United States Government Accountability Office
Washington, DC 20548

January 19, 2010

The Honorable Nydia M. Velázquez
Chairwoman
Committee on Small Business
House of Representatives

Subject: *Status of the Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*

Dear Madam Chairwoman:

Due to recent turmoil in U.S. credit markets, many lenders have been reluctant to offer conventional loans—that is, loans not guaranteed by the federal government—to small businesses so that they can finance their operations and capital needs. While the Small Business Administration's (SBA) principal loan guarantee programs, the 7(a) and 504 programs, are intended to help small businesses raise critical financing that they may have difficulty obtaining from other sources, the availability of such loans has also declined. Under the 7(a) program, SBA traditionally has provided lenders guarantees on up to 85 percent of the value of loans to qualifying small businesses in exchange for fees to help offset the costs of the program. Under the 504 program, which generally applies to small business real estate and other fixed assets, SBA provides certified development companies with a guarantee on up to 40 percent of the financing of the projects' costs in exchange for fees—the small business borrowers and other lenders provide the remaining 60 percent of the financing on an unguaranteed basis.[1] Traditionally, lenders, such as banks, that participate in the 7(a) or 504 programs often sell qualifying small business loans on the 7(a) and 504 secondary markets to raise funds necessary for additional lending.[2] However, from mid-2008 to early-2009, investors that had typically purchased securities collateralized by the pools of 7(a) guaranteed small business loans and certain 504 loans largely withdrew from the secondary markets due to potential

[1]In the financing of a typical 504 loan project, the small business borrower provides at least 10 percent of the funds; a third-party lender originates a mortgage, referred to as a first-lien mortgage, to provide 50 percent of the funds; and a nonprofit certified development company provides the remaining 40 percent of the funding through an SBA-guaranteed debenture.

[2]As described in this report, secondary markets have developed for the guaranteed portions of 7(a) loans and the guaranteed and unguaranteed portions of primarily real estate projects (including machinery and equipment) financed pursuant to the 504 program.

losses, and as a result, many such loans remained on the balance sheets of the broker-dealers that package the securities or on the balance sheets of the original lenders.[3] According to SBA, the dollar volume of 7(a) loans sold as securities on the secondary market dropped from $425.4 million to $85.9 million, or 79.8 percent, from the end of the third quarter of 2008 to the end of the first quarter of 2009.

Under the American Recovery and Reinvestment Act (ARRA), enacted on February 17, 2009, SBA was required to implement eight new authorities—referred to throughout this report, and by ARRA, as administrative provisions—to help facilitate small business lending and enhance liquidity in the secondary markets.[4] The provisions included requirements for, among other things, (1) temporarily lowering or eliminating certain fees on 7(a) and 504 loans, as well as increasing the maximum guarantee on the former;[5] (2) establishing new programs to facilitate secondary market activity;[6] and (3) establishing a new, temporary guaranteed loan program for viable small businesses experiencing financial hardship, which SBA refers to as the America's Recovery Capital (ARC) Loan Program.[7] The administrative provisions took effect when ARRA was enacted, with certain provisions granting SBA emergency rulemaking authority to hasten their implementation. Specifically, ARRA required SBA to issue regulations implementing sections 503 (first-lien guarantee) and 506 (ARC Loan Program) within 15 days of enactment, or by March 4, 2009, and to issue regulations implementing Section 509 (loans to broker-dealers) within 30 days of ARRA enactment, or by March 19, 2009.

In April 2009 we issued a report on SBA's development and implementation of the ARRA administrative provisions, which found that SBA had not completed required emergency regulations.[8] While SBA had taken key steps authorized by ARRA—such as temporarily eliminating existing fees for 7(a) loans and increasing the guarantee on such loans—it had not issued regulations for the secondary market provisions or

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[3]The guaranteed portions of 7(a) loans may be bundled into guaranteed securities, referred to as pools of 7(a) guaranteed loans and 7(a) guaranteed securities. The term broker-dealer is commonly used to describe the person or firm that trades securities on behalf of others (i.e., broker) or on its own account (i.e., dealer).

[4]Pub. L. No. 111-5, Division A, Title V, 123 Stat. 115, 151-161 (2009).

[5]The guarantee fees for 7(a) loans and the third-party participation fees and certified development company processing fees for 504 loans were temporarily eliminated. The maximum guarantee for 7(a) loans was temporarily increased from 85 to 90 percent.

[6]The SBA guarantee was extended to the first-lien portion of 504 loans, and a new program was established to make loans to systemically important broker-dealers that operate in the SBA 7(a) secondary market. A systemically important SBA Secondary Market broker-dealer is routinely engaged in the purchase and sale of the guaranteed portion of 7(a) loans or pools of guaranteed portions originated, underwritten, and closed under the Small Business Act.

[7]The ARC Loan Program is a new, temporary loan program that allows SBA to guarantee loans of $35,000 or less to small businesses with existing qualifying loans that are suffering immediate financial hardship.

[8]As required under Section 507, Pub. L. No. 111-5, Division A, Title V, 123 Stat. 115, 151-161 (2009), we reported within 60 days of ARRA enactment. See GAO, *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*, GAO-09-507R (Washington, D.C.: Apr. 16, 2009).

the ARC Loan Program. The report noted that SBA's inability to implement these provisions was due to a variety of factors, including the challenges associated with developing and implementing new programs and the loss of key staff. However, the report also stated that SBA planned to complete these administrative provisions by June 2009.

Following the issuance of our report, you requested that we continue to review SBA's efforts to implement the eight ARRA administrative provisions. You asked that we pay particular attention to the completion of emergency regulations that were due 15 and 30 days after ARRA enactment, including reasons for any implementation delays. This letter summarizes a November 2009 briefing we provided to your staff on the results of this work (see enclosure I for the briefing slides). Our objectives were to discuss the extent to which (1) SBA has implemented the eight ARRA administrative provisions, with a focus on those that granted SBA emergency rulemaking authority to issue regulations; (2) ARRA administrative provisions and other actions are enhancing liquidity in the markets for SBA 7(a) and 504 loans; and (3) SBA has implemented the ARC Loan Program and how its program terms appeal to market participants. We also updated the enclosed briefing slides to include activities undertaken by SBA to implement the provisions after the date of our briefing.

To address our objectives, we reviewed SBA's development of regulations, policies, and procedures for implementing the ARRA administrative provisions and interviewed SBA officials to obtain data and determine the status of efforts underway, time frames, program accomplishments, and planned activities. We also interviewed SBA officials regarding steps taken to increase liquidity in the 7(a) and 504 primary and secondary markets and reviewed relevant documents. Further, we interviewed market participants, such as primary SBA lenders and broker-dealers, on their views regarding SBA's implementation efforts and the effects of the ARRA provisions on the 7(a) and 504 primary and secondary markets. In addition, we interviewed SBA officials, and obtained and analyzed data on SBA's efforts to develop and implement the ARC Loan Program. We also interviewed market participants on their views regarding the ARC Loan Program, including their views on the attractiveness of program terms and requirements.

We conducted this performance audit from July 2009 through December 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Under the 7(a) loan program, SBA guarantees loans made by commercial lenders to small business borrowers for whom credit is not otherwise available on reasonable terms from nonfederal sources and that do not have the personal resources to provide financing themselves.[9] The 7(a) program guarantee assures the lender that if

[9]Section 7(a) of the Small Business Act, as amended, codified at 15 U.S.C. § 636(a); see also 13 C.F.R. Part 120.

a borrower defaults on a loan, the lender will receive an agreed-upon portion of the outstanding balance, generally between 50 percent and 85 percent. Loan proceeds may be used for working capital and other general business purposes. To be eligible for the 7(a) program, a business must be an operating, for-profit small firm (according to SBA's size standards) located in the United States. To offset some of the costs of the program, SBA assesses lenders two fees on each 7(a) loan, an up-front guarantee fee that may be passed on to the borrower and an annual servicing fee.

The 504 loan program provides long-term, fixed-rate financing to small businesses for expansion or modernization—primarily of real estate—including land and new building construction, existing building purchases or renovation, and machinery and equipment.[10] Financing is delivered through certified development companies (CDC), which are private, nonprofit companies established to contribute to the economic development of their communities. In a typical 504 loan project, a third-party lender provides 50 percent or more of the financing, pursuant to a first-lien mortgage; a CDC provides up to 40 percent of the financing through a debenture that is fully guaranteed by SBA; and a borrower contributes at least 10 percent of the financing. The borrower must meet eligibility requirements similar to those for 7(a) program borrowers, and a project generally must create or retain at least one job for every $65,000—increased from $50,000—guaranteed by SBA. Like the 7(a) program, the 504 program requires lenders, small business borrowers, and CDCs to pay various fees to offset program costs.

Over the years, the development of secondary markets for 7(a) and 504 loans has helped lenders to originate such loans. By selling loans to investors via secondary markets, lenders can receive additional funds, or liquidity, to make more loans. In the 7(a) secondary market, lenders sell the SBA-guaranteed portions of the loans to investors—with the participation of broker-dealers and other market participants—but generally retain the unguaranteed portion in their portfolios. The broker-dealers assemble the guaranteed portions of 7(a) loans from lenders into securities and manage the sale of these securities to investors. Lenders, broker-dealers, and other secondary market participants make profits through various fees, the premiums investors pay for the securities, and servicing the loans over time. Due to the structure of 504 loans, there are two separate markets: one for the SBA-guaranteed, or debenture, portion of the loan and another for the first-lien mortgage portion.

On February 17, 2009, Congress enacted ARRA, which, among a variety of other actions and programs across the federal government designed to help the economy recover, included eight administrative provisions designed to facilitate small business lending and liquidity in the markets for SBA-guaranteed loans. Table 1 summarizes each ARRA administrative provision and identifies those (in boldface type) that granted SBA emergency rulemaking authority to issue regulations.

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[10] 15 U.S.C. §§ 695 *et seq.*

Table 1: Summary of ARRA Administrative Provisions and Primary Requirements

Provision number and title	**Primary requirements and sunset provisions**
501: fee reductions	• Permits the temporary reduction or elimination of fees for 7(a) and 504 loans until September 30, 2010, or until funds appropriated are expended ($375 million total for both sections 501 and 502).
502: Economic Stimulus Lending Program	• Permits SBA to guarantee up to 90 percent of qualifying 7(a) loans made by SBA lenders. Only applies to loans approved within 12 months of ARRA enactment or until funds appropriated are expended ($375 million total for both sections 501 and 502).
503: establishment of SBA secondary market guarantee authority	• **Allows SBA to establish a secondary market guarantee for pools of first-lien 504 loans to sell to third-party investors.** • **This provision terminates 2 years after the enactment of ARRA. Under the emergency rulemaking authority, SBA must issue regulations within 15 days of enactment (March 4, 2009).**
504: stimulus for community development lending	• Authorizes SBA to refinance a limited number of certain existing loans as new 504 loans. • Eligibility criterion for 504 loans has changed from creating one job for every $50,000 guaranteed to one job for every $65,000 guaranteed.
505: increasing small business investment	• Increases the maximum amount of outstanding leverage available to a small business investment company (SBIC) to the lesser of 300 percent of the SBIC's private capital or $150 million. • Leverage allowed for two or more SBICs operated under common control and that are financially sound cannot exceed $225 million.

506: business stabilization program (ARC Loan Program)	• **Creates a new program that allows SBA to guarantee loans of $35,000 or less to small businesses suffering immediate financial hardship and possess existing qualifying loans.** • **Under emergency rulemaking authority, SBA must issue regulations within 15 days of ARRA enactment (March 4, 2009).**
508: surety bonds	• Increases the maximum contract amount for a SBA bond guarantee from $2 million to $5 million (and under certain circumstances up to $10 million). • Requires SBA to study and report on the program's current funding structure.
509: establishment of SBA secondary market lending authority	• **Authorizes SBA to make loans to systemically important broker-dealers that operate in the SBA 7(a) secondary market.** • **Under emergency rulemaking authority, SBA must issue regulations within 30 days of ARRA enactment (March 19, 2009).**

Source: GAO analysis of ARRA data.

The Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Federal Reserve) have also initiated programs to increase access to credit for consumers and small businesses. As part of the Consumer and Business Lending Initiative, Treasury announced plans on March 16, 2009, under the Troubled Asset Relief Program (TARP), that it would directly purchase up to $15 billion in securities backed by the guaranteed portions of 7(a) loans, securities packaged from the debenture portions of 504 loans, and 504 first-lien securities that may receive new SBA guarantees under ARRA. Also under this initiative, the Federal Reserve, with Treasury support, plans to lend funds to investors through the Term Asset-Backed Securities Loan Facility (TALF) to provide up to $200 billion in low-cost financing for investors to purchase a variety of consumer, commercial, and small business securitizations (which include SBA-guaranteed 7(a) and 504 loans), thereby opening the credit markets to consumers and small businesses.[11]

Summary

While SBA did not meet its internal June 2009 deadline for implementing all of the ARRA administrative provisions, all such provisions were implemented by November 2009. Of the three provisions that required the issuance of regulations using SBA's emergency rulemaking authority, SBA implemented Section 506 (ARC Loan Program)

[11]TALF is under the Consumer and Business Lending Initiative of Treasury's Financial Stability Plan. Accordingly, Treasury provides $20 billion in support to TALF.

on June 15, 2009, but did not implement the Section 503 secondary market provision (504 first-lien guarantee) until October 30, 2009, and the Section 509 (loans to systemically important broker-dealers) until November 19, 2009. Consistent with the findings in our April 2009 report, we identified several factors that may have contributed to SBA's delay in implementing these administrative provisions, including:

- challenges related to the creation of new and complex programs, including new systems and processes, regulations, policies, and procedures;
- SBA's reduced staffing levels and loss of expertise through retirements and turnover in key positions; and
- challenges associated with resolving key policy issues and addressing statutory language that, while designed to protect taxpayer interests, could limit acceptance of market participants.

For example, implementation of Section 509 was delayed until SBA officials could determine the extent to which broker-dealers, and perhaps small business lenders, would be required to share in the potential losses associated with extending the guarantee in the 504 loan program. While requiring broker-dealers and lenders to share in potential losses could help ensure sound loan underwriting and thereby limit SBA's potential exposure, it could also lessen their willingness to participate, in turn limiting the expansion of secondary market activity as ARRA intended. Under the interim final rule, which SBA published on October 30, 2009, broker-dealers retain 5 percent of the potential losses on 504 first-lien loans, lenders 15 percent, and SBA 80 percent.[12]

SBA data suggest that liquidity in 7(a) and 504 loan markets appears to have largely recovered. Specifically, SBA data show that lenders' origination of 7(a) loans in the primary market doubled from an average of about $650 million per month in the fourth quarter of 2008 to an average of about $1.4 billion per month in the third quarter of 2009, which is higher than second and third quarter 2008 average monthly originations of $1.1 billion and $1 billion, respectively. In addition, SBA 7(a) secondary market sales more than tripled between the fourth quarter of 2008 and the third quarter of 2009, from a monthly average of about $108.8 million to a monthly average of about $336.9 million. Furthermore, data indicate that the secondary market for the SBA-guaranteed, or debenture, portion of 504 loans has also improved. SBA officials and market participants we interviewed said there has been a significant recovery in the markets for 7(a) and 504 loans throughout 2009, although they also said that the secondary market for 504 first-lien loans remains limited. SBA officials and some market participants cited three general reasons for the recovery in 7(a) and 504 loan markets. First, the temporary reduction or elimination of fees on 7(a) and 504 loans and the guarantee extension on 7(a) loans were critical to igniting activity in the primary markets for such loans. While the $375 million that Congress appropriated under ARRA for the fee reductions and guarantee extensions was exhausted by late November 2009, the Department of Defense Appropriations Act of

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[12]ARRA requires that the seller of the pools purchasing a guarantee retain no less than 5 percent of the dollar amount of the pools being sold to third-party investors. During the rulemaking process, SBA officials said they were considering whether it would be appropriate to require broker-dealers to retain more than 5 percent of the potential losses. There is no statutory requirement for lender retention.

2010 included an additional $125 million in appropriations to continue the enhancements through February 28, 2010.[13] Second, SBA officials and some market participants cited the improvement in credit markets generally over the past several months as contributing to the overall improvement in the markets for SBA-guaranteed loans. Finally, SBA officials and some market participants cited the TARP and TALF programs as helping to revive the markets for SBA-guaranteed loans. While Treasury has not yet purchased any SBA-guaranteed loans under TARP and TALF financing of such loans got off to a slow start, SBA and market participants said that the presence of these programs helped to boost investor confidence in SBA-guaranteed loans and thereby generated market activity for such loans.

While initial reports suggest that the ARC Loan Program began slowly, more recent SBA data indicate that the number of loans SBA is guaranteeing under this program is increasing. By September 30, 2009, SBA had approved a total of 2,904 ARC loans for a total value of $94 million, or 37 percent of the $255 million appropriated to administer the ARC Loan Program. According to SBA, the number of approved ARC loans had increased to nearly 5,200 by January 1, 2010, with a total value of $167 million, or 65 percent of appropriated funds. Some market participants said that while interest in the ARC Loan Program among many potential small business borrowers appears to be high, there is significant confusion about the program's eligibility requirements, which may have contributed to the slow start of the program. In particular, many small businesses facing severe financial problems have inquired about the program, even though they likely did not qualify.[14] Market participants we interviewed also cited other factors that may have contributed to the ARC Loan Program's relatively slow start. First, they said some lenders were uncertain about the definition of a viable business, as defined by SBA regulations, and how to determine immediate financial hardship. They also stated lenders were concerned that if SBA found that a lender had incorrectly approved an ARC loan for a small business, SBA would not honor the guarantee on such a loan. In August 2009, SBA released its new ARC Loan Program Procedural Guidance to provide lenders with updated information and clarification about the ARC Loan Program. For example, the guidance provided an expanded explanation of a viable business experiencing immediate financial hardship. It is not clear to what extent such guidance may have contributed to the ARC Loan Program's growth in recent months. Second, market participants said that many lenders may be reluctant to approve ARC loans because they are likely to be unprofitable. Due to the relatively small size of ARC loans—which cannot exceed $35,000 per business—the administrative costs of processing such loans and complying with SBA requirements, as well as potential audits, may be prohibitive in some cases.

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[13]Section 1006 of the Department of Defense Appropriations Act, 2010, Pub. L. No. 111-118 (Dec. 19, 2009).

[14]To be eligible for an ARC loan, the small business must be an established small business, have financial statements demonstrating it was profitable in one of the past 2 years, and be able to project sufficient cash flow to meet current and future loan payments over a 2-year period from loan approval.

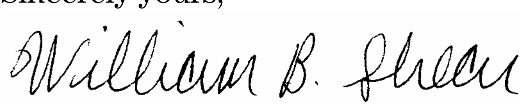
Agency Comments and Our Evaluation

We provided a draft of this letter and the attached briefing slides to SBA for review and comment. In written comments, which are reprinted in enclosure II, the Associate Administrator of SBA's Office of Capital Access said that the draft report presented a thoughtful review of the agency's progress in implementing ARRA's administrative provisions. The Associate Administrator cited steps SBA has taken to implement these provisions, including modifying old programs and creating new programs to help expand access to capital for small businesses while also managing risk. In addition, he stated that the fee reductions and increased guarantees for 7(a) and 504 loans, which were recently extended through February 2010, have been successful in enhancing small business lending. The Associate Administrator also provided statistics which he said show a significant improvement in SBA's secondary markets for 7(a) and 504 loans. Furthermore, he stated that as of January 1, 2010, SBA has approved 5,184 ARC loans totaling more than $167 million. He added that SBA is engaged in continuing discussions with staff, resource partners, lenders, and other stakeholders to identify opportunities for program enhancements.

We are sending copies of this report to interested members of Congress and the Administrator of the Small Business Administration. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report were Wes Phillips, Assistant Director; Michelle Bowsky; Ben Bolitzer; Tania Calhoun; Jennifer Schwartz; and Jarrod West.

Sincerely yours,



William B. Shear
Director, Financial Markets and
Community Investment

Enclosures – 2

Initial Results of SBA's Efforts to Implement Recovery Act Administrative Provisions

Briefing to the House Small Business Committee

November 02, 2009

Note: slides have been updated since the November briefing.

Objectives

Our objectives for this briefing are to discuss the extent to which

1. SBA has implemented the eight American Recovery and Reinvestment Act of 2009 (ARRA) administrative provisions, with a focus on those that required SBA to issue regulations using emergency rulemaking authority;

2. ARRA administrative provisions and other actions are enhancing liquidity in the markets for SBA 7(a) and 504 loans; and

3. SBA has implemented the America's Recovery Capital (ARC) Loan Program and program terms appeal to market participants.

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Background

- Due to recent turmoil in U.S. credit markets, many lenders have been reluctant to offer conventional loans to small businesses so that they can finance their operations and capital needs.

- SBA's 7(a) and 504 loan guarantee programs are intended to provide critical financing for small businesses that may have trouble finding conventional loan financing. The markets for these loans also faced constraints during the recent financial crisis.
  - According to SBA, the dollar volume of 7(a) loans sold as securities on the secondary market dropped from $425.4 million to $85.9 million, or 79.8 percent, from the end of the third quarter of 2008 to the end of the first quarter of 2009.

- As a result, under ARRA, Congress required SBA to implement a total of eight administrative provisions to help facilitate small business lending and enhance liquidity in the primary and secondary markets for loans that the agency guarantees. ARRA also required GAO to report within 60 days after enactment of ARRA on SBA's effort to comply with the provisions.

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Background (continued)

- On April 16, 2009,[1] we reported on the status of SBA's implementation efforts, focusing on four of the eight administrative provisions.
    - The report noted that SBA had implemented two key provisions to temporarily lower or eliminate fees and to increase guarantees on SBA 7(a) loans. These provisions are generally intended to facilitate the origination of such loans in the primary market.
    - SBA had not implemented two provisions to make loans to systemically significant broker-dealers of 7(a) loans and to extend the guarantee on 504 loans. These provisions are generally intended to facilitate activity in the secondary markets.
    - SBA also had not implemented a provision to establish the ARC Loan Program, a new program that would guarantee loans up to $35,000 for financially viable small businesses in economic distress.

[1] GAO-09-507R.

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Background (continued)

- In addition to SBA's requirements under ARRA, the Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Federal Reserve) also initiated programs to increase access to credit for consumers and small businesses.
    - Treasury announced that under the Troubled Asset Relief Program (TARP), it would directly purchase up to $15 billion in securities backed by SBA-guaranteed 7(a) and 504 loans.
    - Also under TARP, the Federal Reserve created the Term Asset-Backed Securities Loan Facility (TALF) to provide up to $200 billion in low-cost financing for investors to purchase a variety of consumer, commercial, and small business securitizations (which include SBA-guaranteed 7(a) and 504 loans), thereby opening the credit markets to consumers and small businesses.[2]

[2] TALF was launched by the Federal Reserve and Treasury under the Consumer and Business Lending Initiative. Treasury provides $20 billion in support to TALF.

Scope and Methodology

To address our objectives, we took the following actions:

- We reviewed SBA's development of regulations, policies, and procedures for implementing the ARRA administrative provisions, and we interviewed SBA officials to obtain data and determine the status of efforts underway, timeframes, program accomplishments and planned activities.

- We interviewed SBA officials regarding steps taken to increase liquidity in the primary and secondary markets and reviewed relevant documents. We interviewed market participants, such as primary SBA lenders and broker-dealers, on their views regarding SBA's implementation efforts and the effects of the provisions on the primary and secondary markets.

- We interviewed SBA officials and obtained data on the agency's efforts to develop and implement the ARC Loan Program. We interviewed market participants on their views regarding the program, including views on the attractiveness of program terms and requirements.

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SBA Recently Implemented Secondary Market Provisions

- SBA has recently completed implementation of the eight ARRA administrative provisions (see slides 8 -10).
- On October 30, 2009, SBA implemented Section 503 to create a Secondary Market Guarantee Program for 504 1st Mortgage Loan Pools.
  - Under the new program, portions of eligible 504 1st mortgage loan pools can be sold with an SBA guarantee to investors. Lenders will retain at least 15 percent of each loan, broker dealers will retain 5 percent of the risk, and SBA will guarantee 80 percent. The program will be in place until February 16, 2011, or until $3 billion in new pools are created.
- On November 19, 2009, SBA implemented Section 509 to establish a secondary market lending authority for systemically important broker dealers of 7(a) loans.
  - Under the new program, SBA established a revolving line of credit to systemically important broker-dealers at a variable interest rate not to exceed the Federal Funds target rate plus 25 basis points.
- Also, subsequent to our April report, on June 15, 2009, SBA implemented Section 506 to establish the ARC Loan Program.

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Status of ARRA Provisions

Provision number and title	*Primary requirements and sunset provisions*	*SBA's actions and related developments*
501 Fee Reductions	Permits temporary reduction or elimination of fees for 7(a) and 504 loans until September 30, 2010, or until funds appropriated are expended ($375 million for both Sections 501 and 502).	Operational on March 16, 2009. Published notice and request for comments on June 8, 2009. Completed risk mitigation plan in July 2009. Published revised project plan on July 29, 2009. Sections 501 and 502 funds appropriated expended on November 23, 2009. Department of Defense fiscal year 2010 appropriations act included $125 million to fund sections 501 and 502 through February 28, 2010.
502 Economic Stimulus Lending Program	Permits SBA to guarantee up to 90 percent of qualifying 7(a) loans made by SBA lenders. Only applies to loans approved within 12 months of enactment or until funds appropriated are expended.	Operational on March 16, 2009. Issued a notice and request for comments on June 8, 2009. Completed risk mitigation plan in July 2009. Published revised project plan on July 29, 2009. Funds appropriated expended on November 23, 2009. Defense appropriations act included $125 million to fund sections 501 and 502 through February 28, 2010.
503 Establishment of SBA Secondary Market Guarantee Authority	Allows SBA to establish a secondary market guarantee for pools of first-lien 504 loans to sell to third-party investors. The authority terminates 2 years after enactment. Under emergency rulemaking authority, SBA must issue regulations within 15 days of enactment (March 4, 2009).	Missed March 4, 2009, statutory deadline and SBA's revised August 31, 2009, deadline. Completed risk mitigation plan in July 2009. Published revised project plan on October 6, 2009. Published interim final rule and request for comments on October 30, 2009.

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Status of ARRA Provisions (Continued)

Provision number and title	***Primary requirements and sunset provisions***	***SBA's actions and related developments***
504 Stimulus for Community Development Lending	Authorizes SBA to refinance a limited amount of certain existing loans as new 504 loans. Eligibility criterion for 504 loans has changed from creating one job for every $50,000 guaranteed to one job for every $65,000 guaranteed.	Published notice on April 10, 2009, explaining the new job creation eligibility criterion. Published interim final rule implementing Section 504 on June 23, 2009. Risk assessment and risk mitigation plan completed.
505 Increasing Small Business Investment	Increases the maximum amount of outstanding leverage available to a small business investment company (SBIC) to the lesser of 300 percent of the SBIC's private capital or $150 million. Leverage allowed for two or more SBICs operated under common control and that are financially sound cannot exceed $225 million.	Completed risk mitigation plan in July 2009. Published interim final rule and request for comments on July 14, 2009. Published revised project plan on July 28, 2009. In process of reviewing comments received.
506 Business Stabilization Program (ARC)	Creates a new program that allows SBA to guarantee loans of $35,000 or less to small businesses with existing qualifying loans that are suffering immediate financial hardship. Under emergency rulemaking authority, SBA must issue regulations within 15 days of enactment (March 4, 2009).	Missed March 4, 2009, statutory deadline. Published interim final rule and request for comments on June 9, 2009. Operational on June 15, 2009. Posted notice establishing the initial interest rate for ARC Loans at prime plus two percentage points on June 10, 2009. Completed risk mitigation plan in July 2009.

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Status of ARRA Provisions (Continued)

Provision number and title	***Primary requirements and sunset provisions***	***SBA's actions and related developments***
508 Surety Bonds	Increases the maximum contract amount for SBA bond guarantee from $2 million to $5 million (and under certain circumstances up to $10 million). Requires SBA to study and report on the program's current funding structure.	Issued notice on March 27, 2009, to increase maximum contract amount for SBA bond guarantee to $5 million. Published interim final rule and request for comments on July 22, 2009. Published revised project plan July 29, 2009. Completed risk mitigation plan July 2009. SBA submitted report to Congress studying the program's current funding structure on August 17, 2009.
509 Establishment of SBA Secondary Market Lending Authority	Authorizes SBA to make loans to systemically important broker-dealers that operate in the SBA 7(a) secondary market. Under emergency rulemaking authority, SBA must issue regulations within 30 days after enactment (March 19, 2009).	Missed March 19, 2009, statutory deadline and SBA's revised September 30, 2009, deadline. Published revised project plan on October 6, 2009. Published interim final rule on November 19, 2009.

Source: GAO

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Factors That Affect SBA's Efforts to Implement Secondary Market Provisions

- SBA's implementation of Section 503 and Section 509 were delayed 7 and 8 months, respectively. In our April 2009 report we identified several factors that contributed to SBA's delay in implementing ARRA secondary market provisions.

- Our recent work also identified several of these key factors, such as

    - challenges related to the creation of new and complex programs, including new systems and processes, regulations, policies, and procedures;

    - SBA's reduced staffing levels and loss of expertise through retirements and turnover in key positions; and

    - challenges associated with resolving key policy issues and addressing statutory language that, while designed to protect taxpayer interests, could also limit acceptance of market participants (e.g., SBA determining the extent to which broker-dealers and perhaps small business lenders would be required to share in the potential losses associated with extending the guarantee in the 504 program).

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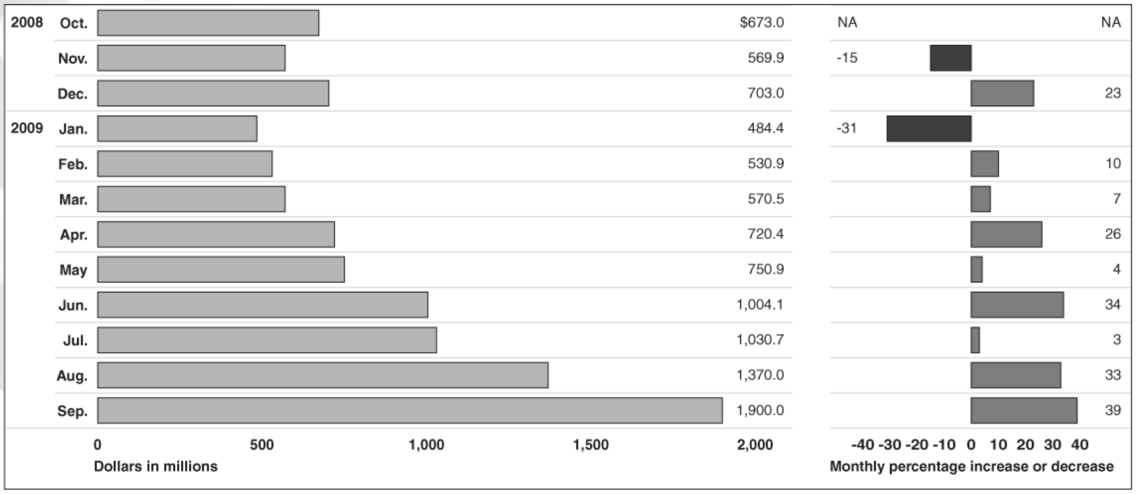
SBA-Guaranteed Loan Markets Appear To Have Largely Recovered

- The primary markets for 7(a) and 504 loans appear to have recovered.
  - As shown on slide 13, 7(a) loan volumes doubled between the 4th quarter of 2008 and 3rd quarter of 2009 from an average of about $650 million per month to an average of about $1.4 billion per month, which is higher than 2nd and 3rd quarter 2008 average monthly volumes of $1.1 billion and $1 billion, respectively.
  - Also, according to SBA data, 504 loan volumes more than doubled since the enactment of ARRA, from an average of about $205 million per month in the 1st quarter of 2009 to an average of about $474 million per month in the 3rd quarter of 2009.

SBA 7(a) Loan Volume in Primary Market



Source: SBA data.

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SBA-Guaranteed Loan Markets Appear To Have Largely Recovered (continued)

- As shown on slide 15, 7(a) secondary market sales more than tripled between the 4th quarter of 2008 and 3rd quarter of 2009, from a monthly average of about $108.8 million to a monthly average of about $336.9 million.

- Some market participants also indicated that the secondary market for 7(a) loans is showing signs of improvement, including low inventory levels and higher premiums paid for securities backed by pools of 7(a) loans. However, the participants stated that SBA loan markets are not back to levels that existed two years ago.

- SBA data and the views of some market participants suggest that secondary 504 debentures also appear to be doing well--providing historically low interest rate to borrowers. However, the secondary market for the unguaranteed portion of 504 loans remains limited.

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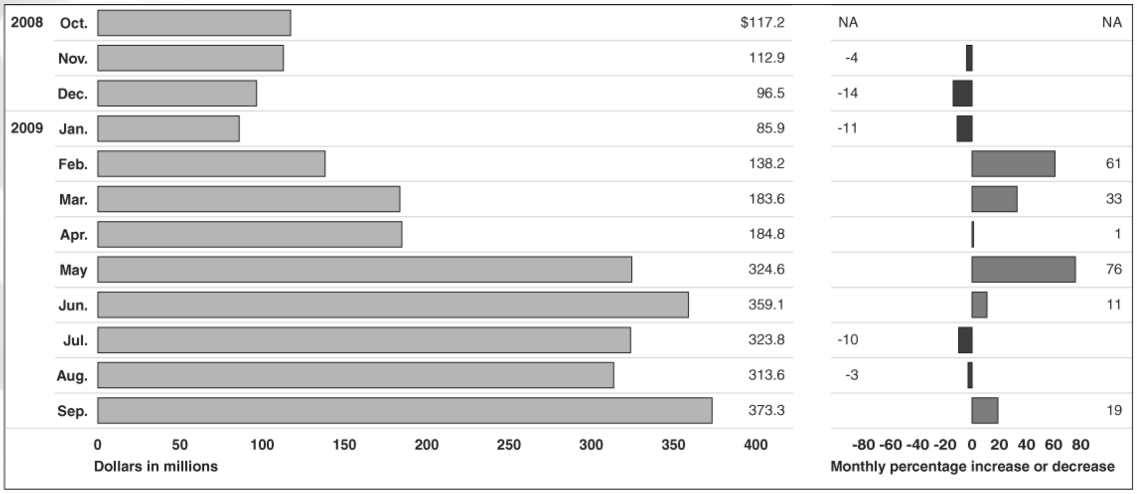
SBA 7(a) Loan Volume in Secondary Market



Source: SBA data.

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Condition of Secondary Market for SBA Loans

- While SBA implemented one ARRA secondary market provision in late October and the other secondary market provision in mid-November, SBA and some market participants cite other key reasons for improvement in the markets in recent months.
    - SBA and some market participants cite ARRA provisions that reduced or eliminated fees (Section 501) and extended guarantees (Section 502) as being critical to generating primary market activity. While the $375 million that was appropriated under ARRA for the fee reductions and guarantee extensions were exhausted by late November 2009, the 2010 U.S. Defense Department appropriation act included an additional $125 million in appropriations to continue the enhancements through February 28, 2010.[3]
    - Some market participants indicated that credit market conditions have generally improved, which has also led to an improvement in SBA loan markets.
    - As of September 2009, Treasury had not utilized any of the $15 billion available under TARP to purchase securities backed by SBA-guaranteed 7(a) and 504 loans. Also, TALF got off to a slow start and the Federal Reserve only recently began providing TALF small business loans (see slide 17). However, SBA officials and some market participants believe just the presence of TARP and TALF have increased investor confidence and helped to spur activity in the markets for SBA loans.

[3] Section 1006 of the Department of Defense Appropriations Act, 2010, Pub. L. No. 111-118 (Dec. 19, 2009).

Status of TALF Small Business Loans

Dollars in millions	March	April	May	June	July	August	September	October	Total
Small Business Loans[4]	$0	$0	$86	$81	$102	$149	$162	$342	$922
Total all TALF Loans[5]	4,707	1,708	10,600	11,453	6,081	9,160	7,943	4,597	56,249

[4]Small business loans include SBA-guaranteed 7(a) and 504 loans, debentures or pools originated on or after January 1, 2008.

[5]Includes auto, credit card, student loan, small business, equipment, insurance premium finance, floorplan, servicing advances, and commercial mortgage-backed securities.

Source: Federal Reserve Bank of New York.

Status of SBA's ARC Loan Program

- Early reports show that the ARC Loan Program started slowly, but ARC loan approval numbers are slowly increasing.

- As shown on slide 19, by September 30, 2009, SBA had approved a total of 2,904 ARC loans with a total value of $94 million, or 37 percent of the $255 million appropriated to administer the program.

- Market participants we contacted noted that while interest in the ARC Loan Program is relatively high, some confusion also exists among potential borrowers regarding eligibility requirements (i.e., the program is not for every small business enduring a hardship, only those that can meet certain criteria, such as demonstrating profitability in one of the last two years).
  - In August 2009, SBA released its new ARC Loan Program Procedural Guidance to provide lenders with updated information and clarification about the ARC Loan Program. It is not clear to what extent such guidance may have contributed to the ARC Loan Program's growth in recent months.

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Status of SBA's ARC Loan Program

Volume by month	Dollar Amount Approved	Number of Loans Approved
June (June 15-30)	$ 6,243,600.00	187
July	$ 25,838,300.00	799
August	$ 28,007,500.00	866
September	$ 34,080,900.00	1,052
Total	$ **94,170,300.00**	**2,904**

Source: SBA data.

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Status of SBA's ARC Loan Program (continued)

- Market participants we spoke with noted two main issues that may have contributed to the slow start of the ARC Loan Program:
    - Some lenders expressed concern over the definition of a viable business and how to determine immediate financial hardship, and believe if they make loans to businesses that are not viable and such borrowers default, SBA will not honor its guarantee.
    - Some lenders also indicated that ARC loans are unprofitable, the loan amount is too small to help many businesses, and the paperwork and process are burdensome. As a result, lenders are offering very few ARC loans, and likely only approving the loans for existing customers.

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

January 6, 2010

Mr. William Shear
Director
U.S. Government Accountability
Office Financial Markets and Community Investment
441 G Street, NW
Washington, DC 20548

Dear Mr. Shear,

Thank you for the opportunity to comment on your recent report, "Status of the Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009" (GAO 10-298R). We appreciate your thoughtful review of the progress we have made in the implementation of Recovery Act programs.

The Agency has indeed worked diligently to implement its small business recovery initiatives. As noted in your report, SBA has successfully implemented the administrative provisions included in the Recovery Act. We modified old programs, and created new programs, to help expand access to capital for small businesses while also appropriately managing risk for the Agency.

The fee reductions and higher guarantee programs included in the Recovery Act have been very successful, and on December 19, these initiatives were extended through additional funding provided in the Department of Defense Appropriations Act, 2010. As of January 1, 2010, the SBA has supported $18.2 billion in Recovery Act lending to small businesses.

The secondary market for the 7(a) program is now operating with both volume and pricing restored to historic levels. Over the past seven months, the average monthly loan volume settled from lenders to broker-dealers in the 7(a) secondary market has been $357 million, which is above pre-credit crisis averages. In December 2009, $475 million settled in this market, which is the highest amount settled since December 2007. Premiums have also recovered in the 7(a) secondary market, and for the past five months have been at or above 2007 levels.

In addition, the market for 504 debentures is now settling with historically low interest rates for borrowers. SBA and industry participants believe these low rates are at least

Federal Recycling Program Printed on Recycled Paper partially due to the positive effects of the TALF program, as well as the Treasury Department's $15 billion commitment as a standby source of liquidity. As mentioned in your report, SBA has published regulations to establish a new secondary market program for guaranteed pools of 504 first mortgage liens, and to provide back-up financing to systemically important broker-dealers in the secondary market.

At the same time, through January 1, SBA has approved 5,184 ARC loans totaling over $167 million to help viable, struggling businesses across the country. SBA's field network continues to train lenders and counsel borrowers regarding how to best utilize this new program, and the Agency is engaged in continuing discussions with staff, resource partners, lenders and other stakeholders to identify opportunities for program enhancements.

Thank you for the opportunity to comment on this report and briefing materials. We look forward to continuing to work with you further.

Sincerely,

Eric Zarnikow
Associate Administrator
Office of Capital Access

(250473)