106TH CONGRESS
2d Session

SENATE

REPORT
106–280

CERTIFIED DEVELOPMENT COMPANY PROGRAM IMPROVEMENTS ACT OF 2000

MAY 9, 2000.—Ordered to be printed

Mr. BOND, from the Committee on Small Business, submitted the following

REPORT

[To accompany H.R. 2614]

The Committee on Small Business to which was referred the bill (H.R. 2614) to amend the Small Business Investment Act to make improvements to the certified program, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

On March 21, 2000, the Committee on Small Business considered H.R. 2614, the Certified Development Company Program Improvements Act of 2000. The Committee adopted by a unanimous voice vote an amendment offered by Senator Paul Wellstone setting the programs levels for Fiscal Years 2001, 2002 and 2003. As amended, H.R. 2614 would make permanent the Preferred Certified Lenders Program, expand and make permanent the Loan Liquidation Pilot Program, increase the loan guaranty limits, and establish the program authorization levels for the next three fiscal years. Having considered H.R. 2614, as amended, the Committee reports favorably thereon with technical and conforming amendments and recommends that the bill do pass.

I. INTRODUCTION

The 504 Certified Development Company (CDC) Program was enacted to leverage private sector resources to fund larger projects for small businesses to acquire, construct or expand their facilities. Such loans create job opportunities and improve the economic health of communities.

The 504 program is unlike any other SBA credit program. SBA guarantees 10- or 20-year debentures issued by CDCs, and the proceeds from these debentures are used to fund loans with similar terms to small businesses for plant acquisition, construction, ex-

pansion, and equipment. The SBA-guaranteed debenture cannot exceed 40% of the project cost. A conventional lender, such as a bank, usually provides financing for 50% of the project cost. The bank's loan is senior to the SBA-guaranteed loan in the event of a default by the 504 borrower.

Since the Committee approved the Small Business Reauthorization Act of 1997, it has followed the progress of the 504 Certified Development Company Program closely. The Committee has watched for any negative fall out on program demand resulting from the 1996 legislation mandating that the program be supported entirely by fees paid by the private sector. We are pleased to report that after an initial decline, program demand has steadily increased. At the same time, the credit subsidy estimate has steadily declined, reducing the fees paid by small business borrowers.

The Committee has been particularly concerned about reports and testimony from the Small Business Administration (SBA) and the Office of Management and Budget (OMB) about low recoveries following a default by a borrower on a loan made under the 504 program. In nearly all cases when a 504 program borrower defaults, it is SBA, not the CDC, that takes the required liquidation and foreclosure actions. The failure of SBA to take aggressive actions to recover the value of collateral held following a default significantly increases the costs to borrowers to obtain a loan under the 504 program.

The recovery rate estimate utilized to determine the credit subsidy rate for the 504 loan program declined from 44 percent in 1997 to 34 percent in 1998 to 31 percent in 1999 and finally to 25 percent in 2000. The Committee is pleased to note the recovery rate estimate for Fiscal Year 2001 has been increased to 31 percent.

II. DESCRIPTION OF BILL

504 loan

Under the Small Business Investment Act of 1958, 504 guaranteed loans for the following public policy goals are eligible for loans guarantees up to $1,000,000:

Business district revitalization;
Expansion of exports;
Expansion of minority business development;
Rural development;
Enhanced economic competition;
Changes necessitated by Federal budget cutbacks;
Business restructuring arising from Federal mandated standards or policies affecting the environment or the safety and health of employees.

The bill adds loans to women-owned small businesses to the current list of public policy goals specified under the Act. A similar provision offered by Senator Kerry in 1998 was approved by the Committee and the Senate; however, the bill was not taken up by the House of Representatives before the 105th Congress adjourned.

In August 1988, Congress approved legislation (P.L. 100–418) to increase the 504 loan guarantee ceiling to $750,000 from $500,000, except for a limited number of loans meeting the special public pol-

icy purposes. In order to adjust this amount to reflect inflation, the loan guarantee ceiling would need to be increased to approximately $1,250,000. Therefore, the Committee agrees with the position taken by the House Committee on Small Business and approved an increase to $1,000,000. The Committee further agreed to increase the maximum guaranteed amount on loans made to meet the public policy purposes to $1,300,000 from $1,000,000.

On April 27, 1999, the Committee conducted a public Roundtable on the 7(a) Guaranteed Business Loan Program and the 504 program. The statements about the 504 program by industry representatives and government officials were encouraging, and the Committee urges SBA to continue its efforts to improve program performance while reducing the credit subsidy rate.

Program fees

In 1995, at the urging of the SBA and the National Association of Development Companies (NADCO), the trade organization that represents the 504 lenders and Certified Development Companies (CDCs), the Committee agreed to legislation mandating that the 504 program be supported entirely by fees paid by the private sector. These new fees were imposed beginning in FY 1996. Subsequently, the SBA undertook an extensive review of the performance of the 504 program, and the credit subsidy rate, which determines the amount of money that must be maintained in the loss reserve account for this program, was increased from 0.57% to 6.85%, an increase of 1200%. Since the 504 program was being funded only by fees paid by the private sector, the fees paid by the borrower in FY 1997 were increased from 0.125% to 0.875%, which placed a financial burden on 504 borrowers. The Committee is pleased to note that since FY 1997 the credit subsidy rate estimate has dropped resulting in a decrease in borrower fees from 0.875% to 0.472% for FY 2001. The bill authorizes SBA to collect these fees to offset the credit subsidy cost through September 30, 2003.

Premier certified lenders program

In October 1994, Congress approved the Premier Certified Lenders Program on a pilot basis (P.L. 103–403). In December 1997, this pilot program was extended by Congress, and the limitation on the number of CDCs that could participate in the PCLP was removed (P.L. 105–135). The Committee has noted the success of the program and has agreed with the House of Representatives to make the PCLP a permanent part of the 504 program. In making the PCLP pilot a permanent part of the 504 program, the Committee expects the SBA to continue its efforts to work with the CDC community to take complete advantage of the strengths of the most successful and well-run CDCs.

Asset sales

In response to the plans by the SBA to undertake the sale of assets held by the Agency, the Committee approved a provision that requires the SBA to notify CDCs prior to including a 504 loan in an asset sale. The Committee adopted this section in order to insure there is an open dialogue and cooperation between the Agency and the relevant CDCs. For the past four years, the Committee has

encouraged the SBA to move forward with its asset sales program; however, we do not believe this step forward should necessarily harm its lending partners.

Loan liquidation program

In response to reports about low recoveries after the default of a 504 loan, the Committee approved legislation in 1996 to establish the Loan Liquidation Pilot Program (P.L. 104–208). The pilot liquidation program allowed up to 20 qualified CDCs to liquidate loans that they originated. It was implemented by the SBA in June 1997. The results to date for the pilot program are encouraging, and the Committee has concluded that it is in the best interest of the 504 program to allow additional CDCs to conduct their own liquidation and foreclosure activities. The Committee is pleased to note that the recovery estimate for FY 2001 has increased for the first time since 1995. The Administration's estimate for FY 2001 is 31 percent, and the assumptions used by OMB and the SBA do not include an increase in recoveries that should result from making the Loan Liquidation Program permanent. The Committee urges the SBA to continue its efforts and to make maximum use of the Loan Liquidation Program so that the recovery level will increase further.

A number of CDCs have demonstrated the ability through the pilot program and other lending programs in which they participate, to perform such activities, and have indicated a willingness to perform such functions to supplement SBA's activities in this area. Accordingly, the bill makes the pilot liquidation program permanent and requires SBA to permit certain CDCs to foreclose and liquidate defaulted loans that they have originated under the 504 loan program.

In order to participate in the loan liquidation program, a CDC must have made at least 10 loans per year for the past three fiscal years, and it must have at least one employee with two years of liquidation experience or be a member of the Accredited Lenders Program with at least one employee with two years of liquidation experience. Representatives of either group must complete a training program developed by SBA. Participants in the pilot liquidation program and Premier Certified Lenders automatically qualify for the permanent liquidation program.

CDCs eligible to participate in liquidation activities are required to perform all liquidation and foreclosure functions pursuant to a liquidation plan approved by SBA. The bill also authorizes CDCs to take other actions, in lieu of full liquidation or foreclosure, to mitigate loan losses pursuant to a workout plan. Prior to a CDC commencing liquidation or foreclosure activities and prior to engaging in other actions to mitigate loan losses, a CDC is required to provide the SBA with a liquidation plan or workout plan, as the case may be, for approval. The SBA has 15 days to approve a liquidation plan or a workout plan. The bill further permits CDCs to litigate matters relating to their liquidation activities subject to SBA monitoring of such litigation.

The bill authorizes the SBA to suspend or revoke the authority of a CDC to liquidate loans if the CDC either does not meet the eligibility requirements or fails to comply with any statutory or

regulatory requirement relating to the foreclosure or liquidation of loans or any other applicable provision of law. CDCs are also prohibited from taking any action that would result in an actual or apparent conflict of interest in connection with the liquidation of their loans.

The bill requires the SBA to submit annually to Congress a report on the results of the delegation of authority to CDCs to liquidate and foreclose loans and a comparison of such results to SBA's liquidation performance.

Program authorization level

During the Committee's consideration of the bill, Senator Wellstone offered an amendment to establish the following 504 program authorization levels: $4,000,000,000 in Fiscal Years 2001, $5,000,000,000 in Fiscal Year 2002, and $6,000,000,000 in Fiscal Year 2003. The Committee approved the amendment by a unanimous voice vote.

III. COMMITTEE VOTE

In compliance with rule XXVI(7)(b) of the Standing Rules of the Senate, the following votes were recorded on March 21, 2000. Senator Wellstone offered an amendment authorizing the program levels for the 504 program for Fiscal Years 2001, 2002 and 2003. This amendment was approved by a voice vote. After a quorum was established pursuant to Committee rules, Senator Bond made a motion to adopt the Certified Development Company Program Improvements Act of 1999 as amended. The motion was approved by a unanimous 18–0 recorded vote, with the following Senators voting in the affirmative: Bond, Kerry, Burns, Coverdell, Bennett, Snowe, Enzi, Fitzgerald, Crapo, Voinovich, Abraham, Levin, Harkin, Lieberman, Wellstone, Cleland, Landrieu, and Edwards.

IV. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

V. CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

VI. COST ESTIMATE

In compliance with rule XXVI(11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be equal to the amounts indicated by the Congressional Budget Office in the following letter.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, March 30, 2000.

Hon. CHRISTOPHER S. BOND,
Chairman, Committee on Small Business,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2614, the Certified Development Company Program Improvements Act of 1999.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Mark Hadley.

Sincerely,

BARRY B. ANDERSON,
(For Dan L. Crippen, Director).

Enclosure.

H.R. 2614—Certified Development Company Program Improvements Act of 1999

H.R. 2614 would make numerous changes to two loan programs that the Small Business Administration (SBA) operates in cooperation with certified development companies (CDCs). Based on information from the SBA, CBO estimates that implementing H.R. 2614 would not have a significant impact on the federal budget. Because H.R. 2614 could affect direct spending, pay-as-you-go procedures would apply, but we estimate that any such effect would not be significant. H.R. 2614 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

CDC loans, also known as section 503 and 504 loans, provide small businesses with long-term, fixed-rate financing for the purchase of land, buildings, and equipment. Under current law, the Administrator of SBA must adjust an annual fee on 504 loans to produce an estimated subsidy rate of zero at the time loans are guaranteed. Both the program and its fee authority expire at the end of fiscal year 2000. H.R. 2614 would extend the authority to make new loans and collect such fees through fiscal year 2003. The extension of the fee authority would maintain a zero subsidy rate for this program.

The act would allow CDCs to litigate bankruptcies in place of SBA and would authorize qualified companies to liquidate loans in their portfolio that the SBA has purchased. (The act would make permanent the pilot program that allowed CDCs to liquidate such loans.) Finally, the act would increase the maximum amount that can be guaranteed from $750,000 to $1 million in most cases, and from $1 million to $1.3 million if the loan would satisfy specific policy goals.

If H.R. 2614 is enacted, the subsidy rates for previous cohorts of CDC loans or the administrative costs of SBA could be affected. (The former would affect direct spending.) However, it is unclear whether the average subsidy costs for SBA guarantees of existing loans would increase or decrease. The pilot program has not produced enough information to date to allow CBO to make any determination about the amount the government would recover on de-

faulted loans if those loans are liquidated by CDCs instead of by SBA. In addition, it is not clear how expenses associated with liquidation would be paid. The Federal Credit Reform Act stipulates that administrative expenses cannot be paid out of the subsidy for loan programs, but expenses to foreclose, maintain, or liquidate an asset can. Many of the expenses CDCs would incur would be to foreclose, maintain, or liquidate assets. It is not clear whether SBA would have the authority to reimburse CDCs for administrative expenses, including litigation costs.

Liquidation activities under the act might cost less than under current law, thus lowering the subsidy costs on existing loan guarantees. But if litigation costs became part of the subsidy costs, those costs could increase. On balance, CBO expects that enacting H.R. 2614 would probably not lead to a significant net change in the subsidy cost for CDC loans or in SBA's administrative costs.

The act would not affect the zero subsidy rate for future CDC loans. H.R. 2614 would increase the maximum size of the guarantee, which could increase the default risk of the program. But added costs for defaults on future loans would be offset by fees paid by borrowers.

On August 2, 1999, CBO transmitted a cost estimate for H.R. 2614, as ordered reported by the House Committee on Small Business on July 29, 1999. That act would not authorize SBA to make new loans.

The CBO staff contact is Mark Hadley. This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VII. SECTION-BY-SECTION ANALYSIS

Section 1. Short title

Section 2. Women-owned businesses

Women-owned businesses are added to the list of concerns eligible for the larger guaranteed loan in order to meet selected public policy goals.

Section 3. Maximum debenture size

The maximum loan guarantee size is increased from $750,000 to $1,000,000 for regular 504 borrowers. The guarantee ceiling on loans that meet the public policy goals is increased from $1,000,000 to $1,300,000.

Section 4. Fees

In order to fund the Financing Account (loss reserve) for the 504 program, it is necessary for the borrowers, CDCs, and the participating banks to pay fees to the Federal government. The participating bank pays a one-time fee, and the borrower and CDC pay annually a percentage of the outstanding balance of the 504 loan. The bill allows the fees to be collected through September 30, 2003.

Section 5. Premier Certified Lenders Program

The Premier Certified Lenders Program demonstration program is granted permanent status. Under current law, the demonstration program will terminate on September 30, 2000.

Section 6. Sale of certain defaulted loans

The bill requires SBA to give any CDC with contingent liability 90 days notice prior to including a defaulted loan in a bulk sale of loans. No loan may be sold without permitting prospective purchasers to examine SBA records on the loan.

Section 7. Loan liquidation

The bill adds a new section 510 to the Small Business Investment Act of 1958 to create a permanent program permitting CDCs to carry out the liquidation of defaulted loans. This permanent program replaces the pilot program authorized by the Small Business Reauthorization Act of 1997 (P.L. 105–135).

Section 8. Funding levels for certain financings under the Small Business Investment Act of 1958

Establishes the following funds levels for the 504 program: $4,000,000,000 in Fiscal Year 2001, $5,000,000,000 in Fiscal Year 2002, and $6,000,000,000 in Fiscal Year 2003.

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