S. HRG. 106–543

THE PRESIDENT'S FISCAL YEAR 2001 BUDGET REQUEST FOR THE SMALL BUSINESS ADMINISTRATION

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

FEBRUARY 24, 2000

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THE PRESIDENT'S FISCAL YEAR 2001 BUDGET REQUEST FOR THE SMALL BUSINESS ADMINISTRATION

THURSDAY, FEBRUARY 24, 2000

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to notice, at 9:05 a.m., in room SR–428A, Russell Senate Office Building, the Honorable Christopher S. Bond (Chairman of the Committee) presiding.

Present: Senators Bond, Kerry, and Wellstone.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, SENATE COMMITTEE ON SMALL BUSINESS, ANDA UNITED STATES SENATOR FROM MISSOURI

Chairman BOND. Good morning. The Senate Committee on Small Business will come to order. We are very pleased to welcome SBA Administrator Aida Alvarez who will be testifying this morning as we focus on "The President's Fiscal Year 2001 Budget Request for the Small Business Administration."

I have been advised by minority staff that my good friend and colleague, Senator Kerry, is probably caught in traffic somewhere so we will give him the metropolitan excuse and go ahead without him. We are delighted that Senator Wellstone has joined us.

This hearing, for everyone's information, is being web cast, which means that audio and video is being broadcast live on the Internet. I join in welcoming all our viewers who have logged on this morning. We appreciate your joining us through the marvels of modern technology.

This is the beginning of my sixth year as Chairman of the Committee on Small Business. During this time, small businesses throughout the United States have demonstrated daily why they are recognized as the backbone of our Nation's economy. Year in and year out, thousands of new businesses are started, many growing very rapidly, creating jobs, new investments, and hope and dreams for families everywhere.

The energy exuded from a vibrant small business is contagious. Once caught up in the entrepreneurial spirit, it is very hard to let go. It is no wonder that delegations from all over the world are studying the success of small business in the United States. I find as I travel around the world they want to know what the secret is for having a strong SME—or a small- and medium-size enterprise part of the economy. I tell them, for the most part it is getting

Government out of the way. But there are certain areas in which Government can be a very positive force.

As we focus our attention on the Small Business Administration and its budget for FY 2001, it is helpful to reflect on the successes of the Agency. The foundation of the Agency rests on its credit and management assistance programs. During the past decade, we have experienced enormous growth in the 7(a), the 504, the Microloan and the SBIC programs. Tens of billions of SBA-guaranteed dollars have been loaned or invested in small businesses. The SBDC and SCORE programs have allowed the SBA to deliver management assistance and counseling to millions of small business owners and budding entrepreneurs.

The Administration's budget request has proposed ambitious plans for various new initiatives. I am pleased the President's plan counts the HUBZone program as part of the New Markets Program. As many of you know, the HUBZone program was created and approved by this Committee and the Congress and signed into law by the President in 1997. The SBA did not begin implementation of the HUBZone program until March 1999 and is now requesting $5 million to expand its staff and outreach efforts to promote the program.

I urge the SBA to take advantage of its excellent resource partners to increase opportunities for potential HUBZone small businesses. For example, there must be at least 1,000 centers and subcenters in the SBDC program, and I would like to see the SBDCs more active in distributing information about the program. I would hope that the SBA HUBZone office could provide each SBDC location with information about the HUBZone program that would be provided to small businesses that are seeking help.

Senator Kerry and Senator Wellstone each have a bill pending before the Committee addressing the community development venture capital proposals. In addition, SBA officials recently provided the Committee staff with a briefing promoting this initiative.

The SBA attempted to explain why the current SBIC program was not reaching all those companies that needed venture capital and singled out San Jose, California, as a community in need of help from the New Market Venture Capital program. The SBA stated that investments made by SBICs in San Jose had not helped the local economy but were really focused on promoting the growth of "dot.com" businesses in the high tech Silicon Valley. Let me take a moment to review the San Jose situation.

Over the past 3 years, SBICs made 98 investments totaling $67 million in 37 small businesses within the San Jose city limits. SBIC investments are creating jobs and generating more spending in San Jose. But somehow, the SBA has determined that these SBIC investments and these new jobs are not helping the local economy. This is counterintuitive. If we could get the same kind of investment in my home town of Mexico, Missouri, we would be extremely happy to have the kinds of problems that San Jose is facing. I assure you, we could deal with them.

The SBA's fiscal year 2001 budget request also sets forth very ambitious plans to (1) expand its core programs and (2) transform the Agency to meet the challenges of the 21st century. The SBA must surpass many hurdles to make this transition a success. At the same time that the SBA is attempting this reinvention, it wants to roll out new programs that require increases in both staffing and budget.

Based on what has been presented to the Committee to date, I have serious reservations about encouraging the Agency's plan to expand its core programs, *while* transforming itself to meet the challenge of the 21st century, *while at the same time* introducing new initiatives.

As we discuss the future of the SBA, I cannot ignore the impact this proliferation of new programs could have on the core programs of the SBA. Congress has approved substantial budget increases for the Agency in recent years. However, I have received reports from the SBA that offices supporting key technological SBA programs are underfunded or understaffed. As the SBA shifts its responsibilities to meet the demands of the 2lst century, I am concerned that the human capital tools may not be available.

In other words, I have no doubt that the SBA has a vision for its future. What I am concerned about is that the Agency lacks a formal written strategy to achieve its vision while ensuring that its core missions are operating efficiently, effectively, and economically.

Let me dissect this concern for a moment beginning with the SBA's core missions and the programs it wishes to expand. Such expansion does not happen without growing pains and change, which can be difficult on a large organization. In addition, we have to be honest, the SBA core programs are not operating flawlessly. As you are aware, during the past year the Committee received reports critical of the SBA's performance in a number of core mission areas.

No. 1, GAO issued a report critical of the SBIR program. No. 2, the Inspector General prepared an audit critical of the 7(a) program. No. 3, the Farm Credit Administration report on the SBLC program was critical of SBA's management of the program. No. 4, while the SBA's auditor gave the Agency an unqualified opinion for its fiscal year 1998 financial statements, the auditor cited three material weaknesses, which call into question the SBA's internal controls designed to reduce the risks in its operations.

Welcome, Senator Kerry. I already explained to them that you had problems in traffic. Does that work?

Senator KERRY. Well, it is as good as anything.

[Laughter.]

Chairman BOND. All right, that will work. Close enough for Government work.

Three years ago, many of us were enthusiastic about the prospects for an SBA computer system that could monitor its loan programs and the lenders that participate in the program. We wanted to assist the SBA in meeting the challenges of the 21st century. As the Agency turned over many loan activities to its lending partners, it would finally have the resources to oversee the lenders.

In the past 3 years, Congress has appropriated $24 million for the so-called Loan Monitoring System. Development of this computer system is critical for the future operations and success of the Agency. However, planning for the first iteration has not been completed.

Just yesterday, I have received a letter from the General Accounting Office about the status of ongoing planning for the Loan Monitoring System. GAO confirms the SBA's failure to meet its own deadlines. After 3 years, the initial planning phase is not yet complete despite the fact that the SBA has advised the Committee that it is anxious to implement the system.

The GAO letter is a good status report of the Loan Monitoring System development, and I encourage my colleagues on the Committee to review it. If there is no objection, I will include the GAO letter in the hearing record. I trust that you all have received a copy of this letter.

[The letter follows:]

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Chairman BOND. The changes confronting the SBA today are enormous just to expand core programs and meet the challenges of the 21st century through, among other things, a new Loan Monitoring System. With these two challenges in hand, I hope we will hear from you, Madam Administrator, about how the Agency intends to address its "Human Capital" issue related to these two challenges at the same time it proposes rolling out a plethora of new programs.

I recognize and commend your commitment to small business, Administrator Alvarez, but I do remain concerned with the SBA's ability to expand its core programs which are not operating optimally now, to transform itself to meet the challenges of the 21st century, and to initiate a series of new programs all at the same time.

I learned a long time ago that it is not very wise to build a house on wet cement. You have to let the cement dry and set before you build on it. That is what I am concerned that may not happen here. Let us make sure that our core programs are operating really well. I do not want to see anymore critical audits or reports or evaluations. Let's get the Loan Monitoring System off the ground. Then we can turn our attention to new programs.

Before calling on the Administrator for her testimony, I welcome the Committee's Ranking Member, my good friend from Massachusetts, Senator Kerry, to make his opening comments.

Senator.

OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, RANKING MEMBER, SENATE COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you. Thank you very much. I do apologize for being late. Senator Levin is not here nor Senator Lieberman. We were down at the State Department at a meeting, and I appreciate your indulgence. And there was some traffic between here and there.

[Laughter.]

Senator KERRY. Administrator Alvarez, thank you for joining us today. We are delighted to welcome you back here to the Committee. In my judgment, you have sent the Congress a good budget. I think the growing demand for the SBA's programs is a reflection of the effectiveness in the way in which those programs are being administered. And also a reflection of the prosperity in the country—the roll that we are on, and the increased opportunity that has been created.

I think your budget is realistic, and I think it is appropriate, not just with respect to the existing programs, but the new programs. I think we may obviously have some differences here, and I hope we can work through them because I do not think it is that provocative, or that challenging, to be honest with you.

I think it is a smart budget. First of all, it eliminates the controversial funding mechanisms for the disaster loan program and the Small Business Development Centers that have been a bone of contention in the past between appropriators in Democratic and Republican Administrations. I think this important change will set the tone for more a favorable appropriations process and allow the Agency to focus on the mission of helping small business owners who cannot access traditional capital or training programs.

Perhaps it comes as no surprise that I do support the new markets component of the budget, and I want to just say a few words about that. There is $52 million in here for the New Markets Venture Capital Program, and I think if you examine what has been happening in certain parts of the country—Massachusetts happens to be one of them—you would see the power of venture capital. This is not a special kick for us in any sense, because we have done very well. We are one of the financial centers of the country. We have more private capital managed in Boston than any other place in the world, and it is reflected in the venture capital efforts that are taking place there now. Likewise, California, Texas, Florida. Different States have fared better than others. And many States—Senator Wellstone's State—and other States are all increasingly witnessing the power of this technology revolution, of globalization, and of venture capital and the impact that it is having on small businesses.

We know that when you have a strategically-targeted effort combined with appropriate management assistance, we really have the potential to organize and improve the economic infrastructure of our poorest communities. It has to be a matter of conscience. I cannot believe it is not, to Republican and Democrat alike, that at this time of remarkable growth in the Nation. There are pockets that just do not share in our strong economy at the proper rate or sometimes at all.

Now, if ever there was a moment for this country to use the power of capitalism effectively, in an enlightened way, to reach into some of these communities, it is now. If you cannot do it now, how are you going to do it if we are in a downturn, the budget is being squeezed, and we are reducing or having to cut and we do not have the surplus? Countless business scholars—I would ask a little indulgence on the light, if I can.

Chairman BOND. I went over by 30 or 40 seconds, so you can go as long as you want.

Senator KERRY. I do appreciate that.

Senator WELLSTONE. Senator Kerry, don't you believe him for a moment.

Senator KERRY. You did not hear what he said; I can have as long as I want.

Senator WELLSTONE. I cannot wait for my time.

[Laughter.]

Senator KERRY. Let me just share with you very quickly, Mr. Chairman. Two of our respected business scholars, William Bygrave and Jeffrey Timmons at the Harvard Business School and Babson College said that venture capital is really responsible for having driven the success of the country over the last 20, 30 years. All of us understand that the reason we are holding inflation down and the reason we are growing at the rate we are growing, is principally because of the productivity increases that are coming by virtue of technology.

Second, Michael Porter at the Harvard Business School has written extensively on competitiveness, and he said that ". . . inner cities are the largest underserved market in America, with many tens of billions of dollars of unmet consumer and business demand."

Third—final point—rural areas in this country are grossly underinvested. In 1998, of the $59 million in true low- and moderate-income investments made by SBICs—meaning those investments less than $1 million made in low- and moderate-income areas—less than $1.1 million out of that total went to rural areas. So, under the Community Development and Venture Capital Act legislation that I introduced last September, many rural areas would qualify as low- and moderate-income communities eligible for Community Development Venture Capital investments.

I would submit for the record, Mr. Chairman, maps of Montana and Georgia that speak volumes about the need for investment in those rural areas.

Chairman BOND. Without objection, they will be included.

Senator KERRY. Thank you, Mr. Chairman. We have seen that the existing venture capital program of the Small Business Administration, the Small Business Investment Company program, has really proven to be one of the most successful private-public partnerships that we have in the country. Over the life of the program SBICs have generated $26.6 billion in 12,000 financings of high-growth small businesses. And over the past 5 years, since the participating securities program was initiated, $131 million in profit has been returned to the Treasury of the United States.

It simply makes sense to continue that, expand that program to reach these other communities. These results really need to be spread throughout the country, and I hope that when we reauthorize on March 21, we can put this venture capital program to use around the country.

Now, let me just say very quickly, I am glad to see that the funding request for e-commerce initiatives has also increased, Madam Administrator, to $5 million. I think it is a modest investment compared to the value of the e-commerce market. It is estimated that every single day 90 million people now are using the Internet around the world. And it is increasing every day. For the past 5 or 10 years there has been just a stunning shift that all of us are still trying to catch up to in this kind of business.

Wearing my Commerce Committee hat, I have been meeting with a lot of the CEOs across the country. Yesterday, for instance, with Mike Armstrong at AT&T, one of our most established companies, they are scrambling to keep up with and get ahead of this new curve. And the impact for small business in terms of B2B, business-to-business opportunities, is where most people say most of the gain is going to come. It is just extraordinary.

So I think we need to stay ahead of that curve. I am also pleased about your $1.5 million for the Office of Advocacy. Last year Senator Bond and I wrote a letter to the appropriators requesting $2.5 million, and there was unanimous consent at the roundtable on advocacy last year that the office needs an increase. So I am glad we are doing that.

There are other efforts I would laud here, but rather than chew up our time, I would ask unanimous consent to have the full text pleased in the record.

Chairman BOND. Without objection, it will be.

Senator KERRY. Thank you, Mr. Chairman. Let me just close by saying, I want to emphasize that the SBA's loan and investment programs are an extraordinary bargain. The taxpayers leverage their money in a remarkably effective way to help thousands of small businesses every year fuel the economy. In the 7(a) program, taxpayers spend $1.24 for every $100 lent to business owners, and we have seen extraordinary successes of companies like Ben & Jerry's and Winnebago, as some examples of the program's effectiveness.

In the SBIC participating securities program, we spend $1.31 for every $100 leveraged for investment. Again, companies like Staples, Callaway Golf, Federal Express, Apple Computers. These are all stellar examples of this kind of investment.

With the 504 program, we do not spend a penny to lend or to leverage. The program is funded through fees. So I think we have done a great job of pulling a bipartisan consensus here together. My hope is we will be able to do that again with community development capital. I hope, Mr. Chairman, that we can get all of the subjects contained in this one hearing. It is a little unusual to try to do this all at one hearing. I am willing to try to do it. But I would hope that if we have some subjects that somehow are not adequately explained, we reserve the right to revisit it before we mark up so that issues will get a proper hearing if there is some sense that there is contention about them, or we do not have the ability to move forward. I thank the Chair.

[The prepared statement and attachments of Senator Kerry follow:]

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Chairman BOND. Thank you.

Senator KERRY. Now one just quick thing. Senator Levin specifically asked me if I would read his statement—just 1 page.

OPENING STATEMENT OF SENATOR CARL LEVIN, A UNITED STATES SENATOR FROM MICHIGAN, AS READ BY SENATOR JOHN KERRY

Senator KERRY. He says, "Mr. Chairman, I apologize that conflicting hearings make it impossible for me to participate in this morning's hearing. A program of particular interest to me is the SBIR program. I hope we can reauthorize that important research and innovation program as soon as possible.

As part of that reauthorization, I appreciate the Chairman's working with me to draft legislation to create an outreach program to increase participation in the SBIR program that will be available to all States. I hope to incorporate my volunteer mentoring idea into this outreach proposal. Mentoring provides an excellent complement to outreach. Through outreach we would let more small, high-technology companies know about the SBIR program, and through mentoring we would help them improve their odds of achieving success.

The SBA also has a proposal to improve the SBIR program that I hope we can work on together."

Chairman BOND. Thank you very much, Senator Kerry. We appreciate Senator Levin being with us by statement.

Senator KERRY. Finally, I ask unanimous consent that a statement by Julia Sass Rubin on New Market Venture Capital be placed in the record.

Chairman BOND. Without objection, I would be happy to do so.

[The statement of Ms. Rubin is in the COMMENTS FOR THE RECORD.]

Chairman BOND. I might just add, on the many subjects that we have before us today, we noticed the conflict in hearings and the difficulty in making sure that we have a full membership of the Committee together. That is why last year we began the roundtable process. The roundtables have gone into great detail in going through the various specific areas of SBA activity.

I have found, and the staff has found, these to be extremely helpful. Senator Kerry and I have attended parts of them. A number of our colleagues, I am afraid, have not fully appreciated the importance of this. I am going to join with Senator Kerry and urge all of our colleagues to make sure that staff is present for the roundtable meetings. We know the pressures of the Senate schedule, and we all serve on at least two A committees that have hearings at the same time so we cannot be here. But I would hope that staff for all Committee Members would make it a point to attend the roundtable meetings.

For the effective functioning of the Committee, it is important that we at least have staff participation, because in a Roundtable there is a lot more information than we can cover than in a hearing. But as you will note today, there are three Members for what we had hoped would be one big markup with as many Members attending as possible. So I share your concern, but we need to make sure we have all the Committee Members involved.

With that, let me turn—for his lengthy opening statement—to my colleague from Minnesota, Senator Wellstone, who has up to a whole 5 minutes, if you want it.

OPENING STATEMENT OF THE HONORABLE PAUL WELLSTONE, A UNITED STATES SENATOR FROM MINNESOTA

Senator WELLSTONE. Mr. Chairman, I promise to keep my remarks under an hour.

[Laughter.]

Chairman BOND. Senator Wellstone, I would say you have been one of the most faithful Members in attending all the hearings and we do appreciate your participation. You have been a very important contributing Member of the Committee.

Senator WELLSTONE. I appreciate your gracious remarks.

Let me welcome Administrator Alvarez. Let me say that I think it is a good budget. I am glad that you maintain and build the funding for some core programs. The 7(a) and 504 programs have been tremendously successful in our State of Minnesota. Ed Dahm runs a great operation. We have a terrific working relationship between the small business community and the SBA office and I want you to know that.

The other thing you do is you find some room for some creative solutions to deal with communities, as Senator Kerry said, that have been left behind. In some ways it has been an uneven recovery and it is painful to see the economy booming while at the same time there are literally communities that do not share in this prosperity, and I appreciate that focus.

Let me in particular focus on one program, and that is the request for funding for the New Markets Program. As you know, Mr. Chairman, 2 years ago as a part of the Small Business Programs Restructuring and Reform Act of 1998, I had a proposal that was in there, and the Committee supported it, which was called the Community Development Venture Capital Demonstration Program. That program was passed by this Committee, later on by the full Senate, but we did not get it done in the House.

I reintroduced that legislation last year because I think my proposal and the New Markets Venture Capital initiative complement each other. In fact, Senator Kerry has been good enough to include my legislation as a part of his overall initiative, and I am very pleased with that.

I think what I need to do today is to say that I hope we can work together. I heard the Chairman's remarks, have respect for what he said. I want to put myself on record that I certainly will have an amendment here in Committee to add this Community Development Venture Capital Act to the SBA Reauthorization bill. Or if Senator Kerry introduces his bill as an amendment, then that would be the effort, and I would prefer to join really with my colleague from Massachusetts. But I think, Mr. Chairman, that as Senator Kerry said, we ought to be able to work this out. I really do not think the differences are that great.

To just highlight one of those, I agree with what you said about these roundtable discussions. On May 18 of last year we had a roundtable discussion on SBA equity programs, and we had a great 45-minute discussion and there were, I think, some perceptive comments made from folks like Don Christenson at SBA, Julia Sass Rubins at Harvard University, in support of these proposals that I am talking about.

Plus we had folks that are out there doing this kind of work right now, Nick Smith with Northeast Ventures in Minnesota, Ray Moncrief of Kentucky Highlands, and Elyse Cherry in Boston. They were very supportive of this initiative. I also would recommend that our colleagues be sure to read, at least get their staffs to read the record and look at that discussion because it was, I think, very important.

Finally, I would commend you, Administrator Alvarez, for the increased funding for the Microloan program, and also the technical assistance. I think that the doubling of funding in both areas is justified because what we find out in Minnesota, it is a heart and soul program. Some of these Microloan businesses are just fabulous. I mean, so inspiring. But the one thing that happens quite often is without the technical assistance they do not succeed. I think the two go hand in hand, and I think you are right on target.

I want to note one request in this budget that has not been mentioned, Mr. Chairman, and that is the request for $3 million out of the proposed $85 million small business development center to establish a Native American small business development center network. This network would focus on providing the assistance to Indian reservations, the training, the counseling, the technical assistance.

I think we really need to get out there in Indian country. I come from a State with a significant presence of Native Americans and I think that proposal is right on target. I am also a member of the Select Committee on Indian Affairs and I just want to indicate to you my strong support.

I think I stayed under 5 minutes, Mr. Chairman.

Chairman BOND. Thank you very much, Senator Wellstone. Now we turn to Administrator Alvarez. Welcome.

THE HONORABLE AIDA ALVAREZ, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.; ACCOMPANIED BY CHARLES D. TANSEY, ASSOCIATE DEPUTY ADMINISTRATOR FOR CAPITAL ACCESS; KRIS MARCY, CHIEF OPERATING OFFICER, SMALL BUSINESS ADMINISTRATION; RUSSELL ORBAN, ASSISTANT CHIEF COUNSEL FOR ADVOCACY; AND JAMES BALLENTINE, ASSOCIATE DEPUTY ADMINISTRATOR FOR GOVERNMENT CONTRACTING AND MINORITY ENTERPRISE DEVELOPMENT, SMALL BUSINESS ADMINISTRATION

Ms. ALVAREZ. Thank you very much. Good morning, Mr. Chairman, Senator Kerry, Senator Wellstone.

I appreciate the opportunity to testify here today on behalf of the SBA's fiscal year 2001 budget. Before I begin, I want to say, Senator Bond, that I do believe many of the concerns you raise are actually addressed in my testimony, and obviously, I would be happy to discuss them. I do have one concern that is not addressed in my testimony and that is the GAO letter that you mentioned. You said you received it yesterday. I have not seen this letter. I understand that GAO sent a draft, unsigned letter to the SBA which, as I said, I haven't seen and I request that the Committee hold the record open for the SBA to fully respond to the letter. I would like our letter to also be a part of the record of the hearing.

[The letter appears in Exhibit 2 of the APPENDIX.]

Chairman BOND. Without objection, that will be. We asked them for a quick status report and they had advised us they had received a response from your Agency just as a partial update on it.

Ms. ALVAREZ. I would appreciate that.

Chairman BOND. They apparently have had some discussion with officials in there but obviously you are welcome to submit a more extensive statement since this is an ongoing program, so, we will be happy to have further comments on it.

Ms. ALVAREZ. Thank you very much.

And also with regard to our modernization effort, I will in my testimony address the progress we have made, which has been significant. We did have a meeting yesterday. My Deputy met with senior GAO auditors and, frankly, I am surprised to hear your statement because we have made enormous progress working with them every step of the way as well as with the IG. And, at the meeting yesterday, they underscored the progress we were making. So, again, it is something that we can revisit, and I do discuss it in my testimony.

Senator Kerry and Senator Wellstone, you have made a very compelling case for the New Markets Initiative, which is actually a bipartisan effort. I know that you mentioned the HUBZone program is a part of the New Markets Initiative because the thinking, the objectives of the HUBZones program is totally consistent with what we are trying to accomplish with new markets. And I know that Speaker Hastert has been working with the President on behalf of a New Markets Initiative.

Senator Kerry has introduced a bill which I believe does include Senator Wellstone's proposal, and I am pleased to say that I was just informed yesterday that on the House side Congresswoman Valazquez, working with Jim Talent and Peter King and a number of other members from both sides of the aisle are prepared to present shortly their version of the New Markets Initiative.

So, I really hope that we can work together. I think there is a recognition across the Congress that this is an opportune moment to address unmet needs and we feel that it is the role of the SBA, always has been, to address the gaps and not be satisfied with our success to date but continue to indentify new frontiers, new areas, like these new markets, where we can make a difference.

With respect to our new budget, it has to be put, I think, in context—and Senator Bond, you, and the other Senators as well, addressed the fact that this is a booming economy and, in fact, so much of this economic expansion is actually being fueled by small businesses; 25 million in the United States, which is 5 million more than in 1990 and the most ever in this country. There has been tremendous growth, for example, among Hispanic-owned businesses, African-American-owned and Asian-American-owned businesses. The number of women-owned businesses has doubled to nearly 9 million and they are now generating over $3 trillion in revenues. The biggest job creators in this country are small businesses.

To keep pace with that growth and also to help America's disaster victims, I am requesting a budget for the fiscal year 2001 of a little more than a billion dollars. This budget would fund record levels of loan and venture capital assistance. It would expand management and technical assistance for America's small businesses and it would also allow us to continue our mission of assisting disaster victims. Last year we approved 36,000 loans a for a little more than $900 million, which helped retain—our loans to businesses—helped to retain 35,000 jobs. And this year we are requesting full funding for our disaster program, which is $296 million, up from $276 million.

As I mentioned, our budget request would fund record levels of lending and venture capital. Let me just address our needs in the area of our loan programs. In fiscal year 1999, the SBA guaranteed 50,000 loans and approximately one-third of those loans, 7(a) loans, went to startup firms less than 24 months old. That is very important to help the most vulnerable and the most promising of small businesses. We have, since 1992, more than doubled our lending to minority-owned businesses, while tripling our lending to women-owned businesses. We are addressing a very important need in the area of equity capital and in 1999 our Small Business Investment Companies accounted for over half of all the institutional-venture capital transactions in the United States; an estimated $4.2 billion. And I think that is a remarkable success for that program.

For our core programs we are requesting $274 million to deliver more than $20 billion of credit, venture capital, and technical assistance, up from $17 billion this past year. It includes an $11.5 billion program level for the 7(a) program, up from $9.8; $3.75 billion in 504, with a reduced guarantee fee for the fourth year in a row; $60 million, a doubling for the microloan program; $45 million for microloan technical assistance; and we propose a $2.5 billion program level for the SBICs. We expect this investment to attract an additional $1.25 billion in private capital. With 3.75 billion in new SBA-leveraged funding, plus their on-hand private capital, we are looking to hopefully see $4.5 billion in investments in fiscal year 2001.

And, as you mentioned, Senator Kerry, the SBIC participating security program is producing returns; $131 million to the Treasury as a taxpayer's share of their profits.

I think to really appreciate the success of the SBA in assisting small businesses, we need to take a step back and look at the big picture. Since 1992, the SBA has backed more than $71 billion in small business loans and venture capital, which is more than in the previous 25 years combined. This is an amazing success story and it is no wonder that representatives from countries around the world are flocking to the SBA asking us, "How do you do it?" This is clearly because small business is the engine of the economy and the role that the SBA plays is critical as a catalyst and a facilitator of this success.

In the area of procurement, small businesses achieved a 22.4 percent share of the procurement goal and obviously, Mr. Chairman, we have talked about this, our goal is 23 percent and we are working to make sure that that is what happens. Last year we were pleased to launch the historically under-utilized business zone program, HUBZone program. I am proud to say that nearly 900 businesses are now certified as HUBZone firms. We are requesting $5 million, up from $2 million, to continue to develop HUBZone contracting.

SBA's Office of Advocacy has done a fine job, especially in showing Federal agencies how to achieve their policy objectives without placing an undue burden on small businesses. Their research and database is a national resource and we are requesting an increase of $400,000 to $1.5 million.

In his State of the Union address, President Clinton repeated his belief, which we have heard repeated here today, that more must be done to extend the benefits of today's economy to our inner cities, our poor, rural areas and Native American reservations. As I said, I am pleased to see the bipartisan support. When I met with Congressman Hal Rogers the other day he said to me, "You know, this New Markets Venture Capital program will help my district." He recognizes the role that this venture capital program will have in rural communities. And, so, I think there is a lot of enthusiasm for the possibilities here.

I want to talk a little bit about what it is going to take to fund this program and why it is worth the investment. To establish the New Markets Venture Capital companies we request $21.6 million, which would support a program level of $150 million. We are also requesting $30 million for the technical assistance component, again, it is the small-sized equity investments plus the technical assistance that are the key to the long-term success of the new markets businesses. We arrived at the cost of this program by using the most conservative assumptions possible. We believe having studied other of our programs, which started out with a higher cost, that it is just a matter of time before the cost of that program will go down. We want to make sure that we are very safe in how we approach the program. I do think that the long-term benefits are impressive.

You mentioned the success that we have had in San Jose with our Small Business Investment Company program. We are very proud of the fact that investments are being made in San Jose. Some of those investments came about because we developed low- and moderate-income debentures, which we saw as another way to give incentives to those venture companies to make these investments. The fact of the matter is that our SBICs are for the most part profit-oriented, as is appropriate. But when we are talking about New Market Venture Capital companies, we are talking about companies that will not so much be profit-oriented as mission-driven. The kinds of investments that New Market Venture Capital companies will make are really going to be quite different from those that our SBICs are making, whether it is in San Jose or elsewhere.

Here is what the picture looks like right now for these smaller type of investments that we are proposing in the New Markets program. Right now there are virtually no institutional sources of equity-type capital in these distressed communities. We are talking about distressed communities. San Jose has distressed neighborhoods, but, for the most part, I wouldn't characterize it all as distressed. Nationwide the community development venture capital industry consists of essentially 25 firms with about $157 million under management. Out of these 25 firms only 14 of these funds are capitalized at $5 million or more, which we believe is the absolute minimum for economic viability. Our own analysis of these community development venture capital companies indicates that one direct job is created for each $10,000–$15,000 equity investment. On this basis, $51.7 million should generate between 13,300 and 20,000 direct jobs at a cost of between $2,600 and $4,000 each. If the indirect jobs are included, the cost is even less.

We believe that this investment in new markets will ultimately pay off in a big way. These investments will not only create capital for those businesses but will generate employment in places that are suffering now from a lack of jobs, very consistent with the objectives of the HUBZone program.

The SBA is requesting funding for other New Markets Initiatives as well; the PRIME program, which was passed last year and signed by the President at the end of the session of Congress. Again, this is a program focused on technical assistance, $15 million to build the capacity of the micro-enterprise industry, generally. We believe that this is a very good complement to our new market strategy. Our new market strategy is clearly focused on newer, smaller businesses, first-time entrepreneurs located in communities that have been overlooked. They need not only the money, they need the technical assistance to make it.

Then $6.6 million for BusinessLINC. We have already had a successful sort of kickoff of BusinessLINC which is a way in which big businesses work hand-in-hand with small businesses. Senator Kerry mentioned AT&T. There are many big companies that can play a great role in working with small businesses.

Native American communities, Senator Wellstone mentioned Native Americans. The figures for Native Americans are really shocking. Many reservations, have between 40 and 60 percent unemployment rates; 53 percent of Indian homes on reservations do not have a telephone. These are the kinds of needs we are trying to address with a budget that proposes $5.75 million for Small Business Development Centers, for BusinessLINC and for Tribal Business Information Centers.

You spoke extensively about the area of safety and soundness and human resources management and modernization, areas where we have spent considerable time and effort to continue to make progress and keep pace with the needs. We feel very confident that as our core programs have grown, which has been in response to the overall growth of small businesses and the economy, we have actually become more sophisticated than ever in addressing safety and soundness and loan monitoring concerns.

Let me just briefly outline the steps that we have been taking to ensure that we can combine our interest in sustaining this unprecedented growth by increased funding for our core programs as well as identifying the new markets and penetrating there.

In fiscal year 1999 we instituted a safety and soundness examination for the Agency's Small Business Lending Companies and examined all 14 companies. This had never happened before. This was the first time. We are already on to the second round of reviews, which we expect to complete in September. The issues and deficiencies that were raised in the first round, for the most part, have already been addressed by the institutions.

We have also established, as you know because we advised you when we were about to do this, the Office of Lender Oversight, and we have a risk management committee, again, a first at the SBA. We have completed our first full cycle of reviews for participants in the Agency's Preferred Lender Program and we expect to complete a second round of reviews by April. Again, this is something that has not occurred before.

We also are requesting an increase in funding for the Inspector General to $14.3 million. We have worked hand-in-hand with them every step of the way on these initiatives and we support their need for funding to continue to review, audit, and provide oversight of SBA's programs and services.

Our core program for small business counseling and technical assistance, the Small Business Development Centers, helped more than a million entrepreneurs in fiscal year 1999 alone. I am very pleased to say that for fiscal year 2001 we are proposing full funding of $88 million for the SBDCs, and as Senator Wellstone said, $3 million to fund an SBDC network for the Native American communities. We think this is a step in the right direction, part of the New Markets Initiative.

For SCORE we propose $5 million, up from $3.5 million. SCORE is doing a great job. They are doing on-line, interactive counseling with small businesses. To meet the growing demand of today's women entrepreneurs, SBA's Women Business Centers have more than tripled in 3 years, growing from 18 funded centers to 59, including 25 new centers in fiscal year 1999, lots of activity, lots of work with women. We request $12 million up from $9 million this year, to expand the network to more than 80 sites. Our goal is to have at least one Center in each State.

SBA requests $10 million to maintain our existing One-Stop Capital Shops and to open new ones in Empowerment Zones. Empowerment Zones, as you know, are located in HUBZones and they also include our targeted new markets communities.

Veterans, we are very pleased that we are asking for $4 million to support initiatives to assist veterans in their entrepreneurial activities, particularly, service-disabled veterans. 7(j) technical assistance, which is a program that really is important to assist particularly minority-owned businesses to enhance their business development and executive education, we are asking for $5 million.

Senator Levin, in his letter, addressed the needs in the area of technological small businesses through the Small Business Innovation Research program, SBIR. We have been helping these small businesses get to a point, Phase III we call it, where they have fully developed their federally-funded products but they lack the necessary capital to market and commercialize the technology. Phase III funding would provide grant dollars to assist them to make that transition into the commercial market place. We request $15 million in grants for fiscal year 2001 to fund the first year of a 3-year SBIR Phase III pilot program which would commercialize the R&D effort of small, high-tech businesses.

Mr. Chairman, our focus is on the success of our small business customers, as it should be; however, I would like to brag a little bit about the success of this small agency. SBA's workforce and the way we deliver programs have changed dramatically over the past decade. Since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time the number of our employees has decreased 22 percent, from 4,000 in fiscal year 1990 to about 3,100 now.

We have involved the private sector where it made sense, contracting out or delegating activities that could be performed more effectively elsewhere. This transition has allowed us to downsize as well as to use staff strategically for marketing, more complicated financial transactions, and loan monitoring, for example, and it has involved training and retraining, which is part of our human resources management. We do have written plans that address the training and retraining needs and, in fact, we have a record of some of the types of training that our senior managers, middle-level managers, people in the field have already received in order to make this transition. We would be happy to share that with you.

All of this has been accomplished while keeping our fiscal house in order. We are proud to report a clean opinion in fiscal year 1998 in our financial audit report, which is the highest rating a Federal entity can receive. This was the third year in a row the SBA attained this rating, and we also expect to obtain a clean opinion when our 1999 report is issued on time next week.

We have laid out an aggressive agenda to improve our internal management and infrastructure. You mentioned $24 million. And $13 million for systems modernization and lender oversight, risk management activities; $7 million for information technology infrastructure support; $4 million to train and transition our workforce. We have spent 2½ years developing plans as required by law which require that we have very detailed plans that outline step-by-step what we will do before we acquire any systems, which is the reason why we haven't done some of this yet. But we have completed those plans working with GAO and with various committees. I am happy to say that we have almost completed the first part of Phase I of our modernization effort. That will be completed and implemented this summer.

For the first time this summer the majority of loan transactions will be processed electronically by the SBA. This will represent 69 percent of our loans and 79 percent of our loan dollars. Not only will this create enormous ease and efficiency in a paperless transaction, it will also allow us for the first time to collect data electronically that we have never been able to collect before, which will help us with lender oversight and loan monitoring.

Senator Kerry mentioned e-commerce, $5 million, and our budget includes, I think, a modest amount to ensure not only that we provide even more of our services electronically—we have 6 million hits a week on our web site. We are doing electronic counseling—we also want to ensure that small businesses can participate in the opportunities created by e-commerce.

We want to build on the success of the Y2K outreach initiative which, thanks to your help and that of your colleagues, allowed us to hold 1,300 workshops on Y2K which were attended by 1.1 million small businesses. These are all small businesses engaged in the topic of technology as it affects their businesses. There is a need and an interest, we want to build on that, we don't want to lose the momentum. The e-commerce, the $5 million request, will help us continue that effort.

So, in conclusion——

Chairman BOND. Madam Administrator, I was just going to say we have been a little generous with the 10-minute light. Unfortunately, Senator Kerry and I both have competing meetings and hearings. The Murphy's Law, which said, if anything can go wrong, it will go wrong, was a gross overstatement and optimistic assessment of Senate schedules. We would be delighted to have your full comments that you have submitted for the record, and I would like to give Senator Kerry an opportunity to ask any questions before he has to leave.

Ms. ALVAREZ. Absolutely.

[The prepared statement of Ms. Alvarez follows:]

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Senator KERRY. Mr. Chairman, thank you very much.

I really do apologize.

Ms. ALVAREZ. No, that is OK. I had hoped to answer a lot of the questions that might be raised in the course of the testimony. That is why I took a little longer.

Senator KERRY. I would like to ask permission to submit any additional questions in writing.

Chairman BOND. I will be submitting some and, of course, all Members of the Committee, and we will advise the staff, are invited to submit any questions for the record. Questions will have to be ready tomorrow. And then we would like to have your responses in a week, if that is possible.

Ms. ALVAREZ. Sure.

Senator KERRY. Madam Administrator, can you share with us quickly the 7(a) policy and program implications of prepayments?

Ms. ALVAREZ. Well, I actually would like Charles Tansey to address that because that is an area on which we have had many, many discussions.

Senator KERRY. Sure.

Mr. TANSEY. I am Charles Tansey. I am the associate deputy administrator for Capital Access.

Chairman BOND. Welcome, Mr. Tansey.

Mr. TANSEY. Thank you.

We have not included this in our legislative package but it is a very serious issue that has been brought before us. The issue became a major one, I think, in the last year or year-and-a-half primarily having to do with long-term 7(a) loans of 15 years or more. There is quite a bit of prepayment activity in the secondary market. Our sense is that from a mission standpoint this may conflict to some degree with the idea of us being a gap lender, but the flip side of it is that prepayments are causing a tremendous amount of anxiety in the secondary market and reducing, thereby, the attractiveness of that market and the possibility of additional 7(a) activity and availability of the 7(a) program for people who participate in it.

So, I think right now what we are doing is we are reviewing the issue, and we are neutral on it.

Chairman BOND. We would like the guidance that your Agency can provide.

Ms. ALVAREZ. Good. We would be happy to do that.

Senator KERRY. Just quickly, on the New Markets Initiative. You addressed that significantly, Madam Administrator, but I just want to clarify. In your statement you mentioned that in 1999 the SBICs averaged less than $1 million per investment and other venture capital firms averaged $6.2 million. But I just wanted to point out that that average $1 million represents all SBIC investments, debt and equity, without looking at a target area.

Ms. ALVAREZ. That is right.

Senator KERRY. So, if you break it out in target area, investments of $1 million or less in low- and moderate-income areas, you actually wind up with, I think, only about $66 million out of the total $4.2 billion of SBIC investments last year. Is that accurate? I mean, do you agree with that?

Ms. ALVAREZ. That is right.

It is still a modest amount and it is why we think that New Markets Venture Capital fund will allow us to make smaller equity investments in communities that just haven't been reached.

Senator KERRY. Good. And I don't disagree with the Chairman's notion that—I mean, it is good to get a sense of how this gels with the other programs. I think we obviously ought to have that sense as we try to approach it.

Finally, in terms of verbal questions right now, given that the PRIME program is authorized for FY 2000, what are your plans with respect to funding and beginning implementation this fiscal year?

Ms. ALVAREZ. We have several funding concerns. One is for the 7(a) loan program where we had requested enough funding for $10.5 billion, and we did not receive that. And of course, it appears, fortunately and unfortunately, that our projections of $10.5 billion were on target. So we are looking to find ways to make up the difference for 7(a) as well as for PRIME, and for the veterans program for this year.

We have been talking on a daily basis about strategies for doing that within our existing budget. We hope to have an answer for you very shortly.

Senator KERRY. That would be great. Obviously, it is still up in the air a little bit.

Ms. ALVAREZ. A little bit, but we have some options that we are looking at.

Senator KERRY. Good. That would be helpful.

Thank you very much.

Ms. ALVAREZ. Thank you.

Senator KERRY. And thank you, Mr. Chairman, for your courtesy, and we will submit a few questions for the record, but not many.

Chairman BOND. Thank you very much, Senator Kerry. I had discussed with Senator Kerry my interest in getting the GAO to undertake a review of the economic stimulus programs that would be related to, and either complementary to or overlap the New Markets Program. I want to make sure that we take advantage of this opportunity but not reinvent any wheels. We have enough wheels running around here without reinventing new ones. I want to get a sense from GAO as to where we stand.

Let me go back to the Loan Monitoring System. I think we have a chart somewhere. I always have to have a chart.

[The chart follows:]

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Chairman BOND. As best we understand, this is from what we have learned from the SBA and the GAO, the status of the mandated actions. I gather the target completion dates were back in August, and in some cases some of these steps are still in draft form. Several of the final products came out a week ago, and I think seven of them just came out last week; several of them are still in draft.

What is your projection on when you are going to finish your work on the mandated actions?

Ms. ALVAREZ. First of all, as I said, this is very complex stuff.

Chairman BOND. We understand that. That is why we——

Ms. ALVAREZ. We talk about, for example, Phase I. I mentioned before that by this summer we intend to do 79 percent of our loan dollars, transactions will be handled electronically, which is something we have never done before. That is a significant breakthrough.

We are also working very closely with disaster to make sure that these disaster loans are all done electronically, which will actually result in some, I think, significant savings for that program.

I would like to ask Kris Marcy, who is our Chief Operating Officer, who has been working day and night on this project, because it is very complex. It cuts across all these departments as well as our outside partners. She has also, by the way, been going to different offices in the field and having meetings and training sessions with our folks around the country.

Chairman BOND. We would be happy to welcome her. I might say, the GAO has advised us that there is an excellent working relationship and it seems that it has worked well together, but there are many hurdles ahead. Ms. Marcy, we would welcome your comments on this.

Ms. MARCY. It is nice to be here. We have worked very closely with the General Accounting Office, and frankly, many of the staff members in this room. We have done that both at their request and, frankly, many times we have offered and asked to come up to review our progress.

This is enormously complicated. It involves all our programs. You have a chart here that is, I think, a very accurate representation. We saw it yesterday for the first time but we have no problem with the accuracy of this chart. You will note that this is only for Phase I, and we are also actively engaged in Phase II as we speak, which is critical for our financial statements, our core accounting. It has many relationships to Phase I and the loan accounting system, and it includes the disaster program.

So we have got an awful lot of activity underway. We think we have made enormous progress and we could not have done it without the help of the staffs and the General Accounting Office.

Up there you have eight planning steps that were articulated in the Reauthorization Act of 1997. These are steps to design a good quality system to avoid risk. Of the steps that you have there, you have 17 work products in the middle column. I believe 14 are shown as final, 3 are still in draft. And to get to that 17 we have 28 separate contract deliverables. It has been exhausting.

But a word about this collaborative process. The way this works—because beauty is in the eye of the beholder—we will not say that we are finished, final, 100 percent perfect by ourselves. We do this in collaboration with the General Accounting Office and also with your staff. And many, many times when we submit a product as draft we are asked to make adjustments or revisions, and we do that willingly. So you will see these things go back and forth many times.

While we would love to have a chart that says everything is final and it was done a year ago, that is just not the nature of this program unfortunately. We do think, all said and done though, that we are ready to begin iteration one, Phase I. We think it is absolutely critical that we do that so that we get the critical loan information that we need.

Chairman BOND. I think you have made the point that I am trying to make in my initial presentation, that this is a major, ongoing program. You have spent $24 million so far on it. There was a request for an additional $13 million for 2001.

Ms. MARCY. We are much more conservative than that. We have received appropriations of $24 million to date through 2000. The way this works is that we get even one more level of review; so before we can spend the appropriations we do need to submit a spending plan to the appropriating committees. We have received acknowledgement to spend $16 million of the $24 million. Of that, we spent $3.2 million of the 1998 appropriations and $3.6 million of the 1999 appropriations. So we have spent about $7 million of the $24 million in appropriations thus far.

Chairman BOND. So you still have $16 million that has been appropriated and not approved? And you have asked for another $13 million, or is this just a request to OK the remaining $16 million?

Ms. MARCY. This is not easy. We have about $9 million which is sitting in an organization called FEDSIM at GSA that basically allows us to put technology money aside, obligated to them so that we can use it and draw it down as we need to. So we have that in the bank, if you will.

For the 2001 budget, as the Administrator said in her testimony, we have requested not $8 million as we have in the prior 3 fiscal years, but $13 million. And of course, that will be subject to lots of review.

Chairman BOND. Is that on top of the $24 million?

Ms. MARCY. Yes, Sir, it is.

Chairman BOND. So that brings it to $37 million. You are at $8 million now and——

Ms. MARCY. We have spent about $7 million now. We have $24 million appropriated.

Chairman BOND. You are $7 million toward completion of a $37 million project.

Ms. MARCY. Yes, Sir.

Ms. ALVAREZ. I think you can appreciate, Senator, that the budget process works on a year-to-year basis. But when you do a complete overhaul of a system you have to think in multiple years.

Chairman BOND. That is my point.

Ms. ALVAREZ. And there are times when, particularly as you are working out a detailed plan you need to keep the money in reserve, because when you spend it, you are going to spend substantial amounts of money and you will not have time at that point to start a process of soliciting funds if you want to move quickly. So that is why some of this money is in the FEDSIM account.

Chairman BOND. I do not challenge that. That is what I understand. I just want to lay out the picture and make sure that I understand, and my colleagues understand, how much work there is yet to be done on this program. That is the point. I appreciate that, and we would probably have a follow-up question or two on those things just so we can see where it stands.

Ms. ALVAREZ. Absolutely.

Chairman BOND. We will look forward to having your comments on this. We are very interested, and I have some people on my staff who even understand what is going on, and they too will be communicating with you on it.

Ms. MARCY. We are well aware of that. Thank you.

Chairman BOND. Thank you very much. Let me jump over to the Office of Advocacy which is of great concern to all Members of this Committee and certainly to our friends in the small business community. The 2001 budget request includes 47 FTEs. How many staff does the Office of Advocacy have on board at this time?

Ms. ALVAREZ. Is Jere Glover or Kay here?

Chairman BOND. I hope Jere is out working.

Ms. ALVAREZ. Russ, do you know the answer to this question? Sit down, Russ, and introduce yourself.

Chairman BOND. Please identify yourself for the record.

Mr. ORBAN. I am Russ Orban from the Office of Advocacy. Jere Glover is working this morning and I am sorry about that—real sorry he is not here.

[Laughter.]

Chairman BOND. How many FTEs do you have on board now?

Mr. ORBAN. I believe we have 47 on board.

Chairman BOND. Madam Administrator, since 1993 the Office of Advocacy staffing appears to us to have dropped dramatically even though the duties of the office were expanded under the Red Tape Reduction Act and the Regulatory Flexibility Act, SBREFA as it is known. Why has that gone down, and is 47 enough to cover the increased requests that are being placed upon this office?

Ms. ALVAREZ. You can imagine I have had a number of conversations with Jere Glover about this topic and what I have said to Jere is, everybody is taking a hit.

Chairman BOND. How much of a hit did they take? From 1993, what was their level in the past?

Ms. ALVAREZ. I am looking here, in 1996 it says here the staff—Russ, do you want to articulate this?

Chairman BOND. Where were we in 1993, and what has the trend been since 1993?

Mr. ORBAN. In 1993 we had, I believe, 62 FTEs and that has gone down now to an authorized level of 50, and I think there are 47 that are currently on board.

[Mr. Orban subsequently submitted the following:]

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ALVAREZ. This year, Mr. Chairman, we are looking to reduce our staffing overall at the SBA by 146 positions.

Chairman BOND. What percent is that of your total employment? How many employees——

Ms. ALVAREZ. It is about a 5 percent reduction from last year. We recognize that in order to implement some of the newer programs and to support HUBZones and other programs we are going to have to increase by about 86 in fiscal year 2001, which will still give us a net reduction in employees from last year. So it is part of this process of managing our human resources and evolving.

With respect to the Office of Advocacy, we have a process where we are managing every single office in terms of their requests, and we need to evaluate the relative sensitivity of the functions being performed. We would love to give Jere more people. We would also love to give Charles Tansey more people. And I can go across the board with all of our managers and I could make a compelling case, as they could, for why these are very important functions.

Chairman BOND. As I said, this is something that I think the Committee on a bipartisan basis supports very strongly. We expect them to carry a much heavier workload, now that we do have under SBREFA the means to enforce the Regulatory Flexibility Act, which we did not have. And if my rough mathematical calculations are close, it is a 20 percent cut, come down from 62 to 50, and we are just concerned, will 47 people be able to do the job?

Ms. ALVAREZ. I have encouraged Jere, as I have others, to the extent that the work can be done using outside consultants and specialists, which would be a one-time cost, it would not increase our FTEs, I am supportive; fully supportive. So I ask people to think in terms of projects where we can add people to complete the project and peel them off so that we do not have to carry them.

Chairman BOND. We will follow up on that and I thank you very much, Russ, for joining us.

Let me turn very briefly to the HUBZone program. Did the Federal agencies meet the fiscal year 1999 goal of channeling 1 percent of Federal procurement dollars to HUBZones, and what is the progress toward the 2000 goal of 1.5 percent? Welcome, and if you would identify yourself for the record.

Mr. BALLENTINE. Thank you very much. Mr. Chairman, my name is James Ballentine, Associate Deputy Administrator, Government Contracting and Minority Enterprise Development. As you mentioned in your statement, we launched the program on March 22 of last year. We anticipate in the 1999 fiscal year, although we have not received the full data, that we will not meet the 1 percent. The 1.5 percent is a lofty goal, but we are feeling very good about the HUBZone program. We have more businesses coming to the program and we feel that we will get fairly close, although it is a new program.

Chairman BOND. Do you have any figures on how many HUBZone contracts have been finalized to date this year?

Mr. BALLENTINE. We do not have final numbers. We will have those actually next week which we will share with the Committee.

[As of June 1, 2000, the requested information was not provided by the SBA.]

Chairman BOND. Good. Thank you. I might ask, is the SBA currently planning to adopt any order of preference that would direct either the HUBZone or the 8(a) program to take precedence over the other?

Ms. ALVAREZ. Mr. Chairman, nearly 2 years ago SBA adopted an order of preference after following the regular process for comment. So that order of preference has been in effect since June 11, 1998.

Chairman BOND. What was that order of preference?

Ms. ALVAREZ. It was an order of preference which did give preference to the 8(a) businesses. That came about as a result of consultation with many Members of Congress, and we will share with you some of the letters that were exchanged that manifest the concern of a number of members that HUBZones not harm the 8(a) program.

I believe that our experience to date, and this to some degree is anecdotal because we do not have the final numbers, is that the HUBZone program has benefited both 8(a) and non-8(a) businesses, which is what we hoped would happen.

Chairman BOND. That is the point. But we crafted that legislation, I wrote that legislation, I negotiated that legislation both within the Congress on a bipartisan basis and with the Administration and the legislation was clear that neither program was to be given preference over the other. That was the legislation we drafted and that was the legislation that was signed into law. Not for a preference of one over the other, but that they should work together.

Now let me ask, you requested $45 million for technical assistance for approximately 8,000 Microloan borrowers and $30 million in technical assistance for the New Markets Venture Capital program, but only $5 million for technical assistance under the 7(j) program to cover about 6,000 8(a) firms plus HUBZones. Does that not seem a little out of whack?

Ms. ALVAREZ. No, because we are talking about different kinds of technical assistance, different needs for different entrepreneurs. Frankly, we would like to have asked for more money for the 7(j) program, but we are trying to work with our previous history and slowly build more support. We are also taking some new directions in the 7(j) program which we think will be effective in helping these minority-owned businesses. Maybe James would like to comment.

Mr. BALLENTINE. As the Administrator mentioned, we are taking a new direction with the 7(j) program. In this current fiscal year we received $3.6 million. We are requesting $5 million to implement some of the changes that we hope to put in place for fiscal year 2000 and fiscal year 2001, in fact. And hopefully we can build the program enough to demonstrate that it is a worthy enough program to receive increased funding in the outyears.

Chairman BOND. I would just say that you have requested $30 million in technical assistance for a new program that is not even going yet and only $5 million for the targeted programs that are authorized, that we expect the SBA to act on. I find it stunning that six times as much money would be requested for technical assistance for a program that is not even authorized. So we are going to work on that problem in the budget process.

How much of the $5 million requested in the budget—have you allocated for the HUBZone or the 8(a) program, and what percentage of the assistance that you had in the past went to the two programs?

Ms. ALVAREZ. You are talking about 7(j) monies?

Chairman BOND. 7(j), yes.

Ms. ALVAREZ. I do not think we have made those kinds of distinctions. The businesses that benefit from the 7(j) program by and large are much more sophisticated than a micro-enterprise. The micro-enterprises require a different kind of technical assistance with different providers. We have turned to universities, for example, to be the principal source, the Dartmouth Business School of Education for these 8(a) and small, disadvantaged businesses. So there are just different needs for different levels of sophistication.

With newer startup micro-enterprises it is going to be more costly. It is more labor intensive. It is just a different kind of training.

Chairman BOND. I understood that your new market programs bring in big businesses to communities and——

Ms. ALVAREZ. We are looking through BusinessLINC to hopefully establish——

Chairman BOND [continuing]. Bringing in sophisticated——

Ms. ALVAREZ [continuing]. Establish some mentoring and partnering relations with small businesses. Again, you do not expect a big business to take under its wing a tiny business. They are more likely to work with—we saw an example of the type of benefits right here in Washington. A small company based in Southeast Washington that hires some folks who were from welfare and they make mops. And as a result of a partnering relationship with Giant supermarkets they were able to grow their business because they ended up with contracts to any number of Giant supermarkets. They are still a small business, but that is a much more sophisticated company in some respects than the ones we are talking about in the micro-arena.

Chairman BOND. I am just saying that if you are bringing in established businesses under the new markets, to give them six times as much technical assistance as you give the small businesses and the 7(j) program and the HUBZones and 8(a) just does not make any sense to me. I will be happy to have your explanation and any further follow-up. We are going to pursue that along with a number of other problem areas. As I mentioned to Senator Kerry, I want to make sure that I get a review from GAO how these subjects are working.

Unfortunately, I have three more hearings to participate in this morning, and since my other colleagues seem to have opted not to present their questions in person we will hold the record open. We thank you, Madam Administrator——

Ms. ALVAREZ. Thank you, Senator.

Chairman BOND [continuing]. For your participation and the good working relationship that we have. We will get all of these questions to you tomorrow and ask that you to return your responses in a week.

There being no further business to come before the Committee, it is hereby adjourned. Thank you.

[Whereupon, at 10:27 a.m., the Committee was adjourned.]

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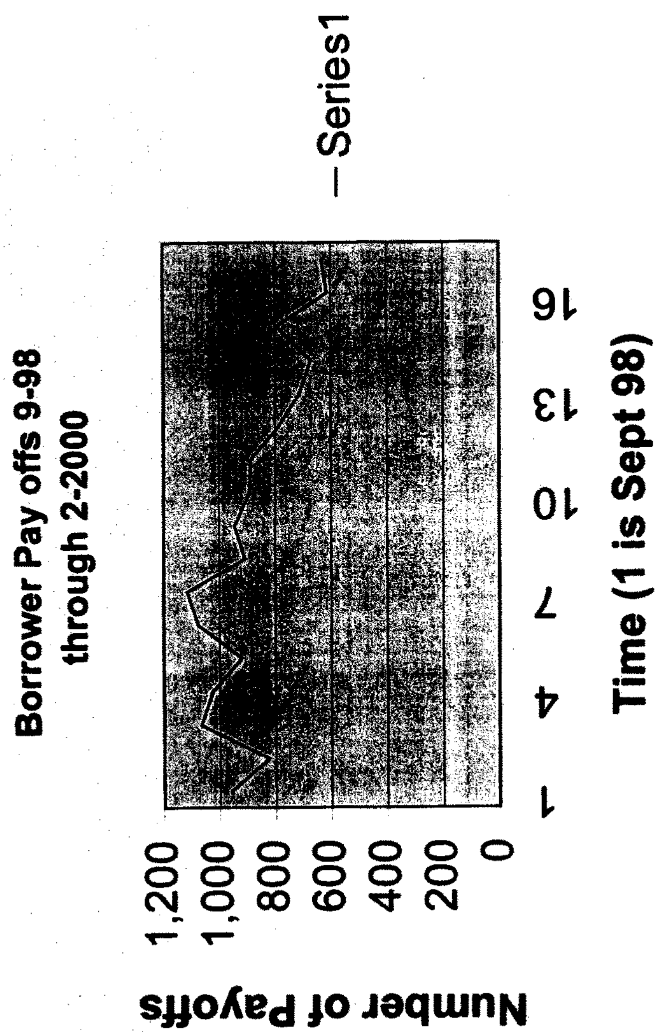


Borrower Pay offs 9-98
through 2-2000
Number of Payoffs
1,200
1,000
800
600
400
200
0
1
4
7
10
13
16
Time (1 is Sept 98)
Series1

EXHIBIT 6

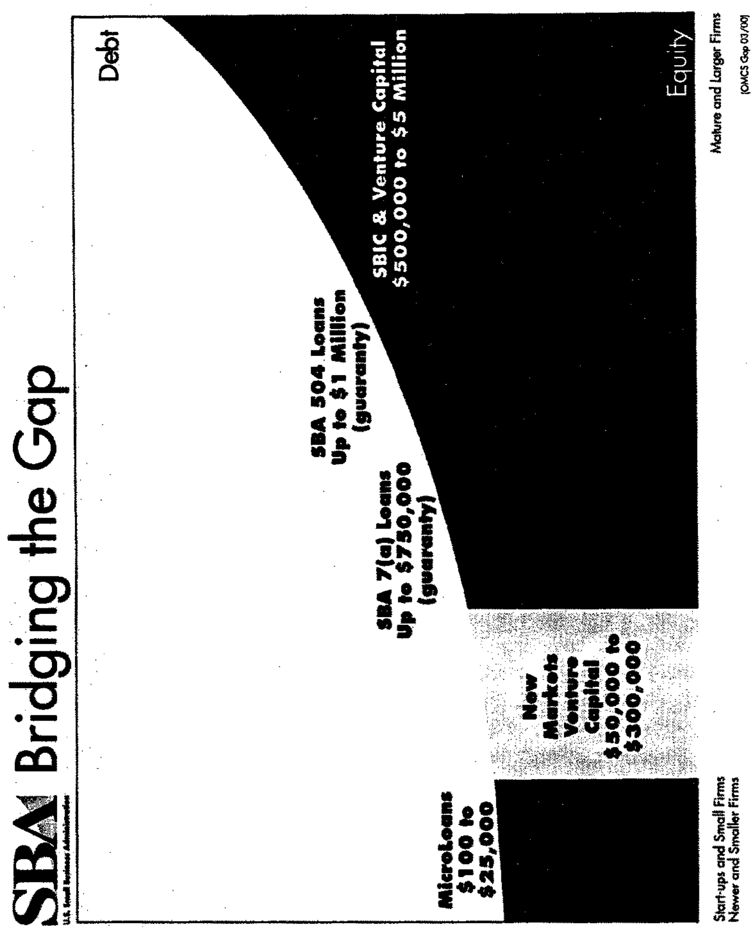

SBA
U.S. Small Business Administration
Bridging the Gap
Debt
Equity
MicroLoans $100 to $25,000
New Markets Venture Capital $50,000 to $300,000
SBA 7(a) Loans Up to $750,000 (guaranty)
SBA 504 Loans Up to $1 Million (guaranty)
SBIC & Venture Capital $500,000 to $5 Million
Start-ups and Small Firms
Newer and Smaller Firms
Mature and Larger Firms
[OMCS Gap 03/00]

EXHIBIT 7

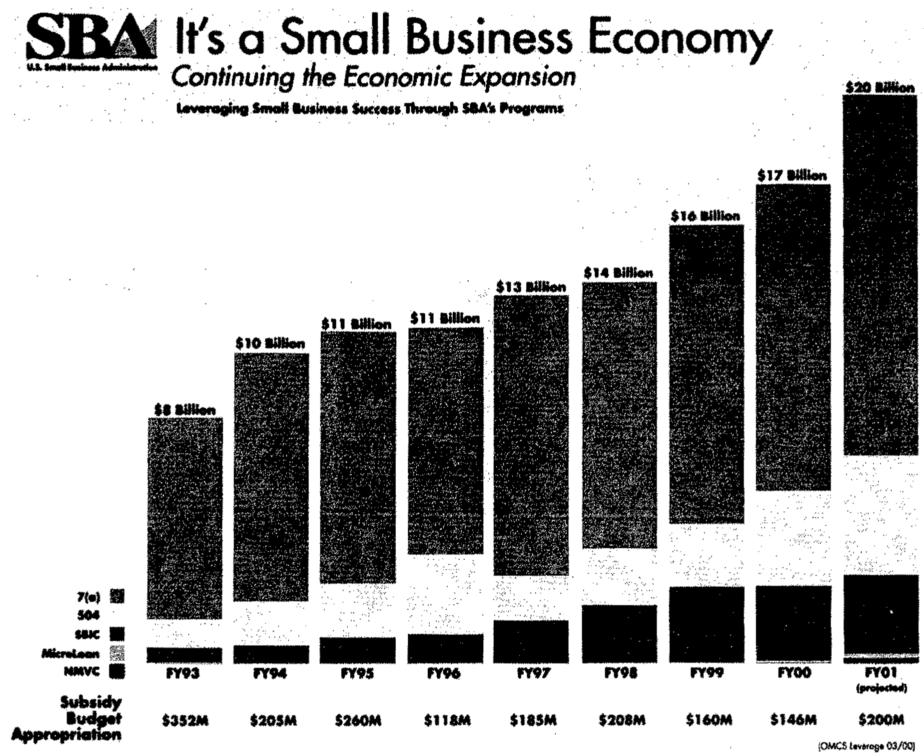
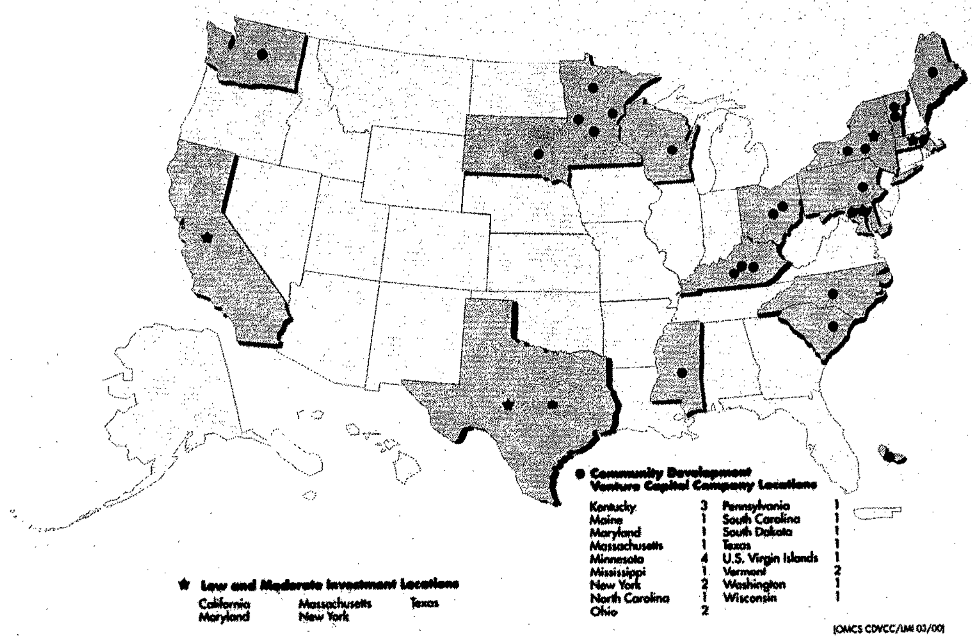

SBA
U.S. Small Business Administration
It's a Small Business Economy
Continuing the Economic Expansion
Leveraging Small Business Success Through SBA's Programs
7(a)
504
SBIC
MicroLoan
NMVC
$8 Billion
$10 Billion
$11 Billion
$11 Billion
$13 Billion
$14 Billion
$16 Billion
$17 Billion
$20 Billion
FY93
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
(projected)
Subsidy Budget Appropriation
$352M
$205M
$260M
$118M
$185M
$208M
$160M
$146M
$200M
(OMCS Leverage 03/00)

EXHIBIT 8

SBA Targeted New-Market-Type Investments

U.S. Small Business Administration



COMMENTS FOR THE RECORD

1445 New York Avenue, NW
Washington, DC 20005-2158
Telephone 202.434.8400
Fax 202.434.8456
www.bondmarkets.com

Headquarters:
40 Broad Street
New York, NY 10004-2373
Telephone 212.440.9400
Fax 212.440.5260

THE BOND MARKET ASSOCIATION

Statement of The Bond Market Association

before the

Senate Committee on Small Business

February 24, 2000

The Bond Market Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Bond Market Association's members include a number of firms who are active in the secondary market for loans guaranteed under the Small Business Administration's (SBA's) section 7(a) program, and for pool securities backed by those loans.

Prepayments on 7(a) Loans

Over the past several years, we have noticed an alarming increase in prepayment rates among 7(a) borrowers. In many cases, loan prepayments can be indicative of the improved financial health of a borrower. If a small business generates greater-than-expected net income, it may be able to repay its debt faster than anticipated. A 20-year loan might be paid off in, say, 15 years. This form of prepayment behavior is expected in any lending market where borrowers are able to prepay loans at any time without penalty, and can be viewed as a success of the 7(a) program. However, we believe recent trends in the pattern of certain prepayments among 7(a) borrowers suggest not a success of the program, but a threat to its effectiveness.

Recent trends suggest that many of the 7(a) loans that prepay very early do so not because borrowers met with unanticipated success and were able to pay down debt from business profits. Rather, it is evident that much of the early prepayment activity results from the actions of conventional lenders who market refinancing transactions to 7(a) borrowers. Often, the non-SBA refinancing loans carry marginally better terms—lower and fixed interest rates, longer maturities, etc.—than SBA loans. Very early prepayments on 7(a) loans result from these refinancing transactions. At first glance, this may appear to be a desirable outcome of the 7(a) program. Borrowers are "graduating" to conventional financing. However, if a borrower is able to qualify for a conventional, non-federally-guaranteed loan shortly after settling on a SBA-guaranteed loan, it is highly likely that the borrower did not need the SBA guarantee in the first place to qualify for financing. In essence, the borrower is using the 7(a) program as a form of short-term bridge financing. It is also likely that another, more needy borrower was displaced and could not obtain SBA financing as a result. Moreover, this very fast refinancing activity is the result of "cherry-picking." Lenders offer refinancing transactions to only the most attractive and credit-worthy SBA borrowers. Those loans that are not refinanced—the loans that remain federally guaranteed and through which the federal government is exposed to default risk—tend to be riskier.

Very fast prepayments also affect the marketability of 7(a) loans in the secondary market. Pools of SBA-guaranteed loans are priced in the secondary market based on assumptions regarding the prepayment speed of loans in the pools. If an unexpectedly large number of loans prepays very early, an investor's rate of return on his or her investment is affected. Eventually, investors will begin to demand higher rates of return on SBA-guaranteed loan pools to compensate for inordinately fast prepayments. Indeed, we have begun to witness this effect in the secondary market for 7(a) loans as a result of prepayment behavior. Higher rates of return for investors translate into higher borrowing rates for small businesses.

House Passed 7(a) Bill Benefits Borrowers

On August 2, 1999 the House of Representatives passed H.R. 2615, legislation to make improvements to the SBA's 7(a) loan program. One provision of H.R. 2615 is designed to strengthen the 7(a) program by curbing the very early prepayment of medium- to long-term small business loans. If left unchecked, these prepayments would increase the cost of capital for borrowers and threaten the long-term viability of the 7(a) program as a ready source of capital for worthy small business borrowers who otherwise may not have access to investment capital.

The House bill includes a provision for modest, graduated prepayment charges for borrowers who prepay their long-term loans in the first five years. The Bond Market Association strongly supports this provision. We support it because we believe it would apply only to loans that, by their terms, are intended to supply long-term business financing, and would therefore discourage the number and volume of extraordinary, very early prepayments which are harmful to the 7(a) program. It would do so without penalizing borrowers who, as a result of business success over a reasonable time frame, are able to repay loans more quickly than expected. Discouraging very early prepayments without penalizing businesses who prepay loans later in their terms strikes an appropriate balance. By reducing prepayment risk to investors, prepayment charges also would benefit borrowers through lower financing costs. If investors view their 7(a) loan investments as less risky, they will demand lower rates of return, which in turn translates into lower borrowing costs for small businesses. This effect has been documented in other loan markets where prepayment charges have been introduced.

Summary

We believe that the SBA's section 7(a) loan guarantee program is effective and successful. It is a proven and efficient source of long-term capital for small businesses that otherwise would find it difficult or impossible to qualify for financing. An active and robust secondary market for 7(a) loans has been and remains vital to that success. Our above-mentioned concerns regarding the program could threaten the viability of the secondary market in 7(a) loans. Unusually high levels of very early prepayments represent not a sign of the program's success, but rather a threat to its continued viability.

We strongly support the prepayment legislation passed by the House. We commend the Committee's attention to this legislation and urge its quick passage.

Appendix

The secondary market for 7(a) loans

Congress created the SBA in 1953 to aid, counsel, assist and promote small business and expand access to capital by guaranteeing private loans. Such loans were expected to carry longer terms and lower interest rates than small businesses would otherwise be able to obtain in a private commercial lending transaction. The secondary market for SBA loans began in 1975 when market participants and the SBA worked together to allow for the sale of the guaranteed portions of SBA loans. The program permits the lender of an SBA loan to retain the unguaranteed portion and servicing of the loan and sell the guaranteed portion to a secondary party, often a dealer, who then may re-sell the SBA-guaranteed loan to an investor, transferring full rights of the government's guarantee. This secondary market liquidity frees lenders' capital for the origination of additional small-business loans, thereby giving small businesses valuable access to more capital.

In 1984, the Small Business Secondary Market Improvement Act provided for the central registration and servicing of loans sold in the secondary market by a single fiscal and transfer agent, Colson Services Corporation. In addition, the 1984 Act allowed for the pooling of SBA loans with the intent of providing increased efficiency, better liquidity and a more established and improved SBA product in the secondary market. Accordingly, such improvements allowed secondary market participants to structure securitized SBA loans to be attractive to institutional investors by creating pools of similar loans diversified geographically and by amount, lender and industry sector, and provide a timely guarantee of monthly principal and interest to investors. In sum, each of these legislative, regulatory and market developments has served to further recognize, expand and improve the efficiency and liquidity of the secondary market in SBA loans. However, even with such improvements, we believe that the secondary market for the 7(a) program could be further strengthened by addressing targeted issues.

The Benefits of Secondary Market Activities

Securitization and secondary market trading of loan pools were introduced into the U.S. capital markets on a widespread basis in the early 1970s with the creation of the Government National Mortgage Association, or Ginnie Mae. Ginnie Mae, by providing credit support for securitized FHA and VA mortgages, made it possible for home mortgage lenders to sell pools of loans into the secondary market. Since that time, the market for securitized home mortgages has blossomed. In 1999, more than $687 billion of agency MBS were issued.

Secondary market activities, including the trading of whole assets as well as the conversion of pools of assets into tradable securities, have also evolved in the markets for a wide range of other financial assets. It is now quite common for lenders to sell or securitize car loans, credit-card receivables, lease contracts, trade receivables, even royalties from intellectual property, among other assets. Last year, nearly $200 billion of publicly offered ABS was issued, and this year promises even higher volume. The SBA permits the trading and securitization of both the guaranteed and unguaranteed portions of loans made under the 7(a) program. Securitization of the guaranteed portion of loans is much more common, and since 1985, $23 billion of SBA-guaranteed loans have been securitized or sold in the secondary market.

The secondary market provides several benefits for lenders and borrowers. First and perhaps most important, securitization provides lenders with a ready and efficient means of selling assets in order to raise capital to generate additional lending. Rather than being forced to carry a loan on its books for its entire term, lenders are able to sell loans to investors and use the proceeds of the sale to make additional loans. Second, securitization attracts sources of capital to lending markets that would never be available otherwise. Securitized SBA loans are sold to a wide range of investors, including pension funds, mutual funds, insurance companies, endowment funds and others. Few, if any, of these investors would ever consider making a small business loan directly. However, because securitized loans are standardized and liquid, they are easily marketable to a variety of investors. Third, the secondary market gives financial institutions and other lenders flexibility in managing the assets on their balance sheets. As market conditions and business strategies change, lenders are able to expand or contract their balance sheets easily and efficiently, for example, to better match their assets and liabilities. In combination, the existence of liquid and efficient secondary markets for SBA debt obligations has resulted in more widespread availability of capital, at lower cost, for small business borrowers.

The secondary market has become an increasingly integral component of the 7(a) program. As a result, it has become ever more important for program administrators to be sensitive to issues that affect the secondary market for SBA-guaranteed loans. Issues such as liquidity and investor confidence have become important to the success of the SBA's programs. If investor confidence in securities backed by SBA-guaranteed loans wanes, the 7(a) program would suffer significantly. Fundamentally, we believe that the 7(a) program is well designed and well managed. The program meets the needs of small-business borrowers and benefits the economy overall in ways that no other government initiative does. By passing H.R. 2615 the 7(a) program could be made stronger and more beneficial to America's small businesses.

Statement of Julia Sass Rubin
New Markets Venture Capital Consultant & Doctoral Candidate
Harvard Business School
Cambridge, Massachusetts

Julia Sass Rubin has studied the community development venture capital (CDVC) industry for the last two years. The CDVC industry is the model for the President's New Markets Venture Capital Initiative. Ms. Rubin advises the Small Business Administration on the President's New Markets Venture Capital Initiative and the Appalachian Regional Commission on increasing the supply of venture capital in the ARC area. Last May she participated in the Senate Small Business Committee's roundtable, "SBA's SBICs and Microloan Programs." Per Senator Kerry's request, she is submitting for the hearing record the following questions and answers.

1. Why do we need a separate venture capital program to encourage low- and moderate-income (LMI) investments when SBA's Small Business Investment Company program is already making them? Although SBICs invested a total of $771 million in LMI areas in 1999, this number is misleading. The vast majority of those investments were very large and not at all comparable to the type of investments that Community Development Venture Capital (CDVC) funds would make.

My research indicates that CDVC investments range from $50,000 to $1 million, with the overwhelming majority of these investments in the $100,000 to $500,000 range. For new businesses, this is the size of equity and near equity investments that are the most difficult to obtain.

Only 1.6% of all SBIC dollars invested in 1999 ($66 million), consisted of investments of $1 million or less in LMI areas. In 1998, only 1.8% of all SBIC dollars ($59 million) went to such investments.

These investments were also narrowly distributed. Only five states received 59% of these dollars in 1999, and only four states accounted for 55% of these dollars in 1998. In 1999, California alone accounted for 30% of all SBIC LMI investments of $1 million or less. In 1998, California accounted for 28% of all such investments. Meanwhile, 21 states in 1999, and 20 states in 1998, received no capital at all. In 1998, only two SBIC investments went to rural LMI areas (comparable numbers are not yet available for 1999).

In addition to the limited SBIC dollars that are going into such deals, those investments that are made are designed to maximize financial returns, not spur economic development. As such, they do not include the intensive technical assistance that developmental investments require. CDVC funds would not only bring much-needed equity and near-equity dollars to LMI regions, they would also provide the intensive oversight that enable young companies to succeed.

2. Why would the SBA defer interest on the LMI debentures for five years when the CDVC funds are able to require immediate interest repayment from their portfolio companies? The SBA is not actually deferring interest charged on the LMI debentures; it is deferring *payments* on the debentures. The CDVC funds are charged interest on the LMI debenture from day one. That means that CDVC funds receive only a portion of the total capital that they must eventually repay to the SBA. For example, a CDVC fund that receives $7.1 million in matching investment capital through an LMI debenture in 2000, at a 7% interest rate, must repay $10 million in principal at the end of the debenture's life in 2010. When this CDVC fund begins making payments in year six, the interest will be calculated off the $10 million that the fund owes, rather than the $7.1 million that it actually received.

3. Are CDVC funds going to charge their portfolio companies interest, particularly during the first five years, even though the SBA is differing interest payments charged to the CDVCs themselves on LMI debentures? As question No. 2 has explained, the SBA is not actually deferring interest charged to the CDVCs. It is merely taking that interest out of the amount of matching investment capital that it provides to the CDVC funds.

Some CDVC funds will charge their portfolio companies interest. If they do so, however, it will be as a portion of a near-equity financing. While equity refers to preferred and common stock, near-equity refers to subordinated debt with some kind of an additional feature, such as warrants, royalties or participation payments. This additional feature allows the investor to benefit from any significant upside that the company experiences in exchange for undertaking the extra investment risk. Near-equity investments, like equity investments, are very risky for the investor and very difficult for portfolio companies to obtain. Near-equity is also an important part of most CDVC funds' tool kits, as it is for SBICs and private venture capital funds. By using a multitude of investment types, CDVC funds are able to tailor each investment to the needs of the individual portfolio company, rather than trying for a "one-size-fits-all" approach.

Pure equity investments are most appropriate for companies that are young and do not have cash flows. By deferring repayment, equity enables such companies to finish developing their products and to get them to market. Expanding businesses, however, often prefer near-equity, which acts like equity in the eyes of other lenders, but does not require the entrepreneur to give up as much ownership in her/his company. Near-equity is still patient capital. It is largely provided without collateral and can even be structured with deferred payments, to give the portfolio company additional time to become more profitable.

4. If small businesses in LMI areas need equity to grow their businesses and build productive wealth in the community, why does the CDVC program use debt instead of equity? The zero coupon LMI debenture that the CDVC program utilizes functions more like equity than debt. By reducing the amount of capital that the CDVC funds actually receive, the SBA is able to defer interest payments for years one to five. This provides the CDVC funds the necessary time to exit their investments before they must begin making regular interest payments to the SBA.

This equity-like financial instrument was utilized because the participating security option is too expensive for the CDVC funds. The existing SBIC program provides SBICs with two types of matching capital: debentures and participating securities. The debenture SBICs make interest-only payments every six months, starting when they receive the SBA's capital. In contrast, the participating securities SBICs do not have a regular interest charge, but must pay the SBA both interest and a portion of their profits, once they have successfully exited their investments.

At present, the participating securities program requires an 11 to 12 percent rate of return on investment in order for the funds to repay the SBA and still break even. This option is too expensive for the CDVC funds, whose rate of return on investment is likely to average between 5 and 10 percent. The SBA would require a significantly higher rate of subsidy in order to utilize a participating security instrument for the CDVC program. Given the flexibility of the zero coupon LMI debenture, that higher subsidy is not necessary for the program to succeed (see question No. 5).

5. Will the CDVC funds be able to produce sufficient profits to pay the interest on the SBA debenture? Yes, they should be able to do so for the following reasons. First, the zero coupon LMI debenture that the CDVC program proposes, would constitute no more than half the investment capital of any given fund. The remainder of the capital would consist of equity raised by the CDVC fund. This mixture would effectively lower the cost of capital for the fund and enable it to make both equity and near-equity investments.

Second, because the LMI debenture functions like equity but is debt, CDVC funds are likely to defer drawing it down until they have invested the bulk of their own capital. This can take anywhere from 1 to 4 years. Since the debenture does not require any repayment for 5 years, the funds would thus have 6 to 9 years before they would have to begin repaying the debenture, depending on when they first drew down the capital from it. By then, they should have successfully exited some of their investments and created profits that can be used for debt repayment. Furthermore, the debentures require only interest payments for years 6 to10, providing additional time and flexibility for the CDVC funds to exit their investments and produce the capital needed to repay the principal.

6. Given the large technical assistance aspect of the program, is it really accurate to portray the need in the expected market as an equity void? The provision of equity capital and management assistance is interconnected for CDVC funds. My research has shown that when the number of deals that a venture fund can invest in is limited and of mixed quality, it is not sufficient to provide equity capital without management assistance. However, just providing management assistance does not address the need for equity capital that exists in low- and moderate-income areas.

A good example of the interconnection between the capital and assistance that CDVC funds provide is the $130 thousand equity investment that the Boston Community Venture Fund (BCV) made in City Fresh Foods. City Fresh prepares ethnic (African-American and Hispanic) meals for community and corporate clients, and for elderly residents in Boston's Roxbury and Dorchester districts. The equity infusion enabled City Fresh to move into a larger facility, and significantly expand its operations. Along with providing capital, Boston Community Venture Fund also helped City Fresh oversee the renovation of the new facility and worked with City Fresh's owners to improve their record keeping and financial management systems, thus helping to increase the firm's gross revenues and net income. BCV also introduced City Fresh to other sources of capital and to several new corporate clients.

7. Why can't existing providers of technical assistance work with Community Development Venture Capital Funds rather than having the SBA provide technical assistance grants to the CDVC funds? Technical assistance is a misleading term for the kind of ongoing oversight and management assistance that goes on between an equity investor and a portfolio company. This assistance is much more intensive and longer-term than external sources of technical assistance can provide. To suggest that this process be separated from a CDVC fund's investment function would be like asking an SBIC to use its management fee to hire local consultants to do its investing and oversight. The two simply cannot be separated from each other.

8. The SBIC and SSBIC programs experienced significant early losses. How is the CDVC program structured so that it does not confront the same problems? The development of the CDVC legislation drew upon the experience of the community development venture capital industry, and on my research, which examines what makes such funds successful. It also drew upon findings of Congressional hearings that were enacted in 1992, and it drew upon the lessons learned by the SBA from administering the SBIC and SSBIC

As a result, the legislation provides many protections to maximize the chances of CDVC funds succeeding financially and having a significant impact on their communities. Some of the steps that the SBA took to maximize the program's chance of success include:

- Setting a minimum fund size in order for an organization to qualify for SBA leverage
- Requiring CDVC funds to have qualified and experienced management
- Reducing the potential leverage that CDVC funds can draw upon, to a 1 to 1 ratio.
- Insuring that SBA money would be protected in the case of any losses — CDVC funds would lose all their capital before any government guaranteed funds are placed at risk.