BEFCOR
Business Expansion Funding Corporation

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Submitted by
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Representative Chu and other distinguished committee members, good morning. I am Elaine Fairman and am here on behalf of Business Expansion Funding Corporation, a CDC in North Carolina. I am pleased share with you the jobs and economic development we bring to many communities, particularly with the 504 loan program, as well as the challenges we face.

Business Expansion Funding Corporation, known as BEFCOR, was created by the City of Charlotte in 1982 to operate a city-wide CDC. Later, the organization became statewide, serving all of North Carolina and portions of upstate South Carolina. Today, we have a staff of 14, in 3 offices, and we have led the state in lending to 504 borrowers for 8 years. In 2016, we merged with another non-profit CDC and absorbed a portion of a third CDC, allowing us more resources and reach to better serve North Carolina's entrepreneurs.

In addition to the SBA 504 program, our CDC operates a Small Business Loan Fund, capitalized by a generous grant from the Golden LEAF Foundation. The SBLF program provides financing for businesses in rural and hurricane-impacted areas. In the last 18 months, we have loaned nearly $500,000 in small amounts to emerging and expanding companies. We are currently seeking other loan program options to allow BEFCOR to serve even more small businesses.

As you know, 504 is SBA's economic development loan program. SBA 504 borrowers are required by statute to create or retain jobs, or meet certain public policy goals identified by Congress. The CDC industry is proud that we are currently assisting small businesses with this program at zero subsidy - this program is self-funded. CDCs assist numerous small businesses, including manufacturers, distributors, retailers, professional offices and many others. Both new and expanding businesses are generally eligible, and this program is the reason many businesses are able to grow.

I entered the SBA lending field in 1987, working with a small CDC in South Carolina as a loan officer. That CDC was affiliated with a Council of Government and I began my career knowing that small business lending was not just about lending – it was also about economic development. That attention to economic development formed the way I view SBA financing. I left that CDC in 2007 to join a large organization, Self-Help Ventures Fund, in their Charlotte, NC office. I left Self-Help in 2012 to become the Executive Director of BEFCOR. I have worked in nearly every facet of the SBA 504 world – marketing, packaging, underwriting, closing, servicing, governance, compliance, oversight, advocacy, and more. In addition to 504 loans, I have worked with EDA, USDA, and privately-funded loan programs. I am proud to be serving my second term as a Board member and the Treasurer for the National Association of Development Companies, the trade association that serves the CDC industry. Needless to say, I am passionate about my work – I truly believe this work matters. I consider it a privilege to work with small businesses and with others in my CDC who are deeply committed to making a difference for small business owners. When a business owner acknowledges the impact that BEFCOR has made on her business and future, I know that our efforts have succeeded.

I would like to share stories of two successful entrepreneurs assisted by BEFCOR through the 504 program. One is a catering business that began in 2010 and soon had offices and kitchens in multiple locations. In 2014, a SBA 504 loan approval allowed this young business owner to unite all business operations under one roof. This project improved efficiency and quality, and the company's workforce tripled. Because the business was relatively new, SBA 504 financing was needed. Now, not only is the business very successful, it is a community-minded company, offering discounts to help many non-profits in the area. The business owner has been such a leader in our business community that BEFCOR nominated the owner for Small Business Person of the Year for North Carolina – we were elated when he won in April 2018.

Another example of the power of the 504 program is a minority female physician who started her practice in 2010. Her goal was to provide an array of therapy and counseling services to the underserved communities in the Raleigh-Durham area. As her practice expanded, she had to relocate every few years in order to accommodate the growth. Finding appropriate space and negotiating terms with landlords for her business' changing needs began to take too much of her time. And, her customers had to keep up with her new locations. A 504 loan allowed her to purchase her own office space, providing stability for both employees and clients. She learned that owning her own building was actually less expensive than paying rent. With her new office space, the physician has continued to grow her practice and she has hired additional staff to keep up with demand. Today, she has six employees on site, and eight outpatient therapists.

While the SBA 504 program has helped numerous businesses thrive, there are policies in place that prevent us from supporting even more businesses.

One of the issues adversely impacting 504 borrowers is what we call the "EPC/OC rules." Initially included in the program's parameters as a way to insure that 504 loans benefit operating businesses instead of developers or investors, the rules have not been updated to reflect common business practices. Often considered "too cumbersome" or "too confusing" to address due to the nuances, details, and complexity, EPC/OC rules are in dire need of revision. The fact that it is too difficult to explain is a clear indicator that it needs to be revisited. Yet we continue to pass opportunities to develop a simple fix to an old problem – I believe the time has come that we MUST address the EPC/OC rules for the benefit of small businesses. These rules are an impairment to accessing SBA loans and unfairly restrict our borrowers' ability to write off expenses afforded to other businesses.

One EPC/OC rule is used to dictate the lease between an operating small business (the OC) and the separate legal entity formed to hold title for the real estate that business purchases (the EPC). Normally, both have similar or identical ownership, and the business uses this structure for business management purposes. The rule, originally designed to ensure that developers and investors do not benefit from SBA 504 loans, mandates unreasonable limits on the rent payments from the OC to its EPC. The control on rent forces small businesses to lose depreciation as a deductible expense and means that lease payments between the OC and its EPC are often determined by the loans that funded the building, instead of being determined by market rates.

The problem with this EPC/OC rule is not only that it dictates lease payments but it also creates ripple effects on basic business decisions that small business owners make. When SBA mandates how much rent can be charged under certain business formation structures, it is effectively interfering with tax strategies, management strategies, and advice of the business' advisors (such as CPAs and attorneys). So many entrepreneurs risk their own financial resources to make their businesses succeed, give up time away from families to launch their companies, and then they personally guarantee their business' debt. The EPC/OC policy, with so much control over the business, seems to be a grievous overstep.

Recently, a borrower that had previously used the 504 program to expand geographically and open additional locations requested financing for a new location. His early loans were very successful for the program's mission, creating jobs and providing services in his local community. However, when he applied for another 504 loan to continue growing, he reached the

EPC/OC hurdle. Because SBA believed the business had not complied with EPC/OC rules when it reviewed his previous loans, the borrower was told to either comply or be denied financing for the new project. This business is the very type of growing, job-creating business that communities want and we strive to serve. If fact, the business had already demonstrated a track record of success within the program, and not a record of risk.

Beyond the rent structure I just outlined, rules governing small businesses with an EPC/OC structure also dictate leasing agreements 504 borrowers have with third parties that are leasing space in their building. In addition, EPCs are prevented from holding other OCs beyond the single one involved in their 504 loan. Similar to the rent issue I already discussed, these requirements routinely go against the advice small businesses receive from their advisors such as accountants and lawyers and do not reflect standard business practices in the industry.

The EPC/OC structure does not impose undue risk on the 504 program. The rules were designed decades ago to address a "then-present" concern that investors or developers would exploit the program. However, over many years of working with the 504 program, it is clear that these fears are unfounded. In addition, when a 504 loan is made to a small business that is using an EPC/OC structure, both the EPC and the OC are obligated for the loan repayment. This is not a structure that allows either of them to avoid their obligation to responsibly manage their government-guaranteed loan. These rules present unnecessary barriers to our ability to serve more growing businesses.

In addition to the EPC/OC rules, the owner-occupancy rules impose additional challenges to small businesses who could benefit from the 504 program. They are inconsistent and have no clear reasoning. Currently, if a business **buys** an existing building using a 504 loan, it can lease up to 49% of the building to another business. However, if a business **constructs** a new building using a 504 loan, it can only lease out 40% for a few years, and then 20% long-term. Once again, these rules are not based on risk mitigation or sound lending – they are arbitrary. Most business owners do not desire to be landlords long-term, so why does buying an existing building or constructing a new one change the amount or length of time they can lease? These occupancy percentages also do not reflect the reality of how existing buildings are laid out. If a business buys a building with two stories, each of which has the same amount of square footage, it cannot have a 504 loan for the purchase; however, if the downstairs has a few extra feet to allow the business to occupy 51% of the building, it can. These occupancy rules should be harmonized and reflect a maximum 50% owner occupancy requirement. In densely populated areas, the Committee could consider making the occupancy requirement even lower, given the limited real estate options and the many multistory buildings in these areas.

Another matter of concern for small businesses who want to access the 504 program is the onerous rules to refinancing existing debt. We appreciate the excellent work of this Committee from 2010 through 2015 to make refinancing permanently available to small business owners. However, some of the regulations implementing that statute have limited its effectiveness. Refinancing through conventional channels has long been a challenge for many small businesses – newer businesses, certain industry sectors, and during times of economic volatility. When reviewing whether a loan secured by fixed assets is eligible for refinancing with a 504 loan, CDCs are required to obtain certification that 85% of the debt was originally eligible for a 504 loan, that only 20% of the refinanced amount can be used as cash for the business, and other confusing percentages. Additionally, expanding businesses are limited by the 504 program to refinancing existing debt of no more than 50% of the cost of the new project. Refinancing is another example of seemingly arbitrary percentages that restrict growing, expanding businesses that are the very foundation of our program – everything we do encourages businesses to expand – yet, the rules tie their hands when they are refinancing an expansion. Rules should be tied to the mission of this program and the risk to the government. Right now, these rules seem to be tied to neither.

Finally, I want to highlight one more issue that is a severe detriment to small business borrowers in the 504 program. The SBA 504 was designed to stimulate economic development and to ease access to capital for growing businesses. When I entered the world of SBA lending, the first thing I learned was why the program exists: job-creating businesses fuel the economic engine that allows people to buy homes, educate their children, and live productive and satisfying lives. While home ownership has often been dubbed the American Dream, it is not a sustainable dream if homeowners cannot find jobs in their communities. The 504 program was designed from inception to be an economic development boon to communities by easing the pain of borrowing money for small businesses. We know that low-cost, low interest rate, low down payment financing accelerates the growth trajectory for many businesses, allowing them to grow faster and on solid footing. However, recent rule changes in how loans are reviewed may raise questions about whether we have forgotten the principles of the 504 program.

CDCs are now required to evaluate the on-hand cash of the business, disregarding what it may need for operations. If a business owner has personal cash on hand for savings, instead of being able to invest those funds in an IRA, she may be required to use those funds in lieu of an SBA loan – in fact, savings for her children's education can be required to be used for business purposes. We all tell children from an early age to make sure they have a rainy day fund for life emergencies that are inevitable. Why wouldn't we want our small businesses to plan the same way? A business owner with no "cash cushion" or "rainy day fund" to help get her business through the loss of a contract or a market fluctuation could receive a 504 approval while that same business that has some "cash cushion" savings might not be eligible. To say that we would fail to assist the business owner who has made better decisions and would be a better credit risk is most definitely counter-intuitive – perhaps, some would consider it a poor lending practice. To penalize a small business owner for caring about her business enough to sacrifice and reserve personal funds to support their business simply seems wrong.

Small business owners should absolutely use their funds as a down payment on a 504 loan, but not to the point that the financial health of their business is jeopardized. Any policy that requires that owners deplete their cash will harm the business, its employees, and the likelihood repayment on a 504 loan.

In all of the percentages, program improvements, statistics and definitions that are shared when the 504 program is discussed, I hope we can maintain clear sight of the extraordinary work the 504 program allows CDCs to perform on a daily basis in conjunction with the Small Business Administration as our partner. Small business are the lifeblood of our economy. At the core, small businesses are not inanimate objects – they are people taking ideas and solving problems, people providing meaningful jobs and advancement opportunities to others, people paying taxes to pay for services in our communities, and much, much more. If we are willing to improve the 504 program by working together, we can expand our reach and impact. I stand ready to assist in any way in finding improvements to the 504 program.

I thank you for your time today and welcome your questions.