

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

To: Members, Subcommittee on Economic Growth, Tax and
Capital Access
From: Committee Staff
Subject: Hearing “Examining the Role of Government Assistance for Disaster Victims: A
Review of H.R. 3042”
Date: February 13, 2012

On Thursday, February 16, 2012, at 10:00 am, in Room 2360 of the Rayburn House Office Building, the Subcommittee on Economic Growth, Tax and Capital Access will meet for the purpose of examining legislation that would amend the Small Business Administration’s (SBA) programs that provide long-term disaster recovery assistance and short-term business interruption assistance. The legislation, H.R. 3042, lowers the interest loans for SBA loans to small businesses and others under section 7(b) of the Small Business Act.

Introduction

On September 3, 2011, rain associated with Tropical Storm Lee began to fall, eventually dropping nearly 14 inches of rain into the Susquahanna river basin in Pennsylvania. The rain fell on an area of land that was already saturated with rain from Hurricane Irene which made its way through Northeast Pennsylvania in August 2011. Tropical Storm Lee caused severe flooding, power outages and damage to infrastructure in 43 counties forcing the closure of over 600 roads and bridges.¹ The storm also resulted in the death of thirteen people and displaced over 100,000 people.²

¹ NORTHEASTERN PENNSYLVANIA INDUSTRIAL RESOURCE CENTER, SPECIAL REPORT: THE QUANTIFIED IMPACT OF TROPICAL STORM LEE FLOODING ON NORTHEASTERN PENNSYLVANIA’S MANUFACTURING INDUSTRY I (Oct. 2011), Available at <http://www.mepirc.com/pdfs/nepirc-flood-2011.pdf>.

² Letter from Tom Corbett, Governor of Pennsylvania to Barack Obama, President of the United States, (Sept. 12, 2011) available at http://www.portal.state.pa.us/portal/server.pt/community/pema_home/4463/Information_on_Presidential_Disaster_Declaration_4030-DR/1009074.

On September 12, 2011, Pennsylvania Governor Tom Corbett sent a letter to President Barack Obama requesting that the President declare a major disaster in Pennsylvania pursuant to Section 404 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.³ On October 27, 2011, the President issued a disaster declaration making 43 counties⁴ in the Commonwealth of Pennsylvania⁵ eligible for SBA physical disaster loans and business interruption loans.⁶

Legislative History

After Tropical Storm Lee, Representative Lou Barletta (PA-11) met with constituents in his district to listen to concerns about the federal response to the disaster and the challenges they faced in reopening their businesses. In response to concerns about the cost of SBA assistance, Representative Barletta and eight original cosponsors⁷ introduced legislation mandating that all SBA disaster loan interest rates be set at one percent.⁸ This legislation would apply to SBA's Home Disaster Loans, Business Physical Disaster Loans, and Economic Injury Disaster Loans. The interest rate would apply⁹ only to loans made to eligible applicants in a declared disaster area, pursuant to section 404 of the Stafford Act.¹⁰ According to the bill, the interest rate would apply for the life of the loan.

SBA Disaster Assistance Program

SBA physical disaster loans help homeowners, renters and businesses restore their property to its pre-disaster condition. SBA economic injury loans assist businesses that suffer business interruption as a result of a disaster. This mission is fulfilled by the issuance of subsidized¹¹ and unsubsidized loans with terms up to 30 years to borrowers who have incurred losses not covered by insurance. While SBA typically only assists small businesses, SBA disaster assistance is available to homeowners, renters and businesses of all sizes. SBA disaster loans are made

³ 42 U.S.C. §§ 5121-5207.

⁴ According to the disaster declaration, 28 counties in Pennsylvania were eligible for full assistance and 15 counties were only eligible for economic injury assistance.

⁵ Counties in Delaware, Maryland, New Jersey and New York were also declared disaster areas eligible for SBA assistance.

⁶ DISASTER DECLARATION NO. 12,822 AND NO. 12,823, 76 Fed Reg. 66,110 (Oct. 27, 2011).

⁷ The original cosponsors include Representatives Fitzpatrick, Holden, Kelly, Marino, Pitts, Platts, Welch and Young. Since introduction, 16 additional cosponsors have signed on, including Representatives Bartlett, Critz, Ellmers, Gerlach, Grimm, Hall, Hinchey, Hunter, Meehan, Owens, Rivera, Schilling, Shuster, Thompson, Tonko and Wilson (FL).

⁸ The Disaster Loan Fairness Act, H.R. 3042, 112th Cong. (2011).

⁹ *Id.*

¹⁰ The lower interest rate set-out in H.R. 3042 only applies to Presidentially declared disasters under Section 401 of the Stafford Act. While SBA can offer assistance for disasters not declared by the President, that assistance will not be addressed in this memorandum and is not subject to the lower rate in H.R. 3042.

¹¹ For the purpose of this memorandum, the term "subsidized" refers to loans to borrowers with no credit available elsewhere. The interest rate on these loans is lower than the SBA determined market rate.

directly by the SBA rather than through SBA's network of lending partners, which make business loans under the agency's loan guarantee programs.

There are several types of disaster assistance provided by the SBA. The type of assistance available is set forth by the terms of the disaster declaration.

Physical Disaster Loans

Homeowners and who suffer damage in a geographic area delineated by the disaster declaration are eligible for loans of up to \$200,000 to replace their primary residence or restore it to its pre-disaster condition.¹² Loan proceeds may not be used to make improvements to property. Borrowers must demonstrate to the SBA that they are creditworthy, have sufficient character and have the ability to repay the loan.¹³ Borrowers are also required to pledge collateral for loans over \$14,000.¹⁴ Business owners suffering damage in a declared disaster area may apply for assistance of up to \$2 million from the SBA.¹⁵

Economic Injury Disaster Loan (EIDL)

Businesses which suffer substantial economic injury and are located in a declared disaster area, are eligible for SBA assistance.¹⁶ Unlike Physical Disaster Business Loans, EIDL are only available to small businesses.¹⁷ The SBA defines substantial economic injury as the inability to meet obligations as they mature and pay ordinary and necessary operating expenses.¹⁸ Loan funds can be used for working capital until normal operations can resume.¹⁹ The maximum loan amount is \$2 million and the length of the loan is dependent on the borrower's ability to repay the loan, but may not exceed 30 years.

Interest Rate

An interest rate is a percentage of a loan that lenders charge for borrowing money. Banks are profitable lending money because their cost of borrowing funds is less than the rate they charge to borrowers.²⁰ The earnings from the interest rate are used to pay overhead costs associated

¹² *Id.* at § 123.7.

¹³ *Id.* at § 123.6.

¹⁴ *Id.* at § 123.11.

¹⁵ 13 C.F.R. § 123.202.

¹⁶ 13 C.F.R. § 123.300.

¹⁷ *Id.* at § 123.300(b).

¹⁸ *Id.* at § 123.300(a).

¹⁹ *Id.* at § 123.303.

²⁰ Banks provide other functions from which they can earn money from a variety of sources other than lending such as: cash management for small businesses; fiduciary services to trusts; and fees paid by customers for everything from the use of automated teller machines to overdraft protection from checking accounts. Unless otherwise noted, this memorandum will focus on the bank lending function.

with making and servicing loans and to cover losses associated with defaulted loans that cannot be recouped through the liquidation of collateral. Interest rates vary with market conditions and government policy set by a central bank.²¹

As a direct lender, the SBA must charge borrowers a rate of interest high enough to cover the overhead costs associated with borrowing funds from Treasury, making and servicing disaster loans, and the cost of defaults. The SBA offsets these costs through an annual appropriation of taxpayer dollars. In the SBA Disaster Assistance Program, interest rates are determined by a statutory formula set out in the Small Business Act. If a borrower has no credit available elsewhere, the interest rate is capped at a maximum of four percent and if the borrower has credit available elsewhere, the interest rate is capped at eight percent.²² The interest rate on Economic Injury Disaster Loans may not exceed four percent.²³

The actual interest rate charged to the borrower is dependent on whether the SBA considers the applicant to have credit available elsewhere. According to the Small Business Act, credit available elsewhere means the availability of the applicant to obtain credit from a non-federal source on reasonable terms and conditions, taking into account the prevailing rates in the community.²⁴ The justification for the “credit elsewhere” test is to prevent SBA from competing with the private lending market, since SBA was intended to support and not compete with it.²⁵

In the disaster assistance program, the credit elsewhere test operates differently than it does for non-disaster business loans. For business loans, a lender must certify that they would not offer the applicant a loan on similar terms.²⁶ In the disaster program, since the SBA is a direct lender, it performs analysis of the lending market to determine if the applicant would have access to credit in the private lending market.²⁷ The analysis performed by the SBA is intended to mirror the underwriting process that a private lender would perform before issuing a loan. The formula for determining the actual interest rate the applicant will receive is set out in the Small Business Act.²⁸ The calculation of the interest rate for each type of loan available is included in the disaster declaration accompanying each disaster. For Tropical Storm Lee, applicants received the following rates:

²¹ In the United States, monetary policy and interest rates are set by the Federal Reserve Board.

²² 15 U.S.C. § 636(d)(5)(D)(iii).

²³ *Id.* at § 123.302.

²⁴ 15 U.S.C. § 632(h).

²⁵ GOVERNMENT ACCOUNTABILITY OFFICE, ADDITIONAL GUIDANCE ON DOCUMENTING CREDIT ELSEWHERE DECISIONS COULD IMPROVE 7(A) PROGRAM OVERSIGHT 5 (Feb. 2009).

²⁶ *Id.* at 11.

²⁷ 13 CFR § 123.104.

²⁸ 15 U.S.C. § 636(d)(4).

Program	No Credit Elsewhere	Credit Elsewhere
Home Loans	2.500%	5.000%
Business Loans	4.000%	6.000%
Economic Injury Loans		
Business and Agricultural Cooperatives	4.000%	N/A
Non-Profit Organizations ²⁹	3.000%	N/A

All applicants showing an ability to repay can receive a loan from SBA. Borrowers are not denied assistance because of ability to obtain credit from a non-federal source. For applicants eligible to receive funds, the question is whether the borrower should receive a loan with a market rate, or one subsidized by the taxpayer.

To determine whether an applicant is eligible for a subsidized loan, SBA looks at several factors to determine the applicant's creditworthiness. This includes consideration of the applicant's income against their fixed debt and living expenses. After SBA determines this figure, it looks to several other credit tests to determine whether the applicant could secure a loan from a non-governmental source.³⁰ For example, SBA considers the applicant's credit score, their cash flow and asset ratio. SBA requires applicants to meet at least two of these tests to determine whether the applicant could obtain a loan from a non-federal source. If the applicant fails to meet two of these tests, he or she is eligible for the subsidized interest rate. The industry standards and market rates used to determine these tests are adjusted quarterly.

The exact cost of this program to the taxpayers depends on SBA's cost of borrowing funds for the disaster assistance program. Federal Reserve Chairman Ben Bernanke recently stated that the Federal Reserve plans to keep interest rates at historic lows to stimulate economic growth.³¹ The exceptionally low interest rate set by the Federal Reserve is a key factor for lenders in determining the interest rate for loans, including SBA disaster loans. When interest rates do rise, SBA will require additional subsidy to maintain lower interest rates.

²⁹ U.S. SMALL BUSINESS ADMINISTRATION, DISASTER DECLARATION NO. 12,822 AND NO. 12,823, 76 Fed Reg. 66,110 (Oct. 27, 2011) available at <http://www.sba.gov/about-offices-content/4/2818/news/23591>.

³⁰ U.S. SMALL BUSINESS ADMINISTRATION, DISASTER RECOVERY PLAN 10 (June 2011) available at http://www.sba.gov/sites/default/files/Disaster%20Recovery%20Plan_0.pdf.

³¹ *Economic Outlook and the Federal Budget Situation: Hearing Before the House Committee on the Budget*, 112th Cong. (2012) (Statement of Ben Bernanke, Chairman, Federal Reserve Board).

Conclusion

With the introduction of the Disaster Loan Fairness Act of 2011, the Committee may analyze an important question related to the proper role of the federal government in the aftermath of a disaster. Under the current system, only borrowers most in need are provided with a taxpayer-subsidized interest rate. Borrowers whom SBA determines have the ability to obtain a loan from a non-federal source are eligible for credit, but only at market rates. Under the proposed legislation, all disaster loan recipients would be eligible for a taxpayer-subsidized rate of one percent.

The goal of this hearing is to provide members of the Subcommittee with information on the role of the federal government in long-term disaster recovery and short-term business interruption assistance. Members will learn about the programs offered by both the state and federal government. A business owner will provide his perspective on what it takes to recover from a disaster, as well as his experience of attempting to get financial assistance from the SBA. There will be expert testimony about the potential consequences of the legislation (H.R. 3042) that proposes changes to federal disaster loans.