Congressional Research Service
Informing the legislative debate since 1914

Small Business Administration 504/CDC Loan Guaranty Program

Updated November 12, 2021

Congressional Research Service
https://crsreports.congress.gov
R41184

CRS REPORT
Prepared for Members and
Committees of Congress

Congressional Research Service
Informing the legislative debate since 1914

SUMMARY

R41184

November 12, 2021

Robert Jay Dilger
Senior Specialist in American National Government

Small Business Administration 504/CDC Loan Guaranty Program

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs designed to encourage lenders to provide loans to small businesses "that might not otherwise obtain financing on reasonable terms and conditions." The SBA's 504 Certified Development Company (504/CDC) loan guaranty program is administered through nonprofit Certified Development Companies (CDCs). It provides long-term fixed rate financing for major fixed assets, such as land, buildings, equipment, and machinery. Of the total project costs, a third-party lender must provide at least 50% of the financing, the CDC provides up to 40% of the financing through a 100% SBA-guaranteed debenture, and the applicant provides at least 10% of the financing. Its name is derived from Section 504 of the Small Business Investment Act of 1958 (P.L. 85-699, as amended), which provides the most recent authorization for the SBA's sale of 504/CDC debentures. In FY2021, the SBA approved 9,676 504/CDC loans totaling over $8.2 billion.

Congress has always shown a great interest in the SBA's loan guarantee programs because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to create and retain jobs. That interest has grown especially acute in the wake of the Coronavirus Disease 2019 (COVID-19) pandemic's adverse economic impact on the national economy. For example,

- P.L. 116-136, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), among other provisions, created the $349 billion (now $806.45 billion) Paycheck Protection Program (PPP), which provides low-interest, forgivable loans to small businesses adversely affected by the COVID-19 pandemic, and appropriated $17 billion for six-month payment relief for existing 7(a), 504/CDC, and Microloan borrowers. Loans in a regular servicing status (i.e., fully disbursed) up to six months after enactment (until September 27, 2020) were also eligible to receive the six monthly payments of debt relief.
- P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act, 2021), among other provisions, appropriated $3.5 billion to resume monthly payment relief for 7(a), 504/CDC, and Microloan borrowers, capped at $9,000 per month per borrower. Payments are dependent on the availability of funds, when the loan was disbursed, the type of loan received, and the business's industry. The act also waived specified 7(a) and 504/CDC loan guarantee program fees in FY2021, modified 504/CDC refinancing regulations to expand borrower access to the refinancing program and create reciprocity for refinancing under the 7(a) and 504/CDC programs, and temporarily authorized the SBA, through September 30, 2023, to establish a 504/CDC Express Loan program to expedite the approval of 504/CDC loans that do not exceed $500,000.

This report examines the rationale provided for the 504/CDC program; its borrower and lender eligibility standards; operating requirements; and performance statistics, including loan volume, loss rates, proceeds usage, borrower satisfaction, and borrower demographics. It also examines congressional action taken to help small businesses gain greater access to capital, including enactment of P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA); P.L. 111-240, the Small Business Jobs Act of 2010; P.L. 116-136; and P.L. 116-260.

This report also discusses issues related to the SBA's oversight of 504/CDC lenders.

Contents

Small Business Administration Loan Guaranty Programs 1
Program Participants and Financing Contribution 2
Borrower Eligibility Standards and Program Requirements 4
Borrower Eligibility Standards 4
Borrower Program Requirements 5
Use of Proceeds 5
Job Creation and Retention Requirement 5
Loan Amounts 7
Loan Terms, Interest Rate, and Collateral 8
CDC Eligibility Standards, Operating Requirements, and Program Requirements 10
CDC Eligibility Standards 10
CDC Operating Requirements 11
CDC Program Requirements 12
The Application Process 12
Loan Guaranty and Servicing Fees 14
SBA Fees 15
CDC Fees 16
Fee Subsidies 17
Program Statistics 19
Loan Volume 19
Appropriations for Subsidy Costs 21
Use of Proceeds and Borrower Satisfaction 22
Borrower Demographics 23
Congressional Issues 24
Fee Subsidies and the 7(a) Program's 90% Maximum Loan Guaranty Percentage 24
Lender Oversight 25
Legislation 26
Concluding Observations 29

Tables

Table 1. 504/CDC Loan Structures and Contribution Requirements 3
Table 2. Number and Amount of 504/CDC Loans, FY2005-FY2021 20
Table 3. Number and Amount of 504/CDC Refinance Loans, FY2011, FY2012, FY2016-FY2021 20
Table 4. Business Loan Credit Subsidies, 7(a) and 504/CDC Loan Guaranty Programs, FY2005-FY2022 21

Contacts

Author Information 29

Small Business Administration Loan Guaranty Programs

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs designed to encourage lenders to provide loans to small businesses "that might not otherwise obtain financing on reasonable terms and conditions."[1] Historically, one of the justifications presented for funding the SBA's loan guaranty programs has been that small businesses can be at a disadvantage, compared with other businesses, when trying to obtain access to sufficient capital and credit.[2]

The SBA's 504 Certified Development Company (504/CDC) loan guaranty program provides long-term fixed rate financing for major fixed assets, such as land, buildings, equipment, and machinery. Its name is derived from Section 504 of the Small Business Investment Act of 1958 (P.L. 85-699, as amended), which provides the most recent authorization in the act concerning the SBA's monthly sale of 20-year and 25-year 504/CDC debentures and bimonthly sale of 10-year 504/CDC debentures.[3]

The 504/CDC loan guaranty program is administered through nonprofit Certified Development Companies (CDCs).[4] Of the total project costs, a third-party lender must provide at least 50% of the financing, the CDC provides up to 40% of the financing backed by a 100% SBA-guaranteed debenture, and the applicant provides at least 10% of the financing.[5]

The borrower makes two loan payments, one to the third-party lender and another to the CDC. The third-party loan, typically provided by a bank, can have a fixed or variable interest rate, is negotiated between the lender and the borrower, is subject to an interest rate cap, and must have at least a 7-year term for a 10-year debenture and at least 10-year term for a 20- or 25-year

---

[1] U.S. Small Business Administration (SBA), *Fiscal Year 2010 Congressional Budget Justification*, p. 30, at https://www.sba.gov/sites/default/files/2018-06/Congressional_Budget_Justification_2010.pdf.

[2] U.S. Government Accountability Office (GAO), *Small Business Administration: 7(a) Loan Program Needs Additional Performance Measures*, GAO-08-226T, November 1, 2007, pp. 3, 9-11, at http://www.gao.gov/new.items/d08226t.pdf; and Veronique de Rugy, *Why the Small Business Administration's Loan Programs Should Be Abolished*, American Enterprise Institute for Public Policy Research, AEI Working Paper #126, April 13, 2006, at http://www.aei.org/docLib/20060414_wp126.pdf. Proponents of federal funding for the SBA's loan guarantee programs also argue that small business can promote competitive markets. See P.L. 83-163, §2(a), as amended; and 15 U.S.C. §631a.

[3] The 504 Certified Development Company (504/CDC) program was preceded by a Section 501 state development company program (1958-1982), a Section 502 local development company program (1958-1995), and a Section 503/CDC program (1980-1986). The 504/CDC program started in 1986.

The 504/CDC program's 20-year and 25-year debentures are pooled and sold on the first Thursday of the first full week of each month (beginning with and including Sunday); 10-year debentures are pooled and sold on the first Thursday of the first full week of every other month (beginning with and including Sunday) starting with the January sale. See Eagle Compliance, LLC, "Monthly 504 Interest Rate," at https://www.eaglecompliance504.com/monthly-504-interest-rate.html.

The SBA made 25-year 504/CDC debentures available for 504/CDC projects approved on or after April 2, 2018. See SBA, "504 Loans and Debentures With 25 Year Maturity," 83 *Federal Register* 14536, April 4, 2018.

[4] Five for-profit CDCs that participated in predecessor programs have been grandfathered into the current 504/CDC program. See SBA, "504 and 7(a) Loan Programs Updates," 79 *Federal Register* 15642, March 21, 2014.

[5] "Generally, a 504 loan may not exceed 40% of total Project cost plus 100% of eligible administrative costs. For good cause shown, SBA may authorize an increase in the percentage of Project costs covered up to 50%. No more than 50% of eligible Project costs can be from Federal sources, whether received directly or indirectly through an intermediary." See 13 C.F.R. §120.930.

debenture.[6] The CDC loan has a fixed interest rate that is determined when the SBA sells the debenture to fund the loan. The CDC loan's term is either 10 years (typically for machinery or equipment) or 20 years or 25 years (typically for real estate).

The SBA's debenture is backed by the full faith and credit of the United States and is sold to underwriters that form debenture pools. Investors purchase interests in the debenture pools and receive Development Company Participation certificates (DCPC) representing ownership of all or part of the pool. DCPCs have a minimum value of $25,000 and can be sold on the secondary market.

The SBA and CDCs use various agents to facilitate the sale and service of the certificates and the orderly flow of funds among the parties.[7] After a 504/CDC loan is approved and disbursed, accounting for the loan is set up at the Central Servicing Agent (CSA, currently PricewaterhouseCoopers Public Sector LLP), not the SBA. The SBA guarantees the timely payment of the debenture. If the small business is behind in its loan payments, the SBA pays the difference to the investor on every semiannual due date.

In FY2021, the SBA approved 9,676 504/CDC loans totaling over $8.2 billion.[8] Included in these figures were 693 504/CDC refinancing loans totaling $709 million. As of September 30, 2021, regular 504/CDC loans had an unpaid principal balance of about $28.9 billion, and 504/CDC refinancing loans had an unpaid principal balance of about $1.7 billion.[9]

This report opens with an examination of the 504/CDC program's operating structures and requirements, including borrower and lender eligibility standards, loan terms and conditions, and program fees. It presents 504/CDC program statistics, including loan volume, credit subsidies, proceeds usage, and borrower demographics. It then discusses issues raised concerning the SBA's administration of the program, including the oversight of 504/CDC lenders. The report also presents 504/CDC legislation enacted from the 111th through 117th Congresses.

Program Participants and Financing Contribution

As shown in **Table 1**, 504/CDC projects generally have three main participants: a third-party lender provides 50% or more of the financing; a CDC provides up to 40% of the financing through a 504/CDC debenture, which is 100% guaranteed by the SBA; and the borrower contributes at least 10% of the financing.

The CDC's contribution, and the amount of the SBA's 100% guaranteed debenture, generally cannot exceed 40% of the financing for standard 504/CDC loans. It cannot exceed 35% of the financing for new businesses (defined as "a business that is two years old or less at the time the loan is approved") or if the loan is for either a limited-market property (defined as "a property with a unique physical design, special construction materials, or a layout that restricts its utility to

[6] SBA, "504 Loans and Debentures With 25 Year Maturity," 83 *Federal Register* 14536, April 4, 2018; and 13 C.F.R. §120.921.

[7] 13 C.F.R. §120.801.

[8] SBA, "SBA Lending Statistics for Major Programs (as of September 30, 2021)," at https://www.sba.gov/document/report-2021-weekly-lending-reports (hereinafter SBA, "SBA Lending Statistics for Major Programs (as of September 30, 2021)").

[9] SBA, "Small Business Administration loan program performance: Table 1 – Unpaid Principal Balance (UPB) by Program," effective September 30, 2021, at https://www.sba.gov/document/report-small-business-administration-loan-program-performance.

the use for which it is designed") or a special purpose property.[10] The SBA lists 27 limited and special purpose properties (e.g., dormitories, golf courses, hospitals, and bowling alleys).[11] The CDC's contribution cannot exceed 30% of the financing when the borrower is a new business *and* the loan is for either a limited-market property or special purpose property.

Borrowers must contribute at least 10% of the financing for standard 504/CDC loans and at least 15% if the borrower is a new business or if the loan is for a limited-market property or special purpose property.[12] They must contribute at least 20% if the borrower is a new business *and* the loan is for either a limited-market property or special purpose property.[13]

Table 1. 504/CDC Loan Structures and Contribution Requirements

Participant	Standard Loan	New Business or Limited or Special Purpose Property Loan	Both New Business and Limited or Special Purpose Property Loan
Third-Party Lender	At least 50%	At least 50%	At least 50%
CDC/SBA	Maximum 40%	Maximum 35%	Maximum 30%
Borrower	At least 10%	At least 15%	At least 20%

Source: U.S. Small Business Administration, "SOP 50 10 6: Lender and Development Company Loan Programs," effective October 1, 2020, pp. 455, 456, at https://www.sba.gov/document/sop-50-10-lender-development-company-loan-programs-0.

[10] A 504/CDC loan generally may not exceed 40% of total project costs, plus 100% of eligible administrative costs. "For good cause shown, SBA may authorize an increase in the percentage of project costs covered up to 50%. No more than 50% of eligible project costs can be from Federal sources, whether received directly or indirectly through an intermediary." See 13 C.F.R. §120.930.

[11] The SBA considers the following to be limited or special purpose properties: amusement parks; bowling alleys; car wash properties; cemeteries; clubhouses; cold storage facilities in which more than 50% of total square footage is equipped for refrigeration; dormitories; farms, including dairy facilities; funeral homes with crematoriums; gas stations; golf courses; hospitals, surgery centers, urgent care centers, and other health medical facilities; hotels and motels; marinas; mines; museums; nursing homes, including assisted living facilities; oil wells; quarries, including gravel pits; railroads; sanitary landfills; service centers (e.g., oil and lube, brake, or transmission centers) with pits and in-ground lifts; sports arenas; swimming pools; tennis clubs; theaters; and wineries. SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," effective October 1, 2020, pp. 478, 479, at https://www.sba.gov/document/sop-50-10-lender-development-company-loan-programs-0 (hereinafter "SOP 50 10 6: Lender and Development Company Loan Programs").

[12] The SBA announced in the *Federal Register* on August 3, 2020, that "due to an economic recession as determined by the National Bureau of Economic Research, borrowers in the 504 Loan Program may contribute not less than 10%, instead of not less than 15%, to projects involving limited or special purpose buildings or structures when refinancing debt without expansion. The lower required contribution will be in effect until the first day of the calendar quarter following the end of the economic recession as determined by the National Bureau of Economic Research or its equivalent." See SBA, "504 Debt Refinancing Without Expansion-Borrower's Contribution for Projects Involving Limited or Single Purpose Buildings During Recession," 85 *Federal Register* 46775-46776, August 3, 2020.

[13] "Loans under the 504 program provide permanent or take-out financing [long-term financing that replaces short-term interim financing, often one with a shorter duration and higher interest rate]. ...An interim lender (either the Third Party Lender or another lender) provides the interim financing to cover the period between SBA approval of the project and the debenture sale. After the project is completed, the CDC will close the 504 loan. The proceeds from the Debenture sale repay the interim lender for the amount of the 504 project costs that it advanced on an interim basis.... The interim financing must be fully disbursed and the project completed prior to the sale of the Debenture with one exception. A portion of the debenture proceeds may be put into an escrow account to complete a minor portion of the total project." SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 457, 500.

Borrower Eligibility Standards and Program Requirements

Borrower Eligibility Standards

To be eligible for a SBA business loan, a small business applicant must

- be located in the United States;
- be a for-profit operating business (except for loans to eligible passive companies);
- qualify as small;[14]
- demonstrate a need for the desired credit and that the funds are not available from alternative sources, including personal resources of the principals; and
- be certified by a lender that the desired credit is unavailable to the applicant on reasonable terms and conditions from nonfederal sources without SBA assistance.[15]

Several types of businesses are prohibited from participating in the program. For example, financial businesses primarily engaged in the business of lending, such as banks and finance companies; life insurance companies; businesses located in a foreign country; businesses deriving more than one-third of their gross annual revenue from legal gambling activities; businesses that present live performances of a prurient sexual nature; and businesses with an associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude are ineligible.[16]

To qualify for a SBA business loan, applicants must be creditworthy and able to reasonably assure repayment. The SBA requires lenders to consider the applicant's

- character, reputation, and credit history;
- experience and depth of management;
- strength of the business;
- past earnings, projected cash flow, and future prospects;

[14] P.L. 111-240, the Small Business Jobs Act of 2010, required the SBA to establish an alternative size standard for the 504/CDC and 7(a) loan programs that uses maximum tangible net worth and average net income as an alternative to the use of industry standards. At the time of passage, the 7(a) program used industry-specific size standards and the 504/CDC program used maximum net worth of $8.5 million and maximum average net income of $3 million to determine program eligibility. The act establishes the following alternative size standard for both the 504/CDC and 7(a) programs on an interim basis: the business qualifies as small if it does not have a tangible net worth in excess of $15 million and does not have an average net income after federal taxes (excluding any carry-over losses) in excess of $5 million for two full fiscal years before the date of application. For further analysis concerning SBA size standards, see CRS Report R40860, *Small Business Size Standards: A Historical Analysis of Contemporary Issues*, by Robert Jay Dilger.

[15] 13 C.F.R. §120.100; and 13 C.F.R. §120.101.

[16] 13 C.F.R. §120.110. Nineteen types of businesses are ineligible for 504/CDC loans. In addition, an associate is an officer, director, owner of more than 20% of the equity, or key employee of the small business; any entity in which one or more individuals referred to above owns or controls at least 20% of the equity; and any individual or entity in control of or controlled by the small business, except a Small Business Investment Company licensed by the SBA. See 13 C.F.R. §120.10.

- ability to repay the loan with earnings from the business;
- sufficient invested equity to operate on a sound financial basis;
- potential for long-term success;
- nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and
- affiliates' effect on the applicant's repayment ability.[17]

Borrower Program Requirements

Use of Proceeds

A 504/CDC loan can be used to

- purchase land and make necessary improvements to the land, such as adding streets, curbs, gutters, parking lots, utilities, and landscaping;
- purchase buildings and make improvements to the buildings, such as altering the building's facade and updating its heating and electrical systems, plumbing, and roofing;
- purchase, transport, dismantle, or install machinery and equipment, provided the machinery and equipment have a useful life of at least 10 years;
- purchase essential furniture and fixtures;
- pay professional fees that are directly attributable and essential to the project, such as title insurance, title searches and abstract costs, surveys, and zoning matters;
- finance short-term debt (*bridge financing*) for eligible expenses that are directly attributable to the project and the financing term is three years or less;
- pay interim financing costs, including points, fees, and interest;
- create a contingency fund, provided the fund does not exceed 10% of the project's construction costs;
- finance "do-it-yourself" construction expenses, including renovations and the installation of machinery and equipment; and
- finance permissible debt refinancing with or without business expansion.[18]

A 504/CDC loan cannot be used for working capital or inventory.

Job Creation and Retention Requirement

All 504/CDC borrowers must meet at least one of two specified economic development objectives. First, borrowers, other than small manufacturers, must create or retain at least one job for every $75,000 of project debenture within two years of project completion.[19] Borrowers who

[17] 13 C.F.R. §120.150.

[18] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 460-462. A project involves expansion "if it involves the acquisition, construction, or improvement of land, building or equipment for use by the Applicant." See "SOP 50 10 6: Lender and Development Company Loan Programs," p. 469.

[19] SBA, "Development Company Loan Program - Job Creation and Retention Requirements; Additional Areas for Higher Portfolio Average," 83 *Federal Register* 55225, November 2, 2018. Previously, P.L. 108-447, the Small

are small manufacturers (defined as a small business with its primary North American Industry Classification System Code in Sectors 31, 32, and 33 and all of its production facilities located in the United States) must create or retain at least one job per $120,000 of project debenture within two years of project completion.[20]

Borrowers enter the number of jobs to be created or retained as a result of the project in their application for funds and the CDC verifies that the project meets the job creation or retention requirements. The jobs created do not have to be at the project facility, but 75% of the jobs must be created in the community in which the project is located. Using job retention to satisfy this requirement is allowed only if the CDC "can reasonably show that jobs would be lost to the community if the project was not done."[21]

If the borrower does not meet the job creation or retention requirement, the borrower can retain eligibility by meeting (1) any 1 of 5 community development goals, (2) any 1 of 10 public policy goals, or (3) any 1 of 3 energy reduction goals, provided that the CDC's overall portfolio of outstanding debentures meets or exceeds the job creation or retention criteria of at least 1 job opportunity created or retained for every $75,000 in project debenture (or for every $85,000 in project debenture for projects located in special geographic areas such as Alaska, Hawaii, state-designated enterprise zones, empowerment zones, enterprise communities, labor surplus areas, or opportunity zones).[22] Loans to small manufacturers are excluded from the calculation of this average.[23]

The five community development goals are

- improving, diversifying, or stabilizing the economy of the locality;
- stimulating other business development;
- bringing new income into the community;
- assisting manufacturing firms; or
- assisting businesses in labor surplus areas as defined by the U.S. Department of Labor.

Business Reauthorization and Manufacturing Assistance Act of 2004, had required borrowers, other than small manufactures, to create or retain at last one job for every $50,000 guaranteed by the Administration. P.L. 111-5, the American Recovery and Reinvestment Act of 2009, increased that amount to every $65,000 guaranteed by the Administration.

[20] Previously, P.L. 108-447, the Small Business Reauthorization and Manufacturing Assistance Act of 2004, had required small manufactures to create or retain at last one job for every $100,000 guaranteed by the Administration.

[21] SBA "SOP 50 10 6: Lender and Development Company Loan Programs," p. 453. The SBA reports that CDCs supported 66,744 jobs in FY2014, 61,454 jobs in FY2015, 61,983 jobs in FY2016, 59,350 jobs in FY2017, 55,729 jobs in FY2018, and 52,701 jobs in FY2021. See SBA, *FY2021 Congressional Budget Justification and FY2019 Annual Performance Report*, p. 31, at https://www.sba.gov/sites/default/files/2020-02/FY%202021%20CJ-508_FINAL.pdf (hereinafter SBA, *FY2021 Congressional Budget Justification and FY2019 Annual Performance Report*).

[22] SBA, "Development Company Loan Program - Job Creation and Retention Requirements; Additional Areas for Higher Portfolio Average," 83 *Federal Register* 55225-55226, November 2, 2018. Previously, P.L. 108-447, the Small Business Reauthorization and Manufacturing Assistance Act of 2004, had set these thresholds as: at least one job opportunity per every $50,000 guaranteed by the Administration and per every $75,000 guaranteed by the Administration for small manufactures. P.L. 111-5, the American Recovery and Reinvestment Act of 2009, increased the $50,000 threshold to every $65,000 guaranteed by the Administration.

[23] A job opportunity is defined as a full-time (or equivalent) permanent job created within two years of receipt of 504/CDC funds or retained in the community because of a 504/CDC loan. See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 531.

The 10 public policy goals are

- revitalizing a business district of a community with a written revitalization or redevelopment plan;
- expanding exports;
- expanding the development of women-owned and -controlled small businesses;
- expanding small businesses owned and controlled by veterans (especially service-disabled veterans);
- expanding minority enterprise development;
- aiding rural development;
- increasing productivity and competitiveness (e.g., retooling, robotics, modernization, and competition with imports);
- modernizing or upgrading facilities to meet health, safety, and environmental requirements;
- assisting businesses in or moving to areas affected by federal budget reductions, including base closings, either because of the loss of federal contracts or the reduction in revenues in the area due to a decreased federal presence; or
- reducing unemployment rates in labor surplus areas, as defined by the U.S. Department of Labor.[24]

The three energy reduction goals are

- reducing existing energy consumption by at least 10%;
- increasing the use of sustainable designs, including designs that reduce the use of greenhouse gas-emitting fossil fuels or low-impact design to produce buildings that reduce the use of nonrenewable resources and minimize environmental impact; or
- upgrading plant, equipment, and processes involving renewable energy sources such as the small-scale production of energy for individual buildings' or communities' consumption, commonly known as micropower, or renewable fuel producers including biodiesel and ethanol producers.[25]

If the project cannot meet any of these guidelines, then the debenture amount must be reduced to meet the job creation or retention requirement.[26]

Loan Amounts

The minimum 504/CDC debenture is $25,000. P.L. 111-240, the Small Business Jobs Act of 2010, increased the maximum gross debenture amount

- from $1.5 million to $5 million for regular 504/CDC loans;
- from $2 million to $5 million if the loan proceeds are directed toward one or more of the public policy goals described above;
- from $4 million to $5.5 million for small manufacturers;

[24] 13 C.F.R. §120.862.

[25] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 454.

[26] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 455.

- from $4 million to $5.5 million for projects that reduce the borrower's energy consumption by at least 10%; and
- from $4 million to $5.5 million for projects for plant, equipment, and process upgrades of renewable energy sources, such as the small-scale production of energy for individual buildings or communities consumption (commonly known as micropower), or renewable fuel producers, including biodiesel and ethanol producers.[27]

Loan Terms, Interest Rate, and Collateral

Loan Terms

The SBA determines the 504/CDC program's loan terms and publishes them in the *Federal Register*.[28] The current maturity for a 504/CDC loan is generally

- 20 or 25 years for real estate;
- 10 years for machinery and equipment; and
- 10, 20, or 25 years based upon a weighted average of the useful life of the assets being financed.[29]

The maturities for the first mortgage issued by the third-party lender must be at least 7 years when the CDC/504 loan is for a term of 10 years and at least 10 years when the loan is for 20 or 25 years.[30]

Interest Rates

As mentioned, 504/CDC borrowers make two loan payments, one to the third-party lender and one to the CDC. The third-party loan can have a fixed or variable interest rate, is negotiated between the lender and the borrower, and is subject to an interest rate cap.[31]

The third-party loan's interest rate "must be reasonable" and the interest rate cap is published by the SBA in the *Federal Register*. The current maximum interest rate that a third-party lender is allowed to charge for a commercial loan that funds any portion of the cost of a 504/CDC project is 6% greater than the New York prime rate or the maximum interest rate permitted in that state, whichever is less.[32]

Borrowers have a general sense of what their 504/CDC loan's interest rate will be when their completed loan application is submitted to the SBA for approval. However, the loan's exact interest rate is not known until after it is pooled with other 504/CDC loan requests and sold to private investors (typically large institutional investors such as pension funds, insurance

[27] P.L. 111-240, §1112. Maximum Loan Amounts Under 504 Program.

[28] 13 C.F.R. §120.933.

[29] SBA, "504 Loans and Debentures With 25 Year Maturity," 83 *Federal Register* 14536, April 4, 2018.

[30] 13 C.F.R. §120.921; and SBA, "504 Loans and Debentures With 25 Year Maturity," 83 *Federal Register* 14536, April 4, 2018.

[31] SBA, "504 Loans and Debentures With 25 Year Maturity," 83 *Federal Register* 14536, April 4, 2018; and 13 C.F.R. §120.921.

[32] 13 C.F.R. §120.921; and SBA, "Reporting and Recordkeeping Requirements Under OMB Review," 77 *Federal Register* 59447, September 27, 2012.

companies, and large banks). Investors receive interest on the debt, called a debenture, semi-annually. Borrowers make monthly payments.

The 504/CDC loan's interest rate has several components: the debenture interest rate (i.e., the rate that determines interest paid semi-annually to investors who purchase the debenture), the note rate (i.e., the monthly-pay equivalent of the debenture rate, which is typically four to eight basis points higher than the debenture interest rate depending on the length of the loan's term), and the effective rate (i.e., the note rate and the cost impact of ongoing fees). Effective rates are provided to CDCs on a full-term basis and in 5-year increments.[33]

The debenture interest rate is based on comparable market conditions for long-term government debt at the time of sale and pegged to an increment above the current market rate. The SBA's fiscal agent, currently Eagle Compliance, LLC, reaches an agreement with the underwriters on the sale price of the debentures and, after reaching this agreement, must obtain approvals from the SBA and Treasury before proceeding.[34]

The 10-year 504/CDC debenture rate (set bimonthly) for September and October 2021 is 0.90%. The comparable Treasury market rate for September 2021 was 0.81%, the note rate was 0.93642%, and the effective full-term interest rate was 2.687%.[35]

The 20-year 504/CDC debenture rate (set monthly) for October 2021 is 1.54%. The comparable Treasury market rate for October 2021 is 1.56%, the note rate is 1.56884%, and the effective full-term interest rate is 3.021%.[36]

The 25-year 504/CDC debenture rate (set monthly) for October 2021 is 1.74%. The comparable Treasury market rate for October 2021 is 1.56%, the note rate is 1.76496%, and the effective full-term interest rate is 3.157%.[37]

Collateral

The SBA usually takes a second lien position on the project property to secure the loan. The SBA's second lien position is considered adequate when the applicant meets all of the following criteria:

- strong, consistent cash flow that is sufficient to cover the debt;
- demonstrated, proven management;

[33] Effective rates do not include the impact of upfront fees and therefore are not APRs. APRs (annual percentage rates) represent the actual yearly cost of funds over the term of a loan.

[34] 13 C.F.R. §120.932; and Eagle Compliance, LLC, "How Effective Rates are Calculated," at https://www.eaglecompliance504.com/monthly-504-interest-rate.html.

[35] Eagle Compliance, LLC, "Monthly 504 Interest Rate, September 2021 Funding Rates," at https://nebula.wsimg.com/c80b5bd96db149b3f5bf20dbc3479252?AccessKeyId=EA7D1AA43344749CDDA0&disposition=0&alloworigin=1.

[36] Eagle Compliance, LLC, "Monthly 504 Interest Rate, October 2021 Funding Rates," at https://www.eaglecompliance504.com/monthly-504-interest-rate.html (hereinafter Eagle Compliance, LLC, "Monthly 504 Interest Rate, October 2021").

[37] Eagle Compliance, LLC, "Monthly 504 Interest Rate, October 2021."

As mentioned in footnote 3, 10-year debentures are pooled and sold the first Thursday of the first full week of every other month (beginning with and including Sunday) starting with the January sale; 20- and 25-year debentures are pooled and sold the first Thursday of the first full week of each month (beginning with and including Sunday).

- the business has been in operation for more than two years; and
- the proposed project is a logical extension of the applicant's current operations.[38]

If one or more of the above factors is not met, additional collateral or increased equity contributions may be required. All collateral must be insured against such hazards and risks as the SBA may require, with provisions for notice to the SBA and the CDC in the event of impending lapse of coverage.[39] However, for 504/CDC loans, the applicant's cash flow is the primary source of repayment, not the liquidation of collateral. Thus, "if the lender's financial analysis demonstrates that the applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available or outside sources of repayment."[40]

CDC Eligibility Standards, Operating Requirements, and Program Requirements

CDC Eligibility Standards

CDCs apply to the SBA for certification to participate in the 504/CDC program. A CDC must be a nonprofit corporation,[41] and it must

- be in good standing in the state in which it is incorporated;
- be in compliance with all laws, including taxation requirements, in the state in which it is incorporated and any other state in which it conducts business;
- provide the SBA a copy of its IRS tax exempt status, organizational chart, articles of incorporation, bylaws, plan of operation, and operating budget;
- indicate its area of operations, which is the state of the CDC's incorporation;[42] and
- have a board of directors that fulfills specified requirements, such as having at least nine voting members, requiring a quorum of at least 50% of its voting membership to transact business, and meets at least quarterly.[43]

[38] See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 485.

[39] 13 C.F.R. §120.934.

[40] See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 246.

[41] Five for-profit CDCs that participated in predecessor programs have been grandfathered into the current 504/CDC program. See SBA, "504 and 7(a) Loan Programs Updates," 79 *Federal Register* 15642, March 21, 2014.

[42] A CDC can apply to be a multistate CDC "only if the State the CDC seeks to expand into is contiguous to the State of the CDC's incorporation and the CDC establishes a loan committee in that State meeting the requirements of [13] C.F.R. §120.823." See SBA, "504 and 7(a) Loan Programs Updates," 79 *Federal Register* 15651, March 21, 2014 (the multi-state CDC language is effective as of April 21, 2014).

[43] See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 67, 68. The SBA issued a final rule, effective April 21, 2015, that changed the SBA's regulations concerning the CDC's board of directors (13 C.F.R. §120.823). For example, the CDC's board of directors are now required to have at least nine voting directors; at least one voting director who represents the economic, community, or workforce development fields; and at least two voting directors, other than the CDC manager, who represent the commercial lending field. See SBA, "504 and 7(a) Loan Programs Updates," 79 *Federal Register* 15641, 15644-15646, March 21, 2014.

If approved by the SBA, newly certified CDCs are on probation for two years. At the end of this time, the CDC must petition for either permanent CDC status or a single, one-year extension of probation. To be considered for permanent CDC status or an extension of probation, the CDC must have satisfactory performance as determined by the SBA in its discretion. Examples of the factors that may be considered in determining satisfactory performance include the CDC's risk rating, on-site review and examination assessments, historical performance measures (like default rate, purchase rate, and loss rate), loan volume to the extent that it impacts performance measures, and other performance-related measurements and information (such as contribution toward SBA's mission).[44]

In FY2020, 208 CDCs provided at least one 504/CDC loan.[45]

CDC Operating Requirements

The CDC's board of directors is allowed to establish a loan committee composed of members of the CDC who may or may not be on the CDC's board of directors. The loan committee reports to the board and must meet specified requirements, such as having at least two members with commercial lending experience satisfactory to the SBA, generally requiring all of its members to live or work in the area of operations of the state in which the 504/CDC project they are voting on is located, not allowing any CDC staff to serve on the loan committee, and requiring a quorum of at least five committee members authorized to vote to hold a meeting.[46] In addition, multistate CDCs are required to have a separate loan committee "for each state into which the CDC expands."[47]

The SBA also has a number of requirements concerning CDC staff, such as requiring CDCs to "have qualified full-time professional staff to market, package, process, close and service loans" and "directly employ full-time professional management," typically including an executive director (or the equivalent) to manage daily operations.[48]

CDCs are also required to operate "in accordance with all SBA loan program requirements" and provide the SBA "current and accurate information about all certification and operational requirements."[49] CDCs with 504/CDC loan portfolio balances of $30 million or more are required to submit financial statements audited in accordance with generally accepted accounting

[44] 13 C.F.R. §120.812.

[45] SBA, *FY2022 Congressional Justification and FY2020 Annual Performance Report*, p. 40, at https://www.sba.gov/document/report-congressional-budget-justification-annual-performance-report (hereinafter SBA, *FY2022 Congressional Justification and FY2020 Annual Performance Report*).

[46] 13 C.F.R. §120.823. The SBA issued a final rule, effective April 21, 2015, that changed the SBA's regulations concerning the CDC's board of directors and the structure and operations of CDC loan committees (13 C.F.R. §120.823). Under the new rule, loan committees are required to have at least two members (instead of one) with commercial lending experience satisfactory to the SBA. See SBA, "504 and 7(a) Loan Programs Updates," 79 *Federal Register* 15650, March 21, 2014.

[47] See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 85.

[48] A CDC "may request that SBA waive the requirement of the manager being employed directly only if: (i) The requesting CDC will have full-time professional management that is employed by a non-profit entity (not another CDC) that has the economic development of the CDC's Area of Operations as one of its principal activities. Such full-time management may also work on and operate the other entity's economic development programs, but must be available to small businesses interested in the 504 Loan Program and to 504 loan borrowers during regular business hours; or (ii) the requesting CDC is rural and has insufficient loan volume to justify having management employed directly by the CDC. The rural CDC must contract with another CDC located (i.e., incorporated) in the same general area." See SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 90.

[49] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 93.

principles (GAAP) by an independent certified public accountant (CPA). CDCs with 504/CDC loan portfolio balances of less than $30 million must, at a minimum, submit a review of their loan portfolio balances by an independent CPA or independent accountant in accordance with GAAP. The auditor's opinion must state that the financial statements are in conformity with GAAP.[50]

CDC Program Requirements

The Application Process

CDCs must analyze each application in a commercially reasonable manner, consistent with prudent lending standards. The CDC's analysis must include

- a financial analysis of the applicant's pro forma balance sheet. The pro forma balance sheet must reflect the loan proceeds, use of the loan proceeds, and any other adjustments such as required equity injection or standby debt;
- a financial analysis of the applicant's repayment ability, which must address debt service coverage after the effects of the SBA loans are taken into account and include a historical analysis of the applicant's cash flow and address the reasonableness of the supporting assumptions used;
- a ratio analysis of the applicant's federal tax returns and financial statements, including comments on any trends and a comparison with industry averages;
- a discussion of the owners' and managers' relevant experience in the type of business, as well as their personal credit histories;
- an analysis of collateral adequacy, including an evaluation of the collateral and lien position offered as well as the liquidation value;
- a discussion of the applicant's credit experience, including a review of business credit reports and any experience the CDC may have with the applicant; and
- other relevant information (e.g., if the application involves a franchise and the success of the franchise).[51]

CDCs submit this information, using required SBA forms, to the Sacramento, CA, loan processing center.

Accredited Lender Program Status

In 1991, the SBA established the ALP on a pilot basis to provide CDCs that "have developed a good partnership with their SBA field office in promoting local economic development and have demonstrated a good track record in the submission of documentation needed for making and servicing of sound loans" an expedited process for approving loan applications and servicing actions.[52] P.L. 103-403, the Small Business Administration Reauthorization and Amendments Act of 1994, authorized the SBA to establish the ALP on a permanent basis.

CDCs may apply to the SBA for ALP status. Selection is based on several factors, including the CDC's experience as a CDC, the number of 504/CDC loans approved, the size of the CDC's

[50] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 95.

[51] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 476-484.

[52] SBA, "Loans to State and Local Development Companies Accredited Lenders Program for Certified Development Companies," 60 *Federal Register* 20391, April 26, 1995.

portfolio, its record of compliance with SBA loan program requirements, and its record of cooperation with all SBA offices.[53] The SBA is able to process loan requests from ALP-CDCs more quickly than from regular CDCs because it relies on their credit analysis when making the decision to guarantee the debenture. About one-third of CDCs have ALP status and they account for about 60% to 70% of all 504/CDC lending each year.[54]

Premier Certified Lenders Program Status

P.L. 103-403 also authorized the SBA's Premier Certified Lenders Program (PCLP) on a pilot basis through October 1, 1997. The program's authorization was later extended through October 1, 2002, and given permanent statutory authorization by P.L. 106-554, the Consolidated Appropriations Act, 2001 (§1: H.R. 5667, the Small Business Reauthorization Act of 2000).[55]

ALP-CDCs must apply to the SBA for PCLP status. CDCs provided PCLP status have increased authority to process, close, service, and liquidate 504/CDC loans. The loans are subject to the same terms and conditions as other 504/CDC loans, but the SBA delegates to the PCLP-CDC all loan approval decisions, except eligibility. Selection is based on several factors, including all of the factors used to assess ALP status plus evidence that the CDC has established a Loan Loss Reserve Fund (LLRF) in compliance with all requirements [described below], has a demonstrated ability "to process, close, service and liquidate 504 and/or PCLP loans," and has satisfactory SBA performance.[56]

PCLP-CDCs are required to establish and maintain a LLRF for its financings under the program. The LLRF is used to reimburse the SBA for 10% of any loss sustained by the SBA resulting from a default in the payment of principal or interest on a PCLP debenture. Each LLRF must equal 1% of the original principal amount of each PCLP debenture.[57]

As of September 30, 2017, 15 CDCs had active PCLP status.[58] In recent years, the number and amount of 504/CDC loans made through the PCLP program have declined. In FY2009, 373 PCLP loans amounting to $185.4 million were disbursed. In FY2019, 22 PCLP loans totaling $14 million were disbursed.[59]

Real Estate Appraisals

As part of its analysis of each application, CDCs are required to have an independent appraisal conducted of the real estate if the estimated value of the project property is greater than the federal banking regulator appraisal threshold (currently $500,000). CDCs may be required to have an independent appraisal conducted of the real estate if the estimated value of the project

[53] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 74-76.

[54] In FY2019, the SBA disbursed 5,845 504/CDC loans totaling $4.74 billion. Of this amount, 4,024 were ALP loans totaling $3.27 billion. See SBA, Office of Congressional and Legislative Affairs, "WDS Report Amount and Count Summary, September 30, 2019: Draft Table 2.8. Delivery Method Approvals by Program and Cohort," October 18, 2018.

[55] P.L. 105-135, the Small Business Reauthorization Act of 1997, extended the program's authorization to October 1, 2002.

[56] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," pp. 77, 78.

[57] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 79.

[58] SBA, Office of Congressional and Legislative Affairs, correspondence with the author, August 24, 2017. All PCLP-CDCs have ALP status as that is a requirement for being provided PCLP authority.

[59] SBA, Office of Congressional and Legislative Affairs, "WDS Report Amount and Count Summary, September 30, 2019: Draft Table 2.8. Delivery Method Approvals by Program and Cohort," October 18, 2018.

property is equal to or less than the federal banking regulator appraisal threshold "and such appraisal is necessary for appropriate evaluation of creditworthiness."[60] The appraiser must have no appearance of a conflict of interest and be either state licensed or state certified. When the project property's estimated value is more than $1 million, the appraiser must be state certified.[61]

Pre-Closing Interim Disbursements

SBA-approved 504/CDC loans are not closed until after project-related construction is complete, which often takes one to two years. All loans must be disbursed within 48 months of approval.[62] Prior to the sale of a debenture and the SBA's funding of the 504/CDC loan, the borrower may obtain interim financing from a third-party lender, usually the same lender that provided the loan covering 50% of the total 504 project financing.[63] The proceeds from the debenture sale repay the interim lender for the amount of the 504/CDC project costs that it advanced on an interim basis.[64]

Closing

The CDC closes the loan in time to meet a specific debenture funding date. At the time of closing, the project must be complete (except funds put into a construction escrow account to complete a minor portion of the project). The SBA's district counsel reviews the closing package and notifies the Central Servicing Agent (CSA, currently PricewaterhouseCoopers Public Sector LLP) and the CDC via email if the loan is approved for debenture funding. If the loan is approved, the CDC forwards specified documents needed for the debenture funding directly to the CSA using a transmittal letter or spreadsheet. As mentioned, because the 504/CDC program provides permanent or *take-out* financing, an interim lender (either the third-party lender or another lender) typically provides financing to cover the period between SBA approval of the project and the debenture sale. Proceeds from the debenture sale are used to repay the interim lender for the amount of the project costs that it advanced on an interim basis.[65]

Loan Guaranty and Servicing Fees

Borrowers are currently charged fees amounting to about 3.5% of the net debenture proceeds plus annual servicing and guaranty fees of about 1% of the unpaid debenture balance. Some of these

---

[60] 15 U.S.C. §696(3)(E)(ii). The federal banking regulator appraisal threshold is "…the lesser of the threshold amounts set by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation for when a federally related transaction that is a commercial real estate transaction requires an appraisal prepared by a State licensed or certified appraiser." See P.L. 115-371, the Small Business Access to Capital and Efficiency (ACE) Act.

Previously, the thresholds in statute were more than $250,000 and $250,000 or less if the appraisal was necessary for appropriate evaluation of creditworthiness. See SBA, "SOP 50 10 5(J): Lender and Development Company Loan Programs," effective January 1, 2018, p. 194, at https://www.sba.gov/document/sop-50-10-5-lender-development-company-loan-programs.

[61] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 260.

[62] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 515.

[63] GAO, *Small Business Administration: Actions Needed to Ensure Planned Improvements Address Key Requirements of the Development Company (504) Loan Program*, GAO-14-233, March 6, 2014, p. 5, at http://www.gao.gov/assets/670/661428.pdf.

[64] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 458.

[65] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 458.

fees are charged by the SBA to the CDC and others are charged by the CDC directly to the borrower.

SBA Fees

The SBA is authorized to charge CDCs five fees to help recoup the SBA's expenses: a guaranty fee, servicing fee, funding fee, development company fee, and participation fee.

Guaranty Fee

The SBA is authorized to charge CDCs a one-time, up-front guaranty fee of 0.5% of the debenture.[66] The SBA elected not to charge this fee in FY2009-FY2011, and FY2016-FY2018. The SBA charged this fee in FY2012-FY2015, FY2019-FY2020, at the outset of FY2021, and in FY2022.[67]

As mentioned, P.L. 116-260, appropriated $1.918 billion for SBA loan enhancements, including the waiver of the 504/CDC guaranty fee from the date of enactment (December 27, 2020) through September 30, 2021.

Servicing Fee

The SBA is authorized to charge CDCs an ongoing servicing fee paid monthly by the borrower and adjusted annually based on the date the loan was approved. By statute, the fee is the lesser of the amount necessary to cover the estimated cost of purchasing and guaranteeing debentures under the 504/CDC program or 0.9375% per annum of the unpaid principal balance of the loan.[68] The SBA's servicing fee for FY2022 is 0.2475% of the unpaid principal balance for regular 504/CDC loans and 0.2590% for 504 refinancing loans.[69]

---

[66] 13 C.F.R. §120.971(d).

[67] SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2011," September 30, 2011, at https://www.sba.gov/sites/default/files/5000-1223.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2012," September 28, 2012, at https://www.sba.gov/sites/default/files/lender_notices/5000-1253.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2013," September 24, 2013, at https://www.sba.gov/sites/default/files/5000-1288.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2014," September 18, 2014, at https://www.sba.gov/sites/default/files/lender_notices/5000-1318.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2015," September 28, 2015, at https://www.sba.gov/sites/default/files/lender_notices/5000-1352.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2016," September 16, 2016, at https://www.sba.gov/sites/default/files/lender_notices/5000-1389.fees_for_FY_2017.pdf; SBA, "SBA Information Notice: 7(a) and 504 Fees Effective On October 1, 2017," August 15, 2017, at https://www.sba.gov/sites/default/files/lender_notices/5000-1954.pdf; SBA, "SBA Information Notice: 504 Fees Effective On October 1, 2018," August 14, 2018, at https://www.sba.gov/document/information-notice-5000-180011-504-fees-effective-october-1-2018; SBA, "SBA Information Notice: 504 Fees Effective On October 1, 2019," September 16, 2019, at https://www.sba.gov/sites/default/files/resource_files/504_Fees_Effective_October_1_2019_0.pdf; SBA, "SBA Information Notice: 504 Fees Effective During Fiscal Year 2021," September 15, 2020, at https://www.sba.gov/document/information-notice-5000-20045-sba-information-notice; and SBA, "SBA Information Notice: 504 Fees Effective During Fiscal Year 2022," September 7, 2021, at https://www.sba.gov/document/information-notice-5000-818642-504-fees-effective-during-fiscal-year-2022 (hereinafter SBA, "SBA Information Notice: 504 Fees Effective During Fiscal Year 2022").

[68] 15 U.S.C. §697(b)(7)(A)(i); and 13 C.F.R. §120.971(d).

[69] SBA, "SBA Information Notice: 504 Fees Effective During Fiscal Year 2022."

The SBA's annual servicing fee was 0.749% in FY2011, 0.9375% in FY2012-FY2015, 0.914% for regular 504/CDC loans and 0.958% for 504/CDC refinancing loans in FY2016, 0.697% for regular 504/CDC loans and 0.731% for 504/CDC refinancing loans in FY2017, 0.642% for regular 504/CDC loans and 0.682% for 504/CDC refinancing loans in FY2018, 0.368% for regular 504/CDC loans and 0.395% for 504/CDC refinancing loans in FY2019; and 0.3205%

Funding Fee

The SBA charges CDCs a funding fee, not to exceed 0.25% of the debenture, to cover costs incurred by the trustee, fiscal agent, and transfer agent.[70]

Development Company Fee

For SBA loans approved after September 30, 1996, the SBA charges CDCs an annual development company fee of 0.125% of the debenture's outstanding principal balance. The fee must be paid from the servicing fees collected by the CDC and cannot be paid from any additional fees imposed on the borrower.[71]

Participation Fee

The SBA charges third-party lenders a one-time participation fee of 0.5% of the senior mortgage loan if in a senior lien position to the SBA and the loan was approved after September 30, 1996.[72] The fee may be paid by the third-party lender, CDC, or borrower.

CDC Fees

CDCs are allowed to charge borrowers a processing (or packaging) fee, closing fee, servicing fee, late fee, assumption fee, CSA fee, other agent fees, and underwriters' fee.

Processing (or Packaging) Fee

The CDC is allowed to charge borrowers a processing (or packaging) fee of up to 1.5% of the net debenture proceeds. Two-thirds of this fee is considered earned and may be collected by the CDC when the SBA issues an Authorization for the Debenture. The portion of the processing fee paid by the borrower may be reimbursed from the debenture proceeds.[73]

As mentioned, P.L. 116-260, appropriated $1.918 billion for SBA loan enhancements, including the waiver of the 504/CDC processing fee from the date of enactment (December 27, 2020) through September 30, 2021. The SBA will reimburse CDCs 1.5% of the net debenture proceeds for not imposing the processing fee.

Closing Fee

The CDC is also allowed to charge "a reasonable closing fee sufficient to reimburse it for the expenses of its in-house or outside legal counsel, and other miscellaneous closing costs."[74] Up to $2,500 in closing costs may be financed out of the debenture proceeds.[75]

---

for regular 504/CDC loans and 0.3220% for 504/CDC refinancing loans in FY2020.

[70] 13 C.F.R. §120.971(e).

[71] 13 C.F.R. §120.972.

[72] 13 C.F.R. §120.972. When there are different liens on a property, the senior lien must be satisfied before junior liens in the event of a default.

[73] 13 C.F.R. §120.971(a)(1).

[74] 13 C.F.R. §120.971(a)(2).

[75] 13 C.F.R. §120.883(e).

Servicing Fee

CDCs can also charge an annual servicing fee of at least 0.625% per annum and no more than 2% per annum on the unpaid balance of the loan as determined at five-year anniversary intervals. A servicing fee greater than 1.5% for rural areas and 1% elsewhere requires the SBA's prior written approval, based on evidence of substantial need. The servicing fee may be paid only from loan payments received. The fees may be accrued without interest and collected from the CSA when the payments are made. CSAs are entities that receive and disburse funds among the various parties involved in 504/CDC financing under a master servicing agent agreement with the SBA.[76]

Late Fee and Assumption Fee

Loan payments received after the 15th of each month may be subject to a late payment fee of 5% of the late payment or $100, whichever is greater. Late fees will be collected by the CSA on behalf of the CDC. Also, with the SBA's written approval, CDCs may charge an assumption fee not to exceed 1% of the outstanding principal balance of the loan being assumed.[77]

Central Servicing Agent Fee

CSAs are allowed to charge an initiation fee on each loan and an ongoing monthly servicing fee under the terms of the master servicing agreement. The current ongoing CSA monthly servicing fee is 0.1% per annum of the loan amount.[78] Also, "agent fees and charges necessary to market and service debentures and certificates may be assessed to the borrower or the investor."[79] CDCs must review the agent's services and related fees "to determine if the fees are necessary and reasonable when there is an indication from a third party that an agent's fees might be excessive, or when an applicant complains about the fees charged by an agent."[80] In cases in which fees appear to be unreasonable, CDCs "should contact" the SBA and if a SBA investigation determines that the fee is excessive, the agent "must reduce the fee to an amount SBA deems reasonable, refund any sum in excess of that amount to the applicant, and refrain from charging or collecting from the applicant any funds in excess of the amount SBA deems reasonable."[81]

Underwriters' Fee

Borrowers are also charged an up-front underwriters' fee of 0.4% for 20-year loans and 0.375% for 10-year loans. The underwriters' fee is paid by the borrower to the underwriter.[82] Underwriters are approved by the SBA to form debenture pools and arrange for the sale of certificates.

Fee Subsidies

The SBA was provided more than $1.1 billion in funding in 2009 and 2010 to subsidize the 504/CDC program's third-party participation fee and CDC processing fee, subsidize the SBA's

[76] 13 C.F.R. §120.971(a)(3).

[77] 13 C.F.R. §120.971(a)(4); 13 C.F.R. §120.971(a)(5); and SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 192.

[78] SBA, "Servicing Loan Agreement," at https://www.sba.gov/sites/default/files/forms/SBA_Form_1506.pdf.

[79] 13 C.F.R. §120.971(c).

[80] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 196.

[81] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 196.

[82] SBA, "SOP 50 10 6: Lender and Development Company Loan Programs," p. 192.

7(a) program's guaranty fee, and increase the 7(a) program's maximum loan guaranty percentage from up to 85% of loans of $150,000 or less and up to 75% of loans exceeding $150,000 to 90% for all standard 7(a) loans.[83] The last extension, P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue the fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through March 4, 2011, or until funding provided by the Small Business Jobs Act of 2010 for this purpose was exhausted (which occurred on January 3, 2011).[84]

The Obama Administration argued that additional funding for the SBA's loan guaranty programs, including the 504/CDC program's fee subsidies, improved the small business lending environment, increased both the number and amount of SBA guaranteed loans, and supported "tens of thousands of small businesses and supported hundreds of thousands of jobs."[85] Critics contended that small business tax reduction, reform of financial credit market regulation, and federal fiscal restraint are better means to assist small business economic growth and job creation.[86]

As mentioned, the CARES Act, among other provisions, appropriated $17 billion for six-month payment relief for existing 7(a), 504/CDC, and Microloan borrowers in a regular servicing status (i.e., fully disbursed) beginning with the next payment due date. Loans already on deferment received six months of SBA payments beginning with the first payment after the deferral period. Loans in a regular servicing status up to six months after enactment (until September 27, 2020) were also eligible for six monthly payments of debt relief.[87]

---

[83] P.L. 111-5, the ARRA, provided $375 million for fee subsidies and the 7(a) program's 90% guaranty for all standard 7(a) loans. ARRA's funding for these purposes was exhausted on November 23, 2009. P.L. 111-118, the Department of Defense Appropriations Act, 2010, enacted on December 19, 2009, provided $125 million to extend the fee subsidies and 90% guaranty through February 28, 2010. P.L. 111-144, the Temporary Extension Act of 2010, enacted on March 2, 2010, provided $60 million to extend the fee subsidies and 90% guaranty through March 28, 2010. P.L. 111-150, an act to extend the Small Business Loan Guarantee Program, enacted on March 26, 2010, authorized the use of $40 million in SBA-appropriated funds to extend the fee subsidies and 90% guaranty through April 30, 2010. P.L. 111-157, the Continuing Extension Act of 2010, enacted on April 15, 2010, provided $80 million to extend the fee subsides and 90% guaranty through May 31, 2010. P.L. 111-240, the Small Business Jobs Act of 2010, enacted on September 27, 2010, provided $505 million (plus $5 million for related administrative expenses) to extend the fee subsidies and 90% guaranty through December 31, 2010. P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue the fee subsidies and 90% guaranty through March 4, 2011, or until the funding provided by the Small Business Jobs Act of 2010 for these purposes was exhausted (which occurred on January 3, 2011).

[84] On January 3, 2011, the SBA announced it had formed a SBA Loan Queue for loan applicants should any funding with the enhancements become available from loan cancellations. Typically, 7% to 10% of previously approved SBA loans are later canceled by the borrower or lender and are not disbursed for a variety of reasons. See SBA, "Jobs Act Supported More Than $12 Billion in SBA Lending to Small Businesses in Just Three Months," January 3, 2011, at https://www.sba.gov/content/jobs-act-supported-more-12-billion-sba-lending-small-businesses-just-three-months.

[85] SBA, "Statement from Administrator Mills on Continuing Support for Small Businesses through SBA Recovery Programs," February 19, 2010, at https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/statement-administrator-mills-continuing-support-small-businesses-through-sba-recovery-programs; and SBA, "SBA Recovery Lending Extended Through April 30," March 29, 2010, at https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-recovery-lending-extended-through-april-30.

[86] Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," Washington, DC, October 21, 2009; and NFIB, "Government Spending," Washington, DC. Also, see NFIB, "Government Spending: Small Businesses Have a Bottom Line – Government Should, Too," at https://www.nfib.com/content/issues/economy/government-spending-small-businesses-have-a-bottom-line-government-should-too-49051/.

[87] Community Advantage Recovery Loans in a regular servicing status (i.e., fully disbursed) up until October 1, 2020, were eligible for six months of loan payments. See SBA, "Guidance on the Implementation of the Extension of the Section 1112 Debt Relief Program for the 7(a) and 504 Loan Programs, as Authorized by Section 325 of the Economic

In addition, P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act, 2021), among other provisions, appropriated $3.5 billion to resume monthly payment relief for 7(a), 504/CDC, and Microloan borrowers, capped at $9,000 per month per borrower. Payments are dependent on the availability of funds, when the loan was disbursed, the type of loan received, and the business's industry. The act also waived the 504/CDC loan guarantee fee and the CDC processing fee in FY2021.

Program Statistics

Loan Volume

Table 2 shows the number and amount of 504/CDC loans that the SBA approved in FY2005-FY2021 and the number and amount of 504/CDC loans after cancellations and other modifications are taken into account in FY2005-FY2019. Each year, 5% to 15% of SBA-approved 504/CDC loans are subsequently canceled for a variety of reasons, typically by the borrower (e.g., funds are no longer needed or there was a change in ownership).

As the data indicate, the number and amount of 504/CDC loans declined in FY2008 and FY2009. The most likely causes for the decline were decreased small business demand for capital during the recession; difficulties in secondary credit markets, especially from October 2008 to February 2009; and a tightening of small business credit lending standards.

The number and amount of 504/CDC loans increased during FY2010 and FY2011 and reached prerecession levels in FY2012. The SBA attributed the increase in FY2010 and FY2011 to the continuation of 504/CDC fee subsidies, which were in place through most of FY2010 and the first quarter of FY2011.[88]

The continuing economic recovery, which contributed to increased demand for small business loans generally, and the temporary two-year expansion of the types of projects eligible for 504/CDC program refinancing of existing commercial debt (through September 27, 2012) under P.L. 111-240, the Small Business Jobs Act of 2010, most likely also contributed to the program's increased loan volume in FY2011 and FY2012 (see **Table 3**).[89]

As expected, given the expiration of the temporary refinancing expansion, 504/CDC loan volume declined in FY2013 and FY2014. The program's loan volume has generally increased since then.

Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act," Procedural Notice 5000-20079, January 19, 2021, at https://www.sba.gov/document/procedural-notice-5000-20079-guidance-implementation-extension-section-1112-debt-relief-program-7a-504-loan-programs-authorized.

[88] SBA, Press Office, "Recovery Loan Incentives Spurred Continued Rebound in SBA Lending in FY2010," October 4, 2010, at https://www.sba.gov/content/recovery-loan-incentives-spurred-continued-rebound-sba-lending-fy2010; and SBA, "Jobs Act Supported More Than $12 Billion in SBA Lending to Small Businesses in Just Three Months," January 3, 2011, at https://www.sba.gov/content/jobs-act-supported-more-12-billion-sba-lending-small-businesses-just-three-months.

[89] The expanded 504/CDC refinancing program became operational on February 17, 2011, began accepting loan applications on February 28, 2011, and ended on September 27, 2012. See SBA, "Temporary 504 Loan Refinancing for Eligible Small Business Assets Under the Jobs Act: Fact Sheet," at https://thebusinesstimes.com/504-loan-refinancing-program/.

Table 2. Number and Amount of 504/CDC Loans, FY2005-FY2021

($ amounts in billions)

Fiscal Year	Number Approved	Number (after full cancellations)	Amount of the Debentures Approved	Amount of the Debentures (after modifications and cancellations)
2005	9,194	7,672	$5.05	$4.22
2006	9,943	8,325	$5.73	$4.77
2007	10,669	8,941	$6.31	$5.22
2008	8,883	7,328	$5.29	$4.25
2009	6,608	5,471	$3.83	$3.09
2010	7,833	6,642	$4.47	$3.68
2011	8,015	6,913	$4.99	$4.19
2012	9,594	8,399	$7.28	$6.34
2013	7,708	6,626	$5.23	$4.33
2014	5,885	5,246	$4.20	$3.70
2015	5,787	5,313	$4.30	$3.94
2016	5,938	5,557	$4.74	$4.94
2017	6,218	5,925	$5.01	$4.23
2018	5,874	5,774	$4.75	$4.38
2019	6,099	6,006	$4.96	$4.89
2020	7,119	NA	$5.83	NA
2021	9,676	NA	$8.22	NA

Source: U.S. Small Business Administration, Office of Congressional and Legislative Affairs, "WDS Report Amount and Count Summary, September 30, 2019: DRAFT Table 2.7. Approvals by Program and Cohort," October 18, 2018; and U.S. Small Business Administration, "SBA Lending Statistics for Major Programs (as of September 30, 2021)," at https://www.sba.gov/document/report-2021-weekly-lending-reports.

Table 3. Number and Amount of 504/CDC Refinance Loans, FY2011, FY2012, FY2016-FY2021

($ amounts in millions)

Fiscal Year	Number Approved	Number (after full cancellations)	Amount of the Debentures Approved	Amount of the Debentures (after modifications and cancellations)
2011	307	272	$255.3	$226.0
2012	2,424	2,119	$2,268.2	$2,007.2
2016	45	41	$41.4	$38.9
2017	266	244	$287.4	$262.3
2018	181	166	$154.1	$142.7
2019	166	161	$154.8	$149.7

Fiscal Year	Number Approved	Number (after full cancellations)	Amount of the Debentures Approved	Amount of the Debentures (after modifications and cancellations)
2020	386	NA	$370.2	NA
2021	693	NA	$709.0	NA

Source: U.S. Small Business Administration, Office of Congressional and Legislative Affairs, "WDS Report Amount and Count Summary, September 30, 2019: DRAFT Table 2.7. Approvals by Program and Cohort," October 18, 2018; and U.S. Small Business Administration, "SBA Lending Statistics for Major Programs (as of September 30, 2021)," at https://www.sba.gov/document/report-2021-weekly-lending-reports.

Appropriations for Subsidy Costs

The SBA's goal is to achieve a zero subsidy rate for its loan guaranty programs. A zero subsidy rate occurs when the SBA's loan guaranty programs generate sufficient revenue through fees and recoveries of collateral on purchased (defaulted) loans to not require appropriations to issue new loan guarantees.

As indicated in **Table 4**, fees and recoveries did not generate enough revenue to cover 7(a) loan losses from FY2010 through FY2013, and in FY2020 and FY2021. Appropriations were provided to address the shortfalls.

The 504/CDC loan guaranty program experienced loan losses from FY2012 through FY2015. Appropriations were provided to address the shortfalls.

Table 4. Business Loan Credit Subsidies, 7(a) and 504/CDC Loan Guaranty Programs, FY2005-FY2022

($ amounts in millions)

FY	7(a)	504/CDC	Total Subsidy
2005	$0.0	$0.0	$0.0
2006	$0.0	$0.0	$0.0
2007	$0.0	$0.0	$0.0
2008	$0.0	$0.0	$0.0
2009	$0.0	$0.0	$0.0
2010	$80.0	$0.0	$80.0
2011	$80.0	$0.0	$80.0
2012	$139.4	$67.7	$207.1
2013	$213.8	$102.5	$316.3
2014	$0.0	$107.0	$107.0
2015	$0.0	$45.0	$45.0
2016	$0.0	$0.0	$0.0
2017	$0.0	$0.0	$0.0
2018	$0.0	$0.0	$0.0
2019	$0.0	$0.0	$0.0

FY	7(a)	504/CDC	Total Subsidy
2020	$99.0	$0.0	$99.0
2021	$15.0	$0.0	$15.0
2022 request	$0.0	$0.0	$0.0

Source: P.L. 108-447, Consolidated Appropriations Act, 2005; P.L. 109-108, the Science, State, Justice, Commerce and Related Agencies Appropriations Act, 2006; U.S. Small Business Administration (SBA), *Congressional Budget Justification: FY2008 Annual Performance Report*, p. 17; SBA, *FY2010 Congressional Budget Justification and FY2008 Annual Performance Report*, p. 11; SBA, *FY2011 Congressional Budget Justification and FY2009 Annual Performance Report*, p. 19; SBA, *FY2012 Congressional Budget Justification and FY2010 Annual Performance Report*, p. 22; SBA, *FY2013 Congressional Budget Justification and FY2011 Annual Performance Report*, p. 19; SBA, *FY2014 Congressional Budget Justification and FY2012 Annual Performance Report*, p. 25; SBA, *FY2015 Congressional Budget Justification and FY2013 Annual Performance Report*, p. 24; P.L. 113-235, the Consolidation and Further Continuing Appropriations Act, 2015; P.L. 114-113, the Consolidated Appropriations Act, 2016, P.L. 115-31, the Consolidated Appropriations Act, 2017; P.L. 115-141, the Consolidated Appropriations Act, 2018; P.L. 116-6, the Consolidated Appropriations Act, 2019; P.L. 116-93, the Consolidated Appropriations Act, 2020; P.L. 116-260, the Consolidated Appropriations Act, 2021; and U.S. Small Business Administration, *FY2022 Congressional Justification and FY2020 Annual Performance Report*, p. 8.

Notes: The Microloan program also receives a credit subsidy, primarily for providing below market interest rates to Microloan intermediaries. The subsidies were $1.45 million in FY2005, $1.3 million in FY2006 and FY2007, $2.0 million in FY2008, $8.5 million in FY2009 ($6 million added by P.L. 111-5, the American Recovery and Reinvestment Act of 2009), $3.0 million in FY2010 and FY2011, $3.678 million in FY2012, $3.498 million (after sequestration) in FY2013, $4.6 million in FY2014, $2.5 million in FY2015, $3.3 million in FY2016, $4.3 million in FY2017, $3.44 million in FY2018; $4 million in FY2019; $5 million in FY2020, and $12 million in FY2021. The Biden Administration has requested $6 million for Microloan credit subsidies in FY2022.

In addition, P.L. 116-136, the CARES Act, appropriated $17 billion and P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act, 2021) appropriated $3.5 billion for loan credit subsidies related to the provision of monthly debt relief payments to 7(a), 504/CDC, and Microloan borrowers. P.L. 116-260 also appropriated $1.918 billion for 7(a) and 504/CDC loan credit subsidies related to temporarily increasing the 7(a) loan guarantee to 90%, temporarily increasing the SBAExpress program's maximum loan amount to $1 million, temporarily increasing the SBAExpress program's loan guarantee from 50% to 75% for loans of $350,000 and less, and waiving specified 7(a) and 504/CDC fees.

Use of Proceeds and Borrower Satisfaction

In FY2016 (the latest available data), borrowers used 504/CDC loan proceeds to

- purchase land and existing building (51.56%),
- building (construction, remodeling, improvements, etc.) (21.10%),
- machinery and equipment (purchase, installation, etc.) (7.09%),
- make renovations to a building (4.90%),
- purchase land (5.18%),
- other expenses (eligible contingency expenses, interim interest, etc.) (2.84%),
- purchase improvements (2.30%),
- debt to be refinanced (1.51%),
- professional fees (appraiser, architect, legal, etc.) (1.41%),
- add an addition to a building (1.04%),
- purchase or install fixtures (0.55%), or

- make leasehold improvements to a building (0.52%).[90]

In 2008, the Urban Institute surveyed 504/CDC borrowers and found that two-thirds of the respondents rated their overall satisfaction with their 504/CDC loan and loan terms as either excellent (21%) or good (45%). About one out of every four borrowers (23%) rated their overall satisfaction with their loan and loan terms as fair, 8% rated their overall satisfaction as poor, and 4% reported that they did not know or did not respond.[91] In addition, 87% of the survey's respondents reported that the 504/CDC loan was either very important (53%) or somewhat important (34%) to their business success (4% reported that it was somewhat unimportant, 4% reported very unimportant, and 6% reported that they did not know or did not respond).[92]

A March 2014 Government Accountability Office (GAO) report examining the 504/CDC program found that, from FY2003 through March 31, 2013, the top four types of small businesses funded by 504/CDC loans were hotels (12%), restaurants (5%), doctor's offices (4%), and dentist's offices (3%). GAO also reported that 85% of approved 504/CDC loans and dollars went to existing small businesses and 15% went to new small businesses.[93]

Borrower Demographics

In 2008, the Urban Institute found that about 9.9% of private-sector small business loans were issued to minority-owned small businesses and about 16% of those loans were issued to women-owned businesses.[94]

In FY2021, 22.9% of the total amount of 504/CDC approved loans went to minority-owned businesses (13.5% Asian, 7.7% Hispanic, 1.3% African American, and 0.3% Native American) and 8.7% went to women-owned businesses.[95] Based on its comparative analysis of private-sector small business loans and the SBA's loan guaranty programs, the Urban Institute concluded that

> Overall, loans under the 7(a) and 504 programs were more likely to be made to minority-owned, women-owned, and start-up businesses (firms that have historically faced capital gaps) as compared to conventional small business loans. Moreover, the average amounts for loans made under the 7(a) and 504 programs to these types of firms were substantially greater than conventional small business loans to such firms. These findings suggest that the 7(a) and 504 programs are being used by lenders in a manner that is consistent with SBA's objective of making credit available to firms that face a capital opportunity gap.[96]

---

[90] SBA, Office of Congressional and Legislative Affairs, correspondence with the author, August 24, 2017.

[91] Christopher Hayes, *An Assessment of Small Business Administration Loan and Investment Performance: Survey of Assisted Businesses* (Washington, DC: The Urban Institute, 2008), p. 5, at http://www.urban.org/UploadedPDF/411599_assisted_business_survey.pdf (hereinafter Christopher Hayes, *An Assessment of Small Business Administration Loan and Investment Performance: Survey of Assisted Businesses*). The percentage total exceeds 100 because recipients were allowed to name more than one use for the loan proceeds.

[92] Christopher Hayes, *An Assessment of Small Business Administration Loan and Investment Performance: Survey of Assisted Businesses*, p. 5.

[93] GAO, *Small Business Administration: Actions Needed to Ensure Planned Improvements Address Key Requirements of the Development Company (504) Loan Program*, GAO-14-233, March 6, 2014, p. 8, at http://www.gao.gov/assets/670/661428.pdf.

[94] Kenneth Temkin, Brett Theodos, with Kerstin Gentsch, *Competitive and Special Competitive Opportunity Gap Analysis of the 7(A) and 504 Programs* (Washington, DC: The Urban Institute, 2008), p. 13, at http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf.

[95] SBA, "SBA Lending Statistics for Major Programs (as of September 30, 2021)."

[96] Kenneth Temkin, Brett Theodos, with Kerstin Gentsch, *Competitive and Special Competitive Opportunity Gap Analysis of the 7(A) and 504 Programs* (Washington, DC: The Urban Institute, 2008), p. 21, at http://www.urban.org/

Congressional Issues

Fee Subsidies and the 7(a) Program's 90% Maximum Loan Guaranty Percentage

As mentioned, the SBA was provided more than $1.1 billion in funding in 2009 and 2010 to subsidize the 504/CDC program's third-party participation fee and CDC processing fee, subsidize the SBA's 7(a) program's guaranty fee, and increase the 7(a) program's maximum loan guaranty percentage from up to 85% of loans of $150,000 or less and up to 75% of loans exceeding $150,000 to 90% for all standard 7(a) loans.[97] The Obama Administration argued that this additional funding improved the small business lending environment, increased both the number and amount of SBA guaranteed loans, and supported hundreds of thousands of jobs.[98] Critics argued that small business tax reduction, reform of financial credit market regulation, and federal fiscal restraint are a better means to assist small business economic growth and job creation.[99]

As mentioned, P.L. 116-136, the CARES Act, and P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act, 2021) appropriated $17 billion and $3.5 billion, respectively, to provide monthly debt relief payments for 7(a), 504/CDC, and Microloan borrowers. P.L. 116-260 also appropriated $1.918 billion for SBA loan enhancements, including the waiver of the 504/CDC loan guaranty and processing fees from the date of enactment (December 27, 2020) through September 30, 2021.

UploadedPDF/411596_504_gap_analysis.pdf.

[97] P.L. 111-5, the ARRA, provided $375 million for fee subsidies and the 7(a) program's 90% guaranty for all standard 7(a) loans. ARRA's funding for these purposes was exhausted on November 23, 2009. P.L. 111-118, the Department of Defense Appropriations Act, 2010, enacted on December 19, 2009, provided $125 million to extend the fee subsidies and 90% guaranty through February 28, 2010. P.L. 111-144, the Temporary Extension Act of 2010, enacted on March 2, 2010, provided $60 million to extend the fee subsidies and 90% guaranty through March 28, 2010. P.L. 111-150, an act to extend the Small Business Loan Guarantee Program, enacted on March 26, 2010, authorized the use of $40 million in SBA-appropriated funds to extend the fee subsidies and 90% guaranty through April 30, 2010. P.L. 111-157, the Continuing Extension Act of 2010, enacted on April 15, 2010, provided $80 million to extend the fee subsides and 90% guaranty through May 31, 2010. P.L. 111-240, the Small Business Jobs Act of 2010, enacted on September 27, 2010, provided $505 million (plus $5 million for related administrative expenses) to extend the fee subsidies and 90% guaranty through December 31, 2010. P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue the fee subsidies and 90% guaranty through March 4, 2011, or until the funding provided by the Small Business Jobs Act of 2010 for these purposes was exhausted (which occurred on January 3, 2011).

[98] SBA, "Statement from Administrator Mills on Continuing Support for Small Businesses through SBA Recovery Programs," February 19, 2010, at https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/statement-administrator-mills-continuing-support-small-businesses-through-sba-recovery-programs; and SBA, "SBA Recovery Lending Extended Through April 30," March 29, 2010, at https://www.sba.gov/content/sba-recovery-lending-extended-through-april-30.

[99] Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," Washington, DC, October 21, 2009; and NFIB, "Government Spending," Washington, DC. Also, see NFIB, "Government Spending: Small Businesses Have a Bottom Line – Government Should, Too," at https://www.nfib.com/content/issues/economy/government-spending-small-businesses-have-a-bottom-line-government-should-too-49051/.

Lender Oversight

The SBA's Office of Inspector General (OIG) has included lender oversight in its list of the most serious management and performance challenges facing the SBA each year from FY2008 through FY2022.[100] In its FY2022 report, the OIG argued that SBA loans

> are originated by lenders and non-bank lenders that have various degrees of expertise in SBA loan program requirements.
>
> Lenders often rely on the services of loan agents and lender service providers to help originate, close, service, and liquidate SBA loans ... [and many] traditional SBA 7(a) and 504 Certified Development Company loans are originated by lenders with delegated approval authority. Our previous audits have found SBA has not adequately recognized or managed significant lender weaknesses.[101]

The SBA's Office of Credit Risk Management (OCRM) manages SBA lending program risk, monitors lender performance, and enforces SBA lending program requirements.[102] OCRM monitors portfolio risk through the SBA's Loan and Lender Monitoring System (L/LMS), which tracks monthly lender and loan performance and quarterly credit scores for all 7(a) and 504/CDC loans. The L/LMS system is designed to help OCRM assess risks for 7(a) and CDC lenders, and it identifies lenders "whose portfolio performance or other lender-specific risk-related factors demonstrated the need for additional SBA monitoring."[103] In FY2020, the SBA conducted 622 risk-based reviews of 7(a) and 504/CDC lenders.

In an effort to further enhance its ability to detect risks and to determine prospective trends, OCRM created new metrics in 2015 for monitoring 504/CDC lender loan performance called SMART (measuring the lender's solvency and financial condition, management and governance, asset quality and servicing, regulatory compliance, and technical issues and mission) and updated those metrics in 2016.[104] SMART is designed to "assist OCRM in identifying high risk lenders and ensuring that lender oversight drives meaningful review activities, findings, and corrective actions that reduce risk to the SBA."[105] OCRM also created a "detailed bench-marking analysis

---

[100] SBA, Office of Inspector General (OIG), "Report on the Most Serious Management and Performance Challenges By Office of Inspector General," reports from FY2008-FY2022, at https://www.sba.gov/document/report-report-most-serious-management-performance-challenges-office-inspector-general.

[101] SBA, OIG, "Top Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2022," Report 22-02, October 15, 2021, p. 14, at https://www.sba.gov/document/report-report-most-serious-management-performance-challenges-office-inspector-general.

[102] P.L. 115-189, the Small Business 7(a) Lending Oversight Reform Act of 2018, codified the SBA's Office of Credit Risk Management (OCRM), required that it be headed by a Director who is a career appointee in the Senior Executive Service, and provided OCRM with a list of duties, including submitting a report to Congress on each December 1st "containing the results of each portfolio risk analysis conducted ... during the fiscal year preceding the submission of the report."

[103] SBA, *FY2022 Congressional Justification and FY2020 Annual Performance Report*, p. 44.

[104] SBA, OIG, "The SBA's Portfolio Risk Management Program Can be Strengthened," July 2, 2013, p. 19, at https://www.sba.gov/sites/default/files/oig/Audit%20Evaluation%20Report%2013-17%20The%20SBA's%20Portfolio%20Risk%20Management%20Program%20Can%20Be%20Strengthened.pdf, SBA, "SBA Information Notice 5000-1348: Revised Risk-Based Review Protocol for Certified Development Companies," October 3, 2017 (effective August 5, 2015), at https://www.sba.gov/sites/default/files/lender_notices/5000-1348.pdf; and SBA, "SBA Information Notice 5000-1398: Updated SMART Methodology for Oversight of CDCs," October 3, 2017 (effective November 9, 2016), at https://www.sba.gov/sites/default/files/lender_notices/SBA_Info_Notice_5000-1398_SM.pdf.

[105] SBA, OIG, "The SBA's Portfolio Risk Management Program Can be Strengthened," July 2, 2013, p. 19, at https://www.sba.gov/sites/default/files/oig/Audit%20Evaluation%20Report%2013-

project that will serve to establish quantitative performance metrics and indicators of quality (Preferred, Acceptable and Less than Acceptable) to be incorporated into each area of risk assessment identified in the ... SMART protocol measurement attributes."[106]

In a 2019 audit, the SBA's OIG reported that OCRM "did not always conduct planned high-risk lender reviews, recommend adequate and consistent risk mitigation actions, or communicate loan deficiencies they noted during their high-risk lender reviews to SBA approval and purchase loan centers."[107] The OIG made six recommendations to address these and other issues (including the development and implementation of policies and procedures to document OCRM's justification for not conducting planned reviews and to communicate systemic lender issues and material loan deficiencies to the appropriate SBA loan approval and purchase centers). SBA agreed with the OIG's findings and recommendations and indicated that it would take actions to resolve all of the recommendations.[108]

Legislation

Congress has always shown a great interest in the SBA's loan guarantee programs because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to create and retain jobs. That interest has grown especially acute in recent years due to the Coronavirus Disease 2019 (COVID-19) pandemic's adverse economic impact on the national economy.

During the 111th Congress, legislation was enacted to assist small businesses during and immediately following the Great Recession (2007-2009). For example,

- P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), provided $375 million to temporarily reduce fees in the SBA's 7(a) and 504/CDC loan guaranty programs ($299 million) and to temporarily increase the 7(a) program's maximum loan guaranty percentage to 90% ($76 million).[109] Congress subsequently appropriated another $265 million and authorized the SBA to reprogram another $40 million to extend those subsidies and the loan modification through May 31, 2010. ARRA also authorized the SBA to allow, under specified circumstances, the use of 504/CDC program funds to refinance existing debt for business expansion.[110]

17%20The%20SBA's%20Portfolio%20Risk%20Management%20Program%20Can%20Be%20Strengthened.pdf.

[106] SBA, OIG, "The SBA's Portfolio Risk Management Program Can Be Strengthened."

[107] SBA, Office of Inspector General (OIG), *Audit of SBA's Oversight of High-Risk Lenders*, Report Number 20-03, November 12, 2019, p. i, at https://www.sba.gov/document/report-20-03-audit-sbas-oversight-high-risk-lenders (hereinafter SBA, OIG, *Audit of SBA's Oversight of High-Risk Lenders*).

[108] SBA, OIG, *Audit of SBA's Oversight of High-Risk Lenders*, pp. 11-12.

[109] SBA, "Recovery Act Agency Plan," May 15, 2009, at https://www.sba.gov/sites/default/files/sba_recovery_act_plan.pdf.

[110] The specified circumstances include the following: the amount of existing indebtedness does not exceed 50% of the project cost of the expansion; the proceeds of the indebtedness were used to acquire land, including the building situated thereon, to construct a building thereon, or to purchase equipment; the existing indebtedness is collateralized by fixed assets; the existing indebtedness was incurred for the benefit of a small business; the financing is used only for refinancing existing indebtedness or costs related to the project being financed; the refinancing provides a substantial benefit to the borrower; the borrower has been current on all payments due on the existing debt for not less than one year preceding the date of refinancing; and the financing provided will have better terms or rate of interest than the existing indebtedness. See P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), Section 504. Stimulus for Community Development Lending.

- P.L. 111-240, the Small Business Jobs Act of 2010, increased the 504/CDC program's loan guaranty limits from $1.5 million to $5 million for "regular" borrowers, from $2 million to $5 million if the loan proceeds are directed toward one or more specified public policy goals, and from $4 million to $5.5 million for manufacturers. The act also temporarily expanded for two years after the date of enactment (or until September 27, 2012) the types of projects eligible for refinancing of existing debt under the 504/CDC program; provided $505 million (plus an additional $5 million for administrative expenses) to continue fee subsidies for the 7(a) loan guaranty program and the 504/CDC program through December 31, 2010; and established an alternative size standard that allows more companies to qualify for 504/CDC assistance.
- P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue the fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through March 4, 2011, or until funding provided for these purposes in P.L. 111-240 was exhausted (which occurred on January 3, 2011).

During the 114th Congress, P.L. 114-113, the Consolidated Appropriations Act, 2016, reinstated the expansion of the types of projects eligible for refinancing under the 504/CDC loan guaranty program, but only in any fiscal year in which the refinancing program and the 504/CDC program as a whole do not have credit subsidy costs. (P.L. 116-260 repealed this limitation.) The act required each CDC to limit its refinancing so that, during any fiscal year, the new refinancings do not exceed 50% (now 100%) of the dollars it loaned under the 504/CDC program during the previous fiscal year.[111] The SBA was authorized to waive the 50% limit for good cause. An interim final rule implementing the new refinancing program was issued by the SBA on May 25, 2016, effective June 24, 2016.[112]

During the 115th Congress, P.L. 115-371, the Small Business Access to Capital and Efficiency (ACE) Act, amended the Small Business Investment Act of 1958 to increase the threshold amount for determining when a CDC is required to secure an independent real estate appraisal for a 504/CDC loan (from if the estimated value of the project property is greater than $250,000 to if the estimated value of the project property is greater than the federal banking regulator appraisal threshold, which was increased from $250,000 to $500,000 in 2018).[113]

In addition, the Trump Administration proposed in its FY2020 and FY2021 budget requests that the maximum dollar amount for a 504 loan to a small manufacturer be increased to $6.5 million from $5.5 million.[114]

---

[111] The act also eliminated an alternative job retention goal for the expanded refinancing program authorized by P.L. 111-240, the Small Business Jobs Act of 2010. It also increased the SBA's Small Business Investment Company program's family of funds limit (the amount of outstanding leverage allowed for two or more SBIC licenses under common control) to $350 million from $225 million and increased the 7(a) loan program's authorization limit to $26.5 billion for FY2016 from $23.5 billion for FY2015.

[112] SBA, "Debt Refinancing in 504 Loan Program," 81 *Federal Register* 33123-33126, May 25, 2016.

[113] Department of the Treasury, Office of the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation, "Real Estate Appraisals," 83 *Federal Register* 15,019, April 9, 2018.

[114] SBA, *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report*, p. 35, at https://www.sba.gov/sites/default/files/2019-04/SBA%20FY%202020%20Congressional%20Justification_final%20508%20%204%2023%202019.pdf; and SBA, *FY2021 Congressional Budget Justification and FY2019 Annual Performance Report*, p. 32.

During the 116th Congress, legislation was enacted to assist small businesses adversely affected by the COVID-19 pandemic. For example,

- P.L. 116-136, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), among other provisions, created the Paycheck Protection Program (PPP), which provides low-interest, forgivable loans to small businesses adversely affected by the COVID-19 pandemic, and appropriated $17 billion for six-month payment relief for existing 7(a), 504/CDC, and Microloan borrowers in a regular servicing status (i.e., fully disbursed) beginning with the next payment due date. Loans already on deferment received six months of SBA payments beginning with the first payment after the deferral period. Loans in a regular servicing status up to six months after enactment (until September 27, 2020) were also eligible for six monthly payments of debt relief.[115]
- P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act, 2021), among other provisions, appropriated $3.5 billion to resume monthly payment relief for 7(a), 504/CDC, and Microloan borrowers, capped at $9,000 per month per borrower. Payments are dependent on the availability of funds, when the loan was disbursed, the type of loan received, and the business's industry.[116] The act also waived specified 7(a) and 504/CDC loan guarantee program fees in FY2021, modified 504/CDC refinancing regulations to expand borrower access to the refinancing program and create reciprocity for refinancing under the 7(a) and 504/CDC programs, and temporarily authorized the SBA, through September 30, 2023, to establish a 504/CDC Express Loan program to expedite the approval of 504/CDC loans that do not exceed $500,000.

During the 117th Congress, P.L. 117-43, the Extending Government Funding and Delivering Emergency Assistance Act, provides continuing FY2022 appropriations for federal agencies, including the SBA, through December 3, 2021. The SBA is authorized to appropriate available funds up to the rate necessary to accommodate increased demand for commitments for several SBA programs, including 504/CDC business loans.[117]

---

[115] Community Advantage Recovery Loans in a regular servicing status (i.e., fully disbursed) up until October 1, 2020, were eligible for six months of loan payments. See SBA, "Guidance on the Implementation of the Extension of the Section 1112 Debt Relief Program for the 7(a) and 504 Loan Programs, as Authorized by Section 325 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act," Procedural Notice 5000-20079, January 19, 2021, at https://www.sba.gov/document/procedural-notice-5000-20079-guidance-implementation-extension-section-1112-debt-relief-program-7a-504-loan-programs-authorized.

[116] The SBA announced that the $3.5 billion appropriation would enable the agency to provide two additional monthly payments on 7(a) and 504/CDC loans that were in repayment before March 27, 2020, starting with the next payment due on or after February 1, 2021. After the first two monthly payments are provided, businesses with an SBA Community Advantage loan, Microloan, or operating in specified economically hard-hit industries would receive an additional three monthly payments. Loans approved from February 1, 2021, through September 30, 2021, would receive three monthly payments beginning with the first payment due. See SBA, "Adjustment to Number of Months of Section 1112 Payments in the 7(a), 504 and Microloan Programs Due to Insufficiency of Funds," SBA Procedural Notice, 5000-20095, February 16, 2021, at https://www.sba.gov/document/procedural-notice-5000-20095-adjustment-number-months-section-1112-payments-7a-504-microloan-programs-due-insufficiency-funds.

[117] P.L. 117-43 §128 provides that amounts made available by Section 101 for "Small Business Administration—Business Loans Program Account" may be apportioned up to the rate for operations necessary to accommodate increased demand for commitments for general business loans authorized under paragraphs (1) through (35) of Section 7(a) of the Small Business Act (15 U.S.C. §636(a)), for guarantees of trust certificates authorized by Section 5(g) of the Small Business Act (15 U.S.C. §634(g)), for commitments to guarantee loans under Section 503 of the Small Business

Concluding Observations

The small business relief legislation enacted during the 116th Congress included several provisions enacted during the 111th Congress to address the Great Recession, such as fee waivers, increased loan limits, and increased loan guarantee percentages. However, the legislation enacted during the 116th Congress is fundamentally different from that enacted during the 111th Congress. First, it is much larger in scale ($1.086 trillion in supplemental appropriations) than the legislation enacted during the 111th Congress ($1.693 billion in supplemental appropriations). Second, expectations about repayment are much different, as the small business relief legislation enacted during the 116th Congress includes PPP loan forgiveness and monthly debt relief payments for 7(a), 504/CDC, and Microloan borrowers. Third, the legislation enacted during the 116th Congress greatly expanded program eligibility, including, for the first time, eligibility for specific types of nonprofit organizations.

In terms of recent program changes, providing 504/CDC fee waivers, expanding 504/CDC refinancing, and creating a 504/CDC Express Loan program were (and are) designed to create and retain jobs by increasing the ability of 504/CDC borrowers to access credit at affordable rates.

Initially, Congress focused on providing relief as quickly as possible to prevent small business failures and job loss. In the coming months, congressional oversight is likely to focus increased attention on the SBA's administration of these programs, especially the SBA's efforts to deter fraud, and the impact these programs have on small business survival and job creation and retention.

Among the lessons learned from the 111th Congress are the potential benefits that could derive from providing additional funding for the SBA's OIG and for GAO. GAO and the SBA's OIG can provide Congress information that could prove useful as Congress engages in congressional oversight of the SBA's administration of these programs, provide an early warning if unforeseen administrative problems should arise, and, through investigations and audits, serve as a deterrent to fraud.

Requiring the SBA to report regularly on its implementation of these programs could also promote transparency and assist Congress in performing its oversight responsibilities. In addition, requiring output and outcome performance measures and requiring the SBA to report this information directly to both Congress and the public by posting that information on the SBA's website could enhance both congressional oversight and public confidence in the SBA's efforts to assist small businesses.

Author Information

Robert Jay Dilger
Senior Specialist in American National Government

Investment Act of 1958 (15 U.S.C. §697), and for commitments to guarantee loans for debentures under Section 303(b) of the Small Business Investment Act of 1958 (15 U.S.C. §683(b)).

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.