United States Senate
WASHINGTON, DC 20510

November 3, 2008

The Honorable Sandy K. Baruah
Acting Administrator
U.S. Small Business Administration
409 Third Street, S.W.
Washington, D.C. 20416

Re: Emergency Changes to SBA Credit Programs

Dear Mr. Baruah:

For almost a year now, Congress has been warning the Administration and the SBA of a credit crunch for small businesses. Now we are hearing from many of our constituents that our worst fears are being realized, and many small businesses are in danger of closing their doors if they cannot secure additional financing.

SBA loan guaranty programs historically have been counter-cyclical, when the private sector decreases small business lending, the demand for government-guaranteed loans increases. However, as the economy started to falter last year, the demand for SBA loans decreased instead of the increase we would have expected. Congress said the decline in SBA lending was a bellwether for the conventional market, and it has been proved right: SBA lending from those first warnings declined from 12 percent to more than 30 percent, and lending to small businesses through conventional loans, as reported in the Federal Reserve's third quarter lender survey, has dropped from 33 percent to 65 percent. Since the major collapse of the financial markets on September 15th, SBA lending has declined more than 50 percent.

No longer can the Administration claim that cuts in the interest rates are sufficient to turn around the SBA lending decline. The rate cuts are actually exacerbating the problems in the SBA programs because it is causing lenders to lose money on SBA loans and driving them out of the program. Not only have many of SBA's private sector lending partners cut back or discontinued making SBA loans, but they are also starting to lay off staff, which means SBA is losing the private-sector capacity to market, process and service loans when the economy needs to be increasing lending. Essentially, the SBA is working at cross purposes with Treasury in its efforts to implement the financial rescue package and unfreeze the credit markets.

Experts are predicting it will take months for the effects of the $700 billion rescue package to reach small businesses, time they don't have. Most small businesses do not have the reserves to wait months for access to capital, and they shouldn't have to wait since the SBA has the authority to make loans available to small businesses immediately through its disaster loan program and temporarily tailor the 7(a) and 504 loan guaranty programs so that the private sector starts making these loans again and the secondary market for SBA loans is active again. As was reported in the *American Banker* yesterday, Unity Bancorp Inc. in Clinton, N.J., one of the SBA's most active lenders among community banks, started an aggressive expansion of its SBA lending a year ago, but last week announced that it shut down eight SBA loan offices in seven states outside its market area, and laid off 10 of its 12 SBA lenders.

Bridge Loans. The most obvious and immediate way to get credit to small businesses suffering substantial economic injury due to the credit crisis is to make bridge loans available through the SBA's economic injury disaster loans, as the Administration did after 9-11. As you know, the Administration has the authority to make these loans and does not need Congressional action. Furthermore, because the SBA makes these loans directly instead of using the private sector to deliver them, this is a quick way to get loans to businesses because they do not need to wait until banks have liquidity freed up through the rescue package to make loans again. Based on the information we have from the SBA, another benefit to using this resource is that it is sufficiently funded to make bridge loans for the economic crisis and still help victims of recent disasters. Congress greatly increased the lending capacity of the SBA's disaster loan program last month when it appropriated almost $500 million in additional funding, giving the agency the potential to lend more than $6.8 billion in emergency loans this year. There is still $6 billion available, far more than the volume of economic injury disaster loans made nationwide after 9-11. The SBA should have the capacity to handle efficient processing and disbursement of such loans based on its much-publicized disaster loan program improvements and recent trends for hurricanes, floods, and fires. Should the SBA need more assistance beyond its existing reserve loan staff, it has all the authority it needs to enlist the help of private lenders through comprehensive disaster reform enacted as part of P.L. 110-234, signed into law in May.

Change to the 504 Loan Guaranty Program. Another way SBA could help small businesses is by temporarily changing its internal policy on 504 loans to allow some existing 504 borrowers to either refinance their unguaranteed first mortgage or obtain another bank loan that SBA would agree to subordinate to the existing 504 second mortgage. This change would enable the borrower to obtain a reasonable amount of cash from its existing business property equity. We are hearing from Certified Development Companies that this change would be helpful to small businesses in today's economy, where even good borrowers are having difficultly obtaining funds for a sound business purpose, such as for expansion or for working capital to make it through this economic downturn. We understand that SBA has done this on a case-by-case basis in the past, and that it does not require a regulatory or statutory change. There are pros and cons to such a change, but SBA could establish guidelines for such loans that would give adequate protection to the 504 portfolio and ensure that the borrower is in a demonstrable position to repay the increased debt.

Changes to the 7(a) Loan Guaranty Program. The SBA could help stabilize lending in its largest loan program by making three sensible programmatic changes, many of which its lending partners and Congress have been seeking since 2007 through S. 1256, S. 2920, and S. 3596. One, SBA should allow weighted average coupons to sell SBA loans on the secondary market. The current requirement that all loans in the pool be the same interest rate is outdated compared to most non-SBA security pools, and, in this climate, is contributing to the complete paralysis of the SBA 7(a) secondary market. The assemblers of the pools believe that using a weighted average coupon, which means loans of different interest rates can be pooled and sold together, will provide efficiency in the process and ultimately move the pool to the marketplace faster. Two, we urge the SBA to make a regulatory change to adopt an alternative interest rate index other than PRIME. As you know, lenders are currently required to charge an interest rate based on PRIME. This does not always give the borrower the best rate and it is incompatible with the rate standard used by many SBA lending partners. Third, we urge the SBA to temporarily adjust the maximum rate cap for the loans to recognize that the current structure, in this environment, actually drives away lenders because they can't even break even when they make an SBA loan.

Time is of the essence for the Administration to use its authority and make these changes. With more than $6 billion in the disaster loan program available for bridge loans to businesses suffering substantial economic injury, and authority to back up to $25 billion in small business loans available through the SBA's 7(a) and 504 loan guaranty programs, the SBA is in a position to help small businesses survive the current recession. Thank you for your attention to these matters, and we hope that you will consider taking these steps as soon as possible. We look forward to hearing from you soon.

Sincerely,

John F. Kerry

Charles E. Schumer