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SBA REAUTHORIZATION: SMALL BUSINESS LOAN PROGRAMS

ROUNDTABLE

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

May 2, 2007

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WEDNESDAY, MAY 2, 2007

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP,
Washington, D.C.

The roundtable convened, pursuant to notice, at 10:14 a.m., in room 428A, Russell Senate Office Building, Hon. John Kerry, Chairman of the Committee, presiding.

Present: Senator Kerry.

Staff Present: Kevin Wheeler, Deputy Staff Director for Senator Kerry; Jacqueline Ferko, Professional Staff Member for Senator Snowe.

OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, CHAIRMAN, SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Chairman KERRY. Thank you all very much. This roundtable will start, and I really appreciate everybody taking time to be here.

I apologize for being a little late. I had to go to the Finance Committee just to weigh in because we have a concurrent hearing going on there, and I just needed to be there for the beginning of it, so thank you for your indulgence. I appreciate it. And because of that, I am not able to stay here the whole time, but that is a normal procedure with the roundtables that we have had.

Senator Snowe initiated the roundtable process here in this Committee, and I think it worked very effectively and has been a very comprehensive and effective way of kind of giving people a chance to talk a little more and have more of a conversation and get rid of some of the formality of the hearing process itself. And we do keep a record, and that transcript will be available. So there is a record. But, on the other hand, there is just much more interchange and exchange and back-and-forth, and I think it becomes a more effective way of helping to respond to people's criticisms and understand what we can get done and how to do it and maybe sometimes even come up with some solutions that we would not otherwise.

Also, I want to put it in the context that last year many of you here today or many of your organizations have already testified or submitted testimony, and you have helped us build a record, which is what we need to do, with respect to the very provisions that are in the small business lending reauthorization bill that Senator

Snowe and I introduced yesterday. So the record has been building for that. In addition, most of those provisions ought to look familiar to you because they were part of the comprehensive reauthorization bill that the Committee adopted last summer.

As you know, we ran into some—the only way to describe it is what it is: We ran into sort of a rolling-hold/administration resistance to it, which I think was regrettable, and hopefully we can avoid it this year.

I want to emphasize that Administrator Preston in his hearings here agreed that that was not a productive way to proceed and that we ought to just sit down and negotiate something. If we have a difference, let's sit down and talk about the difference and see if we can work through it on a reasonable basis rather than just letting things languish indefinitely. And I think maybe the dynamics here may have shifted a little bit since both the House and Senate have changed control, and so there may be a slightly different attitude. I know the House, Nydia Velazquez, is adamant about some of the provisions and wants to proceed forward on them. So there will be a more coordinated effort here to try to do that.

Today's roundtable discussion is really meant to complement not only last year's hearing, but also to complement the hearing that we already held this year on the 2008 budget. That budget has generated a lot of discussions regarding the microcredit programs, and on a universal basis, from members on both sides, there was a deep concern about the proposal to make the SBA Microloan programs self-financing and eliminate the technical assistance grants and prime. So I would say it is a fair representation to say that overwhelmingly members of this Committee were opposed to those proposals, and so we need to really sort of examine where we are heading there.

It also touched on the lender oversight and the need to lower fees on small business borrowers and lenders. My experience has been—and, you know, this is not a pet peeve with me. It is simply a response to what we are hearing from the marketplace, from the users—that these fees are too high. And I do not go to any meeting in Massachusetts or elsewhere where small businesses do not tell us that—and the lenders tell us that, too. It comes from both sides of the ledger.

The bill that we introduced yesterday includes language to reduce the loan fees on borrowers and lenders, and a narrower version of that provision, I want to remind everybody, passed with the administration's cooperation in 2004, when they succeeded in taking the 7(a) loan program to zero subsidy. That was part of the 60 pages that were inserted into the omnibus late at night that actually cut out all but one Democratic provision from what had been a bipartisan authorization bill.

So I hope—you know, however well intentioned, the law is not working, and we need to fix that. The language that we have put in does fix it. We think it does it in a way that would address the lending industry's concerns that any funding scenario provides efficient program levels and stability to the program, avoiding shutdowns of the 7(a) loan program or avoiding mandating restrictions on loan sizes or types of loans, which becomes its own set of problems.

Now, I know the administration remains opposed to providing any appropriations for that program, and so we have got to work through this, folks. But, again, I reiterate, I hope we will work through it by really talking it through and not going through this, you know, blind process on the floor, which will incite my anger and others'. There are plenty of ways to choose to respond. So I hope that we can avoid that kind of response, and I assure you that given the options available to us as the majority, we will respond. But I do not want to do that. I would like to get it worked out. I am a reasonable person. We are happy to try to find some way to do it. But we need a good-faith effort to try to do that.

I might add that while the bill was introduced yesterday, I want to emphasize for the record that there has been a significant amount of time available to review the fee language because it is almost the exact same language that our Committee adopted last summer. It is similar to what the Senate passed as an appropriations bill in 2006. So there is no surprise here. There is no "God, we need to study this. We have to take a while to know it." We have been through this one, folks.

And I might add, OMB has been wrong on calculating the subsidy rate for the 7(a) loan program for 13 out of the last 15 years. So I really think reasonableness dictates that we ought to be able to find the common ground on this one.

I know there will be some differences on a few things. One—let me just mention very quickly—is the microlending program. I would just quickly make the case that we put less than $30 million a year into this microlending program, but we put $200 million into microcredit programs internationally in 2005. We spent $56 for microcredit programs in Iraq in 2006. And there is a request for about $160 million for microcredit programs in 2007 as part of the supplemental funding for the war in Iraq.

So at the same time as we are struggling to get $30 million for our own country for a lot of pockets of poverty in rural and urban centers, we are putting severalfold back into Iraq to, you know, frustration of a lot of people here. Not to mention the contradiction of our Government killing microcredit programs because they are "too expensive," even though the loans are repaid and they work extraordinarily well, and as the Nobel Prize Committee is awarding the Peace Prize to Muhammad Yunus for doing exactly that on an international basis. It just does not make sense, folks.

And so I hope that we can find a way to include this in a cooperative, bipartisan way. You know, if it were super-profitable, obviously a whole lot of banks, big banks, would be doing it. But it is not a loss. It is not a loser for the Government, and it fills a lot of other structural, social, educational opportunity needs.

My final comment is on the 7(a) and 504 loan programs. They provide 40 percent of the country's long-term capital to small business, and we all understand the benefits. You know, with longer repayment terms, the small business owner can spread out their payments, reducing monthly costs. It leverages their working capital, their ability to succeed, and we have got to make sure these programs are reaching those people who really need the financing. And, there are two significant places for improvement in these programs. One is in the lending to minorities, and the other is in the lending in rural areas. Those are two places that sort of leap out at us. And loans to these markets have been proportionally stagnant or modest since 2001. We continue to hear a lot of concerns that the 7(a) lending is largely consolidated in about 10 lenders, and we need to make sure that smaller community banks have an ability to be able to participate. We tried to address this in our bill and look forward to your feedback today and, of course, of this session.

So I want to welcome on a personal note, if I can, Joan Wasser Gish, who worked for me in Massachusetts, and did an extraordinary job. She is now a small business owner herself. And I welcome Chris Sikes of the Western Massachusetts Enterprise Fund. Thanks for being here, Chris, also.

They have worked on an advisory committee regarding child care and small businesses, and I just think it would be good to have that discussion today and for people to sort of focus on how that fits into the array of efforts that we make here to try to empower small business people to be able to succeed.

So, again, I want to thank you all. I am going to ask Kevin Wheeler of our staff to facilitate this roundtable, and Jackie Ferko of Senator Snowe's staff, and together they will manage this, as they have in the past. And if other Committee members come, they will obviously have priority in asking questions or engaging you, as they might choose to do so. And if any of the staffs of members have any particular questions, please just put them in through both Kevin and Jackie. We invite you to do so. We want this to be a free-flowing, open effort to get the best information that we can.

So, again, thank you all very, very much, and I hope that we will have a good record here today that will facilitate our ability to mark up the reauthorization bill on May 16th and pass it out of the Committee and on to the full Senate. And we really look forward to every member's full participation in this so that we do not wind up at the markup with people feeling somehow that they have not had a chance to explore amendments or possibilities. So we look forward to it.

Thank you all very, very much. Kevin?

Ms. WHEELER. The agenda says that we will go ahead and start with the Microloan program, and out of courtesy to the SBA, we will let them make their proposals first from their legislative package. And we will allow the participants at the table to comment on them and to also offer their proposals.

Tee or Mike? We are so informal that we will just use first names here.

Mr. ROWE. Well, thank you, Kevin.

Chairman KERRY. The record actually needs to know who the——

Ms. WHEELER. I am sorry.

Mr. ROWE. Yes, Tee Rowe. I am the head of Congressional and Legislative Affairs at the Small Business Administration. Good morning, everyone. Thank you, Senator Kerry, very much.

I think the Senator has pretty ably summarized SBA's proposal for the Microloan program; that is, the administration believes it would be effective for the subsidy of the program to go to zero by raising the interest rate on the program, which is currently two points below the Federal cost of funds, to slightly above the Federal cost of funds, to, I think, 1.06 percent above. This will enable the program to be self-funding and essentially have an open-ended funding stream for any and all microlenders interested.

At the same time the administration is proposing that technical assistance be provided through our existing technical assistance providers—Women's Business Centers, SCORE, Small Business Development Centers.

That is a pretty straightforward summary. Thank you.

Ms. WHEELER. You know, may I just add, many of you have participated in roundtables before, and I forgot to say—we are so familiar—that I forgot to add that if you would like to speak or respond, turn your cards on their side, and then we will call on you. So would anyone like to——

Chairman KERRY. Let me just sort of ask an open question and some of you can dig into it. What do you say to the sort of universal response of the members and the people we represent that this begins to be counterproductive, works against the purpose of the plan itself? I mean, I understand the market concept, and I understand the constraints we all operate under. But just from a practical, operative, in-the-field reality, how do you respond to this notion, you know, you are kind of giving to Peter and you are taking from Paul. You are giving us here, and you are taking over here.

Mr. ROWE. Well, Senator, to some extent I agree with what you are saying there. I think, however, we cannot view this in a vacuum. I think it is clear, if you ask the other participants—for example, I know Mr. Wilson in North Carolina accesses at least four other Federal funding streams. And what we are looking at here is a larger question of how much and where does the Federal Government support microenterprise. Is there a need for us to begin to coalesce these various programs?

Chairman KERRY. What other funding streams are you including?

Mr. ROWE. There is CDFI, Rural Business Enterprise at the USDA; there are at least several others at HHS, CDBG funding.

Chairman KERRY. CDBG is really——

Mr. ROWE. Yes, it comes through HUD, because for a number of microenterprise providers, that is a significant source of funding.

Chairman KERRY. So you are going to count a Medicare payment? Are you going to count a child deduction? Are you going to count all those others and put them on the table and say that is too much?

Mr. ROWE. Well, what I am talking about, Senator, is the various funding streams that go to the microenterprise lending institutions, the various forms of grant assistance.

Chairman KERRY. Only those in microlending.

Mr. ROWE. Right.

Chairman KERRY. And you feel that in the conglomerate, those microlending grants from various sources are somehow overly generous?

Mr. ROWE. Not overly generous, but I think what we are looking at is: Has there been a diffusion of effort? Is it possible that while supporting microenterprise, we are probably overly broad in our various outlets.

Chairman KERRY. Does that mean we are too generous——

Mr. ROWE. I do not think it is a question of being too generous. I think——

Chairman KERRY. Are we overly effective?

Mr. ROWE. I think it is more like looking at your bills, and if you had five different ways of paying your electric bill, you would say, Why am I not just simply paying one source?

Mr. SIKES. Good morning. I am Chris Sikes. I am the executive director of the Western Massachusetts Enterprise Fund, and thank you, Senator Kerry, for all the support you have given us through all these years, where you are the Ranking Member or the Chair for small business and microenterprise. It has been phenomenal. And as a constituent, I can say that your support has been steady all the way through and very proactive, and thank you for that.

I want to frame, if I could, just very briefly just why the microenterprise program is so effective, because the reason, the central core of this program is that it marries technical assistance and lending. When you are making a loan to a microenterprise, it is the most fragile type of business. They have the fewest resources. Oftentimes, they are in a highly competitive market with larger businesses, and when you can link the technical assistance with the loan, you are forming a critical partnership for the success of an enterprise.

What we have seen over the years—and we have been in this program since it was the first year of a demonstration program—was how effective it is when you link the technical assistance with the loan. And we have come up with a whole array of technical assistance products to meet the specific needs of the businesses in our market. It can be one-on-one technical assistance. We can put together support groups for that business. We can put together advisory groups for business. And the rate of success is seen by the fact that—roughly you flip the equation, which is generally you see an 80-percent failure in the first 5 years, to an 80-percent success rate. And I attribute that directly to linking the technical assistance with the lender, with the microlender. And it is the flexibility of being an unregulated financial institution—that intermediary, that is—that allows us to do that, where a bank cannot do that, and allows us to take the type of risk in terms of lack of collateral and being a start-up, et cetera, that no other lending institute can do.

Also, because the technical assistance is tied to the intermediary, we are the one at risk, so we are there at all times working with that business. We are seeking the business out as much as the business is seeking us out, and that has been a core part of our success.

Chairman KERRY. Let me come to the gist of the proposals that are on the table so we get at it. I doubt we have disagreement on technical assistance. We are all in agreement we need technical assistance. There are two issues on the table. What is the impact on the interest? And what is the impact of shifting this to Women Business Centers and Small Business Development Centers—does it have an impact?

Mr. SIKES. Yes, it has an impact. In terms, first of all, of the fact that you would go to the SBDCs or the Women Business Centers, the big difference there is that when the lender has access to the technical assistance, we are going to be using our resources with that business directly because we are in a partnership for the length of that loan. We need that support to work with them, and we are going to be much more——

Chairman KERRY. So there is a greater synergy to——

Mr. SIKES. And we are going to be more proactive than anybody else because it is in our best interest to be proactive to save our loans and to make this——

Chairman KERRY. Why does it not—I mean, this is like a venture capitalist, you get in, you want to be involved in decisions because you really want to make sure your loan is going to be successful. If you lodge that technical assistance somewhere else, aren't you——

Mr. ROWE. Well, I would say that, unfortunately, when we look at this, we find that the interlocking nature of many of the funds, whether it is Mountain Business Works or the Western Massachusetts Enterprise Fund, is very directly related to the local technical assistance providers. They make no bones about either being a Women's Business Center and being a microlender. And what we believe is we are providing the funding and the technical assistance for these borrowers.

We completely agree that the microlending intermediary needs to be hands-on. That is part and parcel of it. What we are talking about are the multiple funding streams that are coming out of SBA and trying to coordinate and maximize the effectiveness of all these outlets we offer.

Chairman KERRY. Do you want to respond to that?

Mr. SIKES. It is the same comment again. I just think that if you want to see this program work, you have got to allow the intermediaries who are making the loans have the technical assistance resource to support those loans. Let us get our hands dirty, as it were, so we can really work with these businesses. You handcuff this program to the point where it will not work if you separate the technical assistance from the lending.

Chairman KERRY. Mr. Wilson?

Mr. WALKER-WILSON. Greg Walker-Wilson, CEO of Mountain Bizworks, Asheville, NC, also chair of the Association for Enterprise Opportunity.

We work with hundreds of small businesses every year in North Carolina, and many of them are low-income, they are women. Each of these particular funding sources targets the specific needs that each of those has. Prime is for very-low-income and low-income.

I really view these bills as the American dream funding sources. They make the American dream possible. And that is what this is all about. The organizations like mine and Chris', we are helping people succeed, pull themselves up by the bootstraps, and we are able to help them create a better life for their family. And so we are offering them training and consulting to hundreds of people. Each of these sources are unique, and one is focusing on the needs of women's businesses, others on training for low-income.

The microloans do need to be connected to the training and technical assistance. We did a study about 18 months ago looking at the 3-year survival rate of our businesses. We saw a survival rate of 70, 74 percent. Typically, we see just in the general population well under 50 percent. When you marry training and lending together, you have a much higher chance of success. And that is what this is all about, and that is why it is so important.

Chairman KERRY. Mr. Kelly?

Mr. KELLY. I am Kevin Kelly. I am the managing director for policy and advocacy at the Association for Enterprise Opportunity that Greg just mentioned.

I just wanted to mention one thing, Senator Kerry. When this proposal was first released earlier in the year about getting rid of the technical assistance portion of the Microloan program, we had a call with the Microloan intermediaries that are part of our membership, and I said I think I know the answer to this and what you are going to say, but I want to hear from you. What does this mean? How would this work in your community? What is your reaction to what the President's budget is saying here about using SBDCs, Women's Business Centers, and so forth to do this instead of through the Microloan program? And informally they said, This does not work in our community. Some of the SBDCs, for example, they don't work with microenterprises. That is not part of who they target.

So even if there is somebody in that same community—and I heard Mr. Preston talk about the overlap and there are a lot of them in the same place where the intermediaries are—that does not necessarily mean they are working with the same type of entrepreneur or providing the same type of services.

I would echo what Chris is saying because I heard the same thing on our call with our members who are the intermediaries who are doing this on the ground. To them this is not a practical solution to what they are trying to accomplish.

Chairman KERRY. I have got to back to another meeting, but let me just say to everybody it seems to me that there ought to be a way. Draw each other out on this. Listen to each other, is the most important thing. Let's not get fixed in some sort of ideological place. There is a practicality here. There is a reality of how the business world works. There is a reality of how money works. There is also a reality about accountability. I am not suggesting the Government has the best way to handle all of it, but there is a synergy that we ought to be able to try to create here where you can get the best of both worlds, if you can get the Women Business Centers involved in some intelligent way, but not to the exclusion necessarily of the other folks' ability to be able to get a handle on it. Let the marketplace maybe decide. Let people choose, give them the breadth of that rather than become in a sense picking a winner or a loser here and deciding a rigid sense of the road that it is going to go on.

So I urge you to try to explore that as you think about it, and hopefully maybe be able to come to some kind of an agreement and consensus on it.

I know we have got a bunch of folks with cards up and a bunch of other issues to roll through, so let me let you do that.

Ms. WHEELER. Before we go, I did not hear anybody answer the question to Tee's comment about multiple sources and why SBA contends that TA can be provided through these other sources and not through this complementary program. So if somebody could—Ron, I will go ahead and call on you.

Mr. PHILLIPS. Thank you, Senator Kerry—who has just left us. But my name is Ron Phillips from Coastal Enterprises in Maine. We are a rural CDC and CDFI, if you know those acronyms. But we have the great pleasure of being on the recipient end of those multiple programs that the SBA does put out, including the Maine Women's Business Center and SBDC and 504 program and SBA microlender and the whole lot. I am not sure whether to hide under the table or, you know, say a few things here.

But I want to back up the comments that have just started with the three before me. I think it is a slippery slope to delink the TA from the loan program, period. It is a debt instrument and a relationship to borrowers that is so critical that it would get defused with other programs such as the Women's Business Center and SBDC. I would be very cautious about that as a slippery slope.

To the question of those programs being available to this, I am not even sure that it would be advisable to put those programs into a relationship to borrowers because of different goals those programs have. And so I would be very careful about that.

As far as funding goes, that is probably the nub of the issue. In fact, from our experience at the local level, as practitioners, we are struggling for resources to keep those programs going. We are matching funds from the SBA at a significant level. We have to raise those annually. We try to pursue block grant funds. By the way, challenge development block grant, which is not an eligible activity in a continuous way. That is more special project-oriented, at least in the State of Maine. There may be differing plans around that. So I would say that we struggle with other sources just to keep the other programs going, especially the Women's Business Center and SBDC.

As I sit here today, we are putting applications in to just keep the level of effort. We have much greater demand in the market than we have counselor time and availability. So in my mind we should dismiss that as an option.

I think more important is to keep our focus, and we would hope the SBA would because they are a great institution to be backing small business in America, including the micro level, and to delink this TA program from the loan and the important value of the debt instrument to create employment and self-fulfillment among small businesses I think would be a very serious mistake.

Thank you.

Ms. FERKO. First of all, I would like to welcome you from Maine. Senator Snowe gives her welcome, and she apologizes for not being here today. I am Jackie Ferko. I am a staff member with the Committee, and I have been around for 4 years, and some of you know me and some of you do not.

On the macro level, we would like to say obviously this is a very—the Microloan program is a very important issue to Senator Snowe, and we do agree that the technical assistance really does coincide with the lending portion.

I do have a quick question for you. On a micro level, in our proposal, in our legislation, you had a proposal to eliminate the words "short term," and I have been trying to work with SBA just to make sure what your proposal does, and I believe it is in order to provide greater flexibility and ability to provide flexible credit lines to qualified borrowers. And I just want to make sure that is—I want to hear from you that is what you want to do in our legislation and then hear from Tee Rowe to see if that is exactly what it does and if maybe there is—if we need to address that legislation in our leg package.

Mr. PHILLIPS. OK. Am I still on here? This refers to the line of credit type of financing? Well, in our experience that is not a particularly relevant area to be worried about, so, just my opinion, it is not something I would want to spend a lot of time thinking about or worrying about, frankly. We do more term financing, and that is just fine.

It can get a little bit more costly to handle lines of credits, though I would say that there are times and places where that can be useful. But it is a more costly way of financing microenterprise. So you tend to want to do more of a term loan. I hope that is helpful.

Ms. FERKO. Sure, and I absolutely agree with you that we need to address this issue. I am just wondering, you know, does that provision do—especially from the SBA, does that provision do what you want it to do?

Mr. PHILLIPS. I have got to look at the language. I mean, if it is in there—if it does no harm, I suppose it could be in there. Maybe others would comment on that. But I am just saying from our experience as a lender, we are not focused on line of credit language.

Ms. FERKO. Line of credit, OK.

Mr. PHILLIPS. That is all. Thank you.

Ms. FERKO. Tee?

Mr. ROWE. I guess—and when we discussed this, Jackie, I was trying to understand how the change would have affected the program. As I understand from what Mr. Phillips says, it has to do with line of credit financing, though I know that a number of our intermediaries already offer line of credit financing. So I know there is an overall cap for a per borrower lending. I am not sure that the language in the act which says “short-term, fixed-rate financing” prohibits line of credit financing. I know it does—so, you know, we certainly—if there is something in particular that that would change and cure, we are, you know, more than happy to have a discussion on it.

I guess what I am still trying to figure out is what the end goal is, because certainly there is no problem with multiple loans from an intermediary to a borrower, and there is—as long as it is within that overall cap.

Ms. FERKO. OK. Do you have any response to that?

Mr. PHILLIPS. I am not sure where to go with this. If it does not do any harm, if there are others that are availing themselves of line of credit uses—is that what we are saying? As a peer field and network, I certainly would not be one to stand in the way of their abilities to do what they are doing. I am just saying that from our experience we do not need that kind—we do not deploy that kind of capital at this juncture. I can talk another hour about asset financing. That is another issue.

So if it does no harm, and there could be options for others, that would be fine.

Ms. FERKO. Mr. West, do you want to comment quickly?

Mr. WEST. On the technical assistance issue. I am Dennis West. I am president of Northern Initiatives. We are based in the Upper Peninsula of Michigan.

Some of the challenges are the universality of the programs that were talked about. The nearest Women's Business Center is in an 8-hour drive from Marquette. The nearest SCORE volunteers would be a 3-hour drive one way, and if you were on the other end of the Upper Peninsula, it would be 7 hours one day. The Small Business Development Centers have two counselors to cover the 15 counties, and they generally only spend time in the counties where there is matching support being offered. So the ability to offer technical assistance to the providers is not universally applicable, particularly in rural communities.

Our side of the issue is we require monthly statements from all of our SBA Microloan borrowers. So the SBA technical assistance is triggered by the performance of the borrower. So we are able to tailor on a month-to-month basis based upon accounting needs, based upon marketing needs, based upon e-commerce needs, ways to help make that business stronger and better.

And the third point is some of the other programs that were cited, we find ourselves as we make microloans with a multi-year credit and to have opportunities like accessing funds, like community development block grant, would give us potentially one year of funding on a highly competitive basis, and yet our exposure is a multi-year credit and a credit that we are trying to grow.

So those are the three areas I see as problems with moving the TA in the way that you have suggested.

Ms. WHEELER. Mike, do you want to say something?

Mr. HAGER. Michael Hager, head of Cap Access, SBA.

The Senator brought up a great point, and that is, what can we do to reach a practical solution to this? And our big issue here with TA is it is a duplicative effort. We duplicate it in so many of the other programs. That does not mean that we do not have a location Upper Peninsula of Michigan. But we are also entertaining the creation of software TA where one can go online and go through a program that provides technical assistance. As a matter of fact, we are hoping to have it developed to meet the technical assistance requirement for Community Express, for example.

But we have a very nice budget that Congress has provided the SBA for education, and we have talked about the sources of that education: the SBDC, the WBC, and the SCORE. Again, we feel very strongly that let's run this program effectively, and one way to do that is to stop duplication wherever possible.

Ms. WHEELER. You know, we hear complaints that when the argument is made that these programs are duplicative, that it is an oversimplification of technical assistance. And just like one loan does not serve all borrowers' needs, technical assistance does not serve all businesses' needs. And so if we could just go around the table very quickly one minute, try to respond to the SBA's assertion that it is duplicative, and then I have another question if you could get at it. Do any of you receive CDBG money to provide TA to your micro borrowers?

Do you want to go ahead, Greg?

Mr. WALKER-WILSON. Greg Walker-Wilson. Let me see if I can remember all the questions. CDBG, where our central office is in the one city, Asheville, we do receive CDBG funds. It has to be only for low- to moderate-income individuals. We do it on a contract basis. It is sort of a per-fee basis.

The other sources are not duplicative, and while I like the idea of trying to be more efficient and we try to do that, online, for example, could help part of the problem, but we are in the mountains of North Carolina. There are many places that do not really even have dial-up let alone broadband. And the clients that we deal with are people that do not fit into the mainstream. They are lower-income. They have less education. They do not go to their computer to try to get the answers. They say, "I trust those people over there. They are a real person. I trust them. They have been in my city, and they are going to help me out and help me figure out how to do it."

So it may play a role in some ways to do things online. I think in general the populations we serve would not access that. Some of the population would. So I think that we have to deliver them. When we deliver our training and technical assistance, it is very specifically to the people that we are serving. And for folks who can go elsewhere, we want them to do that with financing and whatever. We are not trying to compete with the banks. But what our needs are, we are trying to figure out what is it they need. And so if they are lower education, how do we make it available so it works for them, so they can succeed and achieve the American dream.

Ms. WHEELER. Chris?

Mr. SIKES. I just want to speak to one example on why technical assistance is so important. We have a bakery that we are working with that had a—it had ordered equipment, and they needed that equipment right away because they were just growing. There was a problem with the delivery. It threw off their whole schedule, and it just threw off the whole business, really. And we had to get in there and really working with them in saying, OK, how are you going to restructure by the time that it takes to get the business running well enough until the equipment arrives.

We provided hours of technical assistance in that case, and it was not like making an appointment with another technical assistance provider. We had to be there right away working with them. We restructured the loan, and we worked out a way for them to deal with their payables and help them get a schedule together. All that was obviously to preserve our loan and also to work with that business in a way that we were partnering with them. So that is why, again, linking the technical assistance with the loan is so critical for this program. I do not think the program can honestly run unless you have the TA linked to the loan program.

With regard to the block grant program, block grants, especially for regional funds like ours, are very geographically based by town. So that means with every single town you have to have a separate contract with them. Administratively, it is exorbitantly expensive to do that unless you can get, you know, some grouping. But then you are constantly having to go one year after—on an annual basis—on these contracts. So it is a very costly way, I think, to run the micro program through block grant programs, again, because you have got a long-term commitment on a loan, a liability on the loan, and you have got a short-term technical assistance grant.

Ms. WHEELER. Mr. West.

Mr. WEST. We have never received community development block grant for technical assistance support, and it so far has not shown up as a priority by our State that would enable us. Plus we have the complication of having to go through a local unit of government.

So even if we could get it, it would be hard to do it in such a way that we could cover a large geographic area because the applicant would be a county or a city. So it is a challenge to think that you could use CDBG, particularly in rural areas.

Second, to offer something on the Internet in rural communities where there is not universality of high-speed connection, dial-up sometimes is present, but that is a limitation. And although we respect the use of e-commerce in various ways to connect people using the Internet, it is very much in the future and not currently applicable in a lot of instances.

The third point is that TA is really triggered by the performance of the business, and it is a conversation about how that business is doing based upon its financial performance. And it is not likely that someone is simply going to be able to look at their financials and immediately go to a Web site and figure out off a menu of products what exactly they need.

So working with small borrowers or start-ups, usually their first time in business, it is very important to be able to sit down with them to review their situation and to help craft a plan to help continue their support and growth.

Ms. FERKO. Aside from the technical assistance, I would also like to hear from the microlenders here. How does SBA's proposal of going to zero subsidy affect you? In a negative way? In a positive way? I mean, how would that affect you in lending to the borrowers?

Mr. WALKER-WILSON. It would just make the money much more expensive, and so that affects the bottom line of these small businesses who are just getting started, and every dollar counts in their monthly cash flow. And so that is the reality. And so it is helping them get through in the first loan, getting their business going, and then our goal is to mainstream them and get them farmed out to the private sector. And that is the goal.

So this is only about helping folks get started, having a loan that they can pay for, have enough flexibility, and then from there we can send them out to the private sector.

Ms. FERKO. Would you still participate in the program if——

Mr. WALKER-WILSON. Say again?

Ms. FERKO [continuing]. If it went to zero subsidy?

Mr. WALKER-WILSON. I think it would be difficult to, and it would be much less desirable. I have not evaluated it quite like that, but I have to be a rational manager of resources, and so if this is very expensive and it is not good for our clients, then it would be sort of, you know, the last resort kind of financing.

Mr. SIKES. I fully concur with what Greg said on that. There is a lot of capital out there. People will go to lower-priced capital, to their detriment, because they will lose the technical assistance and they will not understand how important that is, the microenterprises. So the cost will definitely hurt this program, and if you put the high cost and no technical assistance to this program, I think we are effectively saying that this program will not work.

Ms. FERKO. I guess we could assume that if you were still participating in the program, less loans would be made. I mean, there would be less participants.

Do you have——

Mr. PHILLIPS. I do. I dropped my card there to get in here. But just on the block grant, I had said that earlier. I think that is a very difficult source of capital to rely on. But, more importantly, what I would like to re-emphasize is that these other programs are also struggling for resources, and the counselors, whom I worry about, frankly, because we have several at CEI employed—seven business counselors, by the way, in the field—they are overworked and overwhelmed, and we are struggling, too, for their budgets to maintain those every place we can get those funds for matching and other sources. So it is very difficult to think about how a program, an additional program could be put on them aside from the fact of delinking that program from a very special lending relationship. As well, we are doing our best—I am sure others are—to create efficiencies and are attempting to put products through Web-based technology for access both in training—especially for remote rural areas in Maine, and that has some success. So we are, you know, doing some of the efficiencies and coordination that you are talking about. But to delink that, I am not sure that would work.

In terms of the zero subsidy, this is a real struggle because our field is based on helping smaller business with flexible capital and technical assistance, and pushing us into the market level is a place you want to eventually get to and we do get to. But it is very difficult, because we are working with borrowers that are not quite at that market level. Every time you ratchet up the interest rate, you are compressing some aspect of the program.

So to the extent we can maintain the subsidies in this lending area, it would be extremely helpful. Thank you.

Ms. WHEELER. May I ask for a clarification on this? A component of the Microloan program is that each of the intermediaries have a loan loss reserve in which they put up money; they are on the hook for the loans, and if the loans go bad, then they have to cover them. So, really, how would it work for an intermediary to be on the hook, to have to put up the money on these loans but not have control over the TA which counsels the businesses in order to succeed? It seems like it—and maybe SBA could tell me how they see that this would work. How can we expect the intermediaries to put up the money for these loans but not have the funds to counsel them or have control? Because while some of these might have Women's Business Center funding, might have Small Business Development Center funding, some of them do not. So they would not be providing the TA, is what I am saying.

Mr. ROWE. Right. Well, we view it as the lending institution working with the borrower to access the counseling and make sure that that counseling is effective, whether it is through an SBDC or Women's Business Center.

Now, of course, as Mr. West pointed out, you know, there are gaps in rural areas, and these are problems that we have to surmount. Nevertheless, in looking at the TA costs and then looking at the spread—and I believe it is a roughly 8-point spread between what we lend the money out at and what it is lent out at, just to address Mr. Sikes' comment about people seeking less expensive capital. We view the slight shift from 2 points below Fed funds to 1 point above Fed funds as a reasonable cost shift that allows us to expand the program from a current level of about $20 million based on roughly a $2.5 million subsidy to a much larger program level without any subsidy, so that not only Mr. Sikes but, you know, any microlending institution in the country can access these funds, and we do not have to worry about requesting additional appropriations.

Ms. WHEELER. And we understand that it is considered a modest amount, but the feedback we got is that already many of these funds, because it is not a high-profit business, that they are already losing money and this would just exacerbate the situation.

But I want to go back to the loan loss reserve. So if SBA were to take the technical assistance funding away from these intermediaries, would they drop the requirement that they have to put down loan loss reserve funds as an insurance policy for the success of these loans? Because it seems unreasonable to expect them to take scarce dollars for an insurance policy when they do not have control over the management or the counseling of them.

Mr. ROWE. Obviously, if we created a zero subsidy program, we would not consider the need for a loss reserve to be as crucial.

Ms. WHEELER. Right, but they would be paying indirectly anyway. Their fees would simply go up if their defaults go up, and right now there is only one loss in the program. So if there truly is correlation between TA and success and the low losses in the program and we took that out of the equation, defaults go up, then the subsidy to provide the program would go up and, therefore, they would be paying more in fees.

So there seems to be——

Mr. ROWE. OK. I see what you are saying.

Ms. WHEELER. There seems to be a disconnect in the proposal. So if the TA is not going to be provided to these organizations, would the SBA drop the requirement that they have a loan loss reserve fund?

Mr. ROWE. The problem with that is that presupposes that the absence of the TA funding means that there is a complete absence of technical assistance available for the borrowers, and we do not agree with that because obviously we see all the other various outlets that we fund and have available right now.

Ms. WHEELER. Well, I think what it supposes is that these groups are on the hook for these dollars when they are not in control of the technical assistance. We can come back to it, but I wanted to get on the record that this would have to be part of the proposal. It really seems unreasonable that these groups would have to have a loan loss reserve of 15 percent of the loans if they do not have control over the TA.

Mike?

Mr. HAGER. Kevin, I want to be really clear that we are not taking away TA. We are offering several venues to participate in TA.

Ms. WHEELER. Did SBA request money for TA, extra TA money through Small Business Development Centers, Women's Business Centers, or SCORE in order to compensate for the additional borrowers going to those programs?

Mr. HAGER. We think there is capacity to do that.

Ms. WHEELER. I am sorry. Was there a request?

Mr. HAGER. No. But we think there is capacity to handle the request for TA.

Ms. WHEELER. OK.

Mr. HAGER. And, again, you know, the options that we have today, one could argue we think we run a really good TA shop with numerous resources to access that TA, and there could be an argument that we think our TA would be enhanced over what takes place today.

Ms. WHEELER. OK. Greg, do you want to make one final comment? And then we are going to move on to the intermediary lending pilot program?

Mr. WALKER-WILSON. Sure. Greg Walker-Wilson. Just a respectful different point. We do have several different sources, like you are saying. We still have waiting lists, and we still have a budget deficit, and we are leveraging the Federal funds at least one time over. And it is sort of a jigsaw puzzle, and a certain funding source can serve a certain target group, and a certain other funding source can serve another target group. There is not overlap, so it is just—I mean, if we had twice as much money, we could serve that many people. The demand is there, and the creative ideas are there, and I think that our role is to try to help people, help businesses succeed.

Ms. WHEELER. OK. Jackie, do you have a question?

Ms. FERKO. No.

Ms. WHEELER. May I ask one more thing? Could someone please on the record explain to us the distinction between the Microloan program and the Prime program? Go ahead.

Mr. WALKER-WILSON. The Microloan program is specifically to lend money, and so we have been talking about that. Prime is to provide training and technical assistance to low-income and very-low-income, and it has no tie to lending. So there are many people—take my own organization, for example. Probably 75 percent of our clients just want training or technical assistance. They do not want a loan. Or they have some other source. And so if we only put money in the lending, then there are these other folks that want to start businesses that will not have options. And so these are ways of providing capacity building, the prime funds, to helping people have the chance to succeed, adding management capacity, marketing capacity, and so forth.

And for the record as well, I just want to point out that right now the prime funds, only 16 or 17 States are eligible to access these, and this is meant to be a national program in all 50 States. And I think it is important that that barrier be lifted so that any program—there are low-income and very-low-income entrepreneurs in every single State, and to have two-thirds of the country excluded from being able to participate is not fair to those folks.

Ms. WHEELER. OK. We are going to go ahead and move on to the intermediary lending pilot program. For those who do not know, the bill authorizes a 3-year pilot program, and it allows SBA to make loans to local nonprofit lending intermediaries, and then the intermediaries, similar to the SBA's Microloan program, re-loan those funds to small businesses. The program seeks to address the capital needs of start-up and expanding small businesses that require flexible capital, but for some reason are ineligible for private or other funding. It is aimed at businesses that desire larger loans than what can be provide through SBA's Microloan program, loans of sizes between $35,000 and $200,000. The loans to the intermediary would be long term, of 20 years, at 1-percent interest, and they would have a 2-year grace period.

I think we have two participants here today who would like to explain to the Committee why there is a need for this program and why we should test this to see if it could get at this gap lending.

Ron, your card is gone. Do you want to lead off?

Mr. PHILLIPS. Thank you again. And to the SBA, they can take these clam chowders and lobster bisques with them.

Mr. HAGER. You cannot do that.

Mr. PHILLIPS. They are under a hundred bucks each.

[Laughter.]

Mr. PHILLIPS. Or whatever it is, $49. Thank you again.

We have, I guess, the honor in some ways of being the first rural development intermediary lending program in the Nation when USDA adopted that program in the late 1980s. It was a program that came out of Maine with one of our colleagues in Vermont, and it has been a terrific program, well oversubscribed, I believe, and there are a lot of statistics on this throughout rural America, and many entities have advantaged themselves with these kinds of funds and had a tremendous impact in helping to develop and create jobs among small businesses in rural communities.

Our proposal is to have the SBA adopt a pilot program to mimic effectively this successful program.

Ms. WHEELER. This is at USDA, Ron?

Mr. PHILLIPS. Yes, in Rural Development, and I am speaking out of the experience with that rural development program, which in our case we have made loans to over 200 small businesses in rural Maine, and these funds have cumulatively been recycled to amount to something like $15 million of what we call sub-debt capital. And we all know what that means. It is the kind of capital that is near equity that can help enhance the collateral base of the company so that conventional financing can be drawn in, especially the bank. And then you get into this magical area of leverage, and you bring in the banks to that particular deal. And in our case, we leveraged $115 million of bank capital.

The SBA program is modeled on this successful effort. There is no TA assignment to this. The assistance we provide companies is blended in with what you think of as the arbitrage between the cost of funds we have and the amount we loan out to companies.

Some 8,000 jobs, by the way, have been created or sustained in these projects. One of the projects, by the way, is this great company in Whiting, ME, down east Washington County, the poorest county in Maine or among the poorest counties. And they process gourmet-type clam chowders and seafood and herring products and so forth. And you can buy them here in Washington if you are around or at Whole Foods or natural food outlets, because that is their prime market.

The story here is that there is an entrepreneur that decides to try to make a go of it, and he and his significant partner bought a 100-year-old company that was sitting there not going very far. The name Looks goes way back historically in that particular county, and he took it—I think they are employing eight or ten people, and he rebranded the company and developed a strategy to grow the company, and hopefully it will do quite well. They have almost tripled employment, and they are on their way. We hope they are very successful.

Sub-debt money—and even equity capital, but I am talking about sub-debt money—is very important to help a project like this get off the ground. I think Machias Bank is involved with this particular thing.

So my last point—I know I am over my time here. I can go on and mention so many other companies here. But the SBA is not the only institution in this, but it is an important voice and piece to put in it because we cannot use the rural development money in the urban areas. That is only for communities with 25,000 or less population, so we are trying to mimic this into the populations of Maine and throughout the country. And I think you have got a really great program opportunity.

Foundations like the Ford Foundation, the Kellogg Foundation, the Casey Foundation, and many others have been buying into this kind of revolving loan type of program. You are not the only ones there. But to have the SBA, this venerable institution nationally, in this type of pilot would be exceptionally valuable as a pilot.

Thank you.

Ms. WHEELER. Mr. West?

Mr. WEST. Again, I am Dennis West with Northern Initiatives. We serve 49 rural counties, primarily in Michigan. Northern Initiatives has been an SBA microlender since 1994, and we have also been the recipient of USDA IRP loans since that time, too.

We asked Senator Levin and his staff to help create this program because what we saw is a gap in the market. Of the $24 million that we have loaned, 55 percent of our loans have been to start-ups, and 75 percent of our loans come as community bank referrals. Now, why would community banks make referrals to us to help the start-up of businesses? Generally, it is because of the size of the loan, past bankruptcy, often health-related in a rural area is the cause of the bankruptcy, low equity or no equity, collateral shortages, or the loan is just plain odd and they are not sure how to underwrite it.

So typically in our situation we help support a business to get started and grow, and that is a 3- to 5-year process to get back into the hands of a community bank. And by the end of that 3- to 5-

year process, our borrowers typically are back in community banks and successful and growing businesses.

What we would ask the Committee's support for this title is to recognize that what the fund will do is to be able to revolve. We would expect that this amount of money would revolve at least four times over the course of the pilot program the 20 years. So the money will leverage itself.

It will enable us to support the fastest-growing sector of our local economy, which is start-up and entrepreneurs starting and growing small businesses. And, frankly, they have capital needs that are not totally being met by the market, and it gives us the ability to support them.

But in support of the success of small businesses, it helps us to continue to grow and have a stronger partnership with our community banks, so the small business lenders will be the beneficiaries of this program, but also community banks who are our partners will be beneficiaries of this program because in 3 to 5 years they are going to be getting growing businesses that are sound, workable credit.

Ms. WHEELER. James?

Mr. BALLENTINE. James Ballentine, American Bankers Association. I wanted to commend the drafters of the language, but I have some questions in the language of the bill because the language indicates eligibility for participation and that the intermediary can have—it looks like up to 1 year of experience or not less than 1 year of experience in making loans to start-ups. And I wondered whether that level of experience was enough to actually be proficient in making loans through this program if you only have 1 year of experience versus what it sounds like you all have much more experience than that.

I also wanted to speak to the availability of intermediaries in urban communities and whether there were adequate intermediaries in those communities to serve the population that you speak of, these start-up businesses.

And my final point was about a 3-year pilot program. I know that is traditional in Washington, but in light of the fact that these loans will not have to start repayment until 2 years, whether you would have adequate experience within the program to determine whether a 3-year pilot was enough or whether that should be extended to, say, a 5-year pilot.

Those are my basic questions.

Ms. WHEELER. I think that the intermediary drafting question that you asked applies to the SBA Microloan program, separate from the intermediary lending pilot program.

On the 3 years, I think we could certainly go back and discuss making it longer. You are right that it is—typically, we do reauthorization every 3 years, and so we try to put everything on sync. This is Senator Levin's provision, and it has passed the Senate several times, but we could certainly go back and talk about it.

Your middle question was?

Mr. BALLENTINE. The availability of intermediaries in urban communities to serve those particular businesses.

Ms. WHEELER. Whether there would be enough capacity in order to reach those?

Mr. BALLENTINE. Whether there are enough intermediaries. I know there are a thousand, roughly, around the country, and they are primarily in the rural parts of the country, and whether there would be urban capacity for the intermediaries.

Ms. WHEELER. Do any of the intermediaries at the table know the answer?

Mr. WEST. I do not know the answer, although I will tell you one of the intermediaries I have the utmost respect for is in Detroit, Detroit Enterprise Institute, which I think is one of the best that I am aware of. And I simply do not know the answer to where capacity exists in a lot of urban centers.

Mr. PHILLIPS. I would agree with Dennis, though I know that in Maine—and this is from our experience—municipalities where we would be active here generally do not have a funding base. They might have a downtown redevelopment association. I know in Lewiston and Auburn, there is Lewiston-Auburn Economic Growth Council that has come to us for money, by the way, because they cannot get block grant funds to refuel some of the lending. So the demand, I think, is better.

I do not know of any group in Maine, other than us, that would be active in these markets, that would be eligible, that would have an entrepreneurship relationship and a business development relationship as robust as we would have. Now, that is in our State. I think you are talking about 20—there are 20 pilot——

Ms. WHEELER. There would be enough for 20 grants, as I understand it.

Mr. PHILLIPS. Twenty, and maybe if this goes, which I think would be great, there could be more analysis of how this is going to supplement other areas of the country.

Ms. FERKO. I appreciate you, Ron, for bringing up the Maine businesses. Too bad you did not bring clam chowder for the rest of us since we are going to be here until 1:00.

Mr. PHILLIPS. Well, this is for you, then.

[Laughter.]

Ms. FERKO. I do not think I can accept that, either. But I would like to hear from the SBA their comments on this pilot program just to see what they are thinking and get them on the record.

Mr. ROWE. Well, we have looked at this before, and, of course, it was in the bill through 3778 last Congress. At that time CBO scored the proposal at about a 37-percent subsidy rate, which means as it is drafted with the current authorization, you are talking about probably maybe $55 million if you got the full $20 million authorized appropriation, perhaps $55 million being available for intermediaries.

But there are a couple of other questions. First off, you know, James is correct, the definition of an eligible intermediary, 1 year of experience, which seems to be a pretty—an incredibly low bar for an area of lending where you are talking about loans from $35,000 to $200,000. The other thing is that, frankly, the way this is drafted, I would imagine that both CDCs and credit unions would be available intermediaries since they are not-for-profit organizations, whether it is a C-14 credit union or a CDC.

I would just go back to the fact that this is a very significant subsidy, I mean, 1-percent interest over 20 years with a 2-year grace period, and I noticed there is no interest rate set for the borrower. So there is no cap here as to what would be charged between the 1 percent the money is being borrowed at.

Ms. WHEELER. For the record, I just need to clarify that while CBO did assign a subsidy rate estimate of 37 percent, it also said—the quote is that, “We estimate that the subsidy cost for the authorized loan amounts would be about $7 million over the 2007–2011 period.” So I just think it is important to say exactly what the cost would be, because 37 percent sounds so expensive, but the ultimate decision of CBO is that it would be $7 million over a 5-year period.

Mr. ROWE. Yes, well, they are basing that on $20 million authorization for 4 years, so that would work out about right, $7 million a year. And at $7 million a year and a 37-percent subsidy rate, we can figure that would probably be about $11 million in funding that we would be able to put out as SBA in any given year.

Again, there is a question: What is the rate cap there and what is the spread that the intermediary would be expected to offer? And there is very little here that defines the responsibility of an intermediary in this program beyond the actual——

Ms. WHEELER. So SBA would like to see an interest rate parameter added to the program and to address, as American Bankers Association pointed out and SBA has pointed out, the qualifications for eligibility to be an intermediary at——

Mr. ROWE. Well, at the very least, you would expect that if the proposal was to go through. But the larger question is the issue of the market niche that we are trying to achieve here. I will point out that the $35,000 to $200,000 range is probably the largest part of the 7(a) program. I would venture to say it is something on the order of 60 percent of the $15 billion that SBA guarantees in a year.

Ms. WHEELER. I want to move on to the CDC 504 program, but quickly, Chris, you have had your card up. And then we will go to Mr. West to respond to——

Mr. CRAWFORD. Thank you, Kevin. I am Chris Crawford with NADCO, the National Association of Development Companies. We are the 504 lenders around the country. There are about 260 certified development companies, and those CDCs have many more offices spread around the country in their States.

As I read the language on page 22, frankly, I assume that CDCs would be qualified to operate this program. Is that accurate?

Ms. WHEELER. It was my understanding that your proposal was that you wanted to specifically name them, and not only to apply to this program but in general to be defined as an intermediary so that CDCs could apply for any program that calls for an intermediary.

Mr. CRAWFORD. Yes. The language here appears to describe certified development companies. We could probably make it a little clearer if you did name CDCs in that. CDCs, as you know and as Ron knows, are microlenders. We do a lot of microlending. I think we have a fairly successful track record in microlending as well as large lending. So I think our industry would be eminently qualified to participate in this and would certainly offer a number of endpoints, access points, as James has asked the question on.

Ms. WHEELER. OK. Then we can look into that going into mark-up.

Mr. West, did you want to comment on why the 7(a) and 504 loan programs do not serve this financing gap that the pilot is intended to serve?

Mr. WEST. In the Upper Peninsula, we have 29 community banks, and they range in size from $30 million to $300 million, and many are not SBA lenders and do not have a relationship with the SBA. And so start-up money and the money to help support their growth is not always available or easily available to them.

Ms. WHEELER. OK. Chris?

Mr. SIKES. It is important to mention that the IRP program is really a subordinate lending program and that the loan guarantee program is not, and that this really does fill a different niche which the USDA program has really shown in the rural setting to fill. And I would say that by increasing the service area to the urban areas, we are giving a tremendous amount of financial liquidity to the businesses in the urban areas.

Ms. WHEELER. Ron?

Mr. PHILLIPS. Just to reinforce what Chris said, that the differences in this program—of course, it is a pilot—than the 7(a), it is a sub-debt, subordinated debt instrument, and the 7(a) program as a guarantee program still carries with it certain requirements around collateral coverage for that guarantee. And this is a much more flexible way of helping to develop a company and getting them into a more financially—standard, conventional financing market.

Ms. WHEELER. OK. Mr. West, last comment—oh, and Chris.

Mr. WEST. I also wanted to add that the kinds of loan that we find ourselves doing are with low-equity, no-equity borrowers, history of bankruptcy, not brought on by other things other than a lack of access to health care, things of that nature, size of loan, collateral strategies, collateral availability, for God's sake, we take Airedales (dogs) as collateral in one loan.

So these are not things that if a regulator saw that a bank had done them, they would be very pleased to see, because they in many cases are things that a regulator would not want their banks to do and would cite them if they did them.

Ms. WHEELER. And is the administration funding the companion program to this within USDA? This is modeled on a program within USDA, and is it funded in the fiscal year 2008 budget?

Mr. PHILLIPS. I do believe that it is, yes; even the President, I believe, likes this program.

Ms. WHEELER. OK. Great.

Jackie?

Ms. FERKO. Just quickly. Tee mentioned that the 7(a) program covers that niche, but obviously there is a need for it since we are giving out those grants through USDA.

What do the 7(a) lenders think? Is there any thought that there is a niche out there for this? I am just curious.

Mr. KWIATKOWSKI. My name is Chris Kwiatkowski. I am senior vice president with Popular, Inc. I head up the small business lending division, and I would like to thank the Senate Small Business

Committee for holding this important roundtable and letting us participate.

This is probably an underserved niche, as our bread and butter is the 7(a) program. My division focuses totally on SBA lending, and we do have 50-plus business development officers across the Nation, but probably not serving this particular niche. And the size of the loans are difficult. The smaller loans take just as much paperwork to generate as the larger loans do, so it is not very cost effective as a lender to go after these types of loans.

Ms. WHEELER. Jackie, would you like to let Mr. Wilkinson go?

Mr. WILKINSON. I am Tony Wilkinson with the National Association of Government Guaranteed Lenders, and I would like to just hit one of our numbers. Year to date, about 80 percent of the loans made in the 7(a) program are for amounts of $150,000 and under. That said, they are not subordinated debt loans. They are typical credits. And if this program is designed to reach lower than what we are doing, then it is probably a niche that our members are not serving.

Ms. FERKO. Thank you, Tony.

Ms. WHEELER. OK. Let us go ahead and move on to the next topic, which is the certified development companies, the 504 loan program. We will allow SBA to present their proposals, and then as we did under the Microloan program, we will let the participants comment and then make their recommendations.

I am very sorry. We are little behind, so if we could try to keep it short so that we can move through this. I am sorry.

Mr. ROWE. Well, I will move pretty quickly. There are just a few proposals.

First off, there are some proposals that came from our Office of Inspector General, changes to penalty provisions to include fraud by loan packagers and agents, and to include fraud under the 504 program; also to extend the current 5-year statute to 10 years for fraud against CDCs, and also small business lending companies. The IG has pointed out that a longer statute is needed because effective fraud prosecutions often take a great deal of time.

Beyond that, really quickly, there were two proposals: to harmonize the appraisal policies between the 7(a) and 504 programs so that appraisals by a State-licensed appraiser is required in either program when real property is being financed for more than $250,000; and also harmonizing the leasing policy and setting a common standard of up to 40 percent of a facility allowed to be leased out in a new or existing building.

The last proposal is a proposal from the Office of Capital Access. I know there has been some debate between Capital Access and industry about this. SBA has put forward a proposal that issuing debentures for 504 that would use a monthly rather than semiannual payment schedule. One of our reasons is that we believe a monthly payment schedule would allow borrowers to reduce their principal balance on a monthly basis and, therefore, reduce the amount of interest that they are paying on an ongoing basis.

That sums it up.

Ms. WHEELER. OK. Would the participants like to respond to the three proposals that SBA highlighted out of their legislative package? Chris Crawford.

Mr. CRAWFORD. Yes, I would, Kevin. I am Chris Crawford with NADCO. First of all, I apologize, I just received the administration's proposal recently, and so we have just begun to analyze it.

On their authorization request, we oppose their authorization request. We feel it is too short; we will run out of money. I would note, responding to Senator Kerry's concerns, our minority lending is up 15 percent just year to date. Our rural lending is up 11.5 percent year to date. We have loaned over $1 billion year to date to minorities. I would hope that we would not be in a position to run out in 2008, 2009, and 2010 and that Congress would support the higher authorization levels which are in S. 1256. We support those authorization levels.

Secondly, changes to the fee provisions, we absolutely oppose what the administration is proposing. The administration disclosed those fees to us recently in a meeting, and they indicated that the cost of a weekly audit would be $25,000 and that they want to get to field audits to CDCs with portfolios as low as $30 million. A CDC with that portfolio size receives only $150,000 a year in servicing fees per year, total fees. This would take up to 20 percent of their revenues. I would suggest that smaller CDCs would exit this program in droves. They simply could not afford to operate under those circumstances.

They also indicated there would be a fee for the Dun & Bradstreet scoring system that was created several years ago, and we calculated that fee could run from $2,000 a year to $10,000 a year for some CDCs. Those are astronomical costs given our nonprofit status. So we oppose that fee.

Section 211, maximizing use of electronic technologies. While we support the computerization of many of the processes that SBA uses—and Mike knows this—in fact, we oppose the language that is in their request. It is far too vague. There is no description of what they would require CDCs to do. As many folks around this table know, SBA does not have a stellar track record in implementing new technologies. So we would ask for much more definition on this because, otherwise, it could leave CDCs wondering what we should be implementing.

Real estate appraisals. Could I ask Sally to comment on that?

Ms. WHEELER. Sure.

Ms. ROBERTSON. Sally Robertson with Business Finance Group in Fairfax, VA. We are a certified development company.

We noted that the appraisal comment was that appraisals would be required for all projects in excess of $250,000 for both the 504 and 7(a) program. We would like to submit that that is perhaps a fairly low dollar amount for appraisals which cost a minimum of $3,000, and that if an average 504 project exceeds $1 million, that means that 75 percent of 504 projects would be subjected to this requirement. That could amount to some $22 million a year in costs for small businesses.

We would recommend that the appraisal requirement be set at a $750,000 real estate acquisition size with the exception of a business acquisition which involves real estate, where you would definitely need to know the valuation of the fixed assets.

Then we also wanted to talk a little bit about the leasing policy. SBA has proposed that small businesses would occupy 60 percent of the facility and allow 40 percent of that property to be leased out. We believe that that is a serious problem, particularly in inner cities and rural areas. The primary reason is that a two-story building would then essentially become ineligible for 504 because, generally speaking, in a two-story building, the first floor the SBC occupies and it leases out the second floor to another tenant. And we think that that one-size-fits-all rule would make the program unavailable to many more small businesses, and we think that it is our motivation to finance more small businesses and try to keep that more flexible.

I would say that in the District of Columbia or in Boston, which are inner cities, one of the ways you bring small business into the inner city areas and the low- and moderate-income areas is by allowing multiple use particularly of row house type buildings, where you have a commercial tenant on the initial floor and a residential use on the upper floor. And if you eliminate that, you eliminate a lot of jobs to low- and moderate-income individuals that those small businesses are bringing in.

Ms. WHEELER. SBA, would you like to respond to NADCO's request that instead of setting the threshold at 250, that it be raised to 750 and then also address the leasing numbers? Or would you like to, you know, submit comment? We can come back to discuss it, but we would like to give you the chance to comment.

Mr. HAGER. I would like to first of all, if I may, comment on the fee structure.

Ms. WHEELER. Sure.

Mr. HAGER. The fee structure is created, defined as an on-site review every 2 years. There are——

Ms. WHEELER. Actually, you are talking about fees for lender oversight?

Mr. HAGER. Yes.

Ms. WHEELER. The examinations? OK.

Mr. HAGER. Yes. Those are conducted every 2 years. There are 150 of the smallest CDCs that would receive no on-site review, therefore, no cost.

The off-site review, which is a—you are familiar with the Dun & Bradstreet review, and we look at that data monthly. The CDCs, there are 55 of them that would have a fee of $200 or less. We would waive that fee. At least it is our intent to do that. The other fees would range anywhere from $250 per year to the very largest CDC at $32,000. So, again, we believe oversight is absolutely critical for the program. As we expand the portfolio, we simply must expand our role as the oversight regulator. And we feel that these fees are pass-through fees. There is obviously no profit margin involved in these. And we think they are essential for the program going forward.

Ms. WHEELER. Pass through to whom?

Mr. HAGER. Whatever we are charged, we pass it through to the CDC. These are fees that we pay——

Ms. WHEELER. Yes, but then who ultimately pays?

Mr. HAGER. The CDC pays.

Ms. WHEELER. But, indirectly, does the borrower ever get touched?

Mr. HAGER. Chris would have to answer that question.

Mr. CRAWFORD. It is my understanding the borrower would not get touched, except that CDCs are going to be hurting for cash flow. $32,000 a year for the largest CDC in the country is a significant amount of money. So I would be very concerned about that. Pass-through, eventually I would see CDCs having to raise their charges. Right now, most CDCs charge five-eighths, are required to charge five-eighths for servicing, of which one-eighth is going to the agency as part of the guarantee fee to keep us at zero subsidy. CDCs will almost certainly have to increase their fees for the borrowers. There is no doubt. So ultimately there would be a pass-through.

Mr. HAGER. We think these fees are very reasonable. If you compare the other parts of the Government financial services, the oversight, what they charge——

Ms. WHEELER. Are those nonprofit institutions that you are using as comparison?

Mr. HAGER. No.

Ms. WHEELER. No. So they are banks versus intermediaries, that is the distinction here.

Mr. ROWE. We would have to say that we are not—I do not know off the top of my head what the NCUA charges the credit union industry for their regulatory oversight.

Ms. WHEELER. Sally, did you want to comment how your CDC might be affected? I do not know where you fall in the spectrum of small or big.

Ms. ROBERTSON. I think our CDC would probably fall in the spectrum of a large CDC. We rank about number 10 nationally. I think while we are very much in favor of oversight from SBA of CDCs, we think it is extraordinarily important to credit quality. I think the cost is very high and that perhaps SBA should look to some budget authorization for at least some of these fees.

Ms. WHEELER. Mike, did you want to make any comment on the industry's adjustments to the levels for the appraisals and for—the appraisal threshold or for the rent specifications?

Mr. ROWE. Well, I will just toss in here that any proposals we have put forward are just that—proposals, working with the industry.

Now, for example, raising the rate of an appraisal from 250 to 750, obviously, we are talking commercial property, and I do not know what the standard operating procedure is in the commercial real estate industry. It may be that a certified appraisal is really not the norm below a certain level.

Ms. WHEELER. But SBA feels it is important for what reason?

Mr. ROWE. Well, we feel it is important to have a certified appraisal in order to, you know, protect the interest in the property and make sure—this is both a fraud and a financial management issue. Now, the question that Chris raises is whether, you know, $250,000 is really probably going a little low for a certified appraisal, which is an expensive proposition, versus, you know, the more normal course of business if it is not normal in commercial real estate to be seeking certified appraisals for smaller properties.

Ms. WHEELER. OK. Thank you.

One other comment, Chris?

Mr. CRAWFORD. I would say that we are absolutely not opposed to appraisals. We do real estate deals all the time, and we get appraisals all the time. I think our loss record demonstrates that. Our default rate is 4.5 percent and dropping. So I think we are doing good deals, and we are adhering to standard commercial real estate financing practices.

Our concern is that this would hit probably 75 percent of our projects because, as you know, our average loan is $584,000, average project is approaching $1.6 million. The cost of those appraisals would be $22.5 million per year to our borrowers. That is a huge amount of money. But we absolutely do not oppose the notion of appraisals.

Mr. ROWE. We will go back and take a look and reassess.

Mr. CRAWFORD. Thank you.

Mr. ROWE. But I did want, if just for a second, to discuss the monthly debenture payment schedule because what we are looking at here is trying to come up with a possibly more useful tool for the borrower. On the other hand, I know that the industry has some concerns as regards to the financing instrument itself because, of course, debenture financing for the program is based on a secondary market.

You know, I do not want us to be out there with a solution in search of a problem. On the other hand, what we are looking for here is perhaps a more normal and useful product for the borrower. I do not know if Chris had anything to say on that.

Ms. WHEELER. Go ahead, Chris.

Mr. CRAWFORD. This is a grave concern for us. In fact, we believe—and we have met with our dealers, two fairly sophisticated dealers, Merrill Lynch and CS First Boston. We have met with our fiscal agent, our bond counsel. This would, in fact, rise the cost of borrowing if we convert to a monthly debenture repayment, and it would do absolutely nothing in terms of saving any money for anyone.

Wall Street, and I am sure everyone at this table knows, works on the basis of risk and risk management. In fact, we have worked for 22 years to create an instrument, the DCPC, or the bond that is guaranteed by the SBA. We have worked for 22 years to establish a presence and a known quantity in the markets in New York where we sell—now we are selling an average of about $400 million a month in DCPCs. Our spread to comparable instruments is 14 to 18 basis points. We refer to our program as Small Business' Window to Wall Street, because we have brought the kind of financing that Wal-Mart gets and GE gets to Sam's Sunoco in McLean. And I would suggest that to tinker with the instrument that has the understanding of the underwriters, the understanding of our investors, among whom are the largest and most sophisticated investors in the United States—and, in fact, the world, because we are receiving a lot of international interest in our product—this will fundamentally change the instrument, will create a new instrument. So we will have the old instrument, the old DCPC, and we will have the new one. The new one will have absolutely no track record in the markets. It will take us another 15 years to establish that track record and understanding.

If Wall Street does not understand something, they see it as more risky. If they see it as more risky, more interest. By comparison, the SBIC program in March removed the prepayment requirements of penalties from their program. We happened to have a 10-year sale. They happened to have a 10-year sale in March. This just occurred this year. Their rate—both instruments had the SBA full faith and credit guarantee. Their rate was 33 basis points higher than our 10-year rate. Thirty-three basis points. That means that those borrowers for the next 10 years will be paying more interest than our borrowers were paying in exactly the same month of sale.

Ms. WHEELER. And the reason would be that the investors were afraid that people would prepay and, therefore, they would not have the revenue stream. And so it was not as attractive as an investment. Is that what you are getting at?

Mr. CRAWFORD. It created unknown.

Ms. WHEELER. OK.

Mr. CRAWFORD. And any time you create unknown on Wall Street, they are going to charge you for it.

Ms. WHEELER. OK. Thank you.

Mr. HAGER. We will go back on this issue. The purpose of this is to do exactly what it is doing, and taking ideas going back and reassessing it. So we will do that.

Ms. WHEELER. OK. Thank you.

Ron?

Mr. PHILLIPS. Could I just make a comment?

Ms. WHEELER. Quickly. Sorry. Your microphone?

Mr. PHILLIPS. I am sorry. We are a CDC in Maine, rural Maine. I would want to look over this and send some comments. And we have not studied it, but I am inclined to agree with the comments that just went before. I just want to make sure we all understand. It is an exceptionally interesting and important program in rural markets, as well as nationally. We have done 170 projects. Our average venture I think is running around $350,000, with 3,500 jobs. We just approved a daycare center in South Portland using these funds, by the way. It is a job creation program, but it also can finance other services.

So I just wanted to go on record here that it is an important program, and we hope to make some comments, too, as well as around this.

Thank you.

Ms. WHEELER. OK. In fact, that is a very good segue into the next 504 component of the bill that Senator Kerry and Senator Snowe introduced yesterday, and it is the child care lending pilot program. For those who do not know, this pilot has passed the Committee and the full Senate many times, going back to the 107th Congress, and what it does essentially is it makes nonprofit child care providers eligible to apply for 504 loans. And we have two participants here today who are familiar with the genesis of this proposal and will explain to us why it is important, and then we will open it up for others to make comments on it.

We will start with Joan Wasser Gish.

Ms. WASSER GISH. Thank you, Kevin, and good morning. My name is Joan Wasser Gish, and as Senator Kerry noted, I recently opened my own small business and am a former senior policy adviser to Senator Kerry.

While working with the Senator, I spearheaded his Child Care Small Business Initiative, and in 2002, we assembled a statewide advisory committee, which included representatives from the small business community, such as the U.S. Small Business Administration's Massachusetts District, the Massachusetts Small Business Development Centers, the Massachusetts CDCs, the Southeastern Economic Development Corporation, the Center for Women in Enterprise, and microlenders like Accion USA and the Western Massachusetts Enterprise Fund, headed by Chris Sikes, who is to my left.

This advisory committee also included a cross-section of stakeholders from the early education and care or child care industry. These representatives reflected an array of service delivery providers that span economic sectors. They included sole proprietors, home-based family child care businesses, for-profit child care centers, and nonprofit providers.

Senator Kerry charged this group with making recommendations to better connect entrepreneurial resources with child care providers in order to both strengthen the local economy and improve the overall quality of child care programs. This advisory committee met monthly for 1 year. One of the central conclusions this committee reached was the dearth of lending and other financial resources available to the nonprofit child care centers specifically. Nonprofits have barriers to accessing loans through traditional lending institutions as they operate on slim financial margins and often lack the capacity to make a sizable downpayment for capital investments.

Advisory committee members noted that this lack of access could actually have broader economic ramifications, including inhibiting economic growth, community development, and worker availability and productivity. It was the recommendation of this committee that Congress expand the 504 loan guarantee program to nonprofit child care facilities, which is the idea you see embodied in the child care lending pilot program in Section 416 of the SBA reauthorization bill.

This program would be consistent with the 504 loan guarantee program as it does help to maintain and strengthen the overall economy, supports community development, promotes job creation, worker productivity, and job retention. However, we also recognize that the expansion of 504 should not be undertaken lightly. Thanks to the able work of this Committee, there are numerous safeguards placed in legislative language. These include initiating this program, first and foremost, on a pilot basis with a 3-year sunset provision in place; requiring loans to be personally guaranteed and collateral owned by the borrower; limiting access to not more than 7 percent of all loans guaranteed in any fiscal year; requiring eligible entities to meet the same standards as a for-profit would save for their nonprofit status; and also requiring reports by the SBA to this Committee and the House Committee on Small Business regarding implementation of the program on a 6-month basis as well as a final report by the Comptroller General to this Committee and to the House Committee no later than March 2010, which would enable a very careful assessment of the impact of the child care lending pilot program before taking any future steps.

So, with these safeguards in place, I would respectfully urge the inclusion of the child care lending pilot program in the SBA reauthorization package, and I welcome any questions.

Ms. WHEELER. Would anyone else like to comment on this program? SBA, do you have any comments about it?

Mr. ROWE. Well, despite the fact that SBA does make some limited lending available through the microlending program, in general we would oppose this provision for the simple fact that the Small Business Act clearly states that the purpose of the Small Business Administration is to support private enterprise in free competition. And we would not support subsidizing unfair competition from not-for-profit entities which specifically do not pay income taxes or, for that matter, real property taxes, have access to grants that are not available to small businesses that are for-profit, and have access to contracting opportunities which are not available to for-profit small businesses.

Ms. WHEELER. And then how does SBA reconcile the fact that its legislative package proposal this year proposed making disaster loans available to nonprofits?

Mr. ROWE. Disaster lending is a separate item from our regular business lending. We recognize in our disaster lending that we give physical disaster loans to churches and other religious institutions to whom we would not give loans in our regular program due to constitutional implications.

Now, if we are going to start blurring that distinction, then I suppose SBA's response would be to completely get out of lending to nonprofits in disaster situations. But we do not propose that. We believe a disaster is a different set of circumstances from the normal economic life of the community.

Ms. WHEELER. And the agreement has been made to the Committee over the years since this proposal has been out there that the child care industry is different than other industries and that it is worthwhile to try using these loans to get at this very real workforce issue. Would SBA be willing to work with the Committee to find something they would be comfortable with on the pilot given that there is precedent, as you said, in the Microloan program for making loans to nonprofit child care centers and the SBA's proposal this year through disaster loan programs?

Mr. ROWE. Admitting to the precedent set by the prior administration, we would be comfortable exploring this, but what we would really be comfortable with is understanding why the child care industry, I guess, is different in the same way that any other industry is different from any other. We have a large number of for-profit family child care centers in Massachusetts and a number of other States, the majority of which are run by women and are not offered the advantages that the not-for-profit child care industry receives. Those family child care centers run by women in any number of neighborhoods all across the State of Massachusetts pay property taxes, which are specifically exempted under Massachusetts general law under Clause 3 in the property tax.

So we are looking at this as a fair competition issue, and allowing the not-for-profits to have access to the same funding stream that the for-profit child care industry has we find just fundamentally inequitable.

Ms. WHEELER. Chris, and then we will go to Joan.

Mr. SIKES. First of all, I agree that in lending to nonprofits we do need to be very careful. For example, in my town the YMCA and the local what they call "The Body Shop" is a for-profit business are at odds because of exactly the type of things that you have brought up in terms of unfair competition in the exemptions that the Y gets versus this for-profit.

I would say, though, that it—and I understand it is a difficult issue, but I would also say that child care is a crisis issue in this country and that when we look at the for-profit centers, they are generally in areas that can require a higher fee because they are in generally a higher-income area, and that the areas that we see most of the nonprofit daycare centers are in lower-income areas where they just do not have access, as easy access certainly, to the market and market rate, and yet it is a necessity. And so the subsidy is really needed.

We are really trying to fill a gap here—and I was, as Joan said, part of that group—fill a gap in the sense that these lower-income daycare centers do not have access to traditional financing, and they need some sort of subsidy, which the 504 really is, in order to provide the essential services that are needed in the community. And that is why this was brought forward.

So I do think it is needed to be further explored by the SBA, and I would ask that they do that and really see if it is an exceptional basis by which to make a loan.

Ms. WHEELER. Joan?

Ms. WASSER GISH. Thank you. If I may, I would like to respond to a number of the points that, Tee, you raised.

First and foremost, the child care industry does play a vital role in supporting private enterprise in free competition. There are, as you know, 5.8 million small businesses that hire employees, and many of those hires are, in fact, parents who are able to work by the availability of child care.

Moreover, research has shown that quality early education and care is associated consistently with improved worker productivity, and studies have shown that availability of quality child care can reduce employee turnover by 37 to 60 percent.

Conversely, breakdowns in child care availability are associated with absenteeism, tardiness, and reduce concentration at work, all of which can have very substantial impact on the operation of small businesses. It is estimated that child care breakdowns leading to employee absences cost United States businesses in excess of $3 billion annually.

Now, nonprofits comprise a substantial share of the U.S. child care industry. According to the 2002 economic census, they are 35 percent of all firms with employees. They contribute to the economy both by supporting parent workers and also as employers in their own right. In fact, they hire disproportionately. Job growth in the child care industry is projected by the Bureau of Labor Statistics to increase by two and a half times the national rate, and nonprofit firms hire close to half of all employees in that industry.

Nonprofits are also playing a significant role in community development. They are choosing, as Chris said, to serve children and families in economically depressed urban and rural communities, places that are generally unappealing to for-profit entities because the for-profits would like to have a higher parent fee revenue base in order to make their margins.

In many communities, nonprofits are, in fact, the sole source of center-based child care available, and they play a very important role, particularly in helping to allow low- and moderate-income workers to participate in the labor force.

In Massachusetts, for example, 90 percent of the subsidized care purchased by the State, primarily with Federal block grants dollars through the child care development block grant and TANF, is purchased from nonprofit providers.

In talking with Bill Hager from Child Care Services of York County, ME, he estimated that about half of all subsidized care is provided through nonprofits in that county. A study in Minnesota found that 23 percent of all jobs in health care and 16 percent of administrative jobs are directly supported by child care subsidies, which are likely supported by nonprofit child care establishments.

In addition, the nonprofits are often hiring from within the communities in which they locate, and when they are locating in low-income communities, they are facing very significant facilities challenges. One of the few States to study the facilities' needs of the early education and care industry is the State of Maine, and in the study produced last year, it was found that improving facility quality is deemed "an urgent need," that facilities are barriers to providing healthy and safe environments conducive to learning for the children enrolled, and more than 70 percent of child care centers in Maine identified facilities as a barrier to achieving accreditation, which is a proxy for quality within the field.

In Maine, in Massachusetts, and a lot of other States where there is aging building infrastructure, these nonprofits have to go in and remove asbestos, eliminate lead-based paint, fix leaking roofs, update electrical and plumbing. They have to make buildings handicapped-accessible. They have to put in place plumbing and child-size fixtures and other types of modifications that are necessary in order to create settings that are conducive to the health, safety, and learning of the children enrolled. And these entities, which, as I described earlier, tend to work very closely in terms of receiving subsidized vouchers and contracts from the State, are actually prohibited to use their child care development block grant funding for capital expenditures. And so by accessing the 504 loan guarantee program, we would really allow these programs to build and expand and upgrade their facilities and equipment.

Now, you mentioned access to grants that nonprofits might enjoy that would not be available to for-profits, and while that is true, it is also true in a very limited sense almost exclusively for those nonprofits that are in States with a very, very strong philanthropic base. On a national level, you might consider Massachusetts to be one of those places, but places like Maine and Montana and Oklahoma and pretty much most of the country, availability of grants is simply not there to meet those gaps.

You also raised some concerns about for-profits being faced with unfair competition, and because in Massachusetts and in many other States around the country the nonprofits are locating themselves in communities that are generally unattractive to for-profit providers, in most cases that concern is probably not going to be realized. The nonprofits are at more than 95-percent capacity in Massachusetts. There is a wait list of about 19,000 children, which is almost exclusively concentrated within urban and other low-income communities in the State.

In Maine, a study estimated that only one child care slot is available for every four children who need care so that parents can work, and there is a wait list there of over 43,000 children. And the Maine Office of Child Care Service and Head Start projects shortages would be particularly acute in five of Maine's counties—Cumberland, Lincoln, Knox, Waldo, Penobscot, in particular.

So with all of those factors in place as well as some longer-term trends projected in terms of women's participation in the labor force and some national movement toward providing universal prekindergarten, it is anticipated that there is likely going to be both increased enrollment and increased demand, and there would certainly be room for both for-profit and nonprofits because they do serve such different segments of the demand side.

Mr. ROWE. I appreciate all of that, and I have read your very interesting paper on universal pre-care that you did for Progress Policy. But we are not here to talk about the need for daycare generally nationwide. That is not the point. The point right now is the propriety of using a small business program for non-small businesses, not-for-profit organizations.

The fact of the matter is they do compete, and compete unfairly. Without paying income taxes, very often not-for-profit organizations are able to take employees away because they are able to offer better benefits. They do not pay property taxes. Again, I bring that up.

Every family child care center in the State of Massachusetts, just for instance, has to pay property taxes. The State tried to, unfortunately not very well, create an exemption for small businesses on property taxes. That was taken up by exactly five townships in the State of Massachusetts. We are talking about a very wealthy State that cannot support its small business base.

Ms. WHEELER. But the State endorsed this proposal, in fact, came here and testified on behalf of it in 2003 at the last reauthorization, one of the many times it has passed. So while they may have disagreement——

Mr. ROWE. Because the State of Massachusetts has a long and unfortunate history of supporting not-for-profits to the detriment of the small business community. And, frankly, we do not see the propriety of using a small business program for not-for-profit institutions.

Ms. WHEELER. They are not going to have tax revenues if people are not working and people do not have places to put their children.

Mr. ROWE. Again, it is not an issue of the availability of daycare, which we can all agree on, as a useful item for our economy. It is a question of how we are going to support both the small business sector and the nonprofit sector in daycare. And SBA believes that it is not appropriate to use our programs for this.

Ms. WHEELER. But they do for microloans, and now they are asking to do it for disaster loans.

Mr. ROWE. Again, you are asking me to support a prior administration's decision, and I am going to tell you that, yes, they supported that to a limited extent in the microloan industry. But I am going to tell you——

Ms. WHEELER. I am just talking about the double standard that we see here and what is on the books and what has been proposed and what is in this proposal that has passed——

Mr. ROWE. Again, there is no double standard there. As I told you, disaster assistance is a completely different item from our organized assistance for the mainstream of our economy.

Ms. WHEELER. Shall we turn to Chris Crawford? Do you want to make some comments? Microphone, Chris.

Mr. CRAWFORD. I am sorry. Thank you. Chris Crawford with NADCO. We have had a number of discussions about this. As Tee and Mike probably both recognize, I would normally not support lending through our program to not-for-profits because I well understand our mission. I would also suggest that daycare for any of you folks that live in Washington—I have raised a son and now am watching grandsons be raised. My daughter-in-law happens to work in the daycare industry, so I have very personal experience with it. I would suggest that lack of daycare is an economic disaster in this country, especially in the urban areas.

My daughter-in-law, who has worked in several different organizations, indicated to me there is not one that did not have a lengthy waiting list for kids who could not get in. Those are almost invariably, as Joan pointed out, generally mothers who are wanting to work who cannot work because of that. My own daughter-in-law cannot afford to pay for the daycare that she is working in.

I would suggest that not-for-profit daycare is certainly a needed program. I do not believe that it will result in what I would call excess capacity in this country. I am not sure there will ever be excess capacity.

So I would suggest that it is something that needs to be addressed some way by this Congress.

Ms. WHEELER. And I just wanted to clarify for the record that NADCO did bring concerns to us when this pilot was first initiated in the 107th Congress and that we worked through its members concerns about underwriting standards, collateral, safety and soundness issues, and that the 504 trade association, NADCO, signed off on the language and is comfortable with the underwriting standards that we have for the pilot program.

Mr. CRAWFORD. You are absolutely correct. You worked very closely with us, and I believe that these—we have a long history of solid underwriting, as I have said before, and our track record demonstrates it. I am all too aware that we work at zero subsidy, which Mike is certainly concerned about, and we have absolutely signed off on your proposal.

Ms. WHEELER. I would like to add that there was a letter from the president and chief operating officer of Omni Bank in Houston, TX, that said, "Designation as a nonprofit business does not equate to an inability to pay loans or other expenses." And the National Black Chamber of Commerce has submitted comments where they are strongly endorsing this because they see it as a local economic development issue, supportive of small businesses, and believe that this is a worthy cause to give this a try for 3 years. And CBO has not attributed a cost to it of harming the program at all.

Joan, did you want to add something—we need to move on to the 7(a) program. We can come back after 7(a), but do you want to make one more comment? And then we will go on.

Ms. WASSER GISH. Yes. I just again wanted to respond. I do think that there has been an opportunity for comment and input from a variety of different quarters, including SBA, the CDCs, and others. And in that I do think that there are safeguards in place that do reflect the sensitivity of the change that is on the table through the child care lending pilot program. And because those are in place and because this is a pilot and it is something to be learned from, there will certainly be opportunities to address any types of issues that would arise from it. And because of the particular nexus between child care and the small business economy in particular in the Nation, this would seem to be an appropriate provision to include within the bill.

Thank you.

Ms. WHEELER. Jackie, did you want to make any comments before we go on to 7(a)?

[No response.]

Ms. WHEELER. First I want to tell everyone—oh, can we come back? Is it on the child care? Can we come back to that? Just because I know some people need to leave, and I appreciate everyone's patience. Let's go on to the 7(a) loan program, and then when we wrap that up, if others want to make general comments on what the Committee should do or about your organization, things that are important, we will continue. Is that OK? All right. Let us move on the 7(a) loan program, and I am just going to flip the order for a minute from leading with the SBA because Tony Wilkinson, who represents the 7(a) lending trade association, NAGGL, has to catch a plane, and then we will go to SBA to present their proposals. Is that OK, Jackie?

Ms. FERKO. That is fine.

Mr. WILKINSON. I am fine. My flight is not until 2:05 if they want to go first.

Ms. WHEELER. Oh, did you want—OK. Well, Tee?

Mr. ROWE. Yes. Again, I will be brief because I know we have got time constraints. I had mentioned the real estate and leasing proposals previously. SBA is also seeking some additional supervisory and enforcement authority for small business lending companies. Small business lending companies, as you all may know, are the 15 SBA-licensed 7(a) lenders.

SBA is also asking for legislative authority to enable our lenders to use the systematic alien verification for entitlement program that is run through the Department of Homeland Security. This would eliminate the current rather cumbersome verification process and enable SBA and its partners to meet the requirements in the Small Business Act that our programs only be used by resident aliens and citizens.

The last item is SBA is proposing a guarantee fee for the secondary market under the prompt payment guarantee in Section 5 of the Small Business Act. The fee would not be imposed in either fiscal year 2007 or fiscal year 2008. SBA is merely looking for this fee as a possible fee to keep that prompt payment guarantee at zero subsidy.

Currently the market keeps the program at a zero subsidy, and the secondary market works at a wash. But long-term projections, we are worried it may get upside down, and a minor fee, which would be paid by the institutional investors who purchase the securities, would keep that in balance.

That is the entirety of it.

Ms. WHEELER. Tony?

Mr. WILKINSON. Again, Tony Wilkinson with the National Association of Government Guaranteed Lenders, and I appreciate the opportunity to comment today. I just would like to touch on a couple of SBA's points.

I would like to agree with Sally Robertson on the oversight fees. You talked about the 504 fees coming up. The SBA has in process right now a rule—they solicited comments on lender oversight fees in the 7(a) program, and those fees could be upward of $150,000. And I know most folks have opposed the charging of those fees and would hope that this Committee would take a look at that proposal and see what they have in mind. I am under the impression that SBA is moving forward, and it appears to be—well, let me just go to the secondary market fee. This is the third time, I believe, that SBA has requested a secondary market fee—the ability to charge a secondary market fee in their budget, yet they always put a zero subsidy cost along with it. So they are just simply looking for the authority to charge the fee.

It is my understanding that there are out-years—that they are looking at somewhere in the neighborhood of 2017 is where potentially there might be a problem, and I think with that we have plenty of time to figure out whether we really do have a problem. And as we have learned over the last few years, if there is the ability to charge a fee, they are going to charge a fee. And do not think for one minute that a fee on the investor does not end up being charged to the borrower, because it will be.

Now, if there is a fee that is truly needed, then let us sit down and talk about it, because the one thing we simply cannot have happen is that the secondary market would close down because we are a 1- or a 2-basis-point fee away from solving a problem. So if there is a problem, please disclose it. Let us talk about it. We will work through it. But my understanding is this is a problem that is at least a decade away, and so I would question why we would need to put forward a fee authorization today.

I would like to comment quickly on S. 1256. NAGGL endorses this bill. This bill would substantially improve small businesses' access to capital in many ways, including improving the ability of small lenders to participate in the program, particularly through WAC pools or weighted average coupon pools. This is a proposal that NAGGL has had out for 10 years. I do not think the SBA disagrees with this at all. It has been more of a timing thing as to getting around to it. This would improve the efficiency of the secondary market and I think would help bring a lot of community banks back to the program as pricing on Government-guaranteed portions of 7(a) loans would improve. And, thus, if we get more lenders involved in the program, it will improve the ability of small businesses to access the program.

With respect to the idea that 7(a) fees need to be reduced, NAGGL agrees with that proposition. Just a quick history lesson. Over the last umpteen years, anytime there was a need to increase fees, those fees were imposed on the largest borrowers. Anytime there was an ability to reduce fees, the fees were reduced for the smallest of borrowers. So today we have a mismatch between large loans and small loans such that the largest loans pay more than double fees that the small loans do. And on some of our largest loan requests, those fees are more than $50,000, which is very, very expensive. So if there was a way to look at a fee reduction targeted to the largest borrowers or to get our fees more in line, that would be something that we would seriously look at.

That said, any fee reduction that would come forward must not result in any kind of program curtailments or shutdowns, as we have seen in the past. What we learned in the past was the costs of shutdowns and program caps and program restrictions was far greater than any of the fee reductions that came forward. So we would ask that Congress not put anything in action that would result in a program cap or a program shutdown.

Finally, we are realistic and we want a bill. There are a lot of good things in this bill. But we also believe that unless the administration says it is willing to accept authorization language to reduce fees, they will simply place a hold on this bill, and this bill will not move. I hate to say that, but I believe the administration is adamant about the 7(a) program not going back on appropriation, and hopefully this can get resolved soon so that the other pieces of this bill can move forward.

Thank you.

Ms. WHEELER. Anyone else around table like to make a comment?

Mr. CRAWFORD. We are on 7(a)?

Ms. WHEELER. Yes, we are on 7(a).

Mr. KWIATKOWSKI. My name is Chris Kwiatkowski, and I am with Popular, Inc. Popular, Inc., is a 113-year-old financial services institution that was founded in San Juan, PR, and it was founded to serve the underserved. And the North American subsidiary of Popular, Inc., is Banco Popular North America, headquartered in Rosemont, IL.

Since 1961, being in the States, we have participated in the SBA program, and since our institution's mantra is to serve the underserved, the SBA programs are crucial to our ability to do so.

We are a member of NAGGL. We do support what Tony has put forward. There are just a few things that I would just like to reiterate.

First of all, the oversight fees would be exorbitant, excruciating, and would chase lenders away from this program. This program does not exist without lenders like Popular, and to charge over $100,000, as we would be charged, being the fourth largest SBA lender in the Nation now, that would seriously curtail our interest in the programs. So we are very concerned about that.

Restoring funding to the SBA. I myself—just a little background, my career started at the SBA. I worked at the SBA for 3 years. I then went on to work for one of the largest banks in the Nation. I owned my own small business. I have worked for the Nation's largest non-bank SBA lender, and I have been here at Popular, Inc., the number four SBA lender, for the past 2½ years heading up this institution. So I have seen small business lending from all sides.

I have seen the SBA head count severely diminished, and to the points that these other gentlemen brought up before who are in rural areas and locations outside of these metropolitan areas where the SBA offices are located, the staff has been seriously demoralized for the SBA. They cannot reach the people they are trying to reach. They cannot carry out the mission of the SBA. They have been reduced to marketing outposts, and they cannot even effectively do that very well.

So an agency that brings so much good to the economy has been seriously hampered in delivering that service, and we would wish to see restored funding to the Agency.

Increasing loan limits, this is in the bill. I think all of NAGGL is for this. We would love to see the SBA 7(a) loan program increased to $3 million. This would help us serve a much larger market, and it supports and benefits all parties involved—the Government, the private sector, the borrowers.

7(a) simplification. One of the most popular and successful programs the SBA has rolled out lately has been the Express loan program. It allows lenders to lend on their own documentation with a single-page form and with a diminished guarantee. It has been very popular because banks have to have technical expertise to participate in the SBA program.

I would love to see that same sort of ingenuity applied to the 7(a) program as a whole to help uncomplicate it. As I said before, we have to find specialized personnel to help administer this program. The program has become a program of the have and have-nots. As somebody pointed out earlier, ten lenders do the vast majority of the lending in the Nation, and it is not easy to find that talent. It is expensive talent, and most lenders will not participate in the SBA program, or if they do participate and their guarantees get repaired or denied, they do leave the program. And, again, without the lenders, there is no viability to the 7(a) program. So I would love to see some sort of simplification to that program.

As Tony said, reducing the fees, an exorbitant amount of fees is paid by the larger loans. Larger loans do create a lot of jobs, a lot of tax base, and we need to keep that in mind when we are looking at the 7(a) program.

Thank you.

Ms. FERKO. Kevin—and I think you would echo my same comments on here—and, Tee, I have told you this many times. Those oversight fees, we have serious concerns about those. I know there are many banks in Maine that have written to Senator Snowe saying that they are concerned and that they would not participate in the program. And I am sure that is the same for Massachusetts, too.

So before you move forward with making any action, the SBA does, I would like for you to give us sufficient notification, number one, whether you are going to move forward on it, and just let us know what your plans are on that. I think that there is a lot of serious stakeholders in this, and I know many other banks have said that. They plan on not participating in the program.

Ms. WHEELER. Before we go on to James and Todd, may I just ask SBA where they are on the reg regarding the lender oversight fees that participants have raised concerns about.

Mr. HAGER. It is in process.

Ms. WHEELER. As final?

Mr. HAGER. This has been cleared by OMB, and it is going to the Federal Register.

Ms. WHEELER. I am sorry. If that is the case, can you explain to us when this would start to impact the lenders that participate in the 504 and 7(a) loan program?

Mr. HAGER. The 504 is not included in this. Janet, what is the effective date of this?

Ms. TASKER. Well, it is scheduled to be published I believe on May 4th. I believe there is a 30-day effective date.

Ms. WHEELER. In 2 days? Great.

Ms. TASKER. It has gone through the proposed rule and comment process and, you know, a final rule has been developed.

Ms. WHEELER. But, again, the effect is that when this is released on the 4th, the fees that we have talked about will be imposed on these lenders.

Ms. FERKO. For the 7(a) loan program, right, only.

Ms. TASKER. For the 7(a) loan program.

Ms. WHEELER. Right, and there will be——

Ms. TASKER. Smaller lenders, those lenders that would—you know, again, it is an issue of on-site reviews or every other year, unless there is a problem, then we need to go in more frequently. In addition, there is—for really small lenders, we only look at those that are 10 million and above, and then for really small ones that are assessed, the outside market fee, if it is $100, $200, we waive it completely.

Ms. WHEELER. But the issue is not whether people agree that there should be oversight. I think there is agreement that we need soundness. But the question is the imposition of additional fees on our lending partners and how much they would be, right? Isn't that the disagreement at this table? The lenders are not saying they do not want oversight. We understand that argument. It is just that the fees they say they cannot stomach. So—oh, I am sorry. May I just go to Todd. Todd, do you want to comment on the fees?

Mr. MCCRACKEN. No.

Ms. WHEELER. Could we just finish this very quickly? Who else has a comment on the fees? All right. Go ahead.

Mr. MCCRACKEN. I only wanted to step back a little bit and look at the picture that I think the small business community is facing there. We released a survey of small companies just last week where we asked companies specifically about their access to adequate financing, and we have seen a full 10-percentage-point drop in the number of companies that say they have access to adequate financing in the last 7 years. In fact, while they were steadily improving for quite a few years, we are now seeing members that are—we are going to go back down in response to that question, approaching what we were seeing as we were emerging from the credit crunch of the early 1990s for the first time in quite some time.

At the same time, we are seeing a marked jump in the number of companies that say they are carrying balances of some significance on their credit cards every month, and it is not because they are suddenly getting a great deal from the credit card companies. They say that their terms on their credit cards—by a six-to-one margin, they say the terms on their credit cards have gotten worse in the last 5 years. So, clearly, all is not well in the credit and capital markets for the small business community.

So I would like to say that by way of backdrop that this is not the right time, I do not believe, to be increasing fees on lenders and borrowers, and, in fact, we believe it is the right time to begin looking at ways to restore Federal appropriation for the 7(a) loan program and to begin to roll back the fees that you already have in place. And to that end, I think the bill, the provisions specifically in the authorization bill you have put forth begin to move us in that direction and I think ought to begin to help address any emerging credit issues before they fully blossom.

Ms. WHEELER. And, Todd, just remind everybody for the record your organization.

Mr. MCCRACKEN. Oh, I am sorry. My name is Todd McCracken. I am the president of the National Small Business Association.

Ms. WHEELER. OK. James, did you want to go ahead.

Mr. BALLENTINE. James Ballentine, American Bankers Association. I wanted to associate myself with Tony's remarks and Chris' remarks as well. On the issue of the fees, I think at some point we are going to have to carve an "F" into SBA and just put, you know, associated with fees there, because everything is a fee now related to this 7(a) program. And whether it be oversight, whether it be the annual fee, whatever, those fees continue to go up. And we would like to sit here and say that those fees are not passed on to the borrower, but they are passed on to the borrower in some way, shape, or form. So to the extent that SBA is there to help these small businesses, these fees are not helping the small businesses at all.

I wanted to commend the drafters of the bill as well. There are several provisions in there which ABA is in support of—the preferred lenders program, obviously—but I also wanted to commend them on the Minority Small Business Development portion of the 7(a) title and the rural lending outreach program, which I think is significant to help reach some of those smaller lenders that are involved in the 7(a) program.

When we speak of the oversight fees and we say that those fees are largely going to be waived for the lenders that are on the low end of the scale, well, there are over 2,000 lenders that are involved in the 7(a) program. If you go below the top 20, the number of loans below that top 20 decreases significantly, and you have a number of lenders within this program that only make one or two loans.

So I would encourage the Committee not only to look at the oversight issue, oversight fees—I do not know if we can do anything about that since we are, you know, 2 days away from it—but I would also encourage the Committee to look at the 7(a) program in its entirety. I think the program has a certain level of staleness to it that needs to be addressed as we attempt to get more lenders involved in this program.

Ms. WHEELER. Paul, you have been scarily quiet. Would you like to say anything?

Ms. MERSKI. Just to continue on the fees, I find it somewhat preposterous that the SBA needs additional fees to do something when there are several regulators already in the banks examining the entirety of the banks' loan portfolio. I see it as simply a money grab of fees from the SBA to reduplicate a lot of the regulatory work already done by the FDIC, by the OTS, by the Fed. When these regulators come in, they examine all the banks' loan portfolios, including every SBA loan in that portfolio. So it is somewhat preposterous that yet another agency would be levying fees in addition to the fees that banks are already paying to have these loan portfolios examined.

So we strongly object, and hopefully Congress can step in and solve this problem.

Mr. WILKINSON. I would like to comment again on James' point of fees. I think if you look at the trend, first it was to take the 7(a) program to zero appropriation. Then there was a proposal and in last year's budget, I believe, you wanted $7 million to cover your overhead. Then there is a secondary market fee. Now there is a lender oversight fee. And if you just look at the trend, the trend is, you know, let's reduce Government expenditures in this program, period.

And I think at some point in time we have got to raise our hand and say: Where are we going? You know, this program has switched from 90 percent of the loans going into the district offices for loan approval where you had to have massive amounts of staff to process loans, to today where 95 percent of the loans go through expedited procedures, so we are doing all that work for you now, yet your budget has taken a significant hit downward and you continue to try to pass loan fees. We are just raising our hands saying it is time to slow down here, that part of this is your responsibility, in particular the cost of the overhead at the agency. And I just think the lender oversight fees are one that the agency should cover.

Mr. KWIATKOWSKI. I have a question. I am familiar with the PLP audits that we go through every other year, and it has been a normal course of business that we pay for those. Why is there this new oversight beyond that? Because as Paul pointed out here, we are subject to Fed audit. We are subject to our own internal audit. We are subject to the PLP audit. What is this one more oversight?

Mr. HAGER. We do oversight on loan portfolios every month. For example, the D&B system that we contract, we compare you against your peer group of banks. We are under extreme scrutiny to make sure that we are managing that portfolio, managing the growth, which today is at the all-time highest, and to, you know, grow the portfolio and not have increased risk management is just something unacceptable. We have got to do this.

We do think that—you know, I hear a lot about fees, and I hear a lot about the fee increase. Practically every month someone brings up fees. I want to show you something.

The myth is we have been raising fees in 7(a) and 504. Look at these lines. The only time that the dip—this is a congressional dip for a couple of years. But some of these fees go back to the 1990s and they have never been changed. And when you look at 504 fees—I know you are all familiar with this. Look at what is going on with fees. We are working very hard to achieve this. One way we can achieve it is lender oversight, making sure we are managing the portfolios, we are eliminating risk, we are addressing risk.

But here is the fee structure, and I am really puzzled every time I hear the fact that our fees are going up and up and up and up. Look at this. It is not true.

Ms. WHEELER. Well, I think that there needs to be a clarification. One, we are talking about 7(a) fees, and——

Mr. HAGER. This is 504.

Ms. WHEELER. I understand that, but there was a chart up on 7(a) fees. And I have seen the press scolded for printing that the administration doubled the fees and rebuttals from the administration that that is not true. And I think it is important to note that that is not quite accurate. While, yes, Congress holds the only power to change the law and it has changed the law, the reason the fees did not become permanent as Congress was proposing during the 2003 reauthorization is because SBA wanted to go to zero subsidy. In order to take it to zero subsidy, the fees were raised.

That was not in a House bill. That was not in the Senate bill. In fact, when we went into the appropriations season for that omnibus for 2005, there was money that had been put in on the House side to restore appropriations as well as on the Senate side.

Mr. HAGER. What year was that? Excuse me.

Ms. WHEELER. 2004.

Mr. HAGER. OK.

Ms. WHEELER. December of 2004. I believe it was the 4th of December, possibly 108–664. I do not know.

[Laughter.]

Ms. WHEELER. I believe that it was in that bill——

Mr. HAGER. Are you sure it was not 665? No.

[Laughter.]

Ms. WHEELER. The omnibus 2005 bill is where SBA succeeded in taking the program to zero subsidy. In order to get there, the proposals that were put forward by both the House and Senate were eliminated and the fees were raised in the program. So I think it is important to know——

Mr. ROWE. Well, to be fair, Kevin, those fees were not raised. They were restored to their prior level.

Ms. WHEELER. But, no, let's note the distinction here. The legislation pending in Congress was to make those permanent, and the genesis of those fees going down was that, if we go back and look at the record, as Senator Bond's staff noted, the fees were increased at one time when they took the program, they said, oh, the costs are going up, the business community is going to have to contribute a little bit more so that you all can get to the program levels that you want. And the industry started coming to us and noticing that the subsidy rate—and I am sorry to get very technical here. The accounting method by which they determined how much it cost to run these programs was seriously broken, and it was referred to as "a black box." And nobody could figure out where these cost estimates were coming from. And, of course, this is not a partisan issue. Both sides were running OMB during this, and what they said was if we cannot get OMB to cooperate and to fix this subsidy rate problem, then Congress will lower the fees because the GAO study came out and concluded that borrowers and lenders had been overcharged by almost $1 billion. I think it was $980 million or something.

So Congress took it into their hands to lower the fees until we could get traction. So then comes the new subsidy rate model, the econometric model, and what do we see the first year that it comes out in the President's budget? It is wrong by 67 percent. And if we look at the President's budget this year, every year that it has been in place, it is still off. It has been operating at a zero subsidy.

So please do not present the fee increase as the doing of Congress.

Mr. ROWE. You know GAO said that the econometric model is completely reasonable, and, yes, it is not exact. It cannot be exact. No one can make one that is exact.

Ms. WHEELER. I understand that, but please do not present to the public——

Mr. ROWE. The re-estimates have been downward——

Ms. WHEELER [continuing]. That Congress is the one——

Mr. ROWE [continuing]. For the past few years.

Ms. WHEELER [continuing]. Who raised those fees or draw disingenuous nuances that they did not go up, they just lapsed. That was not Congress' intention——

Mr. ROWE. The fees were lowered after 9/11——

Ms. WHEELER [continuing]. And we went into that session making those lower fees permanent. And I do not know anyone in this room who was part of those negotiations who would disagree with the facts there. So, please, do not say that. The administration wanted this program to go to zero subsidy——

Mr. ROWE. I am not denying that——

Ms. WHEELER [continuing]. And to get there, those fees——

Mr. ROWE [continuing]. Any more than the Clinton administration did not want it to go to zero subsidy. They did, too. It is a good policy. It gives us a good solid program.

Ms. WHEELER. But there is disagreement over that, and that is not what this is about. I am asking, please, from the Committee's perspective, do not distort the facts of whose proposals belong to whom.

Now, on the fees, can we go back to the review fees? In 2 days, these go into effect. Is there any way—because we hear grave concern at this table that it would be harmful to access to credit through the SBA's program. Is there any way that we can work with the administration before those are finalized?

Mr. ROWE. I do not know. It is possible for the administration to withdraw that. It is. I would not lie to you about that. But, honestly, I do not know whether it is probable.

Ms. WHEELER. And is the administration going to have anyone place holds on the reauthorization bill if the current language on fee reduction allowing appropriations for fees, should there be any still in the bill when it comes before the full Senate?

Mr. ROWE. The administration's position is that the 7(a) fee, zero subsidy policy, makes the most sense for the program, and that there is honestly no fiscal necessity for lowering fees in the program. The current fee structure is almost identical to the fee structure in place in 1996 and forward. And, frankly, we have all seen the CBO estimate to lower the fees in the program or eliminate—to eliminate the fees would cost approximately $600 million; I think about $589 million to be precise. To just cut the fees in half would be about $300 million. And the cost savings we are talking about there are honestly de minimis. To the average borrower, it is perhaps $10 a month; to a lender, $657 on the annual ongoing fee.

And, frankly, $300 million could be better spent elsewhere because what that does is puts us in the situation of, if you will, a first-to-the-courthouse program. If we run out of appropriation support, then everybody who comes in later in the year ends up with a higher fee. The administration does not support a situation where a borrower is going to be penalized for wanting a loan in September as opposed to May.

Ms. WHEELER. May I just clarify, in case there is a confusion, that the language in the bill does not require full funding to get to a program level that the industry is proposing, such as $18 billion. What the language in the bill does—and it has passed several times, and a version of it was passed as part of that omnibus 2005. What it says is that if there were appropriations or if there were excess fees charged, that the administration could reduce the fees on borrowers and lenders. What is in law right now is not workable because there is the qualifier that it must be a zero subsidy, and it creates a catch-22, and it only applies to borrowers. It would not reduce the fees on lenders, too, and we have heard concerns that should there ever be the occasion, the opportunity to reduce the fees, that it should apply to both lenders and borrowers.

So I want to make clear that while we understand the administration does not want appropriations, this does not mandate appropriations. What it does is fix the current language and make it possible to reduce fees should there ever be an opportunity to do it. And so I just want to make that clear because I think that there could be a distinction that this would cause shutdowns, that it is so expensive, that somehow we are going to have to come up with $600 million in order to keep the program running, and that is not the effect.

Mr. ROWE. Now, and that is not what I said. What I said was——

Ms. WHEELER. OK.

Mr. ROWE [continuing]. That any reasonable reduction—or I would not even say "reasonable," but that to have any noticeable reduction in the program, it would cost something on the order of $300 million.

Ms. WHEELER. OK. I just make that point because it is important that if the administration is planning to put holds on this bill, the holds would not—it seems to me that the holds are not necessary because it does not interfere with zero subsidy or demand the appropriations. It is fixing something that is currently in law. So——

Mr. ROWE. Well, no authorization bill can ever demand an appropriation——

Ms. WHEELER. I understand that, but——

Mr. ROWE [continuing]. Unless it is a mandatory account.

Ms. WHEELER [continuing]. There is a distinction here, and so if the goal is—and I think Senator Kerry made it clear that he wants a bill, a reauthorization bill. We have not had a real reauthorization bill in years. And everybody has worked very hard in the industry. We keep spending people's time and money to come up with proposals that would improve upon these programs, that if we want a bill, that it does not seem reasonable to put a hold on a bill when it would not interfere with the policy stand of the administration.

Mr. ROWE. I guess we are going to have to agree to disagree.

Ms. WHEELER. OK. Tony, did you want to say something?

Mr. WILKINSON. Yes, if I could. The NAGGL members account for over 80 percent of all the 7(a) loans that are made annually, and our members have made it very clear that they have been pleased with the fact that there have been no program disruptions over the last couple of years.

That said, large loan volume since we have gone to zero subsidy has gone down. The SBA has done a very nice job with the express program. There are 10 to 20 lenders who are fully utilizing that program, and that is where we have seen the big growth in numbers. So we have got about 80 percent of our numbers of loans being done by the 20 most active express lenders, and they are doing loans with an average loan size of about $50,000.

But the old regular meat-and-potatoes 7(a) program is still there, and it is done by a broad-based group. The problem is since 2005 our large loan volume is slipping, and that is where we are focusing, on the fees on large loans as perhaps a way to get some volume back into the larger loan category.

That said, we just simply cannot have program caps and shutdowns because that is very disruptive and very difficult to manage a lending operation if you are always worried about are we open tomorrow or are we not. Our members have liked business as usual for the last 2 years.

Ms. FERKO. Tee, again, I want to revisit this oversight issue, the oversight fee. In 2 days, something is going to change, and we need to address this now. I mean——

Mr. ROWE. Well, the rule goes final in 2 days. It does not get implemented for 32 days.

Ms. FERKO. Now, you received overwhelming criticism back in October and November during the comment period. Why wasn't that taken into account?

Mr. ROWE. Well, Mike, maybe you can answer.

Mr. HAGER. The comments were carefully assessed. We come back to the same issue. The way we have stabilized, we believe, the fee structure is through managing the portfolio. This enables us to—managing the portfolio from a quality standpoint. This enables us to expand that oversight of that portfolio. It enables us to place in-depth analysis of lenders on a priority, and we believe over time it will be good for everyone. And, yes, we did solicit comments. We addressed the comments to the extent possible. But we also felt that we had to increase the oversight of the program.

Ms. FERKO. So you are saying what currently in the structure, oversight structure of the program——

Mr. HAGER. That is correct.

Ms. FERKO [continuing]. Is not appropriate.

Mr. HAGER. We think it needs to be enhanced, and that is what this program does for us.

Ms. FERKO. Kevin, could you—I have not heard from SBA that this needed to be enhanced. Have you?

Ms. WHEELER. Again, what I hear is a distinction here only on money. There does not seem to be a disagreement on oversight. There seems to be a disagreement on who should pay for it. And so the feedback we are getting is that it will be harmful to the small businesses, and that is really who the SBA is supposed to be serving. We want to keep that access to capital open. And so I think that there really—the Committee would like to see SBA come talk to us and see where we can—if there is some way to find a more reasonable approach.

Mr. ROWE. And in implementing this, the administration was operating off of the authority we have been given and operating off of what we consider to be fairly regular practice among financial regulatory institutions.

Now, as Paul mentioned, OCS, OTC, FDIC all come in and examine banks for safety and soundness and other financial aspects. But the fact is they do not pull SBA-based loans unless they happen to grab one by accident in a random audit. Our oversight is very specific to our portfolio, which, you know, our guarantee operates as a little bit of a shield for the average bank, and as something that the FDIC will not normally examine very carefully. So that leaves it in our lap.

Now, the cost of the fees, again, that is a separate issue.

Mr. HAGER. You asked specifically what this does. This enables us to move the audits, reviews, from the current level of about 50 a year to 250—again, significantly broad—and the same review process but more of it.

Ms. WHEELER. Again, nobody is arguing——

Mr. WILKINSON. No, we absolutely support the oversight function. I think my overriding concern is the continuation of trying to push your overhead costs out to the lenders. This is a fee that is going to hit the existing portfolio that we did not know anything about at the time the loans were made. So it is now an add-on fee to a loan that is already on the books. It will impact the pricing structure for borrowers going forward because we have got to recoup our costs somehow. I mean, at the very least, it almost needs to be a fee on a go-forward basis, on new loans we originate. But we do not want to have any hiccups in our credit quality. We are all for lender oversight. That is an appropriate function for you to service. I absolutely do not want to come to the Hill and argue about a subsidy rate problem because of bad credit. I do not want to be here doing that. But I do question, you know, whose responsibility is it to pay for these reviews now, and I just think it is an overhead function of the agency that should come out of your budget.

Ms. FERKO. Annually, how much would these fees cost, these additional oversight fees?

Mr. HAGER. It would be between $20,000 and $25,000 a review.

Ms. FERKO. Totally?

Mr. HAGER. Biannually. It is not every——

Ms. FERKO. Annually? OK.

Ms. WHEELER. No. Weren't you asking how much it would cost for the SBA to do the——

Ms. FERKO. Yes, I mean, how much in appropriations instead of for the lenders.

Mr. ROWE. If we did not charge the fees and had to cover the overhead, it would probably be $7 or $8 million, as just an estimate.

Ms. WHEELER. I think the SBA is losing ground here.

[Laughter.]

Ms. WHEELER. I think we have gone over this issue enough, and I feel sorry that so many people have been here and have not had a chance to comment. Let's just say for the record we understand that this is a problem, and hopefully we can talk to SBA about this before the final reg is released, and let's go to the other people at the table who have their cards up.

Mr. HAGER. Excuse me. Just one, if I may.

Ms. WHEELER. Sure.

Mr. HAGER. The lender reviews, the audits, we also have in that a cost for the D&B expense that I referenced earlier. So it is a combination of that. But the number that Tee mentioned, the total budget for this is about $8 million.

Ms. WHEELER. Right, and that includes the——

Mr. HAGER. Which includes the D&B cost.

Ms. WHEELER. OK. As I said, that weakens SBA's justification for charging this if it is not saving $7 million versus the potential unintended consequence of driving lenders out of the program or ultimately increasing the cost of SBA loans to borrowers. So I think we have been over this.

Ann, did you want to say something?

Ms. SULLIVAN. Just two comments on the issues we discussed. I am Ann Sullivan with Women Impacting Public Policy.

First of all, it gives—the people I represent are the borrowers. They are the end users. So it gives us great pause, sitting here listening to this discussion, the comments of the lenders, that increased fees will decrease participation in the programs. That is counterproductive to what certainly my membership is interested in.

Second of all, I just wanted to go back to the Women's Business Center microloan discussion. We are all for cross-pollination, so it sounds like the microlenders sitting here with their technical assistance, I just want to encourage that any cooperation between

Women's Business Centers and their assistance can be coordinated. I know that in rural areas you have mentioned it is not possible, but there are a lot of Women Business Centers that I think are trying to serve the same population that you are, and we just would encourage them to work together.

Ms. WHEELER. Paul, did you want to make a comment? Do you remember what your question was? I know your placard has been up for a long time.

Ms. MERSKI. Not to beat a dead horse here, but I was going to ask if the SBA had checked with several other banking regulators, if they would, in fact, be able to expand their audits or oversight in the process of already being in the bank to look more carefully at the SBA loans if they are not, which, frankly, I think they are already looking into these SBA loans, particularly for banks that have large SBA loan portfolios, and why the SBA would need to charge an additional fee for something other regulators are already in the bank doing. And I would be curious to see if they have checked with the Federal Reserve, the FDIC, the OTS, State bank regulators, if they, in fact, look at this before imposing a new fee and going ahead with additional oversight in the bank, which will be costly to the bank in time and resources in the bank in addition to the fee.

Ms. WHEELER. Giovanni, would you like to make a comment?

Mr. CORATOLO. Giovanni Coratolo. I am Director of Small Business Policy for the U.S. Chamber of Commerce. We represent 4,000 State and local chambers, and I will tell you the 504 program, as well as the 7(a) program, is critical to those State and local chambers. We are very engaged in access to capital for small business. We were involved several years ago in several battles involving subsidy as well as the econometric model. Over the last several years, I guess we have been on the sidelines. We do look toward Tony as well as Chris as far as the leadership in those programs, and we do subscribe to most of what they have said as far as the health of those programs.

I would strongly encourage SBA to look at what they have said as far as the comments they have had as far as the health of those programs, and we will certainly look to see how this proceeds in the future as to whether we get involved again and to making sure that the SBA 7(a) and 504 programs stay healthy for the future.

Ms. WHEELER. And has the U.S. Chamber of Commerce seen, like NSBA, any survey or anecdotes from their members about the increased need for SBA's programs as they rely more heavily on credit cards or about needing more access to capital?

Mr. CORATOLO. We have done several surveys, one involving the minority business lending, and we find that it is an underserved community. As far as over time, we see the health of those programs waning a little bit. As far as when we are talking about 504 and 7(a) as we go into the future, we are a little concerned as to its ability to service our small business needs. And, you know, we have not seen any direct surveys like Todd has put forward, but at this point we are still on the sidelines, but we can be encouraged to be brought into the fight.

Ms. WHEELER. OK. I want to allow anyone else to make comments, and everyone should else feel free to go. Thank you for participating. We really appreciate your time and your patience waiting your turn to make comments. But as I said, we will just spend maybe another 15 minutes to tie up loose ends since we got off to a bit of a late start.

Chris? Oh, I am sorry. Jim Morrison. I am very sorry. We would like to hear from Jim Morrison. He has not had a chance to speak.

Mr. MORRISON. Excuse me. I am Jim Morrison. I am the president of the Small Business Exporters Association of the U.S. I have just a point about one section of the bill I would like to comment on.

Ms. WHEELER. Is your microphone on?

Mr. MORRISON. Section 309. We really do appreciate the Committee's responsiveness to the needs to increase the loan sizes of the international trade loans and utilize the refinancing terms and the collateral terms offered for the other loans. That is a very positive aspect of this bill. We also appreciate the Committee's support on the size of the guarantee.

Ms. WHEELER. And the guarantee is important as an incentive to lenders?

Mr. MORRISON. That is correct, because there is foreign risk involved, and a guarantee is quite important.

Ms. WHEELER. OK. Thank you.

Chris?

Mr. CRAWFORD. Thank you, Kevin. First of all, I want to thank the Committee for the hard work on the bill. We strongly support this bill, as you know already.

Ms. WHEELER. Is your microphone on?

Mr. CRAWFORD. I am sorry. We are concerned—there is one section under the definition of CDC, use of excess funds. We are very concerned with the ethics issue. We are concerned with where SBA is going in terms of pushing CDCs to expand, expand, expand, take greater risks potentially in the future, serve markets they are not naturally serving, they are not used to serving, opening CDCs willy-nilly. There are some IRS regulations that address the question of what are not-for-profits for, what are they supposed to do, what are they not supposed to do. We would urge the SBA to take a look at those IRS regulations—I happen to have a copy here for your benefit—and be cautious in terms of this continued expansion of CDCs, their role, the authorities of their staffs and associates, especially.

Ms. WHEELER. I think the Committee in the bill makes clear that there is a distinction between lenders and the intermediaries and the purposes they serve, that banks are strictly for lending, whereas CDCs have a special role in not only providing capital but spurring community and economic development. And so we will work with you, if you are concerned about that provision. We feel that the Committee worked it out between the Chairman and—well, let's just say Senator Kerry and Senator Snowe in the last Congress, and so it was incorporated it in this bill. But we are happy to work with you to address your concerns.

Mr. CRAWFORD. Kevin, you have actually done a marvelous job doing that, and I appreciate what you have written in 1256. But I urge the administration to look more cautiously at the way they are implementing regulations and proliferating regulations, not the least of which, obviously, is this big surprise on the fees.

Ms. WHEELER. OK. Thank you.

Joan, did you want to have any more comments on the child care?

Ms. WASSER GISH. No.

Ms. WHEELER. SBA, Ron, Paul, Sally?

Mr. PHILLIPS. The only thing I wanted to say earlier about the child care, because I did mention we had financed a child care facility in South Portland with the 504, that was a for-profit. We do a lot of financing of child care facilities in the State of Maine, both nonprofit and for-profit. On the nonprofit side, I just want to back up some of the comments made, that the whole goal here is to get affordable child care to the private sector, and that is the ultimate goal. And nonprofits tend to be working with those harder-to-serve and people who cannot pay as much as in the for-profit side. And so we have a lot of evidence for that, and that is why this program probably would not be competing at all, but just be a complement if you were able to open this up. So that was one thing.

And I did want to thank Senator Snowe, too, and Senator Kerry for this. I thought and we all think quite a visionary and innovative bill that is put forward here with different components. Thank you for your work, and the Senator for that, too. Thank you.

Ms. WHEELER. Thanks, Ron.

Ms. FERKO. Thank you.

Ms. WHEELER. SBA, anything else?

[No response.]

Ms. WHEELER. Thank you, everyone. We appreciate it.

[Whereupon, at 1:14 p.m,. the roundtable was concluded.]

PREPARED STATEMENTS

Business Finance Group Inc.
Financing Real Estate for Mid-Atlantic Businesses

SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

Roundtable on

SBA Reauthorization: Small Business Loan Programs

May 2, 2007

Written Statement of
Sally B. Robertson, President
Business Finance Group

Certified Development Companies are thrilled that the Committee has invested so much time and effort in preparing S.1256, and I personally want to extend my thanks to Senator Kerry, Senator Snowe, the Committee Members and all the staff who have worked so hard on behalf of 504 small businesses. Additionally, I wanted to express my thanks for being invited to participate in this Roundtable which provided a wonderful opportunity to exchange viewpoints with the various participants.

We all had so much to share about so many important topics that we more than filled the allotted time. I was concerned that there was not an opportunity to fully discuss one particular issue – ethics.

Section 410 of the bill defines CDCs and outlines the governance requirements for CDCs, which I believe are critically important for all CDCs. It includes a provision permitting one CDC Director to serve as a Director, but not an officer, of another CDC when the CDCs do not operate in the same geographical area and there is no contractual relationship between the CDCs. I find this particularly troubling and would urge that the exception be stricken from the bill.

As non-profit entities, CDCs must be held to a higher standard in their ethical practices. We are "public trust" entities whose missions are to improve the public good, which in the case of CDCs, means promoting economic development in our communities. Conflicts of interest or simply the perception of a conflict of interest must be avoided to maintain that public trust. The Bill includes a provision limiting Associates of a CDC from also serving as an officer, director,or manager of more than one CDC. However, the exception in the Bill permitting a Director to serve on up to two CDC Boards provides significant opportunities for conflicts of interest to occur. We have already seen "stretching" of the existing rules by a few CDCs to permit operations that we do not believe Congress originally intended, and while we encourage CDCs to be creative in their efforts to serve small business, we cannot cross the line into "for profit" type activities. My concern is that the language as written will provide further ways to manipulate the rules risking public criticism for the CDC industry and SBA when exposed. According to IRS rules, a non-profit **must not** be organized for the benefit of an individual, but rather for the benefit of the community. Since CDCs do and historically have given freely and generously of their time, expertise, and knowledge to mentor other CDCs without serving on the Board of the CDC receiving mentoring, it leads to questions as to the motivations of those who are advocating for this provision.

I would ask that you reconsider the language and eliminate the provision permitting a Director from serving on another CDC Board.

Again, thank you for your efforts on behalf of small businesses in developing this bill.

With warmest regards,

Sally B Robertson

Sally B. Robertson
President

Comments for the record of the Senate Committee on Small Business and Entrepreneurship Roundtable Wednesday, May 2, 2007

Submitted by Christopher Sikes, Executive Director, Western Massachusetts Enterprise Fund, Inc.

Re: the SBA Microenterprise Loan Program

The historic success of the SBA Micro Loan Program.

Thank you for this opportunity to submit my comments to the Committee. The Western Massachusetts Enterprise Fund (WMEF) has been an intermediary since the first round of the SBA Microenterprise Demonstration Loan Program. The SBA Micro Loan Program has been the core of our microenterprise development program since its inception because it is the only program which marries technical assistance with lending. By linking technical assistance with the loan a long term partnership is established which helps move an enterprise from the start-up/early phase to a more stable, mature position.. The importance of this partnership cannot be overemphasized.

Microenterprises are the most fragile of all businesses because, with so few resources, any mistakes, especially ones early in the development of an enterprise, are often fatal. The two most common resources these enterprises lack are business training (the business of running a business) and capital. When an intermediary enters into a loan relationship with a microenterprise it is, de facto, a partnership: we work with the business providing various forms of technical assistance to ensure its success. By being unregulated, the intermediary is able to provide guidance to help the microenterprise avoid those fatal mistakes and nurture its growth.

A whole array of technical assistance tools has been developed since the inception of the program including: one-on-one technical assistance, access to market, the formation of advisory groups, peer support groups, and classes. The forms of technical assistance vary both by the needs of the business and the strategies that the intermediary devises to best meet the needs of the microenterprises in their market. Market factors taken into account in the strongest technical assistance programs include:

- The formality of the local economy (how much it is based on cash, how strong the competition is from larger, niche oriented businesses)

- How the geographic location affects the local economy, for example, near the ocean, mountains, etc., located in an agricultural area, in an urban setting, in a warm climate, in a dry climate

- The demographic composition of their clients: new comer population, ethnicity, education, etc.

Intermediaries employ a unique strategy based on their resources, the type of businesses served and the characteristics of their market. While the technical assistance programs can be quite different the impacts they seek are the same: quality of job, job creation, increase in income and assets, increase in the tax base, provision of needed goods and services.

Recommendations for Reauthorization

As the SBA Micro Loan program itself matures the emphasis of the program's oversight, particularly over the technical assistance, needs to shift from the regulatory level to the program monitoring position. The ability to support the most effect technical assistance program needs to on the performance of an individual intermediary which is in term based its specific conditions.

With that as the general background I would make the following recommendations:

1. **Remove the criteria for a predefined limits on pre-loan technical assistance.** Instead, empower the grants manager to review and approve the intermediary's budget based on past performance. Many intermediaries, need to spend more time preparing a business for a loan based on an array of factors including: high level of start-ups, level of formality of the economy, level of education of the entrepreneur.

2. **Remove the criteria on predefined limits of outside consulting.** Again, the grants manager needs to review and approve the intermediary's budget based on the past performance recognizing that in more formal economies more outside industry specific consulting may be required.

Finally, I want to recognize the real concern for abuse of the SBA technical assistance funds. Everyone shares in that concern: the legislators, the SBA, and the intermediaries themselves. Poorly spent resources hurt the program. I offer these suggestions because I believe that these resources are best protected by programmatic review of the intermediary's performance and not by the superstructure of regulation. Strict regulatory control made good sense in the program's infancy but as the intermediaries have matured and the SBA grant manager have become more skilled at reviewing program performance, these specific technical assistance regulations are increasingly limiting the impact of the program.

SENATE COMMITTEE ON
SMALL BUSINESS & ENTREPRENEURSHIP

Roundtable on

SBA Reauthorization: Small Business Loan Programs

May 2, 2007

Written Statement of
Greg Walker-Wilson, CEO
Mountain BizWorks

Dear Chairman Kerry, Ranking Member Snowe, Senator Elizabeth Dole from my own state of North Carolina and other members of the Senate Small Business and Entrepreneurship Committee:

My name is Greg Walker-Wilson and I am the Chief Executive Officer of Mountain BizWorks (www.mountainbizworks.org) in Asheville, North Carolina. I am also the Chairman of the Board of the Association for Enterprise Opportunity (AEO, www.microenterpriseworks.org), the national association that represents microenterprise development organizations across the country.

I am pleased to be here today to discuss the reauthorization of the Small Business Administration. As a local practitioner I know the real value of the microenterprise related programs at the SBA. In fact Mountain BizWorks receives funding from PRIME (Program for Investment in Microentrepreneurs), the Women's Business Centers program, and most recently was approved for the Microloan Program.

All three of these programs are critical to our work creating and growing microbusinesses in western North Carolina. I want to emphasize that these programs are different and complementary. Each targets a slightly different type of entrepreneur and each provides a different type of service. These programs, while small in the overall size of the federal budget are the lifeblood of the microenterprise field.

I want to comment on the President's proposal to eliminate the subsidy rate for the Microloan Program and to raise the interest rate on the funds borrowed by Microloan Intermediaries. The President also wants to eliminate the technical assistance portion of the program. As a practitioner, I know that this proposal will make this program unworkable. The reason that the Microloan Program has enjoyed success over the years has been this pairing of technical assistance funds with loan capital. By having the same organization that provides the technical assistance and training to the entrepreneur also make the loan, it guarantees a close and constant working relationship that is best positioned to catch any problems that the entrepreneur may encounter and to help them address these problems early on. This is the formula that has led to a default rate of less than 1%. Taking away the technical assistance dollars and asking SBDCs (Small Business Development Centers) and other entities to take on the technical assistance function will disrupt this winning formula and is likely to increase the default rate.

Raising the interest rate on the Microloan Program will make this program much less appealing to microenterprise development organizations. The value of the program is that it allows Microloan Intermediaries to keep interest rates down to their borrowers. By raising the interest rate to the Intermediaries, they will be forced to raise interest rates to the borrowers, which will create an economic hardship for them and make it more difficult for them to grow their businesses. This strategy is counter to the original reason that Congress created the Microloan Program.

Mountain BizWorks offers small business loans up to $35,000, business instruction for aspiring entrepreneurs, and on-going technical support that keeps small businesses *in* business. Since our founding in 1989, we have provided small business training to more than 2,600 entrepreneurs, assisted in the establishment of over 1000 locally-owned businesses, and have loaned more than $1 million to entrepreneurs who were unable to obtain capital from traditional lending institutions. Over the last seventeen years, we have continued to broaden the scope of our services to meet the changing needs of the entrepreneurs we serve. In particular we reach out to women, low-income individuals, rural residents, minorities, and the un- and under-employed.

We have found that small business training often makes the difference between failure and success. In a survey conducted in the summer of 2005, we found that the three-year survival rate of Mountain BizWorks alumni businesses was 74% compared with a 40-50% national average for those not accessing business support services like those at Mountain BizWorks, proving that small businesses *can and do* succeed with our training, ongoing support, and access to capital. In 2006, Mountain BizWorks' alumni businesses contributed more than $50 million to the local economy.

Specifically Mountain BizWorks' PRIME funding allowed us to serve 157 low-income clients (80% of HUD Median Income) in FY2006 with business planning and technical assistance to help them realize their dream of starting or expanding a business for themselves and in the process increasing their family income.

With the help of Women's Business Center funding in 2006, Mountain BizWorks served more than 500 clients with training or technical assistance such as seminars or one-on technical assistance. In the coming year we expect to make approximately 50 loans to borrowers who are otherwise unable to obtain small business loans elsewhere with our new $750,000 SBA Microloan. The Microloan Technical Assistance money will allow us to make sure the loans gets paid back and that the businesses we serve succeeds.

Practitioners in the field, like me, would like to have the three programs that I mentioned earlier, PRIME, Microloan, and Women's Business Centers be reauthorized as part of the overall reauthorization of the SBA. It is essential that these programs be continued. I support the Small Business Lending Reauthorization and Improvement Act of 2007 currently put forward with bipartisan support.

As part of the reauthorization process, we would also like to see some technical corrections made to the Microloan and PRIME programs. There are some small changes that can be made to the Microloan Program that would improve the ability of the Microloan Intermediaries to use the program. Some changes would also make the legislative language consistent with the actual practices of the SBA.

These technical changes include such things as giving the Microloan Intermediaries the flexibility to make longer term loans, where appropriate; to provide more technical assistance to potential borrowers that are not quite ready to receive loan capital yet; and to allow microenterprise development organizations that do not have a long lending history to hire qualified staff with significant experience that will enable them to successfully serve as a Microloan Intermediary.

I also want to state how important I feel it is to reauthorize the PRIME program. This program was created as a result of a survey of the domestic microenterprise field, which identified training and technical assistance to microentrepreneurs that are not ready for or do not want a loan as their most pressing need. PRIME enjoyed strong bi-partisan support, including lead sponsorship from Senators Kennedy and Domenici when it was established. This program needs to be restored to its former stature as a national program. Due to severe budget cuts, PRIME is now only available to microenterprise development organizations in the 15 poorest states and the District of Columbia.

The field of microenterprise gained a lot of attention last year when Muhammad Yunus and the Grameen Bank in Bangladesh won the Nobel Peace Prize. While microenterprise abroad is better known by many people, we have a vibrant microenterprise field right here in the United States and the reauthorization of these microenterprise programs at the SBA will go a long way toward helping local groups like my own build strong local businesses in communities across our country.

Thank you for this opportunity to testify and I look forward to answering your questions.

The United States Senate Committee on Small Business and Entrepreneurship Roundtable

May 2, 2007

Dennis West
Northern Initiatives
Marquette, Michigan
dwest@niupnorth.org

Thank you to Senator Kerry and Senate staff for inviting me to participate in this roundtable.

Northern Initiatives is a fifteen year-old Community Development Financial Institution that serves rural Michigan. Since 1994 Northern Initiatives has participated in the SBA MicroLoan Program. Up to March of this year we have processed 200 loans totaling over \$3M. We have also loaned over \$8M in USDA Intermediary Relending Loans to more than 100 customers. In total, we have loaned close to \$24M. 55% of our loans have supported start-up businesses. We have also partnered with 504 and 7(A) lenders to give rural Michigan businesses broad access to capital.

As you may know, Michigan is in a serious financial crisis. Its manufacturing sector is rapidly declining and the unemployment rate ranks us at 49th in the country. Comerica Bank summed our plight up when the stated that Michigan is in a "one state recession." Rural Michigan's economic plight has gone unnoticed in light of the states' manufacturing misery. But of the 44 rural Michigan counties that Northern Initiatives serves, only 6 finished the year with a lower unemployment rate than the statewide average of 7.1%.

According to a study by the Kansas City Federal Reserve, small businesses having 20 or fewer employees account for 75% of all businesses located in rural America. In Michigan over 9,500 new businesses launched last year with 1-4 employees.

The restoration of rural communities will require a long-term commitment to encourage and work with rural borrowers and particularly new entrepreneurs. New enterprises in predominately rural areas are a segment of the business world that is cut off from access to capital, information resources and markets. To assist them, Northern Initiatives and other organizations like us need comprehensive ways to support business innovation and the creation of new entrepreneurs. The SBA MicroLoan program helps us overcome the isolation that is inherent in rural environments. It supplies necessary and appropriate capital and the means to deliver information and access to larger markets in the form of technical assistance.

When we do loans, 75% of our customers are referrals from community banks. Northern Initiatives is intentional in filling gaps and complimenting, not competing with, community banks. We offer the kind of capital that regulated institutions are unable or prohibited from offering. This makes the banking community a valuable partner.

Northern Initiatives fully supports Senator Levin's Small Business Intermediary Lending Pilot Program. This concept is modeled after the highly successful USDA Intermediary Relending Program. However, Senator Levin's focus on this bill to fill the gap that is exposed as microloan customers grow. This is a product that many of our borrowers need. It will bridge the gap between launch and the time when a customer is ready to have a bank write their commercial loan.

You may wonder how it works today. In some cases we can match funding to make the sort of thing that Senator Levin is proposing happen, but this can also be complex. The eligible counties of one program may not align with another; the underwriting requirements of one fund may not be consistent. As Senator Levin contemplates the Intermediary Lending Pilot, $35,000 may not be enough capital and through the pilot, growth could be seamless, consistent, and lead to efficient transitions to community banks.

Typically it takes 3-5 years for NI borrowers to be eligible for loans from their community bank. During that time they are establishing themselves in the market, building customer consistency, developing consistent sales and business net worth. Some grow enough to require additional capital. Senator Levin's pilot program will help NI and other organizations like us to support our microloan customers by availing them of the capital necessary to grow in the first five years of business. This will make a tremendous difference in moving small businesses from fledgling enterprises to viable commercial loan prospects.

An example of such a business is a start-up business located in a small community in the Upper Peninsula of Michigan. They focus on streaming video and website development, especially for customers engaging in e-commerce. They have a promising sales forecast and will need more equipment in the near future. This will require funding resources beyond what the SBA MicroLoan can provide. Senator Levin's pilot program would address the needs of this business. In the early years this is a customer that NI will assist in the development of solid accounting systems and marketing plan. In three to five years they are likely to be an excellent credit for a community bank and a potential job creator for the community.

In Marquette a local native seed company was started with the SBA MicroLoan program. The company has demonstrated its market and plans to expand with the building of a greenhouse. This next investment will take this credit to $50,000, but because they have low net worth, they are not yet bankable.

Finally I can tell you about a landscaping business that went bankrupt and was on the verge of closing. No bank would or should have serviced them. Using the MicroLoan program NI reestablished a line of credit and assisted them in developing an accounting system and estimation tools. Fifteen jobs were saved. Getting this company back on track required loans and capital that exceeded the microloan limits. After 4 years in business they are back with a community bank.

These examples highlight the need for:

- more technology and assets in a start-up's early years,
- a capital investment that can greatly support revenue growth for a promising business launch,
- and a second chance for a business that operated with energy and limited systems to stay in business and grow.

These are the kinds of business opportunities that Senator Levin's pilot would make common place.

Northern Initiatives will be positioned to work with more companies under the new SBA pilot program. Furthermore, the funding will revolve at least 4 times over its twenty year term and if current standards hold, this will set the stage for significant investments by community banks as they support our early stage graduates.

Thank you to Senator Kerry, Senator Snowe, Senator Levin and staff for your consideration of the SBA Intermediary Lending Pilot program and for your on-going support of the SBA MicroLoan Program.

COMMENTS FOR THE RECORD

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April 30, 2007

Honorable John F. Kerry
Chairman
Committee on Small Business & Entrepreneurship
Washington, DC 20510-6350
Re: Roundtable Discussion, May 2, 2007

Dear Chairman Kerry:

The National Black Chamber of Commerce thanks you for including our organization in the Roundtable. I will be out of town but our Chairman, Morris "Mike" Little, will attend and represent us. He has full authority in decision making.

Most importantly we are very excited about your draft bill for the SBA Reauthorization: Small Business Loan Programs. We highlight the following:

1. Increasing Lending Limits – This is well overdue. Costs have increased across the board and we must be able to allow lending limits relative to the 21st Century.
2. Expanding Alternative Resources – Certified Development Company Financings; investment in Micro Entrepreneurs; allowing nonprofit intermediary lenders to provide financial resources that supplement the small business lending and investments of a bank.
3. Intermediary Lending Pilot Program – This should prove the massive need for such programs and expansion of such should be provided upon completion of the Pilot Program.
4. Alternative Size Standard – By allowing the Administrator to establish an optional size standard for business loan applicants will allow flexibility and will address adversarial placed restrictions on certain industries such as auto dealers, architects, etc.
5. **Minority Small Business Development Office** – This is one of the most important improvements in the draft. This will fill a void and weakness in the structure of the SBA. Our membership would utilize this office immensely.

6. Increasing International Trade Loans Limits – The Global Economy is real. The amount of international trade is growing exponentially. It is obvious that we must increase the loan limits in this arena.
7. Child Care Lending Pilot Program – As the number of entrepreneurs continually increases and the amount of workers employed by these small businesses grows at a faster rate; we need available child care alternatives for the workers. That creates a demand for the number of child care facilities in our communities. To meet that demand we must have lending programs to address it. We strongly encourage a pilot program that will demonstrate this fact.

Again, we support this draft and would encourage and support its passage into law. Please do not hesitate to ask for our support in any way. I look forward to hearing about the Roundtable from Mike Little.

Sincerely,

Harry C. Alford
HARRY C. ALFORD
President/CEO