TESTIMONY OF

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United States Senate

Small Business and Entrepreneurship Committee

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Chairman Kerry, Ranking Member Snowe, distinguished members of the Committee, thank you for inviting me here today to discuss the President's Fiscal Year (FY) 2008 budget requests for the US Small Business Administration (SBA).

President Bush has been an unwavering supporter of America's small businesses, and his leadership has ensured that they have played a vital role in our economic growth – adding more than 7.2 million new jobs since August 2003 and helping to reduce the unemployment rate to 4.5 percent, the lowest average rates of the past four decades. By reducing the tax rates small business owners pay and increasing expensing tax provisions on investments, small businesses have more capital available to hire new workers and expand their businesses.

The President is also committed to helping small business owners provide health insurance to their employees by supporting association health plans, allowing small businesses to get the same discounts on health insurance as big businesses. Further, the Administration is working tirelessly to ensure that small businesses are able to grow, and expand opportunities for their workers, by providing regulatory relief and opening markets abroad to ensure that America's trading partners play by the rules and make it possible for our small businesses to export their products.

SBA's FY 2008 budget request reflects the President's commitment to America's small businesses and the vital role they play in our economy. Enactment of this request will enable SBA to continue serving the small business community while ensuring stewardship of taxpayer dollars. SBA FY 2008 resources will total an estimated $814 million in 2008. This amount includes $464 million in new Budget Authority, $329 million in spending from carry-over balances for the Disaster Loan program, and $21 million in reimbursable services.

This budget request reflects both the vision of the Agency's new leadership team and the progress the Agency has made over the past five years in delivering its programs more efficiently. Since 2001, SBA has achieved major growth in nearly all of its programs while simultaneously streamlining processes and developing more cost-effective budget strategies. The new management team will continue to pursue this expansion in services to the small business community while aggressively pursuing a Reform Agenda to ensure the Agency's programs are customer-focused, outcome-driven and fiscally responsible and sound. In addition, further enabling our employees to fulfill SBA's mission is an essential element in achieving our objectives in this budget.

Reform Agenda

I am pleased to be heading the new SBA management team that includes Deputy Administrator Jovita Carranza, who was just confirmed in December. SBA's agenda is grounded in the belief that the Agency can improve the effectiveness and impact of its programs and activities markedly, by employing important management principles. These principles will seek to ensure that the Agency is driven by clear outcomes, is focused on serving its customers effectively, enables its employees, and operates a compliant and accountable organization.

The Agency also has a renewed focus on ensuring that its products and services are accessible to entrepreneurs in the nation's most underserved markets – those with higher rates of unemployment and poverty and lower rates of economic progress. This budget request highlights SBA's progress to date and describes the Agency's plans for achieving the vision of the new management team in FY 2008.

In 2001, SBA began a drive to deliver more value to the Nation's small businesses while lowering costs to the taxpayer. By restructuring key Agency operations and reengineering its largest loan programs, SBA has achieved record program growth of 56 percent in the loan portfolio, while reducing its total budget by 31 percent since 2001 through increased operational efficiencies and core program improvements.

Through its ongoing restructuring and business process reengineering, SBA has improved and will continue to improve the effectiveness of the taxpayers' dollars supporting small business development. Because of these improvements, SBA will be able to serve record numbers of small businesses in FY 2008 with this budget request.

The principles of SBA's Reform Agenda have already resulted in a dramatic improvement in the Agency's Disaster Loan program. The 2005 Gulf Coast hurricanes resulted in SBA's largest disaster response in its 53-year history. More than 420,000 loan applications from Hurricanes Katrina, Rita, and Wilma (three times the level for the second largest disaster, the Northridge earthquake of 1994) left the Agency struggling to meet its loan processing standards and frustrated many.

Almost immediately after being sworn in as SBA Administrator in July, I spearheaded a fundamental reengineering of the disaster loan processing operation that has dramatically shortened response times, improved quality, and increased borrower support. Backlogs were virtually eliminated and feedback on the new approach has been overwhelmingly positive. We, however, are not finished with the long-term redesign of the disaster process, and are working aggressively to do so in the coming months.

SBA is bringing the same principles to administering its business guaranty programs as well. Reengineering of the loan servicing process is underway and will result in better customer service and less operational redundancy. Building upon its success in consolidating 7(a) loan liquidation functions from almost 70 district offices to a single location, SBA is also finalizing plans to consolidate 7(a) loan processing, 504 loan liquidation, and Disaster loan liquidation. These changes ensure that loans are managed more consistently and efficiently. In the case of 7(a) loan liquidation, considerable budgetary savings were also realized.

Modernizing agency operations is challenging, but it is essential. The Nation's taxpayers expect SBA to operate using the techniques and practices of sound fiscal and operational management. Through its proactive efforts to improve productivity and performance, while reducing cost, the SBA has demonstrated its commitment to deliver ever better products while improving efficiencies.

With a guaranteed and direct loan portfolio of over $78 billion, SBA has a critical role as a steward of taxpayer dollars. While the portfolio has grown at a record pace in recent years, during that time, SBA is implementing a rigorous, state-of-the art risk management program. By using industry data and technology, the Agency is replacing the old, primarily manual processes for reviewing lender performance with automated, quantitative risk-based methods to identify problems more effectively. This approach is improving oversight during a period of strong growth in the loan portfolio.

Highlights of the Budget Request

SBA's budget request represents an increase of 5 percent for FY 2008 above our enacted level in FY 2006 (excluding the Disaster program and earmarks). The overall request is for $814 million in proposed Budget Authority. This includes $464 million in new Budget Authority and $329 million funded out of carryover balances from the $1.7 billion in supplemental funding received in FY 2006 for the Disaster Program.

These resources will support a total of $28 billion in lending authority for small business financing, which represents a 40 percent increase over business lending for FY 2006, through the 7(a), 504, and SBIC debentures programs. For its flagship 7(a) program, SBA requests $17.5 billion – a 27 percent increase over the FY 2006 lending level. SBA also requests $7.5 billion for the 504 program, a 32 percent increase over loans made in FY 2006 – a record year for 504 lending. Finally, SBA requests an SBIC Debenture program of $3 billion.

In addition, this budget will support the following:

- A disaster loan volume of $1.064 billion (the Agency's ten-year average based upon FY 1996 – 2005 average activity, excluding the WTC disaster, adjusted for inflation).
- Counseling and training to small business people through SBA's network of resources partners in Small Business Development Centers (SBDC), Service Corps of Retired Executives (SCORE), and Women's Business Centers.
- Assist federal agencies targeting a total of $84 billion in prime federal contracting dollars to be awarded to small businesses in FY 2008.
- Investing in the Agency's human capital through job skills training, mentoring programs, succession planning, proactive recruitment of highly qualified staff, and implementation of an automated personnel records system.

- Maintaining employee security through continued implementation of Presidential Homeland Security Directive #12 and support of major security improvements in the headquarters building.
- Continuing the process of implementing a loan operations system to replace the current outdated system.
- Enhancing SBIC oversight and recoveries.
- Providing a cost effective microloan program.
- Continuing efforts make it easier and faster for small businesses to comply with government regulations.
- Improving SBA products, services and delivery.

SBA's budget request will support 2,123 FTE through the Salaries and Expenses budget. This staffing level is an increase over both the FY 2006 level and the FY 2007 request. SBA has been able to reduce its budgetary requirements and staffing levels over recent years, but these increases are necessary to support critical oversight and portfolio management functions. Nevertheless, SBA has managed significant administrative savings while increasing financing, counseling, and government contracting opportunities for small businesses. SBA has been streamlining its operations and eliminating costly and inefficient programs, including the following examples:

- The Agency centralized its financial processing operations. As a result, 7(a) loan liquidations cost approximately $18 million less in FY 2006 than FY 2003.
- The Agency created an alternative to the LowDoc program for 7(a). LowDoc was more than 20 times more expensive than SBAExpress ($4,771 per loan approved for LowDoc vs. $227 for SBAExpress). Lenders still have access to the higher 85 percent guarantee for smaller loans formerly available through LowDoc but benefit from the improved process under other 7(a) products, such as Community Express.
- SBA continues to seek opportunities to reduce rented space. The initiatives we have implemented from FY 2004 – 2006 resulted in $3.8 million in annual rent savings.

Disaster

In the summer of 2006, we initiated the Accelerated Disaster Response Initiative to identify and implement process improvements to help the Agency respond more rapidly in assisting small businesses and homeowners seeking financial assistance after a disaster. As a result, the Agency fundamentally reengineered its disaster loan processing operation to shorten response times, improve quality, and provide greater borrower support. Based on customer feedback, the Agency rolled out an "integrated team" model. Each team comprises 15-18 employees with legal, financial, and other required competencies to ensure timely, coordinated loan processing. Customers are assigned to a case manager on the integrated team so they have a single point of contact that is responsible for guiding them through the loan process and ensuring that SBA is responsive to their timing and other requirements.

Under the new model, case managers now proactively contact applicants to determine what impediments exist to closing loans and making disbursements. For example, SBA will assist borrowers in identifying local companies that provide title and recording services necessary for loan disbursements.

In order to complement SBA's reengineered process, the Agency has implemented numerous metrics to track application status and performance of employees. All applications are categorized by processing status and type of outstanding issue. This provides management with necessary information to identify problem areas and implement corrective actions. Further, productivity is monitored to identify areas that require management intervention. These strategies are the foundation for improved responsiveness to borrower needs. For example, the time needed for loan modifications that averaged more than 2 months in July, now averages 8 days, and continues to decline. In addition, the backlog of loans for modification has declined over 90 percent since July.

Additional organizational planning measures to improve SBA's disaster response include development of models to rapidly forecast loan volume and resource requirements (financial, human capital, and logistics) to better position the Agency to respond to large scale disasters when they strike. Moreover, SBA is nearing completion of a protocol to leverage its field network to improve local coordination and communication with citizens and other local authorities.

By 2008, SBA expects to implement an internet-based electronic loan application process to ensure that borrowers' required information is provided to assess loan eligibility. This complements SBA's investment in the disaster computer system that has been tested to support a four-fold increase in concurrent user capacity to 8,000 users. The agency is also evaluating options to access the private sector's skills and resources when dealing with catastrophic disaster events.

Compliant and Accountable Organization

With a guaranteed and direct loan portfolio of over $78 billion, SBA has a critical role as a steward of the taxpayers' dollars. While the portfolio has grown at a record pace in recent years, during that time, SBA is significantly advancing its risk management program. By using industry data and new technology, we have replaced the old, primarily manual processes for reviewing lender and loan performance with automated, quantitative risk-based methods. This approach enables SBA to prudently manage its growing loan and guaranty portfolio using more sophisticated models.

Listed below are the actions SBA has initiated and planned along with specific funding requests regarding its loan and investment portfolio:

- Investment in technology for the loan operations system upgrade of $4.1 million in S&E (to be complemented by about $4.2 million in disaster funding) for project management support, and to acquire and begin implementation of a system to replace our current loan information system for both regular loan programs and disaster loan servicing. Currently, the Agency's business loan operation runs on a Cobol-based system which limits technological advancement opportunities and security. The older system is also significantly more costly to maintain. SBA is making good progress on this major Agency-wide undertaking, which began in FY 2006, and is on track to be completed by 2012. Requested funds for FY 2008 will enable SBA to finalize the business vision, develop the project management plan, and final technical and functional requirements.

- Expanded SBIC Oversight with $1.5 million in S&E to continue the valuation contract, develop a liquidation plan, and implement an examination contract. This investment will help maximize recoveries on the $1.5 billion in the Office of Liquidation, and minimize losses on the $10.4 billion in outstanding leverage and commitments in the Office of Operations.

- Loan and Lender Monitoring System and Lender Reviews – SBA's Office of Lender Oversight (OLO) has a state of the art loan and lender monitoring system that incorporates credit history metrics for portfolio management. The credit information, combined with SBA lenders' current and historical performance, allows the Agency to assign risk ratings to lenders. Such ratings provide both an assessment and a monitoring tool for the most active SBA lenders, and are the primary basis by which lower volume lenders are evaluated. These lenders are under direct oversight of OLO rather than the program office. In addition, OLO is responsible for conducting on site lender reviews and examinations. Through FY 2006, the Agency has not had resources to conduct as many reviews as demanded. However, because the Agency recently received authority for reimbursement for the cost of these reviews, SBA plans to conduct additional reviews in FY 2008.

- Portfolio Analysis Committee – Senior Capital Access and CFO Managers meet monthly to review and assess portfolio trends and identify opportunities for program improvements. This committee is an important component of SBA's risk management program. The committee assesses the risk of the 7(a) and 504 loan program and performance trends. Based on analysis and management direction resulting from these meetings, program changes, operational initiatives, and other actions are generated. For example, in addition to providing support for the elimination of the LowDoc program, the committee's review efforts resulted in the initiative to reduce the backlog in liquidations and charge-offs in our 7(a) portfolio.

- Lender Oversight Committee – Senior managers meet bi-monthly to review lender trends and review corrective actions for poor performing lenders. As mentioned, Lender Oversight has introduced risk ratings to monitor and evaluate SBA lenders. The committee also provided results and performance metrics on lender oversight activities such as examination reports, corrective action plans for lenders under OLO's direct oversight. SBA has placed several lenders under corrective action plans and continues close monitoring to improve performance.

- Lender Portal – Lenders now have access to their risk ratings and performance metrics through our lender portal, making it transparent to lenders what they are rated on and how they compare with their peers. It allows lenders to address data quality issues to improve their risk ratings, which the Agency believes will ultimately result in significant improvements in data quality. The information is also available to SBA's district offices to help identify training opportunities for lenders.

- SBIC Liquidations – SBA currently oversees approximately $1.5 billion in SBIC leverage in its Office of Liquidation and $10.4 billion in leverage and commitments in its Office of Operations. Collecting on the large amount of leverage outstanding in the Office of Liquidation continues to be of great concern. The staff has developed a comprehensive strategy for liquidating this portfolio of investments. As part of this

strategy, several pilot initiatives for liquidating SBIC assets are being pursued to ascertain the most cost efficient means of disposing of this significant portfolio. With $2.4 billion in estimated losses in the Participating Securities (PS) program, oversight on the $10.6 billion in outstanding leverage and commitments for those SBICs (of which almost $7.8 billion pertains to the PS program) remains of high importance.

In addition, SBA is taking the lead, along with the Office of Management and Budget's Office of Federal Procurement Policy, to work with the contracting agencies to ensure accuracy and transparency of the data in the Federal Procurement Data System-Next Generation (FPDS-NG). The agencies are in the process of validating their FY 2005 data to identify the reasons for coding discrepancies and to correct any errors that occurred.

Also in the federal procurement data arena, in FY 2007 we expect that all agencies' subcontracting information will be available in the Electronic Subcontracting Reporting System.

Customer-Oriented

The following are highlights of SBA's plans to focus its products and services on underserved markets:

- Expansion of the Community Express pilot. This pilot was designed to reach underserved markets and combines both capital and technical assistance to increase the viability of the businesses it serves. The Agency is working to broaden lender participation in the product and will seek involvement from its counseling and training partners: SBDCs, SCORE, and Women's Business Centers.

- Expansion of the Urban Entrepreneur Partnership. The Urban Entrepreneurial Partnership (UEP) initiative is a community-based referral program located in an urban setting. The Agency is working to expand the initiative to additional cities that will create a local network of small business resource providers serving urban and inner-city communities (*UEPNetwork*), as initially outlined by the President in a presentation to the National Urban League in 2004.

- Expansion of Alternative Work Sites. One way the Agency has made itself more accessible to small business is to locate certain district office staff away from single urban centers to locations closer to our customers. Currently, there are 22 such alternative work sites in operation. Another 2 are planned by the end of FY 2007. SBA is seeking $100,000 to set up 7 additional sites in FY 2008.
- Business Process Reengineering for the Office of Government Contracting and Business Development (GCBD). SBA's request includes $500,000 to examine how to best serve the 8(a), HUBZone, and Small Disadvantaged Business communities as well as women and veterans. We recognize the Agency can improve the management of these programs, particularly the 8(a) program, and will use these resources to determine how to best serve them – whether through staff realignment and training, or technology improvements.
- New Markets Tax Credit Pilot. In October, the Agency launched the New Markets Tax Credit Pilot Loan Program to provide financial assistance to small businesses in

economically distressed urban and rural areas, or "New Markets." The pilot program allows certain Community Development Entities to purchase up to 90 percent of the gross loan amount of SBAExpress or Community Express 7(a) loans up to $150,000 made to NMTC "qualified" businesses in low-income communities. These new loans are guaranteed by the SBA. By leveraging the SBA's resources with the Treasury's NMTC program, the pilot will provide additional access to loans and technical assistance to both start-up and existing small businesses in New Markets. Under the program, Community Express lenders will assist CDEs to provide small business borrowers with a package of services including mentoring, coaching and counseling.

- Zero Subsidy Microloan Program. Small business loans under $35,000 provide a critical level of capital to certain sectors in our economy, many of which are in underserved communities. Our regular 7(a) program reaches many members of this community. In FY 2006, 42,730 loans, representing 44 percent of all 7(a) loans, were made at the microloan funding level ($35,000 or less). However, additional businesses in target markets can be reached through non-bank micro lenders.

  The Microloan program as currently structured is costly to the taxpayer. In FY 2006 it cost 85 cents to the government for each dollar loaned to a Microloan intermediary. Therefore, the Agency is proposing a zero subsidy microloan program. By raising the very preferential rate at which intermediaries borrow from 3.77 percent (below the government's cost of funds) in FY 2008 to 5.99 percent (SBA's all-in cost), the Agency can eliminate the subsidy cost of this program and greatly expand funding for microloan intermediaries. Intermediaries will continue to receive a better than market rate of interest on loans and SBA will be able to offer loans to any intermediary eligible.

  Furthermore, SBA is proposing that rather than asking for Microloan Technical Assistance funding, SBA should leverage the skills of technical assistance resource partners, including the Small Business Development Centers and Women's Business Centers located throughout the country, to train and counsel micro borrowers. This has the potential of tripling the number of outlets providing training to micro-entrepreneurs for micro enterprise training and will save almost $13 million in FY 2008.

- Expanding the Veterans' Outreach Program. Expanding the Veterans' Outreach Program. The SBA requests an additional $500,000 for the Office of Veterans' Business Development (OVBD) in FY 2008. With the Nation's current engagement in Iraq and its presence in Afghanistan, the number of veterans returning from active duty will continue to increase. SBA's Office of Veterans Business Development (OVBD) plans to increase its efforts to educate and provide programs and services to veterans and active duty personnel in three major areas: access to capital, management and technical assistance, and procurement assistance programs through SBA, other government agencies, and the private sector. The Agency will accomplish this through existing loan programs, the disabled-veteran-owned business government contracting program, a redesigned website populated with a broad range of programs and services available to veterans, the development of training and mentoring programs for veterans by veterans, and funding District Offices to grow veteran-owned business capacity.

Other customer-focused plans include:

- Helping businesses with compliance through the 24/7 anywhere accessible Business Gateway. SBA requests $4.8 million in reimbursable budget authority for the E-Gov initiative for which SBA is the managing partner and $425,000 in S&E for the project management office (SBA's contribution as managing partner). Business Gateway will provide the Nation's businesses with a single, internet-based access point to government services. It will simplify and improve businesses' ability to locate and submit government forms and reduce the time and effort needed to comply with government regulations. Each year, Business Gateway will increase the time saved by business accessing information and forms by 50,000 hours over FY 2006.

- Increase access to Federal procurement opportunities by adding 9 new Procurement Center Representatives in 2007 and 2008. With total Federal contract dollars projected to increase by 56 percent over FY 2001, the small business share is expected to increase to a total of $85 billion. SBA's responsibility is to ensure small business retains access to these opportunities.

  SBA will also continue the development of the Electronic Procurement Center Representative System. During FY 2006, SBA began working on an Electronic Procurement Center Representative (EPCR) System to allow PCRs more timely information about contracting opportunities for small business. It also worked with the Department of Defense to integrate EPCR functional requirements with the DOD's capture of additional pre-solicitation information, and explored possible expansion of existing shared systems in the Integrated Acquisition Environment (IAE). The Agency will prepare a business case and will pursue systems design and development in FY 2008.

  SBA has put into production automated systems for 8(a), Small Disadvantaged Businesses, and HUBZone applications, and will soon finalize the electronic review and certification processes.

- Already implemented the eTran system, which provides a web-based portal for loans guaranteed through the flagship 7(a) loan program. Seventy percent of our 7(a) loans come in through this portal. Expanding the functionality of eTran will further automate lender interactions. In addition, SBA is working with lenders to identify and address other cumbersome processes, which can deter lenders from marketing certain of SBA's products. The Agency is currently implementing a web-based system to be used by both surety bonding companies and the small businesses seeking bonding.

- Enhanced its Entrepreneurial Development Management Information System (EDMIS), used by its technical assistance partners, to simplify the system's use and capture better information.

Employee Enabled

The following are actions to keep our employees safe and able to fulfill the Agency's mission:

- Professional guard services- $1.1 million in S&E to support professional guard services, operation of a magnetometer for the building, and training for the guards, in order for the Agency to increase security to the level recommended by the Federal Protective Service.

- Implementation of government-wide biometric security cards- $600,000 in S&E (complemented by about $600,000 in Disaster funding) for the full implementation of Presidential Homeland Security Directive #12.

- Centralized training efforts- $550,000 (similar level to FY 2006) for a skills gap assessment for mission critical occupations; an electronic learning tool; learning management systems; management and leadership development training; a mentoring program; succession planning; and a program to help staff balance the demands of their professional and personal lives.

- Training for Risk-Related Activities - $140,000 to keep procurement and business development staff current on complex changes; $235,000 for training of Regional and District administrative officers authorized to commit funds on behalf of SBA; and $90,000 for training of staff involved in acquisition activities, which are inherently high-risk, Agency-wide.

- Proactive recruitment - $123,000 to attract the necessary skilled personnel it needs immediately and for succession planning. By 2009, 34 percent of SBA's workforce will be eligible to retire.

- District Office program oversight staff – $100,000 to ensure continued monitoring and oversight of SBDC grant and policy issues, adherence to procedures and knowledge of the program announcement.

- Enterprise human resources integration system -$800,000 to integrate SBA's personnel record keeping into this government-wide record keeping system covering the entire life cycle of Federal employees to replace the current Official Personnel Folder.

Outcomes Driven

To fulfill its mission, it is critical that the SBA understand how to drive outcomes aligned with that mission. SBA is proud of its work on budget and performance integration which has allowed the Agency to maintain a green rating in both status and progress since FY 2004.

The Agency recognizes it still has work to do, particularly in defining our programs' outcomes. As such, SBA has contracted with the Urban Institute to analyze our business loan programs with results due in FY 2007. In addition, the Agency is analyzing penetration of its lending products into various place-based and people-based groups to understand their impact more fully.

By Spring FY 2007, the Agency will complete a major review of its Strategic Plan. The review will incorporate information from SBA's financial assistance programs' evaluation, as well as the new SBA leadership team's vision. In addition, reporting, measurement, and goal attainment is being designed to align the most critical outcomes the Agency is working to achieve.

Conclusion

In closing, this is a good budget for America's small businesses and America's taxpayers. I look forward to working with you to enact this budget and to help entrepreneurs start, build and grow their small businesses. Again, thank you for inviting me here today and I will be glad to answer any questions.