Executive Summary
OCC Web and Telephone Seminar
September 21, 2009

SBA Lending Programs and the American Recovery and Reinvestment Act of 2009

Speakers:

John C. Dugan
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Pat Thomson
Barry Wides
SBA Lending Programs and the American Recovery and Reinvestment Act of 2009

Welcoming Remarks: John C. Dugan, Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Moderator/Speaker: Barry Wides, Deputy Controller, OCC Community Affairs
Speakers: Grady B. Hedgespeth, Director, Financial Assistance, Small Business Administration
Pat Thomson, President, Grow America Fund, Inc.

Overview
Historically, the Small Business Administration (SBA) has partnered with banks to provide needed credit to small businesses through a variety of programs. In the current economic climate, these programs have never been more important.

Program enhancements, as part of the American Recovery and Reinvestment Act (Recovery Act), have improved existing SBA programs and created new ones to stimulate small business lending and retention and creation of jobs for Americans. These enhancements represent lending opportunities for banks.

In addition to the information covered in this OCC Web and Telephone Seminar, the OCC has a wealth of information and resources available to support lenders.

Context
The speakers described the changes and improvements to the SBA’s standard 7(a) and 504 loan programs, provided real-world examples of how these improvements are being implemented, and discussed the regulatory and risk considerations of SBA lending.

They also responded to a wide range of questions from teleseminar participants.

Key Points
- SBA programs are a critical source of credit for small businesses.

Since 1953, the SBA has partnered with banks to provide credit to U.S. small businesses. During this time, nearly 20 million small businesses have received direct or indirect assistance from SBA programs. Today the SBA’s loan portfolio includes roughly 219,000 loans valued at more than $45 billion, making the SBA the largest single backer of small businesses in the nation.

Because of the current economy and the financial and credit-related challenges that many small businesses face, these SBA programs have never been more important.

“One key to our economic recovery is the availability of credit for small businesses.”
—John C. Dugan

While small businesses need credit, it is vital that banks provide that credit in a safe and sound manner. By participating in SBA-guaranteed loan programs, banks can mitigate their risk and increase their interest and fee income by lending funds to creditworthy small businesses.

- The SBA has specific goals to help implement features of the Recovery Act.

These goals are:
- Restore access to capital. Help restore access to capital and credit to small businesses.
- Support viable businesses. Assist viable businesses that are struggling due to the slowdown economy.
- Facilitate recovery opportunities. Ensure that banks and small businesses are aware of opportunities made available through the Recovery Act.

- The Recovery Act includes important changes to the SBA’s signature 7(a) program.

Under the SBA’s 7(a) loan program, the SBA is authorized to provide loan guarantees to small business lenders. In this program, the maximum loan amount is $2 million; the maximum guaranty is $1.5 million; and guarantees are typically 50 percent to 90 percent of the loan amount. Among all SBA programs, 7(a) provides for the widest possible use of proceeds, which include working capital, plant and equipment, and business acquisitions.

There are several eligibility requirements, the most important of which is that borrowers must meet the “credit elsewhere” test. This test means that if a borrower is eligible to secure a loan conventionally, then it should not seek an SBA loan.

For 7(a) loans, there are two allowable spreads for rates. If the loan maturity is less than 7 years, the rate is the base rate plus 2.25 percent; if the maturity is 7 years or more, the rate is the base rate plus 2.75 percent. (A lender can apply these spreads over any of the allowable base rates.)

In general, SBA loan programs are designed to promote longer-term financing than is typically available to small businesses. As a result, the terms for 7(a) loans range from 5 to 10 years for working capital (not to exceed life expectancy), and up to 25 years for existing and new construction real estate.

There are two provisions of the Recovery Act that have had the greatest impact on restoring access to capital:

- Temporary fee elimination. The SBA has implemented the elimination of upfront borrower guaranty fees for 7(a) loans. This represents a savings of 2 percent to 3.75 percent for the borrower. Standard lender origination fees are still allowed.
- Higher guarantee levels. Loan guarantees are up to 90 percent (from the traditional 75 percent to 85 percent range) for loans...
The ARC Loan Program provides stabilization financing.

The America’s Recovery Capital (ARC) Loan Program is a new temporary SBA loan program that offers stabilization financing for “viable small businesses” that may be experiencing economic distress. ARC loans are no-interest, deferred payment loans of up to $35,000 for small businesses. This financing can be used by borrowers to pay principal and interest for existing, qualifying obligations. This loan program helps borrowers free up working capital to better meet their short-term liquidity needs. After a 12-month deferral period, borrowers pay back the loan over 5 years.

The Recovery Act also includes important changes to the SBA’s other flagship program, the 504 loan program.

Loans in the 504 program are only for long-term fixed assets. This program has a three-part structure: 1) borrower equity, which is usually around 10 percent; 2) the bank has a first lien mortgage, typically for 50 percent of the total project financing; and 3) the remainder, typically 40 percent, is provided by a Certified Development Company (CDC). CDCs provide a second lien mortgage, which is backed by an SBA-guaranteed debenture with a 100 percent guaranty, that is sold to investors on a monthly basis. In the 504 program, the SBA position is subordinated to the lender.

The bank-provided first mortgage can be a variable- or fixed-rate loan. The CDC second mortgage is a 10- or 20-year fixed-rate loan funded by a debenture structure. The first mortgages are typically for 20 to 25 years and the second mortgages are usually 10 to 20 years.

With lower LTVs, the lender has less bank capital at risk for proportionately larger loans; while helping to improve the small business’s balance sheet and supporting long-term capital accumulation and growth of the business.

Changes to the 504 program through the Recovery Act are:

—Temporary fee elimination. The application or “processing fee” charged by the CDC has been temporarily eliminated. This fee consists of a 0.5 percent fee charged to the lender and a 1.0 percent fee charged to the borrower. Under the Recovery Act, the SBA is paying the CDC the full 1.5 percent processing fee for loan origination.

—Some refinancing is now permitted. A permanent change brought about in the Recovery Act is to allow a limited amount of refinancing. The Recovery Act allows debt that would be eligible under the 504 program to be refinanced as part of a new 504 transaction for business expansion. What is required is that debt, from the new business expansion and the prior business facility, be for similar kinds of assets. Up to 50 percent of the new project can be included as a refinancing of other debt.

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is in effect through September 30, 2011, makes approximately 70,000 more businesses eligible for the 7(a) program.

—Dealer Floor Plan Pilot. This is a pilot 7(a) program that provides inventory financing for businesses with automobiles, boats, RVs, motorcycles, and other large durable products. The loan size is from $500,000 to $2 million. Guarantees range from 60 percent to 75 percent and the pricing is equal to the base rate plus 2.25 percent. The 2 percent maximum fee limit is waived. Any SBA lender can participate. This pilot expires September 30, 2010.

—A new SBA “Brand Promise.” As of June 2007, the average guarantee was in inventory at the SBA for 279 days. In November 2007, the SBA’s Herndon processing center introduced a new brand promise, which now applies in all SBA centers. This brand promise is, “Send us a clean purchase package and you will receive an answer in 45 days or less.” As a result of this brand promise, the SBA’s cycle time averages less than 30 days and even incomplete packages are usually resolved in less than 60 days.

The results of the SBA’s many programs and activities are significant. They include:

—Substantial increase in loan activity. Through August, 2009 the SBA has supported nearly $10.2 billion in lending to small businesses. Since the signing of the Recovery Act, weekly loan volume has risen over 59 percent in the 7(a) and 504 programs. These activities will result in the creation or retention of 288,000 jobs.

—Lenders are joining or returning to SBA programs. Between mid-February and August 1, 2009, 848 lenders that had not made SBA loans since October 2008 returned to make 7(a) loans. Over half of these lenders hadn’t made 7(a) loans since 2007.

—Support for small businesses is broad based. This includes support for rural, minority-owned, women-owned, and veteran-owned businesses.

The Grow America Fund has direct and relevant experience making and servicing SBA loans.

The Grow America Fund (GAF) is a subsidiary of the National Development Council (NDC). NDC, which has been in existence for 40 years, is a national nonprofit that works to provide credit and capital in low-income and distressed neighborhoods. NDC will make $12-$15 million in loans in 2009.

GAF, in operation since 1992, is the small business arm of NDC. GAF is 1 of 15 SBLCs (small business lending companies) in the country. An SBLC is a non-bank lender authorized by the SBA to make 7(a) loans. GAF is a “preferred lender” which allows it to make credit decisions, do credit approvals, and service its loans. GAF is examined by the SBA for safety and soundness. In addition, GAF is designated by the Department of the Treasury as a Community Development Financial Institution (CDFI).

GAF’s primary business model is to act as a 7(a) lender, with the SBA guaranteeing 75 percent to 90 percent of the loan amount. Unlike a bank or other financial institution, GAF’s sources of capital are:

—Local governments. Local governments provide 10 percent to 25 percent of GAF’s non-guaranteed capital for 7(a) loans.

—Borrowing. GAF borrows the guaranteed portion of its funds from bank partners. The reasons banks lend to GAF include:

  ▪ GAF is a CDFI. As a CDFI, GAF has a mission to provide credit in low- and moderate-income communities. Banks that lend to CDFIs may receive positive consideration from the Community Reinvestment Act (CRA).

  ▪ Loans are backed by an SBA guarantee. The bank receives a return from loan interest earned and enjoys a lower credit risk from the SBA guarantee.

  ▪ Partnerships created. Partnering with entities that work with small businesses is beneficial to lenders because such partnerships can lead to future lending and investment opportunities, broadening banking relationships, additional referrals, and further CRA consideration.

GAF’s typical 7(a) loans have the following characteristics:

—Size. These loans are typically $300,000 to $400,000, but can range from $50,000 to $2 million.

—Borrower. About 80 percent of all borrowers are existing businesses, such as restaurants, retailers, manufacturers, and tool and die shops. Only about 20 percent are startup businesses.

—Collateral. Borrowers often have weak collateral.

—Location. Many borrowers have businesses located in low-income neighborhoods.

The following is an example of how GAF has used the ARC program. A small manufacturer experienced a 22 percent drop in sales because of the economic recession. The company was honest about their problems, had a plan to turn the corner, and was determined to be a viable ongoing business. The $35,000 ARC loan enabled the company to pay off some existing debt. For GAF, this loan has a 100 percent guarantee from the SBA and the SBA provides GAF with interest on the loan at prime +2.0 percent, paid monthly.

“For us [at GAF], it [the ARC program] gave us a 100 percent guarantee on the $35,000 loan we made, and we will be receiving interest from the SBA at prime +2.0 percent paid monthly.”

—Pat Thomson

As an SBA lender, GAF is taking several steps to survive the current credit crunch.

These steps are:

—Watching existing borrowers. GAF is watching its current borrowers closely to detect any signs of trouble early on. This includes looking at payment history and reviewing financial statements. In addition, GAF is working with existing borrowers on restructuring loans, as appropriate, possibly providing additional working capital loans, and at times refinancing existing debt. In some cases refinancing may involve using a 7(a) loan and in other cases might involve an ARC loan.

—Watching new loans. In the last 12 months, the volume of loan requests has increased considerably. One area of growth has been businesses that do energy retrofits, an industry that also has received incentives in the Recovery Act. In addition, some loan requests are coming from small businesses that have had
other options closed. In considering these loans, GAF and other lenders must be cautious to ensure that entities are viable. GAF has sought to avoid “catching falling knives.”

—Watching the bottom line. GAF is focused on keeping its own house in order to survive the economic downturn. This comes as GAF has experienced somewhat lower earnings due to fewer collections and higher losses. Watching its own bottom line entails identifying trends early in order to respond appropriately, working hard to cut costs, and seeking potential new revenue sources.

- **SBA guaranteed loan programs have some distinct regulatory benefits.**
  These benefits include:
  
  — **Exclusion from lending limits.** The portions of 7(a) and ARC loans that are guaranteed by the SBA don’t count toward a bank’s legal lending limit. As a result, banks can expand their commercial lending to additional creditworthy borrowers.
  
  — **Exclusion from supervisory LTV limits.** SBA-guaranteed commercial real estate loans are excluded from the supervisory loan-to-value (LTV) limits, provided that the amount of the guarantee is at least equal to the portion of the loan that exceeds the supervisory LTV limit.
  
  — **Zero percent risk weight.** The guaranteed portion of an SBA 7(a) or ARC loan would receive a zero percent capital risk weight.

- **With each type of SBA loan program there are distinct risk considerations.**
  Some of the primary risk considerations are discussed below.

**SBA 7(a) Loan Program**

The 7(a) loan program was established for borrowers who do not qualify for conventional loans. Accordingly, banks need to consider these borrowers as having a somewhat higher risk of default. The SBA has established requirements to mitigate this risk. This includes requiring an in-depth credit analysis and a projection of cash flows, as well as having lenders hold the first lien on collateral. In addition, lenders must adhere to the SBA’s written operating procedures to secure the full guaranty payout in the event of default.

**SBA 504 Program**

One risk that can arise is the delay between funding the bank loan and funding the second lien loan through the CDC. When this occurs, banks typically provide an interim loan to bridge the timing, temporarily resulting in loans with a 90 percent LTV. If a bank’s 504 loans exceed the supervisory LTV limits, then the loans must be reported in the aggregate amount of all loans in excess of the supervisory limit. (This aggregate amount should not exceed 100 percent of capital for the banking institution.) When a bank is providing interim or construction financing, lenders should secure additional collateral.

**ARC Loans**

These loans must be carefully underwritten because the terms of the program involve special government-backed financing to viable, for-profit small businesses that are experiencing temporary financial hardship. Lenders should become familiar with the ARC Underwriting Guidelines.

**SBA loans may be eligible for CRA consideration.**

Banks may receive positive consideration under the CRA for making SBA loans in one of two ways: as a primary loan product, or as a community development loan. Banks of different sizes have different CRA considerations.

— **“Banks that increase their lending activity to small businesses will receive positive CRA consideration.”**
  — Barry Wides

**Large Banks (Banks with assets greater than $1.109 billion as of December 31, 2008 for the prior two years)**

Large banks are evaluated under three tests: lending, investments, and services. SBA loans of $1 million or less receive positive CRA consideration in the Lending Test. SBA loans greater than $1 million are evaluated as a community development loan under the Lending Test if the loan meets the CRA community development definition.

**Small Banks (Banks with assets $277 million or less as of December 31, 2008 for the prior two years)**

These banks are evaluated solely on their lending performance. Primary loan products are evaluated and SBA loans are included in the population of a bank’s business loans. Examiners are interested in determining whether business loans are made to small businesses (based on the revenue of the business) and where the loans are made within the bank’s assessment area.

**Intermediate Small Banks (Banks with assets greater than $277 million and less than or equal to $1.109 billion as of December 31, 2008 for the prior two years)**

The Lending Test is the same for intermediate small banks as it is for small banks. If an SBA loan meets the definition of a community development loan, it can be considered under either the community development test or the lending test, depending on where the banks feels it will receive the most benefit for CRA purposes.

**Questions & Answers**

Summarized below are answers to some of the questions asked by teleseminar participants.

- **Certified Development Companies.** Only 504 loans (second mortgages) have to go through CDCs; 7(a) loans do not go through CDCs. 7(a) loans can be originated by a commercial bank, a thrift, or any organization that has received approval from the SBA.

- **ARC availability.** ARC loans are available for borrowers not currently receiving an SBA loan. Many of the ARC loans have been made to non-SBA borrowers.

- **7(a) loans for refinancing.** 7(a) loans can be used to refinance existing loans and bank debts, but there are some particulars here that must be addressed. Banks are encouraged to discuss this with their local SBA district office.

- **Paying guarantees.** SBA data indicates that 95 percent of loan guarantee requests and 95 percent of dollars requested are paid. (Coincidently, these percentages are the same.)
- **Floor plans for used cars.** The floor plan provisions do apply for used cars as well as manufactured homes.
- **Exemption from imputed interest.** The IRS was consulted regarding the ARC program. The result is that there will not be a need to impute interest income to an ARC borrower and a 1099 from the lender is not required.

### Additional Resources

#### OCC Resources
- SBA 504 Loan Program: Small Businesses’ Window to Wall Street, *Community Developments Insights*, February 2006
  [www.occ.treas.gov/cdd/Insights_2-06.pdf](http://www.occ.treas.gov/cdd/Insights_2-06.pdf)
- The SBA’s 7(a) Loan Program: A Flexible Tool for Commercial Lenders, *Community Developments Insights*, September 2008
- Community Development Newsletter on Small Business Banking, Winter 2003
  [www.occ.treas.gov/cdd/CD_winter03/cd_header.html](http://www.occ.treas.gov/cdd/CD_winter03/cd_header.html)
- Small Business Resource Guide
  [www.occ.treas.gov/cdd/SBGRG09032003.htm](http://www.occ.treas.gov/cdd/SBGRG09032003.htm)
- Small Business and Microenterprise Article Archive
  [http://www.occ.gov/cdd/ca_archive_sp.htm](http://www.occ.gov/cdd/ca_archive_sp.htm)

#### Other Treasury Resource
- Community Development Financial Institutions
  [www.cdfifund.gov](http://www.cdfifund.gov)

#### OCC CRA Resources
- General Information on CRA
  [www.occ.treas.gov/crainfo.htm](http://www.occ.treas.gov/crainfo.htm)
- Contact Information for OCC’s Community Affairs Officers
  [http://www.occ.gov/cdd/contacts.htm](http://www.occ.gov/cdd/contacts.htm)

#### Other CRA Resources
- January 2009 Interagency Questions & Answers Regarding Community Reinvestment
  [www.ffiec.gov/cra/qaagdoc.htm](http://www.ffiec.gov/cra/qaagdoc.htm)
- CRA Loan Data Collection Grid, rev. September 2006
- Banker’s Guide to CRA, September 2005

#### Small Business Administration (SBA)
- SBA District Offices
  [www.sba.gov/index.html](http://www.sba.gov/index.html)
- SBA Information for Banks
  [www.sba.gov/banking/](http://www.sba.gov/banking/)
- SBA Programs and the American Recovery and Reinvestment Act
  [www.sba.gov/american/index.html](http://www.sba.gov/american/index.html)
- SBA Regulations
  [www.sba.gov/advo/laws/law_lib.html#statutes](http://www.sba.gov/advo/laws/law_lib.html#statutes)

- SBA 7(a) and SBA 504 Standard Operating Procedure (SOP), SOP 50 10 5(A)
- SBA Certified Development Companies
  [www.sba.gov/localresources/district/or/OR_ORCDC.html](http://www.sba.gov/localresources/district/or/OR_ORCDC.html)
- SBA America’s Recovery Capital (ARC) Loan Program Procedural Guidance and other information
- SBA Small Business Investment Company (SBIC)

#### At SBA Headquarters
- Grady Hedgespeth, Director, Office of Financial Assistance, 7(a), 504, and Microloan Programs, grady.hedgespeth@sba.gov
- Janet Tasker, Director, Office of Risk Management, ARC Loan Program, janet.tasker@sba.gov
- Bryan Hooper, Director, Office of Credit Risk Management, Lender and CDC Risk Ratings, Lender and CDC Portfolio Compliance and Risk Reviews, bryan.hooper@sba.gov
- Sloan Coleman, Regulatory Specialist and Financial Analyst, Dealer Floor Plan, w.coleman@sba.gov

#### Industry Trade Associations
- National Association of Development Companies (NADCO)
  [www.nadco.org](http://www.nadco.org)
- National Association of Government Guaranteed Lenders (NAGGL)
  [www.naggl.org](http://www.naggl.org)
- National Small Business Association (NSBA)
  [www.nsba.biz](http://www.nsba.biz)
John C. Dugan  
Comptroller of the Currency

John C. Dugan was sworn in as the 29th Comptroller of the Currency on August 4, 2005.

The Comptroller of the Currency is the administrator of national banks and chief officer of the Office of the Comptroller of the Currency (OCC). The OCC supervises 1,900 federally chartered commercial banks and about 50 federal branches and agencies of foreign banks in the United States, comprising more than half the assets of the commercial banking system. The Comptroller also serves as a director of the Federal Deposit Insurance Corporation, the Federal Financial Institutions Examination Council, and the Neighborhood Reinvestment Corporation.

Prior to his appointment as Comptroller, Mr. Dugan was a partner at the law firm of Covington & Burling, where he chaired the firm’s Financial Institutions Group. He specialized in banking and financial institution regulation. He also served as outside counsel to the ABA Securities Association.

He served at the Department of the Treasury from 1989 to 1993 and was appointed assistant secretary for domestic finance in 1992. While at Treasury, Mr. Dugan had extensive responsibility for policy initiatives involving banks and financial institutions, including the savings and loan cleanup, Glass-Steagall and banking reform, and regulation of government-sponsored enterprises. In 1991, he oversaw a comprehensive study of the banking industry that formed the basis for the financial modernization legislation proposed by the administration of the first President Bush.

From 1985 to 1989, Mr. Dugan was minority counsel and minority general counsel for the U.S. Senate Committee on Banking, Housing, and Urban Affairs. There he advised the committee as it debated the Competitive Equality Banking Act of 1987, the Proxmire Financial Modernization Act of 1988, and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Among his professional and volunteer activities before becoming Comptroller, he served as a director of Minbanc, a charitable organization whose mission is to enhance professional and educational opportunities for minorities in the banking industry. He was also a member of the American Bar Association’s committee on banking law, the Federal Bar Association’s section of financial institutions and the economy, and the District of Columbia Bar Association’s section of corporations, finance, and securities laws.

A graduate of the University of Michigan in 1977 with an A.B. in English literature, Mr. Dugan also earned his J.D. from Harvard Law School in 1981. Born in Washington, DC in 1955, Mr. Dugan lives in Chevy Chase, MD, with his wife, Beth, and his two children, Claire and Jack.

Grady B. Hedgespeth  
Director, Financial Assistance, Small Business Administration

Grady B. Hedgespeth was appointed Director of Financial Assistance, Office of Capital Access, Small Business Administration (SBA), in May 2007. He is responsible for the product and policy development for the SBA’s $80 billion business lending portfolio. A former Secretary of Economic Affairs in Massachusetts, he is skilled in strategic planning, economic development, and corporate governance. Mr. Hedgespeth has spent most of his 30-year professional career in the private sector, primarily in financial services. He was Regional President for BayBank Boston and the founder and President of BankBoston Development Company, the nation’s first bank-owned urban investment bank. Dedicated to community service, his volunteer efforts have focused on developing inner-city youth and nurturing multicultural marketplaces.

Pat Thomson  
President, Grow America Fund, Inc.

Pat Thomson is the President of the Grow America Fund, Inc., the small business lending company of the National Development Council (NDC). NDC is the oldest national nonprofit community development organization in the United States. Its mission is to increase the flow of capital to underserved urban and rural areas across the country for job creation and community development. The Grow America Fund is a community development bank authorized to make loans under the Small Business Administration’s 7(a) program nationwide. Ms. Thomson has been a Director of the NDC since 1991.

As President of the Grow America Fund, she oversees all lending operations of the Fund, which is also a Certified Development Financial Institution.

Prior to serving in that position, Ms. Thomson provided technical assistance to cities, nonprofits, and banks to secure and structure financing for community and economic development projects. Ms. Thomson also is an instructor of finance classes for economic development professionals on such topics as small business and real estate lending. Prior to joining the NDC, Ms. Thomson worked for the North Carolina Department of Commerce in community economic development. She received a B.A. degree from Duke University and a master’s degree from the University of North Carolina at Chapel Hill.
Barry Wides  
Deputy Comptroller for Community Affairs, Office of the Comptroller of the Currency

Barry Wides is the OCC’s Deputy Comptroller for Community Affairs, in which capacity he leads a department of community development professionals located in Washington, DC, and the four OCC districts. The Community Affairs staff is responsible for outreach to banks and their community partners, the administration of the “Part 24” public welfare investment authority, the development of policy, and the creation and distribution of educational materials on community development issues.

Prior to joining the OCC in 1999, Mr. Wides was Director of Affordable Housing Sales at Freddie Mac. He led a nationwide sales team responsible for developing products and strategies to achieve the company’s congressionally mandated affordable housing goals. He previously served as Deputy Director of the Resolution Trust Corporation’s Affordable Housing Program. Mr. Wides began his career in Washington as a presidential management intern and budget examiner at the Office of Management and Budget.

Mr. Wides is a Certified Public Accountant and holds a B.S. in accounting and an M.B.A. from Indiana University.