NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

TESTIMONY OF

Rich Bradshaw
President, Specialized Lending
United Community Bank
Greenville, South Carolina

BEFORE THE

House Committee on Small Business Subcommittee
on Economic Growth, Tax and Capital Access
May 19, 2015

Chairman Rice, Ranking Member Chu, and distinguished Members of this Subcommittee, I am grateful to have this opportunity to testify before you to discuss the impact of the Small Business Administration's 7(a) loan program for both the lending and small business communities.

I wear many hats as I testify this morning—the lender who has worked at both a large, national bank and in my current position at a community bank; the member from NAGGL, the national trade association for 7(a) lenders; and a proud veteran. I hope that all of these perspectives that I bring to the table will help create a productive conversation with this Subcommittee about the strengths, the challenges, and some of the possible misperceptions about the 7(a) loan program.

The 7(a) program annually supports over 45,000 small businesses and over 500,000 jobs with partnership from more than 2,600 participating private-sector lenders. And we do all of this at no cost to the taxpayer. In fact, in many years, the program's subsidy rate has been reestimated down the road to be far less than originally estimated, resulting in over $530 million returned to the Treasury since FY 2010.

The 7(a) borrower is a small business that cannot find the same terms in the conventional market because the banking industry continues to remain cautious with its capital and heavily regulated in this post-Recession, post-Dodd-Frank environment. The bulk of conventional loans are made for 3-year terms of less. This means that the majority of small businesses who typically need long-term, competitively priced loans can only find these terms through the SBA loan programs, which offer loans up to a term of 25 years, with average terms for the 7(a) program of 16 years.

In a Basel III world, banks avoid tying up their deposit base in long-term loans. A larger, short-term deposit base is meant to keep the bank afloat in the event of a recession, allowing the institutions to stay nimble enough to shrink their loan portfolio when necessary. For any bank to tie up a significant portion of their deposits in long-term loans would be a funding mismatch and regulators would raise red flags. The 7(a) loan program provides a way for banks to make these long-term loans that, in today's financial climate, are virtually impossible to obtain by small businesses conventionally. Simultaneously, borrowers are just coming out of the shadows of the Recession, dramatically increasing the pool of 7(a) applicants. It is no wonder that annual new loan originations have grown from $16 billion in FY13 to what industry anticipates will be $23 billion in new loan originations in FY16.

Therefore, the single-most pressing issue that threatens the 7(a) program year in and year out is constantly hitting the lending cap set by Congress. On the one hand, this is a good problem to have—it means that the program is growing beyond what Congress expected and that the program's private sector lenders are pumping more and more loans out into the small business economy than ever before. In fact, the program volume in dollars increased on average 22% ahead of last fiscal year as of the first week of May. On the other hand, it means that like last year, the program is once again facing a potential eleventh hour threat of shutting down in this fiscal year and potentially not receiving enough room to grow in FY 2016.

If there is one thing that Congress can do to help the 7(a) program run more effectively and serve more small businesses, it is to make sure that the authorizing committees and the appropriations committees in both the House and Senate work together every fiscal year to set a cap for the program that gives the portfolio enough room to grow without the looming fear of shutting down. The consequences of not setting an appropriate cap are dire for the program.

Washington stop-and-go funding patterns are a complete mismatch for how the rest of the world operates outside the beltway. Small business owners and lenders alike need assurance that the 7(a) program will be a reliable resource. The 7(a) loan goes to small businesses that incorporate this capital into their business models months in advance for new hires or long-term expansion plans. Quite simply, the small business and lending communities will stop turning to the 7(a) program as an answer to capital access if they feel its existence is uncertain. Believe me—this issue is difficult to explain to the board of directors of a community bank. In addition, participating lenders diligently watch the volume of the program and their anticipated pipelines, and if it seems the program will come close to the authorized cap at the end of the fiscal year, lenders will start to change lending behavior as early as June. If the most important thing in finance is market fears and perceptions, the always precarious nature of the 7(a) authorization is undoubtedly the weakest part of the program.

For Fiscal Year 2016, the President's budget request for the 7(a) program was $21 billion. NAGGL is anticipating that the 7(a) program will actually lend about $23 billion in FY16. We are asking that the House and Senate Small Business Committees work together with their respective Appropriations Committees to give the program what it needs to simply allow for the natural increase in small business lending, a trend I know this committee would strongly applaud. I understand and respect Congress' need to justify every dollar spent. But Congress cannot encourage small business lending on the one hand, and yet on the other hand, keep the lenders and borrowers in constant fear of shutdown for simply robustly participating.

Even more pressing is the potential authorization shortfall this fiscal year. For the past three fiscal years, loan volume in dollars has on average increased by 27% in the second half of the fiscal year from the first half of the fiscal year. And I am confident that trend will remain true for FY 2015, putting us easily at around $23 billion gross and $20.5 billion net, if not more. While that level of lending is encouraging, it is also disastrous since the industry only has $18.75 billion in authorization from Congress. That is akin to giving a car with no brakes a full tank of gas but only giving it a little bit of road. What is the car supposed to do when it runs out of road?

Last year, in FY14, we had this same funding shortfall and Congress included a $1 billion anomaly in the Continuing Resolution in September 2014 to save the program from shutting down. And we certainly would have shut down without that additional authorization—the 7(a) program made loans totaling $19.2 billion gross and $17.7 billion net, given an original $17.5 billion in authorization. That net figure would have been even greater had the additional funding come earlier than the last week of the fiscal year since lenders begin to change their lending behavior at least four months in advance of the end of the fiscal year. I know personally that many lenders slowed down their own lending early last fiscal year in anticipation of a shutdown. No lender wants to tell a small business borrower that its loan was delayed. In real world terms, that means the small business can't make those additional hires or has to find a way to stall construction on a new expansion. That is the opposite direction we want the small business economy to be moving toward.

We hope that either Congress or the SBA can work with us to address this looming issue for FY15. Otherwise, the program could shut down and the 7(a) program's reputation as a reliable resource for small businesses will be damaged. And more importantly, small businesses will not receive the access to capital they so badly need in this economic climate.

As a lender, I can tell you that most people do not understand the 7(a) loan program. This program is not a subsidy for small businesses—it's a loan made with a private financial institution to small businesses that are paid back in full and treated as any other conventional market loan. The program is the very essence of a public-private partnership, allowing government to stand out of the way of what banks know how to do best.

Perhaps the most critical part of the program to highlight is that I know for a fact that without the 7(a) program, the loans I make would never be made. That does not mean the small businesses receiving a 7(a) loan are failing or unable to repay their loans. Many believe that a mission statement of helping small businesses find capital that they could not find elsewhere means that these small businesses are somehow subprime—that is false. These small businesses are not subprime; rather, the current conventional market is unavailable to satisfy the majority of small business needs. As lenders participating in the SBA programs, we have to abide by many parameters, including making sure the borrower is in sound financial health and credit worthy. As bankers, we never want to see a risky loan on our books to open us up to potential losses or criticism from our regulators. The 7(a) program ensures we have skin in the game with the lender standing to lose 25%-50% of the loan in the event of default, as well as heavy oversight measures that would affect our reputation as financial institutions.

As an active part of NAGGL, I co-chair the association's Public Policy Committee, which focuses solely on the public policy goals of the 7(a) program. The 7(a) program is inherently connected to a larger mission—to lend to small businesses that cannot find credit elsewhere. Over the years, this has come to mean not only small businesses that cannot find a conventional loan, but also underserved markets and minority populations. This public policy portion of the program is a critical mission for NAGGL and the 7(a) industry, and we have already begun the task of creatively addressing the gap in lending to certain demographics. Veterans and African-Americans are two of the most underserved populations within the SBA lending programs. It is important to note, according to SBA's weekly lending statistics as of the first week in May, when comparing May 2015 to May 2012 year to date, 7(a) lending to African-Americans has increased by 93%. Similarly, when comparing May 2015 to May 2012 year to date, lending to veterans has increased by 88%. Let me caveat this good news with some sobering reality—these increases are augmented by the fact that the pool for each of these underserved demographics is so small in the first place. These are steps in the right direction, but we have much more we can do as lenders.

In response to this, the 7(a) lending industry is reaching out into the communities to attack this challenge in a personal, hands-on way. For example, the SBA and the industry have learned over the years that it is not a matter of lenders not choosing minority borrowers. Rather, it is a matter of minority borrowers not being credit ready and aware of SBA opportunities. In response to this educational need, NAGGL recently partnered with the SBA to create an entrepreneurial education toolkit for minority communities that will be translated into Spanish and taught through faith-based and local community organizations. This educational initiative, called the "Business Smart Toolkit," is being rolled out this year. I'm looking forward to seeing the results of this terrific partnership.

Additionally, NAGGL has been crisscrossing the country to honor minority small business borrowers who have received a 7(a) loan and subsequently revitalized their neighborhoods. During Black History Month of this year, NAGGL hosted an event to honor James Hamlin, an African-American entrepreneur in Baltimore on Pennsylvania Avenue, the epicenter of the most recent protests have been centered. With the help of a 7(a) loan, Mr. Hamlin opened The Avenue Bakery and turned around a small corner of his community that is currently under the microscope of the world when it comes to underserved segments of the population that have been left behind. Mr. Hamlin's bakery was spared from any recent violence that occurred in the city and he is a beacon of hope when it comes to how we communicate with younger generations about how to make a better life. Mr. Hamlin will also tell you that at the end of the day, struggles in minority communities are all about economics. We hope that the 7(a) loan is a way to inject these underserved markets with the power of economic sustainability and success.

As a veteran, I acutely see the challenges we're facing in the portfolio to lend to veterans, as well as other underserved markets, in a very personal way. I feel compelled to be a part of the answer to help the SBA loan programs become more accessible to minorities. As a young man, I attended the Air Force Academy and subsequently served five years active duty in the Air Force. Following my service, I entered the Naval Reserve and for sixteen years working in Naval Intelligence, until finally retiring in 2005. Now, in a new chapter of life, for the last two years I have served on Senator Lindsey Graham's Academy selection boards, interviewing prospective applicants.

One of the most rewarding parts about my alternate life as a banker is that in the SBA 7(a) program, I actually have the rare ability to merge my two worlds and help veterans achieve economic empowerment when they return from the battlefield. I helped create and chair NAGGL's Operations Veterans Access Subcommittee focused on bringing veterans into the 7(a) program. I was encouraged by so many of my peers committing to NAGGL that they would increase lending to veterans by 5% over the course of the coming year, but we need to do more. Some of my favorite moments of my job is seeing that a loan on my desk is going to a veteran and calling them up personally to thank them for their service. Now, as the industry continues to hone in on underserved markets like veterans, I hope that those calls become more and more frequent.

Once again, thank you for this opportunity to testify. I'm encouraged by being here today that Congress and industry can work closely together to address some of the program's challenges and encourage our strengths. I look forward to discussing the 7(a) program more with you and happy to take your questions.