Catalysts for the entrepreneurial dream

# Catalyzing Economic Growth through SBA Community-Based Lending

Testimony before the U.S. House of Representatives
Committee on Small Business
Subcommittee on Economic Growth, Tax, and Capital Access

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Good morning, Chairwoman Davids, Ranking Member Meuser, and members of the Subcommittee. Thank you for the privilege of testifying before you to discuss the role of Small Business Administration (SBA) lending programs in community-based lending.

My name is Manuel Flores, and I am here on behalf of SomerCor, a Certified Development Company (CDC) with Accredited Lender Program status based in Chicago, Illinois. There is a network of more than 200 non-profit CDCs nationwide working in their communities to deliver the SBA's 504 loan program, as well as other SBA resources like the 7(a) Community Advantage and Microloan programs. Many CDCs also deliver other federal programs through the U.S. Treasury, U.S. Department of Commerce, and U.S. Department of Agriculture. As a critical player in deploying needed capital during the pandemic, CDCs were designated as Community Financial Institutions (CFIs) in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), P.L. 116-136. CDCs participated in emergency relief programs like the Paycheck Protection Program (PPP) and provided technical and other assistance to small businesses seeking emergency relief. Finally, CDCs, like Community Development Financial Institutions (CDFIs), deliver a variety of state and local programs and resources to meet the needs of the businesses we serve. In fact, CDCs are required to provide investments in economic development initiatives in their area of operations beyond their participation in the SBA 504 program.[1]

To use SomerCor as an example, not only are we one of the nation's larger CDCs by annual loan volume - we have originated more than $1.5 billion in 504 loans since our inception with a current loan portfolio of $436 million - we also participate in the SBA's Community Advantage (CA) loan program. CA is a pilot under the 7(a) loan program that provides loans of

[1] Standard Operating Procedure 50 10 6 – Part 1, Section B, Ch 1, pg. 68 SOP 50 10 6 FINAL 8.7.20 LOCKED_0.docx (live.com)

up to $250,000 to small businesses with a focus on serving under-resourced communities, women, minority, veteran-owned businesses, and rural based enterprises. The SomerCor team is especially proud of being named by the SBA as Illinois Community Advantage lender of the year in 2016, 2018, and 2019.

SomerCor also administers the Small Business Improvement Fund (SBIF) and Neighborhood Opportunity Fund (NOF) grant programs on behalf of the City of Chicago. The SBIF and NOF programs provide place-based grants to assist small businesses make building and property improvements to catalyze new neighborhood investment in lower income communities in Chicago. The NOF program specifically is part of a neighborhood investment initiative referred to as INVEST South/West, a public-private partnership between city departments, philanthropy, community leaders, and corporate partners to bring investment to 12 commercial corridors within 10 South and West Side community areas in Chicago. In total, SomerCor has helped the City of Chicago disburse more than $113 million to 1,600 small businesses.

We are proud of our milestones and contributions to help entrepreneurs and strengthen Illinois communities. Our story is one shared by many other CDCs that are also engaged in impactful economic development initiatives to help their respective local small business ecosystems. The national CDC network plays an integral role in helping bring more economic development resources to communities across the nation and has a positive track record, especially through the deployment of the SBA 504 program.

SomerCor’s primary work is the origination and servicing of 504 loans. The SBA 504 loan program is a public-private partnership that grows small businesses and enhances local investment and development. The program brings together traditional lenders and CDCs, who lend on behalf of the SBA, to help small businesses purchase commercial real estate and/or equipment with terms that are typically not available conventionally. The structure of a 504 loan project is as follows: the CDC provides up to 40 percent of the financing through the 504 loan that is backed by the SBA, a third party lender provides 50 percent of the financing, and the borrower provides at least 10 percent.

The program provides loans of up to $5 million and $5.5 million for certain industries. Hallmarks of the program include terms of up to 10 years for equipment and 25 years for real estate with a fixed interest rate. Additionally, the interest rates are below-market and make the 504 loan truly affordable financing. Since August of 2019, the effective interest rate on the 25-year term loan has been below 4 percent.

Coupled with the eligibility requirement that loan recipients create jobs or meet a public policy or community development goal, the 504 program provides small businesses with the capital and loan terms they need to be successful, while creating local jobs and building local economies. Since 1990, CDCs have secured low-cost, fixed-rate financing for nearly 200,000 U.S. small businesses and leveraged $118.5 billion to finance over $338.6 billion in total projects, which supported or created 3.1 million jobs.[2]

During this time of economic recovery, there are several policy issues that Congress should focus on to ensure the SBA lending programs are equipped to best support businesses and grow local economies. First and foremost, it is critical for the 504 program to remain open and viable to meet the capital needs of small businesses. In the wake of the COVID-19 pandemic, the 504 program is positioned to assist small businesses with what they need most: long-term, low-cost capital at a fixed interest rate that provides certainty in the most uncertain times.

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[2] Small Business Administration, 504 Freedom of Information Act (FOIA) Data. 7(a) & 504 FOIA - Dataset - U.S. Small Business Administration (SBA) | Open Data

As a result of increased small business demand for the 504 program, it reached its then-congressionally authorized cap of $7.5 billion on September 7, 2021, which effectively shut the program down for three weeks until the new fiscal year began on October 1, 2021. This three-week shut down of the program caused a myriad of issues for small businesses, including loss of real estate, escrow, and in some cases, jeopardizing their businesses.

As we moved into fiscal year 2022, the demand for the 504 program did not dissipate. I can speak to this first-hand – at the March 2022 funding a few weeks ago, SomerCor marked its largest debenture amount total in company history. From fiscal year 2019, the last true fiscal year before the COVID-19 pandemic, through fiscal year 2021, SomerCor saw a 74 percent increase in total dollars authorized and an 87 percent increase in the number of loans. Seeing the program's growing popularity and proven impact, we advocated with our trade association, the National Association of Development Companies (NADCO), to prevent another program shutdown. We recognized earlier this fiscal year the likelihood of reaching a $7.5 billion authorization for the 504 program sometime in the early summer of 2022. The damage to small businesses and to the future of the 504 program, if a three month shutdown occurred, cannot be overstated. As an industry, we are extremely thankful Congress worked together to include an increase to the 504 program authorization level to $11 billion for the remainder of fiscal year 2022. Because of your collective work and leadership, we can meet the growing demand for the SBA 504 program and support our nation's job creators as they expand their operations and investments throughout our communities.

It would be invaluable for Congress to take steps now to avoid a program shutdown in the future. A step in the right direction would be to combine the authorization levels of the regular 504 program and debt refinance without expansion program, so that all 504 programs are under the same authorization level of $15 billion. For context, no other lending programs at SBA have separate caps for different components of their programs. The regular 504 program authorization level includes both 504 loans and debt refinance loans with expansion, which are usually new projects with a small portion of existing debt being refinanced. In contrast, the debt refinance without expansion program is used to fully refinance an existing loan. This program was originally included as a temporary program in the Small Business Jobs Act of 2010 (P.L. 111-240) under its own authorization level as a tool to stem the damage to the commercial real estate market caused by the financial crisis that first devastated the housing market in 2007 and 2008. At that time, the debt refinance without expansion program was given its own authorization level of $7.5 billion and sunset in 2012.

Congress made the debt refinance without expansion program permanent in the Consolidated Appropriations Act, 2016 (P.L. 114-113) and carried over the $7.5 billion authorization levels included in the Jobs Act for both the regular 504 program and debt refinance without expansion programs, respectively. While we have seen some growth in the debt refinance without expansion program due to the welcome changes made by Congress in the Economic Aid Act (P.L. 116-260), the program has never come close to utilizing the $7.5 billion authorization. In the Consolidated Appropriations Act, 2022 (P.L. 117-103) recently passed by Congress, the debt refinance without expansion received a $4 billion authorization level and the regular 504 program received an $11 billion authorization. Previously, each program received $7.5 billion; combining the two levels would not increase the amount of authority provided to the programs, but allow flexibility for CDCs to lend from each of the three programs organically to meet the growing demand.

My second recommendation also pertains to the 504 program. Though conversations have been ongoing for years, the COVID-19 pandemic starkly highlighted supply chain and manufacturing shortfalls in the American economy. As an economic development program geared toward the acquisition of real estate and equipment, the 504 program is uniquely positioned to support capital intensive industries like manufacturing. Currently, we can provide a 504 loan of up to $5.5 million for manufacturers. I echo NADCO's support of the 504 Modernization and Small Manufacturer Enhancement Act of 2021 (H.R. 1490) that would increase the 504 loan for manufacturers to $6.5 million, decrease the borrower equity injection from 10 percent to five percent, and instruct SBA district offices to work with resource partners, like Small Business Development Centers (SBDCs), to provide training to small businesses in the manufacturing sector.

Though this sector makes up only 10 percent of U.S. gross domestic product (GDP), it drives 20 percent of capital investment, 35 percent of productivity growth, 60 percent of exports, and 70 percent of research and development expenditures by businesses.[3] Furthermore, according to the McKinsey Global Institute, growth and increased competitiveness in 16 key manufacturing industries could increase annual GDP by more than 15 percent.[4] Enhancements to the 504 program for manufacturers will contribute to this kind of growth nationally, which supports the CDC industry's collective effort to do our part to ensure a more resilient and dynamic American economy.

The statistics I just outlined are comprised of individuals, entrepreneurs, and family-owned businesses that build local economies and create jobs. One example is SomerCor client,

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[3] Padhi, Asutosh. Want to drive inclusive economic growth? Start with manufacturing. (January 12, 2022) *World Economic Forum*. Want to drive inclusive growth? Revive manufacturing | World Economic Forum (weforum.org)
[4] Manyika, James, et. al. Building a more competitive U.S. manufacturing sector. (April 15, 2021) *McKinsey Global Institute*. US manufacturing: Building a more competitive sector | McKinsey

Osorio Metals Supply, Inc., a second-generation family metal works business based in Chicago that supplies structural steel and iron products to contractors and fabricators.

Ruben Osorio started the business as a one-man operation in his garage. In 1992, he purchased his first location in the Humboldt Park community. For nearly 30 years the business remained in that space, until the family purchased a building around the corner to serve as the new headquarters. The new property is 30,000 square feet and more than double the size of their original location, allowing for streamlined operations and increased efficiency. However, the new property needed significant renovations to accommodate business operations. In a chance meeting at a National Association of Women Business Owners (NAWBO) Chicago event, Osorio Metals COO, Adriana Osorio, connected with SomerCor loan officer, Lis Williams. By working with SomerCor to use the SBA 504 program, Adriana accessed critical capital needed to complete building renovations and open the new location. "Being able to work with SomerCor to obtain a 504 loan was absolutely vital to the trajectory of our 5-year growth plan," said Osorio. "Acquiring a new facility and transforming the space to fit our needs has been a dream come true for our family business, and it would not have been possible without this program. We are grateful to the SomerCor team, who were as excited and motivated as we were, to help in our lifelong endeavor." Stories like these are why we do the work we do and why I feel so passionately about the 504 program and its ability to affect positive change in our communities.

My final recommendation pertains to another program that we offer and know makes a difference – the Community Advantage program. The CA program was created to fill a gap in the capital markets. One of the program's primary goals was to make it easier for small businesses to find affordable financing in the $50,000-$250,000 range, a loan size that is difficult to secure with conventional lenders. At SomerCor, we have seen small businesses use CA financing to cover operating expenses, pay for capital investments, and sometimes to even pay off exorbitantly high-interest rate loans that choke cash flow and jeopardize the viability of the small business. Notwithstanding its success, the CA program has been deemed a pilot program at the SBA since 2011. For the program to reach its full potential, both lenders and borrowers need certainty on the continuity of the program. I join NADCO in support of Congress making the CA program permanent with appropriate provisions to set the program up for success, like training for new CA lenders.

Moreover, I would be remiss if I did not bring to your attention the issue of liquidity and the fact that delivering CA program is especially difficult for non-depository institutions like CDCs and CDFIs. We use our own funds to make the loans and carry those loans on our books as non-profit entities. There are a number of ways Congress could address this issue; an example is what Congress chose to do during the pandemic and delivery of programs like the PPP – Congress allowed lenders to access the Federal Reserve discount window to help alleviate liquidity issues for non-depository institutions and small community banks. NADCO and I would look forward to a follow-up conversation on this and any of the issues I outlined in my testimony.

Again, thank you for the opportunity to testify today and dive deeper into the SBA programs CDCs deliver, and the impact we are making in the communities we serve.