IMPROVING CAPITAL ACCESS PROGRAMS WITHIN THE SBA

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

HEARING HELD
MAY 19, 2015

Small Business Committee Document Number 114–011
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PUBLISHING OFFICE

94–650 WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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IMPROVING CAPITAL ACCESS PROGRAMS WITHIN THE SBA

TUESDAY, MAY 19, 2015

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

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Tom Rice [chairman of the subcommittee] presiding.

Present: Representatives Rice, Chabot, Hanna, Huelskamp, Brat, Chu, and Hahn.

Chairman RICE. Good morning. Call to order this meeting of the Subcommittee on Economic Growth, Tax, and Capital Access of the Small Business Committee of May 19, 2015. Thank you all for being with us today. I call this hearing to order.

As a result of the Great Recession, lending to small firms declined, and only recently have we started to see signs of growth. For small businesses, access to capital is often the deciding factor if a business will expand or close its doors. Since the Small Business Administration's creation over 60 years ago, the agency has been tasked to administer programs that help entrepreneurs receive capital. In doing so, the SBA oversees four primary lending programs: The 7(a) Guaranteed Loan Program, the Certified Development Company Loan Program, the Small Business Investment Company Program, and the Microloan Program.

Each of these programs, as we will hear today, serves a unique purpose and aims to fill a gap in the commercial marketplace. Although this is a great oversimplification of the process, the Small Business Administration does not directly provide funds to small businesses through any of these programs. Instead, the Administration guarantees the repayment of credit and the equity issued by private-sector partners. These industry partners are vital to the success of the programs and ensuring that small businesses have access to the capital they need to grow.

Today, we are fortunate to have an industry witness here from each program to shed light on the assistance they provide, and share with us their thoughts on how they can better their respective programs. I look forward to hearing your recommendations, and thank you all for taking the time to be here. I now yield to the Ranking Member for her opening remarks.

Ms. CHU. Thank you so much, Mr. Chair. And I thank all the witnesses for being here today. I have been looking forward to this hearing, especially since I know how valuable your programs are. And today's hearing will provide even greater insight into these access-to-capital programs and what potential improvements could be made to help these initiatives reach their full potential.

Our small business sector is back at the heart of job creation after one of the worst economic downturns in history. Small firms with less than 50 employees have averaged 106,000 new jobs per month for more than a year, and that is a good sign. As the economy continues to strengthen, more entrepreneurs will be seeking capital to start a new venture or expand an existing business. And the Small Business Administration's loan programs fill critical gaps in the lending market for small businesses that cannot access traditional lending sources.

For more than 50 years, the SBA has been assisting America's entrepreneurs and small business owners through a myriad of capital programs, including 7(a), 504/CDC, microloans, and the SBIC Program. Last year, it channeled more than $30 billion in assistance to over 58,000 small firms under these programs. And for 2015, SBA is on track to provide over $25 billion in capital to small businesses.

Each program here fills a distinctive, specific need in the market. The 7(a) Program, SBA's flagship access-to-capital initiative, has made an impressive $19 billion in capital available to small businesses in 2014. This number has continued to improve over the past few years; however, more must be done to encourage lending the small-dollar loans, as well as to increase lending in underserved markets—and particularly for women, minorities, and veterans. Small-dollar loans used to account for 25 percent of all dollars approved, but today, that figure is just 10 percent.

The 504/CDC Program provides long-term, fixed-rate loans to help small businesses obtain key fixed assets to expand or modernize—such as in real estate, land, or equipment. Since 1990, the program has provided $64 billion through more than 120,000 loans. In my home state of California, 504 loans have added over 500,000 jobs to the economy, and benefitted over 20,000 entrepreneurs; however, the program faced challenges during the economic downturn to the nature of real-estate-heavy programs.

Despite these setbacks, the program is recovering, and this year will mark the first time in seven years that SBA has not requested a subsidy. I hope this upward trend continues, and I look forward to learning more about what changes we can make to ensure the 504 Program preserves the 504/CDC Economic Develop mission, and increases its lending volume.

The Microloan Program is unique in that it is designed to provide small-dollar loans, under $50,000, to entrepreneurs that cannot access capital through traditional bank loans—and it is required to provide education and training to its borrowers. And often, these borrowers are women and minority-owned firms.

In 2014, SBA Microloan intermediaries provided nearly $56 million in microloans to small businesses, and created or retained 15,000 jobs. That is a big impact.

Additionally, this year, SBA has requested a 30-percent increase in funding for the Microloan Program, which is expected to support about $75 million in loans to small businesses; however, there are many technical changes that could be made to make the program run more efficiently and allow intermediaries to provide the kind of assistance that borrowers need. And I look forward to hearing more about those changes.

And when small businesses are looking for more than a conventional bank loan but are not yet ready for private equity, they can turn to the Small Business Investment Company Program to fulfill their capital needs. In 1958, Congress created the SBIC Program to fill this lending gap. And last year alone, the program provided over $5 billion to startups and high-growth companies.

The SBIC Program faces its own unique set of challenges, such as limits to the amount of leverages available to them, as well as issues with the licensing process for established firms.

Whether it is a working capital loan, a mortgage, a microloan, or an equity investment, capital is the lifeblood of every small business. Without it, most firms cannot make the improvements or hire the people that they need to succeed. SBA has been there for thousands of small businesses over the years, and it is the responsibility of the Committee to ensure that it continues to operate to its maximum potential.

With this in mind, I am looking forward to hearing from today's witnesses on ways to improving the agency's lending programs. And I would like to thank all the witnesses for being here today.

Thank you, and I yield back.

Chairman RICE. Thank you, Mrs. Chu. If additional members have an opening statement prepared, I ask they be submitted for the record.

I would also like to take a moment to explain the timing lights to you. You each have five minutes to deliver your testimony. The light will start out as green. When you have one minute remaining, it will turn yellow. Finally, it will turn red at the end of your five minutes. I ask that you try to keep it to that time limit, but I will be a little lenient if you need to close, all right?

Our first witness is Rich Bradshaw, who serves as the President of Specialized Lending at United Carolina Bank in Greenville, South Carolina—my home state. Mr. Bradshaw is testifying on behalf of the National Association of Government Guaranteed Lenders (NAGGL). At NAGGL, Mr. Bradshaw chairs the Public Policy Committee, tracking and assessing SBA's current lending initiatives. Previously, Mr. Bradshaw served in the United States Air Force and Navy, and I want to thank you for your service to our country. We look forward to hearing your testimony. Please begin.

STATEMENTS OF RICHARD BRADSHAW, PRESIDENT, SPECIALIZED LENDING, UNITED COMMUNITY BANK; BARBARA VOHRYZEK, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES; BRETT PALMER, PRESIDENT, SMALL BUSINESS INVESTOR ALLIANCE; BRANDON NAPOLI, DIRECTOR OF MICROLENDING, VALLEY ECONOMIC DEVELOPMENT CENTER

STATEMENT OF RICHARD BRADSHAW

Mr. BRADSHAW. Good morning, Chairman Rice, Ranking Member Chu, and distinguished members of this Subcommittee. I am grateful to have this opportunity to testify before you and discuss the impact of the Small Business Administration's 7(a) Program on both lenders and the small business community.

As Chairman Rice said, my name is Rich Bradshaw; United Community Bank. I am the President of Specialized Lending. We are headquartered out of Blairsville, Georgia, and I work out of the regional headquarters in beautiful Greenville, South Carolina—and also representing NAGGL, which is the SBA 7(a) trade association. I have had the unique experience of running SBA divisions at very large national institutions, as well as community banks, and I am also a proud veteran.

Let me give you an example of why I think the 7(a) Program exists. If you were a manufacturer, and you are doing about $3 million in annual revenue, and you have 25 employees, and you are looking to buy a new CNC lathe, it is going to run you about $400,000. Conventional financing—we are going to set the interest rate at six percent. It is typically going to be five years, in terms of the term. Under the SBA, we will have that same interest, but it will be 15 years. The cash flow savings for that borrower will be in excess of $50,000.

Now I know in Washington, $50,000 is not a lot of money, but to a company doing $3 million in revenue, it is all the money in the world. And it allows that owner to focus on margins, and market share, and hiring that next employee, and not being so concerned about making payroll on Friday. And I think that is really the strength of the program.

To put it simply, think about your main streets back home. How difficult is it for your small businesses and your constituents to get these loans in a heavily-regulated environment, especially given the post-2007 era that we find ourselves in. I am sure that you all hear this all the time in your districts.

The 7(a) Program annually supports over 45,000 small businesses. These 45,000 small businesses take their loans, and are able to hire an additional 500,000 people on an annual basis. It is also important to note at this time that the 7(a) Program does not cost the taxpayers anything. It is a very important point.

In addition, since 2010, the program has returned over $500 million to the Treasury. Quite frankly, in the current financial climate, the SBA loan programs are the only game in town for long-term financing on any kind of interest rate or terms that would be accepted to a small business.

So, what is the one thing that Congress can do to help the 7(a) Program run more effectively and touch more small businesses? It is make sure that we do not shut down. It sounds simple, I know, but it is a looming threat we faced last year, and we face again this upcoming year and the year after.

Potential shutdown of the program happens because we constantly lend up to the authorized spending cap. This is a good problem to have. It means small businesses are obtaining capital, and the program is working. But as the bank executive who gets to speak to our Board on the updates on the SBA division, it is very difficult to discuss the running out of funding concept. It is also very difficult to discuss that with our borrowers, and we want and need private institutions' support to reach more small businesses.

And they need to know that Washington is behind them; they need to know that you are behind them.

As members of Congress, you are probably all too familiar with having to explain to constituents the ups and downs of funding in Washington. What I want you to know is that—7(a) lender—I am there with you every day, and I am having to do that, as well, and I know we have that experience in common.

For Fiscal Year 2015, the current authorization is $18.75 billion, but we project finishing Fiscal Year 2015 around $20.5 billion. If Congress does not act now, we will simply stop SBA lending, potentially in the August timeframe.

If you are asking yourself why this program is going so quickly, think back to your constituents back home, and some of the challenges they run in obtaining capital and hearing the word 'no' from the conventional lenders, because it is just too risky for them, and because the profiles of the banks have changed since the 2007 Recession.

What this results in is the boxing out the bulk of small business, in terms of getting and obtaining long-term financing. And if we do not keep running into this problem, it is important to make sure that Fiscal Year '16 is also properly funded. The President's request for the 7(a) Program for '16 was $21 billion. NAGGL forecasts the industry will lend up to $23 billion in Fiscal Year '16. Our ask is that the House and Senate Small Business Committee authorize, with the Appropriations Committee, $23 billion.

I also want to, in closing, make sure that the Committee understands that NAGGL is very focused on the underserved markets. I cochair the Public Policy Program. And in Fiscal Year '12 to '15, African-American lending was up 93 percent. In the same periods for veterans, it was up 88 percent. I have been the leader in terms of growing the initiatives within NAGGL, and have a great committee that we work with really focusing on veteran initiatives.

And with that, I will thank you for letting me speak, and open it up for any questions.

Chairman RICE. Thank you, sir. We will have questions after everybody has testified.

Our next witness is Barbara Vohryzek, who serves as the President and CEO of the National Association of Development Companies, NADCO. NADCO represents SBA-certified development companies and other lenders which deliver SBA loans and financing for small businesses.

Thank you for being here today. You have five minutes, and you may begin.

STATEMENT OF BARBARA VOHRYZEK

Ms. VOHRYZEK. Chairman Rice, Ranking Member Chu, and other distinguished members of the Committee, thank you for inviting me to testify, and I look forward to an exchange of ideas today with you on ways we can work together.

My name is Barbara Vohryzek, and I serve as President and CEO of the National Association of Development Companies, a.k.a. NADCO. And we represent more than 90 percent of the 263 certified development companies, also known as CDCs. These CDCs are mostly nonprofit entities that provide small businesses with the

504 Loan Program, while often also participating in other federal, state, and local economic development programs.

This is familiar territory for me. I founded and ran California Statewide CDC for over 21 years. The 504 Loan Program is a financing tool for economic development, and provides small businesses, as Ranking Chair said, with long-term fixed-rate loans to help them acquire equipment. And so I do not have to restate, which you also said—and I appreciate that—that, last year, we did—since 1990, we have provided $64.3 billion in financing over 120,000 loans.

So, by law—and the reason that we are really here is, we are here to create jobs. And we have to create one job per $65,000, and we have to meet a public policy goal. And we have several.

Economic development is the watchword, though, for many of NADCO's members. While 504 was designed to be the larger SBA loan and have a strong community impact, many CDCs also serve entrepreneurs who need smaller loans through programs such as the SBA's Community Advantage Pilot Program, which provides loans under $250,000, and SBA's Microlending Program, which provides loans under $50,000. Incubators, CDFIs, and EDA revolving-loan funds are all represented by multiple CDCs in our community. And these are just a sample of the broader that is being done by CDCs nationwide; however, it is the 504 Loan Program that unites us all.

The program has had, as was previously mentioned, challenging years, as many others did during the Great Recession. But I am pleased to report, as you all know, that we will be back to zero subsidies, self-funded with no appropriation, October 1st of this year.

I recommend that during the 114th Congress, the Subcommittee focus on several long-term modifications, as well as some immediate fixes to a few current challenges that the industry and the program face.

First, the 504 Program lacks definition. It is SBA's Economic Development Loan Program, and CDCs are economic development entities. However, no definition is currently in statute or regulation for the economic development or CDC. I recommend that we work together, as we have been doing with SBA, to formalize these and other definitions, so that there are clear metrics for the program to fulfill its mission.

Second on the list of long-term program modifications, I recommend that the successful debt refinancing with the 504 Loan Program be restarted permanently. This temporary refinance program made available to small businesses precious working capital, which otherwise would have been spent on either high interest rates or—worse yet—balloon payments. This request is quite timely, as well. Over 4,000 small-balance, commercial, mortgage-backed security loans will mature in the next three years. Borrowers will need to refinance out of what is being called the wall of maturities; yet, many banks that handled small-balance loans prior to the financial crisis are no longer in the market or in business. This is a gap for small businesses that could be filled by this debt refinancing program.

Third and finally, the franchise agreements review process needs to be addressed. NADCO recommends that SBA adopt procedures to streamline the review and approval of franchise and license agreements.

While these long-term challenges will strengthen the 504 Program for future small-business borrowers, several pressing matters are preventing CDCs from best serving their communities today.

The first is that of adequate levels of staffing at SBA. Recent retirements and other departures mean that a single SBA staff member may be handling the work of two, three, or even more personnel. This scarcity slows our ability to support small business entrepreneurs seeking 504 loans, and increases the concern and lack of confidence within the small business and banking community about our ability to deliver loans in a timely fashion. We hope this Subcommittee advocates for adequate resources for the budget and appropriations process for SBA to manage this situation.

The other challenge which concerns the industry—and is taking me over five—is a move by some in Congress to institute fair-value accounting. If the small business community is consulted on these budgetary changes, I urge you to oppose them.

Thank you again for the opportunity to share NADCO's thoughts, and I look forward to your questions and a vibrant discussion about America's entrepreneurs.

Chairman RICE. Thank you. Our next witness is Brett Palmer, who serves as the President of the Small Business Investor Alliance. The SBIA is a national organization of lower-middle-market funds and investors, primarily small business investment companies whose members provide capital to small businesses.

Welcome, Mr. Palmer. You may begin.

STATEMENT OF BRETT PALMER

Mr. PALMER. Good morning, Chairman Rice, Ranking Member Chu, and members of the House Small Business Subcommittee on Economic Growth, Tax, and Capital Access. Thank you for holding this hearing today to examine the effectiveness of the capital access programs, including the Small Business Investment Company Debenture Program. The Small Business Investor Alliance represents investors in domestic small business, including nearly all of the SBICs.

I would like to make several points with my testimony. First, the SBIC Program is an effective and important program for enhancing access to capital for domestic small businesses.

Second, the SBIC Program works primarily because at its core is a market-driven effort that serves the public by growing domestic small business and does so while operating a zero subsidy. Legislation to increase the family of funds limit is the most important issue faces us today, and we encourage you to pass it immediately. The cosponsors of the bill, many of whom are here today, thank you for supporting HR 10–23. Its passage will ensure that the best small business investors will continue to invest and grow domestic small businesses.

Improvements can be made to the SBIC Program, because it is operating in a way that is certainly adequate, but there is a lot of room for improvement. And more improvement can help us serve more small businesses and more people in this country.

The SBIC Program exists because, structurally, what was true in 1958 is still true today. It is much harder for small businesses to access capital than it is for their larger brethren. That will always be true.

The SBIC Program helps mitigate this. It will never replace that problem and fix that problem entirely, but it helps significantly. The importance of SBIC capital was made abundantly clear in the financial crisis and the recession that followed. While most financial institutions were cutting off capital to small business and recalling loans, SBICs were throttling up and filling the capital void.

Demand for capital from SBICs has grown dramatically since the financial crisis and continues to grow. From Fiscal Year 2011 to present, SBICs have made $17 billion in investments in about 5,500 small businesses in nearly every state. This activity saved businesses and grew jobs.

In 2004, the SBIC Program had only about $5 billion in assets. Today, it has grown to over $21 billion. Not only did the Debenture Program not take losses during the time of economic turmoil, it ran a small surplus. In the face of economic calamity, this program worked both for small businesses and the taxpayers. This growth is not driven by government directive, but by the market needs of small businesses and the opportunities being recognized by private investors.

These investments do create jobs—and lots of them. A recent Pepperdine study found that private-equity-backed businesses grew jobs at a rate 257 percent faster than the economy at large. We need more of that. With the continued support of Congress, the administration, and the private sector, this program will continue to grow, and serve more small businesses, and create more jobs.

The program works differently than many other programs. To become an SBIC, a potential SBIC must pass two important filters—and they are both critical. The first one is the private market filter. If the private sector will not trust a fund manager with their manager, why should the SBA? It should not. But if they are able to raise that private capital, then they must survive a rigorous licensing process that the SBA runs, and many applicants cannot get through this process. Only about 25 percent of the funds that first approach the SBA about forming an SBIC are able to get through the process.

Assuming they are able to get through the private sector filter and get through the government filter, they are able to access an SBA-backed credit facility—able to lever the fund at a 2:1 ratio. So, what that does is, it takes $50 million in private capital and turns it into $150 million of small business capital at no cost to the taxpayer.

Unlike many other government programs that I know of, there is no guarantee on any of the individual investments. In fact, the private sector is at first-loss position for all the investments. SBA guarantees the investors and the credit facility, but not the SBIC or its individual investment. This means that there is 100-percent private sector skin in the game, and in the interests of the private sector and the public, protections are aligned. This is a key reason why the Debenture Program has gone so many years, running at a small surplus and maintaining a zero subsidy.

The family of funds limit is important to us in this program because the family of funds limit only limits successful small business investors. The only funds that can hit the limit are funds that have repeatedly come back as SBIC funds in raising private capital money and going for the licensing process. Underperforming funds cannot hit this limit, because they cannot raise another fund. We ask that you pass HR 10–23 to raise this limit, to make sure that the successful small business investors can continue to do so.

There are a number of improvements that the program needs. There are a lot of good things that are happening, but there are some improvements, too, that are needed. The licensing process is extremely slow and it is expensive. We have testified for years, the licensing process blocks qualified applicants, and unnecessarily limits diversity in the program—both geographic and other diversity forms. We ask for your help in pushing the SBA to reform its licensing process, and speeding it up, and making it less expensive.

In summary, the SBIC Program is working—and working well. Raising the family of funds limit will increase small business investing, and help many small businesses grow and access more capital. An SBI needs more operational oversight to help make data reforms.

And with that, I turn back the floor and be open to any questions you might have.

Chairman RICE. Thank you, Mr. Palmer.

I yield to Ranking Member Chu to introduce her witness.

Ms. CHU. It is my pleasure to introduce Mr. Brandon Napoli, who is joining us today all the way from Van Nuys, California—Southern California—my area. Mr. Napoli serves as the Director of Microlending for Valley Economic Development Center—or the VEDC—and is here to testify about his experience with the SBA Microloan Program. VEDC is an SBA Microloan intermediary, and it was named one of the top 10 SBA intermediaries in the country, approving over $1 million in microloans for 2014.

Prior to joining VEDC, Mr. Napoli served as a Community Loan Program Officer at the CDC Small Business Finance in San Diego, California. He is a graduate of Point Loma Nazarene University and San Diego State University.

Welcome, Mr. Napoli.

STATEMENT OF BRANDON NAPOLI

Mr. NAPOLI. Chairman Rice, and Ranking Member Chu, and members of the Subcommittee, thank you for the opportunity to submit testimony about a crucial component of a vital American business community.

My name is Brandon Napoli. I am the Director of Microlending at VEDC, located in Los Angeles. We are one of the nation's largest SBA microlenders. We provide real money to real people, creating real jobs.

Microlending is foundational to the economy, and VEDC is committed to helping entrepreneurs like Maria Martir secure microloans to foster healthy, sustainable community. Ms. Martir had saved $40,000 to launch a business, but her request for a $10,000 loan was declined by local, traditional lenders, because there was no outside collateral or existing cash flow. Ms. Martir turned to VEDC, who offers access to capital, as well as free technical assistance, for entrepreneurs unable to secure traditional bank financing.

Three years after receiving a $10,000 loan and help with writing her business plan, Ms. Martir's De Todo Un Poquito Café—A Little Everything—has expanded next door, hired on her four children, and is now looking to expand elsewhere.

Her experience illustrates what we in the industry have known from years of experience: Hands-on technical assistance, coupled with need-based financing, greatly increases a small business's chance of success.

Microlending reaches entrepreneurs who are outside the economic mainstream, who are very much a part of the economic fabric of this country. Ms. Martir's café is one of 25 million businesses—or 88 percent of all business—in the United States considered a micro-business—a business with five or fewer employees and less than $50,000 in startup capital. These businesses generate $2.4 trillion in receipts, account for 17 percent of U.S. GDP, and employ more than 31 million Americans.

Micro-businesses are everywhere—the farmer at the Saturday Market, the trucker who works those long hours on the road, the contractor who built your home, the beauty salon or barber shop, your favorite neighborhood restaurant that you always want them to commercialize the barbecue sauce, and the miniature golf course you worked at as a kid. Think of the business you frequent, and I am sure that you encounter many micro-businesses you call your own.

Ms. Martir's De Todo Un Poquito Café and other microloan businesses could not do what they do without the support they get from SBA Microloan intermediaries, such as VEDC. Since 1998, VEDC has lent over $11 million and 1,000 SBA microloans. Thankfully, there are many others like VEDC around the country. For example, the Economic and Community Development Institute in Ohio that provide a one-stop shop where a business owner can secure flexible financing, as well as individual business assistance throughout the life of a loan.

The proposed Fiscal Year 2016 budget provides continued opportunities for American entrepreneurs to start their own business and become successful, independent, and self-reliant. To keep the American dream a reality for millions of micro-businesses, Congress needs to increase the effective investment it has made in SBA Microloan from $24.8 million to $28.3 million, and make the programmatic changes suggested by the current intermediary micro-lenders.

Increasing lending and easing some of the SBA Microloan Program restrictions will help to further the American dream, one microloan business at a time. Since the Microloan Program was authorized in 1991, intermediary lenders have borrowed over $414 million, of which they have been able to lend $629 million to small businesses that help create or retain 185,000 jobs at the cost to the federal government of around $2,000 per job.

During this time—and since launch of the SBA Microloan Program—intermediaries have realized that several well-intentioned policies now serve as barriers to gains and efficiencies. The most restrictive barrier is the statutory restraint of utilizing 75 percent of the technical assistance post-funding and only 25 percent prefunding.

As Ms. Martir and the majority of micro-enterprises, the need for intense technical assistance before receiving financing ensures that the small business is loan-ready.

In closing, every day, VEDC and microloan lenders across America seed hardworking people like Ms. Martir who want to and can build businesses, create jobs, and strengthen communities. The greatest investment we can make is in people who create jobs. The returns go far beyond dollars paid back.

Thank you for this opportunity to share Ms. Martir's and the industry's story, and I look forward to your continuing support of the programs designed to promote job creation, especially those with proven track records, such as the Microloan Program at SBA.

Chairman RICE. Thank you, Mr. Napoli. I have a lot of questions for you, but I want to start out by saying that, in my opinion, there is nothing more important than American competitiveness and jobs. We cannot have a strong country without a strong economy, and I think you guys are on the frontline, and I cannot thank you enough for what you do—providing access to capital. I think that is one of the foundations, one of the bricks in the foundation of the prosperity of this country. And I am so impressed listening to how you perform your duties and how you grow jobs in this country.

I have so many questions with respect to what areas—where are the gaps here that are not being filled? You know, you have microloans. You have the 7(a) loans. You have the CDC/SBIC. Who is falling through the cracks here? It sounds like you have got the small business area pretty well-covered. Are there broad classes that are not being covered? Mr. Palmer, I will start with you.

Mr. PALMER. Sure. I think that one of the classes that has not been covered and not really discovered is the early-stage equity side—and a lot of businesses to start up that are smaller businesses, that are not necessarily tech and biotech in Silicon Valley, really do have a real challenge in figuring out how to get, you know, early-stage equity investing when you are not cash flowing, and you are not going to be cash flowing in the very near-term, to, you know, pay an interest payment on a debt structure. So, I think that is an area that really is lacking in the economy right now.

Chairman RICE. Mrs. Vohryzek, you said something that intrigued me earlier. You said we need to restart the refinance program—and why did you say that?

Ms. VOHRYZEK. There are a couple of reasons, but the large reason coming is what is known as the wall of maturities. So, these small-balance loans that were done prior to the recession—a lot of small businesses are in these pools and these mortgage-backed securities. And so as they mature and they come out of the pool, then the houses—the larger investment houses—do not do loans under $2.5 million. And so there is all of these owner/user small business types coming out of that, having to come up with other financial instruments.

Chairman RICE. So, there were commercial lenders that made these loans before the financial crisis.

Ms. VOHRYZEK. They were actually pooled loans. So, Wall Street firms would typically be involved. Some of them—I mean, you know, Chase is in the room, and they act on both sides. So, you have a lot of banks that also have investment houses, as well.

Chairman RICE. Here is my question: You know, certainly things were out of hand before the financial crisis, and certainly there needed to be some additional safeguards. But have we snapped back so far that we have taken lenders out of the market that were previously providing this financing? And can the SBA ever—because I do not think they can—can they ever respond to that demand?

Ms. VOHRYZEK. Oh, boy. I am not sure—I am trying to understand the question. For some reason, I was kind of caught with the walls of maturity, thinking of these coming out. The comment we made—and I made—about "as these loans come to market"—as you know, the shrinkage in the number of community banks that are now alive and well, versus who they were back in '07, '08—we have had a shrinkage in numbers of community banks. And very often, the borrowers would look to their community bank to refinance. Those would be where they would typically go.

Chairman RICE. I agree that we have had a huge shrinkage. Mr. Bradshaw, I am going to turn to you. I agree we have had a large shrinkage in community banks, and I think a lot of that is because we have snapped back too far with regulation. And what I am concerned with—Mr. Bradshaw, do you think the SBA can ever fill that niche completely, or do you think we need to expand, do what we can to ease the regulation on community banks and get them back in the market?

Mr. BRADSHAW. I think the answer is probably yes on both sides—meaning, can SBA fill the gap? Yes. Can it fill it all the way? No, but the combination of SBA and a combination of less regulation can get us a long way there.

Chairman RICE. Mr. Palmer?

Mr. PALMER. The private sector can fill a lot of gaps that we cannot. And the SBA is really meant to fill areas where the private sector cannot fill the gap, but where there is a public policy need. The banks, particularly the smaller banks, are feeling all sorts of pressure that really is hindering their lending. They are not something that we compete with. We actually augment a lot of the banks. But I think that is an area—certainly, there is need for regulation; do not get me wrong. But I do think that the banks that I talk to—and I hear from anecdotally—feel there is a lot of pressure that is hindering them from doing small business lending that they otherwise would do.

Chairman RICE. Mr. Napoli, I do not know that this is really in your area of expertise, but I want to ask you the same question.

Mr. NAPOLI. Can you repeat the question?

Chairman RICE. My time is expired. Thank you very much. I will yield to Mrs. Chu for her question.

Ms. CHU. Well, thank you. And I feel the same as Chairman Rice, in terms of all that you are doing for the small business community, in providing them the access to capital. And I am intrigued by your recommendations for improvement.

And I will start with you, Ms. Vohryzek. Last week, I introduced the CREED Act, which would reinstate SBA's 504 Refinancing Program. The President has supported this initiative in his budget. The SBA Administrator has spoken favorably of the program, and the Senate has marked up their version of the CREED Act with bipartisan support from the Chairman and Ranking Member. Do you believe the reauthorization of the 504 Refinancing Program would be beneficial for the small business economy? And simply that while we were already in the recovery period—but can you tell us why right now actually is an optimal time to restart the Debt Refinancing Program?

Ms. VOHRYZEK. Well, first of all, let me thank you for introducing the CREED Act. The industry is very thankful for that. I think it is a good time. I mentioned the walls of maturities that is coming up, and that would be an opportunity to help small businesses that are coming out of that, looking for alternative financing by providing them with refinancing under the 504 Program.

I also believe that the 504 Program is a very efficient way to refinance, and I think it is good for the banks. And I will tell you why. When you refinance a 504—a situation where it is a 504 refi—the bank may be involved, and they continue to be involved. So, they are not taken out by another bank. So, it is an opportunity for many banks—and, often, community banks—to keep their customer, and then we do the second mortgage, because our loan is always in companion with the first mortgage lender. This is a relationship that the lender has, and we are coming in to accommodate them up to a 90-percent loan-to-value, which—Chairman Rice, I apologize. I think I now understand your question, and I guess what I would echo in here—but also state that I think that I am a Director of community bank, and I would say that the guarantee, whether it is a 504 second mortgage or a 7(a), allows us to do loans that we otherwise would not be able to do. So, it is absolutely a critical product—particularly now, with all of the regulation that has fallen on the smaller banks, we are looking for opportunities.

I am sorry, Ranking Member; I wanted to get back to your question. But there is a great need out there for the ability to take advantage of the low rates. We see it across the board in housing right now so homeowners can lower their rate. And in many different cases, it is allowing them to get the working capital, when we speak about small businesses, for growth. And that was alluded to. Mr. Bradshaw alluded to the need for working capital, and how businesses—that $50,000 that was saved on that $400,000 equipment loan.

When we refi, and you look at the cost savings, and you bring them into a low-cost interest—the first mortgage will be lower. Our second mortgage will be a lower interest rate. The savings over time provides that business the opportunity to invest in jobs, inventory, and growth.

Ms. CHU. Okay. Well, thank you. Mr. Napoli, I was impressed by the success of the Microloan Program. And you emphasized this issue regarding technical assistance, this requirement that only 25 percent can be used prior to the loan. Why do you believe that this should be changed?

Mr. NAPOLI. Thank you for the question. Since the creation of the program back in '91, a lot has changed. Micro-lenders are now not just micro-lenders; they also offer other types of technical assistance, or an SBA 7(a) loan, a 504 loan. A lot of times, a client comes in, and through that SBA technical assistance, we find that there might be a better fit for another product. And so we only give them the pre-loan technical assistance.

Another thing is, a lot of times when a client comes to us, they do not have a money problem at first; they have an idea problem. And so to be able to frontload a lot more technical assistance in the frontend, and deal with that idea problem—like creating a business plan, or helping them with lease negotiation, or working with marketing—instead of trying to get them through the process quickly, and get them a loan, so then we can give them more technical assistance—will allow us to be able to really foster that time with the client before they just get the loan and go forward.

Overall, just more flexibility and technical assistance would allow the intermediary—which was proven over the last 20 years—that they are able to serve the clients with customized technical assistance in their local communities.

Ms. CHU. And also, intermediaries are limited to no more than 25-percent contracting out, and you think that this should be changed. Why is that?

Mr. NAPOLI. That is correct. Right now, the SBA says that we can only use 25 percent of our TA dollars for contractors, and that poses two limitations. The first is, it is hard to recruit talent outside of my staff. So, if I need to get a CPA, or a lawyer, or someone that has specific technical experience, overall, I am limited to 25 percent of my money being used for those contractors.

Additionally, if I want to expand in the local markets, and I want to have somewhat of a local presence there, again, I am limited by the fact that I can only do that with 25 percent of my dollars.

Ms. CHU. Thank you. I yield back.

Chairman RICE. Now I yield to the Chairman of the full Committee, Mr. Chabot.

Mr. CHABOT. Thank you, Mr. Chairman, and let me begin by thanking you, Mr. Chairman, and the Ranking Member, Ms. Chu, and the other members for attending this hearing—and especially the witnesses for being here today.

I think we all know that access to capital is one of the most critical challenges that is faced by small businesses in today's environment. It has been the case in the past; probably will be in the future. But it is really important, and so addressing this in this hearing, I think, is quite important. So, thank you.

I just have two questions. And, first of all, Mr. Palmer, I will begin with you, if I can. I recently introduced HR 10–23, the Small Business Investment Company Capital Act of 2015, which would increase the amount of capital available to small businesses by raising the family of funds cap from $225 million to $350 million. Do you have any data on the effect that this would have on small business lending—and just anything you would like to say about that legislation, we would be happy to hear.

Mr. PALMER. Well, Chairman Chabot, thank you first and foremost for your support of that legislation and your leadership in this

Committee. I would also like to thank Congressman Hanna and Congresswoman Chu, who are cosponsors of that bill.

We have a number of funds that are slamming into that ceiling, and there are a number of funds that are going to hit the ceiling that may not apparent that they are going to hit it yet. They know it, but it is not necessarily showing them the data, because they are long-term investors. So, their current fund—they may not be at the limit, but as they are planning their next fund, they know they are going to slam into it, and they are considering whether or not they are going to do a small business fund.

So, I think that once this gets up and running, I think it will be an increase of between $500 and $750 million a year in small business investing. Marketing conditions will dictate that, but that is a significant increase in small business capital that is out there at zero cost to the taxpayer.

Mr. CHABOT. Okay, thank you very much. And my second question, Mr. Bradshaw, I would like to go to you, if I can. Thank you, first of all, for your service to our country. I greatly appreciate that.

I am planning to introduce a bill shortly that would statutorily eliminate the origination fees on 7(a) loans, the express loans to veterans. As you know, SBA is already doing this through the Administrator's discretion, at no cost to taxpayers. Can you discuss the 7(a) Expense Loan Program, and how this fee waiver benefits veteran entrepreneurs?

Mr. BRADSHAW. Sure, and thank you for the support of this, Chairman Chabot. Veterans are my passion. And just for the Committee, I brought our brochure that we do. I know it is a long way to see, but we do this, and we work together as a committee with NAGGL. We compete with each other every day, and so we are always trying to, you know, take deals away from each other. In terms of veterans, we actually share our marketing ideas, and we work together. We electronically send things like this around. Speaking with some of you before—last time I sent this around, I had a person call me and said, "I really, really like this. Is it all right if I copy it?" I said, "Absolutely, but you may want to change the phone number."

So, thank you for the support of the veterans. I have been representing NAGGL—very vocal on that from day one, because several years ago, one of the biggest initiatives of SBA was the veteran push. And I was always, "Well, if we have a veteran push, should not we reduce the fees?" And we take this very seriously in NAGGL and in the institution I run. The fees have really made a difference. Sometimes, it is momentum. It has been very recent. This year has been the biggest year in my institution.

Mr. CHABOT. Thank you very much, and I yield back the balance of my time.

Chairman RICE. I recognize the gentlelady from California, Ms. Hahn.

Ms. HAHN. Thank you for all of your testimony.

You are supporting our small businesses, helping our economy, getting people hired. It really is so critical. And I appreciated all your testimony this morning.

Last August, I held a roundtable with a lot of local women business owners in a waffle shop in San Pedro. It was a great morning, and while I am always impressed to hear, like, the 7(a) Program were up in lending, I think, for loans under $150,000 up by 23 percent. I mean, we are hearing all these great stories about how more capital is getting to our small businesses. But I got to tell you, almost every one of those women owners that came that morning, you know, continued to complain a little bit about always being denied by banks for some of these 7(a) loans.

And still, probably one of the biggest complaints I get from my small businesses in my district is still difficulty—there is a disconnect on getting some of this capital to our small businesses.

So, I was going to ask Mr. Bradshaw, do you have a sense of what are some of the reasons that lenders decide that a small business is not worth the risk? What would those be, and how can we maybe fix that?

Mr. BRADSHAW. I think the challenge when people look at a small business conventionally—probably the biggest challenge is collateral. So, that is probably number one.

And then number two is, traditional, conventional lending has shorter terms. And those shorter terms do not allow the loan to meet bank debt service requirements, because it is just a shorter term. You are thinking about buying a car in five years versus ten years; the financials do not work for the company to do it on five years, where they would on ten years.

And I think those are the biggest impediments.

Ms. HAHN. Do any of the other witnesses have any comment on why you think some of our small business—particularly our women-owned—many women-owned businesses sometimes fall through that crack that we were talking about, of being, you know, not a good risk?

Ms. VOHRYZEK. Well, I would say it is a bit out of my wheelhouse as representing the 504 industry, although a number of our members do a great deal of technical assistance.

I think that the reality of banking these days is that they simply do not have the time to invest in what needs to happen with a small business in order to make them capital-ready. Mr. Napoli actually brought up a very good point I was applauding over on my side that much of the work needs to happen before the loan.

And so there are networks, like the SBDC network SCORE, that can help borrowers—and including the micro-lending network and community advantage network that actually work more intensively, I would say. I do not know the women you met with, but I would probably, you know, speak with them about, you know, where they are on the capital readiness. And you are really looking at the continuum of capital readiness sitting at the table. But I think a lot of it is how they are queuing it up—you know, meaning how they put together their request for funding, and whether they qualify for conventional. And then as you go to SBA, there is obviously a greater tolerance for no collateral or high loan-to-value situations. But a lot of small entrepreneurs and businesses, they simply need hands-on in order for them to be able to get to the capital point.

Ms. HAHN. Right. Thank you. And, Mr. Napoli, I would follow up with what you were talking about—how you offer this kind of assistance helping writing business plans, finding ways to finance businesses that have been considered unbankable. Do you believe that model could also be expanded to assist small businesses that are being denied these 7(a) loans, so that they could also get this kind of financing?

Mr. NAPOLI. Absolutely. And to go back to your original question, I know over 60 percent of my portfolio is made up by women and minority. So, I think what microloans do very well is actually reach out to those communities, and allow them to feel welcomed into the process.

And one of the things is the technical assistance that we do provide, from a gamut of different services that could completely be relevant to more upstream 7(a) lending, as well.

What I find is, borrowers are very competent at making widgets or doing exactly what they do to know. But they do have blind spots. I even have my own MBA, and as I was discussing yesterday, I would be frightened to start my own business because I did not do so well in my accounting class. And so I think, you know, when we are talking to business owners at any level, technical assistance is something that is absolutely necessary for them to become more successful.

Ms. HAHN. Thank you. Mr. Chairman, I yield back.

Chairman RICE. I now yield to the very learned Chairman of the Contracting and Workforce Subcommittee, Mr. Hanna.

Mr. HANNA. Hey, thanks. Mr. Napoli, changing the 75/25 rule, I want to ask Mr. Bradshaw about Dodd-Frank, and commercial banking, and how that has changed the nature of—and you mentioned mortgage-backed securities, the wall of loans. I mean, if you never pay anybody back, basically you never default—which is—I am concerned about the wall of loans.

But, Mr. Napoli, how would you recapture that money if you were to change this or eliminate it all together? Because what you say makes perfect sense—that people need a lot of technical assistance. They have a great idea, but no basic skill set to do this. What would that look like, though, and what would it cost? Because, basically, you are upfronting money before you make a loan, and you may decide otherwise. So, how do you navigate that?

Mr. NAPOLI. That is a great question. I think one way you honestly navigate it is through looking at, obviously, the portfolio's performance of what we have already done, and trusting in these microloan intermediaries that they are going to make the right decisions from the years of experience. And, also, you incentivize them to continue to stay loan-centric in their lending, so they are not just offering technical assistance.

Mr. HANNA. So, what you are saying is that we should allow the subjective nature of the process and the people in the know to take advantage of their knowledge, their interaction with people, and give them more latitude in that ratio of 25/75 and TA assistance.

Mr. NAPOLI. That is correct.

Mr. HANNA. Thank you. That is helpful, because I believe that makes sense to me. I just do not know what it would cost. Mr. Bradshaw, talk to me, if you can, because you have mentioned a couple times about commercial banks, and how they have changed, and how they have walked away a little bit—that is my words.

How did that play out, and why did it make what you are doing more important?

Mr. BRADSHAW. I think, as we are all aware, with the recession—and part of the recession that came was, banks became more conservative; credit became tighter to get. In addition, we became a little more heavily regulated. And you mentioned Dodd-Frank; that has been part of it. And it has not just been—in addition to someone looking over our shoulders, there has been a real cost associated with that, too—meaning you have to hire more compliance officers, you have to have more bank security officers. There has been a real cost associated with that. And I think that has just continued to add to tightening the credit market. And one aspect that does help from this, from the SBA standpoint, is, the SBA loans take less capital. And so by applying SBA loans, banks can take advantage of that attribute—that they are not using as much capital, and they are not running into the capital requirements under Dodd-Frank and other regulatory requirements.

Mr. HANNA. Everybody here has referenced the fact uniformly that the default rate is really, really low, which makes you feel good about the process, and it makes people want to raise the limit, because—what the hell—there is no associated risk, right? We know that is not true, because there has to be. And I could answer the question, why have a limit at all? But could you talk to me about this mortgage wall or this lending wall, Ms. Vohryzek? Because it is interesting to me, because implicit in that is that there are people who will default if they are pushed up against that wall without the extension. Is that fair?

Ms. VOHRYZEK. What would happen, just for the sake of this discussion—let us say you have an owner/user small business borrower in there that was financed through one of these security pools, and they are coming out with a $2 million balloon. And it is very tough to finance a $2 million balloon payment. Basically, you are looking to refi, so you are coming into the commercial market or the SBA market, saying, "I need to refinance this $2 million balloon."

Mr. HANNA. And how long have they been in business, do you think?

Ms. VOHRYZEK. You know, that would require that I would know what was sitting in those mortgage-backed pools back in '05, '04. You know, I would imagine that if they got into the pool in the first place, my guess would be that they were a relatively seasoned business, because in the pooling process, they would be vetting if it were a known user——

Mr. HANNA. Thank you. That is helpful. So, if they are a relatively seasoned business, they took out a balloon mortgage, which can be foolish on its face, right? They knew that. They are facing that. They are a relatively mature business. What do they need with us?

Ms. VOHRYZEK. What was available to them in '05—let us say, for instance, they were financed in '05. They are upside-down on that commercial building in Brooklyn. Well, maybe not Brooklyn. Maybe they are upside-down in that commercial building in Oklahoma City or, you know, wherever things flipped. And California was one of them, but we are recovering. So, their loan-to-value is compromised—or they are at 90 percent if they try to get $2 million, whereas under a normal amortization, they may have been at 70, which would be financeable pretty easily through the banking markets. But 90 is absolutely an SBA product.

And so I want to differentiate. In SBA lending, under our program, the 504, we are looking to provide working capital—free up working capital for these businesses to grow. And in the case of refinance, this is so that they have the funds in order to expand their business and not be taken down by the inability to get a 90-percent loan-to-value. We are not looking at businesses that if they had the financing available would default. We are looking at a market gap. And so these could be healthy businesses coming out, but they are still at a high loan-to-value.

Mr. HANNA. Thank you. That clarifies everything for me—because, really, you are not trying to push out the inevitable; what you are trying to do is help people who inevitably will succeed, in your view.

Ms. VOHRYZEK. And to remember that there have been many times in our history in lending where balloon payments were absolutely the market. When I first started in the '80s, five-year miniperms was kind of a standard on commercial product, and it then stretched to ten. Even to get banks to go to 10 years, given capital requirements and liquidity issues—10 years can be tough. So, it just depends where we are in the market in lending.

Mr. HANNA. My time is way over. I thank the Chairman for indulgence. Thank you.

Ms. VOHRYZEK. Oh, I apologize.

Mr. HANNA. Oh, no, it is my fault. Thanks.

Chairman RICE. I want to just ask a couple more questions. Mrs. Vohryzek, this wall of refis is just a curious thing. Is a part of that because the capacity of lending has declined? You know, we are hearing there are fewer community banks today than there were eight years ago. And there is also, for the first time in seven years, there has been less business startups than there have been businesses going out of business. And I am not sure that those things are not very closely related, because access to capital is one of the keys to our competitiveness.

So, what I am asking you—because I am concerned that the SBA, although you are doing great work, can never fill the void—that commercial lending is going to have to be where this solution is found—do you think it is because of lack of capacity? Has the pendulum swung too far, and are we regulating these community banks out of business, and, therefore, we have this wall of refis coming that presents this big problem?

Ms. VOHRYZEK. I think that things have swung quite to the opposite direction, as has been mentioned several times. It is costly to run a bank now—I do not care if you are large or small—with all the regulations. And, really, you know, things that are in place that they want to avoid another disaster—I understand why they are there. But, as you said, the swing is quite strong. Can SBA fill the gap?

When you are looking at programs—at least three of the four here—that are paying for themselves through zero appropriation, it is a heck of a deal for the taxpayer and for our communities, as we are at zero subsidy.

And so, yes, we are filling a really important gap. And as you have seen in the 7(a) program, the growth is there. And in 504, you know, we have been a little challenged, and we will come back roaring. But, you know, we have had times right now that our volume is not as high as it could be. But we still are zero subsidy. And so we fill a gap, and we fill a gap at no cost to the taxpayer. And so for that reason, I would say that we can grow, and we can be important to fill what you are speaking about.

Chairman RICE. Mr. Palmer?

Mr. PALMER. I guess what I would add to that is, you know, Dodd-Frank existed because we clearly had gotten, you know, overboard, and there were real problems that had to be addressed. But one of the challenges of a Dodd-Frank is that it does not scale. You know, if the big banks are screaming about the costs and the regulatory compliance problems, the little guys—it is 10 times worse. We are seeing that in the private equity space, as well, where the big private equity funds can deal with all this SEC compliance, and the little one are getting creamed.

I mean, you know, with all good legislation, you have to go back and review it. I think if that ever does get reviewed, I think it is worthwhile to look at the scaling challenges of the smaller lenders and the smaller investors, versus the largest, as far as how they can handle the compliance costs on the backend.

Chairman RICE. I think community banks should be exempted, but that is just my opinion. Mr. Bradshaw?

Mr. BRADSHAW. I like that, sir. And to your point, Chairman Rice, I mean, my institution is a large community bank, and we are just under $10 billion. And in Dodd-Frank, going over $10 billion, there becomes essentially a regulatory tax. And so you do not go to $11 billion; you go from just under $10 to $14 or $15, because you have to pay for that additional cost. You just do not go right over it. And so, you know, it is a very real thing in our world.

Chairman RICE. Yeah, I have spoken to community banker after community banker. Community bankers have come in here. The owner of the only minority-owned bank in Washington, D.C. was in here last year, saying that if we cannot find some relief for him, that Dodd-Frank will put him out of business. And I hear that over and over again, and access to capital is just so incredibly important. I worry that we really need to go back and review some of that. I yield to Mrs. Chu, if you have any additional questions.

Ms. CHU. I do. Thank you, Mr. Chair. Mr. Bradshaw, last year, the 7(a) Program faced a funding shortfall, and Congress had to include a billion-dollar allocation for the program in the continue resolution to prevent the program from shutting down.

For 2015, the 7(a) Lending Program is potentially facing another shutdown in a few months if loans continue to follow these projections. How critical is it for Congress to appropriate and authorize adequate funding for the program? And what would be a real-life example of what consequences would be if there is a potential shutdown of the program?

Mr. BRADSHAW. Thank you, Congresswoman Chu. Yes, we feel that the program will run out of money this year. We talked about in my testimony that within—probably in August. And what that would mean in terms of real life is, you could have a customer that you are working with. They are acquiring a business, or a piece of real estate, or both. They have a purchase-to-sale agreement, so they have committed hard money to this purchase-to-sale agreement, and we cannot process their loan, because we have run out of money with the SBA.

Ms. CHU. Thank you. Mr. Palmer, I certainly heartily support the idea of lifting the cap from $225 million to $350 million. And I understand there is also another issue, which has to do with the licensing of the family of funds, and that it is taking longer and longer. Could you talk about that issue and what needs to be done?

Mr. PALMER. Sure. Thank you very much. The licensing process for the SBIC Program is for the frontline of taxpayer protection, in that they are making sure that only qualified people are getting through, and those standards need to be high.

However, the licensing process is really long, and this administration actually did a very good job for several years getting that licensing process down to about five months. The official numbers are around nine or ten months. That does not include a month of the magic mailroom, where the documents do not get processed and some other stuff. So, it really is running over a year for repeat licensees.

And for a repeat licensee, you are talking about someone who has raised the private capital, gotten licensed with the SBA, invested successfully, gone out to the market again several years later, raised private capital, has been compliant, and then it is taking them another year—potentially even longer than it did the first time. That does not make any sense.

And so they have got a process that the standards need to be high, but it has got this multitiered process that really can be consolidated, and sped up, and maintaining taxpayer protections that, really, right now is causing people's, you know, vein in their forehead to pop out, out of frustration, but it is also slowing things down, adding costs, and there really is not any benefit to it. We would really like to get that reformed, and I think probably the SBA would, too. They just kind of need a little push to make it happen.

Ms. CHU. And it makes total sense to differentiate the repeat licensee versus the new one.

Mr. PALMER. And I think there is an added benefit to that, too—because if you put your resources to the first-time funds that are really more unknown, it gives you more opportunity to reach out to geographies that you have not touched before or that you have not done the outreach for. It also lets you do a deeper dive on the backgrounds of the people that are coming in, so you can get more diversity of fund managers that are coming in—because, right now, you know, they are treating everyone exactly the same, even if you have been on your fourth or fifth license. And dedicating those resources there, where you really have a whole new generation of, you know, investment managers, and women, and minorities, and doing different strategies. They cannot get the time of day, because they are not in such a tight band. And I do not think that helps the program or the country at large.

Ms. CHU. Mm-hmm. Mr. Napoli, you had a third reform that you were discussing, which is this 1/55th rule. And the SBA has requested to adjust this cap for the 1/55th rule in the 2016 budget request. Can you tell us what this is, and what you think the adjustment should be on this?

Mr. NAPOLI. Yeah. So, currently, there is a rule called the 1/55th rule. And what it means is that the amount of funding for lending for SBA micro intermediaries is divided equally between 55 states and territories. That is the case, even when several of those territories or states do not even have an intermediary actually located there—or, a lot of times, they do not even need that much actual lending capital, but other intermediaries do.

And so what happens for the first two quarters or six months of the federal year, funds are just sitting at the SBA until they are able to open up to these other intermediaries in other states that actually have a demand that has been waiting for the last six months.

What it can look like is just actually look at eliminating that all together, and allow for those intermediaries that actually have demand to show that, and for the SBA to make loans that are targeted to those intermediaries that make sense for the demand that they have.

Ms. CHU. Thank you. And if I could ask another question—it is about the SBA requesting a 30-percent increase in funding for the microloan intermediary lending authority, which would be expected to support about $75 million in loans to small business. Do you think this increase is enough for the level of demand that you encounter?

Mr. NAPOLI. Well, as I stated, you know, 88 percent of small businesses fall under micro. It is a huge amount of businesses. But I also know that that is a completely digestible demand that we can meet this next year. So, yes, absolutely, that is something I think that we can—I can come back in a year from now, and show the amount of jobs created, the fact that we have gotten the money out, made quality loans, and then the next year, pose the exact same good problem to have.

Ms. CHU. Thank you. I yield back.

Chairman RICE. Mr. Hanna?

Mr. HANNA. Does anybody—Mr. Bradshaw, Mr. Palmer—we have a situation which I think Chairman Rice rightly identified, and that is, this kind of dragnet thing that Dodd-Frank did caught up a lot of commercial banks that were doing just fine, added millions to their cost of doing overhead in small communities, limited their—increased their overhead, limited their ability to make local loans, and do the things that you four do so well.

And I saw you nod your head, Mr. Bradshaw. You would eliminate, at some point—maybe on a sliding scale—the requirement for commercial banks to fall under some of those rules or those—how would you change that? What would you do differently?

Mr. BRADSHAW. Well, I am going to respectfully agree with Chairman Rice. I like the thought process of looking at the community banks first. And if you look at—we announced an acquisition about 30 days ago of a $1.3-billion bank, and in the press release, the CEO of that bank said one of the reasons he was selling was because the regulatory pressures were just too hard on it.

Mr. HANNA. Yeah. Well, I guess what I am suggesting implicitly—and Mr. Palmer or anybody—is that in doing that, we actually made it more necessary for the SBA to do all those things, because we interrupted the marketplace in a place that arguably maybe we did not need to or did not need to do as much as we did.

So, the whole nature of loans from commercial banks has become more strict, more difficult, more onerous for people to go to. So, therefore, you have more need for what you all do, which it is good that you are filling the need, but maybe we can work up the food chain and down the food chain.

Mr. BRADSHAW. I would like to comment that, you know, in a commercial loan environment, you do have a credit approval process. And I can tell you that the credit officers have not forgotten about 2007 and 2008. So, I do not know that all the additional regulation is necessary in that regard.

Mr. HANNA. Mr. Palmer?

Mr. PALMER. Well, the growth in the SBICs has been driven by a couple things, but one of which is just the awareness of the SBIC Pogram. And, frankly, it has been run well. It really had some struggles before the financial crisis, just from management issues and very few licenses were getting out there.

So, as the SBIC product has become normalized, they have partnered with a lot of banks, which they had done before to a certain degree, but not to the extent they do. So, they are backfilling and allowing banks to do lending that they otherwise could not do, because they are often coming in with subordinated debt where the bank comes in with the senior, but the condition of the business itself would not otherwise be eligible for a loan. So, you know, they go hand-in-glove.

But to your point, I do think we need a healthy banking structure generally, and let the banks, you know, operate in an appropriate and prudent way to fill the market needs. And then where the gaps are, where public policy should be applied, let it be applied.

Mr. HANNA. Sure. And if they are not allowed to assume any risk, then there is more and more demand on what you all do.

Mr. PALMER. Well, the challenge—there is a real perception, whether fair or unfair, in the market that risk is trying to be, you know, really stripped of every investment and every loan in the universe. And without a downside risk, there can be no upside risk. And I think at some point, we need to, you know, establish, what is the appropriate level of risk we are willing to live with as a society?

Mr. HANNA. Mr. Napoli, you could probably speak to that better than anybody here, since you do microloans. Do you think a lot of people could be successful that just do not fill the bill for you? Do you think, like, there are opportunities out there that take greater associated risk for microloans, and ultimately grow what it is you are out there growing as businesses, and create jobs, and all of that?

Mr. NAPOLI. Absolutely. As I said before, one thing micro-lending does is definitely address the minority and women-owned markets better than any other lending tool. But one of the trends I see right now is the increase of younger entrepreneurs that is not being addressed by the market—talking about, you know, people coming out of college, even young 30s. And a lot of times, these are held down by the amount of student loans they have. It is a huge factor. But I think that is one thing that we could definitely target and do a much better job.

Mr. HANNA. Thank you. My time has expired again. Thank you, Chairman.

Chairman RICE. That was a great hearing. Thank you all for participating today. I truly appreciate you taking time out of your hectic schedules to provide the Committee with suggestions for improving SBA's lending programs. These ideas will be instructive as the Committee works to ensure small firms have access to capital which is vital to their success, and necessary for the United States's continued economic growth.

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

Without objection, so ordered. The hearing is now adjourned.

[Whereupon, at 11:20 a.m., the Subcommittee was adjourned.]

APPENDIX

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

TESTIMONY OF

Rich Bradshaw
President, Specialized Lending
United Community Bank
Greenville, South Carolina

BEFORE THE

House Committee on Small Business Subcommittee
on Economic Growth, Tax and Capital Access
May 19, 2015

Chairman Rice, Ranking Member Chu, and distinguished Members of this Subcommittee, I am grateful to have this opportunity to testify before you to discuss the impact of the Small Business Administration's 7(a) loan program for both the lending and small business communities.

I wear many hats as I testify this morning—the lender who has worked at both a large, national bank and in my current position at a community bank; the member from NAGGL, the national trade association for 7(a) lenders; and a proud veteran. I hope that all of these perspectives that I bring to the table will help create a productive conversation with this Subcommittee about the strengths, the challenges, and some of the possible misperceptions about the 7(a) loan program.

The 7(a) program annually supports over 45,000 small businesses and over 500,000 jobs with partnership from more than 2,600 participating private-sector lenders. And we do all of this at no cost to the taxpayer. In fact, in many years, the program's subsidy rate has been reestimated down the road to be far less than originally estimated, resulting in over $530 million returned to the Treasury since FY 2010.

The 7(a) borrower is a small business that cannot find the same terms in the conventional market because the banking industry, continues to remain cautious with its capital and heavily regulated in this post-Recession, post-Dodd-Frank environment. The bulk of conventional loans are made for 3-year terms of less. This means that the majority of small businesses who typically need long-term, competitively priced loans can only find these terms through the SBA loan programs, which offer loans up to a term of 25 years, with average terms for the 7(a) program of 16 years.

In a Basel III world, banks avoid tying up their deposit base in long-term loans. A larger, short-term deposit base is meant to keep the bank afloat in the event of a recession, allowing the institutions to stay nimble enough to shrink their loan portfolio when necessary. For any bank to tie up a significant portion of their deposits in long-term loans would be a funding mismatch and regulators would raise red flags. The 7(a) loan program provides a way for banks to make these long-term loans that, in today's financial climate, are virtually impossible to obtain by small businesses conventionally. Simultaneously, borrowers are just coming out of the shadow's of the Recession, dramatically increasing the pool of 7(a) applicants. It is no wonder that annual new loan originations have grown from $16 billion in FY13 to what industry anticipates will be $23 billion in new loan originations in FY16.

Therefore, the single-most pressing issue that threatens the 7(a) program year in and year out is constantly hitting the lending cap set by Congress. On the one hand, this is a good problem to have—it means that the program is growing beyond what Congress expected and that the program's private sector lenders are pumping more and more loans out into the small business economy than ever before. In fact, the program volume in dollars increased on average 22% ahead of last fiscal year as of the first week of May. On the other hand, it means that like last year, the program is once again facing a potential eleventh hour threat of shutting down in this fiscal year and potentially not receiving enough room to grow in FY 2016.

If there is one thing that Congress can do to help the 7(a) program run more effectively and serve more small businesses, it is to make sure that the authorizing committees and the appropriations committees in both the House and Senate work together every fiscal year to set a cap for the program that gives the portfolio enough room to grow without the looming fear of shutting down. The consequences of not setting an appropriate cap are dire for the program.

Washington stop-and-go funding patterns are a complete mismatch for how the rest of the world operates outside the beltway. Small business owners and lenders alike need assurance that the 7(a) program will be a reliable resource. The 7(a) loan goes to small businesses that incorporate this capital into their business models months in advance for new hires or long-term expansion plans. Quite simply, the small business and lending communities will stop turning to the 7(a) program as an answer to capital access if they feel its existence is uncertain. Believe me—this issue is difficult to explain to the board of directors of a community bank. In addition, participating lenders diligently watch the volume of the program and their anticipated pipelines, and if it seems the program will come close to the authorized cap at the end of the fiscal year, lenders will start to change lending behavior as early as June. If the most important thing in finance is market fears and perceptions, the always precarious nature of the 7(a) authorization is undoubtedly the weakest part of the program.

For Fiscal Year 2016, the President's budget request for the 7(a) program was $21 billion. NAGGL is anticipating that the 7(a) program will actually lend about $23 billion in FY16. We are asking that the House and Senate Small Business Committees work together with their respective Appropriations Committees to give the program what it needs to simply allow for the natural increase in small business lending, a trend I know this committee would strongly applaud. I understand and respect Congress' need to justify every dollar spent. But Congress cannot encourage small business lending on the one hand, and yet on the other hand, keep the lenders and borrowers in constant fear of shutdown for simply robustly participating.

Even more pressing is the potential authorization shortfalls this fiscal year. For the past three fiscal years, loan volume in dollars has on average increased by 27% in the second half of the fiscal year from the first half of the fiscal year. And I am confident that trend will remain true for FY 2015, putting us easily at around $23 billion gross and $20.5 billion net, if not more. While that level of lending is encouraging, it is also disastrous since the industry only has $18.75 billion in authorization from Congress. That is akin to giving a car with no brakes a full tank of gas but only giving it a little bit of road. What is the car supposed to do when it runs out of road?

Last year, in FY14, we had this same funding shortfall and Congress included a $1 billion anomaly in the Continuing Resolution in September 2014 to save the program from shutting down. And we certainly would have shut down without that additional authorization—the 7(a) program made loans totaling $19.2 billion gross and $17.7 billion net, given an original $17.5 billion in authorization. That net figure would have been even greater had the additional funding come earlier than the last week of the fiscal year since lenders begin to change their lending behavior at least four months in advance of the end of the fiscal year. I know personally that many lenders slowed down their own lending early last fiscal year in anticipation of a shutdown. No lender wants to tell a small business borrower that its loan was delayed. In real world terms, that means the small business can't make those additional hires or has to find a way to stall construction on a new expansion. That is the opposite direction we want the small business economy to be moving toward.

We hope that either Congress or the SBA can work with us to address this looming issue for FY15. Otherwise, the program could shut down and the 7(a) program's reputation as a reliable resource for small businesses will be damaged. And more importantly, small businesses will not receive the access to capital they so badly need in this economic climate.

As a lender, I can tell you that most people do not understand the 7(a) loan program. This program is not a subsidy for small businesses—it's a loan made with a private financial institution to small businesses that are paid back in full and treated as any other conventional market loan. The program is the very essence of a public-private partnership, allowing government to stand out of the way of what banks know how to do best.

Perhaps the most critical part of the program to highlight is that I know for a fact that without the 7(a) program, the loans I make would never be made. That does not mean the small businesses receiving a 7(a) loan are failing or unable to repay their loans. Many believe that a mission statement of helping small businesses find capital that they could not find elsewhere means that these small businesses are somehow subprime—that is false. These small businesses are not subprime; rather, the current conventional market is unavailable to satisfy the majority of small business needs. As lenders participating in the SBA programs, we have to abide by many parameters, including making sure the borrower is in sound financial health and credit worthy. As bankers, we never want to see a risky loan on our books to open us up to potential losses or criticism from our regulators. The 7(a) program ensures we have skin in the game with the lender standing to lose 25%–50% of the loan in the event of default, as well as heavy oversight measures that would affect our reputation as financial institutions.

As an active part of NAGGL, I co-chair the association's Public Policy Committee, which focuses solely on the public policy goals of the 7(a) program. The 7(a) program is inherently connected to a larger mission—to lend to small businesses that cannot find credit elsewhere. Over the years, this has come to mean not only small businesses that cannot find a conventional loan, but also underserved markets and minority populations. This public policy portion of the program is a critical mission for NAGGL and the 7(a) industry, and we have already begun the task of creatively addressing the gap in lending to certain demographics. Veterans and African-Americans are two of the most underserved populations within the SBA lending programs. It is important to note, according to SBA's weekly lending statistics as of the first week in May, when comparing May 2015 to May 2012 year to date, 7(a) lending to African-Americans has increased by 93%. Similarly, when comparing May 2015 to May 2012 year to date, lending to veterans has increased by 88%. Let me caveat this good news with some sobering reality—these increases are augmented by the fact that the pool for each of these underserved demographics is so small in the first place. These are steps in the right direction, but we have much more we can do as lenders.

In response to this, the 7(a) lending industry is reaching out into the communities to attack this challenge in a personal, hands-on way. For example, the SBA and the industry have learned over the years that it is not a matter of lenders not choosing minority borrowers. Rather, it is a matter of minority borrowers not being credit ready and aware of SBA opportunities. In response to this educational need, NAGGL recently partnered with the SBA to create an entrepreneurial education toolkit for minority communities that will be translated into Spanish and taught through faith-based and local community organizations. This educational initiative, called the "Business Smart Toolkit," is being rolled out this year. I'm looking forward to seeing the results of this terrific partnership.

Additionally, NAGGL has been crisscrossing the country to honor minority small business borrowers who have received a 7(a) loan and subsequently revitalized their neighborhoods. During Black History Month of this year, NAGGL hosted an event to honor James Hamlin, an African-American entrepreneur in Baltimore on Pennsylvania Avenue, the epicenter of the most recent protests have been centered. With the help of a 7(a) loan, Mr. Hamlin opened The Avenue Bakery and turned around a small corner of his community that is currently under the microscope of the world when it comes to underserved segments of the population that have been left behind. Mr. Hamlin's bakery was spared from any recent violence that occurred in the city and he is a beacon of hope when it comes to how we communicate with younger generations about how to make a better life. Mr. Hamlin will also tell you that at the end of the day, struggles in minority communities are all about economics. We hope that the 7(a) loan is a way to inject these underserved markets with the power of economic sustainability and success.

As a veteran, I acutely see the challenges we're facing in the portfolio to lend to veterans, as well as other underserved markets, in a very personal way. I feel compelled to be a part of the answer to help the SBA loan programs become more accessible to minorities. As a young man, I attended the Air Force Academy and subsequently served five years active duty in the Air Force. Following my service, I entered the Naval Reserve and for sixteen years working in Naval Intelligence, until finally retiring in 2005. Now, in a new chapter of life, for the last two years I have served on Senator Lindsey Graham's Academy selection boards, interviewing prospective applicants.

One of the most rewarding parts about my alternate life as a banker is that in the SBA 7(a) program, I actually have the rare ability to merge my two worlds and help veterans achieve economic empowerment when they return from the battlefield. I helped create and chair NAGGL's Operations Veterans Access Subcommittee focused on bringing veterans into the 7(a) program. I was encouraged by so many of my peers committing to NAGGL that they would increase lending to veterans by 5% over the course of the coming year, but we need to do more. Some of my favorite moments of my job is seeing that a loan on my desk is going to a veteran and calling them up personally to thank them for their service. Now, as the industry continues to hone in on underserved markets like veterans, I hope that those calls become more and more frequent.

Once again, thank you for this opportunity to testify. I'm encouraged by being here today that Congress and industry can work closely together to address some of the program's challenges and encourage our strengths. I look forward to discussing the 7(a) program more with you and happy to take your questions.

Representative Rice, Representative Chu, and other distinguished members of the committee: Thank you for inviting me to testify before the subcommittee. I know you all share the goal that I do, which is to ensure American small businesses have the access to capital necessary to grow and, in doing so, help their local communities flourish. I look forward to the exchange of ideas today on ways we can work together towards that vision.

My name is Barbara A. Vohryzek and I serve as President and CEO of the National Association of Development Companies, or as we're commonly known, NADCO. In that role, I represent more than 90% of the Certified Development Companies in the country. These Certified Development Companies, or CDCs, are mostly non-profit entities that execute the financing for SBA's 504 loan program, while often also participating in other federal, state, and local economic development programs, including the SBA Microloan program and the SBA Community Advantage Loans program. This is familiar territory to me—I founded and ran California Statewide CDC for over 21 years.

The 504 loan program is a financing tool for economic development that provides small businesses with long-term, fixed-rate loans to help them acquire major fixed assets for expansion or modernization of their businesses. These loans are most frequently used to acquire land, buildings, machinery, or equipment. Eligibility for 504 loans is linked to job creation. By law, each $65,000 in financing must create or sustain one job, or meet one of several public policy goals. Our loans are closely linked with our local government and local communities so we can help them grow. A loan which includes a 504 guarantee portion can be over $13 million, which allows the CDC community to contribute to impactful economic development work.

The 504 loan program had challenging years during the economic downturn. As a real estate-heavy program, it experienced losses and, in directly tracking with the real estate market, took a while to recover. I am pleased to report though that this October, it is back to being self-funded with no appropriation, as it had been since the program went to self-funding in FY1996. Now that we are on firm footing, we must turn to where the 504 program and the CDC industry must go next.

I recommend that during the 114th Congress, the subcommittee focus on several long term modifications as well as make some immediate fixes to a few current challenges that the CDC industry and the 504 loan program face.

First, the 504 loan program lacks definition. It is SBA's economic development loan program and CDCs are economic development entities. However, no definition exists in statute or regulation for "economic development" or for "CDC." I recommend that we work together, as we have already started to with SBA, to formalize these definitions so that there are clear metrics for this program to fulfill its mission and be respectful stewards of the taxpayer's guarantee. This will be an opportunity for us to delve into many important topics, such as making the Community Advantage loan program permanent and increasing outreach to minority borrowers.

Second, I recommend that the successful debt refinancing with a 504 loan program, a program that was in place several years ago, be restarted permanently. When this program was active from mid-2011 through September 2012, the peak of the economic downturn, more than 2,300 small businesses refinanced over $5 billion in capital. This returned to their business the many tens of thousands of dollars a year previously spent on high interest rates or saved them from balloon loans. Small businesses who participated in the refi program were required to reinvest the savings in their businesses, creating jobs and opportunity for them and into the wider community. SBA estimates that this program would operate at a zero subsidy cost, so no appropriation, if restarted. In fact, this year's subsidy reestimates for the programs show that existing refis have operated at a negative subsidy rate, meaning that they have actually made money for the government. A program with such a strong track record should be available again to our small businesses.

This request is timely as well over 4,000 small balance commercial mortgage-backed security loans will mature in the next 3 years. Most of these borrowers will need to refinance yet many banks that handled small balance loans prior to the financial crisis are no longer in the market or no longer in business. This will be a gap for small business owners which must be filled. Refinancing these conventional loans with the 504 loan program can do that.

Third, last year the committee introduced H.R. 5600, which clarified SBA franchise and affiliation rules. NADCO would welcome passage of a similar bill to address this confusing issue.

While these long term changes will strengthen the 504 program for future small business borrowers, several pressing matters are preventing CDCs from best serving their communities today. Most timely is a recent SBA procedural notice which states, for the first time in the program's history, that the Anti-Deficiency Act prevents 504 loans with open-ended indemnities from closing without onerous waivers, costly attorney fees, and many hours of red tape for small business owners and CDCs. When this unprecedented policy was first issued, NADCO surveyed our members and discovered that a billion dollars in financing had been delayed or canceled from this change. And that was only as of October 31, 2014. More perplexing yet, this policy was issued despite the fact that, according to the SBA, not one single loan has caused any loss of taxpayer dollars due to this issue. While fixing this problem is within SBA's regulatory authority, the Agency has not, as of yet, found a solution that is workable for small businesses. I hope we have the opportunity to discuss this complex issue during your questions. There is no issue more critical in the 504 program and, in my opinion, in the government lending arena, since it seems that this policy logically extends to the many other SBA and federal government loan and guarantee programs that have real estate as collateral.

A final challenge that the CDC industry faces is a challenge that I know is shared by many of the other SBA partners—that of adequate levels of SBA staffing. Recent retirements and other departures mean that a single SBA staff member may now cover portfolios previously managed by 2, 3, or even more staff members. This result of this change is both a slowing of our ability to support small business entrepreneurs seeking SBA 504 loans, and an increasing concern and lack of confidence within the business community about our ability to deliver 504 loans in a timely fashion. Our small business borrowers deserve to have access to capital that is unconstrained by the vacancy of these SBA positions that are so critical to our ability to deliver this high value loan program. We hope this subcommittee provides adequate resources through the budget and appropriations process to hire and train strong SBA employees.

Thank you again for the opportunity to share NADCO's thoughts. I look forward to your questions.

SBIA
SMALL BUSINESS
INVESTOR ALLIANCE

Hearing on Improving Capital Access Programs within the SBA
U.S. House Small Business Committee
Subcommittee on Economic Growth, Tax & Capital Access
May 19, 2015

Testimony by Brett Palmer, President, Small Business Investor Alliance
On behalf of the Small Business Investor Alliance
www.SBIA.org

Good morning Chairman Rice, Ranking Member Chu, and Members of the House Small Business Subcommittee on Economic Growth, Tax & Capital Access.

Thank you for holding this hearing today to examine the effectiveness of the Small Business Administration's capital access programs, including the Small Business Investment Company (SBIC) program. The Small Business Investor Alliance (SBIA) represents investors in domestic small businesses, including nearly all active SBICs. The SBIC program is an effective and important program for enhancing access to capital for domestic small businesses. On behalf of our Members, I appreciate this opportunity to appear today to provide our views and recommendations to the Subcommittee.

My testimony will cover three areas:

- The SBIC program is a market-driven effort that serves an important public purpose of facilitating investment in domestic small businesses while operating at a zero subsidy.
- Legislation to increase the Family of Funds limit is the most important issue and should be passed immediately.
- Improvements can be made to ensure the SBIC program is operating more efficiently.

SBICs Provide a Critical Source of Capital for Small Businesses

The SBIC program was created by the Small Business Investment Act of 1958 to "improve and stimulate the national economy…by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply."[1]

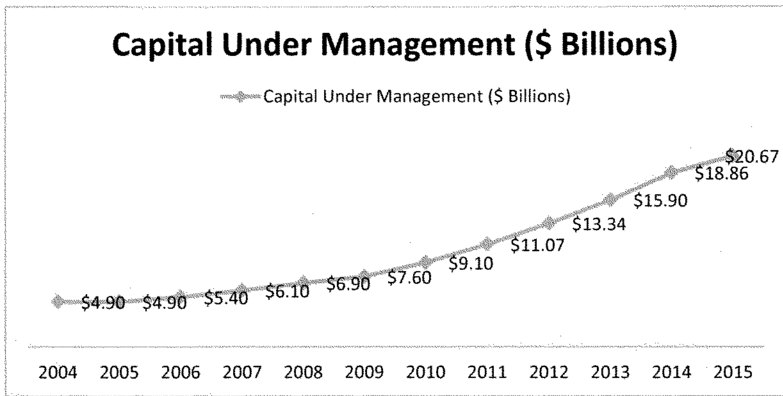
What was true in 1958, when the SBIC program was created, is still true today. It is much harder for small businesses to access capital than it is for larger businesses. This is particularly true for accessing patient capital – capital that is not called back at a moment's notice – that is available for helping businesses survive and thrive in the face of the unexpected bumps in the road.

The importance of SBIC capital was abundantly clear in the financial crisis and the recession that followed. While most financial institutions were cutting off capital to small businesses and recalling loans, SBICs were throttling up and filling the capital void. Demand for capital from SBICs has grown dramatically since the financial crisis and continues to grow. This growth is not driven by government directive, but by the market needs of small businesses and the opportunities being recognized by private investors. It is important to note that the SBIC program has facilitated record amounts of private capital into SBICs and, in turn, into the small business economy. From Fiscal Years 2011-Present, SBICs have made $17 billion in investments in over 5,400 small businesses in almost every state. In 2004, the SBIC debenture program had $4.9 billion

[1] Public Law 85-699, as amended

in assets under management, growing to currently over $20.67 billion. With the continued support of Congress, the Administration, and the private sector, this program will help grow more small businesses than ever before.

SBIC Debenture Program: Total Capital by Fiscal Year



Since the creation of the SBIC program, SBICs have invested more than $73.3 billion in over 118,000 domestic small businesses. In Fiscal Year 2014, SBICs invested $5.46 billion in businesses that employ approximately 113,000 workers across the U.S. SBIC backing is important because private equity funds, and SBICs especially, are important to job creation. According to a 2012 Pepperdine University study, private equity-backed establishments generated 129 percent more revenue growth and 257 percent more employment growth than their non-private equity counterparts. According to the National Center for the Middle Market, employment prospects for smaller businesses entering 2015 continue to be robust with job creation projections greater than four percent.

The SBIC Program is a Market-Driven Program That Increases Small Business Investment

The SBIC program is effectively a market-driven money multiplier for the small business economy – increasing the amount of capital available for small business investment. The SBIC program helps fill the gap created by all the scale and reputational biases against smaller businesses. What makes this program so effective and so distinct is that the private sector leads and the SBA leverage follows to enhance the impact of the private investment.

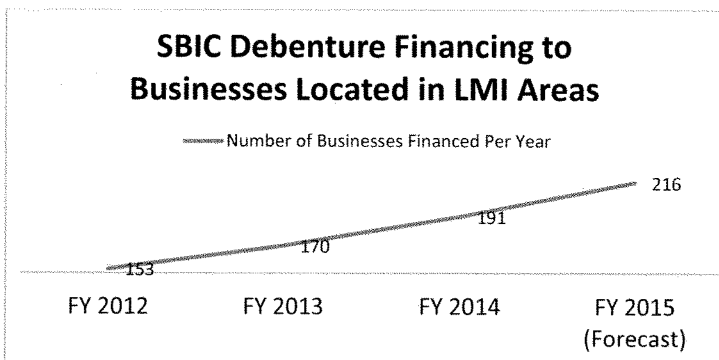
The way the program works is private capital is raised by proven small business investors first. If investors cannot pass this market filter, they are unable to obtain an SBIC license. Once investors have successfully raised private capital, the next step is an extensive background and performance check before qualifying for an SBIC license. While the exact number varies from year to year; in general, only about 25% of the fund managers initially seeking an SBIC license are able to qualify for one. Proven investors that succeed in obtaining a SBIC license are able to enhance the amount of capital available for small business investing by up to two times the amount of private capital raised with SBA-backed leverage. For example, if a group of small business investors raises $50 million (from pension funds or other accredited and institutional investors) and receives an SBIC license, it can then access a credit facility that unlocks an additional $100 million for small business investment. The SBIC program effectively triples the amount of investment capital available – 100% of which will go to domestic small businesses

Some of the SBIC-backed small businesses have since grown into icons of American free enterprise including Apple, Intel, Callaway Golf, and many others. There are also thousands of other fantastic SBIC-backed businesses that are lesser known, but are mainstays of local economies – some of which will grow to be the industry leaders for the next generation. There are currently 195 debenture SBICs nationwide, many in places where traditional private equity funds do not have a significant presence, such as Arkansas, Ohio, Louisiana, and Tennessee. Most private equity investments (51 percent) are concentrated in 15 U.S. counties. While over 75 percent of SBIC investments fall outside those top 15 U.S. counties according to the Fiscal Year 2013 SBIC Annual Report.[2]

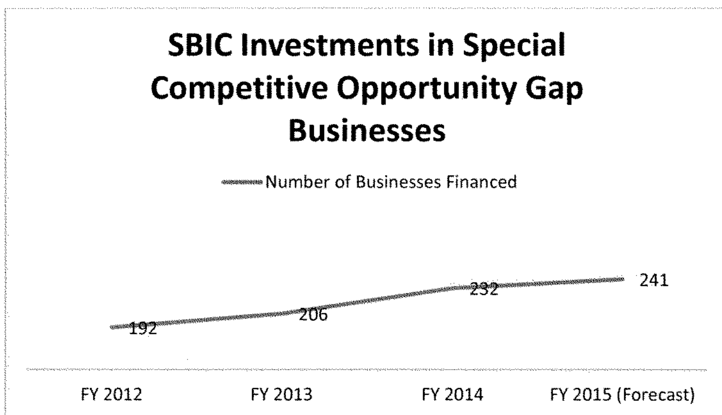
[2] Small Business Investment Company Program, Annual Report for Fiscal Year Ending September 30, 2013 at 17. *Available at:* https://www.sba.gov/sites/default/files/files/Final_SBIC_Annual_Report_FY_2013_signed_06092014.pdf

Total Small Business Investment Companies
Investments by State (FY 2010-2014)

SBICs invest in small businesses in geographically diverse regions of the country that often do not have access to private equity capital. SBICs are proud to invest in businesses located in many low-to-moderate income (LMI) areas. In fact, SBIC investments in businesses located in LMI areas have grown over the past three years and are on track to grow again in Fiscal Year 2015.



In Fiscal Year 2014, approximately 25 percent of the businesses invested in by SBIC were reported as businesses in what SBA calls "special competitive opportunity gaps." Special Competitive Opportunity Gaps refer to businesses owned by "groups that own and control little productive capital because they have limited opportunities for small business ownership."[3] These groups are identified as minorities, women, and veterans, or those conducting business in rural or distressed urban areas. Businesses whose owners identify with these special categories are deemed to face special competitive opportunity gaps. The number of special competitive opportunity gap businesses being financed by SBICs has been rising steadily in the past three years and is forecasted to grow again in Fiscal Year 2015.



SBIC "Family of Funds" Legislation (H.R. 1023)

SBIA urges the Committee to pass H.R. 1023, the Small Business Investment Company Capital Act, bipartisan legislation introduced by House Small Business Committee Chairman Steve Chabot (R-OH) and Representative David Cicilline (D-RI). Passing this bill would increase the amount of capital available for small businesses and not increase federal spending or the zero subsidy rate according to the Congressional Budget Office (CBO).[4] More capital for small businesses without additional federal spending is good policy.

[3] Small Business Administration, 2004. "Fiscal Year 2005 Congressional Performance Request."
[4] http://www.cbo.gov/sites/default/files/s511.pdf

We appreciate the support of the eight bipartisan cosponsors, many of which are on this Committee, including Small Business Committee Vice Chairman Blaine Luetkemeyer (R-MO), and Reps. Mike Bost (R-IL), Judy Chu (D-CA), Richard Hanna (R-NY), Carlos Curbelo, and Steve Knight (R-CA), and also Reps. Renee Ellmers (R-NC) and Chris Collins (R-NY). Bipartisan companion legislation (S. 552) was introduced in the Senate on February 24, 2015, by Senators Jim Risch (R-ID) and Ben Cardin (D-MD), with Senators Kelly Ayotte (R-NH) and Jeanne Shaheen (D-NH) co-sponsoring that bill.

SBICs that hold multiple licenses under the same management umbrella – otherwise known as "Family of Funds" – are currently restricted from accessing SBIC leverage above a statutory cap of $225 million. This statutory cap is currently restricting proven small business investors from accessing new SBIC leverage. Approximately 30% of debenture "Family of Funds" in the SBIC Program are hitting the cap or risk hitting the cap if they raise their next fund. I am regularly asked by SBIC fund managers if this limit will be raised because they are long-term investors and planners who need to plan now for their future small business funds. If Congress increases this cap, SBIA estimates that SBICs will facilitate up to $750 million a year in new small business investing.

In 2009, Congress made a similar modification to the SBIC program, resulting in a substantial amount of capital becoming available to small businesses. The increase in the Family of Funds limit in 2009 allowed proven fund managers to continue managing SBICs. Since that change went into effect, SBICs have made $17 billion in investments in 5,917 small businesses (from Fiscal Years 2010-2014). The influx of this capital saved tens of thousands of jobs and created many more new jobs.

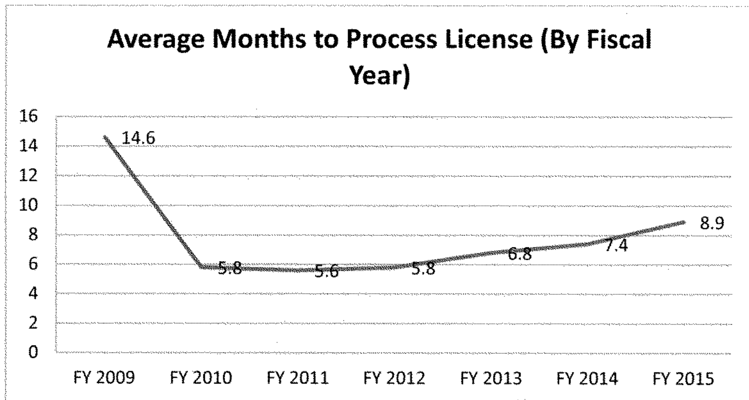
It should be emphasized that increasing the Family of Funds limit actually reduces the risk in the SBIC program. The only fund managers affected by this limit are those who have been successful at small business investing across multiple SBIC funds. The people accessing the expanded leverage are proven small business investing professionals. Again and again, they have passed the private market filters needed to raise a fund and have succeeded in a highly regulated environment. These are the fund managers that policymakers should want to keep in the program.

Challenges and Opportunities for Improvement

Every organization, both private and public, has room for continuous improvement and SBA's Office of Investment is no different. There have been many improvements made to the SBIC program and our comments here should not detract from the many areas where SBA has improved or is in the process of improving.

Licensing

The licensing process is the foundation of the SBA efforts to protect the taxpayer, but it is also at the core of access to capital. If the licensing process is too slow, too onerous, too expensive, or too unpredictable, then investors will leave the program resulting in less capital flowing to small businesses. The current trend in licensing is heading in the wrong direction, but it can be remedied without lowering standards or taxpayer protections.



The licensing process was a mess in the mid-to-late 2000s, plagued with delays and ambiguities. Standards were high, but the process was so broken and erratic that private investors were giving up on the SBA's ability to function and were walking away from the program. This graph above illustrates the major improvements made since that low point, but also shows a recent worrisome trend upwards in the number of months to process a license. The current number for FY 2015 is artificially low because it includes several non-levered funds and impact investment funds that have been fast-tracked for licensure. Debenture licenses, even for repeat SBICs, are averaging well north of the reported 8.9 months.

SBA should streamline the licensing process for successful repeat SBIC funds. If an SBIC team has passed the private market test of raising new capital for an additional SBIC, is pursuing a similar investment strategy, and has earned clean regulatory audits, then there is no reason why they should not be able to get a new license in a matter of weeks, not a year. The only new requirements should need are, proof of private capital raised, a new FBI background check, and an approval of the new legal documents. Repeat licenses have are known entities and have proven themselves.

Streamlining the licensing process would do several critically important things. It would let SBA move its limited resources to vetting thoroughly new funds before they enter the program. It would allow proven SBICs to plan for their next small business investment fund. Finally, with more resources dedicated to reviewing new fund managers, the SBA would have the time to better understand fund managers from different backgrounds than they currently can consider. In the 111th Congress, Congressman Kurt Schrader (D-OR), sponsored the Small Business Investment Company Modernization Act of 2009 (H.R.

3854, Section 402) that would have made these reforms. The House passed this measure with an overwhelming bipartisan vote. This language would provide a very good starting point for reforms.

Second, the SBA should establish clear benchmarks and reporting processes at each stage of the licensing process. SBA should provide certainty in the "green light" letter by explicitly stating the requirements and expectations for earning a license, including amount of private capital the fund must raise. Consolidating the multiple licensing phases and redundant processes would also be a meaningful improvement. Increased clarity of expectations combined with a less redundant process would not reduce any taxpayer protections, but would help immensely.

Modernize SBA Technology

For a myriad of reasons, SBA's technology is a hindrance both to SBA staff and to the SBICs that are interfacing with SBA. The SBA's technological resources are terrible to the point of stifling the ability of staff to serve the public effectively. There are two significant technology improvements that would help remove inefficiencies.

First, SBA should stop requiring any paper documents. They should accept electronic documents and electronic signatures, as is currently required under existing law. Currently, paper documents are commonly required as the IT systems are so antiquated that they cannot store electronic documents and often cannot even receive them via email. Our association with a handful of staff has more secure, cloud-based storage than the SBA and I would wager that we are paying a whole lot less for it. As a result applications or other important documents being "delayed" in SBA's "mail room" for days or weeks, before being received by the receiving party. It also frustrates and minimizes the effectiveness of the SBA staff tasked with running the program, getting capital to small businesses, and protecting the taxpayer. Eliminating the physical filing requirements and providing basic IT infrastructure would eliminate these unnecessary delays and increase the effectiveness of SBA.

Second, SBA should consider allowing the use of "virtual data rooms" for the licensing and operations processes. Investing professionals, legal professionals, and many others commonly use a "virtual data room" to share and protect critical documents. SBA should adopt this approach as a cost-effective and efficient way to provide access to documents by SBA staff and applicants. SBA has proven its inability to provide basic IT infrastructure. Rather than create a unique SBA system, it should use off the shelf technologies that are readily available.

Updating the technology tools through accepting electronic documents, providing basic IT infrastructure, and utilizing virtual data rooms will result in significantly less physical paper at the SBA, faster turnaround times in the program for SBICs, more effective SBA staff and an updated program for the 21st century. The SBIC program is a success and with your continued support it will continue to help small businesses grow.

Thank you for your consideration of our views. I would welcome any questions you might have.

Brandon Napoli, Director of Micro lending at VEDC

Statement for Record for the Subcommittee on Economic Growth, Tax and Capital

Access of the House Small Business Committee

U.S. House of Representatives

May 19, 2015

Chairman Steve Chabot and members of the sub-committee, thank you for the opportunity to submit testimony about a crucial component of a vital American business community. My name is Brandon Napoli and I am the Director of Micro Lending at VEDC, located in Los Angeles. VEDC is one of the largest SBA micro lenders in the nation. We provide real money to real people who are creating real jobs.

Micro lending is foundational to our economy, and VEDC is committed to helping entrepreneurs like Maria Martir secure microloans that foster healthy, sustainable communities. Maria, who started her own business at age 12 in Mexico, is the proud owner of De Todo Un Poquito Cafe (A Little of Everything) in Los Angeles. Raising the funds to start her own business was not easy; Maria saved what she could out of every paycheck she received. Three years later and with $40,000 in savings, she approached several banks for the last $10,000 to provide a working capital cushion for the first several months of operation. Maria was turned down several times for traditional financing. She had no existing cash flow and no outside collateral. Maria turned to VEDC, which offers access to capital for entrepreneurs unable to secure traditional bank financing as well as free technical assistance.

Three years after receiving a $10,000 loan along with help writing her business plan, Maria's original café has grown to occupy the vacant space next to her and has created jobs for her four children. She is now looking to expand elsewhere. Maria's experience illustrates what we at VEDC know from years of experience—hands on technical assistance, coupled with need-based financing, greatly increases a small business's chances of success.

Micro lending is not just about making small loans, though. It is about reaching entrepreneurs who are outside of the economic mainstream and helping them start and sustain a business that eventually creates jobs, adds to the tax base, and after a few years, becomes bankable.

All those micro-businesses add up to big numbers. These businesses generate $2.4 trillion in receipts, account for 17% of U.S. GDP, and employ more than 31 million Americans.[1] Maria Martir owns one of the 25 million businesses, or 88% of all businesses, in the United States considered a micro-business—a business with

[1] Survey of Business Owners and Self-Employed Persons, conducted by the U.S. Census Bureau in 2007 and 2008.

five or fewer employees and start-up capital of under $50,000. Microbusinesses are everywhere—the farmer at the Saturday market, your neighbor who runs the local childcare center, the trucker who works long hours on the road, the contractor who built your home, the beauty salon or barber shop, your favorite neighborhood restaurant that you always suggest needs to commercialize their barbecue sauce, or the miniature golf course you worked at as a kid—think of the businesses you frequent and I am sure that you encounter many microbusinesses you call your own.

The proposed FY2016 SBA Budget provides continued opportunities for American's entrepreneurs to start their own businesses and become successful, independent, and self-reliant like Maria. To keep the American Dream a reality for the millions of micro-business owners, **Congress needs to increase the effective investment it has made in SBA Micro Loan Program from $24.8 million to $28.3 million and make the programmatic changes suggested by current intermediary micro lenders.**

Increasing this funding would have a positive impact on a current market trend that is siphoning the cash flow out of small businesses today. Today, we hear about online lenders and how they are addressing the financial needs of small businesses. But a lender that provides short term, high-interest rate products without transparency in their pricing is not what small businesses need. The good news is that there are initiatives like microloan.org and SBA LINC, both new gateway referral programs for small business owners. These efficiencies are being built, through automation, yet staying committed to the long-term, relationship-based lending that has been the driver behind high performing portfolios and the successful borrowers who have benefited from them.

Maria's De Todo Un Poquito Cafe and other microbusiness could not do what they do without the support they get from SBA micro loan intermediaries like VEDC. Since 1998, VEDC has lent over $11 million by providing over 1,000 SBA micro loans, as well as pairing business technical assistance with the loans. Thankfully, there are many others like VEDC around the country. These participating intermediary lenders, like CDC Small Business Finance in California, Lift Fund which lends in over five Southern States, Common Capital in Massachusetts, Community Investment Corporation in Connecticut, Entrepreneur Fund in Minnesota, Wisconsin Women's Business Initiative Corporation, and the Economic and Community Development Institute in Ohio provide a "one-stop-shop" where a business owner can secure flexible financing as well as the individualized business assistance as needed throughout the life of their loan. This model forges a unique dynamic between the lender and the business owner that has enabled intermediary lenders to maintain healthy and growing loan portfolios while financing businesses deemed "un-bankable" by conventional lenders. And unlike the growing trend of the online lenders, these community based lenders offer affordable capital with longer terms, and lower interest rates.

The SBA Microloan Program reclaims the American Dream, one micro-business at a time. Intermediaries work with every day entrepreneurs to harness their innovative ideas and creativity and empower them to become their own bosses. Our micro entrepreneurs work hard to become self-sufficient. They hire locally, pay taxes, and, in other ways, give back to their communities. It is our responsibility to make sure they have the access to capital they need.

Since the Microloan Program was authorized in 1991, intermediary lenders have borrowed $414 million from the SBA and have used those funds to originate more than $629 million in loans to small businesses that have created or retained 185,800 jobs at a cost to the federal government of less than $2,228 per job. After 24 years, the cumulative default rate on SBA loans made to intermediary lenders is 1.8%. This is due largely to intermediary lenders having "skin in the game" in terms of having to pay back the SBA, and therefore a vital interest in their borrower's success. There are currently 137 active intermediary lenders participating in the program, and, in 2014 alone, these lenders made 3,917 loans totaling $55.5 million to small businesses supporting 15,880 jobs. Overall, intermediary lenders have proven that this is an efficient model to make smart investments in our local communities.

After 24 years, these intermediaries have also realized that several of the, well-intentioned policies, originally placed by cautious policy makers, now serve as barriers to gains in efficiencies. The most restricting barrier is the statutory restraint of utilizing 75% of the technical assistance post funding and only 25% pre funding. As with Maria, and the majority of micro entrepreneurs, the need for intense technical assistance before receiving financing ensures the small business owner is loan ready. Additionally, micro lenders now offer a continuum of services; including, technical assistance, microloan, the SBA 7(a), small business loan, or a 504 loan, that support a business until they are bankable. When they speak to one of the hundreds or even thousands of pre-loan clients, the need identified through the pre-loan technical assistance provided, may result in the client being better suited with one of these other products. In other words, technical assistance is provided to all clients, regardless of the loan they end up, but that is not known at the start of the process.

We are all cognizant of the current budget situation. However, programs designed to promote job creation—especially those with proven track records such as the Microloan programs at SBA—require continued support.

In closing, every day, VEDC and micro lenders across America see good, hardworking people like Maria who want and can build a better country, contribute to society, and create jobs. The greatest investment we can make is in these people, in your people who create jobs. The returns go far beyond the dollars paid back. Thank you for the opportunity to share Maria's story and for your continuing support of microloans.

Friends of the SBA Microloan Program

Friends of the SBA Microloan Program

Statement for the Record for the Subcommittee on Economic Growth, Tax and Capital

Access of the House Small Business Committee

U.S. House of Representatives

May 19, 2015

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to submit testimony to the Small Business Committee of the U.S. House of Representatives on the Small Business Administration (SBA) Microloan Program on behalf of the Friends of the SBA Microloan Program.[1]

The Friends of the SBA Microloan Program is an informal working group of nonprofit SBA Microloan Intermediaries. Its members provide small-dollar loans up to $50,000 and business development resources to help women, low-income, veteran, and minority entrepreneurs successfully create and grow sustainable businesses. In doing so, its members support economic opportunity for underserved entrepreneurs in rural, suburban, and urban communities across the nation by increasing access to the resources and services necessary to create wealth and build assets through business ownership.

The Impact of the SBA Microloan Program

The Friends of the SBA Microloan Program strongly supports the SBA Microloan program as a critical tool for our nation's small businesses. Under the Microloan program, the SBA provides loans to nonprofit intermediary lenders who, in turn, lend the funds—in addition to state and local resources—in amounts of $50,000 or less to the smallest of small businesses. Microloan program intermediary lenders also receive grants to help fund the cost of providing business-based training and technical assistance to small

[1] This testimony is submitting on behalf of the Friends of the SBA Microloan Program, including: Roberto Barragán (VEDC), Wendy K. Baumann (Wisconsin Women's Business Initiative Corporation), Robert Boyle (Justine Petersen Housing & Reinvestment Corporation), Mark Cousineau (Connecticut Community Investment Corporation), Grace Fricks (Access to Capital for Entrepreneurs), Brett Gerber (Impact Seven), Dave Glaser (Montana Community Development Corporation), Luz Gutierrez (Rural Community Development Resources), Clint Gwin (Pathway Lending), Gina Harman (ACCION The US Network, Inc.), Edmundo Hidalgo (Chicanos Por La Causa), Peter Hille (MACED), Inna Kinney (Economic and Community Development), David Kircher (Wisconsin Business Development), Sandy Lowell (Northern Community Investment Corporation), Lisa Macioce (Bridgeway Capital), Ceyl Prinster (Colorado Enterprise Fund), Jeff Reynolds (Center for Rural Affairs), Nelly Rojas-Moreno (LiftFund), Chris Sikes (Common Capital), Kevin Smith (Community Ventures Corporation), Namoch Sokhom (Pacific Asian Consortium in Employment Business Development Center), Jennifer Sporzynski (CEI), Robert Villarreal (CDC Small Business Finance), Birdie Watkins and Jerry Rickett (Kentucky Highlands Real Estate Corporation), Shawn Wellnitz (Entrepreneur Fund), Dennis West (Northern Initiatives), and Karl Zalazowski (California Coastal Rural Development Corporation).

business borrowers and potential borrowers. The fusion of capital and training helps shore up the capacity of these small businesses to help them turn a profit, improve operations, grow the business, and create jobs.

Since the program was launched in 1991, SBA Microloan Intermediaries have borrowed $414 million from the SBA and have made over $629 million in loans to small businesses that have created or retained 185,800 jobs at a cost to the federal government of less than $2,228 per job. According to SBA's Fiscal Year 2014 (FY14) Financial Report, the cumulative loss rate to the SBA on the Microloan Program is exceptionally low at just 1.88 percent.

In FY14, the SBA approved 36 loans—amounting to $26.5 million—to Microloan Intermediaries. By the end of the fiscal year, these Intermediaries leveraged an additional $29 million to provide $55.5 million in microloans to 3,917 small businesses. These businesses created or retained 15,668 jobs in local economies.

SBA Microloan Program

FY14 Performance Metrics

Small Businesses Assisted With Microloans	Jobs Supported by Microloans	Loan Amount Approved by SBA to Microlenders	Loan Amount Approved by Lenders to Microborrowers	Small Businesses Counseled
3,917	15,880	$26.5 million	$55.5 million	15,668

Support for Increased FY16 Appropriations

The Friends of the SBA Microloan Program strongly supports the funding recommendations included in the House Small Business Committee's FY16 *Views and Estimates* of the SBA Microloan Program. Specifically, we support the Committee's call for a modest increase in funding for Microloan Budget Authority and Technical Assistance grants.

In its assessment, the House Small Business Committee voiced its support for an additional $800,000 in Budget Authority for the SBA Microloan program which would allow for an additional $10 million in microlending authority. If enacted, this would increase the program's Budget Authority to $3.3 million and its program levels to $35 million. The Committee noted that its support for increased funding—also proposed by the Administration in the President's FY16 Budget Request—was due to "the effectiveness of the Microloan Program in job creation."

Likewise, the Committee supports the Administration's request of $25 million in FY16 for SBA Microloan Technical Assistance grants, which represents an increase of $2.7 million. Calling the program the "keystone of the Microloan program," the Committee agreed that Technical Assistance grants are both "valuable and irreplaceable."

Recommended Legislative Proposals

The SBA Microloan Program was established in 1991 as a pilot program. Since that time, the program has grown to 137 active intermediary lenders who made more than $55 million in loans to almost 4,000 small businesses across America in 2014.

While the program has grown in size, scope, and success, many of the original provisions of the pilot program remain in effect. These provisions create a paperwork burden for Microloan Intermediaries and the SBA. Moreover, these provisions have been in statute since the inception of the microloan program and are no longer appropriate.

Proposal 1: Limitations on Prospective Borrowers

Section 7(m)(4) of the Small Business Act (15 U.S.C. 636) establishes a grant program to help SBA Intermediaries provide marketing, management, and technical assistance to address the small business concerns of prospective and current borrowers. Under current law, up to 25 percent of the total grant funds may be used to provide highly targeted technical assistance and business counseling to prospective borrowers. This provision is known as the "75/25 Rule." By providing these services, SBA Intermediaries can help prospective borrowers prepare to become microloan borrowers in the future.

Moreover, implementation of this rule has limited the ability of intermediaries to counsel and underwrite prospective borrowers and has created a high administrative burden, as grants must meet the 25 percent limitation on a quarterly basis. Rural organizations indicate that given that time to travel to meet with business, this limitation has made their efforts especially difficult. With a loan loss rate of less than 2 percent, intermediaries have proven their ability to service their loan portfolios. Limiting their ability to work with new or prospective borrowers is no longer necessary.

The Friends of the SBA Microloan Program recommends that Congress eliminate Section 7(m)(4)(E). Specifically, it proposes the following language:

> *Section 7(m)(4) of the Small Business Act (15 U.S.C. 636(m)(4)) is amended—*
>
> *(a) by striking subparagraph (E)(i); and*
>
> *(b) by redesignating subparagraph (E)(ii) as subparagraph (E)(i).*

This language is similar to a provision of the Women's Small Business Ownership Act of 2014, as introduced by Senator Cantwell in July 2014.

Proposal 2: Minimum State Allocations

Section 7(m)(7)(B) of the Small Business Act (15 U.S.C. 636) establishes the minimum state allocation of microloans to SBA Intermediaries. It states that "the Administration shall make available to each state an amount equal to the sum of (I) the lesser of (aa) $800,000; or (bb) 1/55 of the total amount of new loan funds made available for award under this subsection for that fiscal year." The statue goes on to provide that in the 3rd quarter of the year, the Administration may collect and redistribute any funds that are unlikely to be made available.

With 137 borrowers across the country, this provision—which was designed to promote geographic diversity—is no longer necessary.

The Friends of the SBA Microloan Program recommends that Congress eliminate the "1/55th Rule." Specifically, it proposed the following language:

Section 7(m)(7) of the Small Business Act (15 U.S.C. 636(m)) is amended—

(a) by striking subparagraph (B).

<u>*Proposal 3: Third-Party Contracts*</u>

Under current law, no more than 25 percent of technical assistance grants may be used for contracts with third parties. This provision makes it difficult for organizations with small grants that do not have enough money to hire full-time staff and may be better able to fulfill grants obligations with consultants.

The Friends of the SBA Microloan Program recommends that Congress eliminate the limitation on third-party contracts. Specifically, the Friends Network proposes the following language:

Section 7(m)(4) of the Small Business Act (15 U.S.C. 636(m)(4)) is amended—

(a) by striking subparagraph (E)(ii).

<u>Conclusion</u>

Over nearly 25 years, the SBA Microloan program has proven to be a successful tool for assisting small businesses in rural, urban, and suburban communities across the nation. Despite its success, there are a number of provisions that were included in the original authorizing legislation that are no longer appropriate and which limit the ability of Intermediaries to serve small businesses. In light of the program's proven track record, the Friends of the SBA Microloan Program recommends that Congress eliminate these burdensome and unnecessary provisions.

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