STEVE CHABOT, OHIO
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515–6315

February 14, 2018

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

The Honorable John Yarmuth
Ranking Member
Committee on the Budget
U.S. House of Representatives
134 Cannon House Office Building
Washington, DC 20515

Dear Chairman Womack and Ranking Member Yarmuth:

I am writing to advise you of the programs and priorities of the Committee on Small Business with regard to the fiscal year (FY) 2019 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

February 14, 2018

Pursuant to section 301(d) of the Congressional Budget Act of 1974 and House Rule X, clause 4(f), I am writing to advise you of the additional views and estimates of the Committee on Small Business with regard to the fiscal year (FY) 2019 budget. These views and estimates are in addition to those that will be submitted by the Committee's majority. While we concur in several areas, there are some areas of disagreement, which are discussed in greater detail below.

The Committee on Small Business has legislative jurisdiction over the Small Business Administration (SBA) and this letter accordingly focuses on the FY 2019 budget request for this agency and the program it operates under the authorizations contained in the Small Business Act (15 U.S.C. 631 et seq.) and the Small Business Investment Act (15 U.S.C. 661 et seq.).

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 7(a) and 504/CDC programs, entrepreneurs are provided with greater access to capital through the extension of federal guarantees on long-term loans. The 7(m) microloan program provides loans and technical assistance to traditionally underserved borrowers, including women, minorities, and veterans. Finally, the Small Business Investment Company (SBIC) program leverages public and private capital to assist small high-growth firms.

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

<u>General</u>

SBA's flagship lending program, the 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 2017, the 7(a) program supported record lending nationally, more than $25.4 billion across over 62,400 loans. This is an increase in the dollar amount but a decrease in number of loans from the previous year. **The Committee recommends the FY2019 authorization level for the 7(a) program be set at a level that takes into account natural growth in the program, but no less than $29 billion, as was requested for FY 2018.**

<u>SBA Oversight</u>

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.[1] Relatedly, questions have been raised about

[1]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

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.

The Committee recognized that some of the challenges presented may be best addressed through legislation. As such, Chairman Steve Chabot and Ranking Member Nydia Velázquez introduced H.R. 4743, the *Small Business 7(a) Lending Oversight Reform Act of 2018*. The primary goals of the Act are to strengthen the ability of the SBA to conduct lender oversight, increase transparency of the oversight process, and to provide Congress with regular updates of SBA's oversight actions and the performance of its portfolio. **The Committee recommends SBA continue to work with Members and staff in FY2019 to address and correct identified deficiencies in the oversight functions of the Agency.**

Cap Flexibility

Although lending remained under the $27.5 billion authorization cap set by Congress in FY 2017, SBA has run out of authority to make loans twice recently.[2] Furthermore, SBA has underestimated the level of 7(a) lending for at least the last seven years.[3] For example, actual lending volume exceeded SBA's estimates by 30 percent in FY 2014, 56 percent in FY 2015, and 15 percent in FT 2016.

The *Small Business 7(a) Lending Oversight Reform Act of 2018* establishes a notification-and-approval process by which SBA can request an increase of the 7(a) lending cap (up to 15%), subject to approval by the appropriations and authorizing committees to provide stability and certainty to borrowers and lenders when demand for 7(a) financing exceeds the program level. **The Committee expects SBA to closely monitor loan volume and provide Congress with regular reports, but also recommends the Agency have flexibility authority to address unanticipated small business borrower demand for loans.**

7(a) Secondary Market Re-estimate and Changes to SBA Procedure

The 7(a) secondary market program allows lenders participating in the 7(a) loan program to sell the guaranteed portion of their loans on to investors. Similar to the process of packaging and securitizing mortgages, SBA works with financial institutions known as "assemblers" to package SBA loans into a "pool" that is sold off fractionally to investors in shares known as Pool Certificates. Holders of pool certificates are entitled to receive a proportionate share of the principal and interest payments made by the borrowers of the underlying loans.

To ensure timely payment of pool payments to holders of certificates, SBA established the Master Reserve Fund (MRF) and contracted with Colson Services Corp. to act as Fiscal and Transfer Agent (FTA) to collect and disburse payments in and out of the MRF.

In FY 2018, SBA indicated the secondary market guarantee program required a $511 million upward reestimate to cover deficiencies in the MRF dating back to FY 2004. At the same time, SBA issued a notice in the Federal Register making a change to how the pass through of principal

Companies that have various degrees of expertise regarding SBA loan program requirements. *See* SBA OIG, Report on the Most Serious Management and Performance Challenges in Fiscal Year 2017.

[2] SBA required and additional $1 billion FY 2014 and more than $4 billion FY 2015.

[3] *See* SBA FY2018 Congressional Budget Justification, table 1.1d.

payments in the MRF would be made. Both the upward reestimate and the procedural changes have raised concerns in Congress about SBA's oversight of the secondary market guarantee program. **Therefore, the Committee recommends additional Congressional oversight and investigation during FY18, and FY19 if necessary, into the events that led to the reestimate, the reasons why over 12 years elapsed before the underlying causes were identified, and what effect, if any, the policy changes made by SBA in October 2017 will have on the secondary market guarantee program.**

Access to Capital in Underserved Markets

SBA 7(a) lending in underserved communities, including to minority and women-owned businesses must be improved. In FY 2017, 27 percent of 7(a) loans went to minorities, and only 18 percent to women-owned firms.[4] 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. **The Committee recommends SBA 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.**

7(m) Microloan Program

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 FY 2017, SBA approved 3,038 loans totaling $42 million - a 30 percent decline in both approvals and dollar amount. **Due to the success of the program in traditionally underserved communities, the Committee recommends funding be made available to operate the program at or above its peak FY 2016 level.**

504/CDC loan Program

The 504/CDC 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 2017, the program grew nearly 6 percent with $5.013 billion in loans approved. In FY 2016, FY 2017, and FY 2018 SBA requested no subsidy appropriation. **Regardless of fluctuations in the overall economy, the Committee recommends SBA administer the program such that it remains zero-subsidy in FY 2019, with any fee increases being borne by CDCs and lenders participating in the program.**

Small Business Investment Company Program

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

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 2017 the program provided $5.7 billion in financing to 1,077 small businesses, however only 11 percent of those companies were women, minority, or veteran owned. **Therefore, the Committee recommends SBA prioritize expanding outreach to increase minority-led and women-led funds, and to increase the number of women, minority, and veteran owned businesses that benefit from the program.**

Disaster Assistance Program

Overview

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 late FY 2017 and early FY 2018, the SBA Office of Disaster Assistance responded to numerous major disasters across the country, including the aftermath of hurricanes Harvey, Irma, and Maria. As of January 29, 2018, SBA has processed more than 278,885 homeowner and business applications and approved 99,415 loans for more than $5.507 billion for these storms.

SBA's disaster loans are the primary form of federal assistance for the repair and rebuilding of non-farm, private sector disaster losses. **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 to support the SBA's disaster loan-making functions. In addition to any funds appropriated for disaster assistance, the Committee hopes to approve H.R. 2448, the Puerto Rico Small Business Assistance Act of 2017, which advances entrepreneurship in Puerto Rico on a number of fronts, including enhanced SBA lending and entrepreneurial development investments.**

Unimplemented Congressional Mandates

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 nine years, SBA has yet to authorize lending under the IDA and PDL programs. **In FY 2019, the Committee expects SBA to have these programs implemented or have requested the assistance of Congress to make legislative changes needed for implementation. Additionally, to the extent necessary, SBA should continue implementation**

of the provisions of Public Law No: 114-88, the RISE After Disaster Act of 2015, which provide additional improvements to the Disaster Assistance program.

Disaster Authority

Although the SBA Disaster Loan program continues making loans during a short-term continuing resolution, SBA may require additional appropriations to make such loans in the form of a funding anomaly. In the absence of securing an anomaly, SBA may exhaust its disaster subsidy, which has not occurred since 1988. As of the writing of this letter, SBA has indicated it would likely cease disaster lending after the second week of February 2018. The continued ability of SBA to make disaster loans available to victims in disaster areas is of utmost importance to the Committee. Concerns have been raised that SBA could meet similar circumstances in the future. **Therefore, the Committee recommends sustained coordination between the Committee, appropriators, and the agency during FY 2018, and FY 2019 if necessary to ensure adequate disaster funding is in place, particularly during continuing resolutions.**

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. Veteran 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 2017, the SBA received $18 million for WBCs with the goals of advising and train more than 147,000 clients, helping 711,000of them open new businesses. Last year WBC opened six new centers in order to cover more areas of the country and are in the initial stages of the grant and building clientele to leverage this expansion. Furthermore, the SBA conducted a survey of WBC clientele to cover both advising and training to better understand the value and impact of WBC program services. **The Committee recommends raising the authorization and the cap to expand the reach of the program and to increase opportunities for women-owned small businesses.**

<u>Small Business Development Centers</u>

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 2016, SBDC professional business advisors helped clients start more than 14,000 new businesses; provided training and advising to more than 450,000 entrepreneurs including 69,000 long-term clients; helped clients obtain $5 billion in capital for their businesses; and helped clients secure $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.

<u>Procurement Staffing Levels</u>

Currently, there are less than sixty Procurement Center Representatives (PCRs) responsible for overseeing over $500 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. **Therefore, the Committee recommends funding 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. In FY 2016 8(a) firms received 90,789 contracts worth $16.99 billion. 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, the Committee recommends funding for the 8(a) and 7(j) programs

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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.

be increased to accommodate not only the rise of businesses seeking technical assistance but to escalate the levels of outreach to reverse the decline of program participants.

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. 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 1.67 percent of contracts awarded to HUBZones in FY 2016.

Therefore, the Committee recommends SBA formulate metrics so that Congress can determine what reforms are necessary to make this program useful for small businesses. Considering the challenges that SBA has faced in carrying out this program, the Committee suggests SBA 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 480,714 contract actions worth $19.7 billion awarded in FY 2016. 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, the Committee recommends SBA 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 the Committee recommends SBA address, including the need for adequate staffing levels and providing contracting education for participating firms.**

CONCLUSION

The Committee has provided priorities for how the SBA should operate in FY 2019. 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,