Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

March 3, 2017

The Honorable Diane Black
Chairman
Committee on the Budget
207 Cannon House Office Building
Washington, DC 20515

Dear Chairman Black:

I am writing to advise you of the programs and priorities of the Committee on Small Business with regard to the fiscal year (FY) 2018 budget for the Small Business Administration (SBA). These views are in addition to those that will be submitted by the Committee's majority.

With respect,

Nydia M. Velázquez
Ranking Member

Minority Views

The following represent the views of the Democratic members of the Committee on the following issues

March 3, 2017

Undertaking this exercise at the present moment, as we have been asked to do by your Committee, is curious. Traditionally, views and estimates are meant to provide reaction to a budget submission. As you know, the administration has not yet transmitted its FY 2018 budget to Congress, making it impossible to provide insight into the SBA's spending proposal for next year. While we would rather submit such comments *after* a budget for the SBA is submitted to Congress, we are providing the below views reluctantly and only to comply with the long-standing tradition of our Committee to file additional views.

ACCESS TO CAPITAL

SBA administers an array of financing programs that are intended to bridge the gap in the conventional markets that small businesses encounter in trying to secure access to affordable capital. Through the SBA Advantage Loans 7(a) and Grow Loans 504 programs, entrepreneurs are provided with greater access to capital through the extension of federal guarantees on long-term loans.[1]

<u>SBA Advantage Loans 7(a) Program</u>

SBA's flagship lending program, the Advantage Loans 7(a) Program, provides small businesses with comprehensive financial assistance including working capital, fixed and intangible asset financing, as well as refinance and export support through term and revolving loans. During FY 2016, the Advantage 7(a) program supported a record number of loans nationally, more than $24.12 billion across over 64,000 loans. Both the total number and dollar amount of Advantage loans increased from the previous year.

In its annual reports, the SBA OIG has repeatedly pointed to lender oversight and loan agent fraud as management challenges that the agency has faced.[2] Relatedly, questions have been raised about whether the loans being made are reaching the small business borrowers the program is intended to serve, and whether participating lenders are taking on appropriate levels of risk. SBA should focus on improving oversight of its Advantage Loans 7(a) program, though the Committee recognizes that the challenges presented may be best addressed through legislation.

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[1]The SBA Advantage Loan 7(a) Program is formerly the 7(a) Guaranteed Loan Program. The SBA Grow Loans (504) is formerly the Certified Development Company Loan Program.

[2]According to the SBA OIG, with limited resources, SBA's Office of Credit Risk Management manages credit risk for a nearly $120 billion loan portfolio originated by over 2,400 active lenders and Certified Development Companies that have various degrees of expertise regarding SBA loan program requirements. See SBA OIG, <u>Report on the Most Serious Management and Performance Challenges in Fiscal Year 2017.</u>

In addition, notwithstanding the additional lending authorization in recent years, SBA's management of the cap must be a priority. Though lending remained under the $26.5 billion cap in FY 2016, in previous Congressional Budget Justifications, SBA has underestimated the level of Advantage 7(a) lending. For example, actual lending volume exceeded SBA's estimates by 23 percent in FY 2013, 30 percent in FY 2014, and 55 percent in FY 2015. While the Committee recommends providing the agency with sufficient lending authority to keep the program operational for the full fiscal year, SBA must closely monitor loan volume and provide Congress with regular reports in FY 2018.

Access to Capital in Underserved Markets

SBA-guaranteed lending in underserved communities, including minority and women-owned businesses must be improved. In FY 2016, 26 percent of 7(a) loans went to minorities, and only 18 percent to women-owned firms.[3] While the overall number of loans has increased, the percentage going to minority and women-owned firms has remained fairly consistent since 2010, and is lower than before or during the recession (2006-2009). Women-owned business used to account for about 40 percent of 7(a) lending activity while the average loan size going to a woman-owned business is roughly 30 percent *less* than SBA loans going to businesses owned by men. Similarly, minority owned firms used to receive 35 percent of all 7(a) loans. SBA must improve outreach to borrowers and lenders in underserved communities and funds should be made available to the agency to boost access to capital for these firms in FY 2018.

<u>7(m) Microloan Program</u>

The SBA Microloan Program provides loans to intermediaries, which are nonprofit community-based organizations with experience in lending as well as management and technical assistance. The intermediaries in turn help the smallest of small businesses and startups access capital to help new businesses get off the ground. The program plays a critical role in the small business economy, providing credit to those unable to secure traditional bank-based financing. In the Microloan Program, entrepreneurs receive SBA subsidized small dollar loans in conjunction with basic managerial and technical assistance in operating their business, thus increasing an entrepreneur's chances of success. In FY 2016, SBA approved $60.6 million, representing a 14 percent growth in dollar amount and more than 18 percent increase in loan approvals. As a result, SBA should take steps to increase intermediary participation and funding should be made available to operate the program at or above its FY 2017 level.

<u>Grow Loans (504) Program</u>

The Grow Loans (504) program provides permanent, fixed rate financing for businesses to acquire industrial or commercial buildings or heavy equipment and machinery. The program is delivered by local Certified Development Companies (CDCs) working in partnership with private lenders and the SBA. During FY 2016, the program grew nearly 7 percent with $4.74 billion in loans approved. In FY 2016 and FY 2017, SBA requested no subsidy appropriation. Regardless of fluctuations in the overall economy, SBA must administer the program such that it remains zero-

[3]A woman-owned firm is defined as a one that is more than 50 percent female-owned.

subsidy in FY 2018, with any fee increases being borne by CDCs and lenders participating in the program.

504 Refinance Program

In FY 2016, the 504 Refi loan program was permanently reauthorized with common sense reforms to address the shortcomings of the original program.[4] First, the Refi loan program can only operate in years that the normal 504 Loan program operates at zero-subsidy. This provision will ensure the costs of the program are covered by those that use it, not taxpayers. Second, additional lender oversight will prevent over-concentration of CDC portfolios in refinanced loans. Most importantly, the omnibus language has a non-waivable requirement that refinanced loans contribute to economic development, restoring the original intent of Congress and preventing loans from merely allowing businesses to "cash out" equity. SBA must exercise adequate lender oversight to fulfill congressional intent. As such, funds should be made available to operate and provide intensive oversight of the 504 Refinance program in FY 2018.

Disaster Assistance Program

The SBA's Disaster Assistance program was implemented for the purpose of providing timely financial assistance in the form of low interest loans and working capital for businesses and homeowners devastated by a disaster. During FY 2016, for example, the SBA Office of Disaster Assistance responded to 289 declared disasters across the country, including processing more than 59,000 home and 8,500 business applications and approved 25,235 loans for more than $1.4 billion. SBA's disaster loans have become the primary form of federal assistance for the repair and rebuilding of non-farm, private sector disaster losses.

In 2008, in response to the federal government's handling of Hurricane Katrina, Congress enacted the Small Business Disaster Response and Loan Improvements Act of 2008, designed to reform SBA's disaster program. The law created new disaster loan programs to provide more timely assistance to homeowners and businesses impacted by natural disasters including the Immediate Disaster Assistance (IDA) program, and the Private Disaster Loan (PDL) program.

However, after nearly eight years, SBA has yet to authorize lending under the IDA and PDL programs. In FY 2018, SBA must work to fully implement these programs or request the assistance of Congress to make legislative changes needed for implementation. Additionally, SBA should fully implement the provisions of Public Law No: 114-88, the RISE After Disaster Act of 2015, which provide additional improvements to the Disaster Assistance program.

In light of the critical need for funding to help home-owners and small businesses following devastating natural disasters, the Committee supports appropriating amounts necessary for FY 2018 to support the SBA's disaster loan-making functions, but urges appropriators to consider any funds the agency is carrying over into FY 2018.

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[4]The 504 Refi loan program allows borrowers to refinance certain debt and lock in the cost of a portion of their existing debt without a business expansion component, often for substantially less than their current monthly payments.

Small Business Investment Company Program

The Small Business Investment Company (SBIC) Program is an investment program that increases access to capital for high-growth start-up businesses. Specifically, with a $4 billion authorization per year, the SBIC program provides long-term loans and equity capital to small businesses with potential for substantial job growth and economic impact. SBICs are privately owned and managed investment funds, licensed and regulated by SBA, that use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses. SBA provides funding to qualified investment management firms with expertise in certain industries. Over the past five years, the program has channeled over $21 billion of capital to more than 6,400 small businesses in a variety of sectors across the country. In 2016 the program provided $6 billion in financing to 1,200 small businesses. SBA has established initiatives to fill gaps in the current market. As such, it should prioritize expanding outreach to increase minority-led and women-led funds in the program.

ENTREPRENEURIAL DEVELOPMENT PROGRAMS

SBA's entrepreneurial development programs provide the foundation for the agency's small business development efforts. In the past, the SBA has repeatedly funded unproven pilot programs that lack a specific authorization at the expense of proven core programs. As a result of Committee oversight and GAO investigations, there are concerns that these initiatives are not in the best interest of taxpayers or small businesses. Concerns that have been raised repeatedly include a lack of demonstrated need and the absence of robust controls. In addition, given the deficiency of performance data SBA should establish metrics for its pilot programs to understand if these initiatives are successful or not. More importantly, the agency should focus on strengthening its existing network of entrepreneurial development service providers, rather than continuing to establish and operate untested and unproven initiatives.

Each year, more than one million entrepreneurs come through SBA's resource partner network of small business development centers (SBDC), women's business centers (WBC), SCORE chapters, and veterans business outreach centers.[5] Business advisors provide valuable advice and mentoring for every stage of business growth and development. These providers deliver vital services to small businesses and, as more entrepreneurs seek their counseling, SBA should ensure that these partners, specifically those highlighted below, are provided sufficient funding to serve small businesses.

Women's Business Centers

The WBC program provides grants to nearly 100 non-profit organizations that provide quality advising and training services primarily to women entrepreneurs, many of whom are socially and

[5]Small business development centers provide technical assistance to small businesses and aspiring entrepreneurs. Women's business centers assist women in starting and growing small businesses. The SCORE Association is a nonprofit association comprised of over 13,000 volunteer business counselors located in 348 chapters throughout the U.S. and its territories. SCORE members are trained to serve as counselors, advisors, and mentors to aspiring entrepreneurs and business owners. Veterans business outreach centers provide entrepreneurial development services for eligible veterans.

economically disadvantaged. Participating organizations must match the federal funding with one non-federal dollar for every two federal dollars during the first two years and on a one-to-one basis thereafter. In FY 2015, the WBC program reached more than 140,000 small business owners and helped more than 760 entrepreneurs start businesses. For FY 2016, the SBA received $17 million for WBCs with the goals of advising and train more than 142,000 clients, helping 730 of them open new businesses, and opening six new centers in order to cover more areas of the country. The Committee advocates for raising the authorization and the cap to expand the reach of the program and to increase opportunities for women-owned small businesses.

Small Business Development Centers

The SBDC program provides SBA grants to small business development centers and leverages a unique mix of federal, state, and private sector financial resources. This funding model enables SBDCs across the country to foster the economic growth of small businesses that generates business revenue, creates and retains jobs, and enhances local and regional economies. SBDCs deliver management and technical assistance to small businesses through an extensive business education network comprised of 63 lead centers managing more than 900 outreach locations throughout the country. SBDCs deliver professional business advising and training focused on strategic planning, business development, financial planning, and cash flow management to hundreds of thousands of business clients annually. In FY 2015, SBDC professional business advisors helped clients start more than 13,000 new businesses; provided training and advising to more than 450,000 entrepreneurs including 61,000 long-term clients; helped clients obtain $4.7 billion in capital for their businesses; and helped clients secure $1.1 billion in federal government contracts.

Despite these efforts, there have been concerns that SBA has undervalued the SBDC program. As such, in past years the Committee has supported an increase in funding to be reallocated from SBA-created initiatives to the SBDC program and the minority expects to lead legislation in the 115th Congress to improve the program.

GOVERNMENT CONTRACTING PROGRAMS

The primary purpose of the SBA's Government Contracting and Business Development programs is to assist small businesses increase their access to the federal marketplace. Through federal contracts, small businesses are able to increase their capabilities and capacity thereby improving their competiveness. However, the creation of these programs has not expanded the number of contracts awarded each year. Rather, many agencies are awarding fewer contracts worth higher values. Thus, while some agencies and the government have been able to meet their small business goals, the participation of small firms has declined. This trend coupled with a system that has become complex and countless management problems continues to raise concern as to whether the SBA is effectively and efficiently advocating for small businesses in the marketplace.

Procurement Staffing Levels

Currently, there are less than sixty Procurement Center Representatives (PCRs) responsible for overseeing over $440 billion in federal contracting. However, the shortage of personnel is not limited to PCRs. To date, there are approximately 27 Commercial Market Representatives assisting small businesses with subcontracting opportunities. Similarly, staffing for the Service-Disabled Veteran-Owned Small Business Program, one of the set-asides discussed below, has decreased. The lack of resources available to review contracting actions has prevented small businesses from receiving the maximum practicable opportunities available to them and as a result fewer of these firms have been able to participate in the marketplace. To reverse this, funding should be made available to increase the overall number of small business advocates.

Small Business Set-Aside Programs

Government contracts can be set-aside for classes of small businesses, such as socially and economically disadvantaged firms, whose members might not otherwise be considered for award in full and open competition. There are government-wide statutory contracting goals for small businesses as well as sub-goals for small business categories.[6] SBA has several set-aside programs including the 8(a) Business Development, Historically Underutilized Business Zone (HUBZone), Service-Disabled Veteran-Owned, and the Women-Owned Small Business (WOSB) programs designed to promote small business participation in federal contracting. Given that the SBA OIG has identified small business contracting as a serious management challenge since FY 2005, SBA should have adequate resources to improve these programs.

8(a) Business Development Program

The 8(a) program was created to provide business development assistant to eligible small disadvantaged businesses seeking to participate in federal contracting. A major benefit of the program is that 8(a) firms can receive sole source, as well as set-aside competitive federal contracts so that small businesses do not need to compete with large businesses that may have an industry advantage. However, the number of participants has continually declined from about 7,000 in 2010 to about 4,900 as of August 2016, and this trend has been seen in the number of new applications to the program as well. Conversely, the number of businesses that have sought assistance through the 7(j) program, which supports 8(a) firms, has continually increased and in FY 2015, there were 5,360 small businesses that received support through this program. If the number of businesses seeking assistance continues to grow at a similar rate or higher, small firms may see a reduction in the amount of funds spent per business.

SBA must begin to plan for higher numbers of firms to ensure the current level of service continues. As a result, funding for the 8(a) and 7(j) programs should be increased to accommodate not only the rise of businesses seeking technical assistance but also to escalate the levels of outreach to reverse the decline of program participants.

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[6]The federal government has the following statutory goals for small business procurement: 23 percent of prime contracts for small businesses; 5 percent of prime and subcontracts for women-owned small businesses; 5 percent of prime and subcontracts for small disadvantaged businesses; 3 percent of prime and subcontracts for service-disabled veteran-owned small businesses; and 3 percent of prime and subcontracts for HUBZone-certified small businesses. These goals are tracked based on the dollar amount of contracts awarded. A business may qualify for more than one socioeconomic category.

HUBZone Program

The HUBZone program aids urban and rural small businesses that are located in designated distressed areas in accessing federal procurement opportunities. There have been many reports detailing fraud and abuse that has resulted from lack of eligibility verification by SBA of program participants. While the required information was requested to support the applications, SBA failed to verify that the firms had legitimate principle places of business in HUBZones. While the administration has made efforts to combat fraud by increasing site visits and reviewing firms that had previously been certified under the new review guidelines, doubts still remain as to whether enough has been done to ensure that only eligible firms receive contracting dollars from this program.

In addition, SBA has yet to provide metrics that would show whether or not the program is meeting its mission of increasing employment opportunities and stimulating capital investment in designated HUBZones. Therefore, SBA must formulate metrics to answer these questions so that Congress can determine what reforms are necessary to make this program useful for small businesses.

Furthermore, although the HUBZone program continues to recruit new small businesses, over the years, the program has not met its target contracting goal, with only 1.82 percent of contracts awarded to HUBZones in FY 2015. Considering the challenges that SBA has faced in carrying out this program, it should focus more oversight in how resources for the program are spent.

Women-Owned Small Business Contracting Program

An issue of great importance to women-owned businesses is their lack of access to federal contracting. After taking more than ten years to implement the Women-Owned Small Business (WOSB) Federal Contracting program, SBA continues to devote few resources to the program. As a result, few contracts have been awarded using the program with only 1,914 set-aside contracts worth $180.48 million awarded in FY 2014. Congress has made several changes over the past two years to the program including: the removal of caps on award size for set-aside contracts; allowing contracting officers to award contracts through a sole-source contract; the removal of self-certification to participate in the program; and reiterating the original mandate that SBA create its own certification process.

While SBA has implemented the cap removal and sole-source changes, they have been slow to remove self-certification from the program and implement their own certification process. The SBA OIG and GAO have both reported weaknesses in SBA's controls that would ensure only eligible firms receive the woman-owned small business set-aside. Thus, SBA must dedicate funding to this program to maintain its integrity as well as participants.

Service-Disabled Veteran-Owned Small Business Program

The Service-Disabled Veteran-Owned Small Business (SDVOSB) Program provides procuring agencies with the authority to set aside contracts for exclusive competition among eligible participants as well as the authority to make sole source awards. Although the goals for SDVOSB contracting have been met in recent years, the program faces many challenges that

SBA should address, including the need for adequate staffing levels and providing contracting education for participating firms.

CONCLUSION

This year's views and estimates are peculiar in that they are not based on any budget submission. As such, the Committee has provided priorities for how the SBA should operate in FY 2018. SBA should put the appropriate level of resources to its programs and should focus its efforts on increasing outreach and access to both capital and contracting opportunities for traditionally underserved communities, including minority- and women-owned businesses. The agency should also be provided with the resources necessary to administer and oversee its core lending, entrepreneurial development and contracting programs. In addition, the Committee remains concerned with SBA's reliance on pilot programs that have not been objectively evaluated and divert scarce funding from proven, congressionally authorized programs. Going forward, the SBA should recommit itself to its proven programs, rather than diverting funds on untested programs. Doing so would help ensure that taxpayer dollars are being well spent, while small businesses have the resources that they need to grow and expand. Thank you for your consideration of our views on this important matter.

With respect,

Nydia Velázquez
Rep. Nydia Velázquez, Ranking Member

Alma Adams
Rep. Alma Adams, Vice Ranking Member

Stephanie
Rep. Stephanie Murphy

Dwight Evans
Rep. Dwight Evans

Yvette D. Clarke
Rep. Yvette Clarke

Al Lawson
Rep. Al Lawson

Judy Chu
Rep. Judy Chu