

“The SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes”

**Testimony before the Subcommittee on Economic Growth, Tax, and Capital Access of the House
Committee on Small Business**

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Submitted by

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Chairman Kim, Ranking Member Hern, and Members of the Subcommittee—my name is Lynn Ozer and I am currently the President of Fulton Bank’s SBA lending division. After graduating from Temple University with a BBA majoring in accounting, I got my first job at the U.S. Small Business Administration (SBA). After five years there I began my career in commercial lending with an emphasis on SBA lending. I have been leading SBA lending departments in both large banks, regional banks and community banks ever since.

In my current role at Fulton Bank, I oversee all aspects of SBA lending in our bank’s five-state footprint including Pennsylvania, New Jersey, Delaware, Maryland, Virginia, and Washington DC. I am also the past Chairwoman of the National Association of Government Guaranteed Lenders (NAGGL), and in that role, I represented over 800 financial institutions and partners that participate in the 7(a) lending industry. I thank this Committee for giving me the opportunity to testify both in my capacity as a veteran lender, but also as a voice for the thousands of lenders who devote their careers to helping small businesses.

The 7(a) lending program is the agency’s oldest and largest public-private partnership with approximately 2,000 participating private-sector financial institutions. Participating lenders make private-sector loans with their own capital based on their own financial decisions to small business borrowers who meet program standards for creditworthiness and financial health, but who fall into the very common lending gap for American small businesses. I have believed and trusted in SBA’s mission to aid and protect these borrowers for the entirety of my career; however, it is disheartening to see an FY20 budget request from SBA that takes advantage of small business borrowers.

As a lender, when the President's FY20 budget was released, I was surprised. The budget states a positive subsidy calculation for the 7(a) loan program for FY20 of \$99 million—a marked shift from the program's track record of operating at zero subsidy, or no cost to the taxpayer. Even more surprising is that SBA makes clear that its preferred solution for this \$99 million cost is to increase fees on both small business borrowers and lenders in a proposal that would have serious ramifications that I will speak to later in my testimony. In reality, SBA has essentially told Congress that it has a choice of either appropriating \$99 million or hiking up fees on borrowers and lenders—or the program shuts down on October 1.

My first thought as a seasoned lender is to question whether or not there have been any performance issues in the portfolio: there have been none that SBA has made the industry aware of, none that I can see in the data presented by SBA, and none that I have observed as a lender with boots on the ground. The subsidy calculation projects the net present value of the portfolio so that the government may appropriately account for the best estimate of what the cost of that portfolio will be—in other words, it is an estimated measure of how 7(a) loans originated in FY20 will perform over the lifetime of those loans. It stands to reason that for the portfolio to go from a zero subsidy cost to a positive cost of \$99 million, there would be some indication in a worsening of the portfolio's performance, but there is not. In fact, as a lender who has seen many economic swings in my career, while volume has plateaued in the portfolio, the quality of our portfolio has remained high.

It is also disconcerting that the FY20 budget reveals that every cohort of loans made for the past nine fiscal years show significant downward reestimates—meaning that in those years when SBA asked for a certain level of fees from borrowers and lenders, SBA could have asked for much less and still covered

the cost of the program at zero subsidy. SBA has been repeatedly overcharging borrowers and lenders, which tells me that the current subsidy model used is not working as it should. As a lender, I deal with the consequences of explaining to my borrowers and my institution what SBA fees are owed—borrowers make sacrifices to pay for those fees and my bank has to carefully account for every dollar spent. It is discouraging to learn that small businesses and participating SBA lenders did not need to pay that much in fees for nearly the past decade, yet we have no way to recoup those unnecessary losses for the borrowers.

I am fully aware that the subsidy model for the program is complex and involves a number of different assumptions. But as a lender and a steward of access to capital for thousands of small business borrowers, I think it is appropriate for both the industry and Congress to be made aware of what goes into this subsidy calculation. Much of the subsidy calculation involves projections and assumptions—projections and assumptions can be wrong and are not necessarily hard and fast truths. The model to develop the subsidy calculation for the 7(a) program, and all lending programs, has always been shrouded behind a black curtain—never discussed with industry, and I strongly doubt ever discussed with the Hill. This is not right, namely because the results of these subsidy calculations have real life consequences that, in this instance, will absolutely serve to shrink access to capital. I urge this Subcommittee and the House Committee on Small Business to work with OMB and SBA to obtain the details of this subsidy estimate, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model. Lenders are the stewards of this program without whom there would be no SBA lending, and Congress gives the program its authority to exist each fiscal year—does it make sense that neither of us know how the cost of the program is calculated, but are expected to simply take SBA and OMB at their word without any discussion?

There seems to be an expectation that we should simply trust a calculation that does not follow logic, despite the fact that portfolio performance is better than ever with a repeated overcharging of participants for nearly the last decade. This expectation is even more incredulous given the consequences the 7(a) program will experience as a result of SBA’s calculation.

If we refer to SBA’s proposed increased fee structure to cover the cost of the \$99 million subsidy calculation, the small business borrower’s fees will increase measurably—this is a tax on small business. Anyone who claims that SBA’s proposed fee increases are not impactful to the borrower must not be a lender. Not only is SBA proposing increasing caps on the upfront fees to borrowers, but they are also adjusting several tiers that currently separate the various fee caps by loan size (see Table 1 below). The result is that for loans made in the range of \$500,001 to \$700,000, borrowers would pay an increased fee that was formerly reserved for only loans greater than \$700,000, and for loans greater than \$1.5 million, there is a new tier created at a higher rate than borrowers have seen before. There is also an increase in the fee charged to borrowers for a loan term less than a year.

Table 1: Proposed Changes in Upfront Fees

| Current Fee Structure on Upfront Fee on Borrower | SBA Proposed Fee Structure on Upfront Fee on Borrower to Cover the \$99 Million Subsidy |
|---|--|
| Loans <= \$150,000: 2.0% | Loans <= \$150,000: 2.0% |
| \$150,000 < Loans <= \$700,000: 3.0% | \$150,000 < Loans <= \$500,000: 3.0% |
| Loans > \$700,000: 3.50% | \$500,000 < Loans <= \$1.5 million: 3.50% |
| | Loans > \$1.5 million: 3.75% |
| Additional 0.25% fee for any guaranteed amount over \$1 million | Additional 0.25% fee for any guaranteed amount over \$1 million |
| Loan term less than 1 year: 0.25% | Loan term less than 1 year: 0.50% |

At Fulton Bank, many of our loans are made between \$500,000 and \$700,000 and would be impacted, as well as our larger loans and working capital with a one year term or less. By way of example, in Mercer County in New Jersey, we made a \$520,000 loan to Emcom Systems, a small manufacturing company employing 20 individuals that makes security devices for public and transport use—think security phones on subways and blue light phones on college campuses. Upfront fees to the borrower were \$11,700 and under the new scenario, those fees would have been \$13,650. The additional \$1,950 may not sound like that much, but in Emcom’s world, these funds could be utilized to hire additional staff or increase profitability through bulk material purchasing and process improvements.

Or take the example of a \$515,000 loan to Kaylah Designs, Inc., a jewelry manufacturer with locations in Pikesville, Maryland and Lakewood, New Jersey. The upfront fee on this loan was \$11,587.50 and under the proposed budget, this small business would pay an additional \$1,931.25—to this small business, that savings represents additional raw materials to boost sales and represents more than a 16% increase in fees.

Fulton Bank’s borrower, Three Eye Research, in Cherry Hill, New Jersey received an Export Working Capital line of credit for \$1,000,000—they paid \$2,500 in an upfront fee for a 12-month credit facility. Under SBA’s new proposal, the fee would have doubled to \$5,000, potentially hampering the company from being able to utilize these excess funds to create jobs or increase productivity.

T Group, LLC is a trucking company just outside of Bordentown, New Jersey that has seen its business expand due to the enormous boom in delivery services from online purchasing. The company borrowed \$2,975,000 to purchase their location and adjacent property to house their fleet. Their upfront fees

totaled \$81,171.87. Under SBA’s proposed fee structure, the company would pay an additional \$5,578.11.

These fee increases are especially taxing on small business borrowers in light of the repeated overcharging of borrowers to operate this program for the past eight fiscal years. In the end, if SBA’s current proposal is adopted by Congress, many small business borrowers may be dissuaded from considering a SBA loan and there will be a reduction in access to capital. This negative consequence of SBA’s own proposal seems antithetical to SBA’s stated mission and the mission of the 7(a) program.

What would be the impact to participating SBA lenders? Again, if we refer to SBA’s own proposed fee structure to cover the cost of the \$99 million subsidy calculation, lenders’ costs increase significantly (see Table 2 below). For Fulton Bank, the costs for my SBA department would increase by roughly 25% just on new loan originations in FY20, with that number multiplying by itself year over year into the future since these lender fees are charged on an annual basis for the life of the loan.

Table 2: Proposed Changes in Ongoing Fee

| Current Fee Structure on Ongoing Fee on Lender | SBA Proposed Fee Structure on Ongoing Fee on Lender to Cover the \$99 Million Subsidy |
|---|--|
| 55 bps on all loans | 55 bps for loans up to \$1.5 million 69 bps for loans over \$1.5 million |

It is important to emphasize for this Subcommittee that when costs increase on lenders, there is a domino effect on how lenders will utilize this program—the results of which will only hurt the small business borrower in the end. For instance, in an effort to recover lost revenue, lenders who are not at current interest rate maximums (which are capped by statute and regulation), will be forced to increase interest rates on borrowers wherever they can in an effort to recoup losses. For the lenders who are at

the current interest rate maximums, they will have no choice but to simply shrink their 7(a) loan portfolios to still afford to make 7(a) loans with measurably higher costs. At Fulton Bank, many of the larger loans we make are not at the interest rate maximums and we will have to seriously consider increasing those rates, as well as rates on any other loans in our portfolio that we do not currently charge at the interest rate maximum.

Lenders could turn to selling significantly more of their loans on the secondary market in order to create necessary liquidity, putting potential stress on the Secondary Market Guarantee Program. Since lenders with a high percentage of secondary market sales in their portfolio are flagged higher risk in OCRM's risk reviews, OCRM will likely report to Congress in the coming years that lenders are exhibiting higher risk profiles than they were in prior years, which will be a consequence of SBA's own making.

To make matters worse, SBA's proposed fees on lenders are concentrated on large dollar loans, which makes sense if the goal is to find the easiest source of revenue to achieve \$99 million in additional fees since larger loans generate higher fees. However, this Subcommittee needs to understand that when you disincentivize lenders from making larger loans, which is what this proposal will do, the subsidy in future years will be negatively impacted since the fee income from larger loans contribute more to the subsidy account and provides overall subsidy stability—again, another potential consequence of SBA's own making.

Finally, when banks take such a drastic hit to internal costs, efficiency ratios in the bank increase. This efficiency ratio is simply the bank's operating costs, referred to on the bank's income statement as 'non-interest expenses' divided by its net revenue (total income minus interest expense). Banks strive to have

their efficiency ratio as close to 50% as possible. As a result of increased costs and efficiency ratios, many SBA lenders could be faced with a tough conversation with their management, board of directors, or stockholders about whether or not the bank can invest any more in their SBA department or whether SBA lending is a good option for the bank at all. From a big picture perspective, banks will likely shrink their current volume or, at the very least, halt current volume—and they will certainly find it difficult to *increase* their volume of SBA loans. Is this really the outcome that SBA hopes for when it comes to their flagship loan program?

There are several other concerning provisions in the President's FY20 budget request that warrant discussion, such as the continued request for borrowers and lenders to pay for SBA's employees' salaries and expenses by collecting excess fees beyond what SBA needs to cover the credit costs of the program. This is an outrageous request given the questionable positive subsidy calculation this year. The consequences of an additional \$99 million estimated cost to the program I have outlined above will only be exacerbated since this proposal, combined with the necessary cost of covering the positive subsidy, will cost 7(a) borrowers and lenders \$197 million in fees on top of what they already pay. To even request this additional fee structure shows an alarming disconnect between SBA and the reality of the costs of this program on small business borrowers and lenders. I am only comforted by the fact that Congress made clear in FY19 that it would not tax borrowers and lenders for SBA's administrative costs when SBA proposed this same request last year.

But make no mistake, the part of this budget request that is not just a request is the subsidy calculation. SBA reports the subsidy rate every fiscal year and Congress reacts accordingly through the appropriations process. I urge you not to simply take this subsidy calculation at face value and seriously

challenge the subsidy rate—borrowers, lenders, and the ability of the 7(a) program to serve access to capital needs across the country are dependent on how you react to this surprising calculation.

Thank you for holding this hearing and I appreciate the opportunity to testify before this Committee. As lenders, we are incredibly proud of who we serve and the role we play in each of the districts you represent. We want to continue increasing opportunities for small businesses and open the doors to access to capital. The SBA's FY20 budget request would do just the opposite—it would shrink access to capital, closing the door on many borrowers and lenders. I hope that I have helped to make sure that this Subcommittee and Congress are aware of the real consequences that will result from SBA's questionable subsidy calculation and its flawed proposal to address it. I look forward to your questions.