have contributed to a decline in Treasury receipts in three of the last four years. If there is not robust activity in the entrepreneurial sector, job creation will suffer, consumers will have less to spend, government will spend more on public assistance programs and we will have to borrow more to meet our obligations as we have for the past four years.

We are concerned that continued erosion of overall SBA resources will have an adverse impact on the small business sector of the economy. The key to lowering the deficit is economic growth stimulated by entrepreneurial activity and job formation. We cannot expect to stimulate job growth if we do not assist small businesses that are struggling to survive or grow. And I hope we will always be mindful that small businesses create roughly seventy percent of the new jobs in our economy and 53 percent of our nation's Gross Domestic Product.

As to the specific recommended funding for the SBDC program, I am sure there was a collective sigh of relief at every SBDC nationwide when it was learned that the President's budget recommended $ 88 million for the SBDC program for FY 2006. We would appear ungrateful if we did not acknowledge that, in actual dollar terms, the SBDC program has been recommended for the same level of funding that the White House proposed last year. And that recommendation comes at a time when hundreds of programs are being eliminated or are being cut. And we are, indeed, grateful.

However, this committee and your colleagues in the House should understand that years of level funding are gnawing at the very marrow of this program and its ability to help the 23 million small businesses in this country, whether they are manufacturing concerns with 500 employees or a mother operating a home based business to help her family get by.

And our government's obligations abroad in terms of nation building and in terms of the war on terror are creating major problems for thousands of small businesses here at home. When we send National Guard and Reserve Units abroad as we apparently must do, we are sending owners and key employees of small businesses abroad. What do we say to the men and women who return after serving in uniform in Iraq and Afghanistan to find the business they owned or the business that employed them no longer open for business? Additional resources are desperately needed to enable SBDCs to assist small businesses impacted by the call up of owners and key employees to active duty service in the Guard and Reserve.

And where are the SBDC resources to assist the tens of thousands of new immigrants particularly in the Hispanic community who are seeking to start a new business so that they too can enjoy the American dream?

I mentioned earlier the growing number of jobs lost to downsizing and mergers. These realities in the economy have resulted in an ever increasing number of Americans over 50 in the unemployment lines. A recent article in *USA Today* focused on new research that shows 5.6 million workers age 50 and older are now self-employed, **a 23% jump from 1990**. As a result of corporate downsizing and mergers, tens of thousands of workers over 50 have faced loss of employment in recent years. Many of these workers, after months of unsuccessfully searching for new employment, turn to self-employment. And where are they to find the necessary training to develop the wide range of skills required to run a small business successfully? Many of them are turning to their local SBDC. Where are the resources to enable SBDCs to serve what the Rand Corporation's research for the AARP says will be an ever increasing number of baby boomers turning to self-employment to sustain their families in 2005, 2006 and beyond?

Dr. Graham at the Office of Information and Regulatory Affairs at the White House and Small Business Advocate Tom Sullivan are doing a remarkable job in their efforts to slow the ever growing regulatory burden on America's small businesses. Their efforts have resulted in billions in regulatory compliance cost savings. But the number of new regulations grew substantially in 2003 and 2004. Where are the resources needed to enable SBDCs to assist millions of small businesses, your constituents, who are struggling to understand and comply with the ever growing regulatory burden on small businesses?

Recognizing your concerns Mr. Chairman with the state of manufacturing in the U.S., ASBDC commissioned Dr. James Chrisman of Mississippi State University last summer to analyze the impact of SBDC services on SBDC long-term counseling clients who were manufacturers. Dr. Chrisman completed that study in September of 2004. Dr. Chrisman estimates that SBDC long term counseling clients who received services in 2002 generated 9,251 new jobs during 2002 and 2003. Based on client assessments, Dr. Chrisman estimates that as a result of SBDCS counseling, 18, 5321 manufacturing jobs were saved in 2002 and 2003. Dr. Chrisman further estimates that SBDC 2002 long-term counseling clients who were manufacturers generated an increase in tax revenues of $58 million of which $34.8 million went into the Federal Treasury. And those manufacturing firms who received long-term counseling represented a little less than 12 per cent of SBDC long-term counseling clients in 2002. With the continued difficulties facing American manufacturing, where are the additional resources that SBDCs will need to address the growing needs of our nation's small manufacturers?

The more comprehensive 2004 economic impact study of all SBDC long-term counseling clients conducted by Dr. Chrisman, reported that **SBDC long-term counseling clients generated 56,258 new jobs in 2003 as compared to 46,688 new jobs created by SBDC long-term counseling clients in 2001**. The 2004 Chrisman Study also reported that an additional 59,489 jobs were saved in 2003 as a result of SBDC long-term counseling compared to 34,215 jobs saved in 2001. The 2004 Chrisman Study reveals that the average change of employment rate for SBDC established business clients was a positive 10.2%, over twenty-five times the rate of the average U.S. business. The average change in sales for an SBDC long-term counseling client was 17% compared to 2% for the average U.S. firm. Nearly fifty-three percent of SBDC pre-venture clients who received long-term counseling (five hours or more) during 2002, actually started new businesses during 2002 and 2003.

There is one very disturbing piece of data in the most recent SBDC productivity numbers. For the first time in recent years the average hours per counseling client declined as overall counseling hours declined. This decline in the overall number of counseling hours occurred in the face of an increase in the overall number of counseling clients. We believe this is primarily due to the fact that the SBDC national network has experienced a reduction in the number of counselors available nationwide to serve an expanding number of clients seeking counseling services. The reduction in available counselors is clearly due to a decline in available federal financial resources in actual and real dollar terms in recent years.

For example, SBDC programs in low population states such as Congressman Bradley's state of New Hampshire and Congressman Case's state of Hawaii (which get base grants of $500,000) have had no increase in federal funding since 1998. Inflation alone has eroded their ability to serve their states small businesses. To have the purchasing power that the had in FY 1998, low population states would need grants of $ 603,000 in FY 2006. SBDCs in many large population states experienced severe cuts as a result of the 2000 census. Many of these states now have some of the highest unemployment levels in the nation. Mr. Chairman, the SBDC program in your and Mr. Lipinski's state of Illinois under the President's recently proposed FY 2006 budget would receive $ 156,000 less in actual dollars in FY 2006 than it did in FY 2001. The SBDC program in Ranking Member Velazquez's and Congresswoman Kelly's state of New York would receive $ 403,000 less in FY 2006 than it did in FY 2001. The SBDC program in Congressman Chabot's state of Missouri would receive $ 61,000 less in FY 2006 than it did in FY 2001. The SBDC program in Congressman Shuster, Congressman Gerlach and Congressman Fitzpatrick's state of Pennsylvania will receive $ 338,000 less in FY 2006 than it did in FY 2001. Congressman Chocola and Congressman Sodrel's state of Indiana would receive $ 60,000 less in FY 2006 than it did in

FY 2001. And these numbers reflect actual dollars with no adjustment for inflation. **To provide SBDCs in low population states with sufficient funds to restore their purchasing power to FY 1998 levels and to restore states impacted by the census to the actual funding levels of FY 2000 would require an appropriation for SBDCs in FY 2006 of $109 million**, still well below the program's authorized level of $135 million.

If that level of appropriation cannot be accommodated, then no one on this committee should be surprised when SBDC counselors in their state are laid off or service centers are closed. And no one should be surprised when counseling hours per client decline again in FY 2006. Reduced hours per client results in reduced economic impact. And many of our counselors believe that maximum economic impact is attained when clients receive between 5 and 12 hours of counseling. It is impossible for the SBDC program to give an increasing number of clients the attention they need and deserve with the level of decline in resources that has occurred since 1998 as I have outlined above.

Think of this decline in hours of consulting per client in terms of your own health care. What if you were experiencing a variety of concerning health symptoms and went to your family practitioner or internist seeking medical attention? Suppose the doctor came into the examining room, looked at you briefly without a meaningful discussion with you of your symptoms, without ascertaining whether you were running a fever, without checking your blood pressure, without a urinalysis or blood test and then prescribed a treatment regimen. I seriously question whether you would make a return visit to that particular physician or have any confidence that his or her prescribed regimen would do much to improve your health. That is the type of reduced service and response that many SBDC clients may have to expect in the future if demand for SBDC services continues to increase and resources continue to decline. And when the quality of services declines, the beneficial economic impact of our consulting services, that is increased client sales, increased job creation and increased revenues to state and federal treasuries will likely decline.

The latest SBA figures for the SBDC national program show that SBDC counseling cases and training attendees combined increased from 685,000 in FY 2003 to nearly 726,000 in FY 2004. Training attendees increased from 408,000 in 2003 to nearly 446,000 in 2004. These figures clearly demonstrate that America's small business owners and aspiring entrepreneurs are aware that they need management and technical assistance to enhance their likelihood of business success. They are increasingly seeking that assistance from the experienced, capable, and dedicated men and women who are consultants and trainers in America's Small Business Development Center Network.

Lets take a moment to look even closer at the SBDC client base. SBA's latest figures show that in 2004, **40% of SBDC counseling clients nationwide were women.** SBDCs serve more women than all other federal management and technical assistance programs combined. And the increase in entrepreneurial activity among women is dramatic. Entrepreneurial activity is also rapidly increasing among minorities. **Seventeen percent of SBDC clients are African American, over ten percent are Hispanic and four percent are Asian-Americans. Over nine percent of SBDC counseling clients are self- identified veterans**. Sixteen percent of our counseling clients were engaged in retail. Thirty-eight percent were engaged in service, eight percent were engaged in manufacturing, three percent were engaged in wholesale, and four percent were engaged in construction. Forty-four percent of our training seminar attendees were women, twenty-four percent were minorities and seven percent were self identified veterans.

And these clients and firms are not simply statistics. They are our neighbors, our relatives, fellow congregants in our churches, who have children in our children's schools. They are individuals like Delilah Ramos and Sandra Kaul who recently opened a comedy club/ restaurant in the SoHo section of Manhattan; Bill Graham, a small manufacturer in California, Bruced Hartman of Hartman EW, Inc in Pittsburgh, Pennsylvania; Ramachandram Suresh, of Mayur Technologies, a woman owned 8(a) firm in Lanham, Maryland; Christine Henriques with her partners Gabe Linden and Jason Mark of Gravity Switch, a multimedia development firm in Northampton, Massachusetts; Don Thien with Midwest Garden Company in Fulton, Illinois; and Randall Rehders with SeaTech in Wilmington, North Carolina.

These men and women from all types of communities, educational backgrounds, ethnicity, etc., are building and growing companies. And the companies they are building and growing are providing work for others in their communities. Those workers and the companies that employ them are paying local, state and federal taxes. And the tax revenues resulting from the increased economic activity of SBDC clients exceeds the federal outlays for the SBDC program. The 2004 Chrisman Study of SBDC long-term clients who received assistance in 2002 found that the incremental performance improvements of these clients resulted in $ 210. 3 million in additional tax revenues from established businesses and $ 264.8 million from pre-venture clients who started new businesses. This amounted to a total of approximately $ 475.1 million in additional tax revenues of which **$ 211.6 million went to the federal government** and $ 263.5 million went to the states.

Mr. Chairman, very shortly now, you will be submitting a letter to the House Budget Committee regarding the needs of programs under this committee's jurisdiction. In his inaugural address last month, the President told the nation he wanted to enhance opportunities for business ownership. We share his vision of an opportunity society. But just as opportunities are foreclosed for millions of young people who drop out of school or do not attain education past high school, so are opportunities lost to millions of self-employed Americans if they cannot access resources that will enable them to manage their businesses effectively.

We believe that if the SBDC program is to meet the growing needs of women, minorities, baby boomers, small manufacturers, and businesses impacted by National Guard and Reserve call ups, the program must have more resources. To restore states like Michigan, Ohio, Illinois, New York, Pennsylvania, Missouri, etc., to the actual dollar funding they had in FY 2000 and to restore low population states to the real dollar funding they had in 1998 will require an appropriation $109 million. We trust when you write to the Chairman of the House Budget Committee that your recommendation will take into account the real needs of this nation's small business sector for management and technical assistance. We hope you will ask the Budget Committee to include in the budget a level of funding for this program that will begin to restore the real loss of resources that this program has experienced over the last eight years. We hope you will encourage the Budget Committee to take into account that the job creation and increased sales that the SBDC program helps to generate for its small business clients, in turn generates tens of millions more in revenues for the Treasury than the program receives from the Treasury. And we hope that when you write your letter, you will recall the President telling the Congress in his State of the Union address last week that "small business is the path of advancement, especially for women and minorities."

We thank you again for allowing us to appear before the committee today. At this time, I will be glad to respond to any questions that you, Mr. Chairman, or other members of the committee may have.

Association of Small Business Development Centers.

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CURRICULUM VITAE

Don Wilson
President and CEO
Association of Small Business Development Centers

Donald Wilson is the President/CEO for the Association of Small Business Development Centers (ASBDC). He assumed his current position with ASBDC in May of 2001, after having served as the association's Director of Government Affairs for two years.

Prior to coming to ASBDC, Don was for fifteen years Director of Government Relations for the National Tire Dealers and Retreaders Association (NTDRA). NTDRA, with over 5,500 members, was a well-respected small business retail association. During his last few years with the NTDRA, Don also served as the association's General Manager in addition to his responsibilities as Director of Government Relations.

Mr. Wilson joined the Tire Dealers Association after serving ten years as Chief of Staff to three different Members of the U.S. House of Representatives. Prior to going to work on Capitol Hill, Don taught United States History and Public Speaking for a number of years at the secondary school level.

Mr. Wilson is a graduate of the University of North Carolina at Chapel Hill with a major in United States History and a Minor in Political Science. He also studied law for two years at the University of North Carolina School of Law and attended the University of Miami's Institute for the Study of Law and Economics.

Mr. Wilson and his wife, Ann, have two children and reside in Falls Church, Virginia.

ASSOCIATION FOR ENTERPRISE OPPORTUNITY

February 7, 2005

House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

Chairman Manzullo, Ranking Member Velázquez and other Members of the Committee:

On behalf of the Association for Enterprise Opportunity (AEO) and the Community First Fund, thank you for the opportunity to present testimony to the Small Business Committee regarding the Administration's FY 2006 Budget Proposal. My name is Daniel Betancourt, and I am President and CEO of the Community First Fund in Pennsylvania. Community First Fund's mission is to drive community and economic development in the 10 counties that we service, and we are also an SBA Microloan Intermediary. However, I am here today not only on behalf of microenterprise development in Pennsylvania, but also in my capacity as a Board member for AEO.

AEO is the national trade and membership association for microenterprise development in the United States, with nearly 500 member organizations nationwide. The vast majority of AEO's membership consists of microenterprise practitioner agencies, including over half of all Microloan Intermediaries and PRIME grantees. As you know the SBA Microloan and SBA PRIME programs have both been recommended for elimination in the FY 2006 Budget Proposal. In addition, SBA has proposed cuts of $500,000 to the Women's Business Center (WBC) program. **In light of the continuing business assistance needs of low- and moderate-income entrepreneurs, AEO respectfully requests that the Small Business Committee include the SBA Microloan, PRIME and WBC programs in its Budget Views & Estimates at $20 million in lending capital for the SBA Microloan Program, $17 million for SBA Microloan Technical Assistance, $5 million for the SBA PRIME Program, and $16.5 million for Women's Business Centers. More importantly we would like for the Small Business Committee to work to ensure that these vital programs are funded in the FY 2006 appropriations process.**

The Administration's proposed elimination of the SBA Microloan and PRIME Programs threatens to wipe out two essential federal funding sources for microenterprise development in the U.S., effectively terminating the only available sources of business assistance for thousands of underserved entrepreneurs across the country. **The fact is that these entrepreneurs are not served by the private sector, nor do they qualify to receive SBA guaranteed loans like 7(a) or Community Express.**

The SBA Microloan Program

The SBA Microloan Program, the single largest source of funding for microenterprise development in the nation, was created in 1992 to help small business owners in need of small amounts of capital (less than $35,000) that are not yet "bankable" in the private sector lending community. Since 1992, SBA Microloan Intermediaries have made over 21,000

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Microloans totaling more than $250 million, primarily to women, minority, and low-income entrepreneurs. In FY2004, Intermediaries made 2,425 loans, totaling $32,955,487. **In addition, over 40% of Microloans are made to rural microenterprises.**

The Administration contends that banks will now lend to Microloan borrowers through the 7(a) Community Express Program, which is just not the case. Microloan borrowers often have FICO credit scores as low as 550, past credit problems, little or no collateral, and lack business experience. **Traditional banks will simply not lend to these borrowers, with or without a SBA guarantee.** Also, it is important to note that over 40% of SBA Microloans go to start-ups while 7(a) loan guarantees require that individuals already be in business anywhere from 1 to 3 years.

Despite lending to the riskiest borrowers, the Microloan Program has experienced a default rate of less than 1%. This accomplishment can be primarily attributed to the countless hours of intensive technical assistance that Intermediaries provide to Microloan borrowers. The technical assistance acts as a driver for business success and greatly improves the chances for successful business repayment.

The SBA PRIME Program

PRIME is the only federal microenterprise program that provides intensive training and technical assistance to low-and very low- income entrepreneurs. For many entrepreneurs, lack of access to capital is only one of the barriers to starting or growing a successful small business. PRIME provides grants to microenterprise organizations throughout the country to offer this invaluable assistance. In addition, PRIME is unique in that at least 50% of all grant award dollars must be used to provide these services to very low-income individuals.

The Administration has proposed the elimination of the PRIME Program for the past five years. However, Congress has continued to fund PRIME each year and in doing so has recognized that by investing in very low-income entrepreneurs, the program succeeds in creating jobs and income in communities that need it most. **PRIME is just that—an investment. PRIME clients create and retain jobs, move off of public assistance and pay increased taxes as their businesses and incomes grow.**

The SBA Women's Business Center Program

The Women's Business Centers (WBC) of the Office of Women's Business Ownership provide training and technical assistance to women starting or expanding their businesses. In 2003 alone, Women's Business Centers across the country trained and counseled over 104,000 women in core business areas such as marketing, bookkeeping and finance. The Centers serve an invaluable role in meeting the special needs of female entrepreneurs across the country.

America's 9.1 million women-owned businesses employ 27.5 million people and contribute $3.6 trillion to the economy. However, women continue to face unique obstacles in the world of business and greatly need the specialized services that Women's Business Centers provide.

Again, we ask that the Subcommittee do what is truly best for small business in America and include the Microloan, PRIME, and Women's Business Centers in its Budget Views and Estimates at $20 million for Microloan Lending, $17 million for Microloan Technical Assistance, $5 million for PRIME, and $16.5 million for Women's Business Centers. More importantly we would like for the Small Business Committee to work to ensure that these vital programs are funded in the FY 2006 appropriations process.

Sincerely,

Daniel Betancourt

Daniel Betancourt

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DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States

House of Representatives

109th Congress

Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

February 28, 2005

The Honorable Hector V. Barreto
Administrator
Small Business Administration
409 Third Street, SW
Washington, DC 20416

Dear Administrator Barreto:

Thank you for your participation in the Committee's first hearing for the 109th Congress. During the hearing on February 10, 2005 regarding the President's Fiscal Year 2006 budget request, there were a number of questions that I had but was unable to ask due to time constraints and I would like to submit them to you for answer for a complete hearing record.

1. In May 2003, the Committee held a hearing dealing with big businesses being awarded contracts intended for small businesses. One problem identified by some of the witnesses was a frustration that some businesses listed on the PRO-Net profile were in fact large businesses. At that time, the SBA informed the Committee that over the previous six months, more than 600 businesses were removed from PRO-Net because they were not small businesses and that SBA was in the process of developing an automated check of size information for new PRO-Net registrants to avoid this problem in the future. Yet, there still seems to be some large businesses listed on the newly merged Central Contractor Registration (CCR) database as qualified small businesses. What is SBA doing to rectify this problem? Has anyone be subject to prosecution or penalties for misrepresenting their company in the CCR database?

2. To further deal with this problem, in April 2003, the SBA proposed a rule to require small businesses to self-certify once a year that they are still small businesses. In the interim, there have been numerous comments and suggestions for modifying this proposal. What are you doing to finalize this important proposed rule, which has been in the works for nearly two years?

3. In 2000, Congress authorized a women's procurement program to help achieve the statutory five percent goal for women-owned small businesses, particularly aimed at industries where women are historically underrepresented. This program is predicated upon completion of a study on the industries where women have been historically

underrepresented. The Committee was promised that the study would be completed this past December in return for removal of language from the pending SBA reauthorization bill that would have mandated the completion of the study and the launching of the program within 90 days after enactment. It is now almost March 2005 and the study is still not completed. Are there any impediments to having it completed and delivered to this Committee by March 31, 2005?

4. Over the past few years, the 504 Certified Development Company (CDC) program use has grown by about 24 percent per year. With the higher debentures authorized in the 504 program as part of the recently passed SBA reauthorization bill, the 504 program is expected to grow at even a higher rate. How did the Administration come up with the 504 program budget authority level for FY '06 of $5.5 billion, when the need could be as high as $7 billion in FY '06? Would the Administration support the full authorization level for the 504 program for FY '06?

I look forward to receiving your response to these matters of vital interest to this country.

Sincerely yours,

Donald A. Manzullo
Chairman

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR
MAR 16 2005

The Honorable Donald Manzullo
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciate the opportunity to respond to the questions you recently submitted, following my appearance before the Committee in support of the U.S. Small Business Administration's (SBA) Fiscal Year 2006 budget request.

The following are the questions you submitted, with the answers in bold type.

1. In May 2003, the Committee held a hearing dealing with big businesses being awarded contracts intended for small businesses. One problem identified by some of the witnesses was a frustration that some businesses listed on the PRO-Net profile were in fact large businesses. At that time, the SBA informed the Committee that over the previous six months, more than 600 businesses were removed from PRO-Net because they were not small businesses and that SBA was in the process of developing an automated check of size information for new PRO-Net registrants to avoid this problem in the future. Yet, there still seems to be some large businesses listed on the newly merged Central Contractor Registration (CCR) database as qualified small businesses. What is SBA doing to rectify this problem? Has anyone been subject to prosecution or penalties for misrepresenting their company in the CCR database?

   SBA is working closely with the Integrated Acquisition Environment (IAE) e-Government Initiative to improve the accuracy of information regarding the small business and other socio-economic characteristics of CCR registrants, and to eliminate confusion and misperceptions about small business size status. We have implemented an automated check of the small business status of registrants by North American Industry Classification System (NAICS) codes.

   To eliminate any confusion or other misperceptions in calculating the size status of business concerns, SBA has included an advisory notice in CCR, clarifying the application of SBA's regulations regarding the affiliation of

concerns. The notice explains that the firm's CCR information should reflect the combined employment and revenue of its parent and other affiliated companies, if any. Also, we have established a process for resolving registrants' questions on their small business status, and built Internet links to additional sources of information concerning small business contracting program requirements. This year we are removing existing CCR self-representation provisions for HUBZone, 8(a), and small disadvantaged business procurement preference programs, and replacing it with authenticated data based on SBA certification.

SBA has removed companies from CCR's Dynamic Small Business Search (DSBS) database that are not small businesses. Further, SBA reviews all credible information it receives that calls the small business status of a registrant into question, and removes a business from the DSBS database if SBA determines that it does not qualify as a small business concern. In addition, whenever the facts warrant, SBA refers the matter to its Office of Inspector General for criminal investigation and possible prosecution by the U.S. Department of Justice. To date, SBA has not made any such referrals for misrepresentation of small business status on the DSBS.

Finally, it is important to point out that while SBA remains committed to ensuring that CCR contains accurate information concerning the small business status of registrants, CCR does not serve as the definitive authority of small business status. It exists to help contracting officers perform market research, and to facilitate payment of contractors. Companies do not obtain contracts through CCR, and being registered as a small business in CCR does not relieve companies of their obligation to certify their size status through official representations and certifications for each contract in which they bid.

2. To further deal with this problem, in April 2003, the SBA proposed a rule to require small businesses to self-certify once a year that they are still small businesses. In the interim, there have been numerous comments and suggestions for modifying this proposal. What are you doing to finalize this important proposed rule, which has been in the works for nearly two years?

   SBA is currently working on a final rule that will address how often businesses need to recertify size on multiple award contracts such as the General Services Administration (GSA) schedules.

In April 2003, SBA issued a proposed rule suggesting that firms annually recertify their size. While there has been some support for this approach, some Members of Congress, including Congresswoman Nydia Velasquez, Congressman Charles Gonzalez, and Congressman Tom Davis, have urged SBA not to adopt this proposal, believing that it would impose an undue burden on small businesses. Since that time, SBA has continued to analyze the comments and the implications of each of the policy alternatives. SBA expects to finalize the rule shortly. In the interim, GSA and the Office of Federal Procurement Policy are requiring that small businesses recertify their size on schedules and Government-wide Acquisition Contracts at the time an option is exercised, not to exceed every 5 years.

3. In 2000, Congress authorized a women's procurement program to help achieve the statutory five percent goal for women-owned small businesses, particularly aimed at industries where women are historically underrepresented. This program is predicated upon completion of a study on the industries where women have been historically underrepresented. The committee was promised that the study would be completed this past December in return for removal of language from the pending SBA reauthorization bill that would have mandated the completion of the study and the launching of the program within 90 days after enactment. It is now almost March 2005 and the study is still not completed. Are there any impediments to having it completed and delivered to this Committee by March 31, 2005?

   The independent report, prepared by the National Academy of Sciences, was issued on March 10, 2005.

4. Over the past few years, the 504 Certified Development Company (CDC) program use has grown by about 24 percent per year. With the higher debentures authorized in the 504 program as part of the recently passed SBA reauthorization bill, the 504 program is expected to grow at even a higher rate. How did the Administration come up with the 504 program budget authority level for FY '06 of $5.5 billion, when the need could be as high as $7 billion in FY '06? Would the Administration support the full authorization level for the 504 program for FY '06?

   Although lending through the 504 program increased significantly between fiscal years (FY) 2002 and 2004, over the longer term growth has been less consistent. From FY 1995 through FY 2001, the program ranged from high of $2.4 billion in FY 1996 to a low of $1.4 billion one

year later in FY 1997. Loan volume did not exceed the FY 1996 level until FY 2002.

So far, in FY 2005, we are running at a $4.0 billion annualized rate or roughly comparable to the FY 2004 level. Our $5.5 billion request for FY 2006 therefore represents a 35% to 40% increase over projected loan volume in FY 2005.

Our FY 2006 request is adequate to cover anticipated 504 Program growth which we expect to continue because of the effective marketing and outreach strategy that has been put in place over the past three years.

If you have any questions please contact Anthony Bedell in our Office of Congressional and Legislative Affairs at (202) 205-6700.

Sincerely,

Hector V. Barreto

Hector V. Barreto
Administrator