COMMITTEE ON SMALL BUSINESS FIELD HEARING IN COLORADO: LOCAL PERSPECTIVES ON THE STATE OF SMALL BUSINESS LENDING

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BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS

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SMALL BUSINESS COMMITTEE FIELD HEARING IN COLORADO: LOCAL PERSPECTIVES ON THE STATE OF SMALL BUSINESS LENDING

THURSDAY, AUGUST 25, 2011

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

The Subcommittee met, pursuant to call, at 10:11 a.m., in Greenwood Village City Hall, 6060 South Quebec Street, Hon. Mike Coffman (chairman of the Subcommittee) presiding.

Present: Representative Coffman.

Chairman COFFMAN. Good morning. Welcome everyone to Greenwood Village and to the 6th Congressional District of Colorado. I would like to start today's hearing by thanking everyone here in Greenwood Village and in the city hall building for hosting this hearing. Is Mayor Rakowsky here? Thank you so much, Mayor, for making this available. I really appreciate it.

As policymakers in Washington and specifically the Committee on Small Business, we seek advice on policies to create jobs. And today we have a unique opportunity to hear directly from leaders and businesses about what challenges they face and how we can get this economy moving again. Small businesses create 7 out of every 10 new private sector jobs in America. So it is important that any regulation or Government oversight fully takes into account how it will impact small businesses and their ability to access capital.

As chairman of the Investigations, Oversight and Regulations Subcommittee, I wanted to hold this hearing so the people here in Colorado can share their perspective on how Government is affecting their businesses and their communities. We are 1,661 miles away from Washington, D.C., and with that distance, we gain perspective, perspective that allows us to stop looking at Government fixes for our struggling economy and instead focusing on what the people can do without Government interference and regulatory burdens to foster economic growth.

Up first, we have a representative from the Small Business Administration who is here to discuss the SBA loan programs. The goal of the SBA loan programs is to help small businesses who are unable to secure financing elsewhere, get money to start or expand a business. We want to know whether this program is actually helping business entrepreneurs.

Next, we will hear from a few local businesses, including First American State Bank, Centennial Bank, and from the Chamber of Commerce here in the south Denver region. Their testimony will tell us what problems banks and small businesses face as they work to start and grow businesses and create the jobs that will allow our economy to recover.

With that, I would like to again thank everyone for being here.

Our first witness this morning is Steve Smits, Associate Administrator of the Office of Capital Access at the U.S. Small Business Administration. Mr. Smits has 20 years of small business banking experience and began at SBA in October 2010. Prior to joining SBA, Mr. Smits served as Vice President of Operations at Mid-Atlantic Financial Partners. He has also held small business banking positions at Quadrant Financial and PNC Bank. At SBA, he manages and oversees the agency's programs and operations that are designed to expand access to capital for America's entrepreneurs and small business owners. Mr. Smits.

STATEMENTS OF STEVEN SMITS, ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.; JAY DAVIDSON, CHAIRMAN, CEO, AND FOUNDER, FIRST AMERICAN STATE BANK, GREENWOOD VILLAGE, COLORADO; DAVID BROWN, PRESIDENT, SOUTHEAST DENVER CENTENNIAL BANK, CENTENNIAL, COLORADO; AND JEFF WASDEN, MEMBER, SOUTH METRO CHAMBER OF COMMERCE, CENTENNIAL, COLORADO

STATEMENT OF STEVEN SMITS

Mr. SMITS. Thank you, Chairman. Good morning. I am happy to be here in beautiful Colorado. Chairman Coffman, I want to first thank you for your service to this State and to our country, but specifically your service in the U.S. Army and the U.S. Marine Corps. So, again, thank you so much.

Chairman COFFMAN. Thank you.

Mr. SMITS. I am pleased to have an opportunity to be on the panel with Mr. Davidson, Mr. Brown. As you mentioned, before joining the SBA in October, I spent over 20 years as a banker and, specifically, as a small business lender. So I value their thoughts and their opinions and I am looking forward to having a productive meeting and discussion today.

As the head of the Office of Capital Access, my job is to adhere to my mission. I have a ritual every morning when I come into the office in Washington. The first thing that I did when I joined the agency my very first day is I typed out my mission. I taped that mission to the top of my desk. Every morning I read that mission. I go through my day and ask myself what am I doing that is actually moving that mission forward. Every evening I glance down at my desk and I read that mission once again to check myself to see what have I done to move that mission forward. That mission in the Office of Capital Access is to ensure our small businesses have access to capital through our lending partners when access to capital is not otherwise available on reasonable terms and conditions.

I want to focus on a little piece of that and that is "through our lending partners." The Small Business Administration and our lending partners, our community banks, our lending organizations, our certified development corporations all over this country form a partnership, an example of an excellent public/private partnership. So what I have realized—and my wife reminds me of this all the time. She says, Bud, a partnership is a two-way street.

So when I think of SBA lending, I think of a highway. My job really is to identify where there are gaps in financing, to work with our lending partners to find ways to fill those gaps. So in a highway, I think of them as the potholes. So our job is to identify the potholes. As an agency, we develop tools and we ask our lending partners to do the heavy lifting, to use those tools and to provide the asphalt to fill those potholes.

Now, what happens after a big storm? More potholes, larger potholes, more gaps. A functional, healthy partnership isn't simply SBA creating more tools and asking our partners that do the heavy lifting to just use those tools and fill those potholes. A healthy partnership requires a very clear understanding of what challenges, what motivations that your partner is facing and dealing with and what tools work and what tools don't work. And also, by the way, do they have the asphalt necessary to fill the holes?

So to this end, the first thing that I did when I joined the agency is I made a decision that I would travel the country, and as I did so, I would take an opportunity to put together roundtables of lenders and small business owners. It wasn't an opportunity for me to talk about what we are doing as much as it was an opportunity for me to listen. Part of a partnership is for me to listen and understand what is important to my partners.

I also would always ask my lenders what do you see as the challenges facing our small businesses this year and next year and going forward that keeps you up at night. I heard working capital, for example, which makes perfect sense to me. As we pull out of a deep recession, who would have imagined at the beginning of the Great Recession, it would have been as long and as deep and profound as it was?

Our small businesses do what they do. They went into survival mode to protect their employees, protect the house that they have spent their careers building, and they would take the resources they needed to keep their lights on. At the same time, they were faced with challenges such as deteriorating values of real estate. Many of our small business owners rely on the equity in their homes, for example. And when they see the value of their homes going down, they see fewer and fewer resources available just to keep the lights on. They are beat up and they are bruised.

As we pull out and recover, these are our job creators, these are our innovators.

We also need to be aware that many of our lending partners are small businesses themselves. Approximately 61 percent of the dollars that we lend out through our programs are done through community banks. Just like our small businesses, our community banks have felt the pressure of the recession, challenges with their balance sheets, challenges with their portfolios. If they've done the right thing and tried to keep their small business owners in good stead, it has resulted in a deterioration in their ratios and their balance sheets.

The good news is our programs are not only designed to help our small businesses, but they are designed to provide value to our lending partners. Many of our lending partners have found that use of SBA loans helps manage balance sheet challenges, for example. Since the start of the recession, we have seen over 1,200 lenders come back to our program and make an SBA loan for the first time in many years.

So what have we done? With the help of Congress, in order to encourage lending and to help fill these gaps that were appearing in lending, we increased our guarantee on our flagship programs up to 90 percent. We reduced fees that our small business owners pay. This is what I call putting our loans on sale. By increasing the guarantee, we have created an incentive for lenders to take additional risk. By helping to reduce fees for our small business owners, it has taken a burden off of the small business owners.

In addition, we opened up our real estate financing program to allow for refinancing.

We permanently increased our loan size from a $2 million cap up to $5 million.

We have opened up our program to floor planning for struggling Main Street dealerships, auto and RV dealerships, that were having trouble finding financing for their inventory.

We have also taken steps to open up more points of access. We rolled out what we call our Community Advantage Program, and what this has done is for the first time allowed nonprofit, mission-based lenders—these are community lenders in primarily underserved areas around the country who have a mission to provide a level of hand-holding or technical assistance on the front end for primarily young, startup businesses. For the first time, they can apply and become participants in our program to offer small loans up to $250,000. This is a strategy that opens up—I call it matching. A small business owner's success or failure is sometimes determined before the first dollar is lent out. Does your business plan make sense? Have you thought about things like your competition or your challenges or your "what if" scenarios? Many times these young entrepreneurs, these startup businesses, need a level of technical assistance that many of our larger institutions are simply not equipped to provide. So for them, this provides another avenue where the organization has a mission to provide that level of assistance on the front end to lend towards a greater degree of success once the business is ready to borrow.

Now, as I had mentioned, I have gone around the country and I have talked to lenders and I have listened to them. That is not where the partnership stops. What we also need to do is take the partnership all the way through the entire process. So when I heard that there are challenges, for example, for our small businesses securing sufficient working capital as they start to see opportunities for revenue growth or stabilization, they need to take a look at their balance sheets. They need some restructuring or they need some working capital in order to participate and take advantage of these growth opportunities. However, I have heard from our lenders that they just feel that they continue to have a challenge to find conventional means to do that.

So the other part of our partnership is to engage the lending community to help solve the problems together, to come up with creative solutions of what can we do with our programs that offer working capital solutions to our small businesses to make them relevant, to address the concerns that our lenders may have. For example, I have spent the last several months, myself and my team, and we have conducted well over 150 conference calls with individual community banks all over the country. We spoke to community banks in every single one of our 50 States. We have had conference calls with every one of our 68 district offices, and we listened. And what is amazing about that is we hear about the challenges, but our lenders are ready to provide us with solutions and suggestions, and we have taken all of that in. We have taken a look at our policies. Where are the barriers to entry for our lenders? What are thoughtful, common-sense changes to our policies where we can make these programs more effective? And at the end of the day, what that means is more access to capital for our small businesses by working and focusing on that partnership going forward.

So again I want to thank you so much for your time today. I commend you. This is about our small businesses. This is about awareness. Our small businesses are our job creators. Our small businesses are our innovators, and this country has been built on the successes of our small businesses. And I would encourage communities all over this country to offer such hearings because this is an opportunity to create an awareness which is very, very important. So thank you.

[The statement of Mr. Smits follows on page 27.]

Chairman COFFMAN. Mr. Smits, thank you so much for your testimony.

Our next witness on this panel is Jay Davidson, Chairman and CEO and founder of American State Bank. American State Bank opened in 1995 and has grown to over $220 million in assets. Mr. Davidson has more than 25 years' experience in the banking, private business, and corporate sectors and has been recognized by numerous industry and public organizations for his expertise.

Mr. Davidson is a graduate of the University of North Dakota. He and his wife Christina have two children and reside in Greenwood Village. Welcome, Mr. Davidson.

STATEMENT OF JAY DAVIDSON

Mr. DAVIDSON. Thank you, Congressman Coffman, for the opportunity to speak before your Committee today.

I am a community banker. I serve the small business, the independent business market exclusively.

I am going, I hope, today to show you that something is terribly wrong with the recovery which you certainly know and everybody here knows. I want to look at possible reasons for this poor economy. I want to prove that there is a second liquidity crisis in the economy, and I want to provide some suggestions for how to solve this problem. And since I am an engineer by training, I like slides and graphs. So forgive me here.

Chairman COFFMAN. That is great.

Mr. DAVIDSON. I will try to coordinate this whole thing.

The top chart shows the jobs recovery, the current recovery compared to three other recoveries. You notice that the loss of jobs went down further and has stayed down longer than historical. Gross domestic product, GDP, is the total national production. It is an indication of business activity. Again, it went down further than any other recession and has still not even returned to the 0 line. Actually this is one quarter out of date. So we are about 3 years since the beginning of the recession and we have not recovered yet.

I want to talk to you a little bit about why I think that is, and I am going to take a couple of seconds here to show you another very busy slide. This slide is all recessions since World War II. The most important thing to show you that this is the job losses. This is the current recession. It went down further, stayed down longer, and has not even begun to come back really. The reason I think that the job market has stayed down so poorly is that we independent banks, community banks, and the independent business person, small business person is not hiring for a lot of reasons but one of which I am going to talk about lending by banks because I think we are the cause of the liquidity crisis.

This is not a normal recovery.

The next slide gives you some more—just to give you a demonstration of the 1982 to 1984 recovery and the current so-called recovery that we are in, you will note that in 1982–1984, we hit a high of 9.3 on gross domestic product growth. Here we are sitting down at a 1.3 today. We are not recovering. In fact, we are going into a double-dip recession, it looks like.

But this is reduction in Government regulation. In my opinion, it is putting more money back into the market, letting people keep their money to build businesses and supporting capitalism. I think this is a perfect example of Keynesian economics and the failure of Keynesian economics. The Government cannot stimulate the economy. I will go into that a little bit more in the next couple of slides here.

We like to talk about a technical term called the velocity of money, and really, it is just the number of times that money turns, how often is it moving into the economy.

You will notice here that when the recession started—the gray area is the recession—the velocity of money dropped very precipitously down to the point where we felt that GDP had grown for two quarters, so by definition we were out of the recession. This was back in mid–2009.

Well, look what has happened with the velocity of money. It has continued to trend down rather dramatically, and we are seeing that effect in the gross domestic product, consumer spending, et cetera. This is the main reason, I think, that we are not having the recovery that we should, and I think there is a relatively straightforward solution to this.

The Federal Reserve and the Treasury have liquefied this Nation to a point that I have never seen in my life. I mean, we are talking trillions of dollars with TARP stimulus, QE II, QE I, you name it. There is so much money sitting out there. A lot of it is sitting in bank deposits doing nothing, and we are not lending that money out.

The analogy I like to use is that a river can generate electricity because the water is moving. When money moves, it generates jobs and it generates productivity. A lake can't generate electricity. It is static. There is potential there, but there is no actual kinetic energy.

So that is where we are today. The money is sitting in the banks, and I want to explore why that might be.

This is another technical chart. This is what we call the money multiplier. Again, it is related to velocity of money. This is N2, an indication of money in banks, and divided by the monetary base. You notice that normally the turns on the money multiplier are 8 to 10 in a normal environment. We are down here sitting below 4 right now. Again, money is not moving. Frankly, it is banks taking the deposits and not lending it out again.

Just an indication of the manufacturing to tell you that we are going into a potential double dip. They dropped significantly during the recession, came back substantially, and now we are dropping down in both jobs and manufacturing production. Not good for our economy.

This is a survey created by the National Federation of Independent Business, NFIB. This is the future lending that independent businesses, small businesses are intending to do, and from around 2006, it just dropped precipitously and has continued to drop. The independent businesses are not borrowing money for a lot of reasons. One, we are not lending money in my opinion. Two, there is a great deal of uncertainty out there. They don't know what to put the money in. They don't know if the rules are going to change on them, and the rules have changed on them. So the money is being held on the sidelines.

This is very telling. This is from the FDIC. This is the reduction in loans outstanding across the Nation. This is a cumulative number. There is almost a trillion dollars in loans that are no longer outstanding in our economy, $1 trillion not generating new business or generating expansion of business or generating jobs. All banks predominantly have stopped lending in my opinion. There are some anomalies here, but this is what I call the second liquidity crisis the Nation is facing.

Just as in the Great Depression, there were two liquidity crises that occurred. It wasn't just 1929 when the stock market crashed. There were two liquidity crises that helped bring this Nation to its knees. I believe that the bank lending issue is creating a second liquidity crisis that is extremely dangerous for our Nation. I am going to ask for your help and your esteemed Committee's help on this issue.

I will give you an example here in Colorado, commercial real estate lending, what we call CRE lending. In March of 2008, we had $10.1 billion in CRE loans outstanding. 3 years later, we only have $7.3 billion in CRE loans outstanding. That is a decline of $3.4 billion just in the State of Colorado in commercial real estate loans, a 27 percent decline. I submit to you that there is a contagion effect in this number also. $1.4 billion of that decline are banks that are not subjected to regulatory actions. Their capital is over 13 percent. The CRE 1 and 2 ratios are within guidelines. So they are not subjected to the CRE scrutiny that us community banks are, and they are still not making commercial real estate loans. To lose this kind of money into the economy has a strangling effect on our economy. It is extremely dangerous.

I would submit to you that those who own and have these commercial real estate properties are the small businesses. Hence, I believe that the independent banker is the person who serves and services the small business people. Since small businesses generate over 65 to 70 percent of all new jobs and hold 50 percent of the existing jobs, our effect on the small businesses as bankers not lending to them has a magnifying effect on the overall economy. So you take a $3.4 billion reduction in lending and you magnify that, and I don't know what the factor is. I couldn't find that number, but there is a great magnifying effect there. You can see why the Colorado jobs market has gone down. You can see why home foreclosures accounted for 36 percent of all home sales in the State of Colorado. People don't have money today. We are being squeezed.

I am going to tell you why now. The capital ratio is what we are guided by and what our regulatory agencies guide us by. This is probably the most important aspect of what we do as we relate to our regulators. It is capital divided by assets.

There are two ways to increase your capital ratio, which is what is being demanded of us community banks today. You can increase your capital, which in this market is extremely difficult, if not impossible. The stock market for banks went away 5 years ago and has not recovered yet. The dilution effect of raising capital today is horrendous, and you can't even raise capital today no matter what the price.

The other way—and this is the crux of the problem—is that we can reduce our assets, reduce the denominator and increase our capital ratio. Well, assets are loans. There is no way I am going to make loans and imperil my capital ratio. If I increase my loans, I will decrease my capital ratio, and my regulatory agencies will just beat me to death. This is their decision. This is their right, but I think this is the crux of the problem. And I hope that we can find some way to work together to meet their need for safety and soundness in the banking system but let us banks survive and thrive.

This is the issue right here. Bank regulators demanded immediate increases in capital ratios, far above the Basel Accords, to which we all agreed for the past 30–40 years, and they forced banks to reduce lending, and thereby caused a second liquidity crisis in small businesses.

For instance, my capital is higher than it has ever been before, and I am sure Mr. Brown will say the same thing in his bank. And most other bankers will tell you that. We have been driving up our capital ratios for a couple of years now, and yet I can't lend yet. I can't lend because the regulatory agencies have decided that commercial real estate lending is dangerous, and I need to increase my capital levels. The only way I can do that is by reducing my loans. So I can't increase loans.

I submit to you that commercial real estate lending today is much less risky than it was before. In our studies of stress testing of commercial real estate, the MIT study indicates that nationwide commercial real estate values have dropped 48 percent in the past 3 years. If I make a loan today, I am making it at half the collateral value of that loan 3 years ago, and I am making it to an individual who has made it through the Great Recession. This is a strong individual with net operating income. This loan today on a commercial real estate property is much safer than a loan of 3 years ago when I am at the top of the market lending at 80–70 percent loan to value.

Solutions. In my opinion—and I will probably get taken to task for this—I would ask this Committee to consider forcing regulatory agencies to adhere to the Basel rules on capital levels. They have served the industry well for the past 30 years, and the fact that we are having to increase our capital ratios at this time means we cannot lend and we are causing the second liquidity crisis.

Allow us to use the excess capital that we have accumulated over these 3 years to pay off some of our bad debt, sell it off at a loss, and get it off our books, and let us start lending that back into the market. This is the crux of what the hammer that the regulators have over us today.

Second, stop regulators from enforcing CRE, commercial real estate, guidelines as rules. Mr. Guggenheim asked me to define what are the laws that are being broken. Well, no laws are being broken. They are being interpreted to a much higher and more stringent level than ever before in the history of our Nation. For instance, the commercial real estate lending guidelines were sent out as guidelines in 2006, and we bankers viewed them strictly as guidelines. In Colorado where the ratio for CRE 2 was 300 percent of capital, I am at 600 percent of capital because I am a commercial real estate lender. This is what I do. This is what is available to me in Colorado. I think Mr. Brown will agree with that in his banking experience.

Well, the same level occurs across the Nation. Three hundred percent is the number that we have to try and reach. That is absurd. Alabama, Detroit—they don't have commercial real estate loans. They have P&C loans. They have business asset type lending, but they don't have a lot of commercial loans. Colorado does. We are kind of a white collar market, a lot of office space, a lot of office, commercial, and so forth.

The last thing is regulators have forced those banks that have capital loans at the bank holding company that have infused that capital into the bank to make it stronger. They are restricting us from paying the dividend on that capital loan. They are putting me in a direct default position with my lender because in their opinion, well, if I pay that dividend, I am reducing capital. Well, yes, I am. And they don't care about my shareholders. I understand that. They are here to protect the safety and soundness. But this issue is putting extreme pain on the banks. I have got several million dollars in loans outstanding that are making my bank safer and sounder, and I can't pay the dividend on that. So there are some very powerful effects that the regulatory agencies are having.

Granted, my loan portfolio looks pretty ugly right now. I will admit that freely. I have never had OREO, other real estate owned, or a non-performing asset in my life. We had to dust off the books and learn how to handle them because we have some now, and a lot of banks are in this situation. But we are surviving, as are most community banks that have made it through this time.

So the final thing I would like to say is make the regulators live by the rules that they established years ago, the rules by which we have been trained to work instead of increasing and reinterpreting the rules that are out there and having a major impact on the independent business person.

Thank you, sir.

[The statement of Mr. Davidson follows on page 29.]

Chairman COFFMAN. Well, thank you, Mr. Davidson.

Our next witness today is Dave Brown, President of Southeast Denver Branch of Centennial Bank in Centennial, Colorado. His bank is a full-service community bank focused on providing a full suite of banking solutions for businesses in the Denver metropolitan area. Welcome, Mr. Brown.

STATEMENT OF DAVID BROWN

Mr. BROWN. Thank you, sir.

I would like to reiterate everything that Mr. Davidson said, and he is actually the first person I have ran into recently who has a negative look on the current recession as deeply as I do. So it is refreshing to see that. [Laughter.]

We probably shouldn't hang out together too much, though. [Laughter.]

The neat thing about this was when Mr. Guggenheim gave me a call, he asked for five direct things that regulations were doing that are stifling businesses. And honestly, I couldn't come up with five. It is a neat and tidy little package. It doesn't always work in the real world. And part of it is what Mr. Davidson just alluded to is so much of what we are dealing with isn't necessarily the regulation. It is regulatory guidance, but that regulatory guidance in today's world has taken on every bit as much of a focus and it is dangerous to us as regulation is without the enactment of Congress. And to me, I find that to be very disturbing, which is why I have to agree with him on his Basel comments and the capital levels.

But when I do get into it, the first thing that I saw was the FIRREA, the appraisal standard that we have, Financial Institutions Reform and Recovery Act which was actually enacted during the last real estate crisis with the savings and loans way back in the 1980s.

With that, it dictates when you have to do an appraisal on a property, and as Mr. Davidson pointed out, the length, depth, and slow recovery of this recession has been so long—we are 4 years into it already—that there are so many companies, businesses that do have a physical plant that they are using to run their business out of. They have come up with a renewal on a loan and they have to do something to refinance that with the existing lender or move it to another one. Well, the appraisals have gone down, in many instances 48 percent, and so what this has done is a business that has done everything that it could since 2007 to make it through the recession all of a sudden has to come up with a capital call, in some instances as much as 20 percent of the loan, just in order to get it refinanced. In many instances, this is being done where the business has never actually had a payment default, but I would come to them and I would say, for instance, on a $1.1 million loan, I need $200,000 in additional capital from you in order to pay this loan down to an appropriate level. They simply don't have that, Mr. Coffman, and that is creating a massive problem for them.

So I talked to one of my appraisers in preparation for this, and he told me at this point in time that is happening as many as three times a month at his company. And that is only one of the commercial valuation companies here in Denver that do this sort of work. So it is a very prevalent problem throughout our market, and taking that capital away from small businesses right now at the worst possible time and putting it into the banks is a very bad thing to do. And it is also preventing us from lending.

Now, one of the great things that you hear the talking heads in the media spout on about is that what this is doing is it is deleveraging the community. The businesses are deleveraging. The consumer is deleveraging. And I would say I completely disagree with that fact. If we have a building or a house that was worth $1 million—it is now worth $750,000—the loan is still 75 percent. Even though it is much less than it was before, the deleveraging hasn't actually occurred. It is just that the economy as a whole and the asset base of the economy as a whole has shrunk. The leverage ratio is still exactly the same.

So, for instance, if we look at a company that would get into a position where they would have to refinance a loan with me, I go out, I get an appraisal on that house or that commercial building. It has fallen in value. I have to ask for the $200,000. The aftereffect of that for the company is that their building, where it used to be worth—I have got a specific example here. The building at one point in time was worth, say, $1.1 million. I apologize. $1.475 million. Today it is worth $1,192,000. The original loan was $1 million. Now I can loan them $894,000. In that instance, it goes down $145,000 that they have to come up with, $145,000 that they don't have.

Unfortunately, the loan-to-value is exactly the same at 75 percent. The asset has dropped. The company is $148,000 short in capital, and they still have payroll to make and I just took their payroll money. So the 65 percent of the new jobs that are being created, the 50 percent of the existing jobs in the market right now—I have just materially damaged that in my local market by that rule—oh, guidance, not regulation. I apologize for that. [Laughter.]

What happens, for instance, if the loan can't be remargined, if that $148,000 isn't available in that company's business? I am now looking at a foreclosure. I'm looking at—I'm whole if he can come up with $148,000, and my primary regulator, the Federal Reserve, is very happy with me. That is good. The business has taken a hit.

But if the business doesn't have that money, I have two choices. I can go into a thing called the troubled debt restructure with that company or I can enter into a foreclosure. Foreclosure is very bad and that could lead immediately to a personal and corporate bankruptcy personally because most small businesses have to guarantee personally all of the debt that they have. So we have got two bankruptcies that I have created. And the business could quite easily—that could shutter the business if I do that. Or I enter into a troubled debt restructure.

If I go into the troubled debt restructure, at that point in time I now have to reserve more money for that loan because I have demonstrated an obvious weakness in it. And therefore, more money from my current net income is going to be taken out of that, which is going to reduce my net income, taken over to my provision for loan loss reserve, which also takes it out of my tier 1 capital, moves it into tier 2, and then the Basel ratios that Mr. Davidson was talking about—I've just materially hurt those ratios at my bank, and it makes it more difficult for me to lend going forward. That is one thing.

The second thing that the stress testing and all of that led to was—the current guidance right now on just regular C&I, commercial and industrial, lending is to institute stress testing on that. And part of that is with global cash flow, as well as uniform credit analysis cash flow. I have got a lot of problems with both of those, and while each of them have a very strong point—they were instituted to reduce and identify risk—there is good and bad that go along with both of that.

The global—what that does is it takes in everything that a business owner does, money that he has to generate from the business in order to pay his own personal mortgage, as well as take care of the liabilities of the company. And so it blends that all that together and gives you a ratio of, hopefully, over 1 to something, sometimes negative.

The problem with this is that the regulators are pushing this so hard, and again, this is guidance. It is not necessarily a regulation. But it is being pushed so hard right now and there is no actual standard for this. RMA hasn't come out with it. None of the community banking organizations have come out with a standard for it. FASB has done nothing with it. So everybody is just kind of set doing their own thing. I am sure it is done differently at your organization as it would be at mine, as it would be at every other bank. In fact, the differences in this are so universal that at our last FRB exam, Federal Reserve examination, two examiners on the same team were using different formulas in order to come up with global cash flow. This doesn't do very much to help us or the business owners.

Finally on the UCA, UCA is actually an industry standard. It works well, but the way that it is being enforced——

Chairman COFFMAN. UCA stands for?

Mr. BROWN. Uniform Credit.

Chairman COFFMAN. Okay.

Mr. BROWN. Basically it came out of the Risk Management Association many years ago, and it determines how much free cash flow a company has in order to take care of its responsibilities. An excellent standard.

The problem with it is that from the guidance that we are getting right now, the regulators would like us to come up with a specific number that we are going to lend into. So if I am going to leverage that at 1.5 times, it is going to be across the board. That doesn't work.

There are pretty amazing differences. If you look at the same product line, for instance, manufactured windows, the manufacturer of that window, the middleman that is going to take it and do the distribution, and the retail vendor are all going to have remarkably different balance sheet to income statements, and I can't leverage each of them under the same guidelines. So what it really comes down to is we are being asked to do something as a standard which really is an art. Lending is part art, part science. You can only do so much mathematically. The other piece of it has to be what the business is, the strength of management, the character of the people, and that art part is being moved out of this equation and put someplace else. We desperately need that in order to properly service the communities that we are taking deposits from.

The next thing is I am going to get into the capital levels as well. I completely concur with Mr. Davidson on this. Where these capital levels came from was guidance again back in 2005–2006 where they asked us only to do 100 percent of our capital. So if I have $100 million in capital, I can lend $100 million in construction and land development. I think that is probably not necessarily a bad thing because if you look at all of the banks that have been closed over the last several years, they were predominantly in construction and land development lending. So that has helped out with that.

The 300 percent would be inclusive of that 100 percent, and then you would be able to lend 200 percent to the rest of the commercial real estate, people who have apartment buildings, office buildings, retail centers, plant and equipment for plants for their businesses.

The problem with this is that we are combining two areas that don't need to be combined. If you are looking at a plant and equipment for an owner-occupied business and that becomes part of your 300 percent ratio, you could quickly exhaust that ratio and no longer be in a position where you can lend money to people who are trying to do something.

A case in point with this is we just completed a loan. Actually Myron Spanyer in your office gave me a great deal of help through the SBA. It is a Golden Corral that is under construction right now at the intersection of Parker and Arapaho. This business, when open, is going to employ 180 people in the 6th Congressional District in the City of Centennial. I am looking very forward to that. And at the end of the day for a banker, when I go home and I know that what we did at my bank had a small piece, minuscule, in employing 180 people, not to mention all the construction people that are over there, that is why we do what we do. You don't get paid for that, but there is a lot more of that that hits you, and it is worth more than the money that you get at the end of the day. It is what keeps you coming in day after day.

Unfortunately, that now, when it is finished, is going to become part of my 300 percent CRE. That real estate has absolutely no bearing on—as an income-generating piece, it has no bearing on what is going to happen with that. Golden Corral sells food. I am going to be repaid from the sale of food, not from rental income that is coming off of the real estate.

So at the end of the day, if there is one thing that I could ask for, it would be to remove owner-occupied from those guidance levels if we do nothing else with them because that is really restrictive to the business that we have here.

The last thing that I want to get into on that is that right now in Colorado, you have effectively got a number of banks. I don't know how many it is, but several that are actively looking to sell commercial real estate loans out of their portfolio. And I have personally looked at a number of these from several banks. I have purchased a lot of them, and I know that these things are getting sent out to investors, hedge funds, et cetera. And so what this is doing is helping to take care of that capital-to-asset ratio, that 300 percent, that these companies have.

The problem with that is that the banks that are doing that right now, if you are selling loans, you certainly aren't making any. They no longer have the ability to service the community that they are in because of these capital restraints. And on top of that, the loans that they are selling are absolutely the best loans in their portfolio, otherwise investors won't buy them, and it further weakens the bank going forward. So it is highly negative on every front that I look at for that.

In fact, this is so pervasive that Community Banks of Colorado last week just sold 16 branches to the NBH Group out of Boston, Massachusetts. Again, it had a lot to do with the fact that they needed to raise capital and they couldn't do it in the market, and selling half of their franchise was the only way that they could do this.

So the last thing that I want to say is that the regulatory change that we have is going at warp speed. Dodd-Frank is not entirely written. The regulators don't understand what is going to happen with it. The Consumer Financial Protection Bureau was underway. Have no idea how that is going to affect it. And while most of the banks in Colorado are too small for it, the rules that they are going to enforce through the CFPB are going to drill down to us through our primary regulators. That is also included in the law.

The effect of this is primarily what really frightens me individually as a banker right now is that this pace of regulation, the fact that we don't understand what is going on with it. A lot of what we have already enacted hasn't worked out very well. I will give you a case in point.

Several years ago, they redid the good faith estimate for home mortgages, as well as the HUD–1, to help to prevent people from becoming victims of predatory lenders. And the stated goal for this was to provide more simplicity, clarity, transparency, and certainty of mortgage costs for consumers. What this effectively did, however, was it took a good faith estimate that was one page, increased it to three, and when it was one page, the average consumer could look at it, understand it, and figure it out. The three-page one, a CPA really has to be brought in so that you can understand what that is. That is not simplicity. It certainly isn't clarity. Most people aren't going to go to their CPA to take a look at it.

The same thing with the good faith estimate, from three pages to four—or the HUD–1. The HUD–1 as a three-page document was completely unintelligible. As a four-page document, it has been further muddied. And again, people don't take these to their CPA's to look at them beforehand. So who is actually giving them guidance on these very complex, non-simplistic things that the Government has asked us to do? It is that same predatory lender that this was designed to get it out of the hands of.

So that is what scares, again, just me personally. That is what scares me the most about this upcoming regulation.

Jamie Diamond several weeks ago asked Ben Bernanke in an open hearing, have you given any thought to how all of this regulation is going because you are writing so much of it? Ben Bernanke gave a very flippant, off-the-cuff remark that I think he would probably regret at this point in time.

But when I look at the HUD and the good faith estimate, I am very frightened for the stuff that is coming out. In the last couple of weeks, four banks have trimmed 9,500 people from their payroll because, stated fact, the regulation was too great—regulatory burden was too great and they couldn't afford it. So they have to cut costs someplace else. So they get rid of the people that have to check into this regulation. Regulatory staff, on the other hand, has increased at the United States Government and it is the fastest growing part of the United States Government right now. And that was given to me by Mr. Spanyer. I have it on page 4 of my testimony. I should have done a PowerPoint on that. But that is actually coming out of the Office of Personnel Management and the Bureau of Labor Statistics.

So at the end of the day, regulators are growing in numbers. Bankers are decreasing in numbers, and we have to take care of the same amount of regulatory burden or an increased amount of regulatory burden with fewer people. And the Government is sending more people to make sure that we are doing it. It is not a recipe for success in my estimation.

In fact, this regulation—and I will end right here—is so prevalent that the number of emails that I personally get right now from the Colorado Bankers Association, the American Bankers Association, the ICBA, the RMA, the ABA, on and on and on, if I read and tried to understand every bit of it on a daily basis, it would take over 2 hours of my time. I and the rest of the community bankers in this country cannot afford to spend a quarter of our time looking at proposed regulation trying to understand it, but if we don't, we are in even more trouble.

Chairman COFFMAN. Mr. Brown, thank you so much for your testimony.

Our next witness is Jeff Wasden and he is the owner of PROformance, a small business here in Colorado. Jeff is a member of the South Metro Chamber of Commerce, and I believe you are the chairman—am I correct—of the South —

Mr. WASDEN. Public Policy.

Chairman COFFMAN. Of the Public Policy Committee in the South Metro Chamber of Commerce, and he is filling in for Chamber President John Brackney who could not be here today due to a family illness.

Jeff, I know that you don't have an opening statement, but I would like to give you the opportunity to give opening remarks if you would like.

STATEMENT OF JEFF WASDEN

Mr. WASDEN. Thank you, Mr. Coffman. I appreciate the opportunity to be here and I do send out regards and regrets from John Brackney. His father is having some health issues.

I would also like to take a second to thank Mr. Smits, Mr. Davidson, Mr. Brown for their candor and their insight and your expertise in these issues.

I come with a little bit of unique perspective today as probably one of the most recent recipients to capital in the State, having just closed on a loan last week, and then certainly as a board member for the South Metro Denver Chamber of Commerce and also dealing with the public policy arm of that particular chamber.

Talking a little bit on behalf of the Chamber and the Chamber investors are things that you repeatedly hear over and over from fellow investors of that Chamber, not just the access to working capital to stay afloat to keep the businesses to meet their weekly commitments. But there are opportunities out there and there are people that understand the new technologies and the new opportunities that they can do to reconfigure their business, to realign their business in new trends and what is out there is equally as important, and having that access to that I think Mr. Smits alluded to earlier is equally as important certainly on certainty of the regulatory environment.

The Chamber numbers continue to maintain strong. You lose some investors due to various factors with their marketing dollars, with businesses closing. But there are people that understand the impact and importance of maintaining those relationships, cultivating new relationships, being in an environment and marketing their businesses are important to them.

Unscientifically I think from our business side and who work with and then from the Chamber side, I think you are seeing about 10 percent of the businesses that are thriving in this economy and this environment. There is about 20 percent, in my understanding, that are slightly up. About 30 percent are basically flat, which leaves over 40 percent of the businesses that are basically down or struggling on some various level. And I think that is concerning to all of us as you sit down and know not only as a Chamber person but the people that we work with on a day-to-day basis.

From our business perspective and how we look at things and what we were doing, we had moved into a new location. We expanded to about 2,500 square feet and hired some new employees and needed some additional equipment that we now had room to place and put there because of those new opportunities, some new contracts we have received, some new schools, some different bids that we were awarded. It puts you in a difficult position when you have the opportunity to grow your business and have that work to be able to try and chase the equipment, things to be able to do to produce what you ultimately received and were awarded. And I think that is where some of that opportunities that people are struggling with. There are some carrots out there and people's access and ability to get that and maintain those have been severely limited.

The term "uncertainty"—I think I could say with certainty that that phrase is tossed about all too frequently. I think business people put blinders on. They are focused on the day-to-day. Yes, they are aware that there are these regulatory issues. They are aware of the Government and the impacts on these things that are out there. They are trying to produce goods. They are trying to produce product. They are trying to make sure that they meet the demands and timelines of the businesses. They are trying to make sure that their employees are paid, that their lights on, their bills are paid. And I think that is what they are focused on. I think they hear these things about the Government and the regulations and the environments that are out there, but deep down, I think most of those are too busy and struggling too much in some ways to pay attention to those.

You mentioned spending hours a day trying to stay up with those things. I think most of these businesses, because of their trade associations who they are involved with, get those same things but don't have the time or ability to research and to study them, to pay attention to how those things are impacting their businesses.

There was a business in our complex where our business resides that was doing, on a day-to-day basis, quite well. The problem was there were some tax issues and things that were behind and they couldn't catch back up and went to try and get some loans and access to capital to try and take care of some of those past debts because they knew they were poised to continue to be successful. Unfortunately, their doors were shuttered and it is another one of those casualties of our State right now.

So I appreciate the dialogue, appreciate you being here and an opportunity to be here to address that. Thank you, Congressman.

Chairman COFFMAN. Thank you so much, Mr. Wasden.

Let me just start out with a question for Mr. Smits from the SBA. Many banks claim the SBA's procedures are cumbersome. What steps are being taken to further reduce the complexity associated with making an SBA loan?

Mr. SMITS. It starts with engaging our lending partners. So I had mentioned that as we take a look at our policy and procedures, what is real barriers to entry and what is perceived barriers of entry, by engaging our lenders to communicate to us a possible solution, it adds a level of real-world application and it helps us direct towards what really makes a difference.

It is interesting. When I was managing a lending department division, my day-to-day involved dealing with real small business challenges. You know, the local mechanic on the corner has this challenge. How can we make this work? How can we restructure this? You felt very engaged to what was happening outside.

What I have discovered, as I came to work for the Government just 10 months ago, is we run the risk of becoming isolated—I call it the "Washington bubble," which you probably are well aware of—from real-world application of our programs. It is very easy to identify risks, and it is very easy to create policies and procedures to protect against that risk. It is really challenging to take the next level and step back and say what risks have I created by creating this policy to protect against this risk. Have I quantified? How does that play out in the real world?

And so what I have challenged the team to do is to take that extra step, and that extra step often involves having an understanding of how this really plays out. And the best thing that we can do as an agency is to be very engaged with the banks and the small businesses out in the communities to hear the real-world challenges that this policy could possibly create.

So, again, we are looking at all of our programs. We are taking a look at what are policies, why do we have these policies, what are we protecting against, is there another way to do that. Too often in the past, we have said it is simply a matter of making our applications or our forms shorter. Well, see, I know that most lenders—you know, TurboTax. So forms aren't as important as they were when I was a young underwriter 20 years ago where I had to fill out just hours and hours and hours. There is software now that populates a lot of these forms. So making a change to a form doesn't have the impact as maybe taking a look at the process.

So we have to remind ourselves that when a lender is taking advantage of an SBA loan, for example, the process isn't just we see the loan and we see the application and we work through our guarantee and we issue the guarantee. It starts when the small business owner approaches his or her banker, and it doesn't end until the dollars are funded through a loan closing. So there's a great deal of process that is outside of our scope of vision. The best thing that we can do is to be proactive to gain an understanding of the entire process and map out to say, Mr. Banker, what do you do when you originate a conventional loan, what do you have to do to originate an SBA loan, and map out where the differences are. There is a reason for some of the differences. There are other things we can improve upon.

And I always say this. When a banker looks and a lending partner makes a decision to participate in our programs, if they are going to originate a $100,000 loan, they know they have this much resources to put towards the origination and the closing in order for that to be a profitable transaction and everybody wins. When out of this much resources, this much is for us to—you know, the burden from the Government to obtain the guarantee—they are left with this much, which is sometimes the most important part of the origination, which is the underwriting. Is this small business owner positioned for success? Have we looked at the business plan and does it make sense? Have we forced our lenders to underwrite towards the Government guarantee as opposed to the success of the business?

So my argument is this is our responsibility as an agency to continue to look for ways and process improvements and efficiencies that we can pass on to our lenders so that the small business owner has a chance of success, a greater chance of success, because we have allowed our bankers and our lending partners to do what they do best, which is assess the risk and still be able to make economic sense to originate that.

Chairman COFFMAN. Thank you.

SBA's 2012 budget request that was released in March claims to increase the number of participating lenders to 3,000 projected. What steps are you taking to meet that goal?

Mr. SMITS. I will make this comment. My experience with the Small Business Administration stretches across 20 years, and I will say that I have never seen a time period in my 20-year experience where the agency has been more engaged with their lending partners. As I had mentioned, we saw 1,200 new lenders use our program for the first time in many, many years. A lot of those lenders have found it for what we have talked about, managing their capital ratios, the advantages of having a guarantee in order to manage their balance sheets.

We need to keep those new lending partners in the fold. And that is good, old-fashioned customer service. That is providing support at the local level. It is providing streamlined and efficiencies as we move forward with our programs. It is to make the program accessible and easy for them. And it is good, old-fashioned contact with them. It is about making them part of the solution as we look for working capital solutions to benefit our small businesses, make them part of the process to make thoughtful changes to our programs because then, first of all, there is validation from them. They are part of the solution so that they feel some ownership. All of that leads towards building a stronger and stable base of our lending partners.

Chairman COFFMAN. You know, we have had a lot of consolidation in the banking industry, and how has that affected your SBA loan programs?

Mr. SMITS. One of the things I also look at is I look at the concentration, you know, good, old-fashioned concentration analysis of who is using our programs. And we have seen more community-based organizations that have gravitated or used our programs. So we have seen a shift in community banks using our program. We have seen a rise in credit unions to take advantage of our programs. We have seen a decline in some of the finance companies, the national finance companies, that focus on the SBA product sets as being the primary drivers that use our programs. So we have definitely seen a shift in concentration of the makeup, which isn't necessarily a bad thing.

Chairman COFFMAN. How are SBA loans performing right now, and how would you compare that to the private sector?

Mr. SMITS. I pulled the numbers before I came out here, and surprisingly—the good news is—what I watch closely is delinquency because that gives me a real close indication of what is happening today. So our 7(a) program, for example, as of June 30th, the current month, the delinquency was about 1.75 percent compared to a year ago. It was 3.24. So that is the good news. Our portfolio appears to have turned the corner. It looks like we really turned the corner in January of 2010. It has seen a steady improvement in the portfolio performance.

Chairman COFFMAN. Does the SBA communicate with your counterparts in the Fed, in the FDIC, with the Comptroller of the Currency? Could you——

Mr. SMITS. So one of the real values to our proactive approach to being engaged with our lenders has been that when you start to hear the same—you know, when you hear the same concern from a banker in Seattle as you do from a banker in Denver, you say, okay, there is something here. We need to look at this. And it has really helped us. And what we have done is reached out and been proactive. We said, well, gosh, we need to be very engaged with the FDIC, the OCC for a number of reasons. One, it is an opportunity for us to continue to educate. The more touch we have, the more opportunity we have to talk to them about business lending and some of the things that we are seeing from our lending partners and the nuances and the value of our Government guarantee and our enhancements, it is also an opportunity for them to share with us from their perspective. So there is real value to having an ongoing dialogue.

So the FDIC, for example, we have made some great progress where I have been putting the credit groups together with a focus on having monthly productive meetings to just discuss what we are seeing and what they are seeing. And it all goes back to what I was saying, that you need to—you can't simply look at these regulations as an academic exercise. You have to actually take it further and look at it as a real-world. So I feel we as an agency—we have a real value where we can communicate out to them, and we have a very large network of lending partners. And it is an opportunity for us to continue to disseminate what we are hearing, and they seem very open and perceptive to that. So I am encouraged by that progress.

Chairman COFFMAN. Thank you.

Well, let me ask some questions of our bankers, Mr. Davidson and Mr. Brown.

The Wall Street Journal recently reported that a banker in Texas decided to give up his charter because of the regulatory environment, and I remember reading that story. Is this an isolated story or a common concern among bankers? Mr. Davidson.

Mr. DAVIDSON. It is an isolated story. It is unheard of, Congressman Coffman. However, it tells you how onerous the burden is on this bank that he would consider doing it. We can work on some pretty nice margins in banking because our cost of funds are relatively low. It is deposit cost basically. He has got to borrow money to lend money, and so his margin is going to get squeezed. But he has decided that the regulatory burden is too great and it overshadows that margin squeeze. So I think it is indicative at a very extreme end of excessive regulation.

Chairman COFFMAN. Mr. Brown.

Mr. BROWN. I would absolutely concur with that, Congressman Coffman. It didn't seem to me like the most intelligent choice that he could have made on that. I will leave it there.

Chairman COFFMAN. If you were going to give me your top priority to lower the regulatory burden on banks to allow more small business lending, what would that be? What would the top priority be?

Mr. DAVIDSON. If I could, Congressman Coffman, the number one request would be that the regulators live according to the rules that have been set in the past, the Basel Accord rules, for capital. Let me use the excess capital I have generated over these past 3 years to lend money out to the small business market. Capital is the key issue. Capital ratios is the key issue.

Mr. BROWN. I would concur with that.

And then in addition to that, the difference between actual regulation and guidance needs to be—you guys need to really take a strong look at that because if an examiner happens to be in the bank and they make a statement that we would like you to do this, that becomes as strong as regulation. And if you don't comply with what their requests are, it is going to end up causing you a myriad of problems in the very near future. And I don't think that it needs to carry as much weight as the actual regulation.

Chairman COFFMAN. I think you kind of went over this, but if you would just—you know, in a very brief statement, how would you really bring it down to summarize how the regulatory burden has constricted your ability to do small business lending. Would it just go back to not complying with the Basel rule? And was that the 20 percent, the 10–12 percent issue in terms of——

Mr. DAVIDSON. The Basel rules in this case for our bank controls risk-based capital. The rule for a well-capitalized bank on total risk-based is 10 percent or greater.

Chairman COFFMAN. Right.

Mr. DAVIDSON. We have managed our bank to that level, as have a lot of community bankers, to maximize the return on equity for our shareholders. That rule has changed, and we don't know what the new target is but it is much higher than that. My current total capital is over 12.5 percent over the past 3 years in the worst recession that I have ever experienced. I am not getting any credit from the regulators. I am getting beat to death because I am not up higher. So, yes, I would say capital.

Ask the regulators to adhere to the rules that were established. They are concerned about safety and soundness, and I respect their jobs. It is a very difficult job. They do not look at the unintended consequences of their actions, and I submit to you the second liquidity crisis that we are in today is the unintended consequence of regulators trying to protect the safety and soundness of the banking system while at the same time, in my opinion, destroying the national economy.

Chairman COFFMAN. Let me ask you both. Do you think that regulators in a way overreact simply because of the fact—obviously, in the free market system, there is always going to be an element of risk. There is certainly no incentive for them to keep an institution open, but there is every incentive to close an institution in the event that down the road something happens to that institution and their fingerprints are on a particular audit. Is there any——

Mr. BROWN. Oh, yes. I would absolutely agree with that. I think that is human nature. If you came in as an examiner to a bank you took a look at and something had you feeling just a bit squeamish about it and you didn't bring it up and then 6, 8, 12 months down the road something happened with that institution, that is the first thing that you are going to go back to is whatever made you feel squeamish. So from a fear instinct, they aren't looking at that anymore. If there is something that is even giving them the slightest tinge, they are going to go into it at great depth and it is going to cost a lot of money for the bank to comply with all of those things. And while a couple of those may actually be relevant, there are so many more that simply aren't.

Chairman COFFMAN. So your position is, for both of you, that it is not simply the troubled institutions that the regulators are coming down on. It is well capitalized institutions.

Mr. DAVIDSON. It is everyone, absolutely. We are excessively well capitalized, and they are coming down on us.

Chairman COFFMAN. How would you both in a way quantify, I mean, just anecdotally to talk about the increase or decrease in loan demand—or I suppose it is a decrease—over the last 2 years?

Mr. DAVIDSON. The loan demand has decreased over the last couple of years.

Chairman COFFMAN. Okay.

Mr. DAVIDSON. There is a triumvirate here. We stopped lending because of the regulatory environment. They stopped asking for money because we stopped lending I think. Mr. Brown may disagree with that.

But there is certainly a lower demand but there are still loans out there. I am making loans right now, much to the chagrin of my regulators, because I have to maintain my net interest margin. So we are trying to work around a regulatory environment that shouldn't be there today.

One other point, if I could make, Congressman Coffman. Right now, the requirement of the banking regulators is to promote the safety and soundness of the banking system. It is a respectable goal. But if you were able to include to promote credit availability under the guidelines of safety and soundness, then they might be modified. They might modify their actions and understand there is another element here. They are shutting down lending. They don't care about lending. They don't care about—and that is not their job. I understand that. They should and I think it has come to the point where the legislators, the gentlemen in Congress and the Senate, have to step up to protect the banking system from this egregious overreaction by the regulatory agencies. So I would like to say—and I will give the credit to Don Childers with the CBA. I would like to have you say their job is to promote credit availability within the safety and soundness guidelines.

Chairman COFFMAN. Okay.

Mr. Brown.

Mr. BROWN. I agree that the regulatory burden has a measure of an effect on what is happening in lending right now. The bank that I am at—we bought it in—the group that I am with bought it May of 2010. And at the outset, we had such a small loan-to-deposit ratio that the only thing we can do is lend. So we have been very active. And there's really not as much loan activity that is out there that the general public would expect that you would see.

In my estimation, regulation certainly has an effect on the limitation of availability of credit, but the economic environment has a very strong role to play in that right now. Again, we are coming out of a recession as slowly as I have ever seen a recession crawled out of. And the companies that have survived it—their balance sheets are weaker than they were. Their profitability is weaker than it was, and many of them simply aren't good candidates to receive credit. As much as I hate to say that, it happens to be true.

And then on top of that, the third layer that I look at is the fear perception. The stock market moves on perception. It isn't moving on reality. The entire world right now, I believe, is moving on perception. And with all of the negative forces that we have going economically right now, the companies that have weathered it that do have a good balance sheet and could look at it, I don't know that they are necessarily looking to borrow a lot of money. I have asked the same question a hundred times to a lot of different people. If I gave you $1 million right this minute and asked you to return 8.5 percent to me within a year, what would you do with the $1 million? In the last 4 years, I haven't had a good answer.

Chairman COFFMAN. So, Mr. Davidson, let me, if I can sum—because I believe, Mr. Brown, you agree with. The regulatory framework today does not take into account anything about preserving lending. It is all about reducing risk. And the optimistic goal, the idealistic goal would be no risk.

So how did you frame that then again? So what you are doing is you are going in and changing in a way that the mission statement of the regulators to add a dimension to it. How would you define that dimension again?

Mr. DAVIDSON. Yes, sir. The dimension I would add is that they need to promote credit availability within the guidance of safety and soundness. Life does not exist without risk. I know that certain individuals have a higher tolerance for risk than others. Those individuals that are perceived to have a higher tolerance are probably the people that start the businesses. I think we could conclude that. Bankers don't like risk. We don't have a big enough margin for it. But we do take some risks. Regulators in my opinion have no tolerance for risk and don't understand the risk that we feel that we understand. And I think we have done a pretty good job managing that risk.

You can't make a system totally without risk. Life is risk. Business is risk. It is managing that risk that makes the difference. But the regulators have now taken away our ability to manage our bank to a business standard for the benefit of our shareholders and our borrowers, and now we run our bank to a regulatory standard. It is extremely difficult. And that regulatory standard changes with every examination. There is no hard and fast rules. The rules that we used to live by are gone. I have never seen that in 30 years.

My chief financial officer, John Phillips, and Nick Lepetsos, my president, who helped me put together this presentation—in their combined 50 years' experience in banking—and I can say John was in Texas in the 1980s during the oil crisis and, in fact, helped Continental Illinois try to work out of their issues that caused the whole issue. That is what he saw at ground zero. And he says this is nothing like what it was back then. It was bad back then. This is beyond the pale. It is indescribable.

Chairman COFFMAN. The final question, and that is, so if we were going to go back—so you believe that the risk-based capital standards prior to 2009 were adequate.

Mr. DAVIDSON. Yes. The Basel rules are certainly adequate. Absolutely.

Chairman COFFMAN. Mr. Wasden, in your view being a small business owner and a Chamber member, how high is access to capital on the list of things your membership is struggling with?

Mr. WASDEN. I want to address that after I let Mr. Brown know I want to be the recipient of that $1 million challenge you are throwing out there. I would like to take a shot at that. [Laughter.]

You know, you brought up the question about loan demand, and I think using the analogy of running into the wall, running into the wall, at some point you stop running into the wall. And so there are certainly going to be some businesses out there that have asked, that have gone to the banks that have opened the doors to try and have those conversations that have been turned down on that and then stopped doing that.

I think what is happening, Congressman, is we are being forced to evaluate your aspects of your business, how to run more efficiently, how to trim fat, how to shed waste, to re-function where your business is, what your core strengths are, what your market will tolerate, where your business plan is heading. And I agree with Mr. Brown there. There are certain people—and it is hard from, I think, a business perspective from a Chamber that they have someone that comes in that wants to be a business coach, a life coach. You have someone that wants to come in and open a martial arts studio, and that is all they know about and that is what they are good at and they are passionate about it and they know how to run that. It does not make them necessarily a great risk in saying that this is somebody that we want to lend money to. And so I think part of the challenge from the Chamber's standpoint and some of these organizations is to try and help them through that and look at those challenges and those opportunities that are out there so they can see that so we can better prepare them to go and open that door to try and make them a better recipient of those cash and funds that are available that banks clearly are wanting to lend.

Chairman COFFMAN. So what do you think is the biggest factor for small businesses in this area when deciding to hire an additional employee?

Mr. WASDEN. I appreciate that question. Actually our president and CEO did make it back in here. So if he has any insight and there is time for that, I would certainly like to recognize John Brackney who is here and who might be more suited to answer some of those questions.

But I think as you are sitting there and you are talking about hiring or expanding or purchasing new equipment, you are looking, Congressman, at a couple of factors. You are looking at your bottom line. You are looking at what is out there as far as your markets or past history. We came into a very unique situation in our business, but believe it or not, we have had six straight record years of sales in our company. I know that is kind of an unheard of thing, but we have reevaluated. We have opened up a fire and safety division that didn't exist previously. And you find niches. You find roles. You look for opportunities that are there.

When we look at that impression of hiring and it comes down to very simple—I spent till 1:30 on Thursday night, until 3:30 on Friday night not with my wife, not on a great date night, but doing football jerseys in preparation for. Could we hire more staff to do those? Certainly but then it comes out of your bottom line. Then you are worrying about being able to make payroll. And so you are constantly chasing that tail of going back and doing those things yourself as owners and spending that time versus what are the costs of hiring additional staff to take on those burdens and those times to do those.

Chairman COFFMAN. For you and your fellow members of the South Metro Chamber, what do you think is the outlook in terms of hiring over the next 6 months?

Mr. WASDEN. I don't see a lot of businesses within the Chamber—and John, certainly you can correct this statement—that are looking at hiring and expanding as a great percentage. And I mentioned that before. I think you have got 10–15 percent that are thriving, that are doing well in this economy, that are growing and hiring today. I think the rest are sitting on their hands and being very cautious and very concerned about the uncertainty that exists out there and are probably not going to leap at that opportunity.

Chairman COFFMAN. So for businesses that are looking for additional capital, what do you think their biggest impediment is to getting a loan?

Mr. WASDEN. I think it is creating that business plan, that opportunity that comes to let them know that you have thought about this, that you are a safe risk, that you have the ability to make good those loans. And I think that is certainly something that they have to understand going forward. And I think certainly Chambers—and we have within our South Metro Denver Chamber the small business center that is there. I think it is understanding how to proceed with those business plans and how to go to a bank. I think a lot come in there and say, look, I need money, I need money, but don't necessarily take the steps and the plans and the thought process to generate that plan to make them a safe investment.

Chairman COFFMAN. Well, I just want to thank you all so much for your testimony, for coming today. I think it was very insightful for me as a subcommittee chairman in the Small Business Committee to certainly take your comments back and make some changes I think that need to be made and I will certainly work with my colleagues on other committees of reference in the Congress such as the Financial Services Committee to make some of these changes a reality I think that we talked about today that are hurting, I think, access to credit in the United States for small businesses.

Now that the questions are completed, I would like to again thank the folks here at Greenwood Village. Thank you, Mayor Rakowsky, and your staff for hosting us and for all of our witnesses that were here today testifying. I know you are busy. So I appreciate your taking the time out of your schedules to share your views with us.

Small businesses will lead our economic recovery. So we need to do everything we can to make sure that they have the capital necessary to grow and create jobs. It is not every day that we can hold hearings outside of Washington. So I am pleased that we were able to have local witnesses testify about what is going on in this area in the 6th Congressional District. We heard today about some of the problems that bank regulators are causing, as we work to get money into the hands of our Nation's job creators. We will make sure that the Committee of Small Because follows up with banking regulators so they know what is going on outside of Washington.

Mr. Smits, I want to thank you so much for your testimony today. I really appreciate all that you do to help small businesses in this country.

Mr. Davidson, God bless you for all you do. And I know these are tough times, and I really appreciate what you do.

Mr. Brown, a great job again. And I just want to thank you for all you do. Stick with it. I know it is tough. And thank you.

Mr. Wasden, as a former small business owner myself, I know how tough it is. It is a matter of surviving these tough economic times and holding on to the employees you got. But if you can create some more, I would certainly appreciate that.

And I thank everybody else for coming today. This has been extremely helpful and very insightful in terms of, I think, making a difference to get this economy moving again. Thank you.

The Committee is adjourned. The hearing is adjourned.

[Whereupon, at 11:38 a.m., the subcommittee was adjourned.]

U.S SMALL BUSINESS ADMINISTRATION

WASHINGTON, D.C. 20416

TESTIMONY OF STEVEN SMITS

ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

"Small Business Committee Field Hearing in Colorado: Local Perspectives on the State of Small Business Lending"

AUGUST 25, 2011

Thank you Chairman Coffman for your leadership on the Committee, and for your service to this state and our country in so many ways. It's great to be here in Colorado's 6th District to discuss access to capital for small business.

I'm pleased to testify alongside Mr. Brown and Mr. Davidson. I worked for more than 20 years in private sector lending mostly focused on small businesses. So, I look forward to hearing their comments and insights.

I'm also pleased to be here with Mr. Brackney whose Chamber and SBA jointly support the award-winning South Metro Denver Small Business Development Center. As someone who has volunteered at an SBDC, I know that resource is very valuable to entrepreneurs and small business owners.

In my first year at SBA, I've traveled around the country and held roundtables with lenders, including one in Denver. I've gained an understanding of the challenges they face in putting capital in the hands of our nation's top job creators.

Many of them praised the steps that SBA took in 2009 and 2010 to help fill the gap caused by the lending freeze in 2008. As you might know, we raised the guarantee on our loans to 90 percent and waived many of the fees. As a result, we turned just $1.2 billion in taxpayer dollars into more than $42 billion in lending support.

Today, those incentives have ended, but we still provide an excellent partnership for thousands of banks. In fact, our weekly lending volume is now back at levels we saw before the recession.

Here in Colorado, from FY 2010 through FY 2011-to-date, we've already seen an increase by more than 10% to nearly $680 million in lending support. In your District alone, we've helped about 150 small businesses with more than $100 million in lending support so far.

We're building on this success.

1. First, we continue to increase the strength and number of SBA lenders. We're showing how this public-private partnership is a powerful strategy to improve their balance sheets and attract new customers.

2. Second, we're listening. As a former lender myself, I know that SBA loan programs only work when lenders are involved at the earliest possible stage in designing or redesigning our programs. They know what works for their customers, so their buy-in is crucial.

3. Third, I've strengthened the SBA's relationship with other key agencies. FDIC is probably the most important example. Our respective risk management teams are now meeting at least once a month to help ensure that regulation doesn't stop the flow of capital to good, creditworthy small businesses. This is a top concern of mine and I am personally involved in these discussions.

We will continue to ensure that small businesses in this District, this State and across the U.S. can find the lending partners they need to grow and create jobs.

Thank you and I look forward to your questions.

June 29, 2011

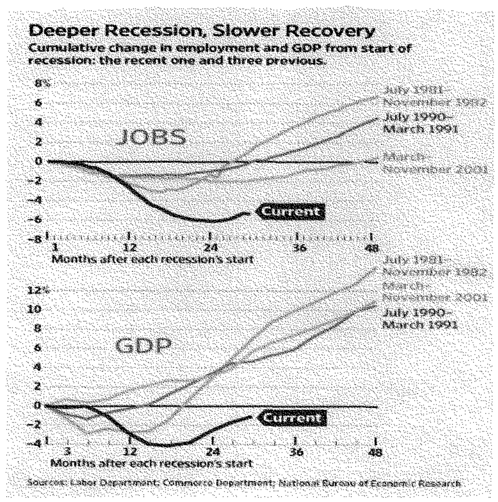
Synopsis for US House of Representatives
Small Business subCommittee

Re Testimony: Banking Crisis in Small Business Lending

The Great Recession of 2008 ended two years ago! The national economy should be in recovery mode for two years now. That is obviously not the case: Unemployment remains painfully high, economic activity is declining, uncertainty abounds. By this time in most recessions we would have a fully recovered economy with jobs aplenty. Something is very wrong. I hope to demonstrate that the nation is in a *second Liquidity Crisis* today whose cause is excessive regulation on banks, especially those banks serving Small Businesses.

Comparison of Economic Recoveries: Anemia, Defined

The following chart is one quarter out of date, but shows the difference between three prior recessions and the current one; it compares job creation and GDP growth. The horizontal axis is "number of months after the recession started." The technical definition for a recovery is two quarters of positive GDP growth (bottom half of chart.) The nation has been in recovery mode for two years but failed to reach pre-recession growth rates.



Following is a slightly different view of the same recession(s); this time we focus on the current and the 1982 – 1984 recovery to identify the state of the economy after two years of recovery in both timeframes.

After Deep Recessions
Quarterly GDP growth, seasonally adjusted on an annual basis

1982		2009	
IV	0.3%	III	1.7%
1983		IV	3.8
I	5.1	**2010**	
II	9.3	I	3.9
III	8.1	II	3.8
IV	8.5	III	2.5
1984		IV	2.3
I	8.0	**2011**	
II	7.1	I	0.4
III	3.9	II	1.3

Sources: Commerce Dept., Bureau of Economic Analysis

The chart at left compares the 1982 recession (left column) to the current one by growth rate in Gross Domestic Product (GDP). The chart is normalized to eight quarters after the end of each recession.

Note that after eight quarters of the current 2009 – 2011 recovery (right column) GDP is an anemic 1.3% growth rate; unemployment is still over 9.1%.

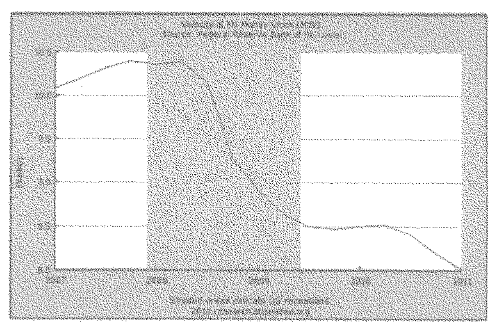
By contrast, the 1982 – 1984 recovery was consistently more robust, reaching GDP growth rate as high as 9.3% and an unemployment rate well below 5%.

By any standard, the current "recovery" is anemic

Federal Reserve Monetary Policy: Velocity Vs Liquidity

How can this be? The Federal Reserve pegged short-term interest rates at effectively zero which is extremely stimulative - one can borrow for almost nothing. The Fed and Treasury completed Quantitative Easing II to provide massive amounts of liquidity to stimulate the economy. This is Keynesian economics on steroids. Classically, vast amounts of cheap money bring strong economic growth and with it, job growth. Yet neither of these truly powerful Monetary Policy tools has worked. Why have these historic, almost infallible tools failed us?

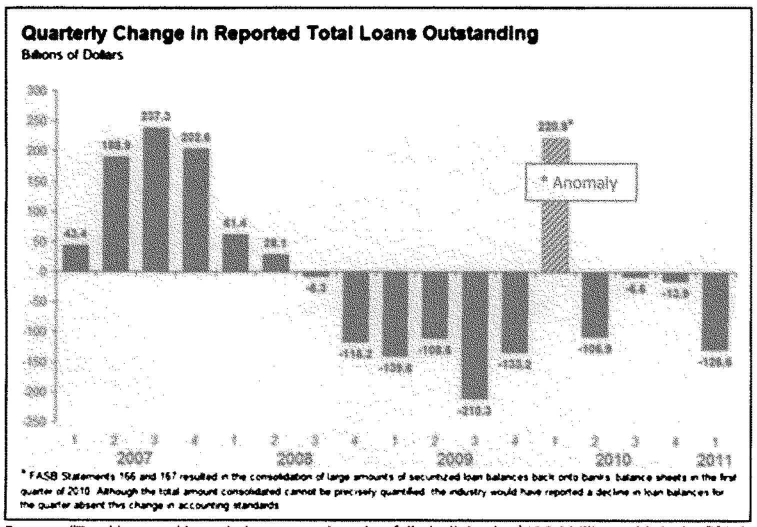
The answer may be in a technical term called Velocity of Money; this term indicates the number of times that money "turns" or is transacted. For instance, money sitting in a bank deposit account, unless the bank lends that money back out, does not improve the economy. Liquidity, as provided by QE II is useless unless that money moves, unless it is transacted. An analogy is that a river can generate electricity because it is moving, a lake cannot.



The chart at right shows Velocity of Money since 2007. The gray area is the 2008-2009 recession. Note the steep decline in Velocity - transactions came to an abrupt halt in early 2008. Note that Velocity has not recovered but is still trending down - two years after the recovery. The number of business transactions continues to decline. In a typical recovery, the chart would demonstrate an increase in Velocity; that is clearly not the case today. The obvious question is why?

Cessation of Bank Lending leads to Economic Malaise

The following graph, assembled by the FDIC (*Quarterly Banking Profile: "Loan Balances Fall by $126.6 Billion")*, proposes the first clue to our nation's economic malaise. Commercial Banking lending is not only declining, loans outstanding are shrinking. This is the underlying reason the Velocity of Money declined so dramatically: Banks are not fulfilling their obligations to assist the economic recovery and therefore small business transactions, expansions and investment are not occurring. No amount of Quantitative Easing will remedy this basic fact. Tools given the Federal Reserve are rendered impotent by this lack of bank lending as demonstrated by the prior two years non-existent recovery.



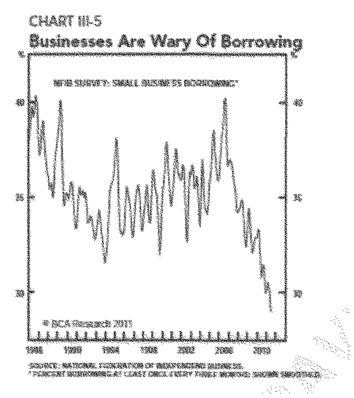
Excerpt: "Total loan and lease balances continued to fall, declining by $126.6 billion. This is the fifth-largest quarterly percentage decline in loan balances in the 28 years for which data are available, and it marks the tenth time in the last eleven quarters that reported loan balances have fallen"

The Second Liquidity Crisis

In spite of massive Federal Reserves Monetary Policy and Liquidity events like TARP, The Stimulus Package, QE I and QE II, the nation fell victim to two *Liquidity Crises* since 2007. The first was caused by Sub-prime home mortgages and the MBS-bonds derived there from.

The second Liquidity Crisis started in mid 2008 when bank regulatory agencies identified those banks that predominantly lend to the Commercial Real Estate (CRE) markets and demanded we immediately increase our "capital ratios." This second liquidity crisis is not recognized by the Federal Reserve, FDIC or OCC; however, as you can see from prior comments and charts, it does exist. Commercial Banks, who serve the Commercial Real Estate market, stopped lending. Our customer and end user is the Small Business person.

The chart at right is a survey of borrowing activity by small businesses prepared by the National Federation of Independent Business (NFIB). Note the peak in 2006 and steady decline in small business loans outstanding.



Further, as evidence of the contagion effect of regulation, even well-performing banks reduced their CRE loans: In Colorado, Commercial Real Estate (CRE) lending declined over $2.7 billion or 27% from March 2008 to March 2011. Of that total reduction in CRE lending, over $1.4 billion or half came from healthy Colorado banks (significantly above 13% Total Risk-Based Capital and within the guidelines for CRE 1 and CRE 2.)

The point is that Federal regulatory actions do impact our state's economy and in a most powerful manner. This effect is magnified because small businesses create over 65% of all new jobs and hold almost half of existing jobs.

The Solution, from a bank at Ground Zero

Bankers and bank regulators all agree that higher levels of capital are safer for the banking system during hard economic times. But there is always a trade-off when regulators enforce new capital rules: Compete cessation of lending to small businesses and the resultant demise of job creation. Instead of creating and sustaining this second Liquidity Crisis, which strikes at the heart of new job creation, regulatory agencies should adhere to Basel rules on bank capital, at least until the current recession is over. **If banks must operate under higher capital levels, then give the banks time to earn our way to higher levels.**

Capital Ratio = Capital / Assets

Banks can increase Capital Ratios in two ways: First, raise new capital (numerator) by diluting existing Shareholders through a new stock offering. Second, reduce the denominator, namely Assets and Loans, by selling loans. Commercial Banks cannot raise new capital because the market for bank capital has been non-existent since 2005. So under duress Commercial Banks did the only other thing we could to comply with regulatory demands for immediate and higher capital ratios: Reduced loans outstanding and make no new loans. We caused the second Liquidity Crisis in which the nation still suffers! If you will remember that Commercial Banks in the Colorado lend predominantly on Commercial Real Estate (CRE) and these borrowers are typically "Mom and Pop shops" or Main Street America, the small business person. Consider that in three short years over $2.7 billion in CRE loans evaporated from the state.

Following are three key issues that prevent Commercial Banks from lending into the Small Business and CRE markets:

1. Capital ratios as defined under Basel are NOT being adhered to by the regulators. The calculation of which provides for the possibility that some banks will have higher concentrations in riskier assets, but nonetheless, regulators have arbitrarily decided that a premium to the Basel capital ratios is at their discretion.
    - Capital Levels are the root cause of the problem and the bat with which regulators bludgeon banks. This is a crude, but effective weapon.

2. Enforcing arbitrary CRE limits, with no adjustments for geographic region, or expertise of the lending staff, dissuaded even healthy lenders from making loans on real estate that supports small businesses.
    - See our study of healthy Colorado banks curtailing lending, attached.
    - CRE 2 ratios are uniform across the nation, with no adjustment for region, business climate or demographics. Denver has the same ratio as Detroit, yet these two economies could not be more different.

3. Regulators unilaterally decided to stop all payments of dividends for the purpose of paying down the banks capital loan. These aggressive actions to stop the reduction in bank capital through dividends has cut off the blood supply to the bank holding company, and dramatically decreased its ability to raise new capital.

I suggest the problem has a solution and would deeply appreciate the opportunity, and the honor, to speak before the House Subcommittee on Small Business.

Jay Davidson
Chairman, CEO, Founder
First American Bancorp
First American State Bank

The stated agenda for this hearing was to list five impediments to lending to small and medium sized businesses from a regulatory perspective, which is quite clear cut and neatly packaged, unfortunately the reality of the current economic environment does not tie up into a very neat package. While regulations are taking a toll on the banking environment in general and lending specifically, there are not simply a set of five regulations that I can easily point to with confidence and state that their removal will fix the problem.

Regulation is certainly an issue with appraisals as affected by FIRREA, Stress Testing which was a directive of the US Treasury, Global cash flow, UCA cash flow testing requirements and new capital levels associated with commercial real estate all have made it difficult to lend. Most of these are guidance rather than regulation, however, for the banker; guidance has become as critical to follow as regulation, without the certainty. Finally, the new regulations that are to come from the Dodd-Frank Legislation and the newly created Consumer Financial Protection Bureau have brought a host of unknowns on top of the current regulatory burden.

FIRREA

FIRREA appraisal standards have created a problem not just with new credits but also with existing credits in conjunction with the real property stress testing that bankers now perform. This regulation in many cases has resulted in capital calls on loans secured by commercial real estate, as the current rents and capitalization rate of the property have been negatively impacted causing a direct devaluation of the properties. While the idea to limit banks exposure to this type of risk is a noble one, unwinding the loan based on the borrower's and guarantor's lack of ability to meet the capital call has been very damaging to the economy. This has led to a number of performing loans becoming foreclosed commercial properties that have been liquidated and in turn brought the broader commercial real estate market down.

The thought process behind this action was to limit speculation on real estate. However, in many instances this has also damaged commercial real estate that is owned by operating companies and used to house their physical plant. While an exemption of $1,000,000 is in FIRREA, many small and most middle market companies would not qualify for the exemption. Therefore, a loan renewal will trigger a new appraisal requirement, if the new appraisal is below the threshold of Loan to Value required by the bank's policies or outside of defined regulatory thresholds, the loan would need to be reduced through a capital call.

Mass media reports of the level of cash held by corporations have been widely discussed over the past two years. While most public companies do have a very strong liquid balance sheet, this is not necessarily true for the small and medium sized firms that make up the bulk of community bank customers, and local employers. Capital calls have been very detrimental to these firms, further stressing the commercial real estate market and in many cases the employment market.

Stress Testing

Stress testing has been a very effective tool to determine the health of commercial real estate loans over the past three years. This has also led most banks to perform annual reviews of all term loans whether they are real estate related or not to determine the overall risk inherent in the portfolio. Identification of the weakest assets of any bank is important, however, it comes with the question of what to do with those assets.

The answer in most cases is to re-margin the asset, requiring additional capital to be brought in and reduce the outstanding balance on the loan. This has happened many times over the past four years and in many instances has been deemed to be the deleveraging that has been so badly needed in our economy.

Theoretically the deleveraging of balance sheets should make the companies much more attractive to banks; this has not been the case in most instances. Unfortunately, while the total leverage of the asset has been reduced, the overall leverage of the project is still at the regulatory maximum, therefore, no additional borrowing capacity has been created; this results in a company that has depleted cash, depleted capital, and the leverage ratio of the company is unchanged. In all, the company is actually weaker. An asset value drop led to a liability drop, and a smaller, less liquid company, which is not a recipe for success.

While this is fundamentally bad for the company, the bank has managed to keep a performing loan that is appropriately leveraged. Should the company not have the resources to reduce the balance of the loan in line with the current market value then the bank has the option of foreclosing on the property, or working with the borrower on a troubled debt restructure. In either case this is a negative for both the company as well as the bank.

From the bank's perspective additional capital will have to be allocated to the loan as its risk rating increases and current income will need to be provided for the potential losses and placed in the loan and lease loss reserve account.

From the borrower's perspective it could easily mean a corporate and a personal bankruptcy which is potentially very damaging to the operating company and its personnel.

Global Cash Flow/UCA Cash Flow

Global cash flow and the increased use of UCA Cash Flow have been touted as additional ways to reduce or identify risk in the bank's portfolios. While I am in general agreement with each of these, they both also have strong negatives attached. Global Cash Flow has no standard at this time and is being done differently in practically every bank. It has been my experience that even Federal and State Examiners show marked differences in the way they treat Global Cash Flow. This is so pervasive that from Examiner to Examiner on the same examination team there can be marked differences in the way this is calculated.

Global Cash Flow is vital to understanding a business but it truly has no industry standard, and one should be developed. This would help the banks and the business owners as well.

UCA Cash Flow is a very good form, and is in fact an industry standard, however, the guidance at this point is to have a standard measure for cash flow leverage. This is again a neat and tidy package that simply does not work in most instances. Cash flow leverage on a retail store, a manufacturer, or wholesale distributor are remarkably different. Industry to industry the rates can also change as well as by the asset/liability structure of the company. Total leverage on a business needs to be completed on a case by case basis and a standard while well meaning serves to limit credit, not risk.

Capital Levels on Commercial Real Estate

Capital levels as they are applied to Commercial Real Estate (CRE) are also a significant drag to lending for small and medium sized businesses. Regulatory Guidance suggests that safe and sound banking practices would limit land and land development loans to 100% of capital with a maximum of 300% of capital for all CRE, inclusive of the land development portfolio.

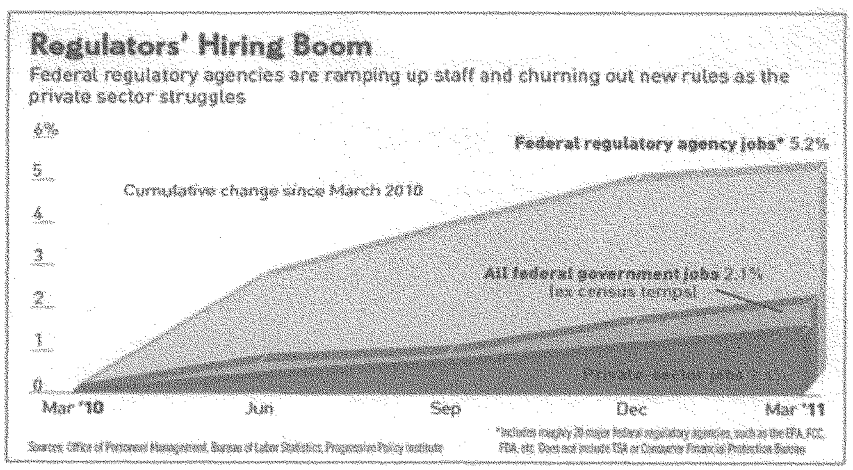
In the Western United States where most banks are dependent on real estate lending to survive, this is difficult. Compounding matters is the definition of CRE. For example, a production facility for oil drilling components, paid for by the sale of the oil drilling components is a real estate loan if the physical plant is used as collateral. While owner occupied real estate has its own definition, it is still included in the leverage ratio, and can effectively reduce a bank's ability to lend.

At the point in time when a bank becomes over leveraged on CRE, there are only two ways out for the bank, raise capital through earnings or the sale of stock or sell performing loans to reduce the numerator. Currently in Colorado there are a number of banks selling loans, as capital is nearly impossible to raise in today's market. Investors are chasing yield therefore they have become a ready market for the purchase of commercial loans as this is viewed as a good way to increase yield over CD's and Treasury Securities. When a bank is selling loans, they are in fact no longer lending at all in most cases and are not a good source of capital for the community.

Regulatory Change

All of the new laws that have been passed will lead to new regulation, and this has been happening at a much quicker pace than at any time in the past. Each new regulation, as it is written will be very expensive for banks to understand and implement. At the current pace of regulation, the regulators are not even sure what each new regulation means, how it will be tested for compliance, and how it will be administered. If Examiners don't understand the requirements of the regulation, the regulated will have great difficulty and expense in complying with these new regulations, not to mention guidance.

In fact, with the new Consumer Financial Protection Bureau and changes from Dodd-Frank, the pace of regulatory hires has increased simply to keep up with the level of new regulation that must be absorbed by the regulators. On the other hand, banks across the country continue to cut staff simply to survive. In the past several weeks more than 9,500 banking jobs have been eliminated at four banks, and additional layoffs at other primarily large banks seems imminent, the common theme has been stated as regulatory burden. This regulatory burden is being shared by new staff at the Federal level and being absorbed by less staff in the banks.



This simple uncertainty has fueled many industry groups over the past several years including Risk Management Associates, Independent Community Banks of America, and The American Bankers Association, not to mention fifty states worth of local industry groups. Information flowing out of these groups to bankers on a daily basis could easily account for two hours per day, just to fully comprehend the information being sent out. Our Nations community bankers cannot spend a quarter of their time simply digesting the changes that Washington is contemplating, but we also cannot afford to ignore it.

Regulation is simply a portion of the lending issue for community banks at this time.

The primary barrier to bank credit currently is a combination of factors, regulatory, economic, and perception of the future from the point of view of the borrowers. From a regulatory perspective the FIRREA, Stress Testing and capital limitations are the primary risk areas for banks and have fundamentally changed the marketing efforts of officers. The economic conditions have made many companies simply too great a risk for a bank to do business with, and finally those that can borrow are facing a very uncertain market making borrowing seem too risky.