

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

MEMORANDUM

To: Members, Subcommittee on Investigations, Oversight, & Regulations
From: Judy Chu, Chairwoman
Date: May 20, 2019
Re: Subcommittee hearing: “Investing in Community: The SBA’s Community Advantage Loan Program”

The Committee on Small Business Subcommittee on Investigations, Oversight, & Regulations will meet for a hearing titled, “Investing in Community: The SBA’s Community Advantage Loan Program.” The hearing is scheduled to begin at **10:00 A.M. on Tuesday, May 21, 2019 in Room 2360 of the Rayburn House Office Building**. The hearing will allow Members to learn about SBA’s Community Advantage loan program, which has been on a pilot status since its creation in 2011, as a program designed to reach communities traditionally underserved by conventional lenders. The hearing will also enable Members to hear perspectives from lenders and borrowers on whether the program should be made permanent. The witnesses will be:

- Ms. Angela Mavridis, Owner, Tribalí Foods, San Marino, CA
- Mr. Robert Villareal, Executive Vice President, CDC Small Business Finance, San Diego, CA
- Ms. Janie Barrera, President and CEO, LiftFund, San Antonio, TX
- Mr. John Kropf, President, Growth Capital Corp, Cleveland, OH

Background and Program Overview

SBA administers programs to support small businesses, including loan guaranty programs designed to encourage lenders to offer loans to small businesses that may not be able to access affordable capital elsewhere on reasonable terms.¹ The 7(a) program is considered the agency’s flagship loan program, and its name is derived from Section 7(a) of the Small Business Act, which authorizes SBA to provide and guarantee commercial loans to U.S. small businesses.² Under this program, participating lenders offer commercial loans to eligible small businesses while SBA guarantees the loan in the event the borrower defaults, thereby minimizing the risk to the lender of making that loan. SBA guarantees from 50 to 90 percent of each 7(a) loan made, depending on the loan characteristics.³

¹ Cong. Research Serv., *Small Business Administration 7(a) Loan Guaranty Program*, R41146 (Mar. 4, 2019) [hereinafter CRS].

² 15 U.S.C. § 636(a); *see also Id.*

³ U.S. Small Bus. Admin., *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report* (2019) [hereinafter SBA Budget].

SBA also administers several subprograms within the 7(a) program that offer streamlined and expedited loan procedures for particular groups of borrowers, including the SBA Express, Export Express, and Community Advantage Pilot programs.⁴ Although these subprograms have their own distinguishing eligibility requirements, terms, and benefits, they operate under the 7(a) program's authorization.⁵

SBA's Community Advantage Loan Program

Originally announced by SBA as a three-year pilot program, the Community Advantage 7(a) loan program (CA) became operational in February 2011, and has subsequently been extended numerous times, most recently through September 30, 2022, when it is set to expire.⁶ The program is designed to “meet the credit, management, and technical assistance needs of small businesses in underserved markets.”⁷ CA provides mission-oriented lenders, primarily nonprofit financial intermediaries focused on economic development, access to 7(a) loan guaranties for loans of \$250,000 or less.⁸ Lenders may also optionally provide borrowers and potential borrowers with technical assistance, but are not required to do so. SBA's goals for CA are to:

- Increase access to credit for small businesses located in underserved areas;
- Expand points of access to the SBA 7(a) loan program by allowing non-traditional, mission-oriented lenders to participate;
- Provide management and technical assistance to small businesses as needed; and
- Manage portfolio risk.⁹

Notably, in its Congressional Budget Justification for FY2019, SBA recognized that the CA program “reached significantly more women and minorities than the traditional 7(a) loan program.”¹⁰

Eligible Lenders

Specifically, the organizations that may participate in the CA program are limited to:

- SBA-authorized Certified Development Companies (CDCs);
- SBA-authorized Microloan program intermediaries;
- SBA-authorized Intermediary Lending Pilot Program intermediaries; and
- Non-federally regulated Community Development Financial Institutions (CDFIs) certified by the Department of Treasury.¹¹

⁴ CRS, *supra* note 1.

⁵ *Id.*

⁶ *Id.*

⁷ U.S. Small Bus. Admin., *Community Advantage Participant Guide*, Version 5.0 (2018) [hereinafter SBA CA].

⁸ *Id.*

⁹ *Id.*

¹⁰ SBA Budget, *supra* note 3.

¹¹ SBA CA, *supra* note 7.

Furthermore, organizations approved to participate as CA Lenders are required to make at least 60 percent of their CA loans in underserved markets.¹² For purposes of CA, underserved markets include:

- Low-to-Moderate Income (LMI) communities (CA Lenders are encouraged to serve low and very-low income communities);
- Businesses where more than 50 percent of the full-time workforce is low-income or resides in LMI census tracts;
- Empowerment Zone and Enterprise Communities;
- HUBZones;
- New businesses (firms in business for no more than two years);
- Veteran-owned businesses;
- Promise Zones;
- Opportunity Zones; and/or
- Rural Areas.¹³

Loan Terms, Guaranty Rates, Use of Proceeds, and Interest Rate

The CA loan program offers the same loan terms, guaranty fees, and guaranty as that of the 7(a) program on loan amounts up to \$250,000.¹⁴ SBA offers a guaranty of 85 percent on loans up to \$150,000 and 75 percent on loans greater than \$150,000.¹⁵ Loan proceeds may be used for the same purposes as those of the 7(a) program, which include:

- acquiring land (by purchase or lease);
- improving a site (e.g., grading, streets, parking lots, landscaping);
- purchasing, converting, expanding, or renovating one or more existing buildings;
- constructing one or more new buildings;
- acquiring (by purchase or lease) and installing fixed assets;
- purchasing inventory, supplies, and raw materials;
- financing working capital; and
- refinancing certain outstanding debts.¹⁶

The loan's maximum interest rate is prime, plus 6 percent.¹⁷ The program has an expedited approval process, which includes a two-page application for borrowers and a goal of completing the approval process within 5 to 10 days.¹⁸

Program Statistics

As shown in the table below, SBA approved 1,118 CA loans totaling \$157.5 million in FY2018, and 4,906 CA loans totaling \$643.72 million from the time the program became operational to the end of FY2018.

¹² *Id.*

¹³ *Id.*

¹⁴ CRS, *supra* note 1.

¹⁵ *Id.*

¹⁶ 13 C.F.R. § 120.120.

¹⁷ CRS, *supra* note 1.

¹⁸ *Id.*

Fiscal Year	# of Loan Approvals	Amount of Loan Approvals (\$ in millions)
2011	15	\$2.14
2012	188	\$25.24
2013	273	\$38.20
2014	453	\$56.47
2015	828	\$103.52
2016	988	\$123.02
2017	1,043	\$137.60
2018	1,118	\$157.53
Total	4,906	\$643.72

Source: Congressional Research Service

Current Issues

Recent regulatory changes

Effective October 1, 2018, SBA placed a moratorium on accepting new CA lender applications, primarily as a means to mitigate the risk of future loan defaults.¹⁹ SBA also:

- increased the minimum acceptable credit score for CA loans “that satisfies the need to consider several required underwriting criteria” from 120 to 140;²⁰
- increased the wait time for CA lenders ineligible for delegated lender status at the time of approval as a CA lender from 6 months to 12 months and increased the number of CA loans that must be initially dispersed before a CA lender may process applications under delegated authority from five loans to seven loans;²¹
- increased the loan loss reserve requirement for CA loans sold in the secondary market from 3 percent to 5 percent of the outstanding amount of the guaranteed portion of each loan;²²
- modified requirements related to the refinancing of debts with a CA loan;²³
- limited fees that may be charged by a CA lender for assistance in obtaining a CA loan to no more than \$2,500, with the exception of necessary out-of-pocket costs such as filing or recording fees;²⁴ and
- added Opportunity Zones and Rural Areas to the list of economically distressed communities that are eligible for a CA loan.²⁵

In response to the October regulatory changes, the National Association of Development Companies (NADCO – which represents 504/CDC lenders), the Mission Lenders Working Group

¹⁹ 83 Fed. Reg. 46237; available at <https://www.govinfo.gov/content/pkg/FR-2018-09-12/pdf/2018-19885.pdf>.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

(which represents nonprofit mission lenders), and various other CA participants submitted public comment letters raising numerous concerns. In subsequent meetings with Committee staff, two specific concerns were highlighted as priorities.

One of SBA's proposals is to modify the requirements for refinancing non-SBA guaranteed, same-institution debt to require a transcript showing the due dates and when payments were received for the most recent 12 month period, rather than 6 months.²⁶ If there are any late payments in the most recent 12 month period, the debt may not be refinanced with a CA loan.²⁷ In addition, debts on the CA lender's books for less than 12 months may not be refinanced with a CA loan.²⁸

In response, the Mission Lenders Working Group argued that this proposal would make it more difficult for a CA lender to offer bridge loan products, which ultimately restricts flexibility for small business owners seeking to refinance unfavorable debt.²⁹ According to a survey of that group of CA lenders, over 80 percent reported a significant number of prospective borrowers seeking to refinance a high-priced loan from an online lender.³⁰ Additionally, several lenders reported that 25 to 30 percent of these businesses are near a financial breaking point due to unaffordable daily automatic payments, resulting in them acquiring quick refinances in order to stabilize the business.³¹ The new rules arguably make it more difficult for CA lenders to provide short-term or emergency bridge loans as immediate relief.³² Furthermore, NADCO also raised the concern that the new requirement to wait an additional six months could result in borrowers choosing predatory lending options due to their immediate need.³³

Secondly, upon determining that the current reserve requirements are insufficient with respect to CA loans sold on the secondary market, SBA is increasing the required reserve for CA loans sold on the secondary market from three percent to five percent.³⁴ For each CA loan approved on or after October 1, 2018, a reserve of five percent of the outstanding amount of the guaranteed portion must be deposited in the Loan Loss Reserve Account if the loan is sold on the secondary market.³⁵

Responding to this change, NADCO and the Mission Lenders Working Group argued that selling loans in secondary markets has been critical for mission lenders to raise loan capital, finance more

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ Mission Lenders Working Group, Comment Letter on Notice of Extension of and changes to Community Advantage Pilot Program (Nov. 13, 2018), available at <https://www.regulations.gov/contentStreamer?documentId=SBA-2018-0008-0025&attachmentNumber=1&contentType=pdf>.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ National Association of Development Companies, Comment Letter on Notice of Extension of and Changes to Community Advantage Pilot Program (Nov. 8, 2018), available at <https://www.regulations.gov/contentStreamer?documentId=SBA-2018-0008-0019&attachmentNumber=1&contentType=pdf>.

³⁴ 83 Fed. Reg. 46237; *supra* note 19.

³⁵ *Id.*

small businesses, and maximize its financial servicing abilities.³⁶ They argued the additional LLR requirement will impact the unrestricted cash of all CA lenders selling loans on the secondary market without regard for their performance as a lender or the health of their portfolios.³⁷

Finally, SBA is imposing a moratorium on accepting new CA lender applications, and simultaneously expanding the definition of “underserved areas” to include rural areas. In response to these changes, the California Association for Micro Enterprise Opportunity (CAMEO) pointed out that in 2017, nine states (Iowa, Kansas, Kentucky, Nebraska, Mississippi, Oklahoma, South Dakota, West Virginia, and Wyoming) had no CA lending, and highlighted that the moratorium would be counterproductive in light of the expansion of the program to include rural areas.³⁸ CAMEO also argued that the moratorium effectively shut out any states with little to no CA lending from the program.³⁹

Program Extension

Legislation was introduced during the 114th Congress by Sen. Dianne Feinstein (S. 2125, the Small Business Lending and Economic Inequality Reduction Act of 2015) to provide the CA program permanent, statutory authorization. In the 116th Congress, Rep. Judy Chu (CA-27) plans to introduce legislation that also gives the program permanency. Furthermore, NADCO and CAMEO both called for permanency in their respective public comment letters.⁴⁰ Others, including the National Association of Government Guaranteed Lenders (NAGGL), expressed support for the 30-month extension of the pilot, arguing it would provide SBA with an appropriate amount of additional time to continue evaluating the performance of the program, and make additional modifications “with the long term goal of assuring the greatest chance for success if the [CA program] is made permanent.”⁴¹

Conclusion

SBA’s 7(a) loan program is designed to reach small businesses and entrepreneurs who cannot reasonably access affordable capital elsewhere. The CA program takes that a step further by reaching those small businesses and entrepreneurs that are not captured by even the 7(a) program. By SBA’s own admission, the CA program reaches “significantly more women and minorities than the traditional 7(a) loan program.”⁴² Therefore, preserving its integrity and mission is a priority of this Committee. This hearing offers Members the opportunity to learn more about the CA program as one that is designed to reach those entrepreneurs and small businesses who are the most difficult to reach by conventional banks and even 7(a) lenders.

³⁶ Mission Lenders Working Group, *supra* note 29.

³⁷ *Id.*

³⁸ California Association Micro Enterprise Opportunity, Comment Letter on Notice of Extension of and Changes to Community Advantage Pilot Program (2018), available at <https://www.regulations.gov/contentStreamer?documentId=SBA-2018-0008-0006&attachmentNumber=1&contentType=pdf>.

³⁹ *Id.*

⁴⁰ National Association of Development Companies, *supra* note 34.

⁴¹ *Id.*

⁴² SBA Budget, *supra* note 3.