“A Review of the SBA’s 504/CDC Loan Program”

Testimony before the House Committee on Small Business Subcommittee on Investigations, Oversight, and Regulations

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Subcommittee Chair Chu and other distinguished committee members, good morning. I am Mary Mansfield and I am here on behalf of Bay Colony Development Corp., a certified development company headquartered in Massachusetts. I'm pleased to have the opportunity to discuss the economic development work our CDC does and jobs we help create, particularly with the 504 loan program, as well as the challenges we face.

Background on Bay Colony Development Corp.

I'd like to begin by sharing a little background information about our company and what we do in general. Bay Colony Development was certified by the Small Business Administration in June of 1981 to serve the small businesses of Massachusetts. At that time, Bay Colony had just two employees, including the company's founder. Over the past 38 years, we've grown to a staff of 15 full-time employees, dedicated to assisting small businesses in our communities. Over the past four years we've expanded our territory to provide 504 loans throughout Rhode Island, New Hampshire and Vermont. We also serve the small businesses of Connecticut in counties contiguous to Massachusetts. In addition, we've grown our product line to include microloans and grants to community revolving loan funds.

Bay Colony Development's Economic Development Success Record

I'd like to share a little of our CDC's success record in meeting our mission of promoting economic development. Our Board and staff believe that the best measure of success combines both the loaned dollars to our small business borrowers with the economic impact of that activity on the community. Here are the results:

SBA 504 Loans	FYE 9/30/2018	Inception to FYE 9/30/2018
Borrowers Assisted	116	1,599
SBA 504 Financing	$59,050,000	$763,955,000
Jobs Created/Retained	242	13,378
Loans to minority owned businesses	11%	10%
Loans to women owned businesses	18%	20%

I joined our CDC back in 1985 as the Office Manager – I was the third employee. Over the past 34 years with the company, my responsibilities grew to Portfolio Manager, Closing Manager, Vice President, Executive Vice President and now President and CEO of the organization. Working in so many roles has given me the opportunity to interact with thousands of small businesses and to watch firsthand how their dreams of expansion have come true. I still enjoy going out to loan closings to see just how excited the borrowers are to be moving into their new properties and how appreciative they are of the SBA 504 loan program. Today, Bay Colony has four Business Development Officers covering 47 counties in five states working with small business borrowers and helping them access the funds they need to grow and create jobs. I'm proud to say last year alone we connected 117 business owners with financing through the 504 Loan Program. These are businesses and jobs that otherwise would not exist. Driving around the local area, I love pointing out to family and friends the businesses I've helped over the years that are now pillars of the community, so much so that my family gets tired of listening to me!

Background Information on SBA 504 Loan Program

To provide background on the 504 loan program, SBA developed the 504 loan program to promote economic development in local communities by encouraging healthy businesses to expand and create jobs.

The program provides long-term, fixed-rate financing for the purchase of fixed assets, typically land, buildings, machinery and equipment. Refinancing existing debt is also allowed and can also include a limited amount of cash out for certain eligible business operating expenses. To be eligible for a 504 or 504 refinance, a business must meet all regular SBA business eligibility requirements and size standards, and the project must meet an economic development goal specific to the 504 loan program – typically the project must create or retain one job for every $75,000 in SBA financing. Alternatively, there are 13 public policy and community development goals Congress set that can be used to qualify the project under certain conditions. These are outlined at 13 CFR §120.862 and include items such as assisting businesses owned and controlled by women, veteran, or minorities or assisting businesses in rural areas or in enterprise zones.

The funds a small business receives to finance a 504 project are typically split. A Third Party Lender (a participating bank, non- bank, or credit union) funds 50% and receives a 1st lien on the project assets, the CDC/SBA 504 loan funds up to 40% of the costs and receiving a 2nd lien, while the borrower/applicant injects an equity contribution of as little as 10%. The 504 loan is funded from a SBA-guaranteed debenture sold on Wall Street, not tax-payer dollars.

Let me share with you a successful entrepreneur - Circle Furniture of Acton, Massachusetts

In 2015, Bay Colony Development was is pleased to assist Circle Furniture in the construction of the store's seventh location in Massachusetts. The story of their entrepreneurial success began over sixty years ago, when Harvard University students on a budget trekked to Robert Tubman's store in Putnam Circle. That's where they bought quality used and unfinished furniture for their dorm rooms that lasted well beyond their college years. Today, Circle Furniture continues to thrive, thanks to Tubman's sons Richard and Harold, with locations in Acton, Boston, Cambridge, Danvers, Framingham, Pembroke and newly opened Middleton.

The Tubman family has also crafted a reputation for Circle Furniture that includes an eclectic, contemporary selection, fast delivery times for made-to-order items, corporate philanthropy, support of the regional economy, and most of all, fun. Circle Furniture offers unique, quality furniture for contemporary and traditional homes. Much of the furniture is not only made in the United States, but it's made **locally** in Massachusetts, New Hampshire, Vermont and Maine. Circle Furniture is a firm supporter of New England-based wood furniture manufacturers.

Bay Colony was first introduced to Circle Furniture in 1999 when we assisted the family with the purchase of the Framingham store. Revenues at that time were $8.3 million, and today they are in excess of $16 million with the company employing 53 people. In addition to expanding the number of stores, Circle Furniture is also expanding into the next generation. Jessica Tubman, Harold's daughter, is in charge of business development, e-commerce, and creating and maintaining the company's website. Jessica started with the company in 2004 and took some time off to obtain her MBA from Sloan School of Management in 2007, before returning to the family business in 2012. Richard's daughter, Erica, started dusting furniture in the store at the age of four and then spent her summers in the delivery department during her high school years. After moving back from California last year with her husband, she is running the sales floor for the Boston location. Erica said she was anxious to get back to working for a company that gives so much back to the community. Circle Furniture partners with local businesses to host events and fundraisers, and they use local vendors and manufacturers as often as they can.

Over the years, Bay Colony has provided four SBA 504 loans to Circle Furniture for various locations and we look forward to working with the next generation of Tubmans on more stores.

Opportunities to Better Support Small Business Owners

The 504 Loan Program is a truly valuable tool for economic development and job creation throughout the country. However, it will be more valuable to small businesses with some updates, streamlines, and simplifications of the program. Let me highlight four areas among many where those opportunities are.

First, the closing process for a 504 loan can be cumbersome, lengthy, and inconsistent from borrower to borrower. There are several ways that the SBA and Congress can consider addressing this. First, minor changes to a loan that do not increase risk to the SBA should not have to go through a second SBA approval process for the changes. Rather, CDCs who have demonstrated reliability and quality when working with borrowers should be able to make these changes with their own authority. Some of these very minor changes all CDCs can currently do. However, there are additional areas where CDCs could have authority to approve changes. For example, changing typos in the name of a borrower or company, correcting the bank name, or adding an additional guarantor to the loan. I know of many of my borrowers whose closing process would have been more efficient if they did not need to get a second round of government approval. I think an example from one of my other colleagues in the CDC industry may best demonstrate how these minor reviews can delay small businesses from receiving their funds. During the last government shutdown when SBA was not open to do these approvals, one small business could not close their loan because it needed SBA approval to add periods to the "LLC" in their company name. Delays like this could result in our borrowers paying a higher interest rate, forfeiting their deposits on the properties, or completely losing the properties if the sellers in the transaction are not accommodating. Allowing a CDC to perform a correction like this will help entrepreneurs move forward in their business without additional risk to the taxpayer.

Another opportunity to make the 504 closing process more efficient for small business borrowers is to streamline the closing legal review process. When a 504 loan gets to closing, it has already gone through the full SBA process and been approved by the Agency as a sound loan. The small business has then closed with the bank (Third Party Lender) and the bank's attorney has reviewed title and they've completed construction on the property, since all building and construction must occur between approval and closing on a 504 loan. The closing is the end of a long process, sometimes multiyear, process. As part of the closing, the small business again must submit business and legal documents. While there is an official list of documents borrowers need to submit for closing, experience has demonstrated that numerous SBA district offices routinely requires different documents. If SBA believes there is a material risk to the taxpayer dollars in the loan, of course we support a thorough review. However, the inconsistency in which SBA reviewer requires which documents, especially if documents are not related to the risk of the loan, means small businesses do not know what documents they must prepare and when they will truly close their loan. The deadlines for borrowers to submit their closing documents to SBA can also vary depending on which area of the country a borrower lives in. Making sure there are clear, consistent documentation rules and timing for these small businesses is critical to give them certainty and reliability in their business planning. These are entrepreneurs who have already had their loan approved by SBA and invested time and money into constructing or modifying their real estate. This is not the moment when we should let them down.

Beyond closing, a second challenge that limits the 504 program from reaching small businesses is occupancy requirements. In densely populated cities, the real estate options are limited. Entrepreneurs often must consider buildings that are two or more stories, but their business would occupy only the first floor. Right now, a 504 owner must occupy the majority of their real estate. That means if there is a two-story building with equal footage on the top and bottom floor, the building is not eligible because the first-floor business would only occupy 50 percent, not the majority. If it is a multistory building where the business only needs the first floor, it is even farther from 504 eligibility. Because of these occupancy challenges, in the decades of Bay Colony's work with the 504 Program in Massachusetts, we have only done 53 loans in Boston. Boston and the surrounding communities have thousands of successful business and has a huge market that would be a boon to many small business owners. However, the 504 program is almost never a viable option because so few buildings can meet SBA's occupancy requirements. Making occupancy requirements reflect the true nature of real estate in urban and suburban areas will help the 504 Program support those entrepreneurs and the mandatory job creation that comes with receiving a 504 loan.

A third area where reforms will help small businesses is in disaster assistance. While disaster assistance is a large topic that could fill many hearings of its own, there is one narrower part I want to raise today. CDCs are required by SBA, but are also very eager to perform, "other economic development" as part of our mission, and fulfilling this is part of our annual reviews by SBA. Since we are mission-based lenders, this is something we do not do to check a box but because we exist to support our communities. During a disaster, we want to provide support beyond our community as well, both to small businesses affected by the disaster as well as our fellow CDCs in the disaster area. Removing any barriers to this assistance and ensuring this work qualifies as "other economic development" by SBA will only help these communities recover faster.

Finally, I want to touch briefly on the 504 program's policies that I'll refer to as "EPC/OC" policies. I know some of my colleagues on this panel will go into more detail about these, but these policies are ones that affect my small business borrowers as well. Briefly, many small businesses, on the advice of their accountants and lawyers, structure their business as an operating company, or OC, and an eligible passive company, EPC. The EPC owns the real estate while the OC is the company itself. In a 504 loan, both the OC and the EPC are equally responsible for repaying the loan, so there is no additional risk to the taxpayer in this business structure. However, SBA has added additional rules to 504 small business that have an EPC/OC structure. These rules limit their tax deductions, increase their legal liability, and prevent an EPC from having any other business. In addition, they go against conventional real estate practices.

These rules should be modified to allow small businesses to follow best practices in their business structure at no additional risk to the SBA.

Conclusion

By solving these problems, we will help our small businesses and our economy grow. As I stated at the beginning of my testimony, 504 borrowers are statutorily required to create or retain jobs for every $75,000 they receive. The easier it is for responsible small businesses to access this program, the more jobs our country creates. It's that simple. I ask for your leadership and assistance in addressing these challenges and growing our economy.

Again, thank you for inviting me to testify today. I am happy to answer any questions.