SUBCOMMITTEE HEARING ON THE EFFECT OF THE CREDIT CRUNCH ON SMALL BUSINESS ACCESS TO CAPITAL

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SUBCOMMITTEE HEARING ON THE EFFECT OF THE CREDIT CRUNCH ON SMALL BUSINESS ACCESS TO CAPITAL

Wednesday, April 30, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 1539 Longworth House Office Building, Hon. Melissa Bean [chairman of the Subcommittee] presiding.

Present: Representatives Bean, Sestak, and Buchanan.

OPENING STATEMENT OF CHAIRWOMAN BEAN

Chairwoman BEAN. I call to order this meeting examining how current economic conditions are impacting small business access to capital. In August of last year, the U.S. financial markets experienced widespread losses stemming primarily from sub-prime mortgages. The impact spread throughout the lending market and is now being felt in other parts of our economy. That includes the nation's small business sector which is our primary source of economic activity and historically led the way to financial recovery and job creation following downturns.

As banks and other institutions struggle to recover from losses on Wall Street they are also pulling back from lending on Main Street. The result is that credit is now harder than ever for small businesses to access. Not surprisingly last month's small business confidence gauge which is compiled by NFIB, the National Federation of Independent Business owners shows it lowest level since th survey was started in 1986. Furthermore, a joint survey conducted by Duke University and CFO Magazine notes that about one-third of small business owners are finding credit more costly, less available or both.

As capital availability tightens, many small businesses are forced to delay important purchases, halt planned expansions or forgo the creation of new jobs. And all of these choices hinder their ability to fuel economic expansion. In such an environment, the SBA's lending programs could play a pivotal role by bridging capital availability gaps.

Unfortunately, the SBA's largest lending program, the 7(a) Initiative, has not risen to that task. Instead in some ways it's exacerbating contractions in the conventional credit markets. Through the first half of 2008, the number of 7(a) loans was down over 17 percent in comparison to the same period last year. The gross dollar amount of loans was also declining. To make matters worse, new fees and program mismanagement are keeping financial institutions from even participating in the program.

There are clear solutions the these challenges and last year the House took action to address many of them. We passed H.R. 1332, The Small Business Lending Improvements Act, which I authored.

The Bill lowers borrower costs, expands lender participation and streamlines the 7(a) application process. This legislation would move us in t he right direction. However, the Senate has not taken action on it at this time.

As Congress continues to address the current challenges facing the economy, we must be sure to explore every avenue of small business financing. After all, with credit availability narrowing, it is more important than ever to insure entrepreneurs have access to the tools they need to operate their businesses and grow the economy. I want to thank our witnesses in advance for joining us here today and for the valuable insights offered in their testimony and I now recognize a ranking member for his opening statement.

OPENING STATEMENT OF MR. BUCHANAN

Mr. BUCHANAN. Is that on? Okay. I want to thank the Chair for yielding and calling this important hearing on the effects of the credit crunch on small business access to capital. I'd also like to extend my thanks to our witnesses today because I know their busy with their schedules to provide testimony in today's hearing. There's no question in my mind that there's nothing more personal than the entrepreneur having the American Dream. I've lived that dream and I know the risk and the rewards. I know its pains and successes.

I've seen it from the bottom up starting a small business and from the top down as Chairman of the Florida Chamber. I also know for someone that's done a lot of planning in my businesses over a lot of years that there's certain internal factors we can control small business and external factors that we can't control. And there's a lot of these external factors that are effecting a lot of people. The other thing as the Chairman of the Florida Chamber, I also realize that 99 percent of businesses in Florida and probably the country, are small businesses which create 70, 80 percent of the jobs.

And right now the view in terms of small business in Florida and I'm sure throughout the country is not pretty. Working families across the country are facing record foreclosures, rising gas prices, double digit layoffs and consumer confidence is at an all-time low. For small business their very survival is at stake. The inability to secure financing and credit can imperil their very existence.

Today this Committee is not simply sitting on the sideline observing the challenge and I thank Madam Chairwoman to take this leadership. We'll be hearing from people that are involved and effected by a capital meltdown, effecting lenders and borrowers as well. I hope to come together and find real solutions that can make it easier for small business to secure the financing they need at a price that makes sense.

Also, being on bank boards for 20 years or so, I realize that a lot of these entities are heavily leveraged themselves, four or five percent capital, so what happens if you look back in '90, '92 when S&L banks were under crisis. Their capital gets under crisis and even good companies, good small businesses that have fairly good balance sheets and good income they can't get loans. So that's critical for someone that's been there.

As I was working on my way up, I never asked for a government handout. I only asked that we never by shut out. Owning a business was my dream and it's a dream of millions of Americans as well. It's my duty here in Congress to construct and maintain a system in which these entrepreneurs have the ability to start and run their business successfully.

Again, I want to thank the Chairwoman for this hearing. I look forward to hearing the testimony from our witnesses today. Thank you for coming. I yield back.

Chairwoman BEAN. Thank you for your comments. Now, we'd like to move to testimony from our witnesses. I'd like to thank you for taking your time and sharing your expertise with us today. Witnesses will have five minutes to deliver their prepared statements. The timer begins when the green light is illuminated. When one minute of time remains. The light will turn yellow. The red light will come on when time is up.

And our first witness is Mr. Scott Eckstein, who is a home builder for James Scott Custom Builders in Naperville, Illinois where he also serves as President of the Home Builders Association. He's testifying on behalf of the National Associations of Homebuilders, the trade association that helps promote the policies that make housing a national priority. Since 1942, NAHB has been serving its members, the housing industry, and the public at large.

Thank you for being here.

STATEMENTS OF MR. SCOTT ECKSTEIN, JAMES SCOTT CUSTOM BUILDERS, NAPERVILLE, IL, ON BEHALF OF THE NATIONAL ASSOCIATION OF HOMEBUILDERS

Mr. ECKSTEIN. Thank you, Chairwoman Bean, Ranking Member Buchanan and distinguished members of the Committee. My name is Scott Eckstein. I am President of James Scott Custom Builders, member of the National Association of Homebuilders and the current President of the Homebuilders Association of Illinois. Thank you for the opportunity to be here today to talk about the impacts of the credit crunch on small builder businesses and potential solutions for Congress to consider.

A pricing induced downturn that began in 2005 has been made worse by the credit crunch that started in mid-2007. This will continue to be the most significant factor effecting the homebuilding industry into the foreseeable future. That means depressed home prices, sharply reduce credit availability, and much tighter mortgage lending standards for those who can still qualify.

Homebuilders all over the country are experienced a negative shift in terms of availability of residential construction loans. In addition, builders with outstanding construction loans are facing challenges as lenders receive appraisals reflecting lower values on lots and homes. In fact, declining valuations are sometimes at or below the cost of building a home or below the attainable market value. Lenders are asking builders to fully or partially pay down outstanding loans while in extreme cases denying requests for loan extensions. Most small homebuilding companies don't have the resources to survive in such an environment for any extended period of time. My personal experience has been that banks are refusing to lend to builders on either pre-sold or spec homes in the current environment, regardless of credit worthiness.

There is a current dislocation in the housing market where entry level home buyers cannot access mortgage credit to purchase a home. In turn homeowners higher up the ladder cannot sell their current home in order to make the next home purchase. Thus, the credit crunch shuts down the normal progression of home selling and home buying. When the credit markets break down in the midst of a housing dislocation, homebuilders' financing is extremely difficult to maintain. For me and many homebuilders the housing market downturn began two years ago and the credit crunch we now experience is a significant additional problem.

I have exhausted my company's resources and am forced to take more extreme measures to keep afloat. Recently, I had to withdraw all my personal 401(k) funds receiving a benefit of less than 50 cents on the dollar to help my struggling business. I paid a severe penalty and I've turned to Consumer Credit to provide operating capital to pay for my loans and make my payroll. Avoiding excessive regulatory restrictions on federally insured banks which are current the dominant source for construction loans is an urgent priority. However, the difficulty for builders in obtaining housing production financing during this time also vividly highlights the need to develop additional sources of construction credit.

My written statement includes a number of specific recommendations for increasing the range of suppliers of housing production credit. Congress has taken several steps to ease the financial losses that homebuilders like many small businesses are facing during this economic downturn. I cannot overstate how important it is for the business owners to have the ability to claim and carry-back net operating losses for years when significant taxes were being paid.

NAHB applauds Chairwoman Bean for her leadership in advancing the expended NOL carry-back as part of the GROW Act of 2008. As Congress continues to look for additional ways to ease the credit crunch on small businesses, it should strongly consider policies that stimulate home purchases in the immediate future. A temporary home-buyer tax credit would reduce excess inventory and relieve pressure on falling home prices by ending the waiting strategy for some potential buyers. An effective home-buyer tax credit would restore confidence in the housing market for homeowners, home-buyers and financial institutions mitigating some of the factors responsible for the current credit crunch.

NAHB appreciates the efforts of Congress to address the problems related to the small businesses and the credit crunch and we look forward to working with the legislators on the most effective way to help America's small businesses during this time. Thank you for the opportunity to testify today.

[The prepared statement of Mr. Eckstein may be found in the Appendix on page 29.]

Chairwoman BEAN. Thank you for your comments.

Our next testimony is going to come from David Schroeder, who is the President of the American Enterprises Bank in Neighborville, Illinois. He's testifying on behalf of Independence Community Bankers Association or ICBA, the leading association for community banks representing over 5,000 community banks of all sizes and charter types throughout the U.S.

The ICBA is dedicated exclusively to representing the interests of the community banking industry and the communities and customers that they serve. Thank you for being here.

STATEMENT OF MR. DAVID SCHROEDER, PRESIDENT, AMERICAN ENTERPRISE BANK, BUFFALO GROVE, IL, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS ASSOCIATION

Mr. SCHROEDER. Good morning. My name is David Schroeder. I am President of American Enterprise Bank in Buffalo Grove, Illinois. Chairwoman Bean and members of the Committee, I am pleased to be testifying today on the credit markets and small business access to capital. I am proud to testify on behalf of the Independent Community Bankers of American. ICBA represents 5,000 community banks throughout the country with 301 community bank members in Illinois alone.

American Enterprise is a locally owned community oriented bank with locations in Buffalo Grove, Highland Park and Schaumburg, Illinois. Since 1995 we have grown to more than $360 million in assets. We pride ourselves on small business relationship banking and actively participate in the SBA lending programs. In 2007 American Enterprise Bank made 62.6 million in SBA 7(a) loans and 15.5 million in SBA 504 loans.

Credit fuels our economy and the broad credit markets are still sorting out many problems. Some of the nation's largest lenders and money center banks have tripped up on aggressive sub-prime lending and toxic investments. As a result many of the biggest financial institutions have been forced to pull in their lending, recognizing huge losses and rebuilding capital. The current turmoil in our economic and financial markets jeopardizes the availability of credit for small businesses. However, community banks remain common sense lenders and largely avoided the sub-prime debacle. We have solid capital positions and we have money to lend to small businesses.

As Congress continues to address the problems in the housing and finance sectors, policymakers must also focus on the small business sector during this economic slow-down. At a time when the economy is faltering, a sharp decline in SBA loans is unacceptable. The SBA loan program should bolster small business credit in economic slow-downs. Instead, as Chairwoman Bean mentioned, the number of SBA loans being made is plummeting.

In order to address the ongoing credit crunch and assure small business lenders and borrowers have an uninterrupted supply of capital, ICBA respectfully advanced several policy recommendations, including 1) strengthening the SBA loan programs by boosting the SBA budget, lowering steep fees on lenders and borrowers and reducing excessive regulation.

2) Next, enacting the Small Business Lending Reauthorization Act introduced by Chairwoman Bean. 3) Also enact the ICBA stimulus plan recommendations included the first-time home-buyer's tax credit and 4) enact the provisions of the Community First Act advanced by Chairwoman Nydia Velázquez. The ICBA believes these measures would help small businesses better access credit, create jobs and boost our economy. Chairwoman Bean, community bankers represent the other side of the credit market story. The community bank model is based on relationship banking not relationship with investment banks and hedge funds. Community banks stick with their business customers in good times and in bad. Unfortunately, we see the missteps of several large financial players fostering costly new regulation on all financial institutions. This will likely cause banks to further tighten credit standards and only increase transaction costs. Therefore, I urge Congress to strongly avoid a one-size fits all regulatory approach. Increased regulatory burden should not be a wet blanket that smothers community banks that had little to do with the recent turmoil.

ICBA also believes additional economic stimulus is needed. Notably 45 percent of small business loan outstandings are collateralized by some form of real estate. Therefore, the ongoing sharp decline in real estate values must be further addressed before stability can be achieved in the broad credit markets and the economy.

The ICBA Economic Stimulus Plan recommends a $5,000.00 first-time home buyer credit for one year in order to jump start home sales, reduce unsold inventories and stabilize home prices and foreclosures. We are pleased to see the home-buyer tax credit advancing in both the House and the Senate as part of a second stimulus effort.

In conclusion small businesses are facing difficult economic times and small business credit needs should be front and center. Community Banks like American Enterprise are well-positioned and prepared to help. We believe strengthening the SBA programs, enacting the provisions of the Community First Act and ICBA stimulus recommendations would go a long way in helping small business. I truly appreciate the opportunity to testify today on behalf of the Independent Community Bankers of America. Thank you.

[The prepared statement of Mr. Schroeder may be found in the Appendix on page 39.]

Chairwoman BEAN. Thank you for your testimony.

Next, we're going to be hearing from Mr. Carl Sorgatz, who is over 31 years of financial and operational experience and has served as the President of the Hawthorne Credit Union since 1987. Mr. Sorgatz is testifying on behalf of the Credit Union National Association or CUNA, the premier national trade association serving America's credit unions. Thank you for being here today.

STATEMENT OF MR. CARL SORGATZ, PRESIDENT, HAWTHORNE CREDIT UNION, NAPERVILLE, IL, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Mr. SORGATZ. Thank you, Chairwoman Bean, Ranking Member Buchanan and members of the Subcommittee, I am Carl Sorgatz, President of Hawthorne Credit Union in Naperville, Illinois. And I appreciate this opportunity to appear before the Committee on behalf of the Credit Union National Association, CUNA, and to express our support for increased access to capital for small businesses, particularly in light of the current credit crunch.

CUNA is the largest credit union advocacy organization representing over 90 percent of our nation's approximately 8400 state and federal credit unions, their state and credit union leagues and their nearly 90 million members. Hawthorne Credit Union has offices in Naperville, Bolingbrook and at Lucent Technologies and provides financial services to employees of over 125 companies and to people who live or work in Cook, DuPage, Will, Kane and Kendall Counties.

Through our Credit Union Service Organization or CUSO, Hawthorne Credit Union provides member business loans to our members. Four of the Chicago area credit unions are also members of that CUSO. Small businesses are the life blood of the economy. For nearly a century, credit unions have been there to serve the business lending needs of their members. Our member business loans reflect the diverse background and expertise of our members and for example, in recent years, the credit unions in our CUSO were able to help their members achieve success with a landscaping business, a restaurant and sports bar, an environmental services company and a long-haul trucking business.

Credit union member business loans are relatively small loans. In 2007, the average credit union MBO was $181,000.00. Nationally, credit union business lending represents less than one percent, .89 percent of the depository institution of business lending market and credit unions have about 28 billion in outstanding business loans compared to 3.1 trillion for banking institutions.

In general, credit unions are not financing skyscrapers or sports arenas. Credit unions are making loans to credit union members who own and operate small businesses. And despite the apparent credit crunch with respect to small business and other lending. The chief obstacle for credit union business lending is not the availability of capital. Credit unions are, in general, very well capitalized. Rather the chief obstacle for credit unions is the arbitrary statutory lending limits imposed by Congress in 1998.

Under the current law, credit unions are restricted from member business lending in excess of 12-1/4 percent of their total assets. This cap severely restricts the ability of credit unions to provide small loans for small businesses. This is at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks. The cap increasingly restricts credit unions engaging in business lending as they approach their limit.

The cap also severely hampers credit unions who would like to enter the business lending market because of the start-up costs and the requirements. The most significant cost is hiring staff with business lending experience. Credit unions approaching the cap face the dilemma of having to turn away members who are unable to secure business loans from other financial institutions.

Congress can help by enacting several bills currently pending that would help promote greater credit union participation in small business lending. Credit unions support the provisions of HR 1537, the Credit Union Regulatory Improvements Act, CURIA, which would increase the current limit on credit union MBLs from 12-1/4 percent to 20 percent of total assets and permit the National Credit Union Administration to increase the threshold for defining a member business loan from 50,000 to $100,000.00.

A second piece of legislation that would facilitate credit union participation in small business lending is HR 5519, the Credit Union Regulatory Relief Act which includes provisions that would clarify existing law that permits credit unions to participate in loan programs secured by the insurance guarantees or commitments of state and Federal Government. Exempt member business loans made in under-served communities from the MBL cap and exclude loans or loan participations by federal credit unions to not-for-profit religious organizations from the member business loan limits contained in the Federal Credit Union Act.

Another helpful bill is the Credit Union Small Business Lending Act, HR 1849, introduced by Chairwoman Velázquez. HR 1849 recognizes the need to enhance credit union business lending through SBA programs and is intended to improve small business lending and cooperation between the NCUA and SBA by excluding from the Federal Credit Union Acts definition of MBLs from any loan made in cooperation with the SBA under Section 7(a) of the Small Business Act.

We also strongly support legislative initiatives that permit the SBA to reduce borrower and lender fees for the 7(a) lending program to the greatest extent possible. My written statement goes into further detail about what I've discussed today, Madam Chairwoman. In summary, I want to thank you and the Committee for providing CUNA with an opportunity to express its support for further access to capital, to small businesses. We urge Congress to enable credit unions to serve member business lending needs by enacting the important legislation discussed today. Thank you.

[The prepared statement of Mr. Sorgatz may be found in the Appendix on page 52.]

Chairwoman BEAN. Thank you for your comments.

And now we're going to move to Ms. Lawrie Hollingsworth, who will provide her testimony as President of Asset Recovery Technologies, a disaster assistance and response business headquartered in Elk Grove Village. Ms. Hollingsworth has 30 years of experiences in the electronic and computer industry. She's also an author of a number of articles on disaster recovery planning and management. She testifies today on behalf of the U.S. Women's Chamber of Commerce which provides political and legal advocacy as well as education assistance and outreach services for our nation's women entrepreneurs. Thank you so much for being here.

STATEMENT OF MS. LAWRIE HOLLINGSWORTH, E.E., PRESIDENT, ASSET RECOVERY TECHNOLOGIES, INC., ANNAPOLIS, MD, ON BEHALF OF THE U.S. WOMEN'S CHAMBER OF COMMERCE

Ms. HOLLINGSWORTH. Good morning, Chairwoman Bean and Ranking Member Buchanan, staff. My name is Lawrie Hollingsworth and I am an electrical engineer and certified disaster recovery planner. I am the CEO and founder of two engineering firms, the Price Hollingsworth Company and Asset Recovery Technologies. We are headquartered in suburban Chicago area of Elk Grove Village and both firms work nationwide with insurance companies and businesses after a disaster or property insurance loss.

PHC employees four people including three engineers and ART employs eight people. We have part time and temporary help as needed up to another 20 people. In addition, we have a certified pool of approximately 200 technicians nationwide. Both firms are 100 percent owned and founded by me and are certified women's business enterprises. I founded PHC in 1987 and ART in 1994. I've never asked for nor received government handouts. I started my businesses on a shoe string and funded them by reinvestment of profits and conventional bank loans.

In addition to being a responder to 9/ll we were also active on the response — disaster response to Hurricane Katrina. Both businesses are typical small businesses. We utilize bank loans, line of credit loans and credit cards to fund out business. In addition to reinvestment of profits. My employees are very hard-working, decent, honest Americans with families to support. Like all small and large businesses, this credit crunch effects us substantially. Money is simply less available. When it is available it is at a new premium cost for less money and more restrictive lending covenants.

In 2007 our sales declined by approximately 50 percent over 2006. Most others in my industry, the disaster recovery industry, have reported similar dramatic drops across the board. While fluctuation is the norm in the disaster recovery business, in part due to weather patterns, I believe this drop in revenue was due in part to soaring interest rates and lack of credit. This is particularly likely as weather patterns for both years were similar.

Something has to account for such a precipitous decline. When businesses are already operating on thin and vanishing profit margins, any sort of disaster will put them under. As will be discussed further in my testimony, businesses seeking working capital and equipment loans from a bank to rebuild after a disaster may simply find credit unavailable insufficient or just too expensive.

Faced with looming business failures, most businesses opt to take the money and run and close their doors. They do not reinvest these insurance proceeds back into the business. This is one more sale of services I do not make and one more business failure in America. Alternately, businesses may have chosen to substantially under-insure themselves to save costs currently, a measure almost guaranteeing their eventual failure in the face of disaster, by the way.

Thus there's not enough money for rebuilding after disaster which requires hiring a firm like us and we also lose revenue. I also believe that the current credit crunch presents a significant drawback to available money for startups. We are focusing today on the impact of currently existing small business to some degree but I believe there's a second substantial and somewhat obscured impact of the tightened credit market. This hidden danger is a lost opportunity for small business start-ups.

Small business is the largest private sector employer in the U.S. The heart of small business and this is my opinion the American dream is the business start-up. For the mom and pop endeavors to the technology firms, these are the life blood of our nation. Start-ups are funded by savings, 401(k)s, gifts and loans from friends and relatives and the occasional governmental source. Home equity loans, equipment loans, collateral based working capital, bank loans and credit card debt.

The statistics on small business failure in general are already severe. Failure rates of over 50 percent in the first two years are often cited. Already started on a shoe string and usually under-funded, these small businesses depend on debt and credit to open their doors and thrive. What is happening now is that debt funding for new ventures is simply disappearing. This is in no small part due to the sub-prime mortgage collapse. Lenders are very nervous about home equity lending, often substantially reducing available loan size.

I'd like to touch quickly on a second disaster, I believe, that's being exacerbated by the tight credit markets and that is rebuilding after any type of disaster, notably things like Hurricane Katrina. The U.S. Department of Labor estimates over 40 percent of businesses never reopen following a disaster. Of the remaining, 25 percent will close their doors within 2 years. Over 60 percent of all businesses confronted by a major disaster will close within two years.

How much will these statistics worsen? I believe this credit crunch is greatly impacting the ability of business to rebuild and re-establish themselves after Katrina. I'm a native Floridian and University of Florida graduate, so near and dear to my heart is the rebuilding of Florida businesses. I have seen many, many areas in disaster after hurricanes and so forth, and I believe the credit crunch is significantly impacting the ability for businesses to rebuild after Hurricane Katrina all impact areas such as Florida for small business to re-establish themselves.

This concludes my testimony, thank you.

[The prepared statement of Ms. Hollingsworth may be found in the Appendix on page 57.]

Chairwoman BEAN. Thank you so much for your testimony and now I'm going to defer to Ranking Member Buchanan who will introduce our next witness who also hails from the Sunshine State of Florida.

[Off the record comments]

Mr. BUCHANAN. I want to thank the Madam Chair. It's a pleasure to have Vanessa Baugh with us today. She's ran a successful jewelry business for a lot of years. She had a couple, three facilities, had to close one because of tight access to capital and also because of the tightening economy in our area. She also chairs, which I was Chairman for two years, the Sarasota Chamber of Commerce.

We have about 2400 primarily small businesses in that area, but she chairs the Small Business Council for that organization, which has done an outstanding job. I appreciate your effort there.

Thanks for taking the time out and coming today. We're just glad to have you up on the Hill and hopefully we'll get a chance to visit a little bit more later today. Thanks for coming. Thank you.

STATEMENT OF MS. VANESSA BAUGH, PRESIDENT, VANESSA FINE JEWELRY, LAKEWOOD RANCH, FL

Ms. BAUGH. Thank you, Congressman Buchanan and Madam Chair Bean thank you for having me here today. The effect of the credit crunch on small business is extremely difficult. As Congressman Buchanan said, I have a jewelry store. It's been open for nine years. It's in the heart of the County of Sarasota in southwest Florida. And I'm here today thanks to the Greater Sarasota Chamber of Commerce where I also serve on the Board of the Directors.

Sarasota, Florida was named last month by the Fortune Small Business Magazine as one of the 100 best places in America to live and launch a small business. The Greater Sarasota Chamber of Commerce, which does represent 2400 businesses, 85 percent of those have 10 or fewer employees. It is one of the top local chambers in the state and nation and our healthcare and educational systems are among the finest and of course, we're known for our pristine beaches.

I, like many other small business owners, have been watching as the real estate market crashes. Just last week we were named as number 15th in the nation for foreclosures. We are losing jobs daily and many small businesses are closing their doors. Part of the problem is that many of us small businesses have what the call soft collateral. We cannot get bank loans like most small business.

They will not loan us money generally, even when the money is good. Because of this, most small businesses have to rely on their equity in the real estate that they own. I am one of these people. We are accustomed to this. However, with the real estate market decreasing so dramatically, many of us have lost this ability because of no equity or because we cannot qualify for the home equity loan because our revenues are down.

In other words, some of us have nowhere to turn for relief. So what do we do? Some of us can use our retirement plans but how many small business owners truly have a retirement plan. We can use our credit cards but either way it's deadly for us. The crunch is especially painful in Sarasota which along with many other areas in Florida is facing an economic downturn because of its primary market real estate.

In our residential real estate sector, we have an inventory in excess of 18 months and prices have dropped 25 percent from a year ago. Needless to say, jobs have plummeted. Sarasota itself overall has lost over 13,000 jobs in our immediate area. Our unemployment rate is far worse than the rest of the state and is approaching 6 percent. Forecast call for Florida's unemployment numbers to continue a downward trend through 2009. From all the indications Sarasota seems destined to continue to lead in this way until the tables turn.

Another problem that small businesses have is that their vendors, who they get their inventory from, are also feeling the credit crunch. So their terms to us are not as good as they used to be. All the while our operating costs are going up, the cost of healthcare and just overall operating cost keep going up, up and up. In Florida, we have 45 business owners and employees that are now uninsured. They have no healthcare because they simply cannot afford the monthly fees involved.

In Sarasota, another key industry is tourism. We are made up chiefly of small businesses with seasonal cash flow and credit needs. Our chamber works hard with other local players to try to attract visitors, domestic and international. So what do we want and need and expect from our representatives here in our nation's capital to try and overcome these problems?

Please give priority to meaningful tax reform and hold the line on tax increases in income, capital gains and estate taxes while the reform debate ensues to allow small business owners and opportunity to grow our businesses, and hopefully that will help stimulate our sluggish economy. At the same time, please enact business friendly incentives such as tax incentives for business who want physical and job expansion. SBA loans are important, but the program does not provide near the solution we need.

Please consider tax incentives to banks to expedite small business loans to relieve the pressure on our free market economy. The revenue might be lost in creating such incentives but it would more be offset by positive impact that it would create that it would create in taxable income revenue generated by businesses who succeed rather than fail.

Thank you for having me here today.

[The prepared statement of Ms. Baugh may be found in the Appendix on page 63.]

Chairwoman BEAN. Thank you so much for your testimony, to you and to all of you today. I'm going to begin with a few questions and then invite other members to participate with their questions and then I may come back with a couple more. I guess I'll start with, is it Ms. Baugh? Am I pronouncing that properly.

Ms. BAUGH. That's right.

Chairwoman BEAN. I think you mentioned you've been in business for about 8 or 9 years.

Ms. BAUGH. Nine years.

Chairwoman BEAN. Okay, have you actually applied for a 7(a) loan at any time?

Ms. BAUGH. I actually started in business with an SBA loan.

Chairwoman BEAN. You did.

Ms. BAUGH. Nine years ago.

Chairwoman BEAN. And have you subsequently tried to get capital there and that has not been —

Ms. BAUGH. No, in all honesty, the reason that I've not looked at that is because it was quite an experience to go through that I've hoped, of course, over time to use other avenues. It took an awful long time to go through it. The paperwork was unbelievable. It was a difficult experience in all honesty but that was 9 years ago.

Chairwoman BEAN. And subsequently, there was easier credit for some period of time maybe that you could have gotten but now as it's tightened up, is it something —

Ms. BAUGH. I've tried over the past few years to get business loans to increase my business and open new stores. I've had to rely on my home equity to do that because I have what they call soft collateral.

Chairwoman BEAN. Right, okay. And can I ask, what the structure of your company is? Are you incorporated or —

Ms. BAUGH. I'm incorporated. I have five employees including myself.

Chairwoman BEAN. Okay, C Corp, S?

Ms. BAUGH. Yes.

Chairwoman BEAN. Okay.

Ms. BAUGH. S Corp, I'm sorry.

Chairwoman BEAN. S, okay.

Ms. BAUGH. S.

Chairwoman BEAN. One of the question I have and you may not know and then I would open this one up to the panel is, does that seem to be effecting the small businesses and their consideration as how they're structured? I've had some people suggest that they think after they became a C Corp, because of the requirements that they have to provide as that entity they have more documentation to provide when they were pursuing loans. Is that relevant or not relevant from your experience? I'll throw it out in general?

Mr. SCHROEDER. As far as our bank is concerned, and we deal with sole proprietorships, partnerships, corporations. There is a set amount of paperwork that really does not differ very much from one form of organization, business organization, to the other. You obviously have very specific forms for these different forms of business but the paperwork is basically the same for all of them based on our experience.

Chairwoman BEAN. And also one other question to layer this in your responses, too, do you see that those who are C Corps are more likely to get approved maybe just because they have more of that information available, not that you're requiring more but because they have to do it already? I'm just curious.

Mr. SCHROEDER. The fact that you have a C Corp versus a sole proprietorship in and of itself does not make a difference. What very well may happen is a C Corp may have audited financial statements. They may have monthly financial statements, budgets, but quite honestly, if the sole proprietorship has the exact same—

Chairwoman BEAN. Has the documentation?

Mr. SCHROEDER. —then there is no difference as far as we're concerned.

Chairwoman BEAN. Mr. Sorgatz, did you want to comment?

Mr. SORGATZ. Yeah, I would just concur with what Mr. Schroeder said. It really, in our case, too, doesn't make—there's no difference in terms of the application process from out standpoint.

Chairwoman BEAN. Does anyone else want to weigh in on that?

Ms. HOLLINGSWORTH. Just that I've always been S Corp with all four of my corporations and there are substantial tax breaks like a Section 179 recovery for capital investment, so I'm not sure why any small business would like to be a C Corp. They miss some very good tax breaks.

Mr. ECKSTEIN. I guess I have to get a new accountant. I'm a C Corp, which is really unusual, but, you know, the carry-back would be substantial for me. You know, again, when I formed my corporation, I assumed I had 20 profitable years ahead of me and I fell short by 3.

Chairwoman BEAN. Okay, all right.

Mr. ECKSTEIN. But the paperwork has not been any more cumbersome, you know, in applications or loans.

Chairwoman BEAN. All right, thank you. My other question for Ms. Baugh is, one of the things I don't know if I actually heard you say it today but I think I had read that you mentioned was the possibility of accessing retirement funds—

Ms. BAUGH. Right.

Chairwoman BEAN. —as a stop-gap measure. Can you share a little bit more about that challenge? We had done actually—in this Subcommittee we had done some hearings on pension parity/equity issues and that's one that had not come up is in hardship being able to access those pension dollars. We did talk about some of the differences of employees of a larger corporation who have access to their tax deferred 401(k) dollars. Some cases small business who may have a SEP don't have the same access to their own tax deferred dollars and so we were looking at that. I'm very curious to hear more about that.

Ms. BAUGH. Well, I do have an IRA. The problem with that, of course, is when you take the money out, the tax consequences are terrible. I think for probably a small business owner, too, we don't get to invest that much money into it as perhaps the larger companies because obviously, we're using our money for operating expenses.

The problem there is that once you take it out, and you lose almost 50 percent of it into taxes, you know, then are you ever going to be able to even put it back. So you're looking at possibly extending, for me, my retirement probably 20 years. I'm 54. I don't want to work until I'm 74.

Chairwoman BEAN. Because what you had to do is you couldn't withdraw from it for hardship purposes and then pay it back in the—

Ms. BAUGH. Exactly.

Chairwoman BEAN. —way sometimes other can from 401(k)s but instead had to withdraw it and take it out.

Ms. BAUGH. Exactly. I was one that opened my IRA many, many years ago and so for me to take the money out, it's—you know, it's a real problem.

Chairwoman BEAN. Okay, thank you. I'd like to ask David Schroeder, if I might, confirming the recent downturn we've seen in the economy, the Fed Reserve survey recently showed weaker demand and tighter lending standards for all borrowers and all types of loans. In most situations credit tightens in response to some perceived risk associated with lending. Has that been the case with the current pull-back that we've seen?

Mr. SCHROEDER. Well, I'm happy to say that community banks are alive and well and community banks are lending money. Now, having said that, the recent mortgage melt-down, the recent credit crunch and liquidity crisis have all had an impact on our economy, and that really has been the reason why there has been a negative impact on our bank and a negative impact on our customers.

Chairwoman BEAN. Okay. And for Ms. Hollingsworth, from 2002 to 2007 the average size of the 7(a) loan has decreased by over 65 percent. Given the current economic situation and business costs increasing, does that make sense for you that the loans would be getting smaller?

Ms. HOLLINGSWORTH. No, Congresswoman, it does not. I speak from time to time on funding small businesses for assorted groups and I think one of the strongest things that gives rise to these high statistics is small business failure in the first couple of years is they're usually significantly under-funded. So further under-funding is sort of saying the death warrant ahead of time.

Chairwoman BEAN. You mentioned in your testimony, you talked about how many of the firms you work with are under-capitalized and also under-insured which then doesn't leave them with the facility to rebuild—

Ms. HOLLINGSWORTH. Right.

Chairwoman BEAN. —when you come in. You also mentioned less companies are disaster recovery planning procedures in advance, certainly not best practices when it comes to risk management. And that's also due to lack of funding. Typically, what size companies have you worked with historically and has that changed over the course of your business?

Ms. HOLLINGSWORTH. Okay, our firm is primarily disaster recovery as opposed to planning, meaning we go in and clean up computers, manufactured equipment, et cetera. We work anywhere from Verizon to NASA to state and Federal Governments, down to mom and pop Insti-Prints or 7-11s and everything in between.

Chairwoman BEAN. So you are in after the fact. You're not —

Ms. HOLLINGSWORTH. We are the after the fact, but what I'm seeing very consistently, we're headquartered in Chicago with offices around the country but a lot of the small manufacturing companies are in the Chicago area and when they have a significant disaster, they're already struggling in the Rust Belt with the manufacturing and they face the choice of literally taking the insurance proceeds and running. And many, many of them are electing in larger numbers than ever to shut their doors.

We just had a disaster in Chicago three weeks ago. A printed circuit board manufacturing company, he's folding up, going out of business.

Chairwoman BEAN. So in some ways in the same way that we're seeing in the residential community of people who are finding themselves so up side down that they're preferring to walk away than restructure their loans because the property values have dropped, you're saying many small businesses are to a greater degree than what you had seen in the past, are finding themselves literally so under water than they're not even going to try to recover.

Ms. HOLLINGSWORTH. Yes, Congresswoman, and literally, as I was mentioning the Gulf Coast and communities in Florida and all along that area notably things they had had for collateral such as homes and so forth, they're simply gone. They have an empty lot. There's no more home equity. The mortgage may still be running. Their insurance did not cover for floods so they did not have insurance coverage, and you know, from the corner bakery to the Ace Hardware Store to Joe's Bait Shop, there's just no way for them to recover.

Chairwoman BEAN. Okay, thank you for your testimony. And I'm going to let our Ranking Member Buchanan speak.

Mr. BUCHANAN. Thank you, Madam Chair. Let me mention, and this is really for the whole panel, because I think this is important, I'm not sure everybody understands it up here but I want to get your thoughts and by the way, with a C Corp, I had a C Corp 25 years ago, but most—a lot of accountants and stuff today are people I know and I'd be interested in the banks, and this leads into the question really, too, is most of them are Sub S, LLCs, partnerships or sole proprietorships because of the pass-through effect.

Now, it's a little different today maybe with the dividends or something but because it's double taxations and if you're primarily the 100 percent shareholder, a lot of people go to that. So my question really is, is that there's a mind set in Washington, unfortunately, that you want to tax the people that make over 150 more aggressively but part of it is when you do that, you really tax small business because of the pass-through in a big way. My example, and just from friends and stuff, they make 500 but say, by the time they pay their taxes, a third, and then they've got a little extra inventory, they add a few extra employees, they — you know, and sometimes they — you know, write things off, but at the end of the day, they always figure out, where's my cash. So if we increase taxes up here on individuals, aren't we really effecting negatively hundred and hundreds or millions of small businesses and I open that up to the panel?

Correct me if I'm wrong because you were both saying, especially the community bank and the credit union, and I'd ask any of the others, isn't that your understanding, so if someone really makes— what I'm saying is some of my show 500 at the bottom line they made 500, but when it gets down by the time they pay their taxes and other things, that they end up with very little liquid assets or cash at the end of the day, many times, and if you added another tax, it just squeezes them that much more. But that's what I find but I want you to give me your sense of it.

Mr. SCHROEDER. I would agree with you, Congressman Buchanan. I would say, looking at our business customers, the overwhelming majority fall into two camps, either sub-S or LLCs, some LLPs, very few sole proprietorships but primarily within those two camps and I would wholeheartedly agree that that pass—

Mr. BUCHANAN. Which just passes all the way through to their tax.

Mr. SCHROEDER. Exactly, so I would wholeheartedly agree with you.

Mr. SORGATZ. I would concur with that, too. With our — you know, we do a lot of sole proprietorships, partnerships but we do have some LLC's also, so I would see that as a definite impact on the small business owner.

Mr. BUCHANAN. So if you raise taxes, say 5 percent on individuals, really what you're doing is you're raising 5 percent on 99 percent of the small businesses in the country as well. So that needs to be taken in to fact, when you consider they create 70, 80 percent of the jobs, am I right on that?

Mr. SORGATZ. Yes.

Mr. BUCHANAN. Okay, anybody else, comment or question?

Ms. HOLLINGSWORTH. Yes, I'd like to comment. In 2007 I showed enormous paper profits and generated enormous six-figure tax burden which I painfully wrote a check out on April 14th and saw very little of that actual profit in my pocket. Simply put, higher taxes on individuals is a higher tax on sub-S corps, period.

Mr. BUCHANAN. I think that needs to be—I'm not sure everybody in Washington understand that but when we decide to go that way, they need to understand the impact that's going to have on small business and I just — does anybody have a different experience than that?

Mr. ECKSTEIN. Well, in my experience, I personally took my 401(k) money out to help my company. Even though I'm a corporation, I transferred that money into my company thus showing a, you know, wonderful year for my income taxes and then had to pay that fee on top of everything else. So I've been extremely penalized and with no incentive to reinvest in the future and that's something that I think really, we should be encouraging small business to reinvest—invest in themselves first when times are tough and then give them some benefit back when things are—

Mr. BUCHANAN. Yeah, I usually find people that end up with maybe 100,000 excess capital, they put it back in their businesses, they're never putting it in their pocket. They're constantly using it because they need it to grow their business. That's been my experience over 30 years.

Let me—did you have something, Ms. Baugh?

Ms. BAUGH. Congressman Buchanan, I think you're absolutely right. As a small business owner, if you raise taxes, I'm going to get hit, we all are and you're right, we use any profit, not that we're making any right now, but in the past we turn that over into the business. So, please, keep—no tax increases. Right now it would be terrible.

Mr. BUCHANAN. Ms. Hollingsworth?

Ms. HOLLINGSWORTH. And just very quickly, not only ordinary income tax but capital gains dividend distribution, this is an opportunity as a sub-S Corp that I can take income at a lower tax rate, so increasing those rates also hurt the sub-S owner.

Mr. BUCHANAN. Okay. Let me just mention on the home building, obviously, Mr. Eckstein, you had mentioned that the impact it's having on you in our area. We've got a lot of homebuilders, I hate to say it, but our businesses I've been in our down 10 percent of so, but homebuilders are down 70, 80 percent. You mentioned a couple of things that you thought would help on behalf of the homebuilders. Any other thing that comes to mind or I'd like to have you jot me any of your additional thoughts of what we might be able to do to help, because really that's—you know, in Florida and all parts of the country, it's a big issue and usually we've got too much inventory so—and I can tell you, I've got—and I can tell you, I've been involved in partnerships and homebuilding and the problem is, is selling the other house, even if you could sell this house.

So I know you mentioned something about carry-back on taxes. You mentioned something about tax credit for home-buyers. Any other thoughts that you've come up or your association?

Mr. ECKSTEIN. Well, the Association, I mean, I think we feel very strongly about some kind of incentive to either—whether it be first-time home-buyers or home-buyers in general, for at least a short-term basis that could begin definitively and soon because with conversation out there, it lingers and people just find more reasons to wait to take advantage of the interest rates that are better than ever. We'd like to see something happen soon that would encourage, you know, first-time home-buyers helps the ladder effect, you know by moving lower end inventory and then, you know, pushing it up the ladder. So anything to entice people to buy right now is what we're—

Mr. BUCHANAN. What's your thoughts on—I know in our area people are very environmentally sensitive. They want to cut energy costs. What about some incentive for homebuilders, small homebuilders that are building more energy efficient homes, is that something, again, incentive for—or would that make a difference in your area? Is that an area that people are sensitive about that or not really?

Mr. ECKSTEIN. Well, it's an emerging area. I mean, with the Green Movement and everything, it's coming into homebuilding, but many of us are doing it already through the new adopted building codes. The latest version of the residential building code has great energy — you know, recovery benefits in it that naturally—and they cost money. I mean, they'll cost 10 to $15,000.00 more per unit to build but there should be some incentive to take advantage of these. People will save money in the long run.

Mr. BUCHANAN. Yeah, I just find like in the auto industry, hybrids, a couple years ago, it was so funny, the government will give an incentive for a sports utility vehicle that weighs 5,000 pounds and they just flew off the lots but, you know, you'd think they would do something ideally with hybrids or energy efficiency homes, especially when we've got our energy crisis that's going on.

A lot of homebuilders have said they thought that that would be a good thing because there's some people, even the hybrid costs more, they just want to, you know, contribute in a small way and I just think that's something that can be helpful.

Mr. SORGATZ. Just in community banks, I wanted to get back, this housing crisis that we're in, I mean, my sense of it is not to pick on Wall Street but it's something that was sub-prime lending they claim was about 20 percent, mortgages today are sub-prime lending. They came up with a creative process and Wall Street or whatever, sold off a lot of these products and probably a lot of lenders might not have done from a conventional standpoint, sold them off, bundled the up and now they're international investors compared if they had, you know, someone's got a problem with a community banker, he can go down the street and talk to the banker and maybe you guys could work with him a little bit. Is that your mind set what's created a lot of these issues nationally from your standpoint or—

Mr. SCHROEDER. Very definitely, and the point I would like to make very clearly is that community banks and community bankers do not put people in homes they can't afford and in loans that they can't afford. And the problem right now with the mortgage meltdown is that these holders, as you mentioned, are so far away from the actual origination and borrowers that there really is a lack of flexibility in trying to restructure and work with the borrowers as problems emerge.

Mr. BUCHANAN. Okay, thanks, I think—how much time do I have left? Are you—okay, I wanted to make sure. Just your thoughts—I mean you were talking about also the community banks in general are pretty good from and equity capital standpoint. Is that what you're saying today?

Mr. SCHROEDER. Very definitely. Community banks are very well capitalized and again, we are not suffering the direct result of the mortgage meltdown but because of the slowdown in the economy, we are definitely suffering as are out customers, the indirect result of the mortgage meltdown. And that's putting pressure on us. It's putting pressure on our customers. It's effecting our underwriting standards, and it is making it more difficult to emerge from this situation.

Mr. BUCHANAN. And your thoughts on a couple of things we could do up here to help the community banks to get more capital out to small business?

Mr. SCHROEDER. Our bank, as I mentioned, is a very active SBA lender. We originated $62 million in 7(a)loans last year and $15 million in 504 loans. Anything that can be done to increase—a number of things. We can increase the guarantee limit, reduce the fees that are charged to bankers and borrowers which are significant. I think one trend that's evident within the SBA program right now is the concentration of originations with the largest banks and the sharp decline in the number of small community banks that are participating in the SBA program. So anything that can be done to increase the number of small community banks that participate in the program would be very, very helpful.

What that does is drive the benefits of the program down and out in terms of geographies, in terms of census tracks and again, from my standpoint, concentration of power is never a good thing. And right now, we have a handful of the largest banks in the country, several of them that are originating 60 percent of the SBA loans. I don't think that's healthy and I think community banks need to participate more in the program and whatever Congress can to do help that would be very much appreciated.

Mr. BUCHANAN. My experience was like Ms. Baugh, it's been 15, 20 years ago working with SBA was almost impossible. Eight months, 9 months, a year, finally you just give up out of frustration. What's been your experience and what's the time frame? She comes in, you know, wants to get an SBA supported loan. You know, what does a normal customer of a community bank, how long is that going to take?

Mr. SCHROEDER. Because our bank is an active SBA lender, I am probably not the best person to ask about—

Mr. BUCHANAN. But I'd like to know from your standpoint, being an active lender, what's possible? I mean, what's the average, you know, how long? She comes in. She's a small business in the community. How long before she gets a yes or a no and if she gets a yes, how long is it going to be before she's going to get funded?

Mr. SCHROEDER. Because our bank is able to underwrite and approve on behalf of the SBA, as soon as we have all of the information and can do our underwriting, we can get an approval. Thirty days is not unusual.

Mr. BUCHANAN. Okay.

Chairwoman BEAN. Will the Chairman yield?

Mr. BUCHANAN. Yeah.

Chairwoman BEAN. If I an also ask, so then what you're essentially saying is it's the challenge of getting banks up to speed the way yours is so that they can facilitate the same type of experience.

Mr. SCHROEDER. Right, yeah, the learning curve is steep. There are certain application standards, underwriting standards, documentation and closing standards, as well as ongoing servicing standards. Our bank has long since gone up on that learning curve and we're very efficient at it. The challenge is to get the smaller banks to participate and again, whatever Congress can do to facilitate that would be very much appreciated and there are several bills moving through, Chairwoman, that will accomplish that.

Chairwoman BEAN. Thank you. I yield back.

Mr. BUCHANAN. Thank you, Mr. Sorgatz, let me ask you, you mentioned the 12-1/2 percent in terms of being capped. How much of difference would it make if Congress relooked at that or rethought that? And I know there's a lot of pressure from a lot of different groups up here on that, but I'm just curious because, you know, today—my mind today needs to be about helping people in small business and we've got to get out of the business of politics to the extent we can, but just what's your sense of how much difference would that make in the credit unions one way or the other?

Mr. SORGATZ. The difference that we've calculated it would make if we were able to get up to the 20 percent level would be approximately 4 to $5 billion that would be available in the marketplace for small businesses. As I mentioned, earlier, you know, our average loan is about $181,000.00. So just that change alone would be able to put more money, liquidity in the marketplace for small business. But also I wanted to talk a little bit about the SBA side of it, too, from a credit union perspective. Being able to reduce the fees, as Mr. Schroeder said, reduce the—you know, the application process, make it more—a lot more smooth and easier for both the financial institution application side and for the borrower side.

I'll mention that a smaller percentage of credit unions today do SBA lending mainly because of the application process and the fees involved. Credit unions would like to get more involved but we need a little help in terms of addressing what those fee issues are and addressing what the application process is, also.

Mr. BUCHANAN. I thank you. I'm going to yield back and then I'll come back with a couple more questions.

Chairwoman BEAN. I'd like to recognize Congressman Sestak from Pennsylvania. He has some questions.

Mr. SESTAK. Actually, I think I only have two. Those were great questions. When Governor Mishkin came before us last November, he had stated that in the—as far as the impact on small businesses of credit that there seemed to be no issues but it was still a bit uncertain what the impact would be and when he went to the Senate side the other day, he made comments that, well, it looks now as though—and I'm sorry I wasn't here to listen to your testimony, but that lending standards have now tightened among the lenders for small businesses, and the rates have increased.

In fact, for small businesses, small commercial banks and all, the spread is actually more now than it was previously between the cost of funds and the interest rates, probably because of the risk attendant to lending today. And so small banks, community banks are now only lending a 12-percent growth this past recent month or two rather than 20 percent you've been seeing.

My question is more one of how well are we really shooting ahead of the rabbit? You know, the Governor was here and said really no issues, but it's uncertain and now we see some harbingers, something that's more than harbingers of impact. How — can you describe to me how well—what is your monitoring out there in the field so to speak for the credit union, for the bank? How do you monitor this so there's a better sense in Washington of are we really shooting ahead of the rabbit early enough to help in some way?

I say that because I was taken by the facts that—and this is what I'm curious about is, 45 percent I gather of all small businesses use collateralized real estate which you were speaking to, you know, to back them up and 15 percent of that is personal. Forty-seven percent of them use credit cards, and house finances and automobiles. What — how do you raise to Washington that early enough there's such an issue that's impacting and if it's going to get worse? That's probably not a great question but I'm just curious how just a few months ago somebody you hope would have a lot of foresight said there doesn't seem to be any issues right now but it's uncertain, and all of a sudden now we're hearing, gee, you know, this is really impacting us.

I don't think it's his fault, it's just how do you get a better view of this from you all?

Mr. SCHROEDER. Well, things have happened incredibly quickly since August of last year. Just look at the decline in the Fed funds rate. There's been a 300 basis point reduction and depending upon how things go at the Fed today there may be an additional reduction. So things have very definitely happened quickly. I can say for the banking community, we —

Mr. SESTAK. They have happened quickly but the impact is still—it seems as though, you know, they happened last August. Here you are this past three months having instead of 20 percent expanded, you know, you're down to 12 percent all of a sudden. Are we doing enough?

Mr. SCHROEDER. Let me try to explain from our standpoint, underwriting standards and how we look at credit. It's not only internal as far as the bank but external in terms of our regulators. In a situation like this, where we have an economic downturn, we, quite honestly have restricted and tightened our underwriting standards. What pays back a loan is profitability and cash flow and when the economy is not doing well, the predictability of profitability and cash flow is not there.

So there are some loans, particularly loans on the margin that may not get done in an economic downturn. If we're not doing this, our regulator is certainly going to be there making sure that we do in terms of monitoring our customers and monitoring the economy and monitoring our portfolio. So we—maybe a different way to answer your question, you know, we look at all the different economic reports that come out the different views on the economy and see what's happening within our own portfolio and with our own customers and based on all of that information, make a decision as to how to proceed.

Mr. Sorgatz. I think from the credit union perspective our consistency in the underwriting standards has been pretty level. When I talk to the other credit unions around the country and ourselves in particular, the group of five credit unions that work together on the commercial lending side, we haven't changed our underwriting standards and to be honest with you, we have no current delinquencies either and that's more of a relative factor with credit unions who have a much smaller delinquency rate on business lending compared to our banking partners. So we haven't changed how we approach the commercial lending side from the due diligence that we do, meeting the requirements of our regulators. I think the concern that we have and that we've tried to express early in my testimony is the ability to be able to continue to offer more services to more small businesses in the community and that goes back to the 12-1/4 percent issue.

That cap level does prohibit or limit severely what credit unions are able to do in terms of serving the small business community throughout the country. And when you have the capability of being able to provide an additional 4 to $5 billion in the marketplace, that's fairly substantial and can help at a time when the tightening standards that banks have had to put into place because of the issues that they've dealt with in terms of obviously, the sub-prime crisis issues and so on, we're here, we're ready to help fill that need at this point, but we do need some help from the congressional standpoint to be able to step up to the plate and be able to deliver those additional services in the community and we like to do that.

Mr. SESTAK. Thank you. That's all I have.

Chairwoman BEAN. Thank you. I wanted to just throw out one thing before I yield to Congressman Buchanan. Mr. Eckstein had mentioned the homebuilders and the lost carry-back is something that you're interested in. As you know, in the stimulus package, we'd introduced that as one of the things that didn't end up making the final cut. I know the Senate is still looking at maybe the future housing package that's still going to be coming out and let me yield.

Mr. BUCHANAN. Thank you, Madam Chair. Ms. Baugh, I wanted to ask, you talked about soft collateral. Just for the audience and that, how do you define that in your mind, sort collateral?

Ms. BAUGH. From what I understand from many bankers, when you have your inventory that you sell, such as in my case or in a restaurant even, I sell jewelry. Well, the jewelry leaves the store. So even though in my store, I have $3 million worth of collateral to me, they will not look at it as collateral, because it leaves the building.

I lease where I am. I don't own the real estate, so therefore, I have no collateral that the banks are willing to loan me a business loan on and it's not—

Mr. BUCHANAN. Just out of curiosity in your industry, do you own that or do you pay for it as a kind of on consignment when you say soft collateral?

Ms. BAUGH. When you're an independent jewelry store, you have to buy the majority of it. There is some that's on memo, but the majority, you do have to purchase. And it's not even just the jewelry industry. There's many other businesses that—retail businesses that are set up the same way as mine.

Mr. BUCHANAN. And when you look at, you know, Sarasota or just that region, you know, we're talking about tight credit but it's a lot more than tight credit. I mean, in our case, we've got property insurance challenges, property taxes have gone up a lot over the years and haven't been adjusted. You've got now the cost of oil and gas and you know, everything at the pump.

What do you see other than the tight credit market is the other big issue for you in your area, your biggest area? When you're talking with your customers and that, what is the biggest thing they're talking about today?

Ms. BAUGH. Well, more on the local level, property taxes, insurance, homeowner's insurance of course, gas is a big issue at this point. And I think that's part of the problem with the economy. Even though the real estate market is so terribly down, a lot of people that do have extra income are not spending it because they just don't know what's going to happen with the economy. So it's a no-win situation all the way around.

Mr. BUCHANAN. Yeah, and let's say if you had access to additional capital, would that in this environment, in your case, make a difference? I mean, what would you do if you had it? I mean, is the market there to expand your business, for example?

Ms. BAUGH. Well, in all honesty, I, myself, I'm in a holding pattern where I'm sitting back waiting to see what is going to happen with the economy. Once we turn around, and I'm sure that we will, I mean, this happens from time to time, we will open another location. I hope that we weather the storm and we're able to do that. That is my goal.

Right now I'm in a holding pattern. I'm sitting back hoping to survive in all honesty.

Mr. BUCHANAN. We appreciate your comments on that. Ms. Hollingsworth, let me mention in terms of your business, you brought up, I thought predatorial lending practices are detrimental to the development. What did you mean by that?

Ms. HOLLINGSWORTH. Are you referring to the credit card interest?

Mr. BUCHANAN. Yeah, stuff like that.

Ms. HOLLINGSWORTH. Our firm, along with probably the majority of small businesses utilize credit card debt for various things. For example, when we mobilize to a disaster site, I have employees in hotels for maybe months. Sometimes we have airfare, all that gets charged on a credit card, typically. So while we have a very favorable lending rate from our bank, and we try to pay our credit cards off as soon as possible, these 17, 18, 19, 20, 22 percent interest rates on credit cards are just unbelievable. And I think credit cards are a cornerstone of small business funding and cash flow management, and that's what I consider predatory lending.

Mr. BUCHANAN. Okay. Thank you. I yield back.

Chairwoman BEAN. Thank you. I just had a few final questions myself, to Mr. Sorgatz and possibly Mr. Schroeder may want to comment as well, the SBA, as you know, recently implemented a portfolio monitoring system to oversee the 7(a) and 504 portfolios. The system is drawing criticism from a number of lenders in the lending community as not accurately providing a good measurement of portfolio risk.

At the same time, the SBA is ready so spend more money on this program. So I'd like to hear your comments about how well this program is doing coming at particular time when the credit crunch is severe. Is it effecting lender participation in the program, number 1? And is it a good idea to spend more money if the tool isn't helpful?

Mr. SCHROEDER. Well, from our perspective, this oversight is new program, again, relatively new, so in that respect we haven't seen all of the—all the ramifications of it, but there is a certain amount of overlap between what the SBA is doing and what our primary regulator is doing, namely the FDIC, and we're a state-chartered bank. So there is a certain degree of overlap there.

Chairwoman BEAN. Which become burdensome then.

Mr. SCHROEDER. Which is an added burden for us. So to the extent, and again I think this will take a little more time to really, you know, flesh out and flush out all of the different issues, but at least right now my initial observation is there's an overlap between our primary regulator and what the SBA is doing.

Chairwoman BEAN. So it mostly presents and obstacle to lenders who otherwise might participate in the program, but might decide not to as a result.

Mr. SCHROEDER. Yeah, definitely.

Chairwoman BEAN. Mr. Sorgatz, did you have any additional comments?

Mr. SORGATZ. Well, we currently don't do SBA lending but I would concur with Mr. Schroeder, with our federal regulator having the oversight on our underwriting standards and lending guidelines and so on. I would agree it would probably dovetail into additional duplication of the process.

Chairwoman BEAN. The other question I had and thank you for that, is on the SBA Express Program. Over the last several years, the SBA has become very heavily reliant on that program because it carries only the 50 percent guarantee. What is the effect of the current credit crunch on the SBA Express Program from your perspective?

Mr. SCHROEDER. We tend to a smaller number of larger SBA loans so we do not use the Express Program.

Chairwoman BEAN. You're not using it.

Mr. SCHROEDER. We're not an active user of that program, no.

Chairwoman BEAN. Do you think the fact that the SBA is relying so heavily on it and emphasizing it is one of the reasons we've seen participation go down?

Mr. SCHROEDER. SBA loans, by their very nature, are riskier than conventional loans, and to the extent that you reduce the guarantee fee, or the—I'm sorry, reduce the guarantee percentage, you will very definitely have a negative impact on banks that participate in the program from my perspective, yeah.

Chairwoman BEAN. All right, I thank you very much for your testimony. Did you have any additional?

Mr. BUCHANAN. The only thing I'd like to comment, just thank all our witnesses for taking your time and all of you are busy and could be doing other things, but it does help us. I know the Chairman of the Committee and myself, it helps us up here to hopefully come up with better policies and things that we can do to help make a difference for you. So I appreciate you coming up. Appreciate you taking your time. It's helpful to me and I know to the Chairwoman, too.

Chairwoman BEAN. Thank you so much, and know that obviously we're both here and on a bipartisan basis recommitted to working together to address what you've raised. I particularly like the questions that both of you raised about having to access your own pension monies and certainly we want to do that in a way that allows you to reinvest your own money in your business and we're going to look at that closely. Thank you so much.

I do ask unanimous consent that members will have five days to submit statements and supporting materials for the record. Without objection, so ordered. The meeting is adjourned.

[Whereupon, at 11:17 a.m., the Committee was adjourned.]

MELISSA L. BEAN, ILLINOIS
CHAIRWOMAN

VERN BUCHANAN, FLORIDA
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
Subcommittee on Finance and Tax
2361 Rayburn House Office Building
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STATEMENT
of the
The Honorable Melissa Bean, Chairwoman
House Committee on Small Business, Finance and Tax Subcommittee
"The Effect of the Credit Crunch on Small Business Access to Capital"
Wednesday, April 30, 2008

I call to order this hearing examining how current economic conditions are impacting small business access to capital.

In August of last year, the U.S. financial markets experienced widespread losses—stemming primarily from subprime mortgages. The impact spread throughout the lending market, and is now being felt in other parts of the economy. That includes the nation's small business sector, which is our primary source of economic activity and has historically led the way to financial recovery and job creation following downturns.

As banks and other institutions struggle to recover from losses on Wall Street, they are also pulling back from lending on Main Street. The result is that credit is now harder than ever for small businesses to access.

Not surprisingly, last month's "small business confidence gauge"—which is compiled by the National Federation of Independent Businesses—shows its lowest level since the survey was started in 1986. Furthermore, a joint survey conducted by Duke University and *CFO Magazine*, notes that about one-third of small business owners are finding credit more costly, less available, or both.

As capital availability tightens, many small businesses are forced to delay important purchases, halt planned expansions, or forego the creation of new jobs. And all of these choices hinder their ability to fuel economic expansion.

In such an environment, the SBA's lending programs could play a pivotal role by bridging capital availability gaps. Unfortunately, the SBA's largest lending program, the 7(a) initiative, has not risen to the task. Instead, it is exacerbating contractions in the conventional credit markets.

Through the first half of 2008, the number of 7(a) loans was down over 17 percent in comparison to the same period last year. The gross dollar amount of loans was also declining. To make matters worse, new fees and program mismanagement are keeping financial institutions from even participating in the program.

There are clear solutions to these problems, and last year the House took action to address many of them. We passed HR 1332, the Small Business Lending Improvements Act—which I authored. The bill lowers borrower costs, expands lender participation and streamlines the 7(a) application process. This legislation would move us in the right direction, however, the Senate has not taken action on it.

As Congress continues to address the current challenges facing the economy, we must be sure to explore every avenue of small business financing. After all, with credit availability narrowing, it is more important than ever to ensure entrepreneurs have access to the tools they need to operate their businesses and grow the economy.

I want to thank our witnesses in advance for joining us here today, and for the valuable insights offered in their testimony. I now recognize the Ranking Member for his opening statement.

U.S. House of Representatives

SMALL BUSINESS COMMITTEE

Subcommittee on Finance and Tax

Wednesday, April 30, 2008

Opening Statement of Ranking Member Vern Buchanan

Effect of the Credit Crunch on Small Business Access to Capital

I want to thank the Chairwoman for yielding and for calling this essential hearing on the effect of the credit crunch on small businesses' access to capital. I would also like to extend my thanks to our witnesses who have taken time out of their schedules to provide this subcommittee with testimony today.

There is no issue more personal to me than helping an entrepreneur realize the American Dream. I've lived that dream. I know its risks and rewards, its pains and successes. I've seen it from the bottom up, trying to start a small business, and from the top down, as Chairman of the Florida Chamber of Commerce.

And right now the view isn't very pretty. Working families across the country are facing record foreclosures, spiraling gas prices, double-digit layoffs, and a consumer confidence that is falling through the floor. For a small business whose survival is at stake, the inability to secure financing and credit can imperil its very existence. Today this committee is not simply sitting on the sidelines observing the challenge. We will be hearing from people most involved and most affected by a capital meltdown afflicting lenders and borrowers alike. Our hope is to come together and find real solutions that can make it easier for small business to secure the financing they need, at a price they can afford.

As I was working my way up, I never asked for a government handout. I only asked that I never be shut out. Owning a business was once my dream, and it is the dream of millions of other Americans as well. It is our duty here in Washington to construct and maintain a system in which these entrepreneurs have the ability to start and run their businesses successfully—not have that system discourage them from even trying to begin or grow their businesses.

Again, I thank the Chairwoman for holding this hearing and I am looking forward to hearing the testimony. I yield back.

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Testimony of

Scott Eckstein

On Behalf of:

The National Association of Home Builders

To The

United States House
Small Business Committee
Subcommittee on Finance and Tax

Hearing On

"The Effect of the Credit Crunch on Small Business Access to Capital"

April 30, 2008

Introduction

On behalf of the almost 235,000 members of the National Association of Home Builders (NAHB), we appreciate the opportunity to participate in this House Small Business, Subcommittee on Finance and Tax hearing on "The Effect of the Credit Crunch on Small Business Access to Capital." My name is Scott Eckstein and I am a home builder from Naperville, IL. I am currently serving as President of the Illinois Home Builders Association, and have been involved in the home building industry for over 15 years.

The majority of NAHB's builder members are small businesses, building less than 25 homes per year. These builders typically get their financing from depository institutions. Many borrow from small, community-based banks and thrifts and have established strong ties to these institutions over time. NAHB's members have been significantly impacted by the credit crunch and there is deep concern that the dislocations in the financing markets will increase the depth and length of the housing downturn.

Housing Credit Market Conditions

The mortgage credit crunch, which began in the summer of 2007, will continue to be the most significant factor impacting the home building industry into the foreseeable future. The U.S. housing market now is in the contraction phase of the most pronounced housing cycle since the Great Depression. This dramatic contraction has exacted a heavy toll on economic growth and employment during the past two years, and now has pushed the U.S. economy into recession according to NAHB macroeconomic analysis.

The adverse economic impacts of the housing contraction involve not only sharp declines in home sales and housing production, but also depressing effects of falling home prices on household wealth and mortgage credit quality. These events have provoked an alarming surge in mortgage foreclosures that have cut into the homeownership rate. Further, events have seriously damaged financial institutions holding mortgage assets, as well as companies that provide mortgage credit enhancement.

The pronounced decline in mortgage credit quality first became evident in the subprime mortgage sector last year, and that debacle triggered a stampede toward credit quality in national and global credit markets. This process has essentially shut down or seriously damaged a wide range of securities markets, including major components of the mortgage securities markets in the U.S. The freezing-up of private securities markets, both here and abroad, has shifted credit demands to government-related securities markets and to depository institutions – resulting in higher loan volume and pressures on capital positions at the depositories. The banking system, in turn, has been aggressively tightening lending standards in order to control volume, maintain asset quality and shepherd capital.

With private securities markets in disarray and banks retrenching, a bona fide credit crunch is underway. This credit crunch actually appears to be worsening despite the concerted efforts of central banks here and abroad. The Federal Reserve has been easing monetary policy aggressively since last fall, and probably will do more in the near future. These actions have improved the functioning of short-term money markets, including the interbank markets, but the Fed has not been able to relieve strains in longer-term credit markets.

With the deterioration of housing demand, exacerbated by the credit crisis and the fear and uncertainty concerning future housing price declines, for-sale housing market inventories are at historic levels. For example, the new homes inventory stands at a 9.8 months supply. The record volume of vacant homes on the for-sale market inevitably will put persistent downward pressure on home prices for some time. These interrelated factors of inventories and home price decline are central to the outlook for the economy and the financial markets.

Continued downward pressure on home prices also further saps the quality of outstanding mortgage credit, making it even more difficult to refinance or restructure adjustable-rate mortgages that have encountered or are facing payment resets. These effects, in turn, will worsen the alarming upsurge in mortgage foreclosures; move even more homes onto the for-sale market, put even more downward pressure on house prices and mortgage quality; and stretch out the contraction in new housing production even further. This represents quite a feedback loop, with ominous potential consequences for the U.S. economy and the financial markets.

Housing Production Credit

The tightening of credit standards and sharp reduction in credit availability that emerged and spread in the consumer mortgage arena has leapt to the housing production loan market. Builders are reporting an adverse shift in terms and availability on loans for land acquisition, land development and home construction (AD&C) and builders with outstanding loans are facing mounting challenges. Lenders are receiving current appraisals reflecting lower values on lots and homes, as well as market studies significantly scaling back absorption estimates. As a result, lenders are seeking additional equity for outstanding credits and balking at loan extensions. Defaults on AD&C loans are rising. The bank regulators have raised concerns about real estate lending and are reviewing the methodology utilized by banks in determining loan loss reserves and levels of delinquent and non-accrual loans for AD&C commitments. In this environment, banks are actively reducing exposure levels to home building credit.

Market Conditions

Residential AD&C loans are used to purchase land; develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. The vast majority of residential AD&C loans are made by depository institutions. NAHB's surveys of home builder and developer financing found that commercial banks and thrifts account for more than 90 percent of residential land acquisition, development and construction (AD&C) lending, and that commercial banks alone account for more than 80 percent of such activity.

Loans extended to builder/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a 6-to-18 month period. The principal and interest on the loans is repaid to the lender when the home is sold. Builders typically secure this financing through personal guarantees and/or offering other assets as collateral.

The deterioration in the mortgage credit markets and in home sales and inventories is spilling over into the markets for AD&C loans. Data from the OTS' Thrift Financial Report shows a marked increase in charge-offs on one-to four-family residential construction loans in 2007, as charge-offs as a percent of average loan balance jumped from 23 basis points in the first quarter to 170 basis points in the fourth quarter. For all of 2007, the average charge-off rate was 82 basis points, the highest since 1991 during the last credit crunch.

Bank Call Report data reflect a similar trend at commercial banks. Non-current rates on residential construction loans rose sharply in the fourth quarter, hitting 4.11 percent, which is an increase of 76 percent from the third quarter and 142 percent from the first quarter. (Unfortunately, prior comparisons are not available since banks just started reporting disaggregated residential and non-residential construction loan data in March 2007.)

Regulatory Perspective

These trends have caught the attention of banking regulators who over the past year have been raising concerns about large concentrations of commercial real estate (CRE) loans, which include residential AD&C loans. In particular, regulators are focusing on problems arising from significant community bank concentrations in CRE at a time of significant market disruptions and the declining quality of these loans, especially those related to residential construction and development.

Financial institutions have been reminded to adhere to the December 2006 CRE Exposure Guidance on understanding and managing CRE risks. While this guidance does not include specific limits on CRE lending, it does emphasize that banks with higher CRE concentrations have higher levels of risk and therefore must have risk management and capital commensurate with the higher level of risk. Consistent with this guidance, regulators have stated that in stressed markets, institutions will likely need to downgrade assets, increase loan-loss provisions, conduct fresh appraisals, and reassess the adequacy of bank capital.

The FDIC issued a Financial Institution Letter (FIL) on March 17 which re-emphasized the importance of strong capital and loan loss allowance levels and robust credit risk management for institutions with high CRE exposure. The letter stressed that institutions should follow the 2006 CRE Exposure Guidance. Importantly, the letter also encouraged institutions to continue to make CRE and construction and development loans in their communities using prudent and strong underwriting standards and loan administration practices.

At present, regulators are addressing these concerns through increased bank examinations and forcing some lenders to bolster reserves. Unlike the last credit crunch, when there was wholesale ban on CRE lending, regulators are working with lenders through the supervisory process to address CRE problems early. Nevertheless, the heightened regulatory scrutiny is having an impact on borrowers. Some builders are rapidly drawing down interest reserves and many have had to put up additional equity as appraised values have declined.

Impact on Builders

The upheaval in the housing credit markets has had a significant impact on NAHB's builder members. Tighter mortgage lending terms have made it difficult for home buyers to obtain financing to purchase new homes. Likewise, stricter credit standards for AD&C loans have adversely impacted the cost and availability of builder financing.

The impact of the credit crunch is magnified for the dominant size of business in our industry – the small home builder. In fact, given the impacts of the ongoing credit crunch, for many small business owners, the only available source of funds to keep their business solvent may be their 401(k) accounts.

Under present law, individuals may withdraw funds from their 401(k) account as a hardship withdrawal. These situations include medical emergencies or to prevent foreclosure. Such withdrawals are not counted as taxable income, so no income tax is paid on these funds. However, a 10 percent penalty is assessed if the individual is under the age of 59 and ½.

Withdrawing funds from a 401(k) to support a small business in a time of emergency is not a qualified hardship withdrawal, so taxpayers must pay the 10 percent penalty (if under age 59 and ½) and pay income tax (up to a 35% rate under present law) on the funds. Moreover, the withdrawn funds cannot be re-contributed when the crisis has passed. While it is possible for some individuals to borrow money, using their 401(k) accounts as collateral, this option is not available to all, thus leading to an expensive but necessary withdrawal from their retirement account.

Tighter Mortgage Lending Standards

In a national survey conducted this month by NAHB, 64 percent of builders reported that more restrictive mortgage lending standards have adversely impacted their sales. By comparison, in April 2007, only 45 percent of builders were noting sales problems due to financing stresses. In terms of the degree of impact on sales, builders citing buyer financing troubles reported an average sales decline of 15 percent. A third of the builders reported sales declines of 10 to 24 percent, 30 percent said their sales were down 25 to 49 percent, and 31 percent experienced a drop in sales of more than 50 percent.

The constriction in mortgage credit also has contributed to sales cancellations. Overall, 33 percent of the builders surveyed in December said they had contracts cancelled because buyers were unable to qualify for a mortgage. This was up from 28 percent in March 2007. Regarding the scale of cancellations, 44 percent of the builders surveyed said their sales pipeline shrunk by 10 to 24 percent.

Builders have used a variety of techniques to bolster sales and/or limit cancellations, including price reductions, no-cost options or upgrades and financing incentives. The two most widely used incentives are including optional items at no-cost and reducing home prices. NAHB's March builder survey found that 56 percent of respondents had included no-cost options, while 49 percent had reduced prices from the preceding month, with an average price reduction of 3.7 percent. Price reductions as a sales incentive seem to have peaked last fall when 59 percent of builders surveyed in October reported lowering their prices. This in part reflects the waning effectiveness of price reductions, as only 55 percent of respondents rated these as somewhat or very effective in the March 2008 survey, compared to 67 percent in the June 2007 survey. By comparison, 73 percent of the respondents to the March 2008 survey rated no-cost options as somewhat or very effective.

Availability of Housing Production Credit

Weakening AD&C loan performance and stricter regulation has translated into tighter AD&C credit availability and underwriting terms. NAHB's builder financing survey for the fourth quarter of 2007 shows that thirty-five percent of respondents stated that the availability of credit worsened in the fourth quarter relative to the third for single family construction loans. This continued a progressive rise over the past year in the proportion making such an assessment. Thirty-six percent of those seeking land acquisition loans reported worse credit availability; this reading was 30 percent for those seeking land development credit and 24 percent for those trying to line up construction funds for multifamily housing. Of those reporting deterioration of credit availability, 81 percent noted lower loan-to-value limits and approximately two-thirds said lenders are reducing the amount they are willing to lend.

NAHB's April builder survey shows continued tightening in the availability of AD&C credit. Thirty-three percent of respondents reported that the availability of credit for single family construction loans worsened in the first quarter of 2008, compared to the final quarter of 2007. Similarly, 30 percent of those seeking land acquisition loans reported worse credit availability; this reading was 29 percent for those seeking land development credit and 21 percent for those trying to line up construction funds for multifamily housing.

In addition to stricter standards for new AD&C loans, lenders also are tightening requirements for outstanding loans. Roughly a third of respondents to NAHB's April survey reported that lenders had reappraised some or most of their single family construction loans. Three-quarters of those with reappraisals were asked to pay down the original amount, and 13 percent had to put down additional assets. For land acquisition loans, 26 percent of respondents were asked to pay down part of the loan due to possible declines in the value of the land.

NAHB Recommendations

Broader Sources of AD&C Credit

The current financing quagmire for home builders vividly illustrates the importance of developing additional sources of AD&C credit. Presently, funding for viable residential development and construction projects is severely limited or blocked entirely by credit, concentration, capital and other regulatory restrictions on federally insured depository institutions, which are the sole source of housing production credit for the small businesses that comprise most of the home building industry. Furthermore, there is no secondary market for residential AD&C loans where community banks and thrifts could turn to help manage their balance sheets and obtain liquidity for additional lending.

A viable secondary market for AD&C loans would directly benefit builders and lenders by: (1) transferring risk away from lenders; (2) increasing availability of funds so that projects can be more reliably completed; and (3) mitigating the devastating impact of equity calls on builders, or transfers of partially completed projects to banks under capital and/or regulatory pressure.

Government Sponsored Enterprises

One potential source of relief is through a program Fannie Mae has developed to purchase participation interests in AD&C loans made by banks and other qualified lenders. This program was tested successfully for more than a decade as a pilot and has been cleared for permanent operation by the Office of Federal Housing Enterprise Oversight and the Department of Housing and Urban Development. The program was designed as an outlet for banks to sell originated AD&C loans so these institutions could recycle funds into other viable AD&C projects, much like the workings of the very liquid and successful Agency mortgage-backed securities market. Fannie Mae, which has moved very cautiously in launching the permanent AD&C loan purchase program, should be encouraged to ramp up to higher activity levels to provide a much-needed outlet for portfolio AD&C lenders. In addition, Freddie Mac should seek approval to operate a similar program.

The Federal Home Loan Banks (FHLBanks) can also provide support to the AD&C loan market. Over the longer-term they could develop loan purchase programs to support housing production lending efforts in their districts. Immediately, however, the FHLBanks can improve AD&C liquidity by accepting housing production loans as collateral for the secured advances they make to member institutions. Currently these loans are secured mainly by the home mortgage portfolios of borrowing banks and thrifts, and advance activity has risen dramatically as these portfolio lenders sought liquidity support amidst credit market turmoil. The FHLBank of Des Moines received approval from the Federal Housing Finance Board on September 10, 2007 to accept one-to-four family construction loans as part of a basket of other real estate collateral that may back the Bank's advances to member financial institutions in its district. This step will improve balance sheet flexibility for members of the Des Moines FHLBank and improve stability in the region's housing production credit market. Other FHLBanks should be encouraged to follow suit.

Federal Housing Administration

NAHB also believes the Federal Housing Administration (FHA) should play a role in supporting the AD&C credit market. FHA insurance would help increase competition in the AD&C market by attracting new originators such as mortgage banking companies. In addition, FHA-insured construction loans could be packaged in Ginnie Mae-guaranteed securities to allow capital to flow from investors in that market. These benefits would translate into improved credit availability for home builders and home buyers and reduced home buying costs.

FHA already has authority to insure permanent mortgages that are converted from construction loans in construction-to-permanent mortgage programs, which have been growing in popularity. NAHB has obtained a legal opinion that confirms that FHA also has authority currently to insure the construction portion of these loans. NAHB has urged FHA to utilize this authority and we have developed legislative language that would provide FHA the additional authority of insuring stand-alone construction loans. As in the case of the end-loan mortgage market, FHA could be a crucial stabilizing force in AD&C lending in turbulent times such as these.

Privately Issued AD&C Securities

NAHB is also pursuing initiatives with key capital market players to develop a prototype private security instrument for AD&C loans. Discussions have included major financial institutions, including several insurance companies, and we are broadening our search to include other Wall Street specialists. NAHB is pursuing several of the tax changes recommended by the New York State Bar Association to facilitate development of securities backed by AD&C loans. In particular, recommended changes to tax provisions relating to REMICs and Taxable Mortgage Pools (TMPs) could be helpful in securitizing construction loans. NAHB also has met with Congressional staff and members on AD&C tax issues and is seeking legislative vehicles to obtain changes to the REMIC and TMP rules that would facilitate securitized pools of AD&C loans.

Balanced Regulation

The approach of the regulators in overseeing institutions involved in AD&C lending will be an important factor determining the length and severity of the current housing and economic recession as well as the vigor of the subsequent recovery. It is crucial for the banking regulators to take a balanced approach when evaluating bank lending, especially in regard to AD&C loans. The regulators should continue to encourage institutions to pursue sound loans on viable projects. In addition, the regulators should provide additional guidance to lenders on dealing with outstanding AD&C loans to ensure that losses are minimized through flexible and prudent loan accommodations. Such actions are just as critical in a nascent recovery as in the current downswing.

While we recognize the importance of the safety and soundness of the banking system, NAHB urges banking regulators to exercise extreme care in order not to produce unnecessary restrictions on credit. Overly pessimistic assumptions about future home sales and values will result in an unnecessary extension of the credit crunch and housing recession. Draconian restrictions on lending or forced reductions in AD&C concentrations will only serve to exacerbate the present crisis and delay, or even prevent, future recovery. Small businesses, including small builders, are vital to the economy and arbitrary or unreasonable regulatory restrictions would only serve to harm many builders, and potentially many banks. It would be ironic and tragic to have the positive work of the Fed undone by bank regulators taking a totally different vision and approach when it comes to lending matters.

Federal Home Loan Bank Guarantees of Municipal Bonds

A lesser discussed aspect of the credit crunch is the increasing difficulties experienced by local governments in funding infrastructure projects such as water treatment facilities. Impediments to such financing often have blocked residential development and have sometimes resulted in additional charges being imposed on home builders to pay for improvements that benefit existing residents as well as residents of newly built homes. The financial strength of the Federal Home Loan Banks (FHLBanks) allows them to provide stand-by letters of credit to facilitate municipal bond issues for infrastructure projects. However, under current law, municipal bonds that are guaranteed by FHLBanks cannot qualify for tax-exempt status and, therefore, carry higher interest costs.

S. 1963, introduced in the Senate by Senators Rockefeller, Crapo, Stabenow and Carper, would address this impediment. The bill would amend Section 149(b) of the Internal Revenue Code by adding FHLBanks to the list of government agencies and government-sponsored enterprises (GSEs) authorized to provide credit enhancement for tax-exempt municipal bonds. Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) have been permitted since 1984 to provide such credit support. A similar provision was included in the Housing Assistance Tax Act of 2008 (H.R. 5720) that was recently approved by the House Ways and Means Committee. Enactment of this measure would help to significantly lower financing costs on public infrastructure and other projects that are the foundation for meeting community housing and economic development needs.

Home Buyer Tax Credit

Two causal factors in the current housing downturn and the related credit crunch are declining house prices and excess inventory. These elements are equally central to the outlook for the broader economy and the financial markets. Policies that stimulate home purchases in the immediate future can pay huge dividends. The biggest bang for the buck most likely would be provided by a temporary homebuyer tax credit, such as the credits approved recently by the Senate in the *Foreclosure Prevention Act of 2008* and by the House Ways and Means Committee in the *Housing Assistance Tax Act of 2008*. Indeed, the recent revival of interest among prospective buyers suggests that temporary credits could stimulate a wave of home buying that could quickly reduce excess supply in housing markets and halt the dangerous erosion of house prices and mortgage credit quality. NAHB applauds the Congress for its efforts to create a homebuyer tax credit, and stand ready to work with Congress in crafting the most effective credit to help solve the current economic crisis.

Tax credits for the purchase of a home would be very effective economic stimulus tool. They are a means of eliminating excess inventory, relieving some of the pressure on falling housing prices, and ending the waiting-on-the-sideline strategy some potential buyers have adopted in response to overly negative media stories concerning the future of the housing market. As Alan Greenspan noted in November of 2007, reducing inventory is critical for the health of the economy, and a tax credit would be the easiest and most cost effective way to achieve this goal.

What is common amongst all of the various models of a tax credit for the purchase of a home is that they represent policies that increase housing demand, thereby enabling home purchases for families and fight falling housing prices, which threatens the economy as a whole. We recommend a targeted homebuyer tax incentive in order to maximize induced purchases. An effective temporary home buyer tax credit would restore confidence in the housing market for homeowners, homebuyers, builders and financial institutions, thereby reducing some of the factors responsible for the current credit crunch.

Expand the Net Operating Loss Deduction Carryback

Home builders, like many businesses, are now reporting financial losses when a few years ago they were generating jobs, providing local development and paying taxes. For home builders large and small the importance of the ability to claim and carry back net operating losses (NOL) deductions to years when significant taxes were paid cannot be overstated. The inability to do so will result in the need to either increase high-cost borrowing or further liquidate land and homes, which will only compound the existing inventory problem. The additional supply of homes and land on market for sale, of course, will put even more downward pressure on prices and further add to the housing crisis. Ultimately, the result of this will be more layoffs of workers and reduced development of communities.

Current law allows for a two-year carryback of NOLs, however, home builder losses began in 2006. Expanding the carryback of NOLs beyond two to years when significant taxes were paid provides financial resources to the home building sector as well as all businesses to weather the economic downturn. Further, this will help all businesses, including financial institutions and manufacturers, facing difficult economic decisions concerning employment. Finally, an expansion of the NOL carryback simply allows businesses to accelerate their claim of NOL deductions that under present law would be claimed in the future. The need for these deductions today is critical. NAHB thanks the Senate for approving a temporary expansion of the NOL carryback period to four years for tax years 2008 and 2009 as part of the *Foreclosure Prevention Act of 2008*. NAHB applauds Senators Snowe, Kerry, Coleman and Landrieu (R-ME) for their work on S. 2552, the *Small Business Stimulus Act of 2008*, which includes an expanded NOL carryback provision. These provisions will help all businesses with losses weather the economic downturn and emerge from this recession in a position to grow.

Expand the Mortgage Revenue Bond Program

The existing Mortgage Revenue Bond (MRB) program also offers a method of increasing housing demand. A special allocation of bonds to be used for either purchase or refinancing would be beneficial for housing. The MRB program allows state and local governments to issue tax-exempt debt that may be used to finance mortgages at below-market interest rates. Certain technical restrictions concerning the MRB program could also be made more flexible to enhance its use as an economic stimulus tool. These include the house price limits and the first-time home buyer requirement. Expanding the reach of the MRB program would allow it to have the largest effect, particularly for communities experiencing the possibility of a wave of foreclosures or an extreme excess of inventory. Such positive results will help reduce pressure on housing prices, thereby restoring financial institutions' confidence in the housing market and reducing the effects of the current credit crunch. NAHB thanks the Senate and the House Ways and Means Committee in approving a temporary $10 billion expansion of the MRB program. The industry looks forward to seeing it enacted into law in the near future.

Expand Small Business Expensing

Section 179 of the tax code allows small business to expense the cost of investment for business property. The Economic Stimulus Act of 2008 temporarily expanded the rules so that small businesses may expense up to $250,000 of qualified investment for tax year 2008 ($128,000 would have otherwise applied in 2008, with that amount indexed for inflation through 2011). The expensing benefit is phased-out for business incurring more than $800,000 in qualified investments in 2008 ($510,000 would have otherwise applied in 2008, with that amount indexed for inflation through 2011).

Home builders in general appreciate the opportunity that Section 179 expensing offers small businesses from both the tax policy perspective, as well as the administrative burden reduction that such rules offer. However, it is useful to remember that many builders currently have no taxable income to offset, so such investment incentives offer no effective relief. These incentives will be more important when the housing market rebounds in the future.

Conclusion

NAHB appreciates the opportunity to testify on behalf of our 235,000 members on critical issues related to small businesses impacted by the credit crunch and economic downturn. We look forward to working with the Committee and the Congress to develop effective responses to these issues and policies to help ensure the continued viability of our nation's small businesses.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

David G. Schroeder
President, American Enterprise Bank

On behalf of the

Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Small Business
Subcommittee on Finance and Tax

Hearing on

"The Effect of the Credit Crunch on Small Business Access to Capital"

April 30, 2008
Washington, D.C.

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Good morning. My name is David Schroeder and I am President of American Enterprise Bank in Buffalo Grove, Illinois. Chairwoman Bean and members of the committee, I am please to be testifying today on the state of the credit markets and small business access to capital. I am proud to be testifying on behalf of the Independent Community Bankers of America.[1]

ICBA represents 5,000 community banks throughout the country, with 301 community bank members in Illinois. Community banks are independently owned and operated and are characterized by personal attention to customer service and lending to small business.

American Enterprise Bank is a locally owned community-oriented bank located in Buffalo Grove, Highland Park, and Schaumburg, Illinois. We will be opening a new branch in Wheaton, Illinois this summer. Since 1995, we have grown to more than $360 million in assets and we currently serve more than 8,800 account holders. We pride ourselves on small business relationship banking and strongly support the work of the Small Business Administration and actively participate in the SBA's lending programs, specifically the flagship 7(a) loan program and the 504 loan program.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Community lenders like American Enterprise Bank are proud to support or communities and nations' economic growth by supplying capital to small businesses across our nation.

Summary of Testimony

The U.S. credit markets have remained quite volatile since August of 2007. Credit fuels our economy and the broad credit markets are still sorting out many problems. Some of the nation's largest lenders and money-center banks have tripped up on aggressive subprime lending and toxic investments. As a result, many of the biggest financial institutions have been forced to pull in their lending, write down losses, and rebuild capital positions.

Consequently, the current turmoil in our economic and financial markets nationwide raises genuine concerns about the availability of capital and credit for small business. Notably, community banks remained common-sense lenders and largely avoided the subprime debacle, have solid capital positions, and have money to lend to small business.

As the Administration and Congress continue to address the problems in the housing and housing finance sectors, policymakers must also focus on the needs of the small business sector during this economic slowdown. At a time when the economy is faltering, a sharp decline in the number and dollar amount of Small Business Administration loans is troubling. The SBA loan programs should bolster small businesses credit in economic slowdowns. Instead, the number of SBA loans being made is plummeting.

ICBA is glad the Small Business Committee Subcommittee on Finance and Tax is conducting this hearing, since there are many proposed financial regulatory and tax reform measures that can greatly assist small businesses in this difficult economic climate. In order to address the ongoing "credit crunch" and ensure small businesses lenders and borrowers have an uninterrupted supply of capital, ICBA respectfully advanced several policy recommendations including:

- Strengthen the Small Business Administration loan programs by boosting the SBA budget, lowering the steep fees on lenders and borrowers, and reducing excessive regulations.

- Enact the "Small Business Lending Reauthorization and Improvements Act," (H.R. 1332 / S. 1256), which is critical to the ongoing viability of the SBA loan programs.

- Enact the ICBA's economic stimulus plan recommendations, including a first-time homebuyer tax credit, immediate alternative minimum tax relief, and increase the bank-qualified municipal bond threshold. (Summary attached as part of this testimony.)

- Enact provisions in the "Communities First Act, (H.R. 1869 / S. 1405) which provide sensible tax and small business regulatory relief for community lenders and their small business customers. (Summary attached as part of this testimony.)

The ICBA believes these measures would all help small business better access credit, grow, and create jobs and boost our economy.

Community Banks are There for Small Business

Community banks represent the other side of the financial story and credit market. Community banks have a uniquely different business model than the biggest money-center banks. It is a model based on relationship-banking in their communities, not on relationships with investment banks or hedge funds. Small businesses can feel confident in using their local community banks for their financial needs.

Despite the media coverage about a "credit crunch," community banks are very much alive and well. Truth is, community banks are open for business. Community banks, in general, rely more on local deposits to fund local lending so they don't rely heavily on Wall Street capital markets for funding.

Community banks are prudent, common-sense lenders that did not entangle themselves in exotic lending practices, off-balance sheet structured investment vehicles (SIVs), collateralized debt obligations (CDOs), hedge funds and the subprime mess. So we do not have to dramatically readjust our lending practices, scurry to rebuild capital, or dramatically cut back lending as the faltering biggest lenders are doing.

Simply stated, community banks balance sheets are transparent and strong. That said, there is a genuine credit market crisis and it continues to have real consequences across the entire financial and economic spectrum from Wall Street to Main Street. Unfortunately, the fallout from the missteps of a few large financial players is fostering costly new regulatory burdens on *all* financial institutions. This will likely cause banks to further tighten lending and will increase the transaction costs for lenders and small business borrowers alike. I urge the Congress to avoid a one-size-fits-all regulatory approach. Increasing regulatory burdens should not be a wet blanket smothering community bank lenders that had little to do with the current turmoil.

Further Economic Stimulus Still Needed

Responding to a slowing economy, ICBA was out front in early January with a "9-point Economic Stimulus" package focused on communities and small business needs. As the economy continues to soften, Congress is advancing a second "economic stimulus" package. The ICBA respectfully recommends a number of economic stimulus items (attached) to help the credit markets, small businesses, and job growth.

In particular, the broad credit markets have been severely damaged by the sharp decline in housing prices and the decline in the collateral real-estate represents. When home prices continue to drop sharply and people owe more on their mortgages than their homes are worth, foreclosures become a growing economic problem. Despite the Federal Reserve Board's sharp reduction in interest rates, home prices continue to decline at a record pace in many regions due to plummeting sales and a 10-month-plus supply of unsold homes nationwide.

Notably, some 45% of small business loans outstanding are collateralized by some type of real estate asset. Therefore, the ongoing sharp decline in real estate values must be addressed before genuine stability can be achieved in the broad credit markets and economy. The ICBA's economic stimulus plan recommends a $5,000 first-time homebuyer federal tax credit for one year in order to jumpstart home sales, reduce unsold inventories, and stabilize home prices and foreclosures. We are please to see a homebuyer tax credit advancing in both the House and Senate as part of a second legislative stimulus effort.

Communities First Act Would Boost Small Business

Community banks run small businesses themselves and finance the entrepreneurs in their towns allowing local economies to prosper. During this credit crunch and economic slowdown, sensible tax and regulatory relief for our nation's community lenders and the small business customers we serve is more important than ever. Introduced by House Small Business Committee Chairwoman Nydia Velazquez (D-N.Y.), the bipartisan Communities First Act (H.R. 1869) provides much-needed regulatory relief and tax reforms so that community lenders such as my bank and small businesses can better focus our efforts and resources on the needs of our local communities.

I urge lawmakers to closely examine and co-sponsor the sensible reforms in H.R. 1869 that will boost the viability of small businesses nationwide. The bill would reduce outdated and punitive regulations and reform tax laws to better enable local lenders to meet the credit needs of small businesses, local governments and others who depend on community-based financial institutions. The Communities First Act is pro-consumer, pro-small business, and pro-community legislation. (Summary of the Communities First Act is attached below as part of this testimony.)

Small Business Lending is Vital to Economic Strength

Small business access to capital is vital to the strength of our economy and employment. Small businesses represent a whopping 99% of all employer firms and employ half of the private sector workers. There are more than 26 million small businesses in the U.S. Small businesses have created 70 percent of the net new jobs over the past decade.

Community banks are essential to the strength and success of small businesses nationwide. American Enterprise Bank specializes in small business relationship lending. Community banks stick with their local communities and small business customers in good times and in bad. Notably, for their size, community banks are disproportionately large small business lenders. While community banks represent about 12% of all bank assets, they make 20% of all small business loans. Community banks make nearly one-third of all small business loans of $100,000 or less.

Because small businesses are integral to our economic strength, ICBA believes it is urgent to properly meet the credit needs of small businesses as the economy has softened and employment levels continue to decline. The Federal Reserve has taken unprecedented actions to slash interest rates, provide liquidity, and recently put $29 billion of private sector assets on its (taxpayers') balance sheet to assist large financial firms JPMorgan Chase and Bear Stearns and to keep the credit markets functioning. Likewise, policymakers should directly and aggressively address small business credit needs.

GDP growth slowed to a minuscule 0.6 percent in the fourth quarter of 2007. Unemployment has jumped to 5.1 percent in March as a result of three consecutive months of declining payroll jobs. Small business optimism is plummeting and credit availability is a genuine concern. In March, the

National Federation of Independent Business index of small-business optimism dropped to its lowest level since it began this survey in 1986.

Soaring energy costs are challenging many small business budgets and profit margins. The January Federal Reserve senior loan officer opinion survey shows that large banks continue to tighten lending standards for households and businesses. The report is discouraging as tighter lending standards will reduce the availability of credit for small businesses and work to further weaken a struggling economy. Therefore, the federally guaranteed SBA loan programs should work to counter tightening credit markets and help provide funding to small businesses in this more difficult economic climate when they need the program the most. Declining SBA loan volume tells us it is not.

Critical SBA Lending in Trouble

The SBA loan programs are a success story. They fund thousands of small businesses that otherwise would not have had access to capital. However, recent budget cuts, sharp fee increases on both lenders and borrowers, and the elimination of the successful Low-Doc program have undermined the full potential of the SBA loan programs. These and other negative changes have caused a disturbing decline in the number of community lenders actively participating in the SBA loan programs. Today, just the top 10 SBA lending banks make nearly 60 percent of all SBA loans. This in turn jeopardizes the ability of interested community lenders to reach a wide variety of deserving small business borrowers and geographic areas with affordable and flexible SBA loan programs.

Banks could be extending more SBA loans to meet the needs of small businesses during this economic slowdown. However, the number of SBA loans is actually falling sharply. As of the end of March 2008, the year-over-year number of SBA 7(a) loans was down more than 17% and the dollar amount down nearly 9 %. The SBA 504 loan program is also in decline. This is unacceptable if the SBA program is to properly support small business lending needs and bolster economic strength. We need more small business lending not less.

Community Banks Build Small Businesses with SBA Lending

American Enterprise Bank strongly supports the work of the Small Business Administration and actively participates in the SBA's lending programs, specifically the flagship 7(a) and the 504 loan programs. In 2007, American Enterprise Bank made $62.6 million in SBA 7(a) loans and $15.5 million in 504 loans.

Community lenders like American enterprise bank are proud to work with the SBA in helping supply needed capital to small businesses across our nation, especially now when the economy is weak and many large, money-center banks are cutting back sharply on small business lending. I want to make it very clear that the SBA guarantee loan programs are unique and extremely valuable in providing needed long-term capital to small business. Lenders can fund small businesses that otherwise would not have had access to capital. The SBA 7(a) loan program provides 30 percent of all the long-term small business lending.

SBA Loans Serve Unique Role

Lenders need to match short-term deposits with short-term small business loans. While the typical commercial small business loan has a maturity of one to three years, SBA 7(a) loan maturities average 12 or more years. Importantly, SBA lending allows longer loan terms up to 25 years. This lowers the entrepreneur's loan payments and frees up needed cash flow to start or grow the small business. As small businesses do their best to weather the current difficult economic climate, the longer loan term offered by an SBA loan is a huge help.

The SBA 7(a) and 504 guaranteed loan programs serve a unique role in providing an alternative means for entrepreneurs to access capital where funding is not available through conventional lending methods. Therefore ICBA believes the economic slowdown and greater credit-risk aversion in the credit markets should be fostering a stronger demand for guaranteed SBA loans. Unfortunately, small business SBA loan volume is declining sharply. This is aggravating the economic problems and only validates the importance of ensuring a more robust Small Business Administration with affordable and workable loan programs for a wide range of lenders and borrowers. Thriving small businesses are exactly what is needed to turn this economy around and to boost payroll and business income tax revenue back to federal, state and local government. Small businesses are critical to supporting a tax base.

Disturbing Decline in the Number of Active SBA Lenders

Despite the growing need for small business capital, the SBA loan programs have been harmed by recent policy changes. In recent years, many community banks have found it much harder, not easier, to provide capital to small businesses through the SBA loan programs. Notably, the number of lenders that have made at least one SBA 7(a) loan has dropped almost in half from 5,288 in 2001 to fewer than 2,700 today. This is a disturbing trend.

Also troubling is the fact that many of the large financial institutions that consumed the lion's share of the SBA loan programs are the same banks that are struggling under the sub-prime mess and unable to continue the same level of SBA lending at this critical economic time. The majority of our nation's commercial banks are community banks. The geographic dispersion of community banks around the country fosters a financial system where money and resources are made available not only in large urban areas, but in suburban and rural areas as well. There are more than 8,500 FDIC-insured commercial banks across America. That is why it is perplexing to note that the top 25 SBA lenders eat up two-thirds of the SBA's 7(a) loans with just 10 big lenders making more than 55 percent of the loans. ICBA does not believe Congress intended the SBA loan programs to be functional for only a handful of the nation's biggest financial entities. ICBA urges that SBA programs be allowed to work for as many interested lenders as possible in many geographic areas to best meet the needs of small business borrowers.

The sharp drop-off in active SBA lenders has been the result of a combination of discouraging factors that has undermined the community banking industry's ability to participate. These damaging changes include sharp SBA budget cuts, the elimination of any appropriations for SBA 7(a) loan programs, increased lender and borrower fees, the elimination of combination or "piggyback" financing, reduced staffing and service from local SBA offices, lower loan guarantee levels, increased regulatory fees, as well as the elimination of popular loan programs such as "Low-Doc."

As small businesses represent a large and growing share of our economic well-being, the sharp budget cuts the SBA has suffered in recent years have come home to roost in this challenging credit market. We cannot shortchange SBA lending and small business needs without consequences, especially when the economy softens. This is no time for the SBA loan programs to be in a sharp decline. The need for affordable small business capital is greater today than ever.

However, we have witnessed sharp SBA budget cuts in recent years. The SBA budget proposed for fiscal year 2009 is a tiny 0.02 percent of the proposed federal budget. In fact, the SBA's non-disaster program budget is about half of what it was in 2001. While there are efficiencies with new technology that can be achieved, when an agency's budget is nearly cut in half, the service and functionality of its programs will suffer. This was most evident in the troubled SBA disaster lending response after the Gulf Coast hurricanes in 2005. We don't want to witness a similar fate now in the SBA 7(a) and 504 loan program as loan volumes decline just when credit is needed most. If stimulating our troubled economy and supporting our nation's small businesses is a priority, we urge that more, not less, budget resources be allocated for the SBA and its proven lending programs.

Ways to Restore Robust SBA Lending

An ongoing major concern of the community banking industry has been the elimination of the long-running appropriation for the SBA 7(a) loan program that was as much as $115 million in FY2001. As a result of the elimination of any appropriation for 7(a), the lender and borrower fees have been increased sharply and continue to increase under the "zero-subsidy" model. With no appropriated money, more and more Small Business Administration costs are being passed on to the lenders and borrowers. When the appropriation was being eliminated with the blessing of the SBA, the SBA officials assured concerned lawmakers, lenders, and small business groups the program would be better off. Today, with declining loan volumes and far fewer SBA lenders, the evidence is clear that this is not the case. Community lenders have been forced to drop out of the program, and a greater concentration of SBA loans have gone to a handful of the nation's biggest banks where many are embroiled in their own capital difficulties and unable to meet the SBA borrowing needs of small business.

With higher fees, many deserving entrepreneurs that were on the margin of obtaining a 7(a) loan are no longer able to afford such financing. This has the effect of shifting the delivery of SBA 7(a) loans further away from the fundamental mission of reaching deserving small businesses in greatest need of inexpensive, guaranteed financing. ICBA believe the decline in the number of SBA lenders and the shrinking of average loan size has left many small businesses with less capital to grow their businesses and create jobs.

For smaller SBA loans, today's higher fees can translate into nearly $1,500 to $3,000 more in upfront closing costs for entrepreneurs. The added costs from today's higher fees can be up to $50,000 for larger small business loans. Higher fees only discourage the very type of small business borrowers the SBA guaranteed loan programs were intended to reach from accessing needed capital during difficult economic times. To restore robust SBA small business lending ICBA recommends several reforms:

- Allow a "Super SBA 7(a) loan program" for one year as an economic stimulus to help small business access needed capital. ICBA's nine-point economic stimulus plan recommends a "Low-Doc," expedited 7(a) loan program with a 85% guarantee, and lender and borrower fees reduced to half of their current level for small business loans up to $250,000.

- Restore a reasonable budget appropriation of $250 million to help offset and lower the recent sharp fee increases on both 7(a) lenders and borrowers.

- Enact the pending SBA reauthorization legislation and improvements in the "Small Business Lending Reauthorization and Improvements Act," (H.R. 1332 and S. 1256).

- Suspend the new lender oversight fees.

ICBA believes these reforms would go a long way in positioning the SBA loan programs to help more small businesses get the capital they need, especially during the current credit crunch.

Conclusion

America's small businesses are facing difficult economic times and acquiring credit is getting more problematic. As policymakers work on ways to stimulate the economy and strengthen credit markets, small business credit needs should be front and center in the debate. Given the importance of small businesses for job creation and economic strength, the plummeting levels of SBA lending is cause for alarm. Community banks like American Enterprise Bank are well-positioned and prepared to help. We believe the provisions in the Communities First Act and the proposed ICBA economic stimulus package would go a long way in jumpstarting small businesses and our economic growth. Importantly, lenders and borrowers need the SBA program fees to be reasonable. ICBA pledges to work with the Small Business Committee to ensure our Nation's small businesses have the access to capital and credit they need to invest, grow, and to provide jobs and continued economic growth.

I appreciate the opportunity to testify today on behalf of the Independent Community Bankers of America. Thank you.

Summary of Provisions
Communities First Act (CFA)
H.R. 1869 / S. 1405

<u>Title I</u>
<u>Targeted Regulatory Relief for Community Banks</u>

Section 101. Call Reports: Permits highly rated, well-capitalized banks with assets of $1 billion or less to file a short form Call Report in two non-sequential quarters of each year.

Section 102. Sarbanes/Oxley: Exempts insured depository institutions with consolidated assets of $1 billion or less from the provisions of internal control attestation requirements of Section 404 of the Sarbanes Oxley Act of 2002.

Section 103. Small BHCs: Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors so that the policy applies to BHCs with pro forma consolidated assets of less than $1 billion and that are not engaged in any nonbanking activities involving significant leverage and do not have a significant amount of outstanding debt.

Section 104. SIPC: Amends Section 9 of the Securities Investor Protection Act of 1970 to provide banks with assets of up to $1 billion with insurance coverage for losses incurred in their own brokerage account if a broker dealer fails.

Section 105. Updated Loans Limits: Allows the Federal Reserve Board discretion to increase the aggregate limit on extensions of credit to insiders up to four times the bank's unimpaired capital, unimpaired surplus and undivided profits for banks with <u>assets</u> up to $1 billion.

Section 106. Community Bank Impact Analysis: Before establishing or making any revision in any regulation, requirement, or guideline, this provision requires the appropriate banking agency to take into account the effect on community banks and savings associations.

Section 107. Shareholder Threshold: Increases SEC shareholder registration threshold to 1,000 from 500.

Title II

<u>Additional Regulatory Relief for Community Banks and their Customers</u>

Section 201. Enhance Customer Capital Access: (1) Directs the Federal Reserve to prescribe regulations authorizing customers who borrow from Federally insured depository institutions to waive the three-day right of rescission, (2) exempts a refinancing with a <u>new lender</u> from the three-day right of rescission where no new money is advanced, and (3) exempts home equity lines of credit from the three-day right of rescission.

Section 202. Bank Secrecy Act CTR Reform: Provides for a seasoned customer exemption from CTR filings and adjusts the CTR threshold for inflation.

Section 203. Privacy Notices: Exempts a bank from the annual privacy notice requirement if the bank does not share customer information other than as permitted by one of the exceptions, and has not changed its policies.

Section 204. Privacy Protection of Consumer Reports: Prohibits a consumer reporting agency from providing another lender with a consumer report where a lender has requested a credit report in connection with a loan application, unless authorized in writing by the consumer.

Section 205. Update Loans to Officers Limits: Increases to $250,000 the special regulatory lending limit on loans to executive officers other than those for housing, education, and certain secured loans.

Section. 206. Reimbursement for Mandatory Production of Records: Requires reimbursement by the Federal government for the production of records for any law enforcement or investigative purpose, modeled after the provision in the Right to Financial Privacy Act.

Section 207. Report on Implementation of Commercial Real Estate Guidance: Requires a GAO report on the implementation of CRE guidance and its effect on local economies, the regulatory burden on banks, community bank portfolios, and community bank market share.

Title III

Tax Relief for Bank Depositors, Rural Banks, Municipalities, Banks Organized and Limited Liability Companies, Individual Savers, and Small Businesses

Section 301. Long-Term CDs: Reduces tax rate and defers income on long-term certificates of deposit. Defers tax recognition of individual interest income on long-term CDs (term of 12 months or more) until maturity and reduces the tax rate to long-term capital gains tax rate.

Section 302. Enhanced Rural Lending: Excludes from taxable income of a bank or savings association, income earned on agricultural real estate loans and mortgage loans in communities of 2,500 or less population. This mirrors exclusion available to the Farm Credit System.

303. Update Tax-Exempt Bond Limits: Increases to $30 million the current $10 million annual issuance limitation for tax-exempt obligations. Cap would be indexed.

Section 304. LLCs: Allows bank, bank holding company, savings association or savings association holding company to be treated for tax purposes as a limited liability company and allows privately-held financial institutions to convert their state or federal charters to an LLC charter in a tax-free transaction.

Section 305. Individual AMT Repeal: Repeals the punitive individual alternative minimum tax.

Section 306. Young Savers Accounts: Permits a Roth IRA account for children under age 25 to encourage early savings.

Section 307. Permanent Section 179 Small Business Expensing: Makes permanent increased limits on small business expensing for equipment.

Title IV

Targeted Tax Relief for Community Banks and Holding Companies

Section 401. Limited Community Bank Credit: Allows banks, bank holding companies, savings associations and savings association holding companies with up to $5 billion in assets that are taxed as C corporations to take a 20% credit against their taxable income up to a cap of $250,000.

Shareholders of financial institutions that are S corporations would be able to exclude 20% of the distributable income from the financial institution up to an aggregate cap of $1,250,000. Also creates a 50% tax credit for financial institutions with up to $5 billion in assets that are operating in distressed communities and/or designated enterprise or empowerment zones, or qualifying New Market Tax Credit Census tracts not to exceed $500,000. Financial institutions that are operating in these areas and that are S corporations would be able to exclude 50% of distributable income not to exceed $2.5 million of income.

Section 402. Community Bank AMT Relief: Repeals the alternative minimum tax for banks, bank holding companies, savings associations and savings association holding companies with assets of $5 billion or less.

Title V
Small Business Subchapter S Reforms

Section 501. Shareholder Limit: Increase shareholder limit for S Corporations to 150 from 100.

Section 502. Qualifying Directors Shares: A banks' qualifying directors' shares not included in the shares counted toward the S Corporation shareholder limit. (Note: Enacted 5/25/2007)

Section 503. Bad Debt Reserve: Provides option to recapture bad debt reserves in first S corporation year or in last C Corporation year. (Note: Enacted 5/25/2007)

Section 504. Preferred Stock: Allows the use of preferred stock for S Corporation banks.

Title VI
Small Business Lending Enhancements

Section 601. SBA Loan Fees: Allows the reduction in Small Business Administration loan program fees on borrowers and lenders commensurate with an appropriation.

Section 602. Low Documentation Loan Program: Permits a low documentation SBA 7(a) loan program for seasoned lenders for loans up to $250,000.

Section 603. Effective Date: Sections 601 and 602 shall take effect October 1, 2007.

Summary of ICBA-Proposed Economic Stimulus Package Measures

- First-Time Homebuyer Tax Credit. One-year, $5,000 federal tax credit for first-time home purchase. Proven incentive that will help sales of 10-month supply of unsold homes and will boost the housing and housing-finance sectors. (Note: Both House and Senate tax committees have passed version of homebuyer tax credit which is advancing as part of second economic "stimulus" package.)

- Extend Work Opportunity Tax Credit. Enhances and extends the employers' WOTC through 2009 to create jobs by encouraging greater hiring of new workers.

- Super SBA Small Business Loan Program. A "low-doc," expedited SBA 7(a) loan program with 85% government guarantee for small business loans up to $250,000 and reduced lender and borrower fees. Will provide greater small business capital in expedited manner to start, or grow a small business and create jobs

- Immediate AMT Relief. Immediate individual AMT relief for tax years 2008, 2009. Will provide tax certainty and prevent additional taxpayers from being swept into punitive Alternative Minimum Tax calculations and payments and increase their after-tax incomes. Notably, AMT relief can be rebated in advance directly to taxpayers. (Note: Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Chuck Grassley (R-IA) advanced AMT fix legislation 4/2008.)

- Immediate Increase in Muni-Bond Threshold. Updates from $10 to $30 million the annual issuance limitation for qualified-tax-exempt-obligations. Will create greater incentives and expedite low-cost funding for local projects such as school construction and other municipal projects. Will assist financially struggling state and local governments.

- Small Business Subchapter S Tax Relief. There are more than 3.5 million Subchapter S businesses in U.S. Will increase the ability to start S corporations or raise needed capital by increasing the shareholder limit to 150 from 100.

- Enhanced Small Business Section 179 Immediate Expensing. Increases allowable Sec. 179 small business immediate expensing base to $250,000 and investment limitation to $800,000 for tax year 2008. Will boost small businesses capital investment in equipment and software and free-up needed cash flow. (Note: Enacted into law as part of first "stimulus" package 2/13/08.)

- Increase SEC Registration Threshold. Immediately increase the SEC registration threshold from 500 to 1,000 shareholders. Will help lift the tremendous dead-weight regulatory cost and burden of SEC registration for the nation's smallest companies. Will prevent costly public-to-private conversions.

- Short Form Call Report. Permit highly-rated, well-capitalized banks with assets of $1 billion or less to file a short form Call Report in two non-sequential quarters for each year. Will free up community lenders' time and resources to focus on community needs.

WRITTEN STATEMENT
OF
CARL SORGATZ
PRESIDENT
HAWTHORNE CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON FINANCE AND TAX OF THE
HOUSE COMMITEE ON SMALL BUSINESS

APRIL 30, 2008

Chairwoman Bean, Ranking Member Buchanan, and members of the Subcommittee, I am Carl Sorgatz, President of Hawthorne Credit Union in Naperville, Illinois. I appreciate this opportunity to appear before the Committee on behalf of the Credit Union National Association (CUNA) and to express our support for increased access to capital for small businesses, particularly in light of the current credit crunch. CUNA is the nation's largest credit union advocacy organization, representing over 90% of our nation's approximately 8,400 state and federal credit unions, their State credit union leagues, and their nearly 90 million members.

Hawthorne Credit Union has offices in Naperville, Bolingbrook and at Lucent Technologies and provides financial services to employees of over 125 companies and to people who live or work in Cook, DuPage, Will, Kane and Kendall Counties. Through our Credit Union Service Organization (CUSO), Hawthorne Credit Union provides Member Business Loans (MBL) to our members. Four other Chicago area credit unions are also members of the CUSO.

Small businesses are the lifeblood of the economy. For nearly a century, credit unions have been there to serve the business lending needs of their members. Our member business loans reflect the diverse background and expertise of our members. For example, in recent years the credit unions in our CUSO were able to help their members achieve success with a landscaping business, a restaurant and sports bar, an environmental services company and a long-haul trucking business.

Madame Chairwoman, you undoubtedly hear a lot of rhetoric surrounding credit union member business lending. But, please allow me to paint a picture of the MBL activity of credit unions. Member business loans that credit unions provide their members are relatively small loans; in 2007, the average credit union MBL originated was $180,710. Nationally, credit union business lending represents less than one percent (.89%) of the depository institution business lending market; credit unions have about $28 billion in outstanding business loans, compared to $3.1 trillion for banking institutions[1] In general, credit unions are not financing skyscrapers or sports arenas; credit unions are making loans to credit union members who own and operate small businesses.

Despite the apparent "credit crunch" with respect to small business and other lending, the chief obstacle for credit union business lending is not the availability of capital – credit unions are in general very well capitalized. Rather, the chief obstacle for credit unions is the arbitrary statutory lending limits imposed by Congress in 1998 and the burdens associated with many of the SBA lending programs.

Under current law, credit unions are restricted from member business lending in excess of 12.25% of their total assets. This arbitrary cap has no basis in either actual credit union business lending or safety and soundness considerations. Indeed, a subsequent report by the U.S. Treasury Department found that business lending credit unions were more regulated than other financial institutions, and that delinquencies and charge-offs for credit union business loans were "much lower" than that for either banks or thrift institutions.[2]

This cap is overly restrictive and undermines public policy to support America's small businesses. It severely restricts the ability of credit unions to provide loans to small businesses at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks.

The cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but also credit unions who would like to enter the business lending market. The cap effectively bars entry into the business lending arena because the startup costs and requirements, including the need to hire staff with business lending experience, exceed the ability of many credit unions with small portfolios to cover these costs. Today, only one in five credit unions have MBL programs and aggregate credit union member business loans represent only a fraction of the commercial loan market.

My credit union will soon reach our MBL cap and will face turning away our members for loans that will help them achieve success. If one of our lending partners, Meadows Credit Union, had been near the cap in early 2006, they would have been forced to turn away a member who was a semi trailer truck driver barely able to make ends meet. He came to his credit union knowing that if he could go into business himself and buy his own truck he could better provide for his family because drivers who own their own trucks are in a much better position to obtain more lucrative contracts and have access to more business.

As the member investigated his options he realized he had two main problems. First, he was beginning what is referred to as a "start up" business and, secondly, the loan that he needed was for an amount that was less than what most banks wanted to consider. So, he

[1] All financial data is December 2007. Credit union data is taken from NCUA; Bank data is from FDIC.
[2] Credit Union Member Business Lending U.S. Department of the Treasury, January 2001.

came to his credit union where they were able to provide him $75,000 to buy his first truck. This member has considerably improved his financial position and has already paid back the loan in full and has seen business improve significantly.

Credit unions approaching the cap face the dilemma of having to turn away members who are unable to secure business loans from other financial institutions. Congress can help credit union members avoid being turned away by their credit union by enacting any or all of the several bills currently pending that would help promote greater credit union participation in small business lending: H.R. 1537, the Credit Union Regulatory Improvements Act (CURIA), H.R. 5519, the Credit Union Regulatory Relief Act (CURRA), and H.R. 1849, the Credit Union Small Business Lending Act.

Credit Union Regulatory Improvements Act (H.R. 1537)

Credit unions support the provisions of H.R. 1537, the Credit Union Regulatory Improvements Act (CURIA), which would increase the current limit on credit union MBLs from 12.25% to 20% of total assets, and permit the National Credit Union Administration (NCUA) to increase the threshold for defining a MBL from $50,000 to $100,000. The bill would also allow, at the discretion of the NCUA Board, credit unions that fall below the net worth requirements for being "well capitalized" to make new business loans. This is especially important for adequately capitalized credit unions that have well-managed business lending programs.

Expanding the limit on credit union member business lending would allow more credit unions to generate the level of income needed to support compliance with NCUA's regulatory requirements and would expand business lending access to many credit union members, thus helping local communities and the economy.

Credit Union Regulatory Relief Act (H.R. 5519)

A second piece of legislation that would facilitate credit union participation in small business lending is H.R. 5519, the Credit Union Regulatory Relief Act. Even though it does not address the MBL cap described above, H.R. 5519 does include several provisions that would permit credit unions to make more small business loans available, including provisions that would:

- clarify existing law that permits credit unions to participate in loan programs secured by the insurance guarantees, or commitments of State or Federal governments;
- exempt member business loans made in underserved communities from the MBL cap;
- exclude loans or loan participations by federal credit unions to non-profit religious organizations from the member business loan limits contained in the Federal Credit Union Act; and

- give the National Credit Union Administration additional flexibility to issue regulations providing for loan terms exceeding 15 years for specific types of loans.

Credit Union Small Business Lending Act (H.R. 1849)
A third piece of legislation that would be helpful to increasing credit union small business lending is a bill introduced by Chairwoman Velazquez entitled the Credit Union Small Business Lending Act (H.R. 1849).

H.R. 1849 recognizes the need to enhance credit union business lending through SBA programs and is intended to improve small business lending and cooperation between the NCUA and the SBA by:

- excluding from the Federal Credit Union Act's definition of MBL from any loan made in cooperation with the SBA under section 7(a) of the Small Business Act;
- directing the SBA to implement an outreach program to increase credit union participation in the SBA's section 7(a) loan program and to simplify the application process for credit unions;
- directing the SBA to provide up to an 85% guaranty for loans made by a credit union up to $250,000 to a member residing in an underserved area, or where a member's business that is receiving assistance is located in an underserved area; and,
- clarifying that a federal credit union making a loan secured by the insurance guarantee, or advance commitment to purchase by the federal government or a state government (or agency of either) may make the loan under the terms and conditions specified in the law and applicable regulations under which the insurance, guarantee, or commitment is provided.

Credit Union Involvement in SBA's 7(a) Loan Program

CUNA is a strong supporter of the 7(a) loan program, which provides America's 26 million small business owners with the capital and technical assistance needed to start and expand their businesses. We view the 7(a) program as an essential tool for achieving the credit unions' mission of serving all the credit needs of members, particularly low- to middle-income individuals and groups living in communities that are not adequately served by other traditional financial institutions.

While CUNA strongly supports the 7(a) program, its member credit unions have not been major participants in the program. Currently, less than 2% of all U.S. credit unions offer SBA loans to their members. While larger credit unions are more likely to be involved with SBA loans, and business lending generally, only about 18% of larger credit unions with more than $500 million in assets offer 7(a) business loans. While the number of credit unions participating in the 7(a) program has increased steadily since 2003, SBA-guaranteed loans represented only a small portion (2.6%) of all business lending to credit union members in 2006.

Several important factors discourage larger numbers of credit unions from participating as 7(a) lenders. First, as previously discussed the statutory MBL cap restricts the ability of credit unions offering MBLs from helping their members even more, and discourages other credit unions from engaging in business lending.

A second factor limiting credit union participation has been SBA policies that, until 2003, limited credit union eligibility to participate in the 7(a) program only to credit unions with geographic or community charters. Since the number of credit unions with community charters still represented a small percent of all credit unions, this severely limited credit union access to the program. Fortunately, SBA issued a revised legal opinion on February 14, 2003, removing restrictions on the types of credit unions eligible to participate as 7(a) lenders. Today 386 credit unions offer SBA 7(a) loans.

While SBA's 2003 policy change was good news for credit unions, it may prove to be even more important for small businesses. An SBA research publication noted that large bank consolidation is making it more difficult for small businesses to obtain loans.[3] Given the fact that the average size of a credit union member business loan is $180,710, and the average credit union SBA 7(a) loan is $82,850, this is a market that credit unions are well suited to serve. And this is a market that credit unions are eager to serve.

CUNA strongly supports legislative initiatives that permit the SBA to reduce borrower and lender fees for the 7(a) program to the greatest extent possible. In March 2007, the House passed H.R. 1332, the Small Business Lending Improvement Act of 2007, with overwhelming bipartisan support. This bill will authorize and put in place a mechanism to reduce SBA 7(a) borrower and lender fees. We encourage the Senate to take action and hope the President will sign into law this important piece of legislation.

Conclusion

Madame Chairwoman, in summary, I want to thank you and the Committee for providing CUNA with an opportunity to express its support for further access to capital to small businesses. We urge Congress to enable credit unions to serve their member business lending needs by enacting the important legislation discussed today.

[3] The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks SBA, March 2005

Asset Recovery
ART
Technologies, Inc.

**Testimony
of
Lawrie N. Hollingsworth, E.E., CEO
Asset Recovery Technologies, Inc.**

Before the U.S. House of Representatives, Committee on Small Business, Subcommittee on Finance and Tax

Hearing on the Effect of the Credit Crunch on Small Business Access to Capital.

Wednesday, April 30th, 2008

Company Background

My name is Lawrie N. Hollingsworth. An electrical engineer and Certified Disaster Recovery Planner, I am the CEO and founder of two engineering companies, The Price-Hollingsworth Company, Inc. (PHC), and Asset Recovery Technologies, Inc. (ART). Headquartered in the suburban Chicago city of Elk Grove Village, both firms work nationwide with insurance companies and businesses after a disaster or property insurance loss. PHC employs four people including three engineers; and ART employs eight people. We add part-time and temporary help as needed up to another 20 people. Additionally, we have certified a pool of approximately 200 technicians nationwide with our certification program. draw Both are 100 % woman-owned and founded, and are certified Women's Business Enterprises (WBE). I founded PHC in 1987, and ART in 1994. Although small businesses, each is well-known in our industry and enjoys a well-respected niche position. ART is a disaster recovery firm that specializes in the evaluation, clean-up and recovery of technology equipment such as computers, communications systems, server networks, radio and television stations, hospital medical equipment, manufacturing equipment and machinery. ART was a responder to 9/11 for a Fortune 50 communications company, where we received numerous assignments to recover equipment and return it to use. In addition to numerous catastrophes and disaster recoveries nationwide for over 14 years, ART was also a responder to Hurricane Katrina, where we received many many assignments.

The Impact of Tightening Credit on my Businesses

Both businesses are typical small businesses: We utilize bank loans, line of credit loans and credit cards to fund our business, in addition to a re-investment of profits. My employees are very hard-working, decent and honest Americans with families to support. Like all small (and large) businesses, the credit crunch affects us substantially. Money is simply less available; when it is available, it is at a new premium and cost for less money and more restrictive lending covenants.

In 2007, ART gross sales declined by approximately 50% over 2006. Most others in my industry have reported dramatic drops across the board. While fluctuation is the norm in the disaster recovery business in part due to weather patterns, I believe that this drop in sales was due in part to soaring interest rates and lack of credit. This is particularly likely as weather patterns for both years were similar. Something has to account for such a precipitous decline. When business are already operating on thin and vanishing profit margins, any sort of disaster will put them under. As will be discussed further in this testimony below, business seeking working capital and equipment loans from a bank to re-build after a disaster may find credit unavailable, insufficient or just too expensive. Faced with looming business failure, most businesses opt to "take the money and run" meaning they do not re-invest insurance proceeds back into the business, but pocket them and close their doors. This is one more sale of services I do not make, and one more business failure in America.

Alternately, businesses may have chosen to substantially under-insure themselves to save costs - a measuring almost guaranteeing their eventual failure in the face of a disaster by the way. Thus there is not enough money for rebuilding after a disaster which requires hiring a firm like ART, and again my business opportunity is lost.

This sharp decline in revenue has caused me to sustain an approximate decrease of 20% of my full-time work force. I have not re-hired employees lost due to resignation or termination. I did not hire any summer interns as I usually do I have also hired far less temporary workers as well, a total decline of 70% between 2006 and 2007.

ART interest expenses were 700% higher in 2006 over 2007. While we are fortunate enough to have a strong banking relationship with stable rates, this is no remedy for lost business. Less business translate into more borrowing for my firm. This translates into less equipment I purchase, smaller inventories I keep on hand, fewer people I employ, and less medical benefits I am able to offer my employees.

Tight Credit -- a Multifaceted Dilemma for Small Business

I believe the current credit crunch presents a multiple dilemmas for the small businesses:

- Added cost of debt service, including rising bank lending costs and untenable credit card costs reduces or eliminates profitability
- Less available credit for expansion
- Impediments to funding for starting new businesses
- Significant impediment to a business recovery after a disaster

What does this translate into? Small Business is buying less equipment, hiring less full-time people, eliminating part-time and student positions, shortening hours of employment, reducing or eliminating benefits, falling behind in debt service (thus further reducing small businesses' ability to borrow and manage cash flow well) and so forth. Naturally, reduced purchasing, less employment, and debt defaults contribute to the overall national impact of the tightening credit markets. Thin profit margins get thinner and vanish altogether. The vicious cycle perpetuates itself: More costly borrowing means smaller or no company profits, reduced employee compensation and joblessness, which in turn means less dining out, less personal purchases, less vacation travel, and so on. This continues the cycle of layoffs and unemployment, debt and despair.

Lost Opportunity for Business Start-ups

We are focused on the impact to currently existing Small Businesses, but I believe there is a second, substantial and somewhat obscured impact of the tightened credit markets. This hidden danger is the lost opportunity for more small business start-ups. Small business is the largest private sector employer in the U.S. The heart of small business, and in my opinion the American Dream, is the business start-up. From "mom and pop" endeavors to small technology firms, these are the life-blood of our nation. Start-ups are funded by savings and 401K's, gifts and loans from friends and relatives, the occasional governmental source, home equity loans, equipment loans, collateral-based working capital bank loans, and credit card debt.

The statistics on small business failure are already severe: Failure rates of over 50% in the first two years are often cited. Already started on a "shoe string" and usually under funded, these small businesses depend on debt and credit to open their doors and thrive. What is happening now is that debt funding for new ventures is simply disappearing. Thanks in no small part to the subprime mortgage market collapse, lenders are very nervous about home equity lending, often substantially reducing available loan size. Further, once a business has a need for a bank loan in excess of the home equity-based loan, they are met with a number of restrictive covenants coupled with historically higher interest rates – if they find a willing lender at all. When they turn to credit card financing they will encounter interest rates from the high teens to the lower 20's of percentage rates. This is simply untenable.

When encountering the true cost of credit and its affect on their potential business, plus the difficulty or impossibility of obtaining a bank loan, I believe that many potential entrepreneurs will simply "walk away" from this opportunity to own their own business. This is a tragic collapse of the entrepreneurial American Dream.

Business Failure – the "Second Disaster" after a Catastrophe Exacerbated by Tight Credit Markets

Turning now to established businesses, I would like to touch on yet another hidden, ominous facet of the so-called credit crunch. That is the likely failure of a business after a catastrophe such as fire, flood, natural disaster, etc., and how that situation is further exacerbated by tight and expensive credit. Consider the following pre-credit crunch statistics:

- "The U.S. Department of Labor estimates over 40% of businesses never reopen following a disaster. Of the remaining companies, at least 25% will close within 2 years."
- "Over 60% of businesses confronted by a major disaster close by two years, according to the Association of Records Managers and Administrators."

How much will these statistics worsening? When our firm was working on the Gulf Coast on various recovery projects after Hurricane Katrina, I noted the inordinate number of small business that were lost, likely gone forever. From the devastated city of New Orleans across the entire Gulf Coast to Pensacola, Florida, I saw business after business in ruins. Gone were the local beauty parlors, hardware stores, fast food franchises, local computer repair companies, car dealers and more. Based on my observations and knowledge, I believe that it is likely most of these businesses have either not re-opened, or even if they have, fail within several years of their Katirna-related disaster. The above cited statistics prevail in the best of times and circumstance; in times of a vanishing small business credit market, we are almost guaranteed the demise of many many Gulf Coast small businesses. These businesses have likely lost their usual collateral for loans such as homes or receivables.

Even if they have maintained these, they are now faced with far higher interest rates and a well-documented reluctance on the part of lenders to write small business loans. I believe this scenario is being played out in mass numbers on the Gulf Coast; it is true anywhere a business has had a fire or flood or other catastrophe recently. It will be true if the US faces another catastrophic regional weather disaster.

Impact of the Credit Crunch on State Recoveries and the Effect on Small Businesses

Another, related effect of the credit crunch is the shortfall state catastrophic insurance funds are reporting. Last year, the State of Florida cited selling $3.5 billion in bonds versus a needed $7 billion. Besides bond funding, such funds depend on borrowing to fill in the differential, otherwise, a potential shortfall could loom in the face of another Hurricane Andrew, Katrina, or even Wilma. The state of Florida has cited a growing concern that the tight credit markets will give rise to this dreaded shortfall. Simply stated, the state may simply be unable to borrow enough money to pay on these catastrophic policies for home owners whose homes lie in pieces. As related above, the home equity line and/or single family home as collateral is a cornerstone of small business borrowing. Without a home to secure a loan against, the small business owner may have no choice but to shutter her business after a regional catastrophe

Summation and Suggestions

I could cite a number of statistics and scenario that validate the highly detrimental effect of the credit crises on small business. Sufficient to say, it is doing great harm to the backbone of American business, translating into higher unemployment, lost health benefits, lost opportunity and more.

Suggestion Number One -- Revitalize the Small Business Administration

The SBA is uniquely poised of all government agencies to assist in the establishment and maintenance of Small Business. Restore loan and funding programs and guarantees that will help quiet the fears of reluctant bankers and lenders.

Suggestion Number Two -- Credit Card Reform

Clamp down on predatory practices and excessive interest rates of credit card firms. This will benefit small business and consumers alike.

Suggestion Number Three – Subprime Mortgage and ARM Mortgage Reform

As the housing market continues to collapse, less and less home equity is available for small business funding. Banks continue to tighten credit and increase rates as they are faced with foreclosure after foreclosure. Besides the obvious consumer benefits, I believe relief in this area will also benefit the small business owner.

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I believe that urgent reform is needed before small business is brought to its knees. I thank you for the opportunity to come before this committee and testify.

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Thank you to Congressman Buchanan, Representative for our 13th Congressional District, for inviting me and thank you to the members of the House Small Business Committee, Subcommittee on Finance & Tax, for allowing me to present my views on "The Effect of the Credit Crunch on Small Business Access to Capital." Special thanks to The Greater Sarasota Chamber of Commerce, where I am a member of the Board of Directors and Chair the Small Business Council, for helping me get here.

Sarasota, Florida, was named last month by Fortune Small Business Magazine as one of the 100 best places in America to live and launch a small business. The Greater Sarasota Chamber of Commerce, which represents 2,200 businesses -- of which 85% have 10 or fewer employees --is one of the top local chambers in the state and nation. Sarasota's health and educational systems are also among the finest around. We are known worldwide for our pristine and award- winning beaches and a creative class that brings visitors and audiences from around the world to our All-American County.

I, like many other small business owners, have been watching as the real estate market crashes, foreclosures escalate, jobs are lost, the stock market fluctuates, and many small businesses close their doors. So many of us have what is called "soft collateral" which means banks, etc., do not want to loan us money even when the market is good. Because of this, most small business owners (more than 99 per cent of all employers in the United States) have had to rely on their equity in real estate they own... I, myself, included. We are accustomed to this; however, with the real estate market decreasing so dramatically, many of us have lost this ability due to no equity being left in our property or because we cannot qualify for a home equity loan through our banks. In other words, some of us have no way to turn for relief. So what do we do? Do we give up our dream and something that some of us have built for years or look at the only thing left: our retirement plans? Of course, if we use our retirement plans, we prematurely suffer tax consequences, so perhaps we turn to our credit cards. Either way, its deadly.

The crunch is especially painful in Sarasota which, along with many other areas in Florida, is facing an economic downturn in one of it primary markets: real estate and construction. In our residential real estate sector, we have an inventory in excess of 18 months and prices have dropped 25 per cent from a year ago. Needless to say, jobs have plummeted. Sarasota, itself, has lost more than 7,000 jobs in the past year with more than 13,000 jobs lost and families affected in our immediate area. Our unemployment is far worse than the rest of the state and is approaching 6 per cent. Forecasts call for Florida's employment numbers to continue a downward trend through 2009. From all indications, Sarasota seems destined to continue to lead the way unless the tables turn.

And the cost of healthcare for an aging population, of which Florida leads the nation, continues to grow at a staggering pace. We also are among the top states in the nation in the number of uninsured. We have more than 1 in 6 people in Sarasota County without healthcare coverage and many of these people – more than 45,000 -- are hard-working owners and employees of small business.

As the dream of a comfortable retirement turns into a nightmare, we see 85 per cent of our retirement-aged Sarasota Chamber members respond to a recent survey that they will "never" retire or that retirement is more than 10 years away. What jobs do we need our small businesses, our country's main economic engine, to create now to sustain our economy for the next 40 years? How will we create a business-friendly atmosphere to generate jobs and bolster our economy as we increasingly play on a global platform? The answers have yet to materialize.

In Sarasota, another key industry is tourism, made up chiefly of small businesses with seasonal cash flow and credit needs. Our Chamber works hard with other local players to attract visitors, both domestic and international, to our beautiful area. We are increasingly reaching out to promote ourselves worldwide with a special emphasis on Canada and Latin America in this hemisphere and Western Europe – especially the colder countries – abroad.

So what do we want, need and expect from our representatives in our nation's capital as we work to overcome these challenges and seek to identify opportunities?

Please give priority to meaningful tax reform and hold the line on tax increases in income, capital gains and estate taxes while the reform debate ensues to allow small business owners an opportunity to grow our businesses, our communities and our legacies which will stimulate our sluggish economy.

At the same time, please enact business-friendly initiatives such as tax incentives for businesses who want physical and job expansion. While SBA loans are important, the program does not provide anywhere near the total solution. Please consider tax incentives to banks to expedite small business loans to relieve the pressure on our free market economy. The revenue that might be lost in creating such incentives should be more than offset by the positive impact it will create in taxable income/revenue generated by businesses who succeed, rather than fail.

Regarding global commerce, it is important to our economy as a nation, in Florida and very much so in Sarasota to be a "go to" place for international visitors who will become our friends and business partners. Please work to balance our need for security with our need to welcome visitors and investors from abroad to our magnificent country.

Please continue to work towards lowering the cost of health insurance by passing legislation to allow small businesses to band together in associations and negotiate lower rates with insurance companies.

And please continue to help small businesses work through the Federal government's complex procurement process. We thank you for your effort thus far, but government agencies are still not reaching their goals, according to our U.S. Chamber of Commerce, for contracting with small businesses, particularly as prime contractors.

We also thank you for your support for legal liability reform and look with interest and hope that such proposed legislation will be enacted so as to curb unfounded and unfair lawsuits which are increasingly threatening the ability of retailers and sellers to run their businesses and contribute to their communities.

And, very importantly, please do not over-regulate. We entrepreneurs are a proud lot. We do not want a "hand out." We want a "partnership" and will work tirelessly with you on solutions to the challenges we face together.