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United States Senate Small Business and Entrepreneurship Committee

Reauthorization of the SBA's Access to Capital Programs

Testimony Submitted by Patricia "Patti" Kibbe

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Good afternoon Chairman Rubio, Ranking Member Cardin, and members of the committee. My name is Patti Kibbe and I am here on behalf of Evergreen Business Capital, where I've served as the organization's CEO since 2013. A non-profit Certified Development Company (CDC), Evergreen Business Capital is headquartered in Seattle, Washington with offices in Alaska, Oregon, and Idaho. I started with Evergreen Business Capital as the Chief Operating Officer in 2002, prior to which I worked as a senior-level banker. I moved to Evergreen due to my belief in its mission of providing America's growing small businesses with access to affordable capital, and the integral part Evergreen plays in helping small businesses to seize opportunities and create jobs. Since 1980, when Evergreen was established as the 11th CDC in the country, its mission has been to strengthen the communities it serves through small business financing. To that end, our CDC offers an array of lending options including the Small Business Administration (SBA) 504 program, SBA Community Advantage Pilot Program, and other non-SBA small business support programs such as loans through our internal Evergreen Business Capital Community Finance. Additionally, Evergreen is in the process of becoming a Community Development Financial Institution (CDFI). I envision, through these tools, a region where growing small businesses serve as the foundation of healthy American communities, from urban to rural.

Our dedicated 32 staff members are located across all four states in which we operate to ensure outreach everywhere we are authorized to make loans, especially rural and underserved markets. Since Evergreen is a mission lender dedicated to small businesses, it is important to have employees who are also members of the local communities, in order to provide the best input and support.

I am pleased to report that our lending mission is routinely successful. Evergreen Business Capital authorized 113 loans for over $85 million in 2018. These loans are anticipated to create over 500 jobs in our communities. Since 1980, Evergreen Business Capital has supported borrowers by providing capital to create or retain over 20,000 jobs. We have assisted nearly 2,800 businesses with SBA funds totaling over $2.6 billion, supporting total projects of over $7.5 billion. These statistics do not account for the impact of other CDCs, of which there are over 200 nationally.

The reason Evergreen and CDCs around the country exist is to help small and startup businesses become bankable for the next level of growth. We work with partners like the Small Business Development Centers (SBDCs) and SCORE. These partnerships are crucial in helping small businesses to thrive. Last year alone Evergreen connected over 124 business owners to resources and capital. Without the financing through the 504 and Community Advantage programs, these businesses simply would not have been able to start or grow. Community Advantage loans, earmarked for very small businesses, are crucial to helping the most underserved markets. I urge the committee to support permanentizing this pilot program so that these small and startup businesses can continue to access capital.

While the story of Evergreen is special to me, it is not unique within the CDC community. CDCs are mission-based lenders, connected to the community not just physically but financially. As non-profit lenders, we use our excess capital on economic development for the communities we support. Many of my colleagues at other CDCs help small businesses access programs beyond the SBA 504 program, as Evergreen does, be it the USDA IRP program, state and local programs, or our own internally created and funded programs to fill gaps we see in the areas we serve. CDCs are leaders in communities across the nation on many fronts, and you can see that here at the witness table with me. My friend Robert Villareal serves as Executive Vice President of another CDC, CDC Small Business Finance, and is here to discuss the wonderful work that they and others, including Evergreen, do through the Community Advantage program. It is a privilege to be part of this community and representing it here today.

I want to turn my attention to the 504 program and the work our CDC does through this. The 504 program is an economic development tool that provides small businesses with long-term, fixed rate loans to help them acquire major fixed assets for expansion or modernization of their businesses. These loans are most frequently used to acquire land, buildings, machinery, or equipment. A 504 loan can be 10, 20, or 25-year term, which is beneficial for small business owners. Pairing the fixed rate aspect with these term options gives a small business owner stability, allowing them to budget and better manage cash flow, without concerns about rising rates or balloon payments. In the rising rate environment that we have been in the last two years, this is particularly critical.

504 loans are a result of a partnership involving third party lenders (such as banks and credit unions), small business owners, and the federal government. Typically, the financing structure is a 50/40/10 split. A bank or credit union provides 50% of the project financing, the 504 portion is 40%, and the small business puts 10% down - giving the small business a lower down payment than a conventional loan, which helps it to preserve working capital for operations. The 504 loan-the “40” in the 50/40/10 - is guaranteed by SBA and funded through a debenture sale on Wall Street. The 504 loan component is not financed using funds from the government. The CDC works with the small business borrower to get the SBA 504 loan portion approved and funded. CDCs work with the small business borrower through the life of the loan. Let me share with you some of those businesses we currently work with.

Evergreen recently assisted a small business in Seward, Alaska called Zudy’s Café, a cozy restaurant that boasts “Cake with a View,” touting delectable desserts and the spectacular view of Resurrection Bay. The building in which they leased space is on the National Historic Registry and had just celebrated its 100th birthday. The small business owners had the opportunity to buy that building and to expand their business into additional space. To do that, they used a 504 loan with an SBA guarantee. Financing was provided using a low borrower down payment, the 504 loan facilitated by Evergreen Business Capital and guaranteed by the SBA, and the conventional loan financed by First National Bank of Alaska. Beyond the actual loan, financial assistance also came through another SBA supported program-the Kenai Peninsula Small Business Development Center. The project was eligible for a 504 through our public policy goals, being a rural business and being located in a designated Labor Surplus Area.

Back in the Lower 48, Monaco Tool Company designs and manufacturers tools that are used by diesel mechanics to repair diesel engines. The company was started 1986 when one man, Joe Monaco, started making tools out of his garage. Inventory complete, Joe pounded the pavement, visiting independent truck stops, and handing out parts catalogs to solicit business; at which point the business began to grow. The growth didn’t stop, even after Joe moved out of his garage. In fiscal year 2018, the company realized it had outgrown its location once again, and used a 504 loan to purchase a new building on the west side of Eugene, OR that will allow the business to meet current production demands, and will allow for continued growth. Through this loan, the 504 program supported a manufacturing company that created 12 new jobs with its move, retained existing jobs, and will allow for new growth and new jobs into the future.

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I could tell 504 success stories all day long-including ones just steps from this room that you all may be familiar with, such as Schneider's of Capitol Hill and La Loma Mexican Restaurant, both just over at Third and Massachusetts Avenue NW. I could also tell you about the nationally known successes such as Chobani, Fat Boy Ice Cream, and the local Port City Brewing company that at one point could not find financing outside of the SBA 504, but because of the program they are now household names. The successes of Zudy's Café, Monaco Tool Company, and all other loans within the 504 program are wonderful for the small business owners and for their communities. But they are also wonderful in another way: all of these loans are done with zero subsidy from the government. Let me say that again-this program requires no appropriation, it is self-funding. In addition, this program guarantees jobs. Congress statutorily mandates that each 504 loan fulfill job retention or creation requirements, community development requirements, or public policy goals to support economic development. For every $75,000 lent in the 504 program, a job MUST be created or retained by a small business. No ifs, ands, or buts. If a CDC maintains that job ratio, it can also make loans to small businesses who fulfill a statutory public policy or community development goal, such as minority or women-owned business ownership or increasing businesses in manufacturing. This job requirement is unique to the 504 program, and CDCs are proud to fulfill it.

These are just a small sample of the work Evergreen Business Capital has been able to do with the 504 loan program. It is a truly valuable tool for economic development and job creation throughout the country. However, small businesses who want to use this program do face some unnecessary challenges. Some of these challenges revolve around speed and modernization. While my territory has the last Blockbuster in the world, as you may have read in the *New York Times* this weekend, our small businesses deserve a 504 program that is the Netflix, not the Blockbuster, of small business lending. What does that mean? It means modernization in policy and technology by SBA, such as elimination of the majority of hard copy forms in favor of data entered directly and passed electronically throughout the system; enhanced user interfaces for small business applicants and CDCs working with them; data validation processes that would eliminate incomplete and incorrect submissions, saving SBA, small businesses, and CDCs time and money; transparency in loan progress and status so small businesses can better plan their financial future; instant electronic access to background checks and other federally-sourced information; normalization of electronic signatures; and other changes such as streamlining the refinancing programs.

This modernization also means looking at ways to speed up low dollar, low risk loans to small business owners, to help keep them from predatory online lenders. These lenders charge exorbitant amounts but small businesses sometimes are trapped into accepting their help because no timely alternative exists. Appendix A to my testimony includes a proposal outlining how a responsible, faster, small dollar 504 program could be implemented by Congress or SBA to help protect these small business owners.

There are other statutory changes this Congress could make that reflect the real-world structure of businesses today. For example, current law requires a 504 borrower who purchases an existing building to occupy 51% of that building. However, this prevents small businesses from buying a building with equally split floors. In urban areas, it is easy to come across buildings where the first floor is zoned commercially and the second floor is zoned residentially. It is also common for a small business to want a building where they can grow without having to move. In buildings with an equal footprint on a first and second floor, the small business cannot lease out the second floor while they grow to the size that will occupy that space as well. Changing this requirement by just 1%, from 51% to 50%, will open up these options to small businesses.

There is another statutory requirement that needs a 1% adjustment. Right now, for a small business to be eligible for a 504 under a public policy goal, the ownership and management control must be 51% consistent with that public policy goal. However, that poses a problem to jointly owned small businesses. For example, say a small business is owned 50% equally by a husband and wife who are both active in all daily management; the wife is of Asian descent and the husband is a US Army veteran. While this small business is 50% woman-owned, 50% veteran-owned, and 50% minority-owned, the business does not meet any existing public policy goals for a 504 because the husband and wife have an equal say in running their business. Surely this is a business we want to encourage lending for, not shut out based on a 1% difference in ownership structure.

Beyond statutory changes, there are regulations and policies that hamper small businesses in their attempts to grow through a 504 loan. You, me, and the SBA share the goal of getting to "yes" for small businesses. However, SBA policies do not always reflect that goal. While we respect and value responsible lending, lending from the SBA should follow policies that manage risk, not completely eliminate risk. Between my banking background and my CDC work, I can assure you: the only way to eliminate risk is to eliminate small business loans. But that's not in the government's best interest-you know from your time on this committee and your time with your constituents that small businesses make up the overwhelming majority of our businesses, and that their growth is our economy's growth.

One way to ensure that SBA hears about the problems their policies can unintentionally cause is to reform the process by which SBA issues their Standard Operating Procedures, or SOP. This document, over 400 pages, is updated and re-released almost every year. It contains almost every detail necessary to get a 504 loan to a small business. However, there is no way for small businesses or practitioners to have input in the drafting, nor is a draft released with a chance to comment and receive responses or explanations from SBA about the changes. This leads to unnecessary confusion for small businesses, and a switch in the "rules of the road" sometimes without an explanation from the Agency.

Another policy unnecessarily harming small businesses is SBA's restrictions on the relationship between Eligible Passive Companies and Operating Companies, or EPCs and OCs. This business structure is common and provides benefits recommended by accountants and lawyers. However, EPC/OC relationships within the 504 program have their rent structures dictated by SBA, their lease structures dictated by SBA, and restrictions placed on other business activities outside of the 504 loan project. All of these are outside the norm of conventional commercial business practices and come at the detriment of the legal and tax advice these small businesses receive. A small business who structures their business this way should not be penalized by the SBA.

We are also concerned about the reinstatement of an SBA regulation that was repealed several years ago, called the personal resources test. Draft SBA regulation last fall included a reinstitution of this rule, which requires small business owners to put down even more money from their savings than previously required, limiting the amount of liquid assets a 504 borrower could have. When SBA removed this requirement only five years ago, it stated that elimination of the personal resources test would enable more robust borrowers to participate in SBA's loan programs, thus mitigating risk to SBA's loan portfolio while facilitating job growth. As you recall, job creation or retention is a statutory requirement of the 504 loan. In addition, the Agency stated it was concerned that even borrowers whose principals had liquidity in their personal resources may be unable to obtain long-term fixed asset financing from private sources at reasonable rates.

Reinstituting this requirement would harm small business owners. The proposed regulation does not adjust for personal circumstances that require liquidity, such as cost of living (which varies significantly throughout the country), childcare, health care, and education needs (such as college tuition for children). The regulation also does not adjust for the variety of business needs, such as business development and training, other business opportunities that may arise, market changes, or increased competition, all of which require liquidity. As a result, the small business that must abide by this will lack the necessary capital required for growth, job creation, and continued economic development within its community and beyond. Finally, the proposed regulation disincentivizes prudent business practices and penalizes small business owners who are economically prudent and are reserving funds for future market changes, expansion, and growth.

Finally, I must briefly address the FY2020 SBA Budget Proposal, which recommends an increase in fees for the 504 program. To do so would be a harmful mistake. This is a zero subsidy program providing loans to small business owners who support jobs or fulfill a public policy goal described by Congress. The program is administered by mission-based lenders, 98% of which are non-profits. Adding on additional fees to small businesses punishes our entrepreneurs and hinders economic development that emanates from the small businesses and CDCs. In addition, the Budget Proposal unnecessarily limits the size of the 504 refinancing program beyond its congressionally authorized level. Congress wisely did not include either of these policies in the FY19 budget when they were previously was proposed, and I urge you to again reject these requests.

By solving these problems, we will help our small businesses and our economy grow. As I stated earlier in my testimony, the 504 program is statutorily required to create or retain jobs for every $75,000 it lends to entrepreneurs. The easier it is for responsible small businesses to access this program, the more jobs we create. It's that simple. I ask for your leadership and assistance in fixing these challenges and growing our economy.

Again, thank you for inviting me to testify today. I am happy to answer any questions and I invite you all to visit the CDCs in your state to see the great work my colleagues do right in your backyards.

Appendix A

Pilot Streamlined ALP-CDC Program for Smaller Debentures

Created by the National Association of Development Companies (NADCO)

NADCO

National Association of Development Companies

504 Express – Pilot Streamlined ALP-CDC Program for Smaller Debentures

Opportunity

The e504 Modernization Project, combined with SBA's new tools for properly managing risk (D&B SBPS Scores, SMART Scores, etc.), provides an opportunity to create a new streamlined program to deliver smaller 504 loans. The streamlined program proposed herewith, **504 Express**, would allow smaller, lower risk credits, to be processed more quickly. This streamlined process will negate the inefficiencies created by processing smaller, lower risk credits through the same processes and procedures that are in place for larger, more complex loan structures. The time and resources saved by both SBA and CDC staff will benefit the borrower experience in speed and service provided.

This proposed pilot program, **504 Express,** would only be delivered by ALP-CDCs. Since the ALP application and renewal process involves the input of all relevant SBA divisions, the SBA could feel a level of confidence regarding the credit underwriting of **504 Express** loans. In addition, access to **504 Express** would encourage existing ALP-CDCs to maintain their high standards and offer a strong incentive for non-ALP-CDCs to improve their overall performance in order to qualify for ALP-CDC status.

In the long term, it is the CDC industry's hope that the e504 Modernization Project will result in a credit scoring model for the processing of smaller debentures for all CDCs. However, the **504 Express** pilot program can provide current relief to small businesses as we work towards that credit scoring goal.

Background Information

Current SBA policies require the same steps and processes to finance a smaller, lower risk 504 loan as a multi-million dollar transaction, whereas in the private sector and other SBA loan programs, there are distinctly different processes for small and large commercial loans because of the inherent difference in risk for those various sizes. The fixed costs of 504-financed projects (land surveys, for example) that may or may not be applicable in the private sector are often required on a 504 loan, regardless of size, which again does not reflect the risk of these loans.

The inefficiencies and costs of this program have led many banks to the conclusion that the value the 504 program brings to their customers is not worth the effort and expense of going through the 504 process on smaller projects. This is one reason that small business owners may not be told about the 504 program when they visit their bank. Often, and particularly in the case of smaller projects, the bank recommends small business owners take more efficient and faster options.

One of the results of banks not presenting 504 as an option has been an emergence of a cottage industry of 504 non-bank lenders marketing aggressively to high risk industry sectors and projects that cannot be done any other way. **504 Express** is an effort to create a more relevant product in today's lending environment, while properly mitigating risk and best using the time and resources of the CDCs and SBA staff. Because strong underwriting will be of paramount importance to ensure the success of **504 Express,** access would be limited to ALP-CDCs. In addition, only smaller 504 projects would be allowed during the pilot period.

<u>Proposed Improvements/Solutions</u>

504 Express Pilot Program

1) The **504 Express** Pilot Program would only be available to ALP-CDCs.

2) The maximum standard 504 or 504 Refi loan (504 loan) allowed to be processed under the program would be $500,000.

3) SLPC would develop a streamlined, reduced combined checklist (only SBA Form 1244, SBA Form 2450, Supplemental Information and the CAIVRS report would be submitted) and the credit memo would have a focus on financial analysis and reduce the duplicative information from other SBA documents (sample attached). In addition, the relevant audit processes (IPERIA, etc.) would be modified in recognition of this new, abbreviated approval process.
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4) Small businesses engaged in high default industries or high default franchises, as defined annually by SBA based on a 20-year rolling average, would not be eligible for the **504 Express** Program.

5) ALP-CDCs, due to the lower risk of these loans, would have delegated authority (same authority currently given to PCLP) on **504 Express** loans to approve the appraisal and environmental reports per current SOP requirements.

6) The following items that currently require 327 actions could be processed with unilateral authority for **504 Express** loans:
    a. Corrections to names or formation of any EPC, OC, Borrower, or Guarantor;
    b. Corrections to the Project Property address (Note: CDCs shall not exercise unilateral authority to change the Project Property);
    c. Corrections to the Interim Lender or Third Party Lender name;
    d. Change the Third Party Lender or Interim Lender, provided that they are a federal or state regulated financial institution;
    e. Make a Guarantor a Co-Borrower or vice versa;
    f. Add a Guarantor;
    g. Reduce standby debt prior to loan closing as a result of regularly scheduled payments;
    h. Reduce project costs; and,
    i. Re-allocation of project costs in an amount equal to 10% of the allocated cost.

7) District Counsel would rely solely on the opinion of the Designated CDC Attorney for these **504 Express** loans.

8) If the 504 borrower is current on their **504 Express** loan, then the following servicing actions would be unilateral:
   a. No cash out subordination;
   b. Addition of guarantors;
   c. Assumption by a new party as long as the existing borrower is not being released;
   d. Release lien on collateral w/ FMV ≤ 10% of Debenture amount or $10,000;
   e. Force place insurance coverage;
   f. Endorse insurance checks ≤$100,000.

9) The **504 Express** pilot program can provide current relief to small businesses, and additional efficiencies can be gained once SBA has the capability to incorporate a credit scoring model for these smaller debentures.

<u>Benefit to Small Business</u>

Small business concerns would benefit from a faster and more predictable approval process. This could help prevent them from taking loans from predatory lenders with high interest rates that put small businesses farther into debt. Additionally, an easier process would encourage greater bank participation, so more small businesses would be aware or have access to the benefits a 504 loan can offer them.