

# **U.S. Small Business Administration**

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## **Presentation to SEC Forum**

November 2009

## Themes

- ***Small businesses represent one of the largest segments of the U.S. economy and employment.***
- ***Small businesses drive significant job creation and economic growth.***
- ***Small businesses play a critical role in innovation and will drive the creation of 21<sup>st</sup> century jobs.***
- ***Small businesses reflect the diversity of our nation, helping to ensure that all Americans have a path toward economic prosperity.***
- ***In the two most recent recessions, small businesses led the economic recovery and fostered continued growth.***

## Supporting Facts

- Firms with fewer than 500 employees represent 99.7% of all employer firms
- They employ just over half of all private sector employees
- These firms pay 44% of total U.S. private sector payroll and create more than half of non-farm private GDP
- Firms with fewer than 500 employees have accounted for 14.5 million net new jobs between 1993 and the third quarter of 2008
- Small businesses hire 40 percent of high tech workers (such as scientists, engineers, and computer programmers).
- SBA's Office of Advocacy study shows that small firms produce 13 times more patents per employee than large firms.
- Of the 23 million nonfarm businesses in 2002 (latest available data), women owned 6.5 million businesses generating \$940.8 billion in revenues.
- Racial and ethnic minorities owned 4.1 million firms that generated \$694 billion in revenues.
- Small businesses accounted for a significant share of job creation and retention.
- In the recovery period following the economic recession of 2001, small businesses drove positive employment gains one to two quarters before larger businesses did.

The **small business credit market is still challenged**, as tightened standards have yet to ease for conventional small business lending, despite some stabilization since previous quarters. Credit standards continue to be affected by **reduced tolerance for risk** and a **more uncertain economic outlook**. A significant driver of reduced C&I lending has been decreased activity in revolving lines of credit, illustrating the **market gap in working capital**.

•**16% of loan officers still report tightening standards for small firms (vs. 36% in last survey)**

- A smaller share of loan officers report tightening, while the majority (84%) say standards remain basically unchanged
- This quarter marks the **8th consecutive quarter of reported tightening** at double-digit percentage levels
- 0% of loan officers reported loosening of standards

•**Why are banks tightening standards?** Banks report the following as important factors:

- 78% claim **reduced tolerance for risk**
- 74% claim less favorable or more **uncertain economic outlook**
- Less than 20% claim deterioration in capital position, and less than 7% claim deterioration in liquidity position

•**Why has C&I lending decreased?** Banks report the following as important factors:

- 89% report decreased originations of term loans
- 87% report decreased draws on revolving lines of credit, potentially reflecting the **gap in working capital**; and 70% report increased pay downs on other draws of revolving credit lines

•**45% of officers report weaker demand from small firms (vs. 60% in last survey)**

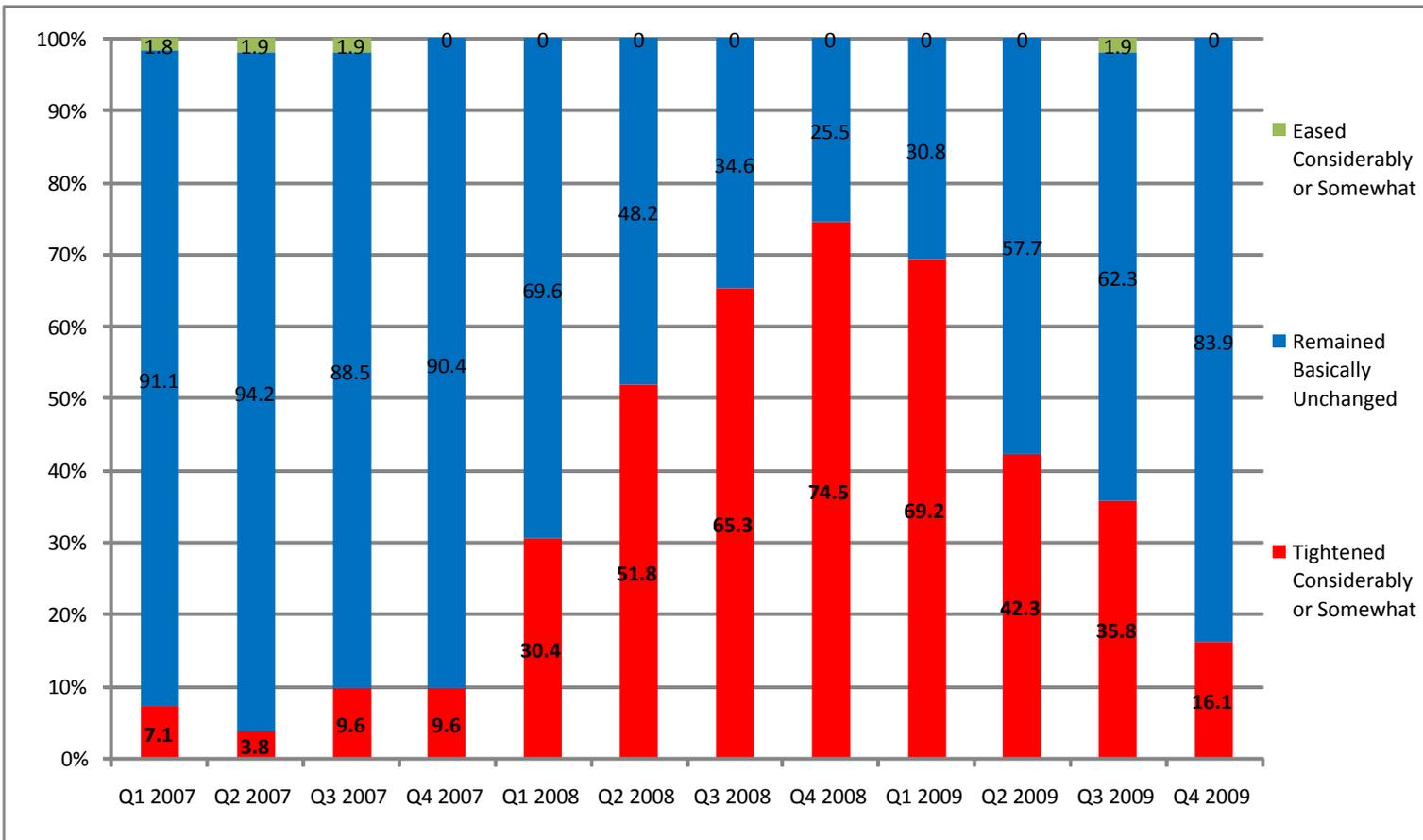
- Demand is decreasing potentially because of decreased investment in plant/equipment and decreased inventories/AR/M&A activity

•**Small businesses still report decreased and costlier lines of credit:**

- 15% say the size of credit lines is still decreasing—while the majority say lines have remained unchanged
- 38% report the cost of credit line is still worsening

# Small business credit market is still challenged, as tightened credit standards have yet to ease

Percent of Bank Loan Officers who report how credit standards have changed for small business firms over past three months



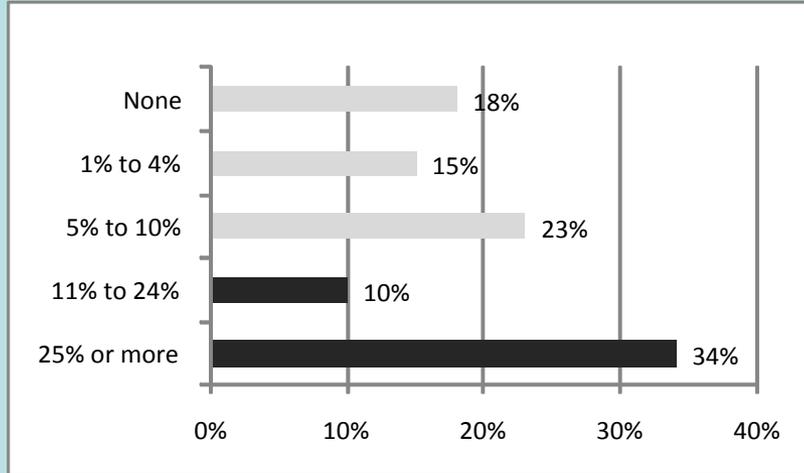
•After increased tightening for two years, the majority of Bank Senior Loan Officers (84%) report stabilization in credit standards in FY Q4 2009

Tightened standards demonstrates the importance of increased guaranties to address risk aversion & increase access to capital

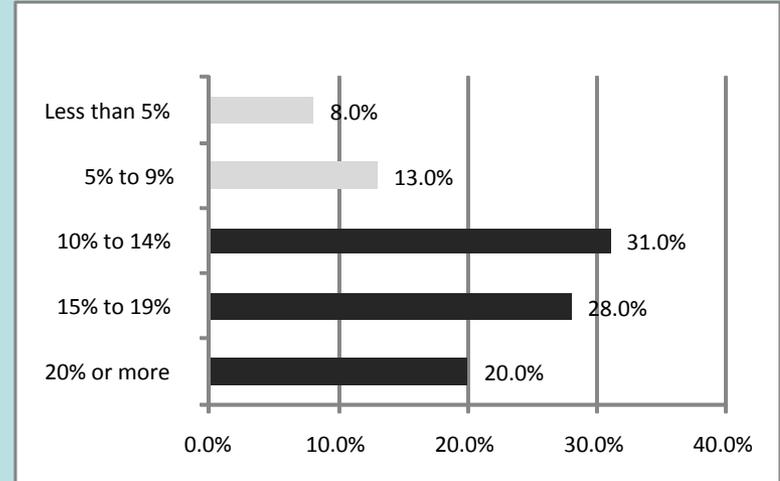
•Yet, there is still minimal sign of easing credit standards

# How Small Businesses Are Affected by the Economic Downturn: Non-Traditional Credit

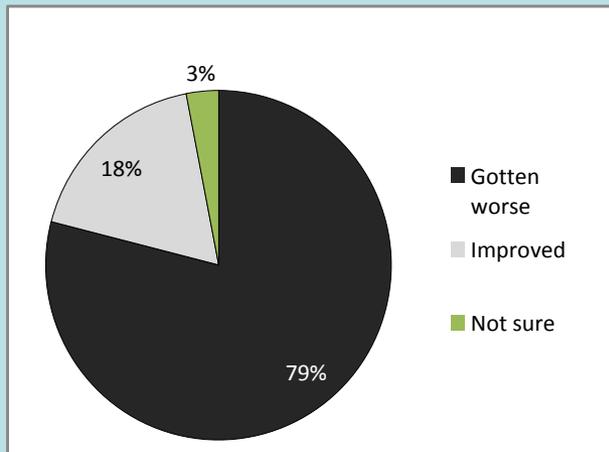
Small businesses rely on credit cards for a **significant portion of their debt...**



...and pay much **higher interest rates** on these cards (than alternate credit products).



The vast majority report that **terms have worsened** in the past five years...



...and the **problems have gotten more severe** in the last year

- 63% reported **interest rate increased**
- 41% reported **credit limit reduced**
- 25% reported a switch from **fixed to variable interest rate**

- While credit cards have been widely used (or overused) by small businesses, they are likely **not a sustainable form of financing**
- This trend **highlights the need for more working capital solutions**

## Impact of the Recovery Act

- In October 2008, credit markets, including SBA's, froze, and the SBA secondary market slowed dramatically.
- On March 16, SBA implemented two critical Recovery Act provisions:
  - 90% guarantees on 7(a) loans, and
  - Fee reductions in both the 7(a) and 504 programs.
- These provisions have helped drive significantly improved loan volumes from the depths of the crisis.
  - **Expanded access to capital:** As of October 30, SBA approved<sup>1</sup> \$10.2 billion in Recovery loans, and supported \$13.9 billion in lending to small businesses<sup>2</sup>.
  - **New lenders:** From Feb. 17 to September 30, over 1,260 lenders that had not previously made a loan since Oct. 2008 made 7(a) or ARC loans. As of October 30, there were over 840 who had not made a loan since at least 2007.
  - **Recovered volumes:** Since the signing of ARRA, weekly loan dollar volumes have risen 76% in the 7(a) and 504 programs, compared to the weeks preceding ARRA's passage<sup>3</sup>. September 2009's gross 7(a) and 504 approval volume was SBA's highest loan volume since August 2007
  - **Broad-based support:** A significant share of loans supported by Recovery Act funding has gone to rural (27%), minority-owned (20%), women-owned (19%), and veteran-owned (9%) businesses<sup>4</sup>
  - **SBA has implemented the ARC loan program:** As of November 1, SBA approved 3,767 loans totaling over \$122 million<sup>5</sup>.
- The secondary market has also recovered.
  - **Improved secondary market volume:** Over the past five months (May – October), the average monthly loan volume settled from lenders to broker-dealers in the 7(a) secondary market has been \$344 million and \$322 million settled in October 2009
  - **Recovering premiums:** In October, 83% of the loans settled, representing 76% of total dollars, were sold at or above premiums of 106 – a return to 2007 premium levels. By comparison, in January and February, zero loans sold at premiums above 106.

<sup>1</sup> This is the total gross loan value approved since February 17. Typically, due to cancellations and loan size reductions, 15 – 20% of gross approval value does not get disbursed.

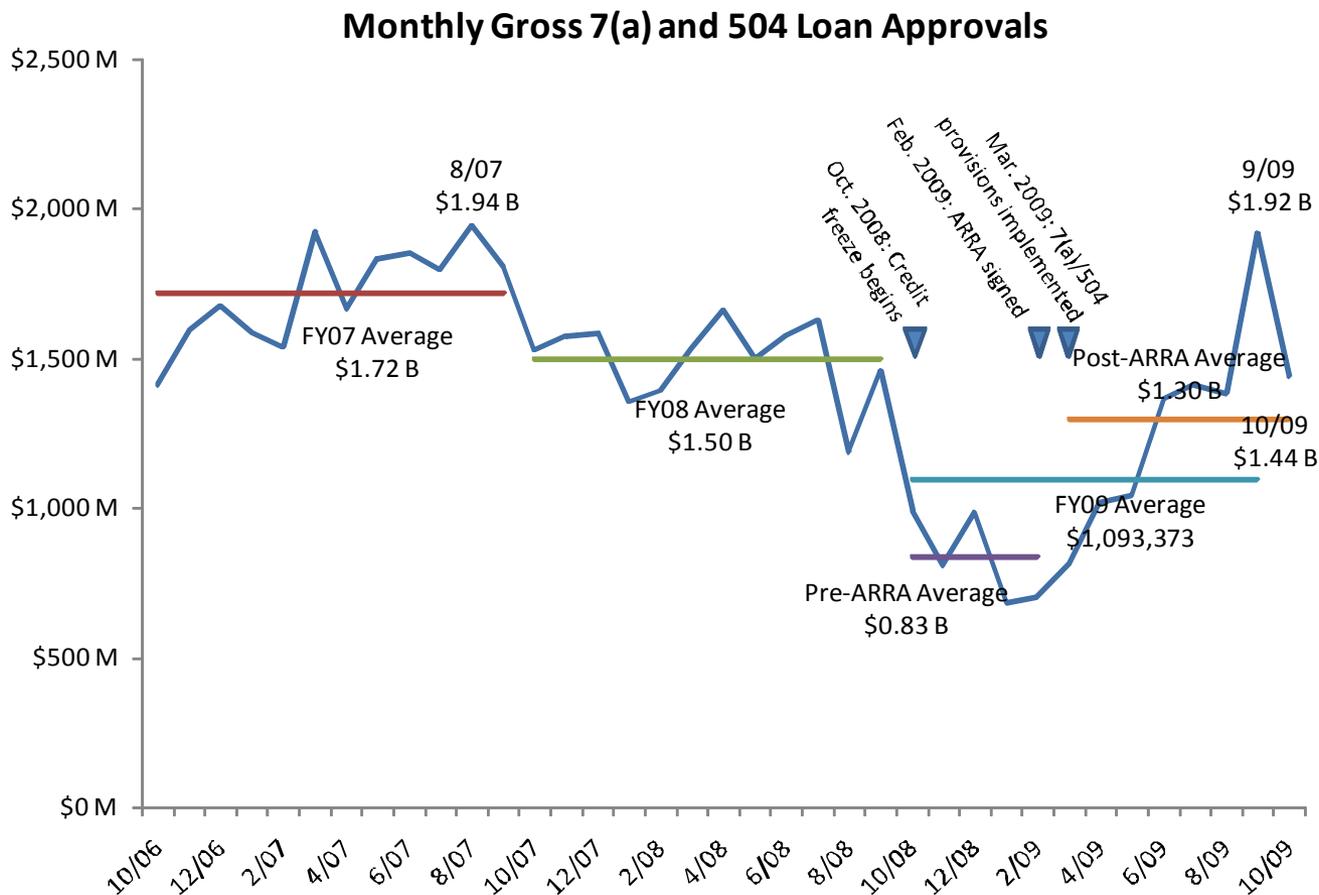
<sup>2</sup> Includes estimate of 504 third-party first mortgages (calculated as 125% of SBA 504 debenture portion due to typical 50/40 split between third-party and SBA portion of 504 loan)

<sup>3</sup> Compares average weekly gross approvals in the 7 weeks prior to Recovery Act to the average weekly gross approvals since the Recovery Act was signed. Normalized for market holidays as well as disruptions caused by Washington, DC water outage (August 7, 2009).

<sup>4</sup> Demographic data is self-reported.

<sup>5</sup> See Footnote 1.

# Monthly 7(a) and 504 Loan Volume: FY2007 – 2010



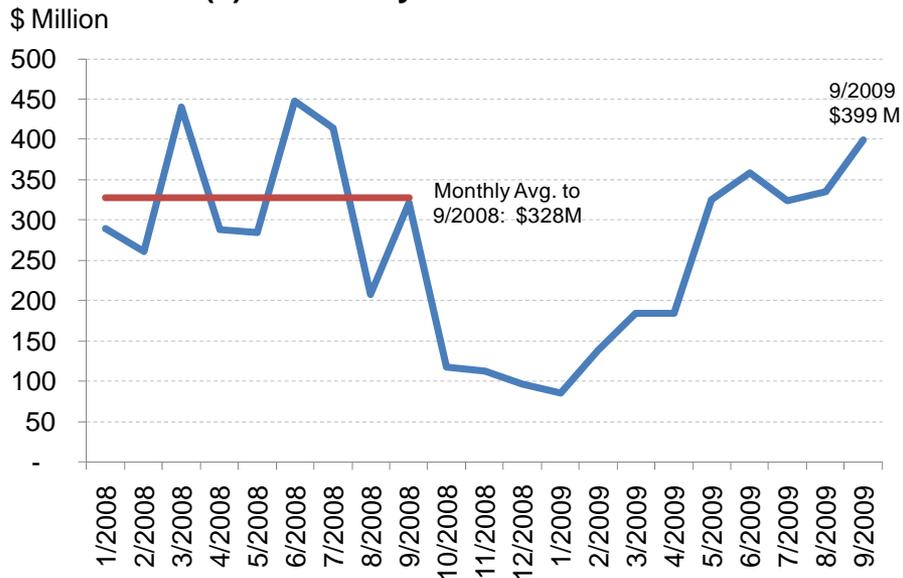
- October 2009's gross 7(a) and 504 approval volume was:
  - 31 percent above the monthly average for FY 2009
  - 4 percent below the monthly average for FY 2008
- Uptick partially driven by increased ongoing annual 504 borrower fees starting in October 2009 (from 0 bps to 38.9 bps)
- FY 2009 loan dollar volumes were 27% lower than FY 2008 loan volume

NOTE: All loan volumes are gross loan value approved. Typically, due to cancellations and loan size reductions, 15 – 20% of gross approval value does not get disbursed.

# Monthly Secondary Market Metrics: September 30, 2009

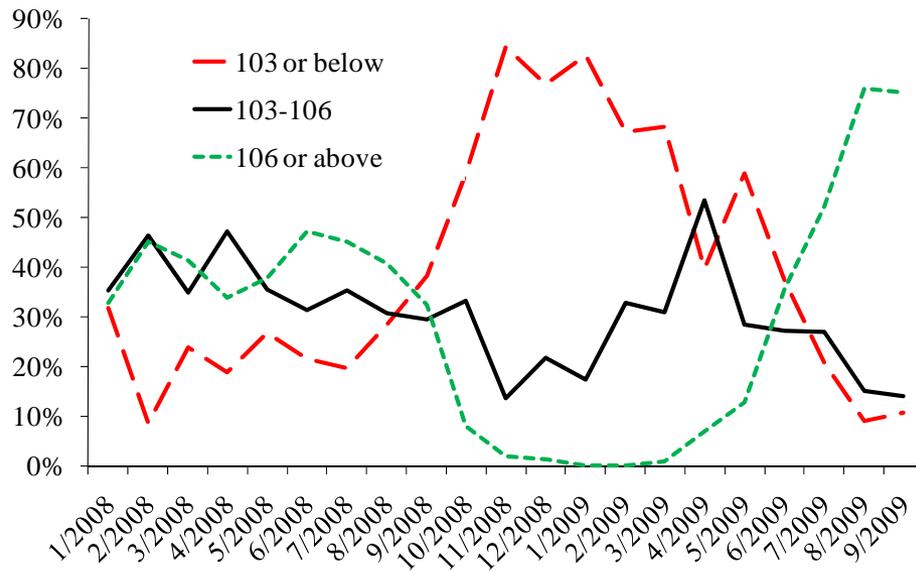
## Volume

### 7(a) Secondary Market Settled Value



## Pricing

### 7(a) Secondary Market Premium Ranges



**Recovery Continuing:** Over the past five months, the average monthly loan volume settled from lenders to broker-dealers in the 7(a) secondary market has been \$348 million, which is above pre-recession averages. In September 2009, \$399 million settled in this market, the highest level since July 2008.

**Premiums Recovering:** Premiums have begun to recover in the 7(a) secondary market, and for the past 2 months have been at 2007 levels.

**Pricing Improving:** In September, 82% of the loans settled, representing 75% of the total dollars, were sold at or above premiums of 106. By comparison, in January and February, zero loans sold at premiums at or above 106.