August 6, 2003

James E. Rivera
Associate Administrator for Financial Assistance
U. S. Small Business Administration
409 Third Street, S.W.
8th Floor
Washington, D.C. 20416

Dear Mr. Rivera:

I appreciate the opportunity to comment to the Small Business Administration (SBA) on the proposed rule changes for the Certified Development Company (CDC) Loan (504) program.

As the Ranking Democratic Member of the House Committee on Small Business, I am well aware of the critical role that the 504 program plays in making capital available to small businesses. As the SBA's core economic development loan program, the 504 program contributes to the revitalization of local communities, creating thousands of new job opportunities annually and helping hundreds of small businesses expand their operations.

Although the 504 program is fulfilling its mission, the SBA should be doing more so that the program can reach even more small businesses. SBA should be taking steps to create more CDCs, to streamline the regulatory burden of the program's borrowers and lenders, and to improve the processing of 504 program applications.

While the SBA has failed to take actions that would improve the 504 program, Congress is moving forward with a comprehensive reauthorization of the SBA and its programs. If enacted, H.R. 2802, the Small Business Reauthorization and Manufacturing Revitalization Act of 2003, would make substantial changes to the 504 program, including changes to the application review process, the Accredited Lenders Program, and the Premier Certified Lenders Program. Last week, the House Committee on Small Business reported H.R. 2802.

I sincerely appreciate SBA's efforts to simplify and streamline the 504 program's regulations. However, many of the proposed rule changes are inconsistent with the program's mission, while other provisions conflict with H.R. 2802. In permitting CDCs to undertake unbridled interstate and intrastate expansion, the proposed rule may lead to an environment where large CDCs will dominate the program. As a result, the core mission of the 504 program, localized economic development, will be surrendered. Instead, the SBA should be proposing a rule that will encourage new CDCs to enter the program and facilitate the growth of existing smaller CDCs so they can better meet their local economic development needs.

I offer the following comments on how the final rule can be improved to ensure that the 504 program is consistent with Congress's intent and is best positioned to meet the needs of small businesses across the country. In addition, I note three significant instances where SBA would need to revise its proposed rule under H.R. 2802.

A. Issues with Proposed Rule

I. Area of Operations

SBA proposes to change the definition of "Area of Operations" such that the minimum area of operations for a CDC is the State in which it is incorporated. SBA states in its proposed rule that "SBA has decided to take steps to increase the availability of the long-term, fixed-rate financing offered by the 504 program…." I believe that this proposed rule change, however, would ultimately limit the availability of capital in many locales because it will result in fewer CDCs controlling the 504 program's resources.

While increased competition among CDCs may lead to an expansion of service and better terms for some 504 program borrowers, I believe that a greater number of small businesses will be injured as smaller CDCs become less viable. The proposed rule will encourage larger CDCs to enter smaller CDCs' territories, cherry-picking the best investment opportunities out of the smaller CDCs' operating area. Smaller CDCs will be less able to diversify their lending portfolio and, as a result, their investment in local businesses will decline.

The proposed rule also modifies CDCs' organizational structure such that they are not required to have membership representatives from their entire operational area. I believe that a CDC must maintain connections with local communities to effectively carry out its mission of localized economic development. The 504 program's strength is its localized focus. CDCs often have substantial knowledge of local economic trends and the needs of their communities. As a result, CDCs are best able to identify and nurture viable small businesses.

Clearly, SBA has recognized that it should be doing more to ensure that the 504 program is reaching more small businesses. However, I believe that the answer is not contained in this proposed rule. Instead of geographically expanding the area of operations, the SBA should be encouraging new CDCs to enter the program and developing a strategy for smaller CDCs to grow their operations. Of no less importance, the SBA should be taking steps to strengthen CDCs' local representation, rather than making it easier for them to limit its field of membership.

II. Multi-state CDCs

Consistent with its changes to the "Area of Operations" definition, SBA proposes to permit multi-state CDCs to determine its maximum geographic coverage in a new State. For multi-state

CDCs, the SBA is proposing to relax the requirements for board representation from the new State by eliminating the current requirement that at least three of the CDC's board members must come from the new State. In addition, SBA is proposing to allow a CDC that currently has ALP or PCLP authority in its State of incorporation to use that authority in its expanded area.

Similar to concerns regarding the expansion of CDCs' area of operations, it is troubling that SBA is moving away from a community-based role for CDCs. The interstate expansion of CDC operations will further challenge the 504 program to fulfill its mission of local economic development. In addition, the proposed rule will increase the likelihood of adverse selection as CDCs are encouraged to target an adjacent state's best investment opportunities. The SBA should be moving in the opposite direction of the proposed rule by requiring CDCs to have local representation and by ensuring that CDCs operating across state lines are not only funding businesses whose capital needs are met by existing CDCs.

III. Professional Management and Staff

In the proposed rule, the SBA continues to require that a CDC have at least one salaried professional employee that is employed directly and in a full-time capacity to manage the CDC. Because many CDCs are a division of a larger economic development organization, the requirement of a full-time manager is often unnecessary. In practice, the manager of a CDC's operations may devote time to other economic development activities of the umbrella organization, while remaining available to fulfill the management responsibilities of the CDC.

What is important is not whether or not the manager of the CDC is employed "full-time," but whether or not the manager is effectively overseeing its operations. Instead of imposing such bureaucratic requirements on CDCs, the SBA should employ lender oversight programs that focus on assessing CDCs' performance against industry benchmarks. Because the "full-time" requirement does not provide any assurance to the safety and soundness of CDCs' operations and serves only to create regulatory burden, the "full-time" requirement should be eliminated.

IV. Enforcement Procedures

The proposed rule limits and restricts the information that SBA may consider in the appeals process. While I understand SBA's need to establish regulations for the appeals process, I am concerned that the proposed rule may deny CDCs' due process by unreasonably limiting their ability to contest an SBA ruling. By not considering arguments or information that were not part of CDCs' previous submissions, the SBA infringes on their right to effectively argue its case before SBA's Office of Hearing and Appeals. As a result of such limitations, qualified CDCs may be deterred from fully participating in the 504 program.

While the enhancement of enforcement provisions is necessary to ensure that the 504 program operates without undue risk to the government, it is not clear that limiting CDCs' input in enforcement actions would further this objective. Past occurrences have proven that the SBA is not always correct in its judgments and I am concerned that the proposed enforcement procedures will give SBA unilateral authority to make decisions of critical importance to the 504 program. After all, the 504 program is a public-private partnership; without the input of CDCs, SBA may take actions that could ultimately reduce the availability of credit to small businesses.

SBA has recognized that the 504 program is an important means for delivering capital to small businesses. Instead of restricting CDCs' access to due process, the SBA should be focusing on strengthening the 504 program and reaching more small businesses. I urge SBA to reconsider the heavy-handedness of this provision.

V. Maturity

The SBA proposes that it will publish in the Federal Register, from time to time, the available maturities for a 504 loan and the debenture that funds it. SBA further states in the proposed rule that such available maturities remain in effect until changed by subsequent Federal Register publication. While the Small Business Investment Act provides the Administrator with the authority to guarantee debentures on such terms and conditions as are appropriate, I am concerned that a regular variation of 504 debenture terms could lead to uncertainty among 504 program CDCs and their associated lenders and, as a result, lead to increased borrower costs. The fluctuation of the 504 program terms may reduce the attractiveness of the 504 program to small business borrowers and curtail one of SBA's leading economic development programs. I urge the SBA to carefully consider the consequences of changing the maturities of 504 program loans and debentures.

B. Interaction between Proposed Rule and H.R. 2802

I. Accredited Lenders Program

SBA proposes to substantially revise the Accredited Lenders Program (ALP) description, including revising the benefits a CDC will receive through the ALP, how to apply for the ALP, and how SBA will process the application. SBA proposes to establish more detailed qualifications for the ALP and states that the revised standards will be consistent with the Small Business Act and will be coordinated with the eligibility requirements for CDC participation in the Premier Certified Lenders Program.

H.R. 2802 would significantly revise the ALP by permitting CDCs to make loan decisions if SBA does not make a decision within five days. In exchange for this enhanced authority, H.R. 2802 would strengthen the eligibility requirements for ALP lenders by requiring participating CDCs to maintain a loan default rate that is less than the national average, unless the CDC makes loans to borrowers that are located in certain disadvantaged areas, where upon the qualifying default rate target is marginally higher. In the proposed rule, however, SBA would require the CDC to meet SBA's portfolio benchmarks, a different standard than those called for in H.R. 2802. If H.R. 2802 becomes law, the SBA will need to reconcile the differences between the ALP eligibility requirements.

II. Premier Certified Lenders Program

In addition to revising the ALP, the SBA proposes to revise the Premier Certified Lenders Program (PCLP). The PCLP is a permanent program pursuant to section 508 of the Small Business Investment Act. SBA proposes to add considerably more detail to the PCLP regulations and move some of its revised and expanded provisions to a new section. Among other changes to the PCLP, the SBA proposes to permit CDCs to withdraw funds from their loan loss reserves that exceed the required minimums, at SBA's discretion.

H.R. 2802 would make substantial changes to the PCLP's loan loss reserve requirements. H.R. 2802 would permit CDCs participating in the PCLP to reduce their loan loss reserves commensurate with the repayment of principal and interest on their outstanding debentures. In addition, the legislation would allow qualifying PCLP CDCs to determine their loan loss reserves based on a risk-based approach. In the event H.R. 2802 becomes law, SBA will have to further revise the PCLP regulations to reflect the changes in the PCLP loan loss reserve requirements.

III. Job Opportunity Average

SBA proposes to increase the job opportunity average requirement to an SBA-specified amount by means of a notice published in the Federal Register. While not specifying a new threshold, SBA does recognize that the current job opportunity average is preventing many CDCs from making loans to small businesses that would satisfy other statutory objectives. In addition, SBA notes that the present ratio has been in effect since 1990 and has not been increased to reflect inflation.

H.R. 2802 would increase the job opportunity average requirement for the CDC program, negating SBA's need to address this issue further. H.R. 2802 sets forth that a project is deemed to satisfy the job creation or retention requirements if it creates or retains one job opportunity for every $50,000 guaranteed by the Administration. For CDCs in higher cost geographic or targeted areas, the requirement will be satisfied if it creates or retains one job for every $75,000 guaranteed by the Administration. Finally, for small manufacturers, the requirement is satisfied if it creates or retains one job for every $100,000 guaranteed by the Administration. As with the ALP and PCLP provisions, I urge SBA to remain cognizant of the changes being made to the job opportunity average requirement.

C. Conclusion

I have previously asked the SBA how it is going to make the 504 program more accessible to borrowers. SBA has stated that 2003 is the "Year of the 504 Program" and that the SBA is taking steps to become more responsive to CDCs and to increase the program's availability to borrowers. In my view, the proposed rule is inconsistent with these mandates. Under the veil of deregulation, the proposed rule moves the 504 program away from its core mission – local economic development.

The benefit of economic development, by its very nature, is shared by all members of a community. Economic development creates new job opportunities, increases tax revenue, and raises community morale. The private market does not supply enough capital to develop all of our nation's local economies. The SBA's 504 program fills this void by providing long-term, fixed-rate financing at reasonable terms to borrowers nationwide.

A critical component of the 504 program is its delivery mechanism – the web of approximately 270 CDCs operating nationwide. SBA states that the proposed rule will make the 504 program "more relevant in today's dynamic financial services marketplace." While expanding consumer access to financial services has driven the deregulation of the financial services industry, it is unclear as to how the proposed rule will increase borrower participation and further local economic development. The proposed rule will likely reduce the number of CDCs participating in the 504 program, reducing the points of entry into the 504 program. The SBA should not be supporting policies that will result in fewer CDCs; rather, the SBA should be pursuing policies aimed at increasing the 504 program's web of CDCs and expanding its reach into underserved areas.

Given the concerns with the proposed rule and the likely passage of major changes to the 504 program by Congress this year, SBA should delay making the proposed rule final and wait to make a rule change until after the reauthorization process is complete. Because the interaction between this year's legislation and the SBA's proposed rule will likely be complex, a single issuance of 504 program rule changes will limit the confusion for the program's participants, while increasing compliance. In the event that the SBA does move forward with the proposed rule in its current state, SBA should ensure that 504 program participation will not be reduced in underserved areas.

Thank you for considering my views on these important issues. If you have any further questions or comments on this matter, please do not hesitate to contact me or Adam Minehardt of the Committee staff at (202) 225-4038.

Sincerely,

Nydia M. Velázquez
Ranking Minority Member

cc: Senator Snowe
Senator Kerry
Rep. Young
Rep. Obey
Rep. Serrano
Rep. Wolf