RSC Republican Study Committee

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Legislative Bulletin……………………………….……October 29, 2009

Contents:

H.R. 3854—Small Business Financing and Investment Act of 2009 *(Schrader, D-OR)*

Order of Business: The bill is scheduled to be considered on Thursday, October 29 2009, under a structured rule (H.Res.875) providing for one hour of general debate and making in order sixteen amendments. The rule waives all points of order against consideration of the bill, except the earmark and "pay-go" violations. The rule allows one motion to recommit with or without instructions. The RSC will summarize each amendment made in order in a separate document.

Summary: H.R. 3854 would reauthorize and make changes to 6 different programs within the Small Business Administration (SBA). Additionally, the bill would create two new programs within the SBA. H.R. 3854 is a combination of eight separate bills (H.R. 3723, H.R. 3739, H.R. 3737, H.R. 3740, H.R. 3722, H.R. 3014, H.R. 3738, H.R. 3743) packaged into a "small business omnibus." Overall, the legislation would increase limits on several SBA capital access loan programs and takes steps to reduce the interest rate on loans made to small businesses under current programs. No Congressional Budget Office (CBO) score is available for the legislation, however the Committee claims the legislation will authorize approximately $2.72 billion over five years.

Title I: The first section of the bill makes several changes to the SBA 7(a) loan guarantee program, which is the primary lending vehicle to provide loan guarantees to small businesses, by increasing business stabilization loans from $35,000 to $50,000 for small businesses experiencing financial hardship. The bill extends this program and several other provisions enacted in the "stimulus" law that reduced fees and red-tape for SBA funding applications through September 30, 2011.

This title also creates several small-business outreach programs to increase rural and veteran-owned business participation and directs the SBA to create a more straightforward standard for determining small business loan eligibility. General business loans authorized under section 7(a) may not exceed $20,000,000,000 for FY 2010 and FY 2011. The legislation authorizes "such sums" to carry out the provision under this section. Other major items of note in Section I are as follows:

> ***Capital Backstop Program:*** Requires the SBA to create a new process for potential borrowers submit loan applications directly to the agency and to identify banks that will

make loans if a small business cannot find one in its local area. If the SBA cannot find a lender within 100 miles of the principal office of the potential borrower, it is required to provide applications to preferred SBA lenders nationwide. If after 60 days no private sector lender approves these loans, the <u>*SBA is authorized underwrite, close, and fund the loan.*</u>

Extension of Recovery and Relief Loan Benefits: Increases guarantees and eliminates borrower fee provisions that were established under the "stimulus" through September 30, 2011.

Secondary Market Lending Authority Made Permanent: Provides the SBA with permanent authority to make liquidity available to brokers and dealers who purchase and sell SBA 7(a) loans. The provision was initially passed as a temporary measure in the "stimulus" on the argument that it was difficult to identify buyers for small business loans with 85% government backed guarantee.

Express Loan Program: Permits the SBA to retain a 25 basis point fee that is currently charged and retained by lenders on all 7(a) loans.

Title II: The second section of the legislation makes changes to the treatment of Certified Development Companies (CDC), also known as the 504 loan program, to increase their access to capital and provide benchmarks for their consideration of guaranteed loans from the SBA. CDC's are non-profit corporations with less than 200 employees that provide long-term funding for fixed assets such as building renovations or land. The bill prohibits the CDC's from assisting small businesses unless the project can certify it will increase jobs within two years, stimulate a local economy, expand minority owned business, or reduce energy consumption by 10%. In addition, the bill will increase guarantees issued by the CDC from a range of $1.5 million to $4 million to a range of $3 million to $10 million. The CDC will guarantee up to $3 million of funding for a small business project, $4 million for a project in a low-income community, $8 million for projects that help small manufacturers or reduce energy consumption by 10 percent or produces renewable fuels, and $10 million for projects that constitute a major source of employment under the Small Business Act. The bill authorizes the SBA to guarantee $9 billion in FY 2010 and $10 billion in guarantees for FY 2011.

Title III: The third section of the bill affects the SBA's microloan program, which provides loans of up to $35,000 to assist newly established small businesses comprising of borrowers with little credit history, businesses working with non-profit entities to secure financing, and minority or veteran borrowers who do may have difficulty qualifying for loans offered under the 7(a) program. H.R. 3854 increases limits for first year intermediary borrows from a $750,000 limit to $1 million in the first year, and doubles the limit from $3.5 million to $7 million in subsequent years. The section also increases the amount a intermediary can spend on providing technical assistance to small business concerns that are prospective borrows from 25% to 35%. The bill also requires intermediaries that provide loans to have at least 1 year of experience making microloans to startup, newly established, or growing small business concerns, or that have a full-time employee who has at least 3 years experience in managing a portfolio of loans to start companies and 1 year experience providing intensive marketing, management, and technical assistance to its borrowers.

The bill also eliminates the "short term" interest rate loans requirements and replaces it with fixed-interest rate over the long-term and increase the minimum aggregate loan amount to qualify for subsidized interest rates under the program from $7,500 to $10,000. In order to carry out the changes to the microloan program, the bill authorizes $80 million for technical assistance and $110 million in direct loans annually for FY 2010 and FY2011.

Title IV: The fourth title of the legislation affects small-business investment companies (SBIC) by raising the current cap on the amount that state funds can invest in SBICs from 33 percent to 40 percent. These private investment companies are licensed by the SBA to private investment to allow them to borrow money from the Treasury and make loans or loan guarantees to small businesses. In addition, the provision would provide for an expedited licensing process for companies with stable management teams. The bill would allow for SBICs that invest in veteran-owned small businesses to receive the same increased leverage limitations that are currently available to SBICs that invest in businesses located in Low and Moderate Income areas (LMI).The bill would authorize the SBA to make $5 billion each, in purchases of SBIC Participating Securities and debenture leverage for fiscal years 2010 and 2011.

Title V: The fifth title of H.R. 3854 expands the New Markets Venture Capital (NMVC) program to make areas that are primarily engaged in manufacturing eligible for funding under the program. The privately managed program's mission is to provide equity financing and operational assistance to small businesses in low-income areas. Additionally, the legislation instructs the SBA to reduce the cost burden of the application process for companies and eliminates the minimum amount of matching commitments for operational assistance that an NMVC company must raise before receiving final approval. This provision reauthorizes appropriations in a total amount of $100 million to fund debenture guarantees, and $20 million for operational assistance grants for fiscal years 2010 and 2011.

The section also expands upon a renewable fuel capital investment program created in 2007 and provides operational assistance grants (OA) to providing matching grants to assist small businesses that receive investment capital with marketing, management, and other operational assistance. This provision doubles the existing authorization for operational assistance grants in the RECI program from its current level of $15 million a year to $30 million for each fiscal year through 2011 and authorizes a program level of $1 billion in debenture guarantees.

Title VI: This title of the bill *creates a new loan guarantee program* separate from other SBA programs to make loan guarantees to small-business health professionals to purchase or install health information technology. The HIT Loan Program will rely on private-sector lenders to provide loans that are guaranteed by the SBA. The provision authorizes the SBA to make loan guarantees of up to 90 percent of the cost for eligible professionals up to $350,000 for any single individual/professionals and $2,000,000 for any group and authorizes $10 billion in loan authority for this provision.

Title VII: This title of the bill creates a *new small business early investment program* for venture capital funds to invest in small early-stage businesses with specific emphasis on early-stage small businesses in targeted industries (defined as gross annual sales revenues below $15,000,000 in any of the previous 3 years) and include companies engaged primarily in researching, developing, manufacturing, producing, or bringing to market goods, products, or services with respect to any of the following business sectors: "Agriculture technology, Energy technology, Environmental technology, Life sciences, Information technology, Digital media, Clean technology, and Defense technology."

An incorporated body, limited liability company, or limited partnership must submit a plan to the SBA that include requirements for describing how the company intends to make successful venture capital investments in early stage small businesses in targeted industries, information regarding the relevant venture capital qualifications and personal background of the managers of the company applying to participate in the program, and a description of the extent to which the applicant meets other selection criteria that are also established under this part. Within 90 days after receiving an application, the Administrator must make a determination to approve a grant following seven specific selection criteria intended to determine the likelihood of success for the project.

The grants issued to selected companies may be up to amounts of $100 million. Each grant must have raised an amount of private capital equal to or greater than the amount of the SBA grant. The total aggregate of SBA grants made to one company may not exceed more than $100 million. A participating investment company must make all of its investments in small businesses, and at least 50 percent of an investment company's investments must be made in early-stage small businesses in targeted industries.

In exchange for SBA participation in the venture, participating investment funds must convey a `grant interest' to the SBA that carry the same rights and attributes of other investors, but do not denote control or voting rights to the project in order to maintain a limited partner interest in a limited partnership or limited liability company. As a condition of receiving a grant, manager profits interest payable to the managers of a participating investment company under the program shall not exceed 20 percent of profits.

The Administrator will establish a revolving fund for the purposes of the program, subject to annual appropriations, and H.R. 3854 authorizes $200 million to be appropriated to carry out the initial grants issued by the program.

- ***Conservative Concern:*** Some conservatives have expressed concern this program is similar to an unsuccessful one that expired in 2006. The Participating Securities (PS) program was an early stage equity investment program where the SBA would provide funding to use as a stake to invest in companies similar to the role as a venture capitalist. However, the Small Businesses Committee estimated that the government lost $2.7 billion in the PS program because the participants were too heavily invested in high-tech companies such as telecom and Internet firms. In part due to these losses, former Chairman Manzullo (R-IL) decided to let the program sunset in 2006.

Title VIII: Title Eight of the bill increases the limit on disaster loans from $1.5 million to $3 million for homeowner loans, and from $2 to $3 million for business loans. The bill also creates a minimum deferment period of 12 months (currently, first payment on a disaster loan usually starts 5 months after the date of the loan), and mandates that the repayment period begin from the date that the final loan disbursement is made. The bill also mandates certain percentages of a disaster loan be disbursed (depending upon the size of the loan) regardless of circumstances on the ground (unless the borrower requests a lower amount). Current practice ties disbursement with need in the rebuilding process to avoid releasing money from the approved disaster loan for services not rendered.

The provision also *<u>creates a new small business disaster grant program</u>* that authorizes “such sums as necessary” for the SBA to make grants to small businesses of up to $100,000 for the businesses most severely affected by a catastrophic disaster. This would be the first time the SBA provides grants directly to small businesses. In order to receive the grant, a small business owner has to be rejected for a disaster loan in and the SBA must give priority to small businesses that they determine are “economically viable but unable to meet short-term financial obligations.”

- ***Conservative Concern:*** Some conservatives have expressed that because most disaster loans made by the SBA are under $100,000, allowing small business owners to receive up to $100,000 in grants in the aftermath of a major disaster would essentially nullify the entire purpose of obtaining a loan. Additionally, in many previous major disasters, Congress has historically passed supplemental appropriations to cover the cost of recovery that can assist small businesses usually through extra funding in the Community Development Block Grant program at HUD. Finally, any disaster victim, including small business owners, can apply for a FEMA grant of up to $30,300 to take care of temporary, emergency needs.

  Some conservatives have also expressed reservations that this provision will incentivize a small business owner to get a disaster grant over a disaster loan because the purpose of the disaster grants are primarily to assist small businesses while they wait for disaster loan approval from the SBA to meet short-term economic needs. However, if the small business has to be turned down for the disaster loan by the SBA first before getting this grant, some conservative may question the need for the disaster grant in the first place because every small business owner will want to be denied a disaster loan to get this grant. Some conservatives may believe this provision also rewards the less responsible small business owner by forcing more responsible small business persons to pay back a disaster loan while less viable firms receive a grant.

  Finally, some conservatives have expressed reservations about instituting a new grant program without any detailed findings that grants would have saved businesses during recovery from a disaster that were not saved by loans.

Title IX: The final title (9) of the bill requires the SBA to promulgate regulations to carry out the provisions contained in the legislation within 180 days following enactment.

Additional Background: In fiscal year 2007, the SBA made approximately 90,000 loans worth about $14 billion through its 7(a) lending program. In fiscal year 2009, those figures were 44,000 and $9 billion. Proponents argue that expanding SBA capital access programs will provide bridge to supplement conventional commercial credit and capital markets that are not supplying funds to small businesses. According to the committee, there are approximately 25 million small businesses in this country and have created 64 percent of new jobs historically. The Obama administration has been vocal on finding an avenue to promote a "main street" agenda through the SBA.

Possible Conservative Concerns:

- ***Cost:*** According to cost estimates provided by the Small Business Committee, H.R. 3854 will *authorize approximately $2.7 billion* over five years. Given the current budgetary constraints and record deficits, some conservatives have expressed concern with the high authorized spending levels of some of the initiatives. Some conservatives may also question the need to create two new programs when the main goal of the bill is to simply free up lending.

  Problematic New Programs: Some conservatives have expressed concern over the necessity on some of the new provision listed in the bill, especially the creation of a disaster relief grant program that would reward less responsible small businesses owners by forcing more responsible small business persons to pay back a disaster loan while less responsible firms receive a grant.

- ***Handouts:*** Some conservative have expressed concern the H.R. 3854 is the wrong approach to assist "main street." The model follows in the same form of government assistance in providing handouts and *expands upon a number of provisions of the "stimulus" that has failed to show any results*. Some conservatives feel the more appropriate assistance would be to reduce regulations and the tax burden on small business to create jobs and grow the economy.

Brief Overview of SBA Programs:

SBA's 7(a) Loan Guarantee Program: The SBA's 7(a) Loan Program gets its name from section 7(a) of the Small Business Act, which authorizes the SBA to provide loans to small businesses. The SBA itself does not make loans, but guarantees a portion of the loans made. The Lender and SBA share the risk that a borrower will not be able to repay the loan in full. The collateral is against payment default, it does not cover reckless decisions by the lender or misrepresentation by the borrower. Loans under the 7(a) program are considered to be the most flexible, since financing can be used for working capital, machinery and equipment, furniture and fixtures, land and buildings (including purchase, renovation and new construction), leasehold improvements, and debt refinancing. Loans for working capital have a 10 year maturity and there is a 25 year maturity for fixed assets.

Since the loan comes from a commercial lender, not the Government, a small business must apply directly to a lender for financing. The lender decides if the loan requires additional support in the form of an SBA guaranty. The SBA assures the lender that in the event the borrower defaults, the government will reimburse the lender for their loss, up to the percentage of the SBA guaranty. The small business borrowing the money still remains obligated for the full amount due. If the loan meets the requirements of the SBA, but the lender does not want to provide the loan, the SBA does not have the authority to force the lender to do so. There are different types of 7(a) loan programs available. They include the Express Programs, Export Loan Programs, the Rural Lender Advantage and the Special Purpose Loans program.

CDC/504 Loan Program: The Certified Development Company/504 loan program provides small, for-profit, businesses with financing options of long-term, fixed-rate loans so that they may purchase assets that are necessary for expansion or modernization. A Certified Development Company (CDC) is a private, nonprofit organization that is set up in order to add to the economic growth of its community. CDCs work with the SBA and private sector lenders in order to provide financing to small businesses. Small businesses are considered those with a tangible net worth of less than $7.5 million and that average net income less than $2.4 million after taxes for the previous two years. Businesses cannot use the 504 program for working capital or inventory, consolidating or repaying existing debt, or refinancing. Loans may not be made to businesses that invest in rental real estate.

Normally, 504 projects contain a contribution from the borrower of at least 10 percent equity, a loan secured from a private sector lender with a senior lien covering up to 50 percent of the project cost, and a loan secured from a CDC with a junior lien covering up to 40% of the total costs. This program provides an ideal Loan to Value Ratio (LTV) for the lender.

SBA's Microloan Program: The program provides small, short-term loans to individuals starting a small business or trying to expand an existing one, as well as to owners of not for profit child care centers. The microloan program is different from other SBA loan programs, in that rather than merely guaranteeing the loan, the SBA actually loans the money to intermediary lenders who then give loans to eligible borrowers. The intermediary lenders are non-profit community organizations who have experience in lending; they also provide technical assistance and business advice to small business owners (most intermediaries actually require microloan borrowers to complete a technical training program). SBA microloans can be under $500 or up to $35,000, though the average loan is around $13,000. Although the applications are open to all entrepreneurs, microloans are especially utilized by underserved individuals who would be unable to get a conventional loan because of little or no credit history, low income, rural location, or minority status.

Microloans can be used to pay for working capital, inventory, equipment, and supplies but cannot be used to pay off existing loans or purchase real estate. Loan terms, rates of interest, and required collateral vary. The intermediary lender who determines the eligibility sets these provisions. The maximum term for a microloan is six years, and interest rates are usually between 8 and 13 percent. In addition to the regular fiscal appropriations, the so called “stimulus” provided an extra $50 million for microloans and $24 million for technical assistance available to the SBA.

Small Business Investment Company: The Small Business Investment Company (SBIC) program was created by the Small Business Act of 1958. SBICs are privately owned and managed investment firms that are licensed and regulated by the SBA. SBICs use their own capital and funds borrowed with an SBA guarantee to make investments in small businesses. The SBA defines a “small business” as a business whose net worth does not exceed $18 million and whose after tax average income for the previous two years was under $6 million. Currently there are over 400 licensed SBICs that provide funding to small businesses in a variety of industries and geographical areas. Some SBICs focus on a particular business field, while others invest more generally. Most SBICs concentrate on a certain stage of business (start up, expansion, or turn around) and a specific geographic locale. SBICs are grouped in several different categories based on the type of SBA guaranteed funding they use.

Debenture SBICs provide debt or debt with equity features and focus on more established companies who can meet their debt obligations, while Participating Securities SBICs offer pure equity investments and are more likely to lend to start up companies. Specialized SBICs (SSBICs) provide investments to socially or economically disadvantaged individuals who would otherwise be unable to get a loan for their small business. The Small Business Program Improvement Act of 1996 repealed section 301(d) of the Small Business Act creating SSBICs, so new SSBICs are currently being licensed, though existing firms were grandfathered in. Among various SBA regulations, SBICs are not permitted to invest in other SBICs, financial or investment companies, undeveloped or farm land, companies with less than 51% of their assets in the United States, or companies whose business activity is contrary to the public interest.

New Markets Venture Capital (NMVC) Program: The New Markets Venture Capital (NMVA) Program was signed into law in December of 2000 by President Clinton. Congress appropriated $150 million for FY 2001 of debenture security authority, and $30 million for Operational Assistance (OA) grants. By August 2003, the SBA had entered into agreements with six New Markets Venture Capital Companies (NMVCCs). These were for-profit investment funds that were privately managed.

Recipients of the NMVC program use funds from loans guaranteed by SBA to make equity capital investments in smaller companies that are located in low-income geographic areas. Grant funds are not allowed to be used for administrative expenses, but can be used for management and technical assistance. Low-Income Geographic Areas are defined by meeting one of the following: any census tract or county division in which the poverty rate is 20% or more, any census tract or county division located within a metropolitan area where at least 50% of the households have an income below 60% of the area's median gross income, any census tract or county division located in a metropolitan areas where the median household incomes is not above 80% of the statewide median household income, any area located within a HUBZone, any area located within an Urban Empowerment Zone or Urban Enterprise Community, any area located within a Rural Empowerment Zone or Rural Enterprise Community.

Loans made within this program mature after 10 years. No loan payments are required within the first five years, with interest only payments due semi-annually in years 6 to 10. A balloon repayment of the principal is due at loan maturity. The interest rate on these loans is determined by the Federal Home Loan Bank of Chicago (FGLB). The SBA is currently not accepting applications for the NMVC program.

Renewable Fuel Capital Investment Program: In 2007 Congress passed the Energy Independence and Security Act which included language authorizing the SBA to create a pilot Renewable Fuel Capital Investment Program. This program would allow the SBA to create Renewable Fuel Capital Investment Companies (RFCICs) which essentially would be specialized types of SBICs that could invest in companies engaged in the research, development, and production of renewable sources of energy. The RFCICs would issue zero coupon debentures to these companies that would be guaranteed and could be sold by the SBA. The SBA Administrator could also make grants of up to $1 million to the RFCICs for use in financing renewable energy companies. Under the terms of the Act, the pilot program became effective on October 1, 2008. It appears, however, that the SBA is still in the process of implementing the Renewable Fuel Capital Investment Program.

SBA Disaster Loans: The SBA offers low-interest loans to homeowners, renters, businesses, and non-profit organizations for uninsured private property, inventory, real estate, equipment, and business assets that have been damaged in a declared disaster. Since 1953, the SBA has provided more than 1.9 million loans to disaster victims. There are three types of disaster loans: Home Disaster Loans (for damaged real estate and personal property), Business Physical Disaster Loans (to repair or replace damaged property owned by a business or non-profit organization), and Economic Injury Disaster Loans (to provide working capital for small businesses damaged in a disaster). Interest rates vary depending on whether or not the applicant has credit available elsewhere, and the maximum loan term is 30 years, though for businesses with credit available elsewhere the term is only 3 years. Home loans are capped at $200,000, while both Business Loans and Economic Injury Loans have a limit of $1,500,000. The SBA may also help with refinancing if an applicant does not have credit elsewhere, has suffered serious losses, and plans to rebuild or repair.

Committee Action: On October 20, 2009, the bill was introduced and referred to the House Committee on Small Business. On October 21, 2009, the committee held a mark-up and ordered the bill to be reported by voice vote.

Administration Position: A Statement of Administration Policy states in part, "H.R. 3854 includes a number of provisions that the Administration believes will provide much needed assistance to small businesses, such as increased maximum loan sizes for the SBA's flagship 7(a) and section 504 programs…Passage of H.R. 3854 in the House is an important step in the legislative process, and the Administration encourages the Congress to build on that foundation by incorporating the President's proposals to further assist small businesses."

Cost to Taxpayers: A CBO score for H.R. 3854 is unavailable at press time. The House Committee on Small Business produced a cost estimate in House Report 111-315 and determined "the cost of H.R. 3854 would be $2,719,462,500 ($2.72 billion) over the 2010-2014 periods, subject to appropriation of the specified and necessary amounts."

Does the Bill Expand the Size and Scope of the Federal Government? Yes, it creates two new programs under the SBA and expands the scope of at least six more.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates? No.

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: According to House Report 111-315, "pursuant to clause 9 of rule XXI, H.R. 3854 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(d), 9(e), or 9(f) of rule XXI."

Constitutional Authority: The Small Business Committee, in House Report 111-315, cites constitutional authority for this legislation in Article I, Section 8, Clause 18. House Rule XIII, Section 3(d)(1), requires that all committee reports contain "a statement citing the *specific powers* granted to Congress in the Constitution to enact the law proposed by the bill or joint resolution." *[emphasis added]*

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