REPRESENTATIVE GARY PETERS

MICHIGAN'S 9TH CONGRESSIONAL DISTRICT

COMMITTEE ON FINANCIAL SERVICES | COMMITTEE ON SMALL BUSINESS

The Effects of Changes to Small Business Administration Lending Policies in Oakland County

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REPORT PREPARED BY THE OFFICE OF UNITED STATES REPRESENTATIVE GARY C. PETERS

From the Desk of Representative Gary C. Peters

Because the success of Oakland County small businesses is crucial to our continued economic recovery, creating an environment where individual entrepreneurs with good ideas can access the tools they need to create and expand firms, create jobs, and strengthen our economy is my top priority.

Small businesses employ over half of all private sector workers in Michigan[1], and are responsible for creating 60% to 80% of all new jobs in the past fifteen years.[2] My office assembled this report in order to highlight the challenges and opportunities faced by Oakland County entrepreneurs through the credit crisis, the great recession, and our continued economic recovery. In it you will find a review of recent legislation designed to extend private sector credit to small businesses, and the direct results for Oakland County.

It is my hope that this report will highlight effective strategies to continue our economic recovery. Let's get Michigan back to work.

Sincerely,

Gary C. Peters
MEMBER OF CONGRESS

[1] U.S. Small Business Administration, Office of Advocacy, *2009 Small Business Profiles for the States and Territories,* Washington, DC 2009, http://www.sba.gov/sites/default/files/files/State%20Economic%20Profiles%202009_Michigan.pdf.

[2] U.S. Small Business Administration, Office of Advocacy, *The Small Business Economy: A Report to the President,* pg. 9. Washington, DC 2009, http://www.sba.gov/sites/default/files/files/sb_econ2009.pdf

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Overview

Types of Assistance Available to Small Businesses

Small businesses have the opportunity to leverage a wide variety of local, state and federal programs. Entrepreneurial development programs help small business owners and prospective entrepreneurs with things like management assistance and help formulating a business plan, along with training, information, and technical assistance. Small business contracting programs help small businesses compete against large corporations for government contracts. There are also a number of research grants available to small businesses, as well as programs to help attract venture capital. Finally, there are numerous tax advantages and incentives available to small businesses.

This report focuses on Small Business Administration (SBA) lending programs which help small firms access private sector capital, a key factor in the development and expansion of any small business. The need for enhanced small business access to capital is highlighted by the important role small businesses have in creating new jobs, as well as by the disastrous effects of the credit crisis. Since new and expanding firms are the most likely to be in a position to create jobs, the ability of Oakland County small businesses and entrepreneurs to secure financing is of paramount importance to our continued economic recovery.

Determining Eligibility as a Small Business

Though we all have a commonsense notion of what a small business is, federal programs rely on more precise definitions. The SBA defines what qualifies as a small business according to annual receipts or by number of employees, depending on where the firm fits into the North American Industry Classification System (NAICS).[3] Additionally, the business must be organized for profit, have a place of business in the United States, and make a contribution to the U.S. economy by paying taxes or using American products, labor, and materials.[4]

While the SBA uses the above guidelines to determine eligibility for SBA programs, other federal, state, local, or private sector programs may use their own size standards to determine eligibility. It is important to check the specific program requirements to determine if your small business is eligible.

[3] A comprehensive list of NAICS codes and size standards can be found at online at http://www.sba.gov/sites/default/files/Size_Standards_Table.pdf.

[4] Congressional Research Service. *Small Business Administration Reauthorization: A Primer on Programs* by N. Eric Weiss. March, 2010.

Primer on Small Business Administration Lending Programs

Loan Guarantee Programs

Some banks and credit unions can be less willing to make loans to small businesses, making access to financing a major hurdle for many small firms. Because of the impact and importance of small businesses on job creation and the economy, the SBA carries out a number of programs which assist entrepreneurs in accessing the capital required to meet a variety of needs, including expanding and retooling. While the SBA does not lend money directly, its lending programs assist firms in obtaining private sector financing when it would otherwise be unavailable. This is accomplished by offering banks a guarantee on a portion of the loan against default, reducing the overall risk and making small business lending a more attractive and viable option for lenders. Among these programs are the 7(a) Loan Program, the 504 Loan Program, and the SBA Microloan Program. A brief primer on these programs follows.

The SBA does not issue loan guarantees to businesses that can otherwise obtain loans. However, if a portion of a loan amount is not available without an SBA guarantee, the SBA can guarantee the additional portion. A list of local participating lenders is provided in the appendix to this guide. You can learn more about the SBA's loan guarantee programs on the SBA's website at http://www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/sba-loan-programs.

7(a) Loan Program

The 7(a) loan program is the most commonly used SBA lending program. 7(a) lending helps entrepreneurs secure loans to establish a new business or to assist in the acquisition, operation, or expansion of an existing business. Eligible uses include the purchase of land or buildings, the purchase of equipment or materials, working capital, and refinancing out of existing indebtedness that carries unreasonable terms and conditions.

A 7(a) loan starts with a perspective borrower and a participating lending institution. If the borrower qualifies, the SBA guarantees a percentage of the loan against default, which reduces the risk to the bank and encourages the lender to extend credit. It is important to note that it is the bank or credit union, not the government, which makes the determination to extend credit. In order to cover the cost of the loans that default, as well as the administrative costs incurred by SBA in processing these loans, the borrower is assessed a fee based on the loan size that is paid back over the life of the loan.

You can read more about the 7(a) loan program on the SBA's website at http://www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/sba-loan-programs/7a-loan-program.

504 Loans

The 504 loan program is similar to the 7(a) program in that a guarantee is extended for a portion of a loan in order to reduce the risk associated with extending credit to a small business. However, the 504 program uses a much different loan structure and involves a third party in addition to the borrower and the financial institution, known as a Certified Development Company (CDC). CDCs are private, nonprofit corporations dedicated to contributing to economic development in their communities. Eligible purposes for loan proceeds through the 504 program are more restricted than with the 7(a) program. 504 loans may only be used for the acquisition of major fixed assets such as land, structures, machinery, and equipment. 504 loans cannot be used for refinancing, repaying debt, inventory, or working capital.

Under the 504 program, a bank or credit union extends credit for 50% or more of the financing. The CDC in turn provides between 30% and 40% of the financing, and the borrower is required to contribute at least 10% of the financing. The SBA provides a guarantee on the portion of the financing posted by the CDC.

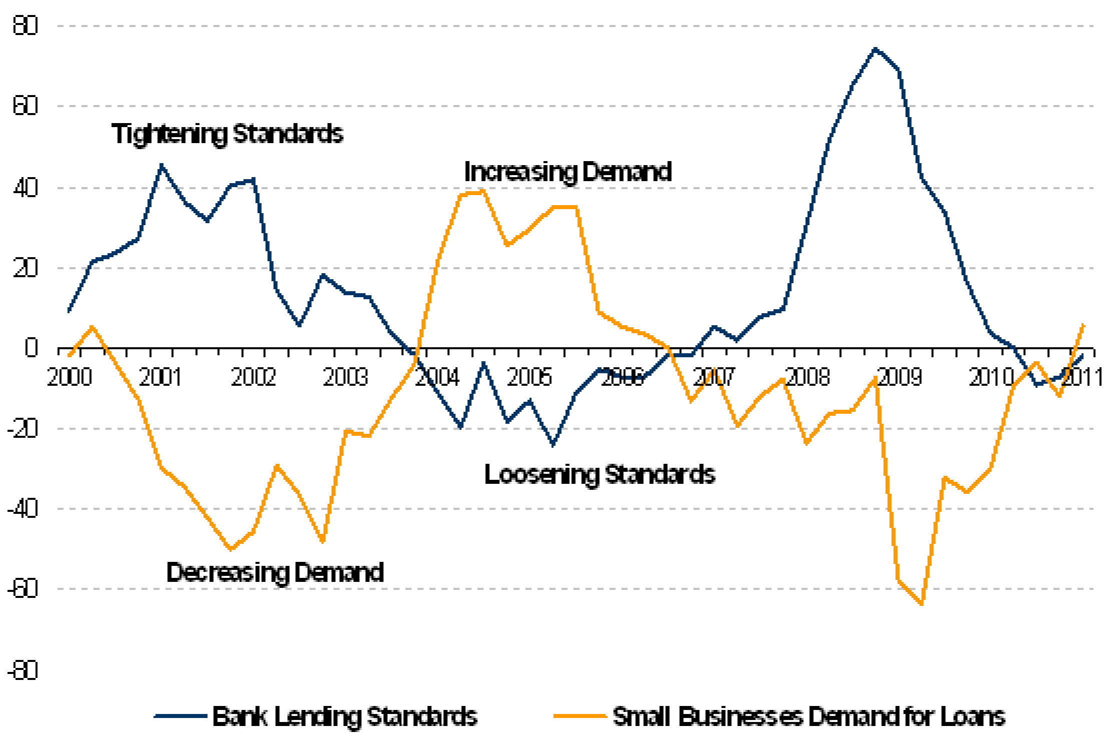
You can read more about the 504 loan program on the SBA's website at http://www.sba.gov/content/cdc504-loan-program.

Policy Changes in Response to the Credit Crisis

The Impact of Tightened Lending Standards on Loan Volume

During the financial crisis, small business lending plummeted nationwide as lending institutions tightened credit standards. Ongoing surveys of senior loan officers conducted by the Federal Reserve Board shows that tightening of credit standards directly and dramatically correlates with demand for small business loans[5], as illustrated in Figure 1.

Figure 1. Small Business Lending Environment, 2000-2011[6]



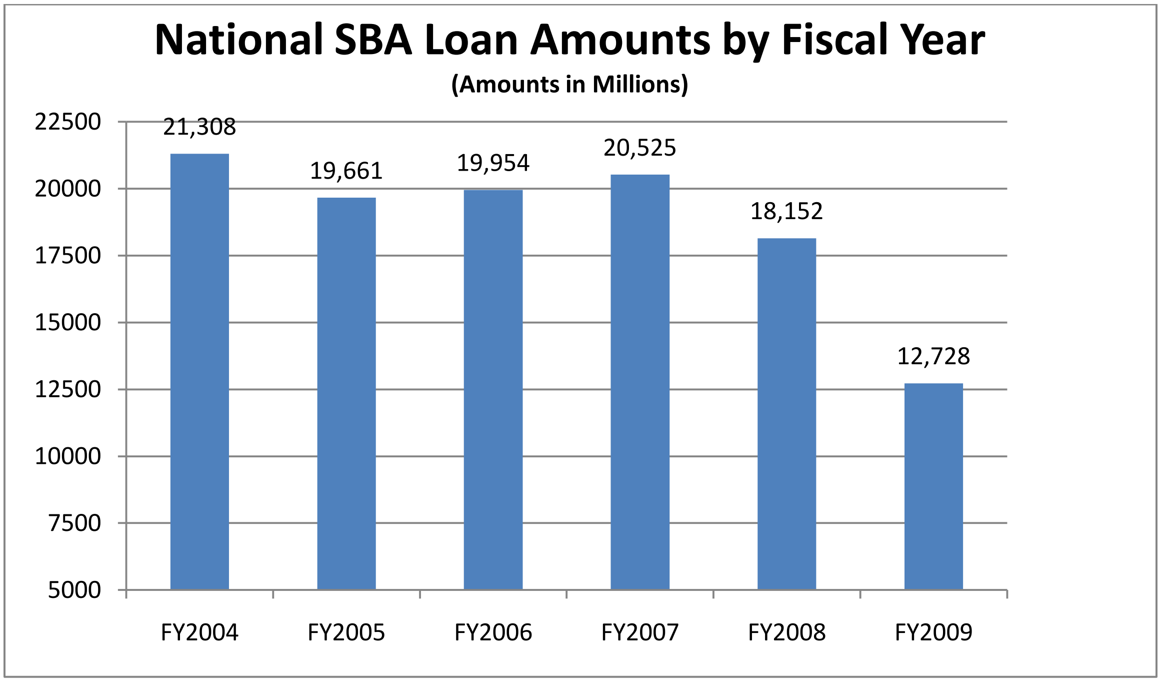
It is not surprising that decreases in loan demand and tightening of loan standards coincides with a dramatic drop-off from historic SBA loan levels (Figure 2). While 2008 saw SBA lending across the nation beginning to be affected by the credit freeze, 2009 saw SBA

[5] Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," Washington, DC, http://www.federalreserve.gov/boarddocs/SnLoanSurvey/; and Brian Headd, "Forum Seeks Solutions To Thaw Frozen Small Business Credit," *The Small Business Advocate*, vol. 28, no. 10 (December 2009), p. 3,http://www.sba.gov/sites/default/files/The%20Small%20Business%20Advocate%20-%20December%202009.pdf.

[6] Congressional Research Service. *Small Business: Access to Capital and Job Creation* by Robert J. Dillinger and Oscar R. Gonzalez, March 2011.

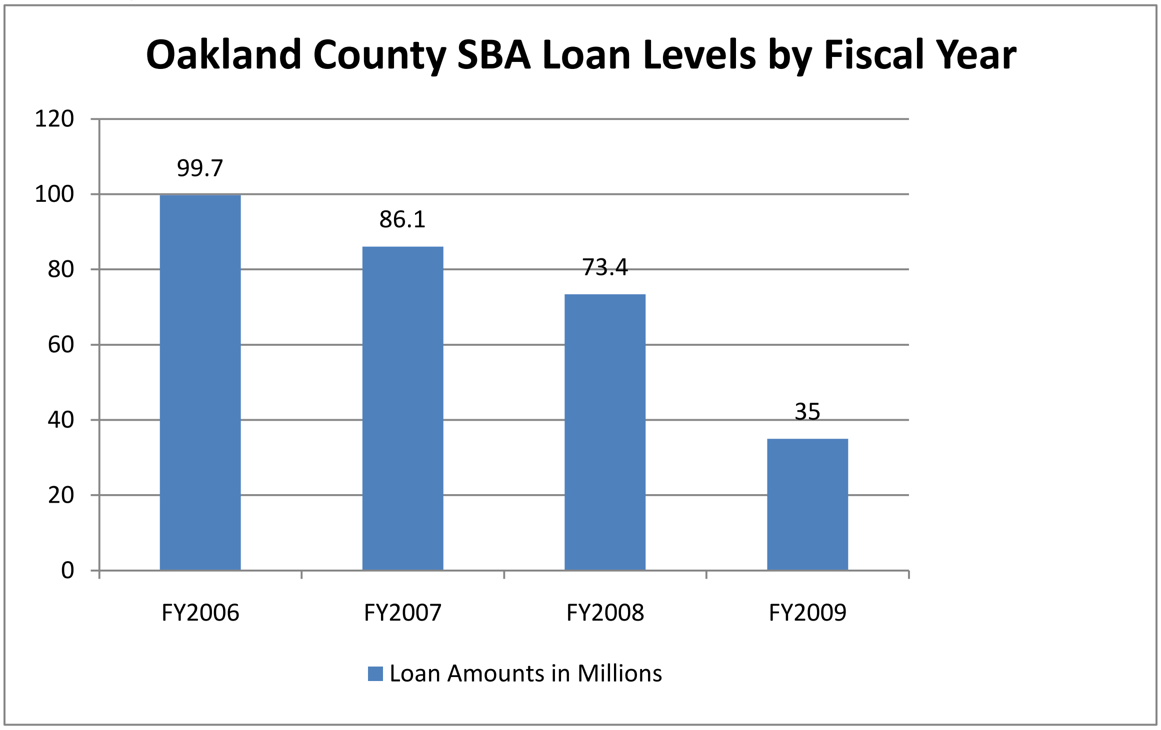
lending drop to nearly half of historic levels. SBA lending in Oakland County followed this trend (Figure 3), with a slight drop in 2008 leading the way to a substantial reduction in 2009 to just $35 million for the entire year, half of the 2008 total and just over one third of levels seen just three years prior.

Figure 2. Recent National SBA Loan Volumes[7]



[7] Data from Congressional Research Service. *Small Business: Access to Capital and Job Creation* by Robert J. Dillinger and Oscar R. Gonzalez, March 2011.

Figure 3. Recent SBA Loan Volumes[8]



As figures 2 and 3 illustrate, tightening of lending standards during the credit crisis had a direct effect on the volume of SBA loans for Oakland County entrepreneurs. In order to address the catastrophic decrease in financing available to small businesses, Congress altered and enhanced SBA loan programs to unfreeze credit markets and ensure the availability of capital to small businesses.

[8] Data furnished by the SBA Detroit district office.

SBA Lending and the American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act (Public Law 111-5) contained a number of provisions aimed at increasing SBA lending, such as a new microloan program, enhanced refinancing capabilities, and support to unfreeze the secondary loan market. Of particular importance to restoring SBA lending levels, however, were provisions which reduced loan fees and increased the size of the government-guaranteed portion of the loan.

Loan Guarantees

In order to incentivize lending to small businesses, the SBA's 7(a) loan program has traditionally guaranteed between 75%-85% of the value of the loan against default. In order to work against tightening bank standards, the Recovery Act increased the government guarantee to 90%. This incentive works on the supply side by increasing commercial lenders' willingness to extend credit, as it decreases lenders' risk.

Waiving of SBA Loan Fees

In addition to addressing the lack of commercial lenders' willingness to extend credit to small firms, the Recovery Act also sought to increase the demand for small business lending by waiving the usual fees associated with SBA loans. These fees typically pay for the administrative costs associated with the loan program. They also are intended to cover potential losses to the government on the guaranteed portion of the loan. Table 1 displays the typical fee schedule, and Table 2 displays fee amounts based on a few hypothetical loan sizes.

The initial period of Recovery act funding for the 90% guarantee and fee waiver lasted from implementation on March 16, 2009, until funds were exhausted on November 23, 2009. Funding to extend the Recovery Act fee waiver and increased guarantee was included in the Department of Defense Appropriations Act (Public Law 111-118), signed into law on December 19, 2009, and was subsequently extended through further bills until May 31, 2010. (See appendix for a list and summary of relevant laws.)

Table 1: Fees charged to borrower for SBA loans

Loan Amount	Fee Percentage
$0 to 150,000	2.00
$150,001 to 500,000	3.00
$500,001 to 700,000	3.50
$700,001 to 5,000,000	3.75*

*3.5%, plus additional 0.25% guaranty fee on the guaranteed amount due within 90 days.
The lender may charge the borrower for the fee after the lender has made the first disbursement of the loan.

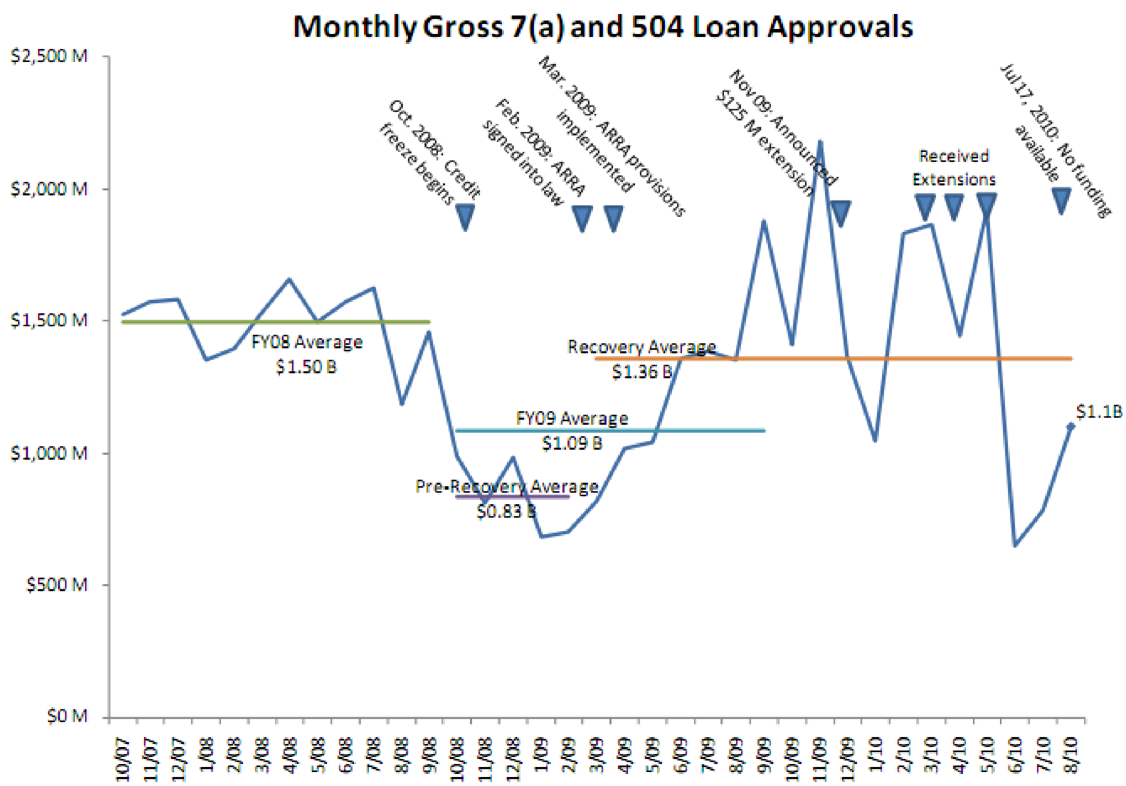
Table 2: Fee amounts for a range of hypothetical loans.

Loan Amount	Guarantee Fees	Additional SBA guaranty fees, chargeable to borrower after first disbursement
$100,000	$2,000	0
$500,000	$15,000	0
$1,000,000	$35,000	0
$2,500,000	$92,500	$6250
$5,000,000	$175,000	$12500

Effect of Recovery Act Policies on SBA Loan Volume

Increasing guarantees and waiving fees had a substantial effect on increasing the amount of SBA loans made to small businesses nationwide. Figure 4 illustrates SBA loan volumes by month over the Recovery Act period, and cites the dates of the enactment, exhaustion, and extension of Recovery Act funds. It is clear that Recovery Act SBA policies lifted loan levels to small businesses from the nadir of the credit crunch closer to historic levels.

Figure 4: SBA Loan Volumes and Recovery Act Implementation[9]



SBA Lending in Oakland County followed national trends for this period. Beginning October 1, 2008 until the enactment of the Recovery Act on March 16, 2009, Oakland County small businesses received $11.3 million in SBA loans, averaging $68,000 in loans per day. During the first period of Recovery Act policies, lasting from March 16, 2009 until November 23, 2009, Oakland County small businesses received $36.5 million in SBA lending, averaging $144,000 per day.

[9] Congressional Research Service. *Overview and Analysis of Small Business Provisions in the American Recovery and Reinvestment Act of 2009* by Oscar R. Gonzalez and N. Eric Weiss, December, 2010.

The period which Recovery Act SBA policies were extended showed even better performance for Oakland County small businesses. With the passage of the Department of Defense Appropriations Act on December 19, 2009, and through the end of subsequent extension periods on May 31, 2010, Oakland County small businesses received $35.3 million in SBA loans, averaging to $216, 000 per day for the period.

SBA loan volumes in Oakland County saw a sharp decrease after Recovery Act policies expired. From May 31, 2010, until the enactment of the Small Business Jobs Act of 2010 (Public Law 111-240) on September 27, 2010, loans decreased to just $13 million, or $109,000 per day.

SBA Lending and the Small Business Jobs Act of 2010

The drop in SBA lending with the exhaustion of Recovery Act policies on May 31, 2010, showed that more needed to be done to increase lending to small businesses and in turn to spur economic growth and job creation. In addition to extending increased loan guarantee levels and fee waivers as under the Recovery Act, the Small Business Jobs Act of 2010 increased maximum loan sizes under the 7(a) and 504 loan programs (see table 3).

The Small Business Jobs Act had a direct simulative effect on small business' access to capital. The continued extension of Recovery Act guarantees help make small businesses more attractive candidates to extend financing from the lenders' perspective, while the waiver of fees continued to attract small businesses to participate. The increased loan sizes allowed for larger projects to be possible through the lending incentivized by the SBA.

Oakland County small businesses directly and dramatically benefited from changes in policy under the Small Business Jobs Act. During the period starting with the enactment of the Jobs Act on September 27, 2010, through exhaustion of program funds on January 3, 2011, Oakland County small businesses received $51.4 million in SBA loans, averaging $541, 000 per day. This time period—roughly one quarter—saw more SBA lending in Oakland County than the entirety of 2009.

Table 3: Changes in SBA Loan Programs under the Small Business Jobs Act.

	Former Policy	**Jobs Act Policy**
7(a) loan limit	$2,000,000	$5,000,000
7(a) loan guaranty: Loans up to $150,000	85%	90%
7(a) loan guaranty: Loans over $150,000	75%	90%
7(a) Express loan limit	$350,000	1000000
504 loan limit (standard borrowers)	$2,000,000	$5,000,000
504 loan limit (manufacturers)	$4,000,000	$5,500,000

Appendix: Recent Laws Affecting SBA Loan Programs

- The American Recovery and Reinvestment Act (Public Law 111-5), signed into law on February 17, 2009, contained the initial round of funding for the waiver of SBA loan fees and increased loan guarantees. These changes took effect on March 16, 2009. This funding was exhausted on November 23, 2009.

- The Department of Defense Appropriations Act, 2010 (Public Law 111-118), signed into law on December 19, 2009, contained $125 million to continue enhanced SBA lending policies through February 28, 2010.

- The Temporary Extension Act of 2010 (Public Law 111-144), signed into law on March 2, 2010, provided for an additional $60 million to continue enhanced SBA lending policies through March 28, 2010.

- Public Law 111-150, an act to permit the use of previously appropriated funds to extend the Small Business Loan Guarantee Program, was signed into law on March 26, 2010. This law provided $40 million for extended enhanced SBA lending policies through April 30, 2010.

- The Continuing Extension Act of 2010 (Public Law 111-157), signed into law on April 15, 2010, provided an additional $80 million to continue enhanced SBA lending policies through May 31, 2010. With the exhaustion of this funding, enhanced SBA lending policies were no longer in place from June 1, 2010 to September 26, 2010.

- The Small Business Jobs Act (Public Law 111-240), signed into law on September 27, 2010, contained $505 million to continue enhanced SBA lending policies. This act also increased loan limits for 504 and 7(a) loans as discussed in Table 3. Funding for enhanced SBA lending policies was authorized to be used until December 31, 2010.

- The Continuing Appropriations and Surface Transportation Extensions Act, 2011 (Public Law 111-322), signed into law December 22, 2010, authorized the SBA to use funds provided under the Small Business Jobs Act to continue enhanced SBA fee subsidies through March 4, 2011. However, funding was exhausted on January 3, 2011.

FOR MORE INFORMATION, VISIT REPRESENTATIVE GARY PETERS' WEBSITE

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