THE AMERICAN INSTITUTE OF ARCHITECTS

TESTIMONY OF
JIM DETERMAN, AIA

"Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

United States House of Representatives
Committee on Financial Services

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Chairman Frank, Ranking Member Bachus, and members of the Committee, I am Jim Determan, AIA, an architect at Hord Coplan Macht of Baltimore, MD; a former member of the American Institute of Architects (AIA) National Board of Directors; and, until recently, a principal of CSD Architects, a small architecture firm in Baltimore. I want to thank you for the opportunity to testify today on behalf of my firm and the AIA.

The current economic crisis has affected every American, but it has hit small businesses particularly hard. Moreover, the impact of this recession on the design and construction industry has been simply devastating. According to the U.S. Department of Labor, the unemployment rate in the construction industry in March 2010 was 24.9 percent, the highest by far in any industry.[1] The Associated General Contractors of America report that in the last year, 48 out of 50 states and the District of Columbia lost jobs in the construction industry.[2]

In my profession, the Labor Department reports that employment at architectural firms has dropped by 18 percent between 2008 and 2009.[3] And that is only counting those who have applied for unemployment insurance. Many of my colleagues report being underemployed or working without pay for as long as 18 months. That is an enormous burden for skilled workers who have families to feed and mortgage bills to pay. Worse, many young architects are simply leaving the profession, looking for opportunities elsewhere. Once economic conditions improve, a dearth of young talent will hamper the ability of our country to design and construct high-quality buildings for years.

Architects are, by and large, small businesspeople. In fact, 95 percent of architecture firms employ 50 or fewer people.[4] They are truly the engine that drives the design and construction industry. Architects are job catalysts – they are the first workers to be involved in the construction process when they develop designs. Hiring an architect leads to employment in other construction-related fields, from engineers and manufacturers, to steel and electrical contractors. In fact, one architectural service worker, on average, begets 34 additional construction industry workers in this country.[5] Our industry created over $1 trillion in economic activity in 2008,[6] and

[1] http://www.bls.gov/news.release/pdf/empsit.pdf
[2] http://www.agc.org/cs/news_media/press_room/press_release?pressrelease.id=568
[3] Bureau of Labor Statistics
[4] http://info.aia.org/aiarchitect/thisweek09/1009/1009b_firmsurvey.cfm
[5] U.S. Department of Labor
[6] www.census.gov/const/C30/total.pdf

a recent study by the George Mason University Center for Regional Analysis found that every $1 million invested in design and construction creates 28.5 new full-time jobs.[7]

Architectural activity is a harbinger of construction work: the AIA Architecture Billings Index (ABI), which surveys work on the drawing boards, is a leading indicator of construction activity nine to 12 months down the line.[8] The most recent ABI, although showing more encouraging results than in recent months, still indicates less demand for architectural work than the month before. Indeed, the most recent issue of *Bloomberg/Business Week* magazine notes that the index has been contracting for 26 consecutive months. In other words, the decline in the industry has not turned around, but is merely slowing. This means that the construction industry should expect soft demand for its service for the next nine to 12 months. Clearly, the green shoots of economic recovery are not bearing fruit in this important sector.

If you ask architects across the country today why conditions are so bad, you will inevitably hear the same two responses: one, firms are unable to secure credit to keep operations going; and two, clients are unable to secure the financing needed to get construction and renovation projects started.

Architecture firms in general – and, in particular, smaller firms – rely heavily on short-term lines of credit to finance their operations. However, lending to small businesses has dropped severely during this economic crisis. According to the Congressional Oversight Panel, "Although Wall Street banks had been increasing their share of small business lending over the last decade, between 2008 and 2009 their small business loan portfolios fell by 9 percent, more than double the 4 percent decline in their overall lending portfolios."[9]

As banks have restricted lending, it has become increasingly difficult for firms to continue to make payroll and fulfill benefit obligations for their employees, let alone expand and pursue new projects. I have heard from many of my colleagues who have reported banks either restricting draws on their lines of credit or, in some extreme cases, calling in those lines. Although some have argued that the recued level of lending to small business is due to a lack of demand for

[7] www.naiop.org/foundation/contdev.pdf
[8] www.aia.org/aiaucmp/ groups/aia/documents/pdf/aias076074.pdf
[9] http://cop.senate.gov/press/releases/release-051310-smallbusiness.cfm

loans, I can tell you that in my experience there are numerous architecture firms that rely upon short-term lending to stay afloat, but have been denied access because of the lack of supply.

More problematic is the lack of access to capital for design and construction projects, which has depressed demand for our services to historically low levels. The January ABI survey questioned firms about the reasons for a lack of work in the design and construction industry. The response was overwhelming: more than 90 percent of architecture firms participating in the survey rated construction project financing as at least a somewhat serious problem, while almost half (44 percent) rated it as an extremely serious problem. Half of firms surveyed indicated that the availability of credit for construction financing had become much more restrictive over the previous year, while an additional 30 percent indicated that it had gotten somewhat more restrictive.[10]

It is both inevitable and understandable that, following the economic collapse in 2008, credit would be tighter than it was in the middle part of the last decade. However, the pendulum has swung so far in the direction of restricted credit that even worthy, well-secured projects by clients with impeccable credentials and proven track records are being denied access to financing. The mentality appears to be, since financing everything didn't work, let's finance nothing.

Last year, the reduction in work due to a lack of financing forced my partners and me to close the doors on our firm – a firm that had weathered previous recessions for over 60 years. A significant contributing factor causing the demise of our business was the lack of credit available to our clients to finance their projects. Projects stopped dead in the water. We could not move fast enough to shed employees or office space. And near the end, the bank called in our credit line. One hundred twenty good people lost their jobs, some of whom had been with the firm more than 30 years.

What is striking about my story is that, if a well-established firm with a six-decade record of achievement can fail, then small firms just starting out have an even more difficult time surviving

[10] http://www.aia.org/practicing/AIAB082315; the most frequently mentioned categories where construction financing is an issue were commercial projects (71%), new construction projects (68%), and large projects (54%). Projects where financing was less likely to be mentioned as a concern were health care (10%), industrial (17%), and education (18%).

in this economic climate – and yet it is precisely the ability of entrepreneurs to form new ventures and strike out on their own that is vital to driving economic recovery.

That is why the AIA and its partners in the design and construction industry have worked hard to call on Congress and the Administration to enact polices that will stimulate and restore confidence in the United States economy. The AIA's *Rebuild and Renew Plan for Long-Term Prosperity* identifies policy objectives that will put architects and their allied professionals back to work designing and building our communities and laying the groundwork for future economic growth.[11]

Congress has taken some important steps over recent years to address these challenges. The American Recovery and Reinvestment Act of 2009 (ARRA), though by no means a panacea, is providing opportunities for work for a number of architects; in fact, the AIA's research shows that, as of March, one in four architecture firms have recorded billable hours from stimulus-funded projects.[12]

However there is much more to be done. As I mentioned, the ABI figures indicate that we are still at least a year away from having a healthy business environment in the design and construction industry. With that in mind, I am pleased that this Committee is considering two pieces of legislation that would help small businesses weather the economic storm.

H.R. 5297, the Small Business Lending Fund Act of 2010, introduced by Chairman Barney Frank (D-MA); and H.R. 5302, the State Small Business Credit Initiative Act of 2010, introduced by Representative Gary Peters (D-MI), both would inject billions of dollars into the small business market, thus providing vital relief for millions of small entrepreneurs who are struggling to make ends meet. I am particularly pleased that H.R. 5297 would allow for the provision of "owner-occupied nonfarm, nonresidential real estate loans." This has a double benefit: not only does it provide a means for small businesses to grow and expand their operations, but it would provide financing for new projects, therefore creating jobs in the design and construction industry.

I would urge the Committee to ensure that the funds provided to small community banks under this legislation are lent to small businesses at rates and under conditions that make them attractive

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[11] www.aia.org/advocacy/federal/AIAB081324
[12] www.aia.org/advocacy/AIAB082671

and usable. I also would like to suggest that the Committee resolve to review and evaluate the results of these programs once they are completed to determine which strategies worked best.

These proposals will address some of the main causes of small business failure and job loss we are facing. However, I would like to urge the Committee to work to address the second problem I raised as well, namely the lack of demand for design and construction services caused by a lack of access to financing for our clients. Although there are many ways to solve this problem, I understand that members of this Committee have introduced bills to address this issue.

For example, Representatives Ed Perlmutter (D-CO) and Mike Coffman (R-CO) have introduced H.R. 5249, the Capital Access for Main Street Act of 2010. Over the next three years, it is estimated that $1.4 trillion in commercial real estate debt will come due. Much of this property has been significantly devalued in the recession, and the borrowers are under water. This legislation would help lenders and borrowers as they attempt to work out their loans under terms that are mutually acceptable, avoid large sums of commercial foreclosures, and free up credit that can be used more constructively.

Second, Representatives Scott Garrett (R-NJ) and Paul Kanjorski (D-PA) have introduced H.R. 4884, the United States Covered Bond Act of 2010. According to the Congressmen, covered bonds are a type of bond that is far less risky than other kinds of investments. Covered bonds are not new; they have been successfully employed in many European economies for decades. Hopefully, this legislation will attract investors back into the real-estate market and worthwhile projects can find the financing they so desperately need.

I believe that the efforts to increase the supply of credit for small businesses, as is envisioned in the Small Business Lending Fund Act and the State Small Business Credit Initiative Act – *combined* with initiatives to increase demand for small business services, such as the Capital Access for Main Street Act and the United States Covered Bond Act – will go a long way to address the challenges that small businesses across the country face in a sensible and coordinated manner.

Having said that, none of these bills are a silver bullet, nor are they meant to be. Until we find a way to get financial institutions to move the pendulum back to the center and begin providing credit for worthy and vital projects, we are not going to see a broad-based recovery. Every idled construction site represents jobs lost and our nation's competitive edge weakened. I call on Congress and the Administration to use every tool at its disposal to address the profound challenges that the lack of credit is presenting to our communities and our nation. America's architects stand ready to work with you to help rebuild and renew our country.

In conclusion, I wish to thank the Committee for its hard work in addressing these complex issues, and I look forward to answering any questions the Committee members may have.