Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

To:	Members, Subcommittee on Economic Growth, Tax, and Capital Access
From:	Committee Staff
Date:	June 26, 2017
Re:	Hearing: "A Review of SBA's 504/CDC Loan Program"

On Thursday, June 29, 2017 at 10:00 a.m., the Subcommittee on Economic Growth, Tax, and Capital Access of the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building for the purpose of examining the United States Small Business Administration's (SBA) 504/CDC Loan Program. From the role of Certified Development Companies (CDCs) to the economic development requirements that are outlined in the loan program, the hearing will provide Members of the Subcommittee the opportunity to hear directly from program participants.

I. Introduction

With deeper resources and a more extensive financial history, larger businesses often utilize the option of obtaining needed capital through debt and equity markets. In contrast, the nation's smallest businesses usually finance their projects and ventures with personal assets or traditional bank borrowing. Despite an improving economy and an unemployment rate that continues to decline,[1] small businesses face a lending environment that is rigid and cumbersome. Since the recession of 2007-2009, the value of small domestic bank loans has remained stagnant.[2] To address the credit and capital gap that faces the nation's smallest firms, the SBA administers several government guaranteed loan programs focused on increasing the access small businesses have to acquiring capital.

II. The 504/CDC Loan Program

As a way to bridge the gap for small businesses that cannot use traditional markets, the SBA offers the 504/CDC Loan Program, which provides long-term and fixed-rate financing. Originally created in the Small Business Investment Act of 1958,[3] the 504/CDC Loan Program assists small businesses with the acquisition of major fixed assets, such as real estate or machinery or for equipment purchases that expand or update their small businesses.

Similar to SBA's 7(a) Loan Program, the 504/CDC Loan Program and SBA charge fees to run the program and cover any losses to protect the American taxpayer in accordance to the

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1 https://data.bls.gov/timeseries/LNS14000000.
2 https://fred.stlouisfed.org/series/EVAXSSNQ.
3 15 U.S.C. § 695.

1990 Federal Credit Reform Act (FCRA).[4] In previous years, SBA has relied on a subsidy from Congress to operate the program. However, because the fees have been sufficient, the program has been running on a zero-subsidy cost to the American taxpayer for the last two fiscal years, and SBA has requested a zero-subsidy for FY 2018.[5]

While the refinancing of 504/CDC loans historically have not met the economic development goals and spirit of the program, the Small Business Jobs Act of 2010[6] contained language that allowed, on a temporary basis, for non-government debt to be refinanced under the program. Although the temporary authority lapsed, refinancing was permanently reinstated in the Consolidated Appropriations Act of 2016.[7] However, the ability to refinance is contingent upon the entire 504/CDC Loan Program running at zero-subsidy. For any given year that the program requires a subsidy, the refinancing option will be put on hold.

III. The Role of Certified Development Companies

Unique to the loan program is the role of the certified development company, or CDC, which must be a non-profit corporation and certified and regulated by SBA to participate in the program.[8] CDCs must be in good standing and in compliance with all laws and tax requirements in the state they have been incorporated in, and in any state they do business.[9] Moreover, SBA has outlined Board of Director guidelines for CDCs that consist of voting member requirements, experience requirements[10] and a requirement for how often they must meet.[11] Beyond the Board, SBA has outlined numerous requirements for CDC staff in order to market and service loans.[12]

Along with the small businesses and the financial institutions that are involved in the credit transaction, CDCs also play a major role in the cost structure of the loan program. A standard loan is organized where the small business or borrower is responsible for 10 percent of the project. The financial institution is in the senior lien position and is responsible for 50 percent of the value of the project, and the remaining balance of 40 percent belongs to the CDC, which is in the second lien position, through a federal government guaranteed debenture. As with SBA's 7(a) Loan Program, funds are not lent by SBA; rather SBA guarantees the loans made by the CDC. SBA applies a slight modification to the percentages if the small business is defined as new or the project deals with a limited or special purpose project.[13]

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[4] For any government loan program, FCRA requires an agency to collect an appropriation or fee to cover the cost of the program. 2 U.S.C. § 661.
[5] For FY 2016, SBA requested zero subsidy. SBA, FY 2016 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2014 ANNUAL PERFORMANCE REPORT at 41. For FY 2017, SBA requested zero subsidy. SBA, FY 2017 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2015 ANNUAL PERFORMANCE REPORT at 39. For FY 2018, SBA is requesting zero subsidy. FY 2018 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2016 ANNUAL PERFORMANCE REPORT at 31.
[6] Pub. L. No. 111-240.
[7] Pub. L. No. 114-113.
[8] SOP 50 10 5(I). Subpart A., Ch. 3(I)(B).
[9] *Id.* at (II)(A)(1).
[10] *Id.* at (5).
[11] *Id*. at (g).
[12] *Id.* at (7).
[13] *Id.* at Subpart C., Ch. 1(IV).

IV. Economic Development Requirements

A hallmark of the 504/CDC Loan Program, and a differentiating characteristic among SBA's many loan products, is the focus on economic development. Eligibility in the loan program and debenture size of the loan is determined based on the borrower either meeting a job creation or job retention requirement. Job creation is defined by creating or retaining at least one job for every $65,000 spent on the project. For small manufacturers, the requirement is one job for every $100,000.[14] If meeting the job creation or retention requirement cannot be achieved, a borrower can still qualify if they meet either one community development goal or a number of public policy goals.[15]

V. Loan Details and Loan Activity

The maturity and maximum loan amounts for the 504/CDC program differ based on the small business borrower and the scope of the project. For example, real estate projects carry a loan maturity of 20 years, while loans for equipment have a maturity of 10 years.[16] With regard to the maximum loan amount, a regular 504/CDC loan carries a limit of $5 million, while a small manufacture that participates in the program can receive a loan of up to $5.5 million.[17] As for the interest rate, the loans are set by the SBA, and benchmarked to a value above the 5 and 10-year Treasury note, and approved by the U.S. Treasury Secretary.[18]

While the program has experienced loan activity fluctuations over the years, FY 2016 performance modestly outpaced FY 2015 activity in three key categories. In FY 2015, SBA approved approximately $4.3 billion in 504/CDC loans. In FY 2016, SBA approved $4.7 billion. When it comes to the number of small businesses assisted through the program, FY 2015 registered 5,618 small businesses being helped. FY 2016 data indicates the loan program assisted 5,722 small businesses. Shifting to the impact on jobs, the loan program supported 61,454 jobs in FY 2015. In FY 2016, the program supported 61,983 jobs.[19] Although the program increased, recent year-over-year statistics have shown decreases in these categories.[20] The Committee will continue to investigate program performance.

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[14] *Id.* at Ch. 2(III)(H)(1)(a)(i).

[15] The community development goals are: improving, diversifying, or stabilizing the local economy; stimulating business development; generating new income; helping manufacturing firms; or assisting the labor supply. The public policy goals are: revitalizing a business district with a redevelopment plan; increase of exports; increase of women owned small businesses, veteran owned small businesses, or minority owned businesses; assisting with rural development; increasing productivity or competitiveness; modernizing facilities to meet health, safety and environmental requirements; helping businesses in areas impacted by Federal budget reductions or base closings; or reducing the unemployment rate. 13 § CFR 120.862.

[16] *Id.* at Ch. 5(I)(B)(3).

[17] 13 CFR §120.931.

[18] 13 CFR §120.932.

[19] SBA FY 2018 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2016 ANNUAL PERFORMANCE REPORT at 29-30.

[20] *Id.*

VI. Conclusion

With the nearly 29 million small businesses in the United States[21] continuing to face a challenging lending environment[22], access to capital programs at the SBA must be working efficiently. Beyond efficiency, they must be operating on behalf of small businesses, while protecting the American taxpayer.

With the fluctuations in the program and the recent refinance policy changes, it is important for Congress to comprehensively understand the 504/CDC Loan Program. Moreover, it is paramount for Congress to oversee the federal government guarantee loan programs at all times, especially during times of interest rate increases.[23] The Committee will steadfastly defend the nation's small businesses as they work to achieve their American Dream. When small businesses perform, so does the American economy.

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[21] SBA OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE (2017), *available at* https://www.sba.gov/sites/default/files/advocacy/United_States_1.pdf.

[22] The Federal Reserve System recently published the 2016 Small Business Credit Survey and found more than 60 percent of small business faced challenges when it came to lending in the previous year, thus resulting in using more personal assets or downsizing. THE FEDERAL RESERVE SYSTEM, 2016 SMALL BUSINESS CREDIT SURVEY (2017) at iii.

[23] https://www.federalreserve.gov/newsevents/pressreleases/monetary20170614a.htm.