Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515-0515

MEMORANDUM

To:	Members, Subcommittee on Investigations, Oversight, & Regulations
From:	Judy Chu, Chairwoman
Date:	February 25, 2019
Re:	Subcommittee hearing: "Shutdown Lessons: SBA Capital Access Programs"

The Committee on Small Business Subcommittee on Investigations, Oversight, and Regulations will meet for a hearing titled, "Shutdown Lessons: SBA Capital Access Programs." The hearing is scheduled to begin at **10:00 A.M. on Tuesday, February 26, 2019 in Room 2360 of the Rayburn House Office Building.** The hearing will allow Members to explore the challenges faced by the Small Business Administration's (SBA) Office of Capital Access during the recent 35-day partial government shutdown, as well as any lessons learned from conducting its business during a lapse in appropriations. The witness will be:

- Mr. William Manger, Associate Administrator, Office of Capital Access, SBA

Background

During the 35-day partial government shutdown of 2018-19, numerous federal agencies were closed and their operations suspended indefinitely. For SBA, this included a freeze on processing all outstanding loan guaranty applications, meaning that any loans submitted to SBA pre-shutdown could not be finalized. Moreover, the shutdown also prevented SBA-partnered lenders from making any new SBA-backed loans. As a result, for the 35 days the government was shutdown, the small businesses that traditionally struggle to access conventional credit were also unable to access SBA-guaranteed loans, which are designed to help fill this gap in the market for commercial loans.

On Friday, February 22, SBA provided the Committee with an update of its lending activity since it resumed full operations on January 28. SBA stated that after four weeks, it approved over 7,900 loans for a total of $3.7 billion, and it has now returned to pre-lapse levels in all its lending categories. Specifically, SBA stated that 7,205 7(a) loans have been approved for a total of $3.17 billion, while 734 loans in the 504 program have been approved for a total of $542 million.

Office of Capital Access

SBA's Office of Capital Access administers the agency's loan programs. These include the 7(a) loan guaranty program, the 504/Certified Development Company (504/CDC) program, the Microloan program, and the surety bond program. SBA is also administering the Community Advantage loan pilot program as part of the 7(a) program.

7(a) Loan Guaranty Program

The 7(a) loan guaranty program is SBA's flagship loan product. These loans are made by SBA lending partners (mostly banks but also some other financial institutions) and partially guaranteed by SBA.[1] 7(a) loan proceeds may be used for fixed assets, working capital, financing start-ups, purchasing an existing business, and for limited other purposes.[2] The maximum loan amount is $5 million.[3] Loan maturity is between 5 and 7 years for working capital, and up to 25 years for equipment and real estate.[4] For all other purposes, the maximum term is 10 years.[5] The current guaranty rate is 85 percent for loans of $150,000 or less and 75 percent for loans greater than $150,000 (up to a maximum guaranty of $3.75 million – 75 percent of $5 million).[6] The 7(a) program has several specialized programs that offer streamlined and expedited loan procedures for particular groups of borrowers, including the SBA Express program (for loans of $350,000 or less), the Export Express program (for loans of up to $500,000 for entering or expanding an existing export market), and, as mentioned above, the Community Advantage pilot program (for loans of $250,000 or less), which is designed to target mission-based lenders and small businesses in traditionally underserved communities.[7]

504/CDC Program

The 504/CDC program uses Certified Development Companies (CDCs), which are private, nonprofit corporations established to contribute to the economic development within their local communities.[8] Each CDC has its own geographic territory.[9] The program provides long-term, fixed-rate loans for major fixed assets such as land, structures, machinery, and equipment.[10] 504/CDC loan proceeds cannot be used for working capital, inventory, or repaying debt.[11] Under the program, a commercial lender provides up to 50 percent of the financing package, which is secured by a senior lien.[12] The CDC's loan of up to 40 percent is secured by a junior lien.[13] The SBA backs the CDC with a guaranteed debenture.[14] The small business must contribute at least 10 percent as equity.[15] To participate in the program, small businesses cannot exceed $15 million in tangible net worth and cannot have average net income of more than $5 million for two full fiscal years before the date of application.[16] Also, CDCs must intend to create or retain one job for every

[1] Congressional Research Service, *Small Business Administration: A Primer on Programs and Funding*, RL33243 (Jan. 17, 2019).
[2] *Id*.
[3] *Id*.
[4] *Id*.
[5] *Id*.
[6] *Id*.
[7] *See supra* note 1.
[8] *Id*.
[9] *Id*.
[10] *Id*.
[11] *Id*.
[12] *Id*.
[13] *See supra* note 1.
[14] *Id*.
[15] *Id*.
[16] *Id*.

$65,000 of the debenture ($100,000 for small manufacturers) or meet an alternative job creation standard if they meet any one of 15 community or public policy goals.[17]

Microloan program

The Microloan program provides direct loans to qualified nonprofit intermediary Microloan lenders that, in turn, provide microloans of up to $50,000 to small businesses and nonprofit childcare centers.[18] Microloan lenders also provide marketing, management, and technical assistance to Microloan borrowers and potential borrowers.[19] Although the program is open to all small businesses, it targets new and early-stage businesses in underserved markets, including borrowers with little to no credit history, low-income borrowers, and women and minority entrepreneurs in both rural and urban areas who generally do not qualify for conventional loans or other, larger SBA-guaranteed loans.[20]

Shutdown Impact

The National Association of Government Guaranteed Lenders (NAGGL), which represents over 800 private-sector lenders and partners that make 7(a) loans, estimated that about $500 million in access to capital for small businesses is lost per shutdown week, using FY18 estimates.[21] Moreover, they estimate 14,000 jobs are not created or retained per week due to the shutdown of the 7(a) program, also using FY18 estimates.[22] This shutdown was particularly devastating to prospective 7(a) borrowers because at the core of 7(a) lending is the requirement that a loan can only be approved if the borrower cannot obtain credit elsewhere. Small business loans, especially those $350,000 or less, are often deemed the riskiest by traditional lenders. This makes the 7(a) loan program the lifeline for creditworthy small businesses that would not otherwise find reasonable and affordable financing to enable the business to grow. Notably, the country's more than 1,800 private-sector financial institutions and partners that participate in the 7(a) loan program have gone from processing over $2 billion of 7(a) loans per month to a complete stop.[23] Many participating lenders also started to consider ways to reduce expenses, including the potential need to furlough bank employees within their SBA department, with discussions of potential lay-offs in the future.

One of the most significant concerns lenders expressed regarding the shutdown was whether SBA had a plan to address the backlog of loan applications once SBA was restored to fully operational status. In correspondence with the Chairwoman, the Administrator unequivocally expressed confidence in SBA's ability to assess and work through the volume of applications pending upon resumption of full agency operations. Accordingly, this hearing will provide Members with an opportunity to conduct oversight over the agency and hold it accountable by questioning Mr. Manger regarding the size of the loan application backlog, what his and his Office's plan was for

[17] *Id*.
[18] *See supra* note 1.
[19] *Id*.
[20] *Id*.
[21] Letter from Anthony R. Wilkinson, President & CEO, National Association of government Guaranteed Lenders, to Nydia Velázquez and Steve Chabot, Chairwoman and Ranking Member, House Committee on Small Business (Jan. 22, 2019) (on file with the House Committee on Small Business).
[22] *Id*.
[23] *Id*.

working through the backlog in a timely and efficient manner, and how much progress has been made in working through that backlog.

As was the case with the 7(a) program, small businesses seeking a loan under the 504/CDC program during the shutdown could not apply for such a loan, and any 504 loan approvals, which were pending because they needed additional information could not move forward. Businesses that were working with their CDC and bank on their application before the shutdown were waiting in proverbial limbo, or worse, scrambling to find alternative financing with suboptimal terms. This includes businesses that completed application packages with SBA, but for which SBA did not review prior to the shutdown. Moreover, businesses whose approvals were conditional upon SBA receiving additional information (such as appraisals or environmental reviews) could not move toward closing their 504 loan because SBA could not receive and approve that additional information. Further, the 504/CDC debenture pools will be low for months to come since loans have stopped making their way through the system, meaning the CDCs that service these loans have fewer loans on which they receive servicing income.

Finally, America's smallest businesses were also unable to access affordable microfinancing during the shutdown. In FY18, the average microloan amount was $14,071,[24] which is an amount most traditional banks cannot profitably make due to cost constraints. This highlights the value of intermediary lenders under the Microloan program, as well as the fact that without microlending under the SBA's Microloan program, our country's entrepreneurs and microbusinesses would be forced into riskier and costlier financing options. According to lending data from SBA, in FY18, Microloan intermediaries provided 5,459 loans to small businesses, totaling $76.8 million.[25] Based on this information, it is estimated that approximately $1.5 million in SBA-backed microlending was lost per shutdown week. This translates into over 100 microloans per shutdown week that could not be made for America's smallest businesses just trying to get started.

There are also broader impacts to the overall economy that are immeasurable and can only be observed on an anecdotal basis. A small business that was relying on a 7(a) loan to finance working capital that did not receive its loan proceeds prior to the shutdown may have trouble making payroll. Expansion plans for many businesses may also be put on hold or scrapped altogether, reducing tax revenue for local and state governments. Particularly, 504 borrowers who are caught up in the frozen system have been losing money since they are unable to end their interim financing by closing their 504 loan, or are moving on to other sources of capital with suboptimal terms because they cannot finalize their 504 application. This puts the future cash flow of the business at risk. Because of these delays, these businesses may lose the opportunity to purchase the property altogether as sellers move on to other more reliable buyers.

Conclusion

For both the 7(a) and 504 programs, policymakers and industry stakeholders will be closely observing how SBA manages the backlog of applications. After four weeks, SBA is reporting that it has returned to its pre-lapse levels in all its lending categories. Because SBA did not make its plan for addressing the backlog public, this hearing will provide Members with a chance to probe

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[24] Congressional Research Service, *Small Business Administration Microloan Program*, R41057 (Dec. 19, 2018).
[25] *Id*.

the agency for answers regarding how it managed to clear its backlog of loans while still receiving and processing loan applications.