U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

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May 15, 2008

The Honorable John F. Kerry
Chairman
Committee on Small Business
and Entrepreneurship
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your recent letter regarding the U.S. Small Business Administration's (SBA) 504 loan liquidation policies.

On Monday, April 14, 2008, we met with your staff to discuss these policies, especially as they relate to compensating Authorized Community Development Company Liquidators (ACLs) for their work to liquidate assets on defaulted SBA 504 loans. We had a productive meeting with your staff, during which we were able to clarify the facts surrounding the Agency's 504 loan portfolio and the efforts made to date by both SBA and ACLs to liquidate defaulted loans in the program. While we answered many of your questions at the meeting, we are writing to specifically address two requests outlined in your letter.

You asked us to provide the Committee with the "total number and dollar amount of 504 loans to be charged off and how that will affect the subsidy rate and fees on the borrowers and lenders."

SBA is working to resolve a number of outstanding cases and charge off loans where liquidation has been completed. Recovery activity is complete on approximately 200 cases that are ready for charge off, with a total balance of $85 million. These charge offs will not significantly affect the program subsidy rate for budget submissions because the subsidy rate is driven by actual cash inflows and outflows, not accounting transactions. The cash outflows for purchases and the cash inflows from recoveries have already been recorded for these loans and therefore are already included in the data used for subsidy modeling.

You also asked us to provide the committee with "estimated funding SBA would need to continue the reimbursements" to ACLs for their administrative liquidation costs.

To be clear, SBA will continue to "reimburse" ACLs for out-of-pocket expenses related to their liquidation efforts. We understand your question as related to the "tiered compensation" for recoveries, which is currently set for ACLs at rates of 4 percent on realized net recoveries up to a fee of $25,000 and 2 percent on net recoveries in excess of this amount.

We can estimate that agency compensation to ACLs for liquidating the 60 loans that qualify for the tiered rates in place between May 2007 and the July 2008 will cost approximately $1.5 million over the next six years (FY 2009-2013) as cases are closed.

Unfortunately, at this time, we are not able to provide the Committee with a useful estimate for the annual costs of continuing to compensate ACLs beyond July 2008. To be able to provide a reliable estimate, we need to estimate the number and dollar amounts of loans that ACLs will liquidate. Given the current economic environment and the recent increase in delinquencies and defaults we are beginning to see in the 504 loan portfolio, we do not believe we can reasonably predict how many 504 loans will be liquidated in future years. Estimating these costs also requires us to predict the recovery rates that ACLs will achieve on these loans. The volatility in the real estate markets will inevitably impact recovery rates in ways that can't yet be predicted making the requested estimate even more unreliable. We don't want to provide the Committee with an estimate that can't be well supported.

If you have any additional questions or comments, please call me directly.

Sincerely,

Eric R. Zarnikow
Associate Administrator
Office of Capital Access