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"A Review of SBA's 504/CDC Loan Program"

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Representative Chu and other distinguished committee members, good morning. I am Brooke Mirenda and I am here on behalf of Sunshine State Economic Development Corporation in Florida. 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.

I would like to share a little bit of background on our company. In the early 1980s, two CDCs were established in the Tampa Bay area, GulfCoast Business Finance and Tampa Economic Development Corporation. In 2016, SBA approved a merger between these two CDCs, creating what is now known as Sunshine State Economic Development Corporation (SEDCO). SEDCO is headquartered in beautiful Clearwater, Florida and is one of four CDCs that operate within the State. We have business development officers strategically located in Orlando, Tampa and Miami who work closely with third party lenders, small business owners and other economic development organizations to meet the financial needs of small businesses.

SEDCO is considered a mid-size CDC and we have seen significant growth over the last several years. We have remained a top 50 CDC over the last couple of years and the most recent statistics have placed us in the top 20. While the 504 Loan Program is our primary focus, we also offer other loan programs to meet the demands of our small business borrowers. This includes the SBA Intermediary Lending Pilot Program (ILP) and the SBA Community Advantage Loan Program (CA). Outstanding loan balances in these programs are approximately $650,000. SEDCO also utilizes its own resources to offer financing to small business owners through a Women/Minority/Veterans Loan Program and SEDCO Loan Program, with balances exceeding $2.3MM. SEDCO believes that our coordinated lending alternatives are essential in helping small businesses grow and create jobs. Our successes are below, but the successes in economic impact from all these programs stretches even farther.

SBA 504 Loans	FYE 9/30/2019	Inception to FYE 9/30/19
Loan Approvals	37	1,102
Authorized Debenture Amounts	$30,824,000	$567,374,000
Loans Funded	24	920
SBA 504 Financing	$14,912,000	$465,442,000
Jobs Created/Retained	247	9,087

Through a combined effort of the Board of Directors, the leadership of our management team and our splendid staff, these results illustrate our vision in economic development, which strengthen and promote small business lending.

I joined the CDC in 2016 as Vice President, Business Development Officer after 15 years in the financial services industry, primarily in mid and executive level management. In the first two years at SEDCO, I was the highest performing Business Development Officer, generating 44 loan approvals totaling over $33 million in loan authorizations. I had the privilege of working with small businesses owners around the state, helping them access funds they needed to continue to grow their business and create more jobs. In November 2017, the Board of Directors appointed me as the President and CEO. In 2018, I was named as The Coleman Report's SBA Woman Lender of the Year. As SEDCO President, I continue to be intimately involved in helping small businesses reach their maximum potential. The SBA 504 loan program not only creates jobs in our economy, it also offers up competitive rates and terms for our small business owners, which helps preserve capital and grow their businesses, while still operating at a zero subsidy.

I want to turn my attention to the work our CDC does with the SBA 504 loan program in particular. We have worked with banks, credit unions, and non-bank lenders throughout the State of Florida to offer a solution to small business owners that is not only attractive but leverages them in a way conventional financing cannot. Our business owners are able to retain capital and utilize their own resources for expanding their businesses and creating jobs. Let me share with you a couple of successful entrepreneurs whom SEDCO was able to help by securing commercial real estate with less money down and long-term fixed rates.

Fort Myers Restaurant Success

A husband and wife had a dream of owning their own business and being their own boss. They had experience in the restaurant industry and in September 2011, acquired a café in Fort Myers. Since then, they have grown the fledgling coffee shop into a popular full-service café. The original coffee shop was already well known for their delicious bagels, homemade Liege waffles, and gourmet coffees and beverages. They operated the café under a month-to-month lease at its original location in Fort Myers Beach, Florida until their lessor unexpectedly sold the property in the fall of 2017, giving them a short window to vacate their restaurant space.

They quickly identified a new restaurant space to rent, but unfortunately, Hurricane Irma hit the Southwest Florida coast as a category-3 hurricane before they could complete their relocation. Hurricane Irma was one of the costliest storms to hit Southwest Florida and the most powerful Atlantic hurricane in recorded history. An estimated 65,000 structures in West and Southwest Florida were damaged or destroyed. Our clients faced this destruction firsthand when the relocation to their new café was significantly delayed due to severe damage caused by Hurricane Irma. The sudden economic impact of a decline in diners and tourists also negatively impacted their business, as tourism to the Fort Myers Beach area halted and many of the local residents were recovering from the storm themselves.

SEDCO partnered with a third-party lender to offer them an SBA 504 loan that would allow them to complete their relocation and make the necessary repairs to their new, much larger restaurant space. With this loan, they were able to reopen as a full-service restaurant that began serving lunch and dinner in addition to their already popular line of bagels, Liege waffles and gourmet beverages. To accommodate this business growth, they created an additional 7 jobs.

Not only did this small business persevere in the wake of Hurricane Irma and the subsequent impact to the hospitality industry, they have prospered in their new location, thanks to the SBA 504 loan that the lender and SEDCO helped them secure.

<u>Refinancing Success</u>

A small, yet impactful, weight loss clinic in Florida was in jeopardy of losing its business property in early 2019. The owners suffered through a financial hardship in the years following the Great Recession and banks were reluctant to lend to them. This forced them to use non-bank lenders to finance the real estate for the clinic they operated. Non-bank lenders typically issue higher interest rate loans with shorter maturities and charge higher fees.

With a profitable business such as this weight loss clinic, a more expensive loan is not necessarily cost prohibitive. However, our borrower's problem was that their note was coming to maturity with a balloon payment (as is typical in commercial lending), but their lender was disinclined to refinance or extend the maturity even for only a few more years.

Our borrowers soon realized that they were faced with the possibility of imminent foreclosure. This meant the lender could take ownership of the property they used to conduct business and they would no longer have a place to earn a living, provide services to the customers that relied on them, and would have to lay off their employees. Four full time employees would be left without work, which would have an impact not just on them, but their families also. Our borrowers would also join this group of unemployed and be left to scramble to find some other income. The 700 customers for this small business would be left hanging to tackle their weight loss ailments on their own. In addition, the community would be left with a vacant building contributing nothing to the progress of the surrounding population.

With the 504 program, SEDCO was able to find a third-party lender to help this minority-owned small business attain long term fixed interest financing, allowing the clinic to further grow. Not only is its client base growing, it is expected to create three more jobs over the following two years. Furthermore, through the 504 loan program and this refinance project, our borrowers were able to save an excess of $33,000 per year in debt service while paying down both principal and interest at about half the interest rate of their previous loan. Finally, since the 504 refinance took place the clinic has been able to use its savings to hire two part time employees which are due to turn into full time employees in 2020.

These successes are just a small sample of the great work being done by SEDCO in the beautiful state of Florida. It is a truly valuable tool for economic development and job creation throughout the country. As you know, the 504 program is statutorily required to create or retain a job for every $75,000 it lends, so these businesses benefit their communities not just with their products, but with their employment.

<u>Opportunities for Improving the 504 Program</u>

As I have outlined above, the 504 program provides tremendous support for small businesses as well as their surrounding communities. I am proud that SEDCO can bring these resources to Florida entrepreneurs. However, during my time with the CDC, I have seen some policies that are not helpful to my small business borrowers, but also do not seem to protect the taxpayer's loan guarantee in a meaningful way. I hope Congress and SBA will review them and consider adjusting them to better meet the needs of small business owners. I have explained a few in detail below.

One way to help small business owners is to allow a more robust refinancing option in the 504 loan program. Thanks in great part to the leadership of this Committee, small business owners can refinance their existing loans using a 504 loan. That has been invaluable to many businesses and jobs, including the one I discussed above. However, there is an important exclusion from 504 refinance eligibility: small business loans from government guaranteed programs. A small business owner that purchased her building with a government product is now barred from refinancing via 504; this refinancing barrier does not exist for other government guaranteed lending programs. As a result, this subset of small businesses cannot take advantage of the 504 program that offers low fixed rate 20 or 25-year financing with payments and terms that enhance stability and certainty for businesses. These borrowers would still need to meet all the eligibility requirements that any other small business owner would, thus the soundness and quality of the refinancing program would not change if they participated. Ensuring that 504 refinancing is an option available for these small business owners will give them an additional tool when deciding what best meets their business needs, while not increasing risk to taxpayers.

Another set of policies currently in place that can be onerous for small businesses yet have a negligible effect on taxpayer risk, are policies with restrictions on small businesses that use real estate holding companies as part of their business structure. In the industry, we often call these "EPC/OC policies." Some small businesses form two entities: an operating company ("OC") and an eligible passive company ("EPC"). This is a common structure for businesses and small businesses may be advised by their lawyers to structure this way when they form their business. However, when a small business structured as an EPC/OC applies for a 504 loan, it faces additional restrictions that are onerous for the small business.

Second, SBA mandates what rent amount the OC can pay to the EPC as the owner of the building. Rent cannot be market rate, but instead only the cost of the mortgage and minor operating expenses. However, because the OC and the EPC are related parties, IRS rules require that the rents an EPC or holding company charge a related OC be at fair and reasonable rates. Because of this, accountants almost always recommend market rents be paid so that the business can avoid potential IRS problems. In addition, because rent can be a deductible expense, a lower-than-market rate prevents the OC from taking advantage of the available tax breaks afforded to small businesses. Finally, commercial real estate is valued partially on the rental income, so a below-market rental payment can reduce the overall value of the property and can harm the resale price if the small business ever sells the property. This rental policy should be changed to allow the small business to set a market rate rental payment and receive the appropriate tax treatment, as long as the rent is not detrimental to the operations of the small business.

There are two other EPC/OC policies that can cause problems for small business. One policy states that an EPC in the 504 program can only exist with a single OC and no others. This is inconsistent with standard business practices, and onerous on small businesses. A business owner will frequently create one EPC for all their OCs, because there is no reason to spend the time and money to have multiple EPCs. Another policy requires the OC to lease the entire property from the EPC, and all third-party leases for the property must go to the OC. This can expose the OC to unnecessary legal liability from those third parties, and as a result is often against the advice a small business receives from their lawyers.

These policies were likely created to ensure that the benefits of the 504 program go to true small businesses, not developers or investors. However, the 504 program has clear requirements for who can qualify, including the mandatory job creation and retention requirements I mentioned earlier. There are surely more effective ways of protecting the program than increasing the tax liability and decreasing the legal protection of these small business borrowers that are not developers or investors.

Another area where current policy may not match program intent is in the program's public policy goals. Beyond requiring job creation and retention, Congress alternatively allows for certain public policy goals to be met in the program. These allow 504 loans to go to businesses who may not meet the requirement of 1 job to $75,000 lent, but nevertheless are important for economic development in other ways. These public policy goals include lending to majority owned businesses by women, minority, rural and veteran borrowers. The current ownership requirement for majority ownership is 51%. As a result, there are many owners who cannot qualify under these public policy goals due to only having 50% ownership. For example, a small business may be owned 50% equally by two partners who are both active in daily management; one is a female of Asian descent and the other is a male who is a US Army veteran. While the small business is 50% woman-owned, 50% veteran-owned, and 50% minority-owned, the business does not meet any existing public policy goals for SBA loan programs. However, it certainly meets the spirit of those goals. If the requirement were adjusted to 50%, a greater number of 504 loans would assist small businesses within these sectors.

An additional policy area in need of reform is the process small business owners go through to close a 504 loan. Currently the process is inconsistent, unpredictable, and lengthy—all characteristics that small business owners try to avoid. Right now, after a small business gets their 504 loan approved, it must go through an additional approval process for almost all changes, no matter how minor, before it can close. Allowing CDCs with a proven track record of accuracy and success to adjust loan documents for items such as typos in business address, business name, or bank name, as well as make small decreases to a loan amount, would benefit the small business and SBA. By reallocating this work, there will be a faster closing process for the small business, greater efficiency and cost savings for SBA, elimination of the need for SBA personnel to spend time approving non-substantive changes, and fewer delays in closing when SBA faces a backlog of these requests. To give you an idea of how allowing CDCs this authority will help small business, one CDC had a borrower that needed to decrease their loan amount by only $2.00, but that small business could not close their loan without SBA approval.

Congress, SBA, and CDCs all have a shared goal of supporting small businesses while ensuring proper use of taxpayer dollars. The 504 program is a wonderful example of that—it creates jobs while at no cost to the taxpayer. The opportunities for change I have pointed to today will help keep that proper balance and I urge Congress to consider them. Again, thank you for inviting me to testify today. I am happy to answer any questions.