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United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

WASHINGTON, DC 20510-6350

February 13, 2008

The Honorable Steven C. Preston
Administrator
U.S. Small Business Administration
409 Third Street, S.W.
Washington, D.C. 20416

Re: Small Business Credit Crunch

Dear Administrator Preston:

When you testified before the Committee in November and in January, I expressed to you my concerns about the impact of the looming credit crunch on our nation's small businesses. Those concerns have only deepened as a result of recent data issued by President Bush, the Federal Reserve Board, and the Small Business Administration (SBA). By all accounts, lenders are tightening credit, making it harder and more expensive for small businesses to get loans. Because the SBA's loans play an important role in the continuum of small business credit in this country, I would like to learn more about the SBA's efforts to help small businesses survive the credit crisis.

This year's Economic Report of the President, which was released Monday, describes how lending standards have tightened for small business. Those findings are based, in part, on the quarterly Senior Loan Officer Opinion Survey, which was issued by the Federal Reserve Board last week. According to the Federal Reserve's survey, over 30 percent of domestic banks indicated that they have tightened their credit standards for commercial and industrial loans to small businesses over the past three months. Even worse, 80 percent of the domestic banks surveyed also reported tighter lending standards for commercial real estate loans—the highest percentage recorded since the Fed began posing the question 18 years ago. Citing the Fed survey data, President Bush's Economic Report cautions Congress that in our slowing economy “firms may need to borrow more in the future, at which point tighter lending standards might become more limiting....”

But the Fed's survey and the President's report are not the only disturbing news for small business borrowers. So far this fiscal year, the number of loans made through the SBA's largest loan program, the 7(a) loan guaranty program, dropped 14 percent compared with the same period last year, and dollar volume fell six percent. Meanwhile, lending through the SBA's 504 fixed asset loan program, which had grown significantly over the past few years, has suddenly gone flat. These figures are especially alarming because, historically, SBA loan activity has *increased* when the conventional credit market has tightened.

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Given this downward trend, the question becomes, what can we—Congress and the Administration—do to help reverse it and provide small businesses with the credit they need? Reducing the fees charged to SBA borrowers and lenders would certainly be a good start. For borrowers, a reduced SBA fee means more money in their pockets for capital investment. For lenders, it provides an incentive to finance the small businesses that are so vital to our economy. Although the Administration is reluctant to acknowledge the problem, the SBA's product has become too expensive in recent years, causing lenders to cut back on 7(a) lending or abandon it for other, more cost-effective loan products. The newly imposed, highly controversial lender oversight fees will likely make matters worse, as many SBA lenders predict a further decrease in 7(a) activity this spring when the first full year of the oversight fees are billed to participating banks.

In addition to reducing fees, we could make legislative changes that would improve the SBA's 7(a), 504, and microloan programs. Last year, I introduced the Small Business Lending Reauthorization and Improvements Act of 2007 (S. 1256), which was co-sponsored by Ranking Member Snowe. Among other things, the legislation would make key changes to the 7(a) program that will benefit the small businesses affected by tighter credit markets. First, it would address the SBA's practice of overcharging lenders and borrowers, which has totaled more than \$900 million since 1992, by giving the SBA authority to reduce the fees charged when there are excess funds to cover the cost of the program. Second, the bill would increase the maximum size of a 7(a) loan to \$3 million from the current \$2 million, and increase the maximum size of the accompanying guarantee to \$2.25 million from the current \$1.5 million. The bill would also allow the SBA to identify an alternative interest rate to the Federal Prime Rate, giving many small business borrowers more affordable monthly payments.

Other highlights of the bill include streamlined lending that would allow the refinancing of certain projects through the 504 program and the creation of a Rural Lending Outreach Program designed to provide capital to businesses located in less-populated regions. While I understand that you initially expressed reservations about the bill, I hope that you will reconsider your stance on S. 1256 given the recent news and mounting evidence that the credit crisis has spread to small business lending.

In addition to S. 1256, there are other, more timely means of helping small businesses survive the looming credit crisis. Last week, I introduced a bill (S. 2612) that will stimulate small business lending by temporarily reducing the fees collected by the SBA. This measure will immediately reduce the cost of capital for small businesses. With lower monthly loan payments and smaller closing costs, more money will be placed into the hands of small business owners—money that will be quickly injected into the economy through purchases of inventory, real estate, and equipment. The fee reduction for lenders, coupled with the government guarantee, will give them an incentive to make 7(a) loans, as banks are scrambling for ways to salvage declining revenues and take on

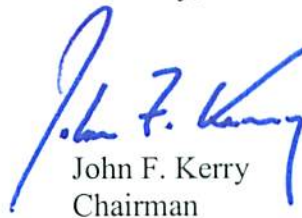
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less risky loans. A similar stimulus package was adopted in response to the recession that occurred after September 11, 2001, and lending increased to businesses nationwide, pumping almost \$3 billion into local economies and creating or retaining more than 90,000 jobs.

While the proposals I have put forward are an important step to providing small business owners with much-needed investment incentives, I look forward to hearing the SBA's thoughts on the issue. The President's proposed FY 2009 budget that was delivered to the Committee last week certainly did not reflect any special concern for the tightening credit markets, and it is important for you, as the Administrator of the SBA, to explain why. I look forward to seeing you at the budget hearing on February 27.

In the meantime, should you have any questions or concerns, please do not hesitate to contact me or relevant members of my staff.

Sincerely,



John F. Kerry
Chairman