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# Small Business Administration Microloan Program

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## Summary

The Small Business Administration's (SBA's) Microloan program provides direct loans to qualified nonprofit intermediary lenders who, in turn, provide "microloans" of up to \$50,000 to small business owners, entrepreneurs, and nonprofit child care centers. It also provides marketing, management, and technical assistance to microloan borrowers and potential borrowers. The program was authorized in 1991 as a five-year demonstration project and became operational in 1992. It was made permanent, subject to reauthorization, in 1997.

The SBA's Microloan program is designed to assist women, low-income, veteran, minority entrepreneurs and small business owners, and other individuals possessing the capability to operate successful business concerns by providing them small-scale loans for working capital or the acquisition of materials, supplies, or equipment. In FY2014, Microloan intermediaries provided 3,919 microloans totaling \$55.7 million. The average Microloan was \$14,210 and had a 7.54% interest rate.

Critics of the SBA's Microloan program argue that it is expensive relative to alternative programs, duplicative of the SBA's 7(a) loan guaranty program, and subject to administrative shortfalls. The program's advocates argue that it assists many who otherwise would not be served by the private sector and is an important source of capital and training assistance for low-income, women, and minority business owners.

Congressional interest in the Microloan program has increased in recent years, primarily because microloans are viewed as a means to assist very small businesses, especially women- and minority-owned startups, to get loans that enable them to create and retain jobs. Job creation, always a congressional interest, has taken on increased importance given continuing concerns about job growth during the current economic recovery.

This report opens with a discussion of the rationale provided for having a Microloan program, describes the program's eligibility standards and operating requirements for lenders and borrowers, and examines the arguments presented by the program's critics and advocates. It then discusses P.L. 111-240, the Small Business Jobs Act of 2010, which increased the Microloan program's loan limit for borrowers from \$35,000 to \$50,000, and the aggregate loan limit for intermediaries after their first year of participation in the program from \$3.5 million to \$5 million. The act also authorized the SBA to waive, in whole or in part through FY2012, the nonfederal share requirement for loans to the Microloan program's intermediaries and for grants made to Microloan intermediaries for small business marketing, management, and technical assistance for up to a fiscal year.

During the 113<sup>th</sup> Congress, H.R. 3191, the Expanding Opportunities to Underserved Businesses Act, would have increased the Microloan program's loan limit for borrowers from \$50,000 to \$75,000. S. 2487, the Access to Capital, Access to Opportunity Act, would have increased that limit to \$100,000. S. 2693, the Women's Small Business Ownership Act of 2014, would have, among other provisions, increased the Microloan program's aggregate loan limit for intermediaries after their first year of participation in the program from \$5 million to \$7 million. The bill would have also removed the requirements that no more than 25% of Microloan technical assistance grant funds may be used to provide information and technical assistance to prospective borrowers and that no more than 25% of those funds may be used on third-party contracts for the provision of technical assistance.

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## Small Business Microloans and Training Assistance

The Small Business Administration (SBA) administers programs that support small businesses, including loan guarantees to lenders to encourage them to provide loans to small businesses “that might not otherwise obtain financing on reasonable terms and conditions” and grants to non-profit organizations to provide marketing, management, and technical training assistance to small business owners.<sup>1</sup> Historically, one of the justifications presented for funding the SBA’s loan guarantee 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.<sup>2</sup> It has been argued that this disadvantage is particularly acute for startups and microbusinesses (firms with fewer than five employees):

Traditional lending institutions, such as banks and investors, are unlikely to offer loans and investment capital to microfirms due to a variety of reasons. One barrier to microlending is a concern that startups and smaller enterprises are risky investments since growing businesses typically exhibit erratic bursts of growth and downturn. The perceived risk of these types of companies reduces the chances of a microbusiness to obtain financing. Another issue is that microbusinesses by and large require smaller amounts of capital, and thus banks or investment companies often believe that it is not efficient use of their time or resources, nor will they receive a substantive return on investment from such a small loan amount.<sup>3</sup>

An Urban Institute survey of SBA 7(a), 504/Certified Development Company (504/CDC), Small Business Investment Company (SBIC), and Microloan borrowers conducted in 2007 found that Microloan borrowers reported having the most difficulty in finding acceptable financing elsewhere. Less than one-third (31%) of Microloan borrowers reported that they would have been able to find acceptable financing elsewhere, compared with 35% of SBIC borrowers, 40% of 7(a) borrowers, and 48% of 504/CDC borrowers.<sup>4</sup>

Since its inception in 1953, the SBA has provided loan guarantees to encourage lenders to issue small businesses loans.<sup>5</sup> Interest in creating a separate loan program to address the specific needs of startups and microbusinesses increased during the 1980s, primarily due to the growth and experience of microlending institutions abroad and evidence concerning private lending practices that led Congress to conclude that a new loan program was necessary “to reach very small businesses that were not being served by traditional lenders of SBA’s credit programs.”<sup>6</sup>

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<sup>1</sup> U.S. Small Business Administration (SBA), “Fiscal Year 2010 Congressional Budget Justification,” pp. 29-30, at [https://www.sba.gov/sites/default/files/aboutsbaarticle/Congressional\\_Budget\\_Justification\\_2010.pdf](https://www.sba.gov/sites/default/files/aboutsbaarticle/Congressional_Budget_Justification_2010.pdf).

<sup>2</sup> 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/files/2006/04/13/20060414\\_wp126.pdf](http://www.aei.org/files/2006/04/13/20060414_wp126.pdf). Also, see U.S. Government Accountability Office, *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>.

<sup>3</sup> U.S. Congress, House Committee on Small Business, *Full Committee Legislative Hearing on the SBA’s Microloan and Trade Programs*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., July 12, 2007, H.Hrg. 110-35 (Washington: GPO, 2007), p. 6.

<sup>4</sup> Christopher Hayes, *An Assessment of the Small Business Administration’s Loan and Investment Programs: Survey of Assisted Businesses* (Washington: The Urban Institute, January 2008), p. 5, at [http://www.urban.org/UploadedPDF/411599\\_assisted\\_business\\_survey.pdf](http://www.urban.org/UploadedPDF/411599_assisted_business_survey.pdf).

<sup>5</sup> The SBA also provided direct loans to small businesses until 1994. For further analysis, see CRS Report R40985, *Small Business: Access to Capital and Job Creation*, by Robert Jay Dilger.

<sup>6</sup> Robert Cull, Asli Demirguc-Kunt, and Jonathan Morduch, “Microfinance Meets the Market,” *Journal of Economic* (continued...)

To address the perceived disadvantages faced by very small businesses in gaining access to capital, Congress authorized the SBA's Microloan lending program in 1991 (P.L. 102-140, the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1992). The program became operational in 1992. Its stated purpose is

to assist women, low-income, veteran ... and minority entrepreneurs and business owners and other individuals possessing the capability to operate successful business concerns; to assist small business concerns in those areas suffering from a lack of credit due to economic downturns; ... to make loans to eligible intermediaries to enable such intermediaries to provide small-scale loans, particularly loans in amounts averaging not more than \$10,000, to start-up, newly established, or growing small business concerns for working capital or the acquisition of materials, supplies, or equipment; [and] to make grants to eligible intermediaries that, together with non-Federal matching funds, will enable such intermediaries to provide intensive marketing, management, and technical assistance to microloan borrowers.<sup>7</sup>

The SBA's Microloan lending program was authorized initially as a five-year demonstration project. It was made permanent, subject to reauthorization, in 1997 (P.L. 105-135, the Small Business Reauthorization Act of 1997).<sup>8</sup>

Congressional interest in the Microloan program has increased in recent years, primarily because microloans are viewed as a means to assist very small businesses, especially women- and minority-owned startups, obtain loans that enable them to create jobs. Job creation and

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*Perspectives*, vol. 23, no. 1 (Winter 2009), pp. 169-172; and U.S. Congress, Senate Committee on Small Business and Entrepreneurship, *Microloan Program Improvement Act of 2001*, report to accompany S. 174, 107<sup>th</sup> Cong., 1<sup>st</sup> sess., May 26, 2001, S.Rept. 107-18 (Washington: GPO, 2001). About 3.54 million employer firms in the United States in 2012 had fewer than five employees. See U.S. Census Bureau, *Statistics of U.S. Businesses: U.S. & States, Totals*, at [http://www2.census.gov/econ/susb/data/2012/us\\_state\\_totals\\_2012.xls](http://www2.census.gov/econ/susb/data/2012/us_state_totals_2012.xls).

<sup>7</sup> 15 U.S.C. §636(m)(1)(A).

<sup>8</sup> Prior to the Microloan program, the SBA temporarily established, in 1964, the "6 on 6" pilot lending program, which provided up to \$6,000 for a term of up to 6 years "aimed specifically at disadvantaged potential entrepreneurs." See U.S. Congress, House Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise, *Government Minority Small Business Programs*, hearing pursuant to H. Res. 5 and 19, 92<sup>nd</sup> Cong., 1<sup>st</sup> sess., July 27, 1971 (Washington: GPO, 1972), p. 6. Also, in 1964, P.L. 88-452, the Economic Opportunity Act of 1964 (Title IV-Employment and Investment Incentives), authorized the director of the Office of Economic Opportunity, through the SBA, to provide what were subsequently called Economic Opportunity Loans (EOL). The EOL program became operational in January 1965 and continued through 1992 (the final EOL loan disbursement took place in 1996). P.L. 93-386, the Small Business Amendments (approved August 23, 1974) transferred authority for the EOL program from the Office of Economic Opportunity to the SBA. Initially, the EOL program provided direct loans (of up to \$25,000, with loan terms of up to 15 years) to assist small businesses promote employment of the long-term unemployed. Starting in 1968, EOL loans increasingly were issued as guaranteed loans. The program's loan limits were increased, by law, from \$25,000 to \$50,000 in 1972 and to \$100,000 in 1976. The EOL program's requirements and operations evolved over time, but remained focused on providing loans to low-income, minority-owned, very small businesses. The EOL program also emphasized the provision of management and technical training assistance to disadvantaged entrepreneurs. See U.S. Congress, House Committee on Education and Labor, *Economic Opportunity Act Amendments of 1967*, hearing on H.R. 8311, 90<sup>th</sup> Cong., 1<sup>st</sup> sess., June 23, 1967 (Washington: GPO, 1967), pp. 1356-1362; U.S. Congress, House Committee on Appropriations, Subcommittee on Commerce, Justice, State, and Judiciary, *Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1993*, 102<sup>nd</sup> Cong., 2<sup>nd</sup> sess., February 19, 1992 (Washington: GPO, 1992), pp. 503-504; and U.S. General Accounting (now Government Accountability) Office, *Most Borrowers of Economic Opportunity Loans Have Not Succeeded in Business*, CED-81-3, December 8, 1980, pp. 1-8, at <http://www.gao.gov/assets/140/131190.pdf>.

preservation, always a congressional interest, has taken on increased importance given continuing concerns about job growth during the current economic recovery.<sup>9</sup>

This report describes the Microloan program's eligibility standards and operating requirements for lenders and borrowers and examines the arguments presented by the program's critics and advocates. It also examines changes to the program authorized by P.L. 111-240, the Small Business Jobs Act of 2010.

P.L. 111-240 authorized the Secretary of the Treasury to establish a \$30 billion Small Business Lending Fund (SBLF) to encourage community banks to provide small business loans (\$4.0 billion was issued), a \$1.5 billion State Small Business Credit Initiative to provide funding to participating states with small business capital access programs, and about \$12 billion in tax relief for small businesses.<sup>10</sup> It also authorized changes to the SBA's loan guaranty programs, including increasing the Microloan program's loan limit for borrowers from \$35,000 to \$50,000, and the aggregate loan limit for intermediaries after their first year of participation in the program from \$3.5 million to \$5 million. It authorized the SBA to waive, in whole or in part through FY2012, the nonfederal share requirement for loans to the Microloan program's intermediaries and for grants made to Microloan intermediaries for small business marketing, management, and technical assistance for up to a fiscal year.

This report also discusses several bills introduced in the 113<sup>th</sup> Congress. For example,

- H.R. 3191, the Expanding Opportunities to Underserved Businesses Act, would have increased the Microloan program's loan limit for borrowers from \$50,000 to \$75,000;
- S. 2487, the Access to Capital, Access to Opportunity Act, would have increased that limit to \$100,000; and
- S. 2693, the Women's Small Business Ownership Act of 2014, would have, among other provisions, increased the Microloan program's aggregate loan limit for intermediaries after their first year of participation in the program from \$5 million to \$7 million. The bill also would have removed the requirements that no more than 25% of the Microloan and technical assistance funds may be used to provide information and technical assistance to prospective Microloan borrowers and that no more than 25% of those funds may be used on third-party contracts to provide technical assistance.

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<sup>9</sup> SBA, Office of Advocacy, *Small Business Economic Indicators for 2003*, August 2004, p. 3; and Brian Headd, "Small Businesses Most Likely to Lead Economic Recovery," *The Small Business Advocate*, vol. 28, no. 6 (July 2009), pp. 1, 2.

<sup>10</sup> For further information and analysis concerning the Small Business Lending Fund see CRS Report R42045, *The Small Business Lending Fund*, by Robert Jay Dilger. For further information and analysis concerning the State Small Business Credit Initiative see CRS Report R42581, *State Small Business Credit Initiative: Implementation and Funding Issues*, by Robert Jay Dilger.

## The SBA Microloan Program: Funding, Eligibility Standards, Program Requirements, and Statistics

Unlike the SBA's 7(a) and 504/CDC loan guarantee programs, the SBA Microloan program does not guarantee loans.<sup>11</sup> Instead, it provides direct loans to qualified nonprofit intermediary Microloan lenders who, in turn, provide "microloans" of up to \$50,000 to small business owners, entrepreneurs, and nonprofit child care centers.<sup>12</sup> There are currently 152 intermediaries participating in the program, serving 45 states, the District of Columbia, and Puerto Rico.<sup>13</sup>

As mentioned previously, during the 113<sup>th</sup> Congress, H.R. 3191 would have increased the Microloan program's loan limit for borrowers from \$50,000 to \$75,000; and S. 2487 would have increased that limit to \$100,000.

### Funding

The Microloan program's administrative costs are funded through the SBA's salaries and expenses and business loan administration accounts. In addition, each year the SBA receives an appropriation for credit subsidies for its direct lending (Microloan) program.

Business loan credit subsidies represent the net present value of cash flows to and from the SBA over the life of the loan portfolio. For guaranteed loans, the net present value of cash flows is primarily affected by the difference between the cost of purchasing loans that have defaulted and the revenue generated from fees and collateral liquidation. For direct (Microloan) lending, the net present value of cash flows is primarily affected by the cost of offering below market interest rates to intermediaries because the cost of purchasing loans that have defaulted is typically relatively small because intermediaries are required to maintain a loan loss reserve. In addition, the SBA does not charge intermediaries fees.<sup>14</sup>

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<sup>11</sup> For information and analysis concerning the SBA's 7(a) and 504/CDC programs, see CRS Report R41146, *Small Business Administration 7(a) Loan Guaranty Program*, by Robert Jay Dilger and CRS Report R41184, *Small Business Administration 504/CDC Loan Guaranty Program*, by Robert Jay Dilger.

<sup>12</sup> P.L. 111-240, the Small Business Jobs Act of 2010, increased the loan limit for borrowers from \$35,000 to \$50,000.

<sup>13</sup> SBA, *Microloan Program: Partner Identification & Management System Participating Intermediary Microlenders Report*, January 13, 2015, at [https://www.sba.gov/sites/default/files/articles/Participating%20Intermediary%20Microlenders%20Report\\_1501.pdf](https://www.sba.gov/sites/default/files/articles/Participating%20Intermediary%20Microlenders%20Report_1501.pdf). As of January 13, 2015, there were no Microloan intermediaries serving Alaska, Idaho, Mississippi, Rhode Island, and Utah. An intermediary may not operate in more than one state unless the SBA determines that it would be in the best interests of the small business community for it to operate across state lines. For example, the Microloan intermediary located in Washington, Pennsylvania, is allowed to service 10 West Virginia counties due to its proximity to these counties and the distance to the only other intermediary serving West Virginia, which is located in Dunbar (near Charleston), West Virginia.

<sup>14</sup> The SBA's Office of Financial Analysis and Modeling is responsible for ensuring that the computation of subsidy rates for the SBA's credit programs are in compliance with the Federal Credit Reform Act of 1990 (FCRA). As indicated on its website: "The FCRA requires all credit agencies, including the SBA, to budget and account for the cost of credit programs by determining the net present value of cash flows to and from the Government over the life of the portfolio and expressing the net amount as a credit subsidy rate. The process to develop a subsidy rate is lengthy and complex, requiring unique data collection techniques and analysis efforts. SBA develops its subsidy rates by creating models that incorporate data on loan maturity, borrowers' interest rates, fees, grace periods, interest subsidies, delinquencies, purchases or defaults, recoveries, prepayments, advances and borrower characteristics. See SBA, Office of Financial Analysis and Modeling, "Summary of Responsibilities," at <https://www.sba.gov/offices/headquarters/ocfo/> (continued...)

In FY2015, the SBA was provided \$2.5 million, to remain available until expended, for direct (Microloan) business loan credit subsidies. This appropriation was expected to support about \$25.0 million in lending to intermediaries.<sup>15</sup> The Obama Administration has requested \$3.3 million for Microloan business loan credit subsidies for FY2016 to support about \$35 million in lending to intermediaries.<sup>16</sup>

The SBA also received an appropriation of \$22.3 million in FY2015 for grants to selected Microloan intermediaries and qualified “non-lending technical assistance providers” to provide Microloan borrowers and prospective borrowers marketing, management, and technical training assistance.<sup>17</sup> The Obama Administration has requested \$25.0 million for the Microloan technical assistance program for FY2016.<sup>18</sup>

The Microloan technical assistance program provided counseling services to 15,892 small businesses in FY2012, 19,368 small businesses in FY2013, and 15,668 in FY2014.<sup>19</sup> The program’s goal is to provide counseling services to 14,600 small businesses in both FY2015 and FY2016.<sup>20</sup>

## Intermediary Microloan Lender Eligibility Standards

To become a qualified intermediary Microloan lender, an applicant must

- be organized as a nonprofit community development corporation or other entity, a consortium of nonprofit community development corporations or other entities, a quasi-governmental economic development corporation, or an agency established by a Native American Tribal Government;
- be located in the United States, including the Commonwealth of Puerto Rico, the U.S. Virgin Islands, Guam, and American Samoa;
- have made and serviced short-term, fixed rate loans of not more than \$50,000 to newly established or growing small businesses for at least one year; and

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resources/13299. Also, see U.S. Congress, Senate Committee on Small Business and Entrepreneurship, *Small Business Reauthorization and Improvements Act of 2006*, report to accompany S. 3778, 109<sup>th</sup> Cong., 2<sup>nd</sup> sess., November 16, 2006, S.Rept. 109-361 (Washington: GPO, 2006), p. 6; and U.S. Government Accountability Office, *Participants in SBA’s Microloan Program Could Provide Additional Information to Enhance the Public’s Understanding of Recovery Act Fund Uses and Expected Outcomes*, GAO-10-1032R, September 29, 2010, p. 2, at <http://www.gao.gov/assets/100/97128.pdf>.

<sup>15</sup> P.L. 113-235, the Consolidated and Further Continuing Appropriations Act, 2015; and SBA, “Fiscal Year 2016 Congressional Budget Justification and FY2014 Annual Performance Report,” pp. 24, 95, at <https://www.sba.gov/sites/default/files/1-FY%202016%20CBJ%20FY%202014%20APR.PDF>.

<sup>16</sup> SBA, “Fiscal Year 2016 Congressional Budget Justification and FY2014 Annual Performance Report,” pp. 3, 10, 24, 95, at <https://www.sba.gov/sites/default/files/1-FY%202016%20CBJ%20FY%202014%20APR.PDF>.

<sup>17</sup> P.L. 113-235, the Consolidated and Further Continuing Appropriations Act, 2015.

<sup>18</sup> SBA, “Fiscal Year 2016 Congressional Budget Justification and FY2014 Annual Performance Report,” pp. 10, 21, 95, at <https://www.sba.gov/sites/default/files/1-FY%202016%20CBJ%20FY%202014%20APR.PDF>

<sup>19</sup> Ibid., p. 94.

<sup>20</sup> Ibid.

- have at least one year of experience providing technical assistance to its borrowers.<sup>21</sup>

If accepted into the program by the SBA, it can borrow no more than \$750,000 from the SBA during its first year of participation, no more than \$1.25 million each year thereafter, and no more than an aggregate of \$5 million.<sup>22</sup>

During the 113<sup>th</sup> Congress, S. 2693, the Women’s Small Business Ownership Act of 2014, would have, among other provisions, increased the aggregate loan limit for Microloan intermediaries after their first year of participation in the program from \$5 million to \$7 million.

## Intermediary Microloan Lender Program Requirements

Intermediaries are not required to make any interest payments on the Microloan during the first year, but interest accrues from the date that the SBA disburses the loan proceeds to the intermediary. After that, the SBA determines the schedule for periodic payments. Loans must be repaid within 10 years.<sup>23</sup>

The SBA charges intermediaries an interest rate that is based on the five-year Treasury rate, adjusted to the nearest one-eighth percent (called the Base Rate), less 1.25% if the intermediary maintains an historic portfolio of Microloans averaging more than \$10,000, and less 2.0% if the intermediary maintains an historic portfolio of Microloans averaging \$10,000 or less. The Base Rate, after adjustment, is called the Intermediary’s Cost of Funds. The Intermediary’s Cost of Funds is initially calculated one year from the date of the note and is reviewed annually and adjusted as necessary (called recasting). The interest rate cannot be less than zero.<sup>24</sup>

Intermediaries are required to contribute not less than 15% of the loan amount in cash from nonfederal sources and, as security for repayment of the loan, must provide the SBA first lien position on all notes receivable from any microloans issued under the program.<sup>25</sup> Unlike the SBA’s 7(a) and 504/CDC loan guarantee programs, the SBA does not charge intermediaries upfront or ongoing service fees under the Microloan program.<sup>26</sup>

As mentioned previously, P.L. 111-240 temporarily allowed the SBA to waive, in whole or in part through FY2012, the intermediary’s 15% nonfederal share requirement under specified

<sup>21</sup> 13 C.F.R §120.701; and 13 C.F.R §120.702. P.L. 111-240, the Small Business Jobs Act of 2010, increased the loan limit for borrowers from \$35,000 to \$50,000.

<sup>22</sup> 13 C.F.R §120.706; and SBA, “SOP 52 00: Microloan Program,” (effective March 1, 2013), p. 19, at [https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20\(FINAL\).pdf](https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20(FINAL).pdf). P.L. 111-240, the Small Business Jobs Act of 2010, increased the aggregate loan limit for intermediaries after their first year of participation in the program from \$3.5 million to \$5 million.

<sup>23</sup> 13 C.F.R §120.706.

<sup>24</sup> 15 U.S.C. §636(m)(3)(F)(iii); and SBA, “SOP 52 00: Microloan Program,” (effective March 1, 2013), p. 20, at [https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20\(FINAL\).pdf](https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20(FINAL).pdf). In recent years, the Intermediary’s Cost of Funds has been either zero or close to zero.

<sup>25</sup> 13 C.F.R §120.706. Note: The 15% contribution must be from nonfederal sources and may not be borrowed. For purposes of this program, Community Development Block Grants are considered nonfederal sources.

<sup>26</sup> Ibid.

circumstances (e.g., the economic conditions affecting the intermediary and the intermediary's performance) for up to a fiscal year.<sup>27</sup>

Intermediaries are required to deposit the proceeds from the SBA's loans, their 15% contribution, and payments from their Microloan borrowers into an interest-bearing Microloan Revolving Fund. Intermediaries may only withdraw from this account funds necessary to make microloans to borrowers, repay the SBA, and establish and maintain an interest-bearing Loan Loss Reserve Fund to pay any shortage in the Microloan Revolving Fund caused by delinquencies or losses on its microloans.<sup>28</sup> They are required, until they have been in the program for at least five years, to maintain a balance in the Loan Loss Reserve Fund equal to 15% of the outstanding balance of the notes receivable from their Microloan borrowers.<sup>29</sup> After five years, if the intermediary's average annual loss rate during the preceding five years is less than 15% and no other factors exist that may impair the intermediary's ability to repay its obligations to the SBA, the SBA Administrator may reduce the required balance in the intermediary's Loan Loss Reserve Fund to the intermediary's average annual loss rate during the preceding five years, but not less than 10% of the portfolio.<sup>30</sup> Intermediaries are required to maintain their Loan Loss Reserve Fund until they have repaid all obligations owed to the SBA.

The SBA does not maintain detailed data necessary to determine an aggregate default rate for Microloan borrowers. However, in 2007, the SBA estimated that the borrower default rate for the Microloan program was about 12%.<sup>31</sup> Because the Loan Loss Reserve Fund is used to contribute toward the cost of borrower defaults, and is often sufficient to cover the entire cost of such defaults, the SBA's loss rate for intermediary repayment is typically less than 3% each year.<sup>32</sup>

An intermediary may be suspended or removed from the Microloan program if it fails to comply with a specified list of program performance standards. For example, intermediaries are required to close and fund a minimum of four microloans per year, cover the service territory assigned by the SBA, honor the SBA determined boundaries of neighboring intermediaries and non-lender technical assistance providers, fulfill reporting requirements, maintain a loan currency rate of 85% or more (where loans are no more than 30 days late in scheduled payments), maintain a default rate of 15% or less, and "satisfactorily provide" in-house technical assistance to microloan clients and prospective microloan clients.<sup>33</sup>

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<sup>27</sup> P.L. 111-240, the Small Business Jobs Act of 2010, §1401. Matching Requirements Under Small Business Programs.

<sup>28</sup> 13 C.F.R. §120.709.

<sup>29</sup> 13 C.F.R. §120.710.

<sup>30</sup> *Ibid.*

<sup>31</sup> U.S. Congress, House Committee on Small Business, *Full Committee Hearings on the Small Business Administration's Microloan Program*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., June 14, 2007, H.Hrg. 110-30 (Washington: GPO, 2007), p. 15. Note: A study released on December 28, 2009 by the SBA's Office of the Inspector General concluded that Microloan intermediaries may be under-reporting the default rate. See SBA, Office of the Inspector General, "SBA's Administration of the Microloan Program under the Recovery Act," December 28, 2009, at <http://www.sba.gov/office-of-inspector-general/868/12427>.

<sup>32</sup> SBA, Office of Congressional and Legislative Affairs, correspondence with the author, August 2, 2012. In FY2014, the Microloan program's intermediary default rate was 1.88%. See SBA, *Agency Financial Report, Fiscal Year 2014*, p. 69, at [https://www.sba.gov/sites/default/files/aboutsbaarticle/FY2014\\_Agency\\_Financial\\_Report.pdf](https://www.sba.gov/sites/default/files/aboutsbaarticle/FY2014_Agency_Financial_Report.pdf). At the end of FY2013, \$8.22 million in loans to intermediaries had been charged off. This represents 2.07% of total funds disbursed to intermediaries (\$8.22 million of \$395.81 million) and 6.19% of the current outstanding principal balance of loans to intermediary lenders (\$8.22 million of \$132.68 million).

<sup>33</sup> 13 C.F.R. §120.716.

## Intermediary Marketing, Management, and Technical Training Assistance

As mentioned previously, in FY2015, the SBA received \$22.3 million for grants to selected Microloan intermediaries and qualified “non-lending technical assistance providers” to provide Microloan borrowers and prospective borrowers marketing, management, and technical training assistance.

Intermediaries are eligible to receive a Microloan technical assistance grant “of not more than 25% of the total outstanding balance of loans made to it under this subsection.”<sup>34</sup> Grant funds may be used only to provide marketing, management, and technical assistance to Microloan borrowers, except that up to 25% of the funds may be used to provide such assistance to prospective Microloan borrowers. Grant funds may also be used to attend training required by the SBA.<sup>35</sup> In most instances, intermediaries must contribute, solely from nonfederal sources, an amount equal to 25% of the grant amount.<sup>36</sup> In addition to cash or other direct funding, the contribution may include indirect costs or in-kind contributions paid for under nonfederal programs.<sup>37</sup> Intermediaries may expend no more than 25% of the grant funds on third-party contracts for the provision of technical assistance.<sup>38</sup>

During the 113<sup>th</sup> Congress, S. 2693 (as mentioned earlier) would have, among other provisions, removed the requirement that no more than 25% of Microloan technical assistance grant funds may be used to provide information and technical assistance to prospective Microloan borrowers. The bill also would have removed the requirement that intermediaries may expend no more than 25% of the grant funds on third-party contracts for the provision of technical assistance.

Congress directed the SBA in the explanatory statement accompanying P.L. 113-235, the Consolidated and Further Continuing Appropriations Act, 2015, to “assess the impact of the requirement that only 25 percent of funds for microloan technical assistance may be used for prospective buyers, and to submit any recommendations for statutory changes to improve the microloan technical assistance program to the Committees on Appropriations and Small Business of the House and Senate within 90 days of enactment of this Act [which took place on December 17, 2014].”<sup>39</sup>

In addition, as mentioned earlier, P.L. 111-240 temporarily allowed the SBA to waive, in whole or in part through FY2012, the 25% nonfederal share requirement for grants made to Microloan

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<sup>34</sup> 15 U.S.C. §636(m)(4)(A). Note: Although currently not funded, the SBA’s Program for Investment in Microentrepreneurs Act (PRIME) program also provides non-profit organizations grant funding to assist low-income entrepreneurs with training assistance. See, SBA, “PRIME Program,” at <http://www.sba.gov/content/prime-program-0>.

<sup>35</sup> 13 C.F.R. §120.712.

<sup>36</sup> Ibid. Intermediaries who make at least 50% of their loans to small businesses located in or owned by residents of Economically Distressed Areas are not subject to the 25% contribution requirement. An economically distressed area is a county or equivalent division of local government in which, according to the most recent available data from the U.S. Census Bureau, 40% or more of the residents have an annual income that is at or below the poverty level. See 13 C.F.R. §120.701.

<sup>37</sup> 13 C.F.R. §120.712. Intermediaries may not borrow their contribution.

<sup>38</sup> Ibid.

<sup>39</sup> Rep. Harold Rogers, “Explanatory Statement Submitted by Mr. Rogers of Kentucky, Chairman of the House Committee on Appropriations Regarding the House Amendment to the Senate Amendment on H.R. 83,” *Congressional Record*, vol. 160, part 151 (December 11, 2014), p. H9741.

intermediaries for small business marketing, management, and technical assistance under specified circumstances (e.g., the economic conditions affecting the intermediary and the intermediary's performance) for up to a fiscal year.<sup>40</sup>

The SBA does not require Microloan borrowers to participate in the marketing, management, and technical assistance program. However, intermediaries typically require Microloan borrowers to participate in the training program as a condition of the receipt of a microloan. Combining loan and intensive training assistance is one of the Microloan program's distinguishing features.

Intermediaries that make at least 25% of their loans to small businesses located in or owned by residents of an Economically Distressed Area (defined as having 40% or more of its residents with an annual income that is at or below the poverty level), or have a portfolio of loans made under the program "that averages not more than \$10,000 during the period of the intermediary's participation in the program" are eligible to receive an additional training grant equal to 5% of "the total outstanding balance of loans made to the intermediary."<sup>41</sup> Intermediaries are not required to make a matching contribution as a condition of receiving these additional grant funds.

## Non-lending Technical Assistance Providers

Each year, the SBA is authorized to select qualified nonprofit, non-lending technical assistance providers to receive grant funds to provide marketing, management, and technical assistance to Microloan borrowers. Any non-profit entity that is not an intermediary may apply for these funds.<sup>42</sup>

The SBA may award up to 55 grants each year to qualified non-lending technical assistance providers to deliver marketing, management, and technical assistance to Microloan borrowers. The grants may be for terms of up to five years and may not exceed \$200,000.<sup>43</sup> The nonprofit entity must contribute, solely from nonfederal sources, an amount equal to 20% of the grant. In addition to cash or other direct funding, the contribution may include indirect costs or in-kind contributions paid for under nonfederal programs.<sup>44</sup>

The SBA stopped awarding these grants at the beginning of FY2005. The SBA determined at that time that the non-lending technical assistance providers duplicated much of what was already being provided by Microloan intermediaries and other SBA entrepreneurial development programs.<sup>45</sup>

## Microloan Borrower Eligibility Standards

With one exception, Microloan borrowers must be an eligible, for-profit small business as defined by the Small Business Act. P.L. 105-135, the Small Business Reauthorization Act of 1997,

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<sup>40</sup> P.L. 111-240, the Small Business Jobs Act of 2010, §1401. Matching Requirements Under Small Business Programs.

<sup>41</sup> 13 C.F.R §120.712; and 15 U.S.C. §636(m)(4)(C)(i).

<sup>42</sup> 13 C.F.R §120.714.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid.

<sup>45</sup> SBA, Office of Congressional and Legislative Affairs, correspondence with the author, August 2, 2012.

expanded the Microloan program's eligibility to include borrowers establishing a nonprofit childcare business.

## Microloan Borrower Program Requirements

Intermediaries are directed by legislative language to provide borrowers "small-scale loans, particularly loans in amounts averaging not more than \$10,000."<sup>46</sup> They are also directed, "to the extent practicable ... to maintain a microloan portfolio with an average loan size of not more than \$15,000."<sup>47</sup> Microloans for more than \$20,000 are allowed "only if such small business concern demonstrates that it is unable to obtain credit elsewhere at comparable interest rates and that it has good prospects for success."<sup>48</sup> The maximum loan amount is \$50,000 and no borrower may owe an intermediary more than \$50,000 at any one time.<sup>49</sup>

Microloan proceeds may be used only for working capital and acquisition of materials, supplies, furniture, fixtures, and equipment. Loans cannot be made to acquire land or property, and must be repaid within six years.<sup>50</sup> Within these parameters, loan terms vary depending on the loan's size, the planned use of funds, the requirements of the intermediary lender, and the needs of the small business borrower.

On loans of more than \$10,000, the maximum interest rate that can be charged to the borrower is the interest rate charged by the SBA on the loan to the intermediary, plus 7.75 percentage points. On loans of \$10,000 or less, the maximum interest rate that can be charged to the borrower is the interest charged by the SBA on the loan to the intermediary, plus 8.5 percentage points.<sup>51</sup> Rates

<sup>46</sup> 15 U.S.C. §636(m)(1)(A)(iii)(I).

<sup>47</sup> 15 U.S.C. §636(m)(6)(B).

<sup>48</sup> 15 U.S.C. §636(m)(3)(E).

<sup>49</sup> 13 C.F.R. §120.707. P.L. 111-240, the Small Business Jobs Act of 2010, increased the loan limit for borrowers from \$35,000 to \$50,000.

<sup>50</sup> *Ibid.*

<sup>51</sup> 15 U.S.C. §636(m)(6)(C)(i) and 15 U.S.C. §636(m)(6)(C)(ii) indicate that the threshold average loan amount for determining the maximum interest rate charged to borrowers is \$7,500. The SBA increased the threshold average loan amount used to determine the maximum interest rate charged to borrowers from \$7,500 to \$10,000 in 2001, citing authority provided in P.L. 106-554, the Consolidated Appropriations Act, 2001 (2000 legislation—Small Business Reauthorization Act of 2000): "SBA is amending § 120.707(c) [the section in the U.S. Code of Federal Regulations concerning the threshold average loan amount for determining the maximum interest rate charged to borrowers] to reflect the statutory change which increased the dollar amount to \$10,000 up from \$7,500." See SBA, "Microloan Program," 66 *Federal Register* 47877, September 4, 2001. However, P.L. 106-554 included language amending Section 7(m) of the Small Business Act (15 U.S.C. 636(m)) "in paragraphs (1)(A)(iii)(I), (3)(A)(ii), and (4)(C)(i)(II), by striking "\$7,500" each place it appears and inserting "\$10,000." The three sections cited in P.L. 106-554 referred to encouraging intermediaries to make "loans in amounts averaging not more than \$7,500;" directing the Administration to "give priority to those applicants that provide loans in amounts averaging not more than \$7,500;" and eligibility for technical assistance grants "the intermediary has a portfolio of loans made under this subsection that averages not more than \$7,500 during the period of the intermediary's participation in the program." According to the SBA, "at the time of the change in the law, SBA staff believed that Congress intended to raise all of the microloan thresholds to \$10,000 from \$7,500, as evidenced by the fact that Congress revised the general purpose language in §7(m)(1)(A)(iii). That provision was revised to state that one of the purposes of the Microloan program is to enable intermediaries to provide small-scale loans, 'particularly in amounts averaging not more than \$10,000.' In addition, the legislative history indicates that the loan amounts were increased to reflect inflation, but does not explain why only some loan amounts were adjusted and not others.... Furthermore, it would be confusing to have different thresholds in the several provisions that incentivize intermediaries to make small loans, especially when those thresholds had been the same prior to the changes implemented by P.L. 106-554.... For these reasons, SBA staff believed that increasing all of the (continued...)

are negotiated between the borrower and the intermediary, and typically range from 6.5% to 9%. In FY2014, the average interest rate charged was 7.54%.<sup>52</sup> Each intermediary establishes its own lending and credit requirements. However, borrowers are generally required to provide some type of collateral (consistent with prudent lending practices), and a personal guarantee to repay the loan.<sup>53</sup> The SBA does not review the loan for creditworthiness.<sup>54</sup>

Intermediaries are allowed to charge borrowers reasonable application and origination fees up to 2% of the Microloan, and actual out-of-pocket closing expenses, such as collateral appraisals and credit reports. These fees may be added to the loan amount and financed over the life of the loan.<sup>55</sup>

## Microloan Program Statistics

In FY2014, the SBA approved 36 loans totaling \$26.7 million to intermediaries, and intermediaries provided 3,919 microloans totaling \$55.7 million to small businesses.<sup>56</sup> The average approved loan to an intermediary was \$742,094, and the average microloan to a small business was \$14,210.<sup>57</sup> At the end of FY2014, the Microloan program's unpaid principal balance was about \$136.7 million.<sup>58</sup>

The Microloan program is open to all small business entrepreneurs, but targets new and early-stage businesses in “underserved markets, including borrowers with little to no credit history, low-income borrowers, and women and minority entrepreneurs in both rural and urban areas who generally do not qualify for conventional loans, or other, larger SBA guaranteed loans.”<sup>59</sup> An analysis conducted by the Urban Institute found that about 9.9% of conventional small business

(...continued)

microloan thresholds to \$10,000 from \$7,500 would achieve the Congressional purpose in making more small loans available. The regulations implemented the legislative changes in 2001. There is Congressional awareness of these longstanding microloan program regulations, which have never been challenged or questioned. There is also Congressional awareness of the discrepancies in the statute, as evidenced by the 13 bills that have been introduced since 2001 to correct them.” SBA, Office of Congressional and Legislative Affairs, correspondence with the author, November 14, 2013.

<sup>52</sup> SBA, “Nationwide Loan Report, October 1, 2013 through September 30, 2014,” November 17, 2014.

<sup>53</sup> The SBA urges intermediaries in its Microloan SOP “to temper collateral requirements with strong technical assistance and to be creative in their definition of acceptable collateral.” See SBA, “SOP 52 00: Microloan Program,” (effective March 1, 2013), p. 46, at [https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20\(FINAL\).pdf](https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20(FINAL).pdf).

<sup>54</sup> SBA, “Microloan Program,” at <https://www.sba.gov/content/microloan-program>.

<sup>55</sup> SBA, “SOP 52 00: Microloan Program,” (effective March 1, 2013), p. 47, at [https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20\(FINAL\).pdf](https://www.sba.gov/sites/default/files/Microloan%20SOP%2052%2000%20(FINAL).pdf).

<sup>56</sup> SBA, “Nationwide Loan Report, October 1, 2013 through September 30, 2014,” November 17, 2014; SBA, “Gross Approval Amount By Program,” at [https://www.sba.gov/sites/default/files/files/WDS\\_Table2\\_GrossApproval\\_Report.pdf](https://www.sba.gov/sites/default/files/files/WDS_Table2_GrossApproval_Report.pdf); and SBA, “Number of Approved Loans by Program,” at [https://www.sba.gov/sites/default/files/files/WDS\\_Table3\\_ApprovalCount\\_Report.pdf](https://www.sba.gov/sites/default/files/files/WDS_Table3_ApprovalCount_Report.pdf). In FY2012, the SBA provided 42 loans amounting to \$23.9 million to intermediaries, and intermediaries provided 3,973 microloans amounting to \$44.7 million to small businesses. In FY2013, the SBA provided 70 loans amounting to \$43.2 million to intermediaries, and intermediaries provided 4,426 microloans amounting to \$51.2 million to small businesses.

<sup>57</sup> SBA, “Nationwide Loan Report, October 1, 2013 through September 30, 2014,” November 17, 2014.

<sup>58</sup> SBA, “Unpaid Principal Balance (UPB) by Program,” at [https://www.sba.gov/sites/default/files/files/WDS\\_Table1\\_UPB\\_Report.pdf](https://www.sba.gov/sites/default/files/files/WDS_Table1_UPB_Report.pdf).

<sup>59</sup> SBA, “Microloans Help Small Businesses Start, Grow and Succeed,” (no longer available on-line).

loans are issued to minority-owned small businesses and about 16% of conventional small business loans are issued to women-owned businesses.<sup>60</sup> In FY2014, of those reporting their race, minority-owned or -controlled firms received 42.4% of the number of microloans issued and 31.2% of the amount issued.<sup>61</sup> Women-owned or -controlled firms received 46.7% of the number of microloans issued and 37.4% of the amount issued.<sup>62</sup>

More than three-quarters of all Microloan borrowers (78.4%) in FY2014 were located in an urban area. Also, startup companies received about one-third (36.5%) of the number of microloans issued in FY2014, and about one-third (34.4%) of the total amount of microloans issued in FY2014.<sup>63</sup>

As mentioned previously, the estimated borrower default rate for the Microloan program is about 12%.<sup>64</sup> Because the Loan Loss Reserve Fund is used to contribute toward the cost of borrower defaults, and is often sufficient to cover the entire cost of such defaults, the SBA's loss rate for intermediary repayment is typically less than 3% annually. For example, in FY2014, the Microloan program's intermediary default rate was 1.88%.<sup>65</sup>

Microloans are often used for more than one purpose. In FY2014, they were most commonly used for working capital (72.8%), new equipment (28.4%), inventory (19.2%), and supplies (6.9%).<sup>66</sup>

## Congressional Issues

Critics of the SBA's Microloan program argue that it is duplicative of other available programs, expensive relative to alternative programs, and subject to administrative shortfalls. The program's advocates argue that it provides assistance that "reaches many who otherwise would not be served by the private sector or even the SBA's 7(a) loan program" and "has provided an important source of capital for low-income women business owners and minority borrowers."<sup>67</sup>

<sup>60</sup> Kenneth Temkin, Brett Theodos, with Kerstin Gentsch, *Competitive and Special Competitive Opportunity Gap Analysis of the 7(A) and 504 Programs* (Washington: The Urban Institute, 2008), p. 13, at [http://www.urban.org/UploadedPDF/411596\\_504\\_gap\\_analysis.pdf](http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf).

<sup>61</sup> SBA, "Nationwide Loan Report, October 1, 2013 through September 30, 2014," November 17, 2014. 500 of 3,919 Microloan borrowers (12.76%) did not report their race. These borrowers received \$5.8 million in loans. Because the race of these borrowers is unknown, their borrowing was removed from the calculation of the proportional share percentage figures provided for minority-owned or -controlled firms.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> U.S. Congress, House Committee on Small Business, *Full Committee Hearings on the Small Business Administration's Microloan Program*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., June 14, 2007, H.Hrg. 110-30 (Washington: GPO, 2007), p. 15. Note: A study released on December 28, 2009 by the SBA's Office of the Inspector General concluded that Microloan intermediaries may be under-reporting the default rate. See SBA, Office of the Inspector General, "SBA's Administration of the Microloan Program under the Recovery Act," December 28, 2009, at <http://www.sba.gov/office-of-inspector-general/868/12427>.

<sup>65</sup> SBA, *Agency Financial Report, Fiscal Year 2014*, p. 69, at [https://www.sba.gov/sites/default/files/aboutsbaarticle/FY2014\\_Agency\\_Financial\\_Report.pdf](https://www.sba.gov/sites/default/files/aboutsbaarticle/FY2014_Agency_Financial_Report.pdf).

<sup>66</sup> SBA, "Nationwide Loan Report, October 1, 2013 through September 30, 2014," November 17, 2014. Percentages add to more than 100% as proceeds may be used for more than one purpose.

<sup>67</sup> U.S. Congress, House Committee on Small Business, *Full Committee Hearing on the Small Business* (continued...)

## Program Duplication

Critics of the SBA's Microloan program argue that its direct lending program is duplicative of the SBA's 7(a) loan guarantee program and its marketing, management, and technical training assistance grant program is duplicative of the SBA's training assistance provided through Small Business Development Centers, SCORE (Service Corps of Retired Executives), and Women Business Centers. For example, President George W. Bush proposed to eliminate all funding for the Microloan program in his FY2005, FY2006, and FY2007 budget requests to Congress, arguing that "the 7(a) program is capable of serving the same clientele through the Community Express programs for much lower cost to the Government."<sup>68</sup> President Bush also proposed to terminate the Microloan program's marketing, management, and technical assistance grant program in his FY2008 and FY2009 budget requests to Congress.<sup>69</sup>

Critics argued in 2007 that about 44% of the SBA's 7(a) program's loan guarantees at that time were for loans under \$35,000 (the Microloan program's former loan limit for borrowers), representing more than 17 times the number of loans issued through the SBA's Microloan program.<sup>70</sup> In their view, the 7(a) program had demonstrated that it can service the needs of small businesses targeted by the SBA's Microloan program.<sup>71</sup> They also argued that the SBA's Microloan program's marketing, management, and technical assistance grants program was not necessary because the SBA "already supports a nationwide network of resource partners who provide counseling and training to entrepreneurs, including Small Business Development Centers, Women's Business Centers, and SCORE."<sup>72</sup> They argued that about 94% of Microloan intermediaries are located within 20 miles of a Small Business Development Center, a Women's Business Center, or a SCORE partner.<sup>73</sup>

Advocates argue that the SBA's Microloan program is complementary, not duplicative of the SBA's 7(a) loan guarantee program. They assert that Microloan borrowers are particularly disadvantaged when seeking access to capital, often having no credit history or lower credit scores than most applicants for the SBA's 7(a) loan guarantee program.<sup>74</sup> In their view, it is

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*Administration's Microloan Program*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., June 14, 2007, H.Hrg. 110-30 (Washington: GPO, 2007), pp. 1, 2.

<sup>68</sup> U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2005*, p. 334, at <http://www.gpoaccess.gov/usbudget/fy05/pdf/budget/sba.pdf>; U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2006*, p. 313, at <http://www.gpoaccess.gov/usbudget/fy06/pdf/budget/sba.pdf>; and U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2007*, p. 283, at <http://www.gpoaccess.gov/usbudget/fy07/pdf/budget/sba.pdf>.

<sup>69</sup> U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2008*, pp. 139, 140, at <http://www.gpoaccess.gov/usbudget/fy08/pdf/budget/sba.pdf>; and U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2009*, p. 130, at <http://www.gpoaccess.gov/usbudget/fy09/pdf/budget/sba.pdf>. The Bush Administration also proposed to increase the interest rate charged to intermediaries.

<sup>70</sup> U.S. Congress, House Committee on Small Business, *Full Committee Legislative Hearing on the SBA's Microloan and Trade Programs*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., July 12, 2007, H.Hrg. 110-35 (Washington: GPO, 2007), p. 37.

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*, pp. 37, 38.

<sup>73</sup> U.S. Congress, House Committee on Small Business, *Full Committee Hearing on the Small Business Administration's Microloan Program*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., June 14, 2007, H.Hrg. 110-30 (Washington: GPO, 2007), p. 7.

<sup>74</sup> U.S. Congress, House Committee on Small Business, *Full Committee Legislative Hearing on the SBA's Microloan and Trade Programs*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., July 12, 2007, H.Hrg. 110-35 (Washington: GPO, 2007), p. 27.

important that the SBA has a program whose sole focus is to assist Microloan borrowers in starting microbusinesses and have in place intermediaries that “have essential expertise on the needs of this key demographic.”<sup>75</sup>

Advocates also argue that the SBA’s Microloan marketing, management, and technical assistance grants program is “a crucial element which enables intermediaries to assist microbusiness owners step by step through their development and growth” and “not only increases the likelihood of full repayment of the loan, but augments business survival and success.”<sup>76</sup> As mentioned previously, intermediaries typically require Microloan borrowers to participate in the training program as a condition of the receipt of the microloan.

## Program Cost

Critics of the SBA’s Microloan program argue that it is expensive relative to other SBA programs, costing about \$8,960 per small business assisted in FY2014, compared to \$1,456 per small business assisted in the SBA’s 7(a) loan guarantee program.<sup>77</sup> President George W. Bush cited the program’s higher expense when he recommended in his FY2005, FY2006, and FY2007 budget requests to Congress that the program be terminated and when he recommended in his FY2008 and FY2009 budget requests to Congress that the interest rate charged to Microloan intermediaries be increased to make the program “self-financing.”<sup>78</sup>

Advocates argue that the program’s higher cost per small business assisted is unavoidable given the relatively unique nature of the program and the special needs of its borrowers. They assert that intermediaries often have to spend a significant amount of time with Microloan borrowers because those borrowers tend to have less experience with the credit application process and a more difficult time documenting their qualifications for assistance than borrowers in the SBA’s loan guaranty programs. Also, in their view, raising the interest rate charged to intermediaries to make the program self-financing would reduce the program’s cost, but could also defeat the program’s purpose. They assert that because microloans are small, it is difficult for intermediaries to generate enough interest income to cover their costs. As a result, if the interest rate charged to intermediaries is increased, they contend that intermediaries would have to pass the increase on to Microloan borrowers. In their view, increasing the program’s cost to Microloan borrowers “will create an economic hardship for them and make it more difficult for them to grow their businesses” and “lead to fewer jobs created and fewer tax dollars paid.”<sup>79</sup>

<sup>75</sup> Ibid., p. 7.

<sup>76</sup> Ibid.

<sup>77</sup> SBA, “Fiscal Year 2016 Congressional Budget Justification and FY2014 Annual Performance Report,” pp. 37, 38, 94, at <https://www.sba.gov/sites/default/files/1-FY%202016%20CBI%20FY%202014%20APR.PDF>.

<sup>78</sup> U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2008*, pp. 139, 140, at <http://www.gpoaccess.gov/usbudget/fy08/pdf/budget/sba.pdf>; U.S. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2009*, p. 130, at <http://www.gpoaccess.gov/usbudget/fy09/pdf/budget/sba.pdf>; U.S. Congress, House Committee on Small Business, *Full Committee Legislative Hearing on the SBA’s Microloan and Trade Programs*, 110<sup>th</sup> Cong., 1<sup>st</sup> sess., July 12, 2007, H.Hrg. 110-35 (Washington: GPO, 2007), p. 38; and U.S. Congress, House Committee on Small Business, Subcommittee on Finance and Tax, *Subcommittee Hearing on Improving the SBA’s Access to Capital Programs for our Nation’s Small Businesses*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 5, 2008, H.Hrg. 110-76 (Washington: GPO, 2008), p. 33.

<sup>79</sup> U.S. Congress, House Committee on Small Business, Subcommittee on Finance and Tax, *Subcommittee Hearing on Improving the SBA’s Access to Capital Programs for our Nation’s Small Businesses*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., March 5, 2008, H.Hrg. 110-76 (Washington: GPO, 2008), p. 46.

## Program Administration

On December 28, 2009, the SBA's Office of Inspector General released an analysis of the SBA's administration of the Microloan program. It reported a number of deficiencies that it argued needed to be addressed. The analysis was undertaken in response to language in P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), directing Offices of Inspector General to perform audits of their respective agencies to determine whether adequate safeguards exist concerning the use of ARRA funds.<sup>80</sup>

## Program Oversight

The SBA's Office of Inspector General (OIG) found that the SBA's oversight of the Microloan program "was not sufficient to ensure effective operation of the Microloan program":

SBA's oversight is focused on the intermediaries' ability to repay their SBA loans and is limited to a cursory review of quarterly financial reports supported by only one monthly bank statement.... The bank statements are used to simply verify the outstanding balances reported on the intermediaries' quarterly reports. This review process does not allow SBA to analyze the sources and uses of funds ... which is necessary to detect inappropriate fund transfers between the intermediaries' [Microloan Revolving Funds and Loan Loss Reserve Funds] accounts.<sup>81</sup>

The OIG's report noted that the SBA only conducts onsite reviews when an intermediary defaults on its SBA loan. It also argued that the program was inadequately staffed, operating at that time "with 6 analysts who oversee more than 160 intermediaries, 460 intermediary loans, and approximately 2,500 microloans per year."<sup>82</sup>

The SBA agreed with the OIG that a more detailed review of the financial information provided by intermediaries was appropriate. It now collects three months of bank statements each quarter from intermediaries. It also hired three additional staff members to monitor the program's ARRA funding, and indicated that it will continue to reassess the program's overall staffing needs.<sup>83</sup>

## Reliability of the Microloan Program's Performance Data

The SBA's OIG found that the SBA's reported Microloan borrower default rate of 12% "appeared low given the high-risk nature of the program."<sup>84</sup> It found that one intermediary made 1,182 microloans valued at over \$11 million since 1993 and only reported slightly more than a 1% historical default rate, and 39 other intermediaries that reported that none of their loans had defaulted. It also identified duplicate loan reporting; multiple loans to Microloan borrowers in the same amount, indicating the use of revolving lines of credit, which is disallowed by program regulations; and 92 Microloan borrowers with outstanding microloan balances exceeding the then-\$35,000 limit. It noted that ARRA "makes clear the importance of data verification" yet "all

<sup>80</sup> SBA, Office of the Inspector General, "SBA's Administration of the Microloan Program under the Recovery Act," p. 1, at <https://www.sba.gov/sites/default/files/oig/om10-10.pdf>.

<sup>81</sup> *Ibid.*, p. 4.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*, p. 8.

<sup>84</sup> *Ibid.*, p. 4.

of the data used by SBA to report on the Microloan program performance is based on unverified information that is self-reported by intermediaries.”<sup>85</sup> It concluded that “as a result, SBA cannot ensure that the reported microloan default rates are accurate and comply with the statutory requirement.”<sup>86</sup>

In response, the SBA agreed with the OIG with the need for accurate program data and indicated that microloan data will be evaluated as part of a “data quality initiative to identify areas for improvement.”<sup>87</sup> The SBA also indicated that it will revise its SOPs (standard operating procedures) to “include guidance on data review and procedures for following up with intermediaries to resolve data discrepancies.”<sup>88</sup> An SOP for the Microloan program providing intermediaries guidance regarding the Microloan procedures and program requirements was subsequently issued with an effective date of March 1, 2013.

### Outcome-Oriented Performance Measures

The SBA’s OIG found that the SBA’s program performance is based on the number of microloans funded and small businesses assisted. It argued that these “performance metrics ... do not ensure the ultimate program beneficiaries, the microloan borrowers, are truly assisted by the program” and “without appropriate metrics, SBA cannot ensure the Microloan program is meeting policy goals.”<sup>89</sup> It noted that the SBA does not track the number of microloan borrowers who remain in business after receiving a microloan to measure the extent to which the loans contributed to the success of borrowers and does not determine the effect that technical training assistance may have on the success of microloan borrowers and their ability to repay loans.<sup>90</sup> It recommended that the SBA “develop additional performance metrics to measure the program’s achievement in assisting microloan borrowers in establishing and maintaining successful small businesses.”<sup>91</sup>

In response, the SBA indicated that it has “contracted with the Aspen Institute to advise on appropriate program and performance metrics for both microloans and technical assistance grants.”<sup>92</sup> It also indicated that the program metrics developed will be used to assist the agency in measuring the Microloan program’s effectiveness.

## Legislation

The 111<sup>th</sup> Congress considered several bills concerning the Microloan program before passing the Small Business Jobs Act of 2010 (P.L. 111-240), which made several changes to the program. The act was signed into law by President Obama on September 27, 2010. Since then, no bills were introduced during the 112<sup>th</sup> Congress concerning the Microloan program and, to date, just one bill has been introduced in the 113<sup>th</sup> Congress that would affect the Microloan program. H.R. 3191,

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<sup>85</sup> Ibid., p. 5.

<sup>86</sup> Ibid.

<sup>87</sup> Ibid., p. 8.

<sup>88</sup> Ibid., p. 9.

<sup>89</sup> Ibid., p. 6.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid., p. 7.

<sup>92</sup> Ibid., p. 9.

the Expanding Opportunities to Underserved Businesses Act, introduced and referred to the House Committee on Small Business on September 26, 2013, would increase the Microloan program's loan limit for borrowers from \$50,000 to \$75,000.

During the 111<sup>th</sup> Congress, H.R. 3854, the Small Business Financing and Investment Act of 2009, was passed by the House by a vote of 389-32, on October 29, 2009.<sup>93</sup> The Senate did not act on the bill. It would have authorized several new SBA programs and changed several existing SBA programs, including the Microloan program. For example, it would have

- increased the Microloan program's loan funding to "such sums as may be necessary" to support \$110 million in direct microloans in FY2010 and \$110 million in FY2011.<sup>94</sup>
- increased the program's marketing, management, and technical assistance grant funding to \$80 million in FY2010 and \$80 million in FY2011.
- authorized \$20 million (\$10 million in FY2010 and \$10 million in FY2012) for a new Microloan interest assistance grant program.<sup>95</sup>
- broadened the eligibility requirements for Microloan intermediaries to qualify for lower interest rates.<sup>96</sup>
- increased the program's maximum loan amount to intermediaries during their first year of participation in the program from \$750,000 to \$1 million, and in later years from an aggregate of \$3.5 million to \$7 million. The SBA's Administrator would have been provided discretion to increase the limit to \$10 million if such treatment was determined by the SBA Administrator to be appropriate.<sup>97</sup>
- broadened the eligibility requirements for Microloan intermediaries "to help expand access to the Microloan program."<sup>98</sup>

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<sup>93</sup> H.R. 3854 combined language from eight bills and would have authorized changes to several SBA programs and create several new programs. For further analysis, see CRS Report R41385, *Small Business Legislation During the 111<sup>th</sup> Congress*, by Robert Jay Dilger and Gary Guenther.

<sup>94</sup> H.R. 3854, the Small Business Financing and Investment Act of 2009, §310. Authorization of Appropriations.

<sup>95</sup> Ibid.

<sup>96</sup> H.R. 3854, the Small Business Financing and Investment Act of 2009, §307. Interest Rates and Loan Size. The interest rate charged to intermediaries is based on the five-year Treasury rate, adjusted to the nearest one-eighth percent, less 1.25%. However, intermediaries that maintain an average loan size of \$7,500 or less are charged an interest rate based on the five-year Treasury rate, adjusted to the nearest one-eighth percent, less 2.0%. H.R. 3854 would have enabled more intermediaries to qualify for the lower rate by increasing the required average loan size from \$7,500 to \$10,000.

<sup>97</sup> U.S. Congress, House Committee on Small Business, Small Business Financing and Investment Act of 2009, report to accompany H.R. 3854, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 34; and H.R. 3854, the Small Business Financing and Investment Act of 2009, §304. Increased Limit on Intermediary Borrowing.

<sup>98</sup> U.S. Congress, House Committee on Small Business, Small Business Financing and Investment Act of 2009, report to accompany H.R. 3854, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 34. At that time, intermediaries must have made and serviced short-term, fixed rate loans of not more than \$35,000 (now \$50,000) to newly established or growing small businesses for at least one year and have at least one year of experience providing technical assistance to its borrowers. Under H.R. 3854, intermediaries would have been required to have at least one year of experience making microloans to startup, newly established, or growing small business concerns, or have a full-time employee who has not less than three years' experience in managing a portfolio of loans to startup, newly established, or growing small business concerns. They would have been required to also have at least one year of (continued...)

- required the SBA to establish a process under which Microloan intermediaries “provide to the major credit reporting agencies the information about the borrower, both positive and negative, that is relevant to credit reporting, such as the payment activity of the borrower on the loan.”<sup>99</sup>
- provided lenders with the authority to offer more flexible loan terms to Microloan borrowers, particularly with longer-term loans or revolving lines of credit, by removing existing requirements that all microloans be “short-term.”<sup>100</sup>
- increased the percentage of technical assistance grant funds that an intermediary can spend on prospective borrowers from 25% to 35%, and on the provision of technical assistance through third-party providers from 25% to 35%.<sup>101</sup>
- required the SBA to annually provide the House Committee on Small Business and the Senate Committee on Small Business and Entrepreneurship a detailed, comprehensive report on the Microloan program.<sup>102</sup>

S. 2869, the Small Business Job Creation and Access to Capital Act of 2009, was ordered to be reported by the Senate Committee on Small Business and Entrepreneurship on December 10, 2009. It would have authorized changes to several SBA programs, including the Microloan program. The Senate did not take further action on the bill, but several of its provisions, including those affecting the Microloan program, were later included in P.L. 111-240. For example, it would have

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experience providing, as an integral part of its microloan program, intensive marketing, management, and technical assistance to its borrowers, or one full-time employee who has not less than one year experience providing, as an integral part of its microloan program, intensive marketing, management, and technical assistance to its borrowers. This change would have allowed an aspiring intermediary with no direct experience in microlending and technical assistance to hire trained employees with considerable, equivalent experience and still qualify to participate in the program.

<sup>99</sup> H.R. 3854, the Small Business Financing and Investment Act of 2009, §301. Microloan Credit Building Initiative. This change was designed to enhance Microloan borrowers’ credit scores and their future access to capital. Intermediaries generally opposed the provision, viewing it as an administrative burden. U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 34.

<sup>100</sup> H.R. 3854, the Small Business Financing and Investment Act of 2009, §302. Flexible Credit Terms; and U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 34.

<sup>101</sup> U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111<sup>th</sup> Cong., 1<sup>st</sup> sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 35.

<sup>102</sup> H.R. 3854, the Small Business Financing and Investment Act of 2009, §308. Reporting Requirement. The report was to include the following information: the names and locations of each intermediary participating in the program; the amounts of each loan and each grant provided to each intermediary during the fiscal year and in prior fiscal years; a description of the contributions from nonfederal sources; the number and amounts of microloans made by intermediaries to all borrowers and to each of the following: women entrepreneurs and business owners, low-income entrepreneurs and business owners, veteran entrepreneurs and business owners, disabled entrepreneurs and business owners, and minority entrepreneurs and business owners; a description of the marketing, management, and technical assistance provided by each intermediary to all borrowers and to each of the following: women entrepreneurs and business owners, low-income entrepreneurs and business owners, veteran entrepreneurs and business owners, disabled entrepreneurs and business owners, and minority entrepreneurs and business owners; the number of jobs created and retained as a result of microloans and marketing, management, and technical assistance provided by each intermediary; the repayment history of each intermediary; and the number of businesses that achieved success after receipt of a microloan.

- increased the SBA's Microloan program's maximum loan amount to intermediaries after their first year of participation in the program from \$3.5 million to \$5 million;<sup>103</sup> and
- increased the maximum loan amount to Microloan borrowers from \$35,000 to \$50,000.<sup>104</sup>

P.L. 111-240 authorized the Secretary of the Treasury to create a \$30 billion SBLF to encourage community banks to provide small business loans (\$4 billion was issued), a \$1.5 billion State Small Business Credit Initiative, and about \$12 billion in tax relief for small businesses. It also includes revenue raising provisions to offset the act's cost, and authorizes a number of changes to the SBA's loan guaranty, export promotion, and contracting programs, including changes to the SBA's Microloan program. For example, it

- authorized the SBA to increase the Microloan program's loan limit for borrowers from \$35,000 to \$50,000, and for Microloan intermediaries after their first year of participation in the program from \$3.5 million to \$5 million;<sup>105</sup> and
- temporarily allowed the SBA to waive, in whole or in part through FY2012, the nonfederal share requirement for loans to the Microloan program's intermediaries and for grants made to Microloan intermediaries for small business marketing, management, and technical assistance under specified circumstances (e.g., the economic conditions affecting the intermediary and the intermediary's performance) for up to a fiscal year.<sup>106</sup>

## Concluding Observations

During the 111<sup>th</sup> Congress, congressional debate concerning proposed changes to the SBA's loan guaranty programs, including the Microloan program, centered on the likely impact the changes would have on small business access to capital, job retention, and job creation. As a general proposition, some, including President Obama, argued that economic conditions made it imperative that the SBA be provided additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs.<sup>107</sup> Others worried about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocated business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small business economic growth and job creation.<sup>108</sup>

<sup>103</sup> S. 2869, the Small Business Job Creation and Access to Capital Act of 2009, §103. Maximum Loan Limits Under Microloan Program.

<sup>104</sup> Ibid.

<sup>105</sup> P.L. 111-240, the Small Business Jobs Act of 2010, §1113. Maximum Loan Limits Under Microloan Program.

<sup>106</sup> P.L. 111-240, the Small Business Jobs Act of 2010, §1401. Matching Requirements Under Small Business Programs.

<sup>107</sup> Representative Nydia Velázquez, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12074, H12075; Senator Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12910; and The White House, "Remarks by the President on Job Creation and Economic Growth," December 8, 2009, at <http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth>.

<sup>108</sup> Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," Washington, DC, October 21, (continued...)

In terms of specific program changes, the provisions considered in H.R. 3854 and S. 2869 and authorized by P.L. 111-240 (allowing the SBA to temporarily waive the Microloan program's nonfederal share matching requirements, increasing its loan limit for borrowers from \$35,000 to \$50,000, and increasing its loan limit for intermediaries after their first year of participation in the program from \$3.5 million to \$5 million) were all designed to achieve the same goal: to enhance job creation by increasing the ability of Microloan borrowers to obtain credit at affordable rates. Determining how specific changes in federal policy are most likely to enhance job creation is a challenging question. For example, a 2008 Urban Institute study concluded that differences in the term, interest rate, and amount of SBA financing "was not significantly associated with increasing sales or employment among firms receiving SBA financing."<sup>109</sup> However, they also reported that their analysis accounted for less than 10% of the variation in firm performance. The Urban Institute suggested that local economic conditions, local zoning regulations, state and local tax rates, state and local business assistance programs, and the business owner's charisma or business acumen also "may play a role in determining how well a business performs after receipt of SBA financing."<sup>110</sup>

As the Urban Institute study suggests, given the many factors that influence business success, measuring the SBA's Microloan program's effect on job retention and creation is complicated. That task is made even more challenging by the absence of performance-oriented measures that could serve as a guide.

The SBA's Office of Inspector General has recommended that the SBA adopt performance-oriented measures, specifically recommending that the SBA track the number of Microloan borrowers who remain in business after receiving a microloan to measure the extent to which the Microloan program contributed to their ability to stay in business. It has also recommended that the SBA require intermediaries to report the technical assistance provided to each Microloan borrower and "use this data to analyze the effect technical assistance may have on the success of Microloan borrowers and their ability to repay microloans."<sup>111</sup> Other performance-oriented measures that Congress might also consider include requiring the SBA to survey Microloan borrowers to measure the difficulty they experienced in obtaining a loan from the private sector; the ease or difficulty of finding, applying, and obtaining a microloan from an intermediary; and the extent to which the microloan or technical assistance received contributed to their ability to create jobs or expand their scope of operations.

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2009, at <http://www.nfib.com/press-media/press-media-item?cmsid=50080>; and NFIB, "Government Spending," Washington, DC, at <http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49051/>.

<sup>109</sup> Shelli B. Rossman and Brett Theodos, with Rachel Brash, Megan Gallagher, Christopher Hayes, and Kenneth Temkin, *Key Findings from the Evaluation of the Small Business Administration's Loan and Investment Programs: Executive Summary* (Washington, DC: The Urban Institute, January 2008), p. 58, at [http://www.urban.org/UploadedPDF/411602\\_executive\\_summary.pdf](http://www.urban.org/UploadedPDF/411602_executive_summary.pdf).

<sup>110</sup> *Ibid.*

<sup>111</sup> SBA, Office of the Inspector General, "SBA's Administration of the Microloan Program under the Recovery Act," pp. 6, 7, at <https://www.sba.gov/sites/default/files/oig/om10-10.pdf>.

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