TO: SBA Transition Team
FROM: Chris Crawford, President & CEO
National Association of Development Companies
RE: Recommendations on SBA's 504 Program
DATE: November 5, 2008

Ladies and Gentlemen:

Congratulations on winning the 2008 election. The members of the National Association of Development Companies (NADCO) hope to have a close and successful relationship with the new leadership appointed to help improve the Small Business Administration. The following is a brief overview of the 504 loan guaranty program. CDCs ("Certified Development Companies") are the primary delivery vehicle for 504 loans. CDCs are non-profit community-based organizations that market, package, and service the 504 loans they create to bring new jobs to their states and communities. NADCO is the national trade association representing more than 450 member Certified Development Companies (CDCs), banks, and attorneys who provide the SBA's 504 loan program to America's small businesses.

The 504 loan program is the largest most successful small business Federal economic development program in history. 504 financing provides long-term(principally 20 year) fixed-rate low down payment capital to growing small firms for land, buildings and capital equipment just at the time they are most ready to grow, create new jobs and strengthen their local economies. Through a collaboration of private lenders, CDCs, and the SBA, 504 has created more than two million new jobs through the lending of over $100 billion in long term capital to more than 100,000 small businesses.

With the very difficult economic times we face today, there are few priorities greater than getting America growing again. CDCs and 504 do this one business at a time and cumulatively add tens of thousands of new jobs every year. It is critical to the small businesses of America that we keep 504 functioning and that we quickly improve access to badly needed capital to companies at rates and terms they can afford.

The attached summary and documents describe 504, its mission, and what is needed from Congress and the new administration. We hope that you will find it beneficial as you move forward to make needed changes to SBA and its programs.

Representatives of our industry would like to meet with members of your transition team, as soon as you would be available to discuss the critical needs of America's small businesses.

Sincerely,
Christopher L. Crawford
President & CEO

SBA 504 Loan Guaranty Program:
The 504 program is a loan guaranty program created in the mid 1980s to answer the need for low cost, low down payment, long term capital for the fixed assets (land, building and capital equipment) needed by growing small businesses. These companies could generally qualify for fixed asset conventional financing, but not at amounts that would enable their companies to be able to afford conventional commercial down payments, which are typically in the 25% to 40% range. 504 provides well structured capital to fill in the gap between a reasonable down payment and what a commercial bank would typically offer, enabling companies to retain needed working capital so they could grow that much faster, create more jobs, and assist the local economy.

504 is an "economic development" program, meaning that it is charged by Congress and SBA with creating and retaining jobs for communities or meet other national public policy objectives, such as assistance to women and minority owned companies, redevelopment of blighted areas, etc. 504 projects must add or retain one new job for every $50,000 of 504 funding, and Certified Development Companies (CDCs) are measured on these performance standards, the only Federal program to have such dollar-per-job standard.

504's Loan Parameters:
A 504 loan is long term (typically 20 year) financing used by small businesses to fund plant, store expansions, or new plant acquisition. It is not used for working capital or short term assets. An owner must provide a minimum of 10% new equity in his project, with a commercial lender typically providing 50% through a non-guaranteed first mortgage on the project property. A CDC then provides up to 40% of the needed funds through a second mortgage guaranteed by SBA. 504 loans may be up to $1.5 million, $2.0 million for projects that meet public policy goals, and up to $4 million for manufacturing concerns.

How are 504 Loans Funded?
The first mortgage is funded by the bank on a conventional (non-SBA-guaranteed) basis. The 504 second mortgage is funded by the pooling of all 504 loans, and the sale of portions of those pools to investors. The pools of 504 SBA-guaranteed debentures have historically delivered capital to small businesses at very low rates, and which has earned 504 the name of "The Small Business Window to Wall Street". During 2008, 504 funded about $6 billion to 9,000 small businesses through this process.

How Much Has 504 Cost the Government?
504 has operated as a "zero subsidy" program since 1997. It receives no appropriation from Congress, and all program costs (except minor SBA administrative costs for staff) are funded through fees that borrowers, banks, and CDCs pay to SBA. As the attached study from the California State University shows, 504 actually returns to the Federal, State, and local governments about $94 for every $1 that it costs SBA to administer the program. Thus, with a zero federal appropriation, 504 provides billions of dollars of expansion capital each year to small businesses that return many millions of dollars in fees and increased real estate, sales, income, and payroll taxes to all levels of government.

Why Are Certified Development Companies Critical to 504 Success?
CDCs are "mission driven", not profit driven, by their very charter and makeup. CDCs are non-profit organizations that have representatives from government, small businesses, community organizations, and commercial lenders as their members. CDCs identify small businesses that need and qualify for SBA 504 financing. Once approved and funded, the CDC also services the loans throughout their 20-year life, and if necessary, the CDC assists SBA with collection in the event of a loan default to minimize loss to the government.

As non-profit lenders, with regulated loan fees, CDCs deliver 504 financing at the lowest possible cost. As community-based lenders, CDCs go to extraordinary efforts to work with small business borrowers in order to ensure that their business success continues and their SBA loan gets repaid. CDCs also take their net revenues and reinvest them in their local communities, frequently providing other types of small business financing (e.g. micro lending) marketing the 504 and SBA programs, and even providing grants to other community-based organizations. The result is that virtually every dollar of CDC net revenue is plowed back into the community to provide additional growth of these economies.

The Capital Markets Crisis and Small Business 504 Needs:
With the enormous changes on Wall Street and in banks throughout the country, small businesses are left with fewer, more restrictive, and more expensive options for long term capital. Once again, as in past recessions, a vibrant 504 program is critical to getting many small businesses growing again. While the 504 funding mechanism has accomplished its mission for years, the severity of the current capital markets crisis has resulted in two very negative factors for potential 504 borrowers.

The primary issue is that 504 loans are now beginning to be priced out of the market, not due to risk, but simply the lack of liquidity in the market for agency guaranteed securities. A second aspect of this is that the secondary market for 504 first mortgage loans has largely dried up. This is a problem for many 504 first mortgage lenders who depend on this secondary market for their liquidity and results in less access to 504 for many small concerns. A short term solution for both of these issues must be found in order to keep 504 viable for the nation's small businesses. As a result of the above, NADCO is requesting that the new Administration propose the following legislative actions be included in the pending stimulus bill:

► That funds be appropriated in order to reduce the one time fees for 504 borrowers. These fees would include the first mortgage lender fee and the first year of CDC servicing fee. The estimated budget appropriation needed for this over the next year is estimated at $100 million.

► That funds be appropriated in order to reduce the interest rate by 1% for all 504 clients obtaining loans over the next year. The estimated appropriation for this would be $500 million.

► That the Agency be directed to work with Congress, the CDC industry, and the first mortgage lending industry to develop a program to restore liquidity to the lending industry. This will enable more banks that provide the first mortgage loans to determine their necessary level of capital to expand their 504 program participation and provide loans to more small businesses. Without banks participating in the program, no 504 guaranteed second mortgages can be made to potential borrowers.

► That the Agency be directed to issue standards that would enable existing 504 borrowers to utilize a reasonable portion of the equity in their property to help their companies. This should be done by allowing small businesses to refinance their existing first mortgages, provided they are current on the 504 loan, the 504 loan is seasoned, and that the SBA will be left with an appropriate loan to value.

Other Essential Changes to 504:

Our industry has been working closely with both the House and the Senate Small Business Committees for several years now on comprehensive Access to Capital legislation for small business that would accomplish a number of essential longer term changes affecting the administration of the 504 program. The attached draft legislative language is based on prior House and Senate bills (including HR 1332 and S.2920) and is the product of our industry's collaboration with the Members and staffs of both committees. The major areas of the program changes would be as follows:

► Statutory Definition of a CDC--Although historically defined in policy and regulation, the definition of the proper operation of a CDC, from membership, to operating territory, to ethical behavior has never been put into statute. The attached draft bill language would accomplish this for the first time in the 25 year history of the 504 program and is critical to the long term successful implementation of the 504 program.

► Program Enhancements—There are numerous technical program enhancements in the attached draft legislation that would enable 504 to reach out to many more small businesses and better meet both the particular needs of these companies and the economic development needs of the communities throughout our nation.

► Minimize Loan Losses Through Effective Liquidation & Recovery--- With a 504 loan portfolio of almost $30 billion, SBA has a loan liquidation staff in its two Servicing Centers of fewer than fifteen. Additionally, this staff has no ability to travel to the locations of loan defaults to track down borrowers, guarantors, or collateral. Both the judicial process and common sense dictate that the recovery process is best handled in the towns and cities where the project collateral, borrower, and guarantors are located, not from 1,500 miles away. The attached draft legislative language proposes that CDC staff would be used as local agents of SBA in performing workouts, liquidations and recoveries. CDCs costs for both staff and contractors, as needed, would be repaid by SBA from the funds ultimately coming from increased recoveries on these defaults

► Improve 504 Loan Program Oversight--CDCs have long supported SBA in its effort to establish accurate, fair and cost effective review of CDC operations, loan policies and overall credit quality. SBA has created a loan default "forecasting" system unique in the financial services industries. Our industry has concerns about the accuracy, usefulness and also the cost of this program. We support recent Congressional requests for SBA to more fully utilize their in house data to establish a more cost effective 'on the ground' and accurate system, based on data the Agency already has. We ask that this system must be reconsidered by the new Administration to ensure that it addresses the SBA's needs for a state of the art

► Delegation of Additional Loan Authorities to Qualified CDCs—The CDC industry is very diverse in size, geography and program offerings. However, many CDCs of all types demonstrate a very high expertise in 504 loan making and servicing. At the same time, SBA remains under constant budget pressure. The solution is to identify policies and procedures that SBA staff now perform that could be delegated to these qualified CDCs. Our industry seeks to work with the new Administration to re-think the approval, closing, servicing, and liquidation functions in order to streamline and privatize appropriate functions to improve service to small businesses and reduce costs to the Agency.

Summary

The CDC industry has a long history of working closely with SBA loan policymakers to improve the 504 program. Both during the current financial markets crisis and afterwards we believe that change, innovation and enhancement of 504 is vital to our ability to continue to provide the absolute best service and products to the small businesses of our nation.

NADCO believes that change is imperative and that the new SBA must undertake the challenge of creating significant 504 program improvements that will make a real difference to small business. We are confident that the new Administrator will make 504 innovation a major priority, and we stand ready to do whatever it takes to provide our expertise gained from nearly thirty years of economic development lending towards this goal.