

**Report on the
Small Business Administration's**

**SUPPLEMENTAL TERRORIST ACTIVITY RELIEF
LOAN PROGRAM**

**From the Majority Staff of the United States Senate
Committee on Small Business & Entrepreneurship
September 6, 2006**

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PREFACE

In December 2001 Congress approved legislation, later signed into law by the President, that created, among other items, a loan program intended to assist small businesses affected by the tragic events of September 11, 2001 and their aftermath. The Supplemental Terrorist Activity Relief (STAR) loan program sought to provide loans to businesses nationwide that were “adversely affected” by the terrorist attacks and could not obtain adequate financing elsewhere. Prior to the attacks, the Small Business Administration (SBA) already administered a program to provide loans to small businesses nationwide that were unable to obtain adequate financing elsewhere. The only differences between the STAR program and this pre-existing program were that STAR borrowers were identified as those businesses that had been adversely affected by the September 11 attacks, and lenders paid a lower fee to the government to make STAR loans. There were 7,058 STAR loans made during the program’s 12 month existence, for a total volume of approximately \$3.7 billion.

The STAR program was administered by the SBA. It was structured to benefit affected businesses throughout the nation, and was not restricted only to those businesses located in the New York and Washington metropolitan areas.

The Senate Committee on Small Business and Entrepreneurship has the responsibility to oversee the SBA and to encourage the Agency to fulfill its role as a vital resource to this country’s 25 million small businesses. As the foundation of our economy, these small businesses deserve the unwavering support of the SBA and of the country.

As stewards of taxpayers funds, government agencies, such as the SBA, are expected to administer programs with competency and efficiency, and to ensure that participants in those programs adhere to a system of reasonable rules and regulations. When agencies fail to do so, it is Congress’s responsibility to maintain the checks and balances that our founders set in place. The Committee is firmly committed to its oversight responsibility, and the following report is an extension of the Committee’s duties.

2. Summary of Committee Report

On January 10, 2002, in the wake of the terrorist attacks of September 11, 2001, the President signed into law an Emergency Supplemental Act, previously approved by Congress,¹ which appropriated \$40 billion in response to the attacks. Among many other items, that Act appropriated \$75 million to the Small Business Administration (SBA) to subsidize loans to small businesses that were “adversely affected” by the September 11 attacks and their aftermath. The SBA made the loans as a variation of the SBA’s already-existing Section 7(a) loan program, and the SBA named the new program the Supplemental Terrorist Activity Relief (STAR) loan program. The program was administered from January 2002 to January 2003, and 7,058 STAR loans were made for a total volume of approximately \$3.7 billion.

Beginning in September 2005, at the request of Senator Olympia J. Snowe, the current Chair of the Senate Committee on Small Business and Entrepreneurship, the SBA’s Office of the Inspector General (IG) conducted an audit of the STAR program to gauge the validity of media reports that began in that month and alleged that STAR program loans had been made to borrowers that were not eligible. The objective of the audit was to determine whether STAR loan recipients were appropriately qualified to receive STAR loans and whether the SBA established and implemented proper administrative procedures to verify STAR loan recipient eligibility. The IG issued its findings on December 23, 2005.²

The IG reviewed 59 borrower loan files. According to the IG’s report, eligibility for most STAR recipients was difficult to ascertain based on the lender loan files it examined, and ultimately could not be determined for 85 percent of the loan files reviewed by the IG.

Concurrently, Chair Snowe also instructed the Committee’s staff to conduct an examination of the STAR program.

The Committee staff’s review was conducted with the purposes of (a) examining lender documentation used to determine borrower eligibility for the program; (b) assessing borrowers’ eligibility; (c) examining the SBA’s administrative procedures to determine if the procedures were adequate or flawed; and (d) analyzing whether these above matters were in accord with Congressional guidance and intent. Items (a), (b), and (c) had also been analyzed by the IG. The Committee staff’s review of items (a) and (b) were to determine whether results would be found different from the IG’s findings.

¹The full name of the act is Emergency Supplemental Appropriations for Recovery and Response to Terrorist Attacks on the United States, 2002 P.L. 107-117 (the Emergency Supplemental).

²Audit by the Office of the Inspector General of the Small Business Administration on the SBA’s Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program; Issue Date: December 23, 2005; Audit Report Number 6-09 (Appendix A)

During the review, Committee staff examined 66 STAR loan files from 27 lenders. The staff reviewed SBA documentation, lender documentation, and borrower documentation.

The following report is the result of an examination and analysis of the SBA's STAR loan program. This review was conducted independently by the Majority staff at the direction of the Chair. No part of this report was compiled by the SBA, the SBA's Office of the Inspector General, or any other organization, office, or Member of Congress.

3. The SBA's Section 7(a) loan program

Overview

Administered by the SBA's Office of Capital Access (OCA), the 7(a) Loan Guaranty program includes guarantees issued by the SBA for short- and long-term loans made by lending institutions to eligible, credit-worthy start-up and existing small businesses that cannot obtain financing on reasonable terms through normal lending channels.³ The guaranty program is offered through private lenders that are often referred to by the SBA as "participating lenders." There are three principal types of participants in the 7(a) Guaranty process: the small business borrower, the participating lender, and the SBA.

Eligibility Criteria

To qualify for an SBA guaranty, a small business must meet the 7(a) criteria and the lender must certify that it could not provide funding to the small business on reasonable terms without an SBA guaranty.

The eligibility requirements are designed to be as broad as possible so that the lending programs can accommodate a diverse variety of small business financing needs. Some criteria are applicable to all businesses. All businesses seeking a 7(a) loan must:

- Meet SBA size standards,
- Be a for-profit business,
- Not have the internal resources (business or personal) to provide the financing, and
- Demonstrate an ability to repay the loan.

Loans under the program are available for most business purposes, including purchasing real estate, machinery, equipment, and inventory, or for working capital.

Guaranty Levels

Under Section 7(a) loan regulations, the maximum total loan size is \$2 million, but the SBA can guarantee a maximum of \$1 million per 7(a) loan. The maximum SBA guaranty rate per loan is

³The program derives its name from the location of its statutory provisions, which are in Section 7(a) of the Small Business Act. (15 USC 636)

85 percent for loans of \$150,000 or less, 75 percent for loans greater than \$150,000; 90 percent for loans made under the Export Working Capital Program (EWCP); and 50 percent for loans made under the SBA Express program. Borrowers can have more than one loan at a time, as long as the total amount guaranteed does not exceed the SBA's guaranty cap of \$1 million.

Loan Fees & Interest Rates

To offset the costs of the SBA's loan programs to the taxpayer, the agency charges lenders a guaranty fee and a servicing fee for each loan approved. These fees may be passed on to the borrower once they have been paid by the lender. The amounts of the fees are determined by the amount of the loan guaranty and estimated costs of the program during that year.

For loans of \$150,000 or less, the guaranty fee is 1 percent of the guaranteed portion. Lenders may retain 25 percent of this guaranty fee (25 basis points). For loans of more than \$150,000 but less than or equal to \$700,000, the SBA charges a 2.5 percent guaranty fee. For loans greater than \$700,000, the guaranty fee is 3.5 percent. All loans are also subject to a 0.25 percent (25 basis points) annualized servicing fee, which is applied to the outstanding balance of SBA's guaranteed portion of the loan.

Interest rates for 7(a) loans may be fixed or variable. The rates are negotiated between each borrower and lender, but they are subject to SBA-established maximum rates.

4. The Origin of the STAR Program

The STAR program originated in emergency legislation enacted on January 10, 2002. That Act, among many other items, provided that the SBA should reduce the fees paid by lenders for loans made under the 7(a) program from 0.50 percent (50 basis points) of the outstanding balance of the guaranteed portion of the loan to 0.25 percent (25 basis points) if the borrowers had been "adversely affected" by the September 11, 2001 terrorist attacks.⁴ The SBA delegated to its participating lenders discretion to assess the eligibility of individual borrowers, and informed lenders that the lenders would have to document that assessment but need not submit it to the SBA.⁵ In addition to existing small business owners that had experienced difficulty in maintaining normal business operations, start-up small businesses that had planned to begin operating, but were impeded from doing so due to the attacks, could also qualify for the program.⁶ The STAR program was not limited to businesses located in the New York and

⁴ **P.L. 107-117, : The entire relevant text of the Emergency Supplemental was: "Sec. 203** Notwithstanding any other provision of law, the limitation on the total amount of loans under section 7(b) of the Small Business Act (15 U.S.C. 636(b)) outstanding and committed to a borrower in the disaster areas declared in response to the September 11, 2001, terrorist attacks shall be increased to \$10,000,000 and the Administrator shall, in lieu of the fee collected under section 7(a)(23)(A) of the Small Business Act (15 U.S.C. 636(a)(23)(A)), collect an annual fee of 0.25 percent of the outstanding balance of deferred participation loans made under section 7(a) to small businesses adversely affected by the September 11, 2001, terrorist attacks and their aftermath, for a period of 1 year following the date of enactment and to the extent the costs of such reduced fees are offset by appropriations provided by this Act."

⁵ SBA Procedural Notice 5000-779- 1/31/2002 stated, "Documentation must be available for review by SBA, but need not be submitted to SBA." (Appendix B)

⁶ SBA Procedural Notice 5000-779- 1/31/2002 (Appendix B)

Washington metropolitan areas, but was intentionally structured to benefit businesses across the country.

FIGURE 1.
Fee Comparison: Standard 7(a) loans vs. STAR loans

Fees	Fees in Regular 7(a) Program From Jan 11, 2002 through Sep. 30, 2002 (overlap with first 8.5 months of STAR program)	Fees in STAR Program Jan. 11, 2002-Sep. 30, 2002	Fees in Regular 7(a) Program Beginning Oct. 1 2002 (overlap with last 3.5 months of STAR program)	Fees in STAR Program Oct. 1, 2002-Jan. 10, 2003
Loans up to \$150,000 (Charged to lender, may be passed on to borrower)	2.0 %	2.0 %	1.0 %	1.0 %
Loans of \$150,001-\$250,000 (Charged to lender, may be passed on to borrower)	3.0 %	3.0 %	2.5 %	2.5 %
Loans of \$250,001-\$700,000 (Charged to lender, may be passed on to borrower)	3.0 %	3.0 %	2.5 %	2.5 %
Loans of \$700,001-\$2 million (Charged to lender, may be passed on to borrower)	3.5 %	3.5 %	3.5 %	3.5 %
Annual Fees (Charged to lender, may NOT be passed on to borrower)	0.50 %	0.25 %	0.25 %	0.25 %
Maximum Loan Size	\$2 million	\$2 million	\$500,000	\$2 million

Prior to passage of the Emergency Supplemental Act of 2002, SBA staff stated that they consulted with the staff of the Senate Committee on Small Business and Entrepreneurship and

that in those discussions there were not disagreements about the basic elements of the STAR program.⁷

5. Background Information on Budget Issues Surrounding the Section 7(a) and STAR Loan Programs:

To gain a full understanding of the STAR program, it is necessary to understand the history of the SBA budget plans and proposals that immediately preceded the creation and implementation of the STAR program.

On August 21, 2001, the Government Accountability Office (GAO), then called the General Accounting Office, issued a report that found the SBA's subsidy rate estimates for the 7(a) program between 1992 and 2000 were inaccurate.⁸ The SBA had drastically over-estimated the necessary subsidy rates and thus the costs of the program. As a result of these over-estimations, the subsidy rates during that time period were higher than necessary and the cost for lenders to provide standard 7(a) loans was nearly double what was necessary, given the actual economic performance of the program.

Chronology of 7(a) Subsidy Rates

1992-2000

Between 1992 and 2000, the SBA over-estimated defaults by over \$2 billion, or about 87 percent, when compared to actual loan performance. The SBA also originally over-estimated recoveries for 1992 through 2000 by nearly \$450 million, or about 62 percent, when compared to actual loan performance.⁹

Oct. 1999-Sept. 2000

From October 1999 through September 2000 (Fiscal Year (FY) 2000), the 7(a) program made 30,196 loans for a total dollar volume of \$9.7 billion. The original subsidy rate was 1.16 percent. The SBA re-estimated the rate to be 0.54 percent, less than half of the original estimate.

Oct. 2000-Sept. 2001

From October 2000 through September 30, 2001 (FY 2001), the 7(a) program made 30,562 loans for a total dollar volume of \$9.1 billion. The original subsidy rate was 1.16

⁷Committee staff met with SBA staff in March 2006 at the main office of the Committee to review several issues pertaining to the STAR program and the Committee's review of the program.

⁸Government Accountability Office Report- GAO-01-1095R *SBA's 7(a) Credit Subsidy Estimates* (Appendix D)

⁹Government Accountability Office Report- GAO-01-1095R *SBA's 7(a) Credit Subsidy Estimates* (Appendix D)

percent. The SBA re-estimated the rate to be 0.47 percent, less than half of the original estimate.¹⁰

Aug. 2001

GAO released report on the subsidy rates for the 7(a) loan program.

Sept. 2001

On September 7, 2001, Senator Kerry and Senator Bond, the then-Chair and Ranking Member of the Senate Committee on Small Business and Entrepreneurship, sent a letter to the Director of the Office of Management and Budget (OMB). The letter noted that since 1992, the SBA had over-estimated the costs of the 7(a) program, leading to inaccurate credit subsidy rates and subsequently, unnecessarily high fees for the lenders and borrowers participating in the program.¹¹

Four days later, the September 11 terrorist attacks occurred.

Oct. 2001

On October 4, 2001, Sen. Kerry introduced S.1499, which, among other items, attempted to amend the Small Business Act to authorize the SBA to make disaster loans to small businesses that were directly affected and suffered substantial economic injury as the result of the terrorist attacks of September 11, 2001.¹² This measure did not become law, but SBA procedural notices used by lenders as guidance for administering the STAR program were loosely based on S. 1499.

Oct. 2001-Sept. 2002

From October 2001 through September 30, 2002 (FY 2002), the 7(a) program made 38,239 loans for a total dollar volume of \$9.4 billion. The original subsidy rate was 1.07 percent. The SBA re-estimated the rate to be 0.31 percent, less than one-third of the original estimate.¹³

Dec. 2001

In December 2001, Congress approved legislation later enacted by the President (P.L.107-100) to reduce by 50 percent the fees in the 7(a) program starting on October 1, 2002. Once in effect, the reduced fees caused the subsidy rate to double (in order to maintain a zero subsidy program), which in turn caused the cost to lenders of providing 7(a) loans to increase.

¹⁰Office of Advocacy Performance and Accountability Report Fiscal Year 2003

¹¹Letter from the Chair and Ranking Member of the Senate Committee on Small Business and Entrepreneurship to the Director of the Office of Management and Budget- 9/7/2001 (Appendix E)

¹²American Small Business Emergency Relief and Recovery Act of 2001 (S.1499)

¹³Office of Advocacy Performance and Accountability Report Fiscal Year 2003

Jan. 2002

In January 2002, Congress passed the emergency supplemental that, among other items, provided \$75 million for special 7(a) loans for businesses “adversely affected” by the 9/11 attacks. The STAR program lasted from January 2002 through January 2003.

Oct. 2001-Sept. 2002

Between October 2001 and September of 2002 (FY 2002), the STAR program (which did not begin until January 2002) had a total dollar volume of \$1.8 billion (half of the total dollar volume of the program). Between October of 2002, which was the beginning of the two-year reduction in fees for 7(a) loans, and the end of the program in January of 2003, the STAR program also had a total dollar volume of approximately \$1.8 billion (half of the total dollar volume of the program).¹⁴

¹⁴Office of Advocacy Performance and Accountability Report Fiscal Year 2003

FIGURE 2.
STAR
CHRONOLOGY OF EVENTS

DATE	EVENT
August 2001	<i>GAO releases report on subsidy rates for the 7(a) loan program.</i>
September 2001	<i>9/11 terrorist attacks occur.</i>
October 2001	<i>Senator Kerry introduces bill (S. 1499) to allow small businesses affected by 9/11 to receive new type of 7(a) loan (difference from regular 7(a) loan is lower fees for lenders and separate appropriation). The bill passes the Senate on March 22, 2002, but never passes the House.</i>
December 2001	<i>P.L. 107-100, introduced by Senator Bond on July 18, 2001, is approved by the Senate and the House and signed into law by the President. As a result, fees in the 7(a) program are reduced by half effective on October 1, 2002.</i>
January 10, 2002	<i>P.L. 107-117 is enacted, containing \$75 million in appropriations for STAR. The STAR program began in January 2002, and new loans continued to be made until January 2003. S. 1499, introduced in October 2001, had not been approved by the Senate at the time the STAR program began.</i>
January 17, 2002	<i>SBA issues Procedural Notice 5000-775 detailing how lenders should implement the new program. The procedural notice hews roughly to the provisions of S. 1499.</i>
January 31, 2002	<i>SBA issues Procedural Notice 5000-779 naming the new program the Supplemental Terrorist Activity Relief (STAR) program.</i>
October 2002	<i>Regular 7(a) loans are capped at \$500,000, from \$2 million, while STAR loans continue to have a maximum size of \$2 million.</i>

Overlap of Budget Issues with the 7(a) and STAR Programs

In 2002, the SBA had underestimated the demand for standard (non-STAR) 7(a) loans and requested insufficient appropriations from Congress for FY 2003 (as it again did for FY 2004, leading to the shutdown of the program in January of 2004). As a result, the Agency implemented a loan cap of \$500,000 (one-fourth of the normal maximum loan size of \$2 million), effective on the first day of FY 2003 (October 1, 2002). STAR loans, however, were not effected by this loan cap because Congress had appropriated funds for the program separate from standard 7(a) appropriations. As a result, STAR loans could still be made up to the full \$2 million per loan. The impact of this disparity between STAR loans and standard 7(a) loans is even more notable considering that the fees in the standard 7(a) loan program were lowered to be

exactly the same as the fees in the STAR program, and this fee reduction became effective on the same day as the new loan cap.

As of October 1, 2002, the fees for issuing STAR loans and standard 7(a) loans were thus identical. From that date on, however, standard 7(a) loans could not be issued in amounts exceeding \$500,000 whereas STAR loans could be issued for amounts up to \$2 million.

Impact

\$1.8 billion in STAR loans (50 percent of the program's total volume) was approved in the first eight and a half months of the program (from January 2002 until the end of FY 2002, on September 30, 2003). Another \$1.8 billion in STAR loans (50 percent of the program's total volume) was approved over the next three and a half months, from October 1, 2002 until the STAR program ended in January of 2003.¹⁵ Thus, half of the STAR program's loan volume (in dollars) was made over a period representing 71 percent of the program's duration, and the other half of the program's volume was made during the last 29 percent of the program's duration.

Because of the dwindling funds available in the 7(a) program during FY 2002 and during the beginning of FY 2003, the STAR program became an alternate means of accessing additional funds for small business loans. As a result, lenders may have taken advantage of the higher loan caps by being more inclined to make loans as STAR loans than had previously been the case.

6. Congressional Intent – “Adversely Affected”

The SBA formulated broad guidelines for the lenders to interpret the definition of the phrase “adversely affected.” It is clear that the Agency wanted the STAR program to be utilized by lenders and borrowers across the country, and not just borrowers located in New York or Washington.¹⁶ According to SBA Procedural Notice 5000-779, a small business concern is:

“A small business that suffered economic harm or disruption of its business operations as a direct or indirect result of the terrorist attacks perpetrated against the United States on September 11, 2001... Agency guidance should not be construed as limiting eligibility to any particular geographic area or to any specific type(s) of business.”

The SBA provided a list of examples of economic harm in the notice, but added that it “does not intend that this list be considered all-inclusive.”¹⁷ The notice also allowed for the lenders to use their discretion when determining whether a business was adversely affected:

¹⁵The STAR Program never ran out of money, but instead ended after its appointed 12-month term without all of its money being allocated. If any STAR loan application was rejected it would have been because the borrower was not qualified, and not that the program was out of funds.

¹⁶Committee staff met with SBA staff in March 2006 at the main office of the Committee to discuss several issues containing to the STAR program and the Committee's review of the program.

¹⁷SBA Procedural Notice 5000-779- 1/31/2002 (Appendix B)

“Determine that the applicant business was ‘adversely affected’ by the terrorist activity of September 11, 2001, and document the basis for this conclusion in loan file. This documentation must be available for review by the SBA, but need not be submitted to the SBA.”

It is evident from statements made in the Congressional Record by Senator Kerry and Senator Bond, at that time the Chair and Ranking Member, respectively, of the Senate Committee on Small Business and Entrepreneurship, that they expected the interpretation of the phrase ‘adversely affected’ would be broad and widely inclusive.¹⁸

Senator Kerry:

“Small Businesses would be better served through a combination of disaster loans and government guaranteed loans...Our proposal combines public and private sector approaches to ensure small businesses nationwide receive the maximum amount of assistance.”

Senator Bond:

“Small businesses from across the United States are continuing to struggle under the dual pressures from the economy and the aftermath of the terrorist attacks.”

Senator Kyl, on the other hand, voiced his concerns over the potential for fraud under a program similar to the STAR program. In October 2001, Senator Kerry had introduced legislation, S. 1499, creating a program similar to the STAR program. Speaking about S. 1499, Senator Kyl stated the following:

“Additionally, S. 1499's language is so broad that loan assistance could be provided to any small business that have ‘been, or, that (are) likely to be directly or indirectly adversely affected’ by the terrorist attacks. Obviously, such language is ripe for abuse and could lead to exorbitant costs for the American taxpayer.”¹⁹

After the STAR program began, the SBA informed lenders that the Agency would not “second-guess” the lenders’ decisions as to which loan applicants had been adversely affected by the 9/11 attacks, or their aftermath. According to press reports, when speaking to a lender’s association in June 2002, the SBA Associate Administrator for Financial Assistance stated the following:

¹⁸Excerpts from the Congressional Record (Appendix E)

¹⁹Excerpts from the Congressional Record (Appendix E)

*“It is not our intent to substitute our judgement for your judgement in these cases. As a matter of fact, we believe that every business can probably demonstrate some degree of economic disadvantage as a result of the terrorist attacks of September 11.”*²⁰

7. SBA Inspector General’s Audit of the STAR Program

In the wake of media reports in September 2005 alleging mismanagement and abuse of the STAR program, Senator Snowe requested an audit by the SBA’s Office of the Inspector General. The purpose of the audit was to examine the program and assess the qualifications of STAR loan recipients and the procedures of the SBA’s management of the program.²¹ The audit report was released on December 23, 2005.

At the same time as the IG was conducting its audit, Committee staff began its own review of the program. Conducted separately and independently, the review by Committee staff yielded similar results to the report by the Inspector General on those issues that were covered by both reviews.

Key Findings of The Inspector General’s Audit

- **IG Conclusion:** Recipient eligibility for STAR loans could not be determined for 85 percent of the 59 STAR loans reviewed by the IG. The IG found that only 15 percent of the files it reviewed were “appropriately qualified to receive a STAR loan.” The other 85 percent of the files fell into one of five categories designated by the IG (see figure 3.).
- **IG Conclusion:** The STAR program contained “lack of adequate controls and oversight.” The IG determined that “STAR loans may have gone to businesses that were not adversely impacted by the terrorist attacks.”

Recommendations of the Inspector General

The IG included in its report several recommendations for the SBA. These recommendations were designed to provide guidance to the Administration for handling the STAR program as well as for future disaster loan program management. The IG recommended that the SBA:

²⁰Coleman Report, June 2002. “SBA Vows Not to Play ‘Gotcha’ for STAR Loans” (Appendix F)

²¹Audit by the Office of the Inspector General of the Small Business Administration on the SBA’s Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program; Issue Date: December 23, 2005; Audit Report Number 6-09 (Appendix A)

- *Require lenders to submit justifications when seeking to receive guarantee payments from the SBA for STAR loans that have defaulted.*
- *Determine whether apparent ineligible STAR loans should be reclassified as regular 7(a) loans.*
- *Review guarantees the SBA has already paid for defaulted STAR loans to determine if eligibility justifications were sufficient.*
- *Improve oversight for future disaster loan programs by requiring that documentation be submitted and reviewed by the SBA (rather than the lenders) thoroughly demonstrating each borrower's eligibility for the program.*

SBA Response to the Inspector General's Report

On February 1, 2006, SBA Administrator Hector Barreto provided a memo to Senator Snowe responding to the IG's report.²² The memo from the Administrator defends the Agency and the STAR program:

"Despite widespread press accounts there is no evidence of any widespread misuse or abuse of the STAR program. In particular, there is no basis for the claims that STAR in any way affected the availability of any form of disaster assistance to any small business directly affected by the terrorist attacks of 9/11. By its very nature, as a part of the 7(a) program, STAR was separate and distinct from the funding and purposes of the SBA's direct disaster loan assistance program. As the IG report made clear, and any objective assessment would include, no eligible business needing physical disaster, EIDL, or Expanded EIDL assistance was declined or denied assistance as a result of the STAR program.

As to the implementation of the STAR program itself, it was far from flawless. Despite the broad eligibility criteria, proper documentation by some of SBA's lending partners have not been included in the files and the SBA recognizes that we should have been more diligent in our oversight of the lending files. However, while not excusing the lack of clear documentation, the OIG still found no evidence of ineligible lending."

The STAR program was designed to benefit small businesses in need of financial relief as a result of the terrorist attacks of 9/11. The SBA's oversight responsibility included ensuring that STAR loan recipients were, in fact, the businesses the program was designed to help. Struggling small businesses unaffected by the 9/11 tragedy were not the targeted borrowers intended to benefit from the STAR program. In his response, Administrator Barreto acknowledged that there were flaws in the Agency's execution of its oversight responsibility regarding the STAR program.

8. Objectives and Scope of Committee Review:

²²Memorandum from SBA Administrator to the Chair of the Senate Committee on Small Business and Entrepreneurship, February 1, 2006 (Appendix C)

Preliminary Organization

At the direction of the Chair, Committee staff examined the origin, purpose, and implementation of the SBA's STAR Loan program. The Committee staff's review was conducted with the purposes of (a) examining lender documentation used to determine borrower eligibility for the program; (b) assessing borrowers' apparent eligibility; (c) examining the SBA's administrative procedures to determine if the procedures were adequate or flawed; and (d) analyzing whether these above matters were in accord with Congressional guidance and intent. Items (a), (b), and (c) had already been analyzed by the IG. In particular, the Committee staff's review of items (a) and (b) were merely to determine whether results different from those of the IG would be found.

Objectives and Scope

Committee staff examined a random sample of 66 STAR loan files from 27 participating lenders to review SBA documentation, lender documentation, and borrower documentation. The files were classified by Committee staff into three separate categories based upon the data and information found in the file:

- Sufficient Documentation (Class A- Sufficient)
- Questionable Documentation (Class B- Questionable)
- Insufficient Documentation (Class C- Insufficient)

The goal of this review was to examine the STAR program, from inception through completion. Committee staff examined the loan files in order to determine if the documentation and justifications were adequate but also, more broadly, to determine if STAR loans were properly issued to small businesses that qualified under the eligibility standards established for the program.

9. Findings of Committee Staff Review:

Review of Loan Files

Documentation: One of the objectives of the Committee staff's review was to determine if the participating lenders maintained clear, adequate documentation of borrowers' eligibility to receive a STAR loan. Committee staff reviewed the justifications provided by the lenders illustrating eligibility and detailing the adverse impacts of 9/11 on the borrowers.

According to procedural notices issued by the SBA to their participating lenders, documentation specifically citing and explaining justifications for STAR loan eligibility was required to be maintained by the lenders:

*“Each lender making a reduced fee 7(a) loan under the provisions of the new law is responsible for determining that the loan is being made to a small business that was adversely affected by the terrorist attacks of September 11, 2001. For each such loan, the lender must prepare, place, and keep in its loan file, a short written statement documenting the basis for its conclusion that the loan is eligible for inclusion under this provision.”*²³

This SBA procedural notice clearly required lenders to maintain proper documentation, and future procedural notices added that the SBA would not review the lender’s files or require the lenders to submit the documentation to the SBA.²⁴ SBA Procedural Notice 5000-779 states:

“The lender must...prepare and maintain in its loan file a write up summarizing its analysis and its conclusion that the loan is eligible for the STAR program. A lender will not be found to have met its responsibility for determining that a borrower was adversely affected if the lender statement merely states that conclusion, but does not provide a narrative justification demonstrating the basis for that conclusion.”

The lenders were required to retain records in the borrowers’ files supporting a clear connection between the 9/11 attacks and any adverse economic impact on the recipient small business as a result of that attack. Failure to do so by the lenders resulted in non-compliance with SBA guidelines. For example, one of the lender files reviewed by Committee staff contained this justification for STAR loan eligibility:

“Slowdown in business activity.”

In this example, there is no description of a correlation between the slowdown in business activity and the events of 9/11. The lender in the example did not retain documentation supporting a clear connection between 9/11 and the “slowdown” in business.

A loss in revenue or profits after 9/11 does not, in itself, demonstrate an adverse affect caused by 9/11. Similarly, borrowers who demonstrated increases in revenues or profits after 9/11 might still have suffered adverse affects from 9/11. There are many other intervening factors such as business management, business experience, and industry conditions that were specific to each individual loan recipient and could have affected normal business operations regardless of the events of 9/11.

Upon examination of lender files, Committee staff found that only 26 percent of the loan files reviewed contained adequate documentation demonstrating recipient eligibility to

²³SBA Procedural Notice 5000-775- 01/17/2002 (Appendix G)

²⁴SBA Procedural Notice 5000-779- 1/31/2002 (Appendix B)

receive a STAR loan. Of the files reviewed by Committee staff, 74 percent contained either questionable, inadequate, or no documentation.

Eligibility: Committee staff did not utilize “new” or external evidence to assess STAR loan recipients’ eligibility but rather considered the evidence in the files used by the lenders to justify use of the STAR program. SBA guidelines instructed the lenders to retain short, written statements explaining their justifications. However, because Committee staff’s review found that most lenders did not follow these guidelines, further examination of the information in the lenders’ files was necessary.

Committee staff inspected financial records to gauge the economic impact of September 11 on the borrowers after the attacks. Borrowers’ qualifications for the STAR program were studied regardless of whether the lenders’ files contained the required short statement by the lenders explaining their justifications for using the STAR program.

However, due to its broad structure, the STAR program was open to wide interpretation by the lenders regarding the proper borrower qualifications for eligibility to receive STAR loans. The lack of clear guidelines allowed lenders to justify making a STAR loan to almost any borrower.

Committee staff determined that almost any small business could have been found by the lenders to be eligible for a STAR loan due to the vague design of the program.

CLASS A- Sufficient

Some borrower files contained justifications that clearly supported the borrower had been adversely affected by the events of 9/11. Increases in revenue did not disqualify a borrower from being eligible for the STAR program. A borrower could still have been adversely affected by 9/11 despite experiencing an increase in revenue:

“Revenues since 9/11/01 have not increased as dramatically as they have in the past; (30% growth from 1999 to 2000; 40% growth from 2000 to 2001; only 12% from 2001 to 2002).”

This documented justification clearly indicates why the lender determined that this specific borrower was adversely affected by the terrorist attacks of 9/11 and thus, was eligible to receive a STAR loan. Committee staff classified this borrower as ‘Class A- Sufficient’ based on this documentation and additional documentation found in the file.

Lender files that contained sufficient documentation, including financial records, to indicate the adverse economic effects of 9/11 were grouped into this category by Committee staff. These borrowers were impacted financially by the attacks and were properly issued STAR loans, and the lenders maintained sufficient documentation to justify the use of the STAR

program. **Of the files examined by Committee staff, 26 percent were classified as CLASS A-Sufficient (Figure 3.).**

CLASS B- Questionable

In several cases, the lenders' justifications were vague and questionable. Although the STAR program was designed to benefit start-up business as well as existing businesses, proper justification was still a mandatory requirement of the lenders. This justification was found by Committee staff in one of the loan files:

“Delayed decision in starting a freighting type business due to the events of 9/11.”

This justification was classified as “Class B- Questionable,” since the STAR program was in fact designed to be available to start-up businesses as well as existing businesses. This justification, however, does not explain clearly enough specific reasons for the “delayed decision.” Committee staff was unable to determine this borrower's level of eligibility based upon the justification provided, as well as all other documentation contained in the loan file.

A borrower located in California was issued a STAR loan based on a drop in business activity after 9/11:

“General construction activity fell sharply as a result of the general decline in consumer and business confidence following 9/11.”

The financial records in the file indicate an increase in sales each year from 1999-2002. The file did note that sales dropped 5 percent after 9/11, however sales had picked up 17 percent in the first half of FY 2002 prior to being approved for a STAR loan. Based on the information in this file, Committee staff was unable to definitively and specifically determine that the borrower had been adversely affected by the 9/11 attacks. **Of the files examined by Committee staff, 27 percent were classified as CLASS B- Questionable (Figure 3.).**

CLASS C- Insufficient

Some files indicate that the loan is a STAR loan but provide no justification for that conclusion. Or, the files offer generic statements regarding all businesses and the United States economy as a whole after September 11, 2001. Some of the justifications simply stated that every business was “adversely affected” by the attacks of 9/11, hence every business qualifies for a STAR loan:

“This loan will be funded as a S.T.A.R. loan under the PLP program. Any small business that has suffered economic harm or disruption of its business operations as a direct or indirect result of the terrorist attacks perpetrated against the United States on September

11, 2001 is eligible under the S.T.A.R. program. The lender is then permitted to pay the on-going guarantee fee of 0.25% instead of 0.50% of the guaranteed portion.”


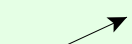




Without offering detailed information specific to the borrower, Committee staff was unable to consider the documentation acceptable and classified such loans as “Class C- Insufficient.” **47 percent of the files examined by Committee staff were classified as CLASS C- Insufficient (Figure 3).**

No Justification Provided and No Eligibility Determined

Committee staff found that 9 percent of the loans reviewed contained absolutely no documentation or justification of borrowers’ eligibility and no reference to the STAR program anywhere in the file (classified as part of the ‘Class C-Insufficient’ category). It is unclear why these loans were classified by lenders and by the SBA as STAR loans.

Figure 3.

Committee Staff's Classification of Loan Files

Committee Staff Categorical Breakdown of Loan Files	Findings of Committee Staff	Committee Staff Classifications of IG's Categories into Broader Categories	IG Categorical Breakdown of Loan Files
CLASS A Sufficient Documentation	26%	15% 	<i>"Appropriately qualified to receive STAR loan" (15%)</i>
CLASS B Questionable Documentation	27%	34%  	<i>"Justification was based on the adverse effects suffered by the business being purchased with a STAR loan rather than the "loan applicant" and SBA procedures did not specify whether such loans could qualify" (19%)</i>
			<i>"Justification was vague and neither contrary to nor supported by documentation in the lender's loan file or borrower statements" (15%)</i>
CLASS C Insufficient Documentation	47%	51%   	<i>"Justification was missing" (8%)</i>
			<i>"Justification was merely a conclusion with no support" (7%)</i>
			<i>"Justification was contrary to documentation in the lender's loan file or borrower statements" (36%)</i>

Correspondence with STAR Loan Recipients

According to the IG's report, most STAR loan recipients were unaware that they received a loan designed to benefit small businesses after the September 11 terrorist attacks:

“Only two of the 42 borrowers [contacted] were aware they had obtained a STAR loan. Thirty-six of the 42 borrowers [contacted] said they were not asked or could not recall if they were asked about the impact of the attacks on their businesses.”²⁵

Committee staff also contacted STAR loan recipients and did not determine that any borrowers were aware the loans they received were related to the terrorist attacks.

Without directly asking borrowers about the economic effects of 9/11 on their business operations, borrowers' qualifications to participate in the STAR program could not have been adequately and thoroughly determined.

The STAR program was designed to provide financial relief to small businesses in cases where adverse economic injury was linked to the 9/11 attacks. Many small businesses across the country sought financial assistance in various forms after the 9/11 attacks. There are, however, external factors unrelated to 9/11 that could have caused some small businesses to experience financial decline. Lender reviews that were only limited to borrowers' financial records were insufficient to effectively determine that small businesses were adversely affected by 9/11. In order to adequately determine borrowers' qualifications to receive STAR loans, lenders should have directly asked borrowers about the economic effects of 9/11 on business operations.

It was not determined by Committee staff that any small business intentionally took unfair advantage of the STAR program, nor was it determined that any small businesses unaffected by the events of 9/11 purposefully sought a STAR loan. **No small businesses were found by Committee staff to have deliberately misused the STAR program.**

10. Conclusions

According to SBA Administrator Hector Barreto, the SBA offered four levels of economic assistance to small businesses in the aftermath of the September 11, 2001 terrorist attacks:

- Direct physical disaster lending to businesses directly injured by the physical effects of the attacks.

²⁵The IG's statistical sample included 59 STAR loan borrowers, however the IG was only able to reach 42 borrowers out of their total sample for interviews.

- Direct Economic injury disaster lending (EIDL) to businesses at Ground Zero, businesses in the adjoining five boroughs in New York, and businesses in Northern Virginia due to the attack on the Pentagon.
- Expanded economic injury lending (EEIDL), available to businesses nationwide affected either by federal safety and security measures or a direct casual link to the 9/11 attacks.
- The STAR program.

The STAR program comprised the fourth and final level of assistance. The Administration has stated that the STAR program operated within the intent of Congress, and benefitted businesses nationwide in the wake of the attacks. The Agency has also acknowledged that its implementation of the program was “far from flawless,” but has contended that no ineligible lending occurred.²⁶

As previously stated, the AP alleged in September 2005 that the SBA, its participating lenders, and small business STAR loan recipients had engaged in widespread “abuse” of the program after 9/11. These reports cited examples of various small businesses across the country that had received STAR loans despite arguably being unaffected by the events of 9/11.

In reviewing the STAR program, Committee staff determined that various factors, including the vague design of the program, inadequate oversight by the SBA, and insufficient documentation on the part of the SBA and its participating lenders contributed to problems with the implementation of the program. Committee staff did not determine, however, that any small business STAR loan recipients abused or misused the STAR program.

After underestimating demand for standard 7(a) loans, and requesting insufficient appropriations from Congress for FY 2003, the SBA’s 7(a) loan program began to run out of money. As a result, the Agency imposed a loan cap of \$500,000, down from \$2 million, on all standard 7(a) loans effective on October 1, 2002. On the same day, as a result of a previous Congressional Act, the lender fees in the standard 7(a) program were reduced by half.

The STAR program, although a subset of the 7(a) program, had a separate appropriation and lower lender fees than the standard 7(a) program.

On October 1, 2002, the fees in the standard 7(a) program matched the fees in the STAR program. STAR loans, however, could still be made in amounts up to \$2 million while standard 7(a) loans could only be made in amounts up to \$500,000.

The STAR program had been in existence for almost nine months prior to October 1, 2002. After that date, the STAR program lasted just over three more months. Half of the total

²⁶Memorandum from SBA Administrator to the Chair of the Senate Committee on Small Business and Entrepreneurship, February 1, 2006 (Appendix C)

dollar volume of STAR loans was approved after October 1, 2002, during the final three and a half months of the program's duration, after the reduction-in-fees in the standard 7(a) program and the imposition of the \$500,000 loan cap on standard 7(a) loans became effective.

The STAR program became an alternate means of accessing funds after the standard 7(a) program became more burdensome to the lenders. Participating lenders had the ability to justify the use of a government guaranty loan program at their own discretion because of a lack of adequate oversight on the part of the SBA. Committee staff's review revealed that most lenders, 74 percent of those whose files were reviewed, did not properly administer the STAR program, in the sense that they did not maintain adequate documentation.

Committee staff also determined that the STAR program was designed with an extremely broad conception of eligibility and, as a result, evolved into an all-inclusive program. While the intent of Congress for this program was broad inclusion, the manner of the implementation of the program meant that conceivably every small business across the country became eligible to participate in the STAR program. Other levels of disaster assistance may have been more appropriate for some small businesses.

Committee staff concludes that vague guidance from Congress and a lack of specific guidelines from the SBA caused the STAR program to become all-inclusive, and also provided a path for lenders to circumvent the newly-implemented restrictions of the standard 7(a) program.

Appendices

Appendix A: *Audit by the Office of the Inspector General of the Small Business Administration on the SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program; Issue Date: December 23, 2005; Audit Report Number 6-09*

Appendix B: *SBA Procedural Notice 5000-779*

Appendix C: *Memorandum from SBA Administrator to the Chair of the Senate Committee on Small Business and Entrepreneurship; February 1, 2006*

Appendix D: *Government Accountability Office Report – GAO-01-1095R SBA's 7(a) Credit Subsidy Estimates*

Appendix E: *Letter from the Chair and Ranking Member of the Senate Committee on Small Business and Entrepreneurship to the Director of the Office of Management and Budget; September 7, 2001*

Appendix F: *Excerpts from the Congressional Record*

Appendix G: *Coleman Report, June 2002. "SBA Vows Not to Play 'Gotcha' for STAR Loans"*

Appendix H: *SBA Procedural Notice 5000-775*

Appendix A

*Audit by the Office of the Inspector General
of the Small Business Administration on
the SBA's Administration of
the Supplemental Terrorist Activity Relief
(STAR) Loan Program;
Issue Date: December 23, 2005;
Audit Report Number 6-09*



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

AUDIT REPORT
Issue Date: December 23, 2005
Report Number: 6-09

To: Michael W. Hager
Associate Deputy Administrator for Capital Access

/S/ original signed

From: Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Audit of SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program.

At the request of the SBA Administrator and the Chair of the U.S. Senate Committee on Small Business and Entrepreneurship, the Office of Inspector General reviewed SBA's administration of the STAR loan program. Attached is a copy of the subject audit report. The objectives of the audit were to determine if STAR loan recipients were appropriately qualified to receive STAR loans and if SBA established and implemented proper administrative procedures to verify STAR loan recipient eligibility. The report contains one finding and seven recommendations addressed to you. Based on responses received from SBA officials, minor revisions were made to the report. Your response has been synopsisized and included as Appendix D and the response from the former Associate Deputy Administrator for Capital Access and former Associate Administrator for Financial Assistance has been synopsisized and included as Appendix E.

The recommendations in this report are subject to review and implementation of corrective action by your office in accordance with existing Agency procedures for audit follow-up. Please provide your management decisions for the recommendations to our office within 30 days of the date of this report using the attached SBA Forms 1824, Recommendation Action Sheet.

Should you or your staff have any questions, please contact me at 202-205- [FOIA Ex. 2] .

Attachment

**AUDIT OF SBA's ADMINISTRATION OF THE SUPPLEMENTAL
TERRORIST ACTIVITY RELIEF LOAN PROGRAM**

Report Number: 6-09

The finding in this report is the conclusion of the Office of Inspector General's Auditing Division based on testing of SBA operations. The finding and recommendations are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

**AUDIT OF SBA’s ADMINISTRATION OF THE SUPPLEMENTAL
TERRORIST ACTIVITY RELIEF LOAN PROGRAM**

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INTRODUCTION

The terrorist attacks of September 11, 2001 disrupted the economy of the United States. In response to concerns about the impact of these terrorist attacks on small businesses, Congress authorized the Small Business Administration (SBA) to guaranty up to \$4.5 billion in loans made by lenders to small businesses “adversely affected” by the terrorist attacks and their aftermath. These loans were designated by SBA as Supplemental Terrorist Activity Relief (STAR) loans.

Several Associated Press articles issued in September 2005 raised concerns whether STAR loans were made to borrowers that were not affected by the September 11 terrorist attacks. The SBA Administrator and the Chair of the U.S. Senate Committee on Small Business and Entrepreneurship subsequently asked the Office of Inspector General (OIG) to perform a review of the STAR loan program. This report presents the results of our review.

BACKGROUND

Overview of Relevant Loan Programs

Under section 7(a) of the Small Business Act (15 U.S.C. § 636(a)), SBA may guaranty up to 85 percent of the amount of a loan made by an authorized lender to a small business. This program is known as the “7(a) program.” In 1983, SBA implemented the Preferred Lenders Program (PLP) which allows designated lenders to process, service and liquidate SBA guarantied loans with reduced SBA oversight. Loans made under the 7(a) program that go into default are individually reviewed by SBA to determine whether the lender complied with agency lending requirements. If it is determined that the lender did not comply materially with SBA’s regulations, SBA can negotiate a settlement of the guaranty amount or deny payment of the guaranty entirely.

The Small Business Act also permits SBA to make direct loans to victims of declared disasters in 15 U.S.C. § 636(b). Disaster loans, which are available to businesses and to homeowners, can be used to fund repairs of physical damage to homes and businesses, and to provide working capital to disaster-impacted businesses to allow them to pay their bills or otherwise fund operational needs. These latter loans are known as Economic Injury Disaster Loans (EIDLs). In order to make Federal assistance available to more businesses that were impacted by the September 11th terrorist attacks, and not just those located in the declared disaster areas, on October 22, 2001, SBA expanded the EIDL program to assist small businesses located outside the declared disaster areas.

Congressional Authorization of the STAR Loan Program

The STAR loan program was authorized under the Defense Appropriations Act of 2002, Public Law 107-117, January 10, 2002 (The Act). The Act provided that:

[T]he [SBA] Administrator shall, in lieu of the fee collected under section 7(a)(23)(A) of the Small Business Act (15 U.S.C. 636(a)(23)(A)), collect an annual fee of 0.25 percent of the outstanding balance of deferred participation

loans made under section 7(a) to small businesses adversely affected by the September 11, 2001 terrorist attacks and their aftermath, for a period of 1 year following the date of enactment and to the extent the costs of such reduced fees are offset by appropriations provided by this Act.

The Act did not define the term “adversely affected,” and we did not discover much relevant legislative history for this particular Act to help discern Congress’ intended meaning of this term.¹ SBA managers involved in the implementation of this program have asserted that they participated in numerous discussions with congressional staff, as well as top Agency political and career leadership, as to the appropriate interpretation of the legislative mandate; and that there was a general understanding that the intent was to be more, rather than less, inclusive. Congress appropriated \$75 million for the STAR loan program, which allowed SBA to guaranty up to \$4.5 billion of STAR loans². Funds were available from January 11, 2002 through January 10, 2003.

SBA Guidance on STAR Loan Program Procedures

SBA issued two procedural notices in January 2002, providing guidance for the STAR loan program: Notice 5000-775 (January 17, 2002) and Notice 5000-779 (January 31, 2002). The notices identified small businesses eligible for STAR loans as follows:

[T]he term “adversely affected small business” means a small business that has suffered economic harm or disruption of its business operations as a direct or indirect result of the terrorist attacks perpetrated against the United States on September 11, 2001. Some examples of economic harm are: difficulty in making loan payments on existing debt; difficulty in paying employees or vendors; difficulty in purchasing materials, supplies, or inventory; difficulty in paying rents, mortgages, or other operating expenses; and, difficulty in securing financing.

The procedural notices made clear that the list of examples was not all inclusive and that the Agency anticipated there would be other circumstances where a business was adversely affected by the terrorist attacks so as to be eligible for a STAR loan. The notices, however, did not provide any examples illustrating what would constitute a “disruption of business operations.” Procedural Notice 5000-779 provided the following additional guidance on eligibility:

Agency guidance should not be construed as limiting eligibility to any particular geographic area or to any specific type(s) of business. A loan to a start-up business may qualify for the STAR program if, for example, the business planned

¹ We note, but have not relied upon, floor statements by various Senators and Congressional Representatives relating to separate legislation which would have revised certain SBA programs, including the 7(a) program, to facilitate provision of financial assistance to small businesses harmed by the September 11th attacks. Although that legislation was pending at the same time that Congress enacted the Defense Appropriations bill establishing the STAR loan program, it was never passed by both Houses of Congress.

² Congressional appropriations for the 7(a) program are generally far less than the amount of loans that SBA is authorized to guaranty because appropriations are based upon historical default rates in the program and program costs are offset through fees paid by lenders to obtain an SBA guaranty. Therefore, the amount of money appropriated to fund the STAR loan program was substantially less than the total lending authority for that program.

to commence operations earlier, but its ability to do so was hampered by the terrorist actions and their aftermath.

The SBA Associate Administrator for Financial Assistance (AA/FA) at the time the STAR loan program was in effect explained that her recollection was that “earlier” as used in the above quote applied to businesses that were planned before and after September 11, 2001.

Procedural Notice 5000-775 indicated that responsibility for determining program eligibility would rest with the lenders and provided broad guidance on the documentation that would be needed to show borrower eligibility for a STAR, stating, “Each lender making a reduced fee 7(a) loan under the provisions of the new law is responsible for determining that the loan is being made to a small business that was adversely affected by the terrorist attacks of September 11, 2001. For each such loan, the lender must prepare, place, and keep in its loan file, a short written statement documenting the basis for its conclusion that the loan is eligible for inclusion under this provision.” Notice 5000-779, however, imposed additional requirements, stating as follows:

SBA believes that a high percentage of businesses finding it necessary to seek SBA-guaranteed financing may be found to have been adversely affected by the terrorist actions. In order to qualify for the reduced fee, however, the lender must: 1) find that the loan applicant was adversely affected by the terrorist events of September 11, 2001; AND, 2) prepare and maintain in its loan file a write up summarizing its analysis and its conclusion that the loan is eligible for the STAR program. A lender will not be found to have met its responsibility for determining that a borrower was adversely affected if the lender statement merely states that conclusion, but does not provide a narrative justification demonstrating the basis for the conclusion.

Procedural Notice 5000-779, further provided:

In order for a loan to qualify as a loan under STAR, the SBA lender must:

Determine that the applicant business was “adversely affected” by the terrorist activity of September 11, 2001, and must document the basis for this conclusion in its loan file. This documentation must be available for review by SBA, but need not be submitted to SBA.

Lenders were, accordingly, advised that they would not be required to provide their justifications for prior SBA approval.

Procedural Notice 5000-779 also provided instructions to lenders to reclassify a loan that had either been approved or disbursed after January 11, 2002 from a regular 7(a) program loan to a STAR loan. SBA subsequently issued Procedural Notice 5000-782 on February 21, 2002 to “streamline the process for re-classifying previously approved loans as STAR loans.”

None of the procedural notices required that money loaned to a small business under the STAR loan program had to be used to address the adverse effect suffered by the business as a result of the September 11 attacks and their aftermath. According to an SBA internal fact sheet, STAR loan proceeds could be used for all regular 7(a) loan purposes. This was confirmed in an article written by the SBA Associate Deputy Administrator for Capital Access (ADA/CA) at the time in a publication issued in April 2002 by the National Association of Government Guaranteed Lenders, Inc. (NAGGL), a trade association for lenders that participated in the 7(a) Program and other government guaranteed lending programs. An SBA regulation (13 C.F.R. § 120.120) permits 7(a) loans to be used for any or all of the following purposes:

- (1) Acquire land (by purchase or lease);
- (2) Improve a site (e.g., grading, streets, parking lots, landscaping), including up to five percent for community improvements such as curbs and sidewalks;
- (3) Purchase one or more existing buildings;
- (4) Convert, expand or renovate one or more existing buildings;
- (5) Construct one or more new buildings;
- (6) Acquire (by purchase or lease) and install fixed assets;
- (7) Purchase inventory, supplies and/or raw materials;
- (8) Working capital; and
- (9) Refinancing certain outstanding debts (certain types of refinancing are prohibited).

Lender Participation in the STAR Loan Program

During the first three months of the program, only two percent of the \$4.5 billion program authority had been used. According to SBA officials, certain lenders were reluctant to use the Program due to concerns that the Agency would second guess their justifications used to establish eligibility and possibly deny payment of the guaranties. According to SBA officials, various congressional staff expressed considerable concern about the lenders' apparent lack of interest in the STAR loan program and urged SBA to promote the use of the program among its participating lenders.

SBA responded by promoting the program through articles in trade journals, speeches at lender conferences, and by directing agency district offices throughout the country to contact local lenders to persuade them to use the STAR loan program.

In the April 2002 NAGGL article, discussed above, the ADA/CA at the time voiced SBA's concern about the limited use of the STAR loan program by lenders. The ADA/CA voiced two theories for this based upon discussions with lenders: (1) some lenders hadn't heard about STAR yet; and (2) others who knew about the program either "do not yet know that loans for small businesses in all areas of the country can qualify, or do not fully understand how to determine that a business was adversely affected by the events of September 11." To provide guidance on the latter, the ADA/CA advised:

The terrorist actions on September 11, 2001 fundamentally changed the day-to-day lives of all Americans. But small business owners, who in times of economic disruption are more vulnerable than large businesses, were particularly hard hit.

In many industries, small businesses saw sales plummet as Americans temporarily deserted the marketplace in favor of the comfort afforded by home and family. This dramatic decline in the purchase of goods and services was very apparent in the hospitality and travel industries. But, the disruption of normal business operations was also experienced by small businesses in industries less visibly affected by the events of September 11. Because of this, the SBA believes that a very large percentage of small business borrowers located in areas throughout the country may be eligible for the STAR program.

In guaranteeing a STAR loan, the SBA will rely on the lender's determination that a small business was adversely affected by the terrorist actions. When performing compliance or loan purchase reviews, the SBA will be looking only to verify that the lender documented its evaluation of the small business' eligibility for the STAR program. The SBA has not established any requirements regarding the severity or duration of the adverse impact that the small business suffered.

The ADA/CA also offered the following guidance on eligibility for STAR loans:

Perhaps the best way to illustrate circumstances where loans would likely be found eligible for the STAR program is through examples:

- For a few days after September 11, a small bakery in Niagara Falls, NY suffers dramatic decline in its business and has difficulty obtaining delivery of its raw materials. Both situations are quickly corrected. Now the bakery comes in seeking a loan to expand its operations. Is this loan request eligible to be processed under STAR? YES. The business was clearly adversely affected by the terrorist act. It does not matter how severe the impact was, or how long it lasted. The lender should find the loan eligible for STAR, and simply summarize how the bakery was adversely impacted by September 11- in this instance, the temporary loss of sales and disruption of supplier deliveries.*
- Since September 11, a small trucking firm in Peoria, IL, has had increased travel times for its deliveries due to more frequent inspections because of heightened security. These delays have increased the firm's operational costs. Despite this, the business is still operating profitably, and is seeking a loan to finance the purchase of two additional trucks. Is this loan eligible to be processed under STAR? YES. In this case, the adverse affect [SIC] could be considered ongoing, but is not fatal to the business' success. The lender should find the loan eligible, and, again, simply summarize the basis for that conclusion.*

As these examples show, we expect that a very high percentage of 7(a) loan applications are appropriate for STAR processing. We also expect that some loans made through the regular 7(a) program since January 10, 2002 may also

qualify under STAR, and we have established procedures for reclassifying such loans, when appropriate.

On May 30, 2002, the AA/FA at the time spoke at a conference in Northern California attended by 125 lenders participating in the 7(a) program. According to our interview with the AA/FA, the purpose of the speech was to market the STAR loan program to the lenders and encourage participation. A newsletter that reports on the 7(a) program, Coleman Report, in an issue dated June 1, 2002, quoted extensively from the AA/FA's presentation. The newsletter advised that the AA/FA's presentation was made at a time when lenders participating in the 7(a) program were concerned about SBA's heightened level of scrutiny in reviewing lender requests for payment of loan guaranties resulting in an increasing number of SBA denials of guaranty payments. The newsletter advised that the AA/FA also promised the agency would not second guess lender justifications on Supplemental Terrorist Relief (STAR) 7(a) loan program loans. The newsletter quoted the AA/FA as saying:

"SBA has taken a stand that is very inclusive. We have an expansive definition of economic disadvantage. As a matter of fact, we believe that every business can probably demonstrate some degree of economic disadvantage as a result of the terrorist attacks. We so strongly believe this -- we have a lunch meeting every Tuesday -- we've offered any lender who has a loan that can't find any basis for it to be a STAR loan to e-mail us the facts of the situation and we'll spend our lunch hour looking at it for you."

"I know many of you have not used the program because you are worried about post-lending review by SBA. First of all, I want to tell you that by the terms under which we have implemented the program, we delegate to you, the lender, the authority to determine that a business was adversely affected. It is your determination, not SBA's determination. It is not our intent to substitute our judgment for your judgment in these cases."

"The second factor for PLP reviews and for post-purchase reviews on any loan that defaults is that SBA will only be looking for one thing. They will be looking for a document that you have put in the file where you discuss how the business was adversely affected. It is not enough to say 'This business was adversely affected.' It is enough to say 'This business was adversely affected because...' And we believe that the 'because's' can be very inclusive. For example, one of our lenders on the East Coast sent in a whole series of examples where they were asking us to make judgments so they could get benchmarks for what was considered eligible for STAR and what wasn't."

"In fact, every single example they sent in we determined would have been eligible for STAR. One example was a bakery in downtown Washington, DC. First of all, the events shut down Washington for about a day, so that effectively the business was out of business for a little bit -- a day, maybe two. Secondly, there were some disruptions to the bakery's ability to deliver products and its ability to get raw materials. For those that weren't in Washington, traffic

patterns in the city were changed immediately and many remain changed. There are a lot of streets that are no longer open to traffic on a daily basis, so there was some disruption of traffic patterns. The borrower wanted to buy his building. On first blush you might say that buying the building has very little to do with anything related to the attacks. It doesn't have to. The business was adversely affected, and because it was adversely affected, it is eligible for STAR no matter what purpose the loan is to be used for."

"There will be lots of examples that will come to mind automatically. The travel agent who not only had a number of cancellations because the planes stopped flying but also had cancellations because people were reluctant to travel. Those things are clear. But you also need to think about the printer who provides the materials for the brochures for the travel agent who doesn't have any business right now."

"One of our lenders actually said he has instructed his staff if he has a loan that is not a STAR loan, the lender has to justify that as well as justify the ones that are STAR loans. I think that's a great practice. We want to encourage these loans to be made, and we want you to understand that we do not intend to play 'gotcha..'"

On June 24, 2002, the SBA issued Information Notice 5000-805 to its field offices entitled "Lenders Determine Borrowers Eligibility for 7(a) STAR Loans." The notice advised as follows:

The Office of Financial Assistance reminds all SBA employees that the responsibility for making the final determination regarding whether a borrower qualifies for a 7(a) STAR Loan has been delegated to the participant. When the program was announced, the following was stated in Notice 5000-775.

Each lender making a reduced fee 7(a) loan under the provisions of the new law is responsible for determining that the loan is being made to a small business that was adversely affected by the terrorist attacks of September 11, 2001. For each such loan, the lender must prepare, place, and keep in its loan file, a short written statement documenting the basis for its conclusion that the loan is eligible for inclusion under this provision.

Information Notice 5000-805 did not contain the language in Procedural Notice 5000-779 that stated that a "lender will not be found to have met its responsibility for determining that a borrower was adversely affected if the lender statement merely states that conclusion, but does not provide a narrative justification demonstrating the basis for the conclusion."

Subsequent to these actions, there was a significant increase in STAR loan approvals and reclassifications. From July 1, 2002 through September 30, 2002, a total of 3,191 STAR loans were approved or reclassified, totaling approximately \$1.3 billion which is more than 14 times greater than the lenders' use of the program during the first three months.

On October 1, 2002, SBA issued Procedural Notice 5000-828, stating that the maximum loan size for regular 7(a) loans was capped at \$500,000 due to restrictions that Congress had imposed on spending under the program in a continuing budget resolution. The Notice advised that the cap on loan size did not apply to the STAR loan program, and that the maximum loan that could be made under that program was \$2 million. After October 1, 2002, there was a significant increase in the percentage of STAR loan approvals exceeding \$500,000. Prior to the 7(a) loan cap, 27 percent of the STAR loans were greater than \$500,000. After the cap, 44 percent of the STAR loans were greater than \$500,000.

There was also a significant increase in program activity immediately prior to expiration of the STAR loan program on January 10, 2003. Eight percent of all STAR loans disbursed were approved during the last four days of the program (577/7058). Ultimately, there were 8,201 STAR loans approved totaling approximately \$3.7 billion, but only 7,058 were disbursed. Of the 7,058 disbursed loans, 1,262 loans were reclassified from the 7(a) program to the STAR loan program.

When the STAR loan program expired on January 10, 2003, funds remained in the appropriations for that program. After the STAR loan program expired, Congress authorized 37 percent of the \$75 million budgetary authority for making STAR loans to be transferred to the appropriations for the 7(a) program.

AUDIT OBJECTIVES AND SCOPE

As requested by the Chair of the U.S. Senate Committee on Small Business and Entrepreneurship, the objectives of the audit were to determine if STAR loan recipients were appropriately qualified to receive STAR loans and if SBA established and implemented proper administrative procedures to verify STAR loan recipient eligibility. To answer the audit objectives, we selected a statistical sample of 59 STAR loans from the universe of 7,058 disbursed STAR loans approved between January 11, 2002 and January 10, 2003. We used the Defense Contract Audit Agency's 'E-Z-Quant' statistical sampling program to compute the sample size at a 95 percent confidence level. See Appendix A for the statistical sample loan results and projection information and Appendix B for information about the loans included in our sample.

Our review for the first objective was limited to an examination of the documentation maintained in the lenders' loan files to support their eligibility determinations and interviews with as many of the 59 borrowers as we were able to contact. Therefore, to the extent that lenders did not adequately document the eligibility of loan recipients, it could not be determined whether those borrowers were appropriately qualified for the STAR loan program.

During the audit, we (i) examined loan files maintained by the lenders, (ii) interviewed SBA officials from the Office of Financial Assistance, the Office of General Counsel, the Office of Congressional and Legislative Affairs, the Office of the Chief Financial Officer, and the Office of Lender Oversight, (iii) interviewed selected lender officials, and (iv) contacted certain small businesses that obtained STAR loans. While we made repeated attempts to contact all 59 STAR loan recipients in our sample, we did not have current contact information for 2 of the borrowers, and 15 others did not respond to our inquiries. As a result, we interviewed only 42 of the 59 loan recipients in our sample. We did not verify the accuracy of the borrowers' statements.

There were 27 lenders included in our sample. We made site visits to six of the lenders that made 30 of the 59 sampled loans, and 3,934 (56 percent) of the total population of 7,058 disbursed STAR loans, to review loan files and interview lender officials. These lenders were located in Dallas, TX; Phoenix, AZ; Minneapolis, MN; San Diego, CA; Kimberly, WI; and Livingston, NJ. The other 21 lenders for the remaining 29 loans shipped the files to our audit offices for review. The audit was conducted during September and October 2005, in accordance with Government Auditing Standards.

RESULTS OF AUDIT

Finding - Eligibility of Most STAR Loan Recipients Was Difficult to Determine From Lender Loan Files

Most lender files did not contain sufficient information to demonstrate that borrowers were adversely affected by the September 11th terrorist attacks and their aftermath. As a result, eligibility could not be determined for 85 percent of STAR loans reviewed. While SBA initially established broad criteria for determining how borrowers were adversely affected, lenders were required to document in their loan files a “write up summarizing its analysis and conclusion” that the loan was eligible for the STAR loan program. A conclusion absent a narrative justification demonstrating the basis for the conclusion was not acceptable.

Due to initial limited lender participation in originating STAR loans, SBA undertook efforts to promote the program by advising lenders that virtually any small business qualified and assuring them that SBA would not second guess their justifications. Although SBA established criteria for documenting STAR loan eligibility, it did not establish specific requirements to review or verify lenders’ STAR justifications. Despite the documentation requirements, we found that lenders did not include sufficient justifications showing impact on borrowers and STAR loans may have gone to businesses that were not adversely impacted by the terrorist attacks of September 11th or their aftermath. As a result, funds appropriated for guaranties on loans made to small businesses adversely affected by the terrorist attacks may not have been used for that purpose. Nevertheless, it appears that qualified borrowers were not precluded from receiving STAR loans due to a lack of funds because there was a surplus of budget authority available when the program expired.

STAR Loan Criteria

Pursuant to SBA Procedural Notice 5000-779, in order to qualify for a STAR loan, lenders were required to:

“...(1) find that the loan applicant was adversely affected by the terrorist events of September 11, 2001; AND, (2) prepare and maintain in its loan file a write up summarizing its analysis and its conclusion that the loan is eligible for the STAR program. A lender will not be found to have met its responsibility for determining that a borrower was adversely affected if the lender statement merely states that conclusion, but does not provide a narrative justification demonstrating the basis for the conclusion.”

Questionable Eligibility

Nine (15 percent) of the 59 borrowers in our statistical sample appeared to have been appropriately qualified to receive STAR loans based on a review of the lenders' loan files and discussions with available borrowers. Eligibility for the remaining 50 (85 percent) STAR loans could not be determined because the required justifications were either missing, related to the seller of an existing business rather than the "loan applicant" and SBA procedures did not specify whether such loans could qualify, contrary to documentation in the lender's loan files or borrower statements, or ambiguous. The justifications for the 50 loans can be grouped as follows:

- **Justification was missing (5 loans).**
- **Justification was merely a conclusion with no support (4 loans).**

Three of the four loans had this justification: *"This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has experienced a business disruption"* (Appendix C, Nos. 13, 14 & 15)

- **Justification was based on the adverse effects suffered by the business being purchased with a STAR loan rather than the "loan applicant" and SBA procedures did not specify whether such loans could qualify (11 loans).**

While Procedural Notice 5000-779 was clear that existing and start-up businesses could qualify for STAR loans, it did not specify whether a borrower purchasing an existing business could qualify. Procedural Notice 5000-779 required lenders to find that the "loan applicant" was adversely affected by the terrorist events of September 11, 2001. It is our interpretation that a justification based on the business being purchased rather than the "loan applicant" did not qualify for the STAR loan program. We recognize, however, that there may be other interpretations of this requirement, and therefore, have concluded that eligibility could not be determined for the loans in this category.

A loan to a dry cleaner illustrates this type of justification: *"Borrower has advised that subject business had closed down for the day on September 11 and September 12, due to the tragic events of 9/11/01. We will therefore designate this as a STAR."*

The adverse impact was under the previous ownership and therefore, the justification did not apply to the applicant borrower. (Appendix C, No. 24)

- **Justification was contrary to documentation in the lender's loan file or borrower statements (21 loans).**

The following example illustrates this type of justification: *"[Borrower] experienced a considerable drop-off in revenue after the terrorists attacks in September. It took a significant toll on the cash flow of the business. With sales*

down, overhead costs diminished the working capital of the business. [Principal] did an excellent job utilizing all his resources to fulfill all his obligations and pay his suppliers and creditors in a timely manner. With the proposed SBA loan, [Principal] will be able to consolidate his entire corporate debt into a low interest note, benefiting cash flow immediately. Since January, sales are back on track and [Borrower] is on target to meet all their projections for 2002.”

The information that contradicted this justification was found in the lender’s credit memorandum which stated, “*In 2001, [Principal] took a break from working at the shop and being on site at all times. The result was a drop off in quality control and efficiency, ultimately leading to a fall off in sales from \$575,564 in 2000 to \$438,880 for the 12-months ending 12/31/01. This was disappointing to [Principal], who then decided he wanted full ownership back.*” (Appendix C, No. 30)

- **Justification was vague and neither contrary to nor supported by documentation in the lender’s loan file or borrower statements (9 loans).**

An example of this type of justification is the following statement: “*[Borrower] has been planning to expand their business by adding on to their existing facility and upgrading their equipment. Because this business is closely tied to the new construction industry the borrower has been reluctant to expand his business due to the impact 9/11 had on the economy.*”

There was no evidence in the lender’s loan file to support or contradict that the borrower was reluctant to expand his business. The borrower’s financial statements indicated a strong growth in income from 1999 through 2003 with no significant increase in costs. The borrower did not respond to our inquiries. (Appendix C, No. 58.)

The statistical projection of these groupings to the entire disbursed STAR loan portfolio of 7,058 loans is shown at Appendix A.

It is not our position that the recipients of the 50 loans were unqualified for the STAR loan program. We only conclude that eligibility could not be determined for these recipients due to the lack of adequate STAR justifications and supporting documentation in the lenders’ loan files.

Many Borrowers Were Unaware They Had Received STAR Loans

We interviewed 42 of the 59 STAR loan recipients in our sample to determine if they knew they had a STAR loan and had discussed the impact of the terrorist attacks with the lender. The remaining 17 borrowers could not be reached during the audit. The results of the interviews are listed below.

- Only two of the 42 borrowers were aware they had obtained a STAR loan.

- Thirty-six of the 42 borrowers said they were not asked or could not recall if they were asked about the impact of the attacks on their businesses.
- Of the nine borrowers who appear to have been adversely affected, eight confirmed they were adversely affected by the attacks. (The ninth did not respond to our inquiries.)
- Twenty-five of the 34 borrowers we interviewed, where eligibility could not be established, stated they were not adversely affected by the terrorist attacks.
- The other nine said they were adversely impacted, but provided different justifications than what was documented in the lender files or provided explanations of how the sellers were impacted rather than themselves.
- After repeated attempts, we were unable to reach the other 16 borrowers whose loans were not properly justified and therefore, we relied solely on the justifications and documentation in the lenders' files in categorizing these loans.

Lack of Adequate Controls and Oversight

SBA did not implement adequate internal controls and oversight of the STAR loan program to ensure that only eligible borrowers obtained STAR loans. SBA delegated to its lenders the responsibility for the final determination of an applicant's qualification for a STAR loan without any oversight by SBA. Although SBA was responsible for determining if the borrowers met eligibility and credit requirements for regular 7(a) loans, SBA loan officers were directed not to question the lenders' justifications for regular 7(a) STAR loans. Further, in an effort to promote the STAR loan program and encourage lender participation, senior SBA officials made several public statements that broadened the scope of eligibility for the program and provided assurances that lender eligibility justifications would not be second guessed.

Public statements made by the then ADA/CA and the AA/FA conveyed SBA's expansive interpretation of the term "adversely affected" and that SBA believed that virtually every small business had suffered some direct or indirect adverse impact and could likely qualify for a STAR loan. In an April 2002 NAGGL article, the ADA/CA at the time offered the following guidance on eligibility for STAR loans:

Perhaps the best way to illustrate circumstances where loans would likely be found eligible for the STAR program is through examples:

- *For a few days after September 11, a small bakery in Niagara Falls, NY suffers dramatic decline in its business and has difficulty obtaining delivery of its raw materials. Both situations are quickly corrected. Now the bakery comes in seeking a loan to expand its operations. Is this loan request eligible to be processed under STAR? YES. The business was clearly adversely affected by the terrorist act. It does not matter how severe the impact was, or how long it lasted. The lender should find the loan eligible for STAR, and simply summarize how the bakery was adversely impacted by September 11-*

in this instance, the temporary loss of sales and disruption of supplier deliveries.

• Since September 11, a small trucking firm in Peoria, IL, has had increased travel times for its deliveries due to more frequent inspections because of heightened security. These delays have increased the firm's operational costs. Despite this, the business is still operating profitably, and is seeking a loan to finance the purchase of two additional trucks. Is this loan eligible to be processed under STAR? YES. In this case, the adverse affect [SIC] could be considered ongoing, but is not fatal to the business' success. The lender should find the loan eligible, and, again, simply summarize the basis for that conclusion.

As these examples show, we expect that a very high percentage of 7(a) loan applications are appropriate for STAR processing. We also expect that some loans made through the regular 7(a) program since January 10, 2002 may also qualify under STAR, and we have established procedures for reclassifying such loans, when appropriate.

The AA/FA at the time was quoted in the June 1, 2002 Coleman Report as saying:

“SBA has taken a stand that is very inclusive. We have an expansive definition of economic disadvantage. As a matter of fact, we believe that every business can probably demonstrate some degree of economic disadvantage as a result of the terrorist attacks. We so strongly believe this – we have a lunch meeting every Tuesday – we've offered any lender who has a loan that can't find any basis for it to be a STAR loan to e-mail us the facts of the situation and we'll spend our lunch hour looking at it for you..”

Furthermore, statements by the ADA/CA and the AA/FA advised lenders that although STAR justifications would be required during compliance and purchase reviews, SBA would not substitute its judgment for the lenders' judgment as to the substance of those justifications. The ADA/CA wrote:

When performing compliance or loan purchase reviews, the SBA will be looking only to verify that the lender documented its evaluation of the small business' eligibility for the STAR program.

The AA/FA further advised, as quoted in the Coleman Report:

“I know many of you have not used the program because you are worried about post-lending review by SBA. First of all, I want to tell you that by the terms under which we have implemented the program, we delegate to you, the lender, the authority to determine that a business was adversely affected. It is your determination, not SBA's determination. It is not our intent to substitute our judgment for your judgment in these cases. The second factor for PLP reviews and for post-purchase reviews on any loan that defaults is that SBA will only be

looking for one thing. They will be looking for a document that you have put in the file where you discuss how the business was adversely affected.”

Lenders, however, were not required to submit STAR loan justifications with their guaranty purchase requests to SBA, and SBA loan officers were not required to evaluate the justifications during the purchase review process. Furthermore, although officials in the Office of Lender Oversight stated that STAR loan eligibility was examined during PLP lender reviews and any problems would have been noted as either an ineligible business or an ineligible use of proceeds citation, there were no such citations made in the PLP lender reviews that we examined which included 5 STAR loans with inadequate justifications.

Lenders’ Understanding of STAR Loan Program Requirements

According to several lenders, participation in the STAR loan program was low when the program was introduced due to unclear and poorly defined requirements. After a vigorous marketing campaign by SBA, lender participation in the STAR loan program increased. Statements by the ADA/CA and AA/FA were interpreted by certain lenders we interviewed to mean that every small business could claim it was somehow impacted by the attacks, and therefore, eligible to receive a STAR loan. While several lenders stated they were aware of the program requirements and limitations set out in the governing procedural notices, they stated that they relied on the public statements made by senior SBA officials. For example, one lender claimed that SBA approved a list of boiler-plate STAR loan justifications used by their loan officers, although SBA officials could not recall approving such a list. Such boiler-plate justifications, however, were not in compliance with the requirements of Procedural Notice 5000-779 that lenders document their analysis supporting eligibility. Thus, it appears that certain lenders believed that abbreviated justification statements were acceptable.

STAR Loan Program Compared to SBA’s Disaster Loan Program

Prior to implementing the STAR loan program, SBA expanded the Economic Injury Disaster Loan (EIDL) program to assist small businesses located outside the declared disaster areas and the contiguous geographic areas that suffered substantial economic injury as a direct result of the terrorist attacks and their aftermath. The expanded EIDL program consists of direct loans approved by the SBA Office of Disaster Assistance. Regulations were published in the Code of Federal Regulations and memos were written describing loan processing procedures and specific eligibility criteria with sample questions and answers for the loan officers to refer to in determining eligibility.

Under Expanded EIDL, the applicant was required to establish how it suffered substantial economic injury as a direct result of the terrorist attacks and had to provide monthly sales figures for the 3 years prior to the disaster and up to the most recent month before loan application. SBA then performed and documented an analysis before approving the loan.

The STAR loan program was comparable to the Expanded EIDL program in that both were designed to assist victims of the September 11th terrorist attacks and their aftermath. Unlike Expanded EIDL applicants, however, loan applicants under the STAR loan program were not required to demonstrate that they had been injured by the terrorist attacks or provide supporting documentation.

Regular 7(a) Loans Capped at \$500,000

On October 1, 2002, SBA issued Procedural Notice 5000-828, stating that the maximum loan size for regular 7(a) loans was capped at \$500,000 due to restrictions that Congress had imposed on spending under the program in a continuing budget resolution. The Notice advised that the cap on loan size did not apply to the STAR loan program, and that the maximum loan that could be made under that program was \$2 million. After October 1, 2002, there was a significant increase in the percentage of STAR loan approvals exceeding \$500,000. Prior to the 7(a) loan cap, 27 percent of the STAR loans were greater than \$500,000. After the cap, 44 percent of the STAR loans were greater than \$500,000. The cap provided an incentive for the liberal use of STAR loans to get around the \$500,000 7(a) cap and may have been a contributing factor towards the increased use of the STAR loan program.

STAR Loan Program Performance and Funds Availability

While STAR loan eligibility could not be ascertained from most lender files, it does not appear that any eligible business concern would have been prevented from receiving a STAR loan due to a lack of funds. When the STAR loan program expired, there was a surplus of funds available and more than \$27 million (37 percent) of the \$75 million STAR loan budgetary authority was transferred to the 7(a) program. Further, the default rate for STAR loans is not excessive when compared to similar SBA guaranteed loans. As of September 30, 2005, only 8 percent of disbursed STAR loans approved between January 11, 2002 and January 10, 2003 had been transferred to liquidation status, while 10 percent of the 7(a) loans approved during the same time period had been transferred to liquidation status.

RECOMMENDATIONS

If SBA enacts another special program where 7(a) loans are to be used for Nation-wide disaster relief, we recommend the Office of Capital Access take the following actions:

1. Require loan applicants to justify how the business was harmed by the disaster.
2. Require lenders to obtain supporting documentation to verify applicant claims of injury and provide detailed justifications showing applicant eligibility.
3. Implement effective internal controls and program oversight to ensure borrower eligibility and lender compliance.

In relation to the STAR loan program, we recommend the Office of Capital Access take the following actions:

4. Implement procedures to require lenders to submit STAR loan justifications when seeking SBA's purchase of a STAR loan guaranty.
5. Establish criteria, in consultation with the Office of General Counsel, to provide more definitive guidance and examples for purchase reviewers to use in determining what constitutes an inadequate justification for STAR eligibility.

6. For future purchase requests, determine, in consultation with the Office of General Counsel, whether STAR loans that contain inadequate justifications can be reclassified as 7(a) loans (if budget authority remains available) or whether SBA can deny lender requests for purchase of the guaranties under SBA regulation 13 C.F.R. 120.524.
7. Review guaranties the agency has already paid under the STAR loan program, obtaining additional records from lenders as necessary, to determine whether lenders were paid despite the absence of adequate borrower eligibility justifications. If lenders had inadequate justifications, determine, in consultation with the Office of General Counsel, whether SBA should reclassify the loans as 7(a) loans (if budget authority remains available) or seek recovery of the guaranties from the lenders.

SBA Management's Response

SBA management generally concurred with the audit recommendations, but expressed concerns with the extent of audit work performed and several OIG conclusions in the audit report.

The Associate Deputy Administrator for Capital Access (ADA/CA) and the former ADA/CA and former Assistant Administrator for Financial Assistance (AA/FA), believe that the OIG report failed to reflect a full understanding of the purpose of the STAR loan program. The more significant comments from the two responses are presented below.

- Most, if not all, STAR loan program borrowers were eligible for the STAR loan program, but more rigorous controls are needed for the guaranty review process for STAR loans.
- The report is deficient because it does not provide any historical context for the authorization and implementation of the STAR program.
- The SBA officials emphasized the different purposes of the STAR loan program and the disaster loan program, suggesting that the OIG has an overly narrow definition of which borrowers were eligible for STAR loans.
- The former ADA/CA and AA/FA suggested that the STAR loan program was intended as a general economic stimulus program.
- Guidance provided to lenders regarding eligibility and documentation requirements through the speech and article detailed in the report were clear and consistent with the earlier Agency procedural notice.
- The ADA/CA stated that lenders were aware that loans would be reviewed during the guaranty purchase process and had no basis to believe a purchase request would not be evaluated for STAR loan program eligibility.
- In a May 2002 speech, the AA/FA at the time specifically stated that during PLP and post purchase reviews, SBA would be looking for documents in the lender's files that discussed how the businesses were adversely affected, but would not play "gotcha" to deny a guaranty or otherwise penalize lenders.
- The former ADA/CA and AA/FA believe that the OIG is now engaged in second guessing STAR loan program justifications, including those that appear to meet the broad program eligibility guidelines.

It was recommended that the OIG consider extending its audit work and interview other individuals involved in creating and implementing the STAR loan program. In particular, it was suggested that the OIG interview staff on the congressional committees at the time the program was created as well as the former ADA for Management and Administration, the former Counselor to the Administrator, the former ADA/CA, the former Acting ADA/CA and other current and former SBA employees directly and indirectly related to the implementation of this program. The former ADA/CA and AA/FA believe the information gained from these interviews would allow a more complete and comprehensive OIG audit report. (Copies of the actual responses from the ADA/CA and the former ADA/CA and AA/FF are at Appendices D and E, respectively.)

OIG Evaluation of SBA Management's Response

SBA Management generally agreed with all OIG recommendations and did not disagree with the audit finding that eligibility of most STAR loan recipients in the loans reviewed was difficult to determine from lender files. Nevertheless, SBA officials raised concerns with several of the OIG conclusions in the report. The more significant concerns are addressed below.

With regard to our understanding of the STAR loan program, the OIG believes that when Congress established the program to assist small businesses that were “adversely affected” by the September 11th attacks and their aftermath, the intent was that loan applicants would be required to demonstrate that they had actually been directly or indirectly harmed in some discernible manner to obtain a STAR loan. As set forth in the report, in the vast majority of cases, the lender files did not contain sufficient documentation to support such a determination. Additionally, rather than passing legislation to benefit small businesses adversely impacted by the attacks and their aftermath, Congress could have increased the level of appropriations for the regular 7(a) program if congressional intent was limited to stimulating the economy.

The OIG does not agree that guidance provided through the speech and article was always consistent with the procedural notice. In the procedural notice, which the OIG reviewed and concurred with, the Agency offered a non-exhaustive list of examples of discernible economic harm that a business might have suffered to be eligible for a STAR loan (e.g., “difficulty in making loan payments on existing debt; difficulty in paying employees or vendors; difficulty in purchasing materials, supplies, or inventory; difficulty in paying rents, mortgages, or other operating expenses; and, difficulty in securing financing”). The article and speech by the former loan program officials, however, offered examples of businesses that had shut down for a day or two due to the September 11th attacks as being eligible for a STAR loan. In our opinion, these communications appear to have broadened the scope of eligible applicant businesses.

Further, the Agency notice advised that a lender making a STAR loan needed to prepare “a write up summarizing its analysis and its conclusion that the loan is eligible for the STAR program,” and that merely stating a conclusion of eligibility without a “narrative justification demonstrating the basis for the conclusion” would be insufficient. The guidance offered by the former ADA/CA and AA/FA, although reiterating that lenders were required to document their justifications, also advised that SBA would only “verify that the lender documented its evaluation of the small business’ eligibility” and that SBA would not “substitute [its] judgment for [a lender’s] judgment” as to eligibility. We believe these communications were intended to, and did, send a message to lenders that the Agency would not question lender eligibility

determinations. As the former ADA/CA and AA/FA stated, “[i]n order to encourage lenders to make STAR loans, we needed to give them some level of comfort that we would not later ‘play gotcha’ to deny guaranty liability or otherwise penalize lenders.” Our interviews with several lenders that made a significant number of STAR loans confirmed that some lenders believed that SBA only required very minimal documentation of borrower eligibility. In effect, the guidance by the former loan program officials suggested that SBA delegated broad, if not, complete discretion to lenders to determine applicant eligibility.

Indeed, this implication finds support in the fact that, although the Agency required lenders to document STAR eligibility justifications, it did not require lenders to provide these justifications when requesting SBA to purchase a guaranty on a defaulted STAR loan. Typically, however, the Agency requires lenders to provide documentation showing borrower eligibility when seeking purchase. In contrast, under the STAR loan program, the Agency did not implement any control either at loan inception or after a loan default to determine whether lenders were adequately documenting whether STAR loan recipients were adversely affected by the September 11th attacks or their aftermath. The Agency now acknowledges that “more rigorous controls over the purchase review process can be put in place prior to approving purchases of STAR loans to confirm eligibility” and recently issued a notice implementing this requirement.

With regard to extending our audit work, the objective of our audit was to determine, based on established law, if STAR loan recipients were appropriately qualified and if SBA established and implemented proper administrative procedures to verify STAR loan recipient eligibility. Our objective was not to determine how the enabling law was established. Accordingly, the OIG does not believe it was necessary to interview all individuals involved in creating and implementing the STAR loan program to accomplish our objective.

Statistical Sampling Results and Projection Information

From the population universe of 7,058 disbursed STAR loans, we randomly selected a statistical sample of 59 to compute our estimate of population values. In statistical sampling, the estimate of attributes in the population universe has a measurable precision or sampling error. The precision is a measure of the expected difference between the value found in the sample and the value of the same characteristics that would have been found if a 100 percent review had been completed using the same techniques.

Sampling precision is indicated by ranges, or confidence intervals, that have upper and lower limits and a certain confidence level. Calculating at a 95 percent confidence level means the chances are 9.5 out of 10 that, if we reviewed all of the loans in the total population, the resulting values would be between the lower and upper limits, with the population point estimates being the most likely amounts.

We calculated the following population point estimates and the related lower and upper limits for the selected attributes using the Defense Contract Audit Agency's 'E-Z-Quant' software program at a 95 percent confidence level. Accordingly, 50 of 59 loans or 85 percent did not contain adequate justifications and/or supporting documentation.

Value	Occurrences in Sample of 59 Loans	Population Point Estimate	Lower Limit	Upper Limit
Lender file did not contain an adequate justification and/or supporting documentation.	50	5,981	5,152	6,549
Justification missing or merely a conclusion.	9	1,076	511	1,905
Justification related to the seller rather than applicant borrower.	11	1,315	684	2,180
Justification contrary to documentation in file.	21	2,511	1,665	3,465
Justification vague and neither contrary to nor supported by documentation in file.	9	1,076	511	1,905

Information on Sampled Loans

#	Approval Date	Gross Loan Amount	SBA Guaranty Amount	Business Type	Business Location	Primary Use of Proceeds	Lender Justification	Borrower Response
1	8/2/02	\$988,900	\$741,675	Restaurant	FL	L, Imp	A	U
2	12/18/02	\$520,000	\$390,000	Construction	CA	L, Imp, WC	A	Y
3	11/15/02	\$622,000	\$466,500	Dentist	AZ	L, Imp, R	A	Y
4	7/31/02	\$589,500	\$442,125	Measuring / Testing Equip.	AZ	L, Imp, R	A	Y
5	8/6/02	\$866,200	\$649,650	Machine Shop	KS	D,E	A	Y
6	11/27/02	\$160,000	\$120,000	Day Care	FL	L, Imp	A	Y
7	9/12/02	\$50,000	\$25,000	Radiator	AZ	WC	VS	Y
8	7/31/02	\$25,000	\$12,500	Electrical	WI	WC	VS	Y
9	11/27/02	\$205,000	\$153,750	Moving/Storage	MD	BO, WC	VS	Y
10	6/4/02	\$450,000	\$337,500	Drycleaner	TX	A, WC	N	U
11	7/2/02	\$725,000	\$543,750	Restaurant	FL	L, Imp, R	N	N
12	9/9/02	\$25,000	\$12,500	Dentist	CO	WC	N	U
13	4/26/02	\$72,000	\$36,000	Electrical	KY	WC	N	Y
14	4/15/02	\$25,000	\$12,500	Carpenter	CO	WC	N	N
15	1/7/03	\$510,800	\$383,100	Apparel	OH	BO, WC	N	U
16	11/26/02	\$136,000	\$102,000	Bar and Grill	OH	L, Imp	N	N
17	8/22/02	\$650,000	\$487,500	Limo Service	CT	D, WC	N	Y
18	8/23/02	\$100,000	\$50,000	Oil Company	CT	WC	N	U
19	6/12/02	\$640,000	\$480,000	Golf Course	TX	L, Imp, E	S	N
20	10/4/02	\$541,600	\$406,200	Auto Accessories	TX	L, Imp, WC	S	U
21	9/10/02	\$860,000	\$645,000	Gas station and convenience store	TX	L, I	S	U
22	12/5/02	\$1,079,000	\$809,250	Liquor Store	GA	L, Imp, A, WC	S	N
23	6/4/02	\$1,000,000	\$750,000	Machine Shop	FL	A, WC	S	N
24	3/26/02	\$420,000	\$315,000	Drycleaner	FL	E, A, WC, I	S	N
25	10/29/02	\$200,000	\$150,000	Cleaning Supply Wholesaler	NC	A, WC	S	Y
26	3/7/02	\$412,000	\$309,000	Restaurant	TX	A, WC	S	U
27	11/15/02	\$770,000	\$577,500	Gas station and food mart	NJ	L, Imp, A	S	Y
28	12/6/02	\$976,000	\$732,000	Gas Station/ Mini Market	CA	A, L, Imp	S	N
29	12/27/02	\$73,000	\$54,750	Printing	WI	L, Imp	S	Y
30	5/16/02	\$115,000	\$97,750	Auto Repair	CA	D	C	U
31	10/9/02	\$825,000	\$618,750	Dr. Office	NC	L, Imp,	C	U

Appendix B

#	Approval Date	Gross Loan Amount	SBA Guaranty Amount	Business Type	Business Location	Primary Use of Proceeds	Lender Justification	Borrower Response
						WC		
32	12/5/02	\$770,000	\$577,500	Restaurant	NJ	L, Imp	C	N
33	9/12/02	\$175,000	\$131,250	Beauty Salon	TX	LHI, D, FF, WC	C	N
34	8/8/02	\$459,000	\$344,250	Electronics Store	CA	L, Imp	C	N
35	6/5/02	\$877,500	\$658,125	Home Health Care	OH	L, Imp	C	N
36	4/26/02	\$371,500	\$278,625	Appraiser	OR	L, Imp	C	N
37	3/14/02	\$168,000	\$126,000	Convenience Store	LA	D, WC	C	U
38	12/5/02	\$290,000	\$217,500	Chiropractor	TX	D, R, WC	C	U
39	1/9/03	\$772,700	\$579,525	Pharmacy	PA	L, Imp, A, WC	C	N
40	9/27/02	\$624,700	\$468,525	Furniture Store	FL	C, D	C	N
41	10/4/02	\$78,000	\$66,300	Janitorial Services	CO	A, WC	C	N
42	4/12/02	\$160,000	\$120,000	Chemical Product Wholesaler	MN	E, LHI, WC	C	Y
43	9/19/02	\$55,500	\$47,175	Communications Equip. Wholesaler	TX	I,D	C	Y
44	4/26/02	\$1,395,000	\$922,932	Medical Clinic	TX	L, Imp, R	C	N
45	1/9/03	\$1,957,500	\$999,988	Dr. Office	WA	L, Imp	C	N
46	8/29/02	\$212,400	\$106,200	Apparel	CO	R/E	C	Y
47	9/23/02	\$1,600,000	\$1,000,000	Computer Repair	IL	A	C	N
48	1/18/02	\$62,370	\$53,014	Orthodontist	WI	E, LHI	C	N
49	7/10/02	\$51,900	\$44,115	Chiropractor	TX	WC, E, I	C	N
50	12/3/02	\$583,500	\$437,625	Tanning Salon	NV	E, Imp, WC, FF, D	C	N
51	1/8/03	\$930,000	\$697,500	Clothing Wholesaler	CA	L, Imp	VN	Y
52	2/25/02	\$237,000	\$177,750	Restaurant	TX	E, LHI, WC	VN	U
53	7/26/02	\$147,400	\$125,290	Printing	AZ	WC, E, I	VN	N
54	6/18/02	\$154,100	\$115,575	Painting Contractor	AZ	D, WC	VN	U
55	9/4/02	\$25,000	\$21,250	Candy Store	IL	WC	VN	N
56	11/12/02	\$10,000	\$5,000	Machine Shop	WI	WC	VN	U
57	12/27/02	\$1,460,000	\$897,900	Gas Station and Convenience store	CA	L, Imp	VN	N
58	11/1/02	\$1,100,000	\$825,000	Painting Contractor	MN	D, C, E, WC	VN	U
59	8/26/02	\$240,000	\$180,000	Chiropractor	IA	A, WC	VN	U

Table Legends

Primary Use of Proceeds:

L – Land purchase
Imp – Improvements purchase
WC – Working Capital
R – Renovations
D – Debt Refinance
E – Equipment Purchase
BO – Buyout of partner
A – Acquisition of Business
LHI – Leasehold Improvements
FF – Furniture and Fixtures purchase
C – Construction
R/E – Real Estate Purchase
I – Inventory Purchase

Lender Justification:

A – STAR loan recipient appeared to be appropriately qualified
VS – STAR justification was vague, but was supported by documentation in the lender’s loan file and borrower statements
N – STAR justification was missing or merely stated a conclusion with no support
S – STAR justification was related to the seller rather than the applicant borrower
C – STAR justification was contrary to documentation in the lender’s loan file or borrower statements
VN – STAR justification was vague and neither contrary to nor supported by documentation in the lender’s loan file or borrower statements

Borrower Response:

U – Auditor was unable to get in touch with the borrower
Y – Borrower stated they were adversely affected by the terrorist attacks of September 11th
N – Borrower stated they were not adversely affected by the terrorist attacks of September 11th

Sample Loan Justifications

The justifications as presented in the various categories in this appendix are verbatim from the STAR loan justifications documented in the lenders' loan files. In categorizing these justifications, we relied on additional supporting or contradictory information located in the lenders' files or that we obtained from statements made by the borrowers we interviewed. We determined that the recipients of loans in categories A and VS appeared to be qualified to receive STAR loans based on a review of the lenders' loan files and discussions with available borrowers. It is not our position that the recipients of the loans listed in categories N, S, C, and VN were unqualified for the STAR loan program. We only concluded that eligibility could not be determined for these recipients due to the lack of adequate STAR justifications and supporting documentation in the lenders' loan files or non-specific SBA procedures. Our audit was limited to reviews of the loan files maintained by the lenders and interviews with the borrowers we were able to contact.

We interviewed 34 of the 50 borrowers in categories N, S, C, and VN. Twenty-five claimed they were not affected by September 11, while the other nine claimed they were adversely impacted for reasons other than those documented in the lender files (see number 46 as an example). These nine borrowers may have been considered to be eligible if the lenders had prepared a more appropriate justification. After repeated attempts, we were unable to reach 16 of the borrowers of loans in categories N, S, C, and VN; therefore, we relied solely on the justifications and documentation in the lenders' file in categorizing these loans. We did not verify the accuracy of the borrowers' statements.

Category “A”
STAR Loan Recipient Appeared to be Appropriately Qualified

No.	Justification Provided by Lender	Additional Info obtained from lender file or borrower statements
1	<p>“The SBA loan is being submitted under the STAR Program due to the adverse effects the OC experienced directly linked to the events of September 11. The applicants Attorney/CPA (name withheld) was located at One World Trade Center Drive, 89th floor. A great deal of the principal’s legal and financial documents were located in the office of (name withheld). All of the documents were destroyed in the tragic events of September 11, along with the loss of the life of (name withheld). The borrower has spent a great deal of time and cost of reconstructing the documents including obtaining copies of his personal tax returns directly from the I.R.S. Based on this information, the loan qualifies for the STAR Program.”</p>	<p>Justification supported by documentation in the lender’s loan file.</p>
2	<p>“The results of the 9-11 occurrence resulted in extreme financial hardships which effected our business operations. Our existing government contracts were slowed because of governmental priorities. Release of new contracts was also affected. New contracts were no longer awarded on a timely basis, but extended to a period of 60-120 days. This action resulted in employee layoffs, because of the inability to provide employment to our workers.”</p>	<p>Support in the lender’s loan file consisted of an aging schedule of account receivables showing past due accounts from various federal agencies.</p>
3	<p>“The OC was indirectly affected by the far reaching short term and long term economic malaise that was a direct results of the events of 9/11. The OC is located in a fly-in destination, Phoenix, a town which relies heavily upon tourism and hospitality as a vital part of the economic engine that drives its local economy. Hospitality and the construction industry were both greatly impacted after the terrorist attacks, which resulted in the loss of jobs and/or a reduction of wages, which many times led to the loss of benefits. Local residents were therefore not buying goods and services that could be put off. Most dental procedures are considered non-urgent or are cosmetic. Borrower reports that some patients canceled routine cleaning or minor cosmetic procedures as a result of loss of benefits or reduced discretionary income. Therefore, the OC is eligible for an SBA “STAR” loan.”</p>	<p>Justification supported by documentation in the lender’s loan file. Borrower corroborated the justification.</p>
4	<p>“Borrower’s financial performance as evidenced by the six month interim statement reflects the economic impact of the events of 9/11. The borrower provides selection and design of laboratory and in-situ testing apparatus and software for a variety of industries including construction related businesses as well as many public works and educational entities across the country and around the world.”</p> <p>“Much of the testing equipment is used on soils, rocks, pavement and construction materials. As the construction industry was impacted throughout the country indirectly as a result of 9/11, the need for testing of this type for new projects was reduced.”</p> <p>“The construction industry suffered directly and indirectly as a result in the downturn of in the economy. Layoffs in the construction, tourist, and airline industries (to name a few) and major educational facilities all felt the impact of the increased demand on public monies as a result of the 9/11 attacks.”</p> <p>“Additionally, the company exports many of its services and products internationally. Interruption of major transportation channels after 9/11 further impacted the business operations of the company.”</p>	<p>Justification supported by documentation in the lender’s loan file.</p>
5	<p>“After several years of economic expansion, the major economies of the United States and Europe began to slow in 2001. The industry downturn in the wake of the terrorist attacks on September 11, 2001, was immediate, serious and widespread. Air travel to, from and within the United States was halted for a period of days. Airlines cutback their routes, and frequencies, to deal with the fall off in traffic. The major U.S. airlines reported significant financial losses in the fourth quarter and profits for European and Asian airlines declined. Recent trends indicate that, absent an event similar to that occurring on September 11, 2001, air travel growth and airline revenue will gradually return to pre-September 11 levels. As this happens, airlines are expected to slowly expand their routes and frequencies and return to profitability.”</p> <p>“[Borrower]’s weak operating performance in 2001 and 2002 is a direct result of 9/11 that resulted in a sharp decline in commercial airline traffic and cancellation of new aircraft orders from the major airlines. This obviously has a trickle-down affect on all subcontractors that support the commercial aircraft manufactures. The company is starting to see an increase in tooling volume that generally proceed an increase in parts volume.”</p>	<p>Justification supported by documentation in the lender’s loan file.</p>
6	<p>“The applicant’s business has experienced a slight slow down from the affects of September 11. With the economic slow down following September 11, many people were laid off and subsequently did not need daycare. As the economy has begun to return to normal level, daycare services have begun to return to a normal level.”</p>	<p>The annualized 2001 financial statement (FS) shows that revenue decreased 1.24%.and the annualized interim 2002 FS shows that revenue increased by 21%. The borrower stated that the day care industry was probably hurt somewhat and she did see a decline in her business that she had just acquired in March 2001.</p>

Category “VS”
STAR Justification was Vague, but Supported by Documentation
in the Lender’s File and Borrower Statements.

No.	Justification Provided by Lender	Additional Info obtained from lender file or borrower statements
7	“The OC was adversely affected by the events of 9/11/01 as shown by the slight sales dip in 2001. However, management is confident that the subject transaction is prudent and is a good time to expand and acquire this business/customer.”	While the justification is vague, financial statements show a slight dip in 2001 and the borrower corroborated the statement.
8	“The applicant is requesting assistance through SBA’s STAR (Supplemental Terrorist Activity Relief) program as a result of the economic downturn following the terrorist attacks on September 11, 2001. The business has experienced some difficulty in one or more of the following areas: making loan payments of existing debt; paying employees or vendors; purchasing materials, supplies or inventory; paying rents, mortgages or other operating expenses; or securing financing.”	While the justification was vague, the lender’s credit memorandum supported that the business experienced a decrease in revenue for FY ending 6/30/2002 as a result of 9/11. The borrower stated that he was affected by the overall slow down in the economy.
9	“The subject performs moving and storage for military personnel and was adversely affected by the September 11 th tragedies. Prior to 2001, revenue and cash flow were trending higher and this trend has continued after 2001.”	While the justification is vague, financial information in the lender’s file showed that sales dipped in 2001. The borrower stated his business experienced a downturn after 9/11

Category “N”
STAR Justification was Missing or Merely Stated a Conclusion with No Support

No.	Justification Provided by Lender	Additional Info obtained from lender file or borrower statements
10	No justification in loan file	
11	No Justification in loan file.	
12	“STAR: How was your business impacted by 9/11? Slowed down”	
13	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has experienced a business disruption.”	Merely a conclusion with no support.
14	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has experienced a business disruption.”	Merely a conclusion with no support.
15	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has experienced a business disruption.”	Merely a conclusion with no support
16	No justification in loan file.	
17	No justification in loan file.	
18	No justification in loan file.	Statement by lender in credit analysis alluding to warm weather as cause for business downturn.

Category “S”
STAR Justification was Related to the Seller Rather than the Applicant Borrower

No.	Justification Provided by Lender	Additional Info obtained from lender file or borrower statement
19	“From 1999 to 2000 revenues reflected a 24% increase to \$494,644. Revenues reflected a 7% decline to \$460,283 in fiscal 2001. The seller stated the majority of the decline in revenues was realized immediately after the September 11, terrorist attack. He stated that during this period, people were more interested in staying home and watching the coverage of the attack on television than playing golf.”	Impact was under previous ownership and therefore, the justification did not apply to the applicant borrower.
20	“This loan was approved and submitted under the “STAR” Program. This business was actually shut down due to decreases in sales and losses pursuant to September 11, 2001.”	The shut down occurred under the previous ownership and therefore, the justification did not apply to the applicant borrower.
21	“The business was negatively impacted by the events of September 11, 2001 because of the decrease in commercial and tourist travel on U.S. Highway 259.”	Impact was under previous ownership and therefore, the justification did not apply to the applicant borrower.
22	“The applicant company was adversely affected as a result of the terrorist attacks of September 11, 2001. The effects on the company include: A loss of sales volume; sales dipped about 2% from 2000 to 2001 due to the sluggish economic environment after 9/11/2001. Holiday sales were down slightly.”	The negative effects on company were under previous ownership and therefore, the justification did not apply to the applicant borrower.
23	“The applicant company was adversely affected as a result of the terrorist attacks of September 11, 2001. The effects on the company include: closed for the day.”	Impact was under previous ownership and therefore, the justification did not apply to the applicant borrower.
24	“Borrower has advised that subject business had closed down for the day on September 11 and September 12, due to the tragic events of 9/11/01. We will therefore designate this as a STAR.”	Impact was under previous ownership and therefore, the justification did not apply to the applicant borrower.
25	“The applicant company was adversely affected as a result of the terrorist attacks of September 11, 2001. The effects on the company include: delays receiving inventory & supplies from various vendors due to the terrorist attacks.”	Adverse affects occurred under previous ownership and therefore, the justification did not apply to the applicant borrower.
26	“The applicant company was adversely affected as a result of the terrorist attacks of September 11, 2001. The effects on the company include, a slight decline was noticed in September, 2001, but recovered to normal levels by October 2001.”	The effects on the company were under previous ownership and therefore, the justification did not apply to the applicant borrower.
27	“The current seller has suffered economic hardship in his attempts to upgrade the facility and install a convenience store. He has invested over \$250,000 in renovation and legal expenses to renovate and install the food mart. The station had been closed for 4 months due to renovations. Subsequent to his re-opening in late August of 2001 he was dealt another set back due to the terrorist acts of September 11, 2001. The subject property is located approximately 50 miles from “ground zero” in NY city. Traffic volume decreased by as much as 40% in the area affecting the seller’s ability to consistently meet his financial obligations. As a result of this impact, the borrower is applying under the SBA STAR Program.”	The adverse affects all occurred under previous ownership and therefore, the justification did not apply to the applicant borrower.
28	“The borrower is seeking SBA loan proceeds because he does not have enough available capital injection to pursue conventional financing. The lack of injection is due to losses sustain in investments which were the result of the economic downturn that was further exasperated by events of 9/11.” “The seller’s business suffered from the events of 9/11 as well. Although financials would indicate growth, the seller expected to see higher revenues during 2001 (the first full year of the subject business’s operations).”	The first part of the justification applies to the impact on the principal’s personal investments, rather than an adverse affect on a small business as required by SBA procedures. Therefore, this justification is not relevant. The second part of the justification relates to the adverse affect of 9/11 on the previous owner and therefore, did not apply to the applicant borrower.
29	“The applicant is requesting assistance through SBA’s STAR (Supplemental Terrorist Activity Relief) program as a result of the economic downturn following the terrorist attacks on September 11, 2001. The business has experienced some difficulty in one or more of the following areas: making loan payments of existing debt; paying employees or vendors; purchasing materials, supplies or inventory; paying rents, mortgages or other operating expenses; or securing financing.”	The lender’s credit memorandum showed that the adverse affect was a loss in sales attributed to the events of 9/11 and the subsequent down turn in the economy. This occurred under the previous ownership and therefore, the justification did not apply to the applicant. The applicant did not purchase the business until 12/02.

Category “C”
STAR Justification was Contrary to Documentation
in the Lender’s Loan File or Borrower Statements

No.	Justification Provided by Lender	Contradictory Information obtained from the lender file or borrower statement
30	“[Borrower] experienced a considerable drop-off in revenue after the terrorists attacks in September. It took a significant toll on the cash flow of the business. With sales down, overhead costs diminished the working capital of the business. [Principal] did an excellent job utilizing all his resources to fulfill all his obligations and pay his suppliers and creditors in a timely manner. With the proposed SBA loan, [Principal] will be able to consolidate his entire corporate debt into a low interest note, benefiting cash flow immediately. Since January, sales are back on track and [Borrower] is on target to meet all their projections for 2002.”	The lender’s credit memorandum stated: In 2001, [Principal] took a break from working at the shop and being on site at all times. The result was a drop off in quality control and efficiency, ultimately leading to a fall off in sales from \$575,564 in 2000 to \$438,880 for the 12-months ending 12/31/01. This was disappointing to [Principal], who then decided he wanted full ownership back.
31	“This loan qualifies for financing through the STAR Loan Program. Borrower’s negotiations on the real estate were hampered by the events of 9/11. The borrower was trying to purchase the real estate prior to 9/11. The sellers were hesitant to sell after the instability of the economy brought on by the events of 9/11. The doctor continued to pursue the real estate as it was exactly what she needed for her practice, completely furnished and only 3 miles away. There were no other properties in the immediate area that met this criteria.”	In our opinion, the justification is illogical and does not explain why the seller would be reluctant to sell. It appears the sale would have benefited the seller during an unstable economy. In discussions with a lender official, they could not explain the justification and indicated it did not make sense.
32	“Revenues for the existing location have risen in each of the years presented, and are on pace to eclipse the \$200M mark for the first time since the business started. This mark would have been met in 2002, however, the borrowers experienced a drop in sales due to their proximity to New York City and the terrorist attacks of 9/11/01. The business is located less than a ½ mile from the Hudson River, and is directly across the river from the site where the World Trade Center once stood.”	The lender’s credit memorandum and tax returns showed that sales increased each year from 1999 to 2002. There was no monthly breakdown of sales to show whether or not sales decreased after 9/11/01. The borrower indicated they were slightly affected during the month of the attacks, but that it did not adversely affect the business over the long term. The SBA loan was used to purchase a second location for the business.
33	“The current owner purchased the business in June 2001. Last year end financial statement reflected 2% decrease in Gross Revenue due to the slow trend in economic after the 9/11 event in the fourth quarter.”	In its credit memorandum, the lender compared the borrower’s gross revenue in 2001 to the previous owner’s gross revenue in 2000. There was no analysis linking the 2% decline in sales to 9/11. The borrower stated he did not believe his business suffered economic harm as a result of 9/11.
34	“The request is submitted under the Defense Appropriations Act of 1/10/02. The subject business has been adversely affected through economic harm or disruption of business by the Sept. 11, 2001 terrorist attacks, and their aftermath through the following: General slowdown in revenues”	In general, the business was in an upward sales and net income trend shown in the three prior years’ financial history and interim period through 5/31/2002. The loan was used to purchase land and improvements.
35	“This request is submitted under the Defense Appropriations Act of 1/10/02. The subject business has been adversely affected through economic harm or disruption of business by the 9/11/01 terrorist attacks, and their aftermath. The client indicated that as a result of the events of 9/11/01, the business has experienced the following: General slowdown in revenues and/or business activity Difficulty in purchasing material, supplies, or inventory Difficulty in securing financing”	The credit memorandum did not include specific information on how 9/11 affected this business. In general, the business was in an upward sales and net income trend shown in the three prior years’ financial history and interim period through 3/31/2002. The business (including affiliates) had a 68% increase in revenue in 2001. There was no evidence that the borrower had difficulty in obtaining financing as a result of 9/11. The loan was used to purchase land and improvements.
36	“The request is submitted under the Defense Appropriations Act of 1/10/02. The subject business has been adversely affected through economic harm or disruption of business by September 11, 2001 terrorist attacks, and their aftermath through the following: Slow down in the economy had a temporary negative affect on the business as fewer borrower’s applied for real estate loans and projects were cancelled.”	The financial reports and loan review showed a growing business and an 87% increase in revenues. In addition, there was no indication there had been a decline in the number of real estate loans submitted and approved. The borrower stated he was not adversely affected by 9/11. The loan was used to purchase land and improvements.
37	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has suffered loss in annual business volume. Borrower has experienced unusual increase in cost of goods sold/services/operational expenses. Borrower has experienced difficulty purchasing raw materials, supplies or inventory.”	Financial statements indicate the borrower’s sales increased from 2000 to 2001. No evidence in file supported that the borrower suffered loss in volume, had difficulty purchasing inventory or experienced an increase in cost of goods sold. In fact, the financials showed that cost of goods sold was 65% of sales for the year 2001 but only 64% of sales for the month of December 2001.

Appendix C

No.	Justification Provided by Lender	Contradictory Information obtained from the lender file or borrower statement
38	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower requires economic relief in maintaining current status on fixed debt obligations.”	A review of the tax returns and financial statements for the 4 year period 1999 - 2002 reveal that the business was experiencing growth in revenue over this time frame. From 1999 - 2000, the business had a 13% growth in gross revenue. From 2000 to 2001, the business experienced a growth in gross revenue of 24% and when annualized, the growth from 2001 to 2002 was a 23% increase. There was no evidence that the borrower had difficulty maintaining current status on fixed debt obligations as a result of 9/11. Furthermore, interim 2002 financial statements showed an adequate debt service coverage and lender’s credit memorandum stated the borrower requested the loan to refinance his debt because he wanted a higher reduction of principal and a lower interest rate. He did not, however, request to have his payments reduced and loan term extended.
39	“This loan is eligible for the STAR program. The borrower was in the process of purchasing this business when everything was delayed due to the events of September 11, 2001.”	There was no evidence the purchase was in process prior to September 11. The Board of Directors did not approve the purchase until April of 2002 and the borrower stated he did not delay the purchase as a result of 9/11.
40	“The applicants indicated that they postponed their decision to move forward with this expansion until they could better gauge the impact on the Economy from the terrorist attacks of 9/11/01.”	There was no evidence in the lender’s file to support the justification. The borrower stated that his business actually increased during the fourth quarter of 2001 and first quarter of 2002. He did not indicate that he postponed his expansion as a result of 9/11.
41	“The loan is eligible for the STAR LOAN program because the seller was waiting to sell and the buyer was unsure about purchasing a cleaning business until they could wait a full year to see how the events of 9/11/01 had affected the business. They postponed the purchase until they were certain the business was stable.”	There was no evidence in the lender’s file that the borrower postponed the purchase as a result of 9/11. The borrower did not believe the business was adversely by 9/11 and stated the business was purchased more than a year after 9/11.
42	“This is classified as a STAR loan because the borrower wanted to purchase additional equipment, but due to the events of 9/11, was were (sic) unsure of the general economic environment. This affected liquidity and potentially the ability to cash flow additional debt service.”	There was no evidence in the lender’s file that the borrower postponed the purchase of the additional equipment as a result of 9/11. The lender’s credit memorandum showed the loan was originally approved as a regular 7(a) loan and was converted to a STAR loan. The loan was an extension of a previous equipment loan and was needed because the borrower’s original bid was low and they needed additional loan funds to fund the purchase. The credit memorandum indicated that the past 4 or 5 months were difficult for the borrower due to their move to a new location, moving production on-site, sales staff turn over and new product concentration. The borrower stated that she believes her business was greatly impacted by 9/11 because business dropped off significantly as customers would not order any inventory. She stated she had a hard time staying in business. She stated that none of this was discussed with the lender. The borrower did not indicate that she delayed the purchase of this equipment as a result of 9/11.
43	“Due to 9/11 and the downturn in the economy which reduced consumer spending and created uncertainty in the economy, the business expansion for [Borrower] was delayed and was adversely impacted by that event. The loan is thus eligible for the STAR program.”	There was no evidence in the lender’s loan file that the borrower delayed its business expansion as a result of 9/11. The loan was not used for the expansion. It was used to purchase inventory and refinance debt. The borrower stated that she was affected by 9/11 because she sold equipment used for broadcasting and the industry slowed down after 9/11. She stated that broadcasters focused more on what was happening with 9/11 and not on purchasing equipment. She did not indicate that she postponed her business expansion as a result of 9/11.
44	“An economic impact after 9/11 tragedy on the borrower is that they are in difficulty in securing financing from other financial institutions. The borrower planned to begin financing process earlier, but its ability to do so was hampered by the terrorist actions and their aftermath.”	There was no evidence in the lender’s file that the borrower had difficulty securing financing as a result of 9/11. The borrower stated he was not affected by 9/11 and that his ability to begin the financing process was not hampered by 9/11.

Appendix C

No.	Justification Provided by Lender	Contradictory Information obtained from the lender file or borrower statement
45	<p>“The request is submitted under the Defense Appropriations Act of 1/10/02. The subject business has been adversely affected though economic harm or disruption of business by Sept. 11, 2001 terrorist attacks, and their aftermath through the following: Difficult in securing financing. The borrower indicated that they were planning to buy the property earlier this year, but due to the terrorist attack, they had to wait and see how the business was affected.”</p>	<p>There was no documentation of previous efforts or decisions to secure financing or of a decrease in financial position in the lender’s file. The credit memorandum shows an increasing trend in revenues. The credit memorandum stated that the borrower indicated the practice is not sensitive to the economy. Furthermore, the borrower told the auditors that his business decisions were not affected by 9/11.</p>
46	<p>“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has had to defer fixed asset purchases/replacement and/or scheduled maintenance.”</p>	<p>There was no evidence in the lender file to support that the borrower had to defer its fixed asset purchase and/or scheduled maintenance. The borrower stated that her business was absolutely affected by 9/11. She said that business had begun declining prior to 9/11 (around June 2001) but got even worse after 9/11. She said that she had talked in detail with the lender regarding how 9/11 affected her business. Her business sells sweaters in a resort area and resorts were heavily affected by 9/11 as travel declined. She stated that the loan she received was to purchase real estate to relocate the business, however, her decision to purchase the real estate was not delayed by 9/11 as the underwriter indicated in his justification.</p>
47	<p>“The acquisition of this business was delayed due to the generally ailing 4th quarter economic conditions. The Buyer did not buy out the company until 1st quarter 2002 until the year-end fiscal data was available to better assess risk levels. The company was in a considerable growth mode in 2000 and then showed declining sales of 23% in 2001.”</p>	<p>There was no evidence in the lender’s file that the business acquisition was delayed as a result of 9/11. The credit memorandum indicated that the change of ownership was necessary because the seller violated loan covenants by converting company funds to personal uses. Furthermore, the credit memorandum showed that the decline in sales resulted from the loss of 2 partial contracts during FY 01. The borrower stated they were not affected by 9/11.</p>
48	<p>“This business was adversely affected by the events of 9-11-01. They were unable to open in the fourth quarter of 2001 due to the tragedy and the public’s unwillingness to accept new business at that time. This resulted in lost revenue and lost profits to the business owners.”</p>	<p>There was no evidence in the lender’s file that the business’ 2nd location was unable to open in the 4th quarter of 2001 due to 9/11. The credit memorandum stated that the borrower wished to establish a new practice in the same area he was practicing and would work out of both offices. Accordingly, this was not a new business. The borrower stated he was not affected by 9/11.</p>
49	<p>“Due to 9/11 and the downturn in the economy which reduced consumer spending, this business start-up was delayed and was adversely impacted by that event. The loan is thus eligible for the STAR program.”</p>	<p>There was no evidence in the lender’s loan file to support or contradict that the borrower delayed its start-up. The borrower stated that the start-up of her business was not delayed due to the events of 9/11.</p>
50	<p>“Based on conversation with the borrower, the Borrower had trouble securing financing for this project due to the economic conditions and uncertainty as a result of the terrorist attacks of 9/11/01. While growth for the company was positive in 2001, it was below projections due to the slow-down in late 2001. The company has had trouble securing financing for this venture due to the effects of 9/11 on the local economy. Many of the customers who use tanning salons are performers in casinos and work in various capacities in the casino industry. Las Vegas tourism was hit hard by 9/11 and many casino workers lost their jobs or had their hours scaled back...this is a large part of [Borrower’s] customer base. The company believes that the long term prospect of Las Vegas are strong and that now is an opportune time to expand its presence in the Valley (rental rates are lower and incentives are being offered by shopping center owners due to a slow down from 9/11).”</p>	<p>While the justification appeared to be adequate, it was contrary to documentation in the lender’s loan file and the borrower’s statements. There was no evidence in the lender’s loan file that the borrower could not obtain financing as a result of 9/11. The lender’s credit memorandum showed the borrower experienced a 51.6% sales growth for 2001 and an annualized 2002 sales growth of 31.6%. The borrower stated that 9/11 did not affect his ability to secure financing. He further stated that his business was not affected by 9/11. He stated that although there was a slight down turn in the month following 9/11, subsequent months were not affected.</p>

Category “VN”
STAR Justification was Vague and Neither Contrary to Nor Supported
by Documentation in the Lender’s Loan File or Borrower Statements

No.	Justification Provided by Lender	Additional Info obtained from lender loan file or borrower statements
51	“Due to the result of the terrorist attacks perpetuated against the U.S. on September 11th, 2001 the applicant’s ability to purchase a commercial property was hampered by the terrorist actions and their aftermath. As a result, the applicant was not able to secure a financing of conventional loan; therefore, the applicant is requesting an SBA loan under the STAR program.”	There was no evidence in the lender’s loan file to support or contradict that the applicant was unable to secure financing for the purchase of commercial property.
52	“The applicants stated they planned to open the new business for some time, but the events of 9-11 delayed their decision in doing so. Therefore, the applicant is eligible for the STAR program. [Lender] requests that this loan be reclassified as a STAR loan.”	There was no evidence in the lender’s loan file to support or contradict that the applicant planned to open the new business for some time and the events of 9/11 delayed their decision in doing so. We could not obtain current contact information for the borrower.
53	“Borrower was uncertain about proceeding the project and initiating the application until there were clear signs confidence was restored the nation and the economy would resume moving forward.”	There was no evidence in the lender’s loan file to support or contradict that the borrower delayed his start-up. The borrower stated that he believes he was laid off from his previous employer in 2/02 as a result of 9/11 and signed on with a franchise to start his own business is 5/02. The loan was approved on 7/26/02 and was used to purchase equipment and inventory and for working capital.
54	“This customer has been adversely affected by the terrorist attacks of September 11, 2001 in the following manner: Borrower has suffered loss in annual business volume.”	The borrower’s tax returns did indicate a down turn in gross receipts from FY 2000 to FY 2001, however, an analysis or monthly breakdown of gross receipts was not found in the loan file. Therefore, it is impossible to determine if the loss in annual business volume was a result of 9/11. We could not obtain current contact information for the borrower.
55	“This loan qualifies under the STAR Loan program, as our borrower would have gone into business sooner had it not been for September 11, 2001 and the impact on the economy. Borrower had to delay the opening of the business.”	There was no evidence in the lender’s loan file to support or contradict that the borrower delayed its start-up due to 9/11.
56	“This business was adversely affected by the events of 9-11-01. They were unable to open in the fourth quarter of 2001 due to the tragedy and the public’s unwillingness to accept new businesses at that time. This resulted in lost revenue and lost profits to the business owners.”	There was no evidence in the lender’s loan file to support or contradict that the borrower delayed its start-up due to 9/11.
57	“The applicant has been adversely affected by the events of 9-11. The events of 9-11 has caused down turn in overall economy which in turn has limited the applicant’s ability to secure a conventional financing for the proposed purchase. Based on its difficulty in obtaining financing due to the events of 9-11, the applicant is determined to be eligible for STAR program.”	There was no evidence in the lender’s loan file to support or contradict that the borrower could not obtain financing as a result of 9/11.
58	“[Borrower] has been planning to expand their business by adding on to their existing facility and upgrading their equipment. Because this business is closely tied to the new construction industry the borrower has been reluctant to expand his business due to the impact 9/11 had on the economy.”	There was no evidence in the lender’s loan file to support or contradict that the borrower was reluctant to expand his business. The borrower’s financial statements indicated a strong growth in income from 1999 through 2003 with no significant increase in costs. The borrower did not respond to our inquiries.
59	“Transaction qualifies for the STAR program. The customer had originally intended to purchase this business in late 2001. However, due to the events occurring on 9/11/01, the project was postponed until now. The customer was unsure of the event’s impact on personal investments which represented sources of liquidity. In addition, borrower was unsure of the economy in general and how this would impact the business being purchased.”	There was no evidence in the lender’s loan file to support or contradict that the borrower postponed the purchase of the business. The borrower did not respond to our inquiries.



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

Appendix D

DATE: December 19, 2005

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing
/S/ original signed

FROM: Michael W. Hager
Associate Deputy Administrator for Capital Access

SUBJECT: Draft IG Audit of SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program

Thank you for the opportunity to review the draft audit report on SBA's Administration of the Supplemental Terrorist Activity Relief (STAR) Loan Program. We appreciate the work that went into the audit and are providing the Office of Inspector General (OIG) with the following comments.

First, we want to reiterate that every eligible business, directly or indirectly impacted by the September 11th terrorist attacks, was able to receive a STAR loan. As your report notes, the STAR loan program expired with over one third of the budgetary authority established for the program unused and "qualified borrowers were not precluded from receiving STAR loans due to a lack of funds." In fact, Congress subsequently authorized SBA to use the excess budgetary authority more broadly – for loan guarantees for small businesses generally, including those not adversely affected by the terrorist attacks.

Second, OIG's audit report appears to misunderstand the purpose of the STAR loan program, which is different from SBA's disaster loan program. SBA's disaster loan program was available to those businesses directly impacted by the September 11th terrorist attacks. The disaster loan program has significantly more favorable terms and rates. In fact, we believe that those borrowers in the STAR loan program that OIG has concluded were clearly eligible for a STAR loan could have received the more favorable terms available through the disaster loan program.

SBA believes that most, if not all, STAR loan program borrowers were eligible for the STAR loan program. At the same time, SBA acknowledges that more rigorous controls over the purchase review process can be put in place prior to approving purchases of STAR loans to confirm eligibility. However, it is important to remember that (1) there were more than sufficient funds available for all borrowers; (2) SBA did provide clear guidance as to the breadth and depth of situations eligible for the STAR loan program and clearly established standards for the analysis and documentation required to support a STAR loan; and (3) the direction provided to lenders either orally or through Agency directives was consistent with that guidance. All of these points are made either directly or indirectly in the draft audit report. We also wish to note

that OIG reviewed and approved the Procedural Notices for the STAR loan program before they were issued. Presumably, OIG reviewed the notices for the adequacy of guidance, criteria and internal controls before providing its concurrence.

As OIG states in the draft report, “it is not [the OIG’s] position that the recipients . . . were unqualified for the STAR loan program.” Rather, OIG “conclude[d] that eligibility could not be determined for these recipients due to the lack of adequate STAR justifications and supporting documentation in the lenders’ loan files.” Lenders were provided clear direction both orally and in writing by SBA on the requirement to document their files. SBA will improve its internal controls governing the guaranty purchase review process to ensure that these justifications are provided prior to purchase but a requirement for lenders was clearly established and communicated.

Further, lenders are aware that loans are reviewed for requirements at purchase and would have no basis for believing a purchase request would not be evaluated for STAR loan program eligibility. SBA did not waive any requirements to document the analysis in the file supporting a borrower’s eligibility for the STAR loan program. In fact, our guidance repeatedly discussed documentation requirements.

The statute established eligibility for the STAR loan program as a “small business adversely affected by the September 11, 2001 terrorist attacks and their aftermath.” Given the broad statutory mandate and the general concern at the time that the September 11th terrorist attacks would have a significant negative impact on the national economy, SBA interpreted its statutory mandate most broadly, and SBA’s interpretation in this regard must be accorded due deference. Guidance issued by SBA in procedural notices and public statements supported that determination and was consistent throughout the program. As the draft report states, SBA Procedural Notice 5000-779 established a requirement that the lender prepare and maintain in its loan file a statement summarizing its analysis and its conclusion that the loan was eligible for the STAR loan program; a statement merely concluding that a borrower was eligible without the analysis was insufficient. The statements made by the AA/FA quoted in the draft report, such as that SBA would “be looking for a document that [a lender had] put in the file where [the lender] discuss[ed] how the business was adversely affected,” were consistent with these requirements. While the AA/FA’s statement may not have repeated the procedural notice word for word, the intent was the same – simply providing a concluding statement was insufficient without the accompanying analysis, i.e., a document discussing how the business was adversely affected was required.

With regard to OIG’s recommendations 1-3, SBA agrees that if another nation-wide disaster relief program is established within the 7(a) program that the factors identified by OIG should be incorporated going forward, as appropriate to the specific situation. With regard to the recommendations provided relative to the STAR loan program, SBA agrees that lenders should submit STAR loan justifications when seeking SBA’s purchase of a STAR loan guaranty and has already implemented this recommendation. With regard to recommendation number five, while we believe that SBA has established standards as to what constitutes an eligible loan that should guide purchase reviewers, SBA will review its existing guidance and determine if additional guidance is necessary. With regard to the last two recommendations related to treatment of

Appendix D

STAR loans either already purchased or future purchase requests without adequate justification of eligibility, we do not object to the intent of the recommendation but will need to ascertain the availability of appropriated funds from the relevant year as well as assess any legal implications of the recommendation.

We are available to discuss any questions you may have with our comments.

Comments on the Draft OIG Report on the STAR Loan Program
From the Former Associate Deputy Administrator for Capital Access and the Former Associate
Administrator for Financial Assistance
December 20, 2005

Thank you for providing this opportunity for us to offer comments on the draft OIG audit report on the STAR loan program. In general, we agree with the official Agency comments. Particularly, with regard to the implication in the OIG report that we (Bew and Butler) exceeded the intent of the STAR loan program, we would reiterate the Agency position that our words -- written and oral -- fully reflected the policy of the Agency. And we would note that they also reflected the policy that was discussed and concurred with, at the highest levels within the Agency; and, as we believe, also concurred with by the congressional staff most closely involved with the creation and implementation of the STAR program. What we did during those dark days after September 11, 2001 was play very small roles in getting assistance to America's small businesses in an effort to try to keep our economy from faltering. At the time, and still today, we believe that what we did was fully in keeping with the intent of Congress and the desires of the Administration.

With regard to the specific Agency comments on the report, we share the concern expressed by the Agency that the OIG report fails to reflect a full understanding of the purpose of the program. And, we would add our opinion that the report is deficient in that it does not provide any historical context for the authorization and implementation of the STAR program.

On September 11, 2001, when the terrorists attacked U.S. citizens on U.S. soil, they destroyed far more than planes and buildings, and they took a toll far greater than the lives that were so tragically lost. By their actions on that day, the terrorists forever took away Americans' sense of security and our feeling that we were somehow insulated from the terrorist activities that frequently take place in other countries. In the aftermath of 9/11, vast numbers of Americans actually experienced the various stages of grief -- eschewing restaurant meals, movie dates, and shopping expeditions for quiet times in their homes with their families. In addition, immediately after 9/11, many Americans could not travel, and later, many chose not to travel. As a result of this so-called "cocooning" effect, there was a very real concern that the stability of the American economy was at risk -- and, a very real bi-partisan and virtually universal desire to make sure that we did not allow the terrorists' actions to cause the American economy to falter. That concern was so great that America's leaders actually called on Americans to defeat the intent of the terrorists by getting back to their day-to-day activities as quickly as possible. It was in this environment that the STAR loan program was conceived and implemented. What is missing from the OIG analysis is any acknowledgment of that environment.

In the days and weeks that followed 9/11, SBA staff met frequently with small business committee staff in both the Senate and the House to discuss ways to help assist small businesses that, although not eligible for SBA disaster assistance, had none-the-less been directly or indirectly affected by the terrorist activities of 9/11 and their aftermath. And, although the report does not reflect it, many of us involved in those discussions recall strong bi-partisan agreement that SBA should do as much as it could as quickly as it could to help bolster the economy. Even

the name "STAR," coined by SBA staff in the Office of Financial Assistance is an indicator of the context in which the program was developed -- a very real patriotic intent to do all we could to help America thrive after so unimaginable an event.

The OIG report criticizes SBA for not providing detailed guidance as to what constituted "adverse impact." What it fails to acknowledge is the fact that because the attacks were so unprecedented, there was no way for us to imagine or gauge what short- and long-term affects the attacks would have on the American economy, particularly on its small business segment. This is important because it created a situation that demanded a creative approach to assure the best possible structuring of the program to address multiple unknowns. What is also missing in the OIG report is any acknowledgment that all parties involved in the implementation of the STAR program were, at that time, in agreement with the proposed inclusive and far-reaching approach. Unfortunately, to the best of our knowledge, many of those individuals, particularly those outside SBA, were not asked to provide their recollections or insight about the program's origins and intent for inclusion in the OIG report.

Obviously we agree with the Agency's contention that SBA provided clear guidance and that additional "guidance provided to lenders either orally or through Agency directives was consistent with that guidance." Nothing quoted in the OIG report can be construed as giving lenders carte blanche to find all loans eligible for STAR. Rather, SBA staff guidance, both in writing and orally, was consistent in that lenders were made fully aware of their responsibility to document in their files the bases for their determinations of STAR program eligibility. At that time, the desire of the Agency and the Congress was that the STAR program be used to the maximum extent appropriate to assure that the economy remained strong.

As to the issue of what can be imputed from the clearances of the STAR notices by OIG and others, it must be noted that, when the notices were being cleared, those clearing them apparently believed that the requirements specified for lenders were adequate. Second-guessing today whether it may have been more appropriate to have SBA review lenders' eligibility assessments prior to loan approval is therefore not appropriate. However, it may be appropriate to consider such process for similar loan programs that may be enacted in the future.

As to the issue of what lenders should expect regarding post-approval examinations by SBA, we note that in the cited speech made by the former AA/FA in May, 2002, she specifically stated that, for PLP and post-purchase reviews, SBA would be looking for documents in the lenders' files that discussed how the businesses were adversely affected. In order to encourage lenders to make STAR loans, we needed to give them some level of comfort that we would not later "play gotcha" to deny guaranty liability or otherwise penalize lenders. We believed then, and continue to believe, that given the circumstances at the time, the guidance that we provided was appropriate. Now, however, the SBA OIG is engaging in the very conduct that we thought our guidance would preclude -- second- guessing even those justifications that appear to meet the broad program eligibility guidelines. Here, we should note, however, that we certainly agree that those loan folders that contain no justification, or provide just boiler plate "the loan is eligible" language, cannot be construed to be eligible for the program.

In summary, in addition to the specific language changes and additions that we are recommending, we would also recommend that consideration be given to extending the work under this audit to enable OIG to interview other individuals involved in creating and implementing what became known as the STAR program. In this regard, we particularly recommend that staff on the congressional committees at the time the program was created be interviewed. We also recommend that interviews be conducted with SBA's former Chief of Staff, the former ADA for Management and Administration, the former Counselor to the Administrator, the former ADA for Capital Access, the former Acting ADA/CA and other current and former SBA employees directly and indirectly related to the implementation of this program. The information gained by conducting such interviews will allow a more complete and comprehensive OIG audit report.

Appendix B

SBA Procedural Notice 5000-779



SBA Procedural Notice

TO: To All Employees

CONTROL NO.: 5000-779

SUBJECT: Guidelines for Implementation of the Fee Reduction on Loans to Small Businesses Adversely Affected by the Terrorist Activities of September 11, 2001

EFFECTIVE: 1-31-2002

SBA Procedural Notice 5000-775 provided information regarding the 7(a) program fee reduction authorized in the Defense Appropriations Act of 2002 which was signed into law on January 11, 2002. The purpose of this notice is to provide more detailed guidance on the implementation of that fee reduction. In order to distinguish loans made under the Defense Appropriations Act from other 7(a) loans made during the same period, loans with the fee reduction will be known as “Supplemental Terrorist Activity Relief” (“STAR”) loans.

1. Background Information on SBA’s Annual Fee

Section 7(a)(23) of the Small Business Act authorizes SBA to collect an annual fee on each outstanding SBA guaranteed loan equal to 0.5 percent (50 basis points) of the guaranteed share of the outstanding balance of the loan. The Defense Appropriations Act authorized a reduction in that fee from 0.5 percent to 0.25 percent (25 basis points) for loans made to small businesses adversely affected by the September 11th attacks. This reduced fee will apply for the life of the loan. Both the original and the temporarily reduced fees are subject to the provisions of Section 7(a)(23)(B) which states that this fee is “. . . payable by the participating lender and shall not be charged to the borrower.”

2. Period of Applicability

The reduction in the annual fee is effective for eligible loans approved (funded) by SBA between January 11, 2002, and January 10, 2003, or until the approximate \$4.5 billion program level provided for this initiative has been used up, whichever occurs first.

Any 7(a) loan approved before January 11, 2002, will continue to be subject to the 50 basis points fee, subject to the following exception. If the lender finds that a borrower that had its 7(a) loan approved prior to January 11, 2002, was adversely affected by the terrorist actions, AND, if the loan is fully undisbursed; the lender may cancel the approved loan and submit a new application which will then meet the criterion of having been approved after January 10, 2002. If SBA approves the new loan, a new loan number must be issued.

3. Definition of “Adversely Affected” Small Business

As indicated in the previous notice, for purposes of the STAR program, the term “adversely affected small business” means a small business that suffered economic harm or disruption of its business operations as a direct or indirect result of the terrorist attacks perpetrated against the United States on September 11, 2001. Some examples of economic harm are: difficulty in making loan payments on existing debt; difficulty in paying employees or vendors; difficulty in purchasing materials, supplies, or inventory; difficulty in paying rents, mortgages, or other

operating expenses; and, difficulty in securing financing. As previously noted, SBA does not intend that this list be considered all-inclusive. The Agency anticipates that there will be other circumstances that are appropriate for use to illustrate that a business has suffered economic harm or a disruption of its business operations. Agency guidance should not be construed as limiting eligibility to any particular geographic area or to any specific type(s) of business. A loan to a start-up business may qualify for the STAR program if, for example, the business planned to commence operations earlier, but its ability to do so was hampered by the terrorist actions and their aftermath.

SBA believes that a high percentage of businesses finding it necessary to seek SBA-guaranteed financing may be found to have been adversely affected by the terrorist actions. In order to qualify for the reduced fee, however, the lender must: 1) find that the loan applicant was adversely affected by the terrorist events of September 11, 2001; AND, 2) prepare and maintain in its loan file a write up summarizing its analysis and its conclusion that the loan is eligible for the STAR program. A lender will not be found to have met its responsibility for determining that a borrower was adversely affected if the lender statement merely states that conclusion, but does not provide a narrative justification demonstrating the basis for the conclusion.

4. Steps Required for Lender to Submit a STAR program Application

In order for a loan to qualify as a loan under STAR, the SBA lender must:

- a) Determine that the applicant business was “adversely affected” by the terrorist activity of September 11, 2001, and must document the basis for this conclusion in its loan file. This documentation must be available for review by SBA, but need not be submitted to SBA.
- b) Indicate that the loan is being submitted under the STAR program by writing “STAR Loan” at the top of the SBA Form 4-I, “Lender’s Application for Guaranty or Participation,” or 4-L, “Application for LowDoc Loan,” as applicable.
- c) Amend the loan authorization provision regarding the on-going fee to be paid to SBA on the loan to indicate that the fee will be 0.25% per annum.

5. Collection of the Reduced Fee

Lenders will submit to Colson Services, Inc. (Colson), the 0.25 percent fee using the same SBA Form 1502 process as it uses for other SBA loans. SBA will provide Colson with a list of loans that are subject to the lower fee. As with all other fee collections, Colson will work with a lender to make any necessary corrections to the fee and reporting submissions.

6. PLP/SBAExpress/Community Express

The PLP center will provide additional direction to PLP lenders regarding STAR program requirements.

7. Processing STAR Loan Requests

The SBA Loan Accounting Tracking System (LATS) has been modified to provide a STAR program indicator to track STAR loans. Data must be entered into this indicator field as follows:
1) An “S” must be entered for any loan submitted by the lender under the STAR program; and,

2) An “N” (for “no”) must be entered for any non-STAR loan. This data field must be completed for each loan (including a 504 loan) even if the loan is not STAR eligible.

When the STAR Indicator is filled in with an “S”, it will mean that:

- a) The lender has informed SBA that the loan is eligible for the STAR program;
- b) The lender will be charged the reduced 0.25 % annual fee;
- c) The loan will be subject to the STAR program subsidy rate; and
- d) The loan will be funded out of the separate STAR loan fund.

There are four sets of circumstances that may occur in connection with a loan that is potentially eligible for the STAR program. The attachments to this Notice (described below) provide instructions for SBA’s data input under each of these circumstances.

A. New Loan Application Submitted by a Lender after the Effective Date of this Notice

The Star program Indicator field shown on LAS001 must be completed as part of the data input for all new loan applications. For any loan designated by a lender as a STAR loan, the “S” designation must be entered. For any non-STAR loan the “N” designation must be entered. [Attachment A provides instructions for processing a STAR-qualified loan submitted to SBA by a lender after the effective date of this notice.]

B. Re-Classification of a Loan after Submission, but Prior to SBA Approval

If a loan was originally input as a non-STAR loan, but prior to SBA’s approval, the lender provides a written request to SBA to reclassify the loan as a STAR loan, the SBA processing office must use the LSA005 Screen to input an “S” in the STAR program indicator field. [Attachment B provides instructions for re-classifying a loan as a STAR-qualified loan after SBA’s initial data input, but prior to SBA approval.]

C. Re-Classifying a Loan as a STAR loan after Approval but before Disbursement

For any loan approved by SBA on or after January 11, 2002, that was not initially classified as a STAR loan; if, subsequent to SBA approval and prior to any disbursement, the lender provides a written request to SBA to reclassify the loan as a STAR loan, the SBA field office servicing the loan must:

1. Verify that the loan is fully undisbursed;
2. Prepare a SBA Form 327 action to support cancellation of the regular 7(a) funded loan and re-instatement of the loan as a STAR loan;
3. Cancel the existing loan, thus returning the regular 7(a) funds to the regular 7(a) program account; and,
4. Wait at least one business day after completing step 3 and reinstate the loan and enter an “S” in the STAR Indicator on LAB00 screen.

[Attachment C provides instructions for re-classifying a fully undisbursed loan as STAR-qualified after approval by SBA.]

D. Re-Classifying a Loan as a STAR Loan after Full or Partial Disbursement

If a loan was approved by SBA on or after January 11, 2002, and is partially or fully disbursed when the lender makes a written request that the loan be reclassified as a STAR loan, two

additional steps must be taken. First, SBA must reverse the amount disbursed to show a loan balance of zero. Then, after the proper classification is entered, SBA must re-enter the amount disbursed to return the loan to its actual condition. [Attachment D provides instructions for re-classifying a partially or fully disbursed loan as a STAR loan.]

9. Post Approval Modifications

Any increases to an existing STAR loan or reclassifications of a non-STAR to a STAR loan must be completed prior to January 10, 2003, or before the use of all available funds, whichever occurs first. After expiration of the STAR program authority, any additional required funding will require a new loan application processed under the regular 7(a) program. For small increases, lenders may want to establish separate side notes.

10. Referrals from the Disaster Program

As you are aware, after the September 11th attacks, SBA published regulations that expanded the availability of the Agency's Economic Injury Disaster Loan (EIDL) program to small businesses which have suffered substantial economic injury as a direct result of the terrorist attacks and certain related Federal action. See 66 Federal Register 53329 (October 22, 2001). Despite this program expansion, however, there may be some circumstances where a small business that is found ineligible for an EIDL loan may be found to qualify for a STAR loan. Therefore, when appropriate, the Office of Disaster Assistance (ODA) will advise a business that it may qualify for other SBA assistance, and may refer such business to the appropriate SBA field offices. Field staff should be prepared to discuss SBA's loan programs, including STAR, with the businesses, and should also make referrals for assistance to one of the Agency's management and technical assistance partners, when appropriate.

11. Questions

Lenders should contact their local SBA field office for more information regarding the STAR program. Field staff with questions on how to input data to classify a loan as a STAR loan should contact David Kimble at (202) 205-6299. SBA staff with questions on any other issues related to STAR should contact A. B. McConnell, Jr. at (202) 205-7238.

Jane Palsgrove Butler
Associate Administrator
for Financial Assistance

Expires: 1-01-2003

ATTACHMENT "A"
LSA001 - Initial Application Screen
Use To Identify a STAR Loan at Time of Application

```
LSA001          INITIAL INPUT FORMAT          01/22/02
CID NUMBER GENERATED: 000000000000          LOANOFFCR:
                                                LOANOFFCRCD: 00

DT APL RECD: 000000
APPL NAME:                                     Y2K APPLICATION: (Y/N)
TRADE NAME:                                     STAR: (S/N)
APPL STREET:                                  ALPHA CODE:
APPL CITY:                                   APPL STATE:
APPL TEL NR:( 000) 000- 0000                 APPL ZIP CD:
PART NAME:                                   PART ID NUM: -
PART STREET:                                 PART STATE:
PART CITY:                                   PART ZIP CD:
TOT REQST $: 00000000.00                     FOR CLP (Y), CAIP (C):N
PREQUALIFICATION (1-9) 0
(1) WOB   (4) WET   (7) 8(a)/SDB             FISH RESTRUT: (Y/N):
(2) MIN   (5) SM BUS (8) DISABLE             ONE STOP SHOP CD:
(6) RURAL (9) SPEC IND                       0000
                                                0000
                                                0000

*** DIRECT MODE* DATE/PA ENTERED IN THIS DISPLAY ARE MMDDYY FORMAT ***
```

Enter an "S" to designate a STAR Loan. Enter an "N" for a Non-STAR Loan

This field must be completed.

The LSA001 Screen is used to introduce a loan into the LATS System. Any 7(a) loan classified by the lender as a STAR loan should be identified through this screen.

Every loan funded through LATS must now have the STAR Indicator completed. For non-STAR loans (including 504s), enter an "N" in the indicator field.

ATTACHMENT "B"

LSA005 – APPROVE LOAN APPLICATION RECORD PART A

Used to Re-Classify as a STAR Loan after Submission, but Prior to SBA Approval

```
LSA005 010102012201 APPROVE LOAN APPLICATION RECORD PART A 01/22/02
LOAN NUMBER: 5113754007

BORR NAME: APPLICATION NAME LSA001      SOC SEC NUM: 00- 00- 0000
TRADE NAME: TRADE NAME                  EMPLOYER ID: 00- 0000000
BORR STREET: 409 3RD STREET              ALPHA CODE: SBACT
BORR CITY: WASHINGTON                    BORR STATE: DC
BORR TEL NR: ( 202) 205- 6599            BORR ZIP CD: 20416
PART NAME: CASCADES W. FINAN SERVICES INC PART ID NUM: C381750- 898
PART STREET: 1400 QUEEN AVENUE, S.E., POB 6 PART STATE: OR
PART CITY: ALBANY                        PART ZIP CD: 97321
STATE CODE: 00                           LOAN TYPE: 7
COUNTY CODE: 000                         SERV GRP CD: 0
STAR: S ← (ENTER "S" FOR STAR OR "N" FOR NON-STAR)
```

Before loan is disbursed, make sure the **STAR** indicator has an "S" or "N" as appropriate.

The LSA005 Screen allows you to make changes to the account records of a loan before that loan is disbursed.

Make sure there is either a "S" or a "N" (as appropriate) in the STAR Indicator field.

ATTACHMENT "C"
LAB000 - 7(A) 327 Screen

Use to Re-Classify as a STAR loan after Approval but before Disbursement

```

XABH04          BLIF LOAN APPROVAL          DATE: 01/22/02
                  CHANGE                     TIME: 09:11:25
LOAN NR: 42572940-05 ( ) OFFICE NR: 0101   EFF/FUND DT:      ( )
BORROWER'S NAME: LA VITE E L'UVA, INC.
= = CURRENT NET APPROVAL VALUES = = =   = = REVISED NET APPROVAL VALUES = = =
: SBA              312,188.00 ( ) :      : SBA              _____ ( ) :
: BANK             104,062.00 ( ) :      : BANK             _____ ( ) :
:                   ----- :      :                   ----- :
: TOTAL            416,250.00 ( ) :      : TOTAL            _____ ( ) :
=====
: LOAN TYPE         07 ( ) :      : LOAN TYPE         ( ) :
: SUBPROGRAM CODE   1003 ( ) :      : SUBPROGRAM CODE   ( ) :
: STAR              ( ) :      : STAR              ( ) :
=====
: SBA PERCENT       75.000 ( ) :      : SBA PERCENT       |_____| ( ) :
: BANK PERCENT      25.000 ( ) :      : BANK PERCENT      _____ ( ) :
=====
: SBA INTEREST RATE ( ) :      : SBA INTEREST RATE _____ ( ) :
: BANK INTEREST RATE 10.000 ( ) :      : BANK INTEREST RATE _____ ( ) :
=====
                  ENTER 'X' TO CANCEL LOAN:  _
ENTER FUNCTION:  _   NEXT LOAN NUMBER:  _____ -
*** VALID FUNCTIONS: 1=NEW 327, 2=QUERY, 3=DELETE, 5=MENU, 9=SIGNOFF ***

```

Enter an "S" to designate a STAR loan, and an "N" to designate a non-STAR loan.

On day one, cancel the loan approval to return the full, obligated amount to the regular 7(a) program fund. On day two, reinstate the loan and enter an "S" in the STAR Indicator field. This will cause the loan funds to be obligated from the STAR program fund. Note: If the lender has already paid the guaranty fee before these actions are taken, the accounting system will automatically generate a rebate of the guaranty fee. The lender must then re-submit this

ATTACHMENT D

Use to Re-Classify as a STAR loan after Approval and Disbursement

Procedures for Changing Loans that are Partially or Fully Disbursed

For 7(a) guaranty loans that are partially or fully disbursed, the procedures used are the same as for loans that have changes to the sub program code. This is a 4-step procedure and takes 5 business days of loan updating cycles in order to change funding. Access to 2 systems, the LAB000 (327 Loan Approval Change Screen) and the PMGI01 (SBA Guaranty Loan Reporting System) are required.

1. On day one, access the PMGI01 system. Choose screen PMGI06 to access the 1502 template for your loan. Before making any changes, print the screen for future reference when completing step 4. On the 1502 template, enter the total gross approval amount in “Total Amount Undisbursed,” leave all other areas blank or delete all other information, and then update. Note the PMGI01 screens are only accessible from the 1st to the 20th day of each month.
2. On day two, verify that the loan is shown as “in approval” status (that is, shown as fully undisbursed). If so, go to the LAB000 system and cancel the full amount of the loan approval.
3. On day three, verify that the loan is in “canceled” status. If so, go to the LAB000 system and reinstate the loan approval entering the revised net approval values and entering an “S” in the STAR indicator field.
4. On day four, verify that the loan is in “approval” status. If so, access the 1502 template for the loan (PMGI06), and enter the required information. For disbursed loans you must enter a next installment due date, interest paid through date, amount undisbursed (if any, gross share) and total outstanding principal.
5. On day five, verify that the loan is shown as in “regular servicing” with the correct principal balance and undisbursed balance (if any).

Note: If the lender has already paid the guaranty fee before these actions are taken, the accounting system will automatically generate a rebate of the guaranty fee. The lender must then re-submit this fee.

Appendix C

*Memorandum from SBA Administrator
to the Chair of the Senate Committee on Small Business
and Entrepreneurship (February 1, 2006)*



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

MEMORANDUM
February 1, 2006

TO: Honorable Olympia Snowe
FR: Honorable Hector V. Barreto
RE: STAR Loan program

PURPOSE OF MEMORANDUM

I believe it is important to provide you with direct and accurate information on the STAR program, how the SBA implemented the STAR program and what the Office of Inspector General's (OIG) report concluded. I realize you must be hearing from other Senators, and I want to set the record straight. My intent is to provide you the most accurate information possible. As always, I am available to answer any questions you may have on this issue or any other small business issue.

THE STAR PROGRAM AND SBA DISASTER LOANS

I believe what has been missed by the press and, in part, by the OIG is an understanding of the basic nature of STAR, which was to provide an injection of capital into the small business economy to counter the adverse economic effects that rippled through the nation after 9/11.

To put this in context, our assistance after 9/11 can best be viewed as the application of a series of different tools and levels of aid based on the situation of the borrower.

- The first level of assistance was direct physical disaster lending available to those businesses directly injured by the physical effects of the attacks. These borrowers were primarily businesses located at Ground Zero and its environs. Those 567 eligible applicants received disaster assistance totaling \$37.6 million.
- The second level of assistance was direct economic injury disaster lending (EIDL) to businesses at Ground Zero and the adjoining declared disaster areas including the five boroughs in New York as well some adjoining counties and parts of Northern Virginia based upon the attack upon the Pentagon. Those 5,661 eligible applicants received disaster assistance totaling \$538.7 million.
- The third level of assistance was the expanded economic injury lending (EEIDL) which consisted of direct disaster lending made available nationwide to small businesses directly affected either by federal safety and security measures undertaken after 9/11, or that could show a direct causal link to the attacks of 9/11. This program provided \$ 558.2 million in disaster assistance to 4,991 eligible applicants nationwide.
- All three of these levels of direct disaster assistance consisted of low-interest direct lending from the SBA.
- The fourth and last level of assistance was the STAR loan program authored by Senator Kerry and ultimately passed as a part of the Defense Appropriations Act. These were guaranteed loans available nationwide to small businesses adversely affected (directly or indirectly) by the economic repercussions of 9/11. These

loans were made through the 7(a) loan program by 7(a) lenders at regular market interest rates from January 2002 to January 2003. The only variation between these loans and regular 7(a) loans was a reduction in the ongoing annual fee paid by the lender. The STAR borrower received no different interest rate or fee structure than any other 7(a) borrowers.

- Unfortunately, some reactions to the press reports and the OIG's report have only confused the issue. As you know, the STAR loan program and the Disaster loan program are authorized under separate and different appropriations. They do not overlap, they do not conflict, and most importantly no small business that qualified for a disaster loan was denied the loan because of STAR.

BACKGROUND

After the attacks of 9/11 SBA acted to provide relief to businesses and the few homeowners located in the affected areas (Lower Manhattan and Northern Virginia). All these victims were eligible for direct SBA disaster loans for physical damage and all small businesses in those areas were eligible for low-interest (4%) direct loans to assist with economic injury. These loans, offered at reduced interest rates, were unaffected by STAR or other loan programs. Because SBA direct disaster loans operate under a different subsidy rate and financing account they are separated from guaranteed lending and funds from one account are unaffected by activity in the other.

Additionally, SBA direct disaster lending is offered under far more lenient terms and conditions than are found in our guaranteed loan programs. Therefore, a small business ineligible to obtain assistance, for credit reasons, from our direct loan programs would be unlikely to receive a loan, even a STAR loan, from any lender or lending institution.

I believe it is both inflammatory and illogical for anybody to suggest that disaster assistance for any eligible small businesses located in the declared disaster areas was denied or diverted by the STAR program. I have fought for and will continue to fight for small businesses nationwide who have been repeatedly accused of doing something wrong for accepting a STAR loan. I hope you will join me in this fight, because small businesses nationwide need to know that the press has incorrectly characterized these loans and these small business borrowers.

THE STAR LOAN PROGRAM

In December of 2001 the then Chairman of the Senate Committee on Small Business, Senator John F. Kerry, proposed a variety of measures through the bill S. 1499. One provision of this bill was a proposal to reduce the ongoing annual fee paid by 7(a) lenders from 0.50% to 0.25% for loans made "*to small businesses adversely affected by the September 11, 2001, terrorist attacks and their aftermath*". No further description of this provision was provided and on January 11, 2002 it was included in the Defense Appropriations Supplemental.

Pursuant to the legislation, SBA operated the program purely as an adjunct of the 7(a) program. The legislative language specifically made this program a part of the 7(a) program and SBA had no authority to act otherwise.

As you may recall, STAR loans were to be made available through our 7(a) lenders under the normal terms and conditions of the 7(a) program. The only added incentive to the lender was the reduced fee for those loans that met the description of going to a small business that was "adversely affected". I opposed the STAR program when it was first drafted and passed Congress because I believed the definition of "adversely affected" was far too broad. (see attached 11/30/01 letter to Senator Kerry) Additionally, since 1996 the SBA has had a limited role in the basic underwriting of most 7(a) loans. Prior to the 1996 SBA Congressional reauthorization, we performed several pre-approval loan processing functions. However, these functions were removed by Congress to help speed the 7(a) loan processing under the Certified Lender Program (CLP) and Preferred Lender Programs. As a result, the SBA reviews all loan files in the event of a default, and since the STAR program was legislatively created as a 7(a) loan program, we implemented it consistent with the procedures already in place in the 7(a) program. Senator Kerry and his staff were aware of all these actions and SBA's efforts to implement this program. (see attached 01/29/02 and 02/08/02 letters to Senator Kerry).

In our outreach to the lenders to implement this program SBA staff heard from our 7(a) lenders that they were hesitant to make such loans absent a definition of "adversely affected". SBA's Office of Financial Assistance (OFA), working with our lending partners, drafted a definition to help ease the problem and implement the legislation as Congress intended. While OFA staff worked with the lending community to facilitate the implementation of the program there was never an effort to "push" or promote the program. With that definition and with the concurrence of the Office of the Inspector General, we began the implementation of the STAR program. In March of 2002 SBA updated its "Loan Wizard" document system to provide standardized loan documents that clearly identified loans under the STAR program, which was in accordance with our normal implementation procedures for a loan program.

CONGRESSIONAL INTENT

I believe it was clear from Senator Kerry's proposal of this program that the general purpose was to relieve a "credit crunch" and the economic repercussions of the attacks of 9/11 (See Congressional Record excerpts below and attached). This purpose was supported by the fact that the only clear incentive in the STAR program was an incentive to the lending community. Fees paid by borrowers were not reduced, and congressional statements regularly dealt with lack of incentive for lending in the small business community. In addition, the statements (in conjunction with staff communications) conveyed a desire for speed in making this assistance available.

Senator Kerry's floor statements on S. 1499 March 22, 2002 talking about continuing STAR along with passage of S. 1499 are an example:

"(S. 1499 and STAR are) very important to so many small businesses in this country crippled by the economic fall-out of September 11, including businesses that were already struggling before September 11 during the recession and are now faced with even more difficult prospects."

"SBA is calling these "STAR loans," and compared to the economic injury disaster loans, borrowers are accessing capital faster. In just seven weeks, since the loans were made available, nearly \$38 million has been loaned to 129 small businesses."

It reminds us that being able to go sit in the office of a lender in the same town is far more efficient and effective than requiring a small business in West Virginia or Puerto Rico to call a 1-800 number in Niagara Falls for emergency assistance."

"(T)hey have been forced to make ends meet by using credit cards and depleting personal savings because small businesses doesn't have the same access as big business--to credit or otherwise."

"It simply was not enough, not efficient, and not cost-effective to use only one of SBA's many lending programs to serve all the small businesses throughout this country that were hurt by the terrorist attacks or that have been struggling with the credit crunch."

(for further Congressional Record excerpts see attachments)

THE INSPECTOR GENERAL'S REPORT

- No small business was deprived of disaster assistance based upon the STAR loan program.
- No evidence of an improper use of a STAR loan was found.
- No small business eligible for STAR assistance was denied a loan due to improper use of the program. There were in fact STAR funds left over.
- Documentation of the STAR eligibility could have been better.

There are a number of areas that the report did not cover:

- No mention was made of the Office of Inspector General (OIG) concurrence on SBA's policies and procedures for STAR loans. Nor did OIG ever recommend that SBA alter its loan making procedure to include pre-approval review.
- No effort was made to interview any of the 2001-2002 Congressional staff that had been involved to discuss their conversations with SBA employees regarding implementation.
- No effort was made to interview any SBA's 2001-2002 Congressional Affairs staff regarding conversations with congressional staff.
- The report failed to mention that the loan documents for the majority of STAR loans (those made after March 2002) contained clear statements in the standard authorizing documents identifying the loans as STAR loans.
- The sample size used in the report was small, only 59 out of over 8,000 loans

CONCLUSION

Despite widespread press accounts there is no evidence of any widespread misuse or abuse of the STAR program. In particular, there is no basis for the claims that STAR in any way affected the availability of any form of disaster assistance to any small business directly affected by the terrorist attacks of 9/11. By its very nature, as a part of the 7(a) program, STAR was separate and distinct from the funding and purposes of the SBA's direct disaster loan assistance program. As the IG report made clear, and any objective assessment would conclude, no eligible business needing physical disaster,

EIDL, or Expanded EIDL assistance was declined or denied assistance as a result of the STAR program.

As to the implementation of the STAR program itself, it was far from flawless. Despite the broad eligibility criteria, proper documentation by some of SBA's lending partners have not been included in the files and the SBA recognizes that we should have been more diligent in our oversight of the lending files. However, while not excusing the lack of clear documentation, the OIG still found no evidence of ineligible lending.

I believe the program operated within the intent of its authorization and purposes. The program was designed to provide incentives to small business lending by offering 7(a) lenders a reduced fee. This action was needed to alleviate a "credit crunch" (in the words of the program's author and lead sponsor) brought about by the widespread economic repercussions of the 9/11 attacks. The nature of these repercussions and the broad mandate of the STAR program necessarily created a situation whereby eligibility for these loans would be almost universal. At the end of day the program provided the stimulus sought, and boosted or maintained small business lending during a period of economic uncertainty – its primary goal.

Chair Snowe, as always we are committed to work with you and the committee to continue assisting small businesses in every way possible.

Sincerely,

HVB

Appendix D

Government Accountability Office Report- GAO-01-1095R SBA's 7(a) Credit Subsidy Estimates



GAO

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

August 21, 2001

The Honorable John F. Kerry
Chairman
The Honorable Christopher S. Bond
Ranking Minority Member
Committee on Small Business
United States Senate

The Honorable Donald A. Manzullo
Chairman
The Honorable Nydia M. Velazquez
Ranking Minority Member
Committee on Small Business
House of Representatives

Subject: Small Business Administration: Section 7(a) General Business Loans Credit Subsidy Estimates

In your May 4, 2001, letter, you expressed concerns about the Small Business Administration's (SBA) 7(a) Business Loan Program subsidy rate calculations. As agreed with the staff of your committees, we reviewed the subsidy rate estimation process and the data SBA uses in its calculation, with a specific focus on defaults and recoveries. We identified differences between originally estimated defaults and recoveries and actual data, and the causes of these differences. Additionally, we assessed the implications of proposed changes to SBA's current approach to estimate defaults. On July 30, 2001, we briefed your staff on the results of our review. This letter transmits the material from the briefing.

In summary, the process and types of data SBA uses to estimate the subsidy cost of the 7(a) program are generally reasonable and comply with existing Office of Management and Budget (OMB) guidance. However, our review of actual and originally estimated defaults and recoveries showed that, on a cumulative basis since 1992, defaults were overestimated by approximately \$2 billion and recoveries were overestimated by approximately \$450 million.¹ During this same period, SBA overestimated the cost of the 7(a) program by \$958 million as evidenced from a trend

¹Because SBA calculates estimated recoveries as a percent of estimated defaults, most of the overstated recoveries resulted from the initial overestimate of defaults. When recoveries were calculated independent of the default overestimate, the cumulative overstatement of recoveries was less than 1 percent of actual recoveries, or about \$3 million.

of downward reestimates.² The majority of these downward reestimates can be attributed to the overestimate of defaults.

For those loan guarantees approved from 1992 through 1997, we were unable to determine the specific reason for the overestimate of defaults primarily because the basis SBA used for the estimated default rate for these years was not documented.³ Reestimates during this period account for approximately 84 percent of the total \$958 million reestimate. SBA began using its current methodology in 1998. This methodology uses average historical data since 1986 to estimate defaults. Under this method, high default rates associated with loan guarantees approved in fiscal years 1986 through 1990 contributed to the difference between estimated and actual defaults for loan guarantees approved from 1998 through 2000.

SBA has proposed to OMB another methodology that uses the 5 most recent years of actual loan performance prior to each activity year being estimated—referred to as the lookback period⁴—rather than the current approach that uses all actual loan performance since 1986, to estimate loan performance for each activity year. OMB is currently considering this proposal. Either approach has certain benefits and inherent risks.

Under the current approach, initial estimates of the subsidy rate are fairly stable because they include more years of historical data that smooth out fluctuations in economic conditions from year to year. As previously mentioned, the current approach includes several early years with relatively high default rates. A benefit of this approach, given SBA's historical experience, is that it provides a cushion in the event of an unexpected downturn in the economy. However, this cushion ties up appropriations that could have been available to other discretionary programs. As has recently been the case for SBA, this approach is more likely to result in continuing annual downward reestimates when there is a strong economic environment.

The proposed method would be more sensitive to fluctuations in economic conditions or changes in program delivery or design because it uses a shorter lookback period. The benefit of this approach is that, in a continuing stable economy, the original subsidy cost estimate would be expected to more closely match actual loan performance and reestimates would therefore be smaller. However, the risk of this approach is that a sudden downturn in the economy would be much more likely

²In addition to the differences between actuals and estimates to date, the total downward reestimate would also be affected by the present value of these differences and changes in the estimates for expected future loan performance.

³According to SBA officials, prior to the estimate of the 1998 cohort's subsidy cost in fiscal year 1996, subsidy cost estimates were prepared based on direct consultation with OMB.

⁴For example, under the 5 year lookback period, the 2002 cohort estimate of year one default activity would be based on the average actual first year defaults that occurred for the 1996 through 2000 cohorts and the second year default activity would be based on actual second year defaults that occurred for the 1995 through 1999 cohorts. Under the current approach, the lookback for all activity years includes the average of all cohorts back to 1986.

to result in actual loan performance being different than estimated and thus would likely result in larger upward reestimates than under the current approach.

SBA generally agreed with the information presented in this briefing. SBA officials added, however, that they view the proposed changes in default estimation methodology to be an interim solution. SBA views the long-term solution as a sophisticated econometric modeling approach. Econometric modeling considers key relationships between loan performance and economic and other indicators.

We are sending copies of this letter to the Administrator of the Small Business Administration and the Director of the Office of Management and Budget. This letter will also be available on GAO's homepage at <http://www.gao.gov>.

If you have any questions, please contact me at (202) 512-9508 or by e-mail at calboml@gao.gov, or contact Dan Blair, Assistant Director, at (202) 512-9401 or by email at blaird@gao.gov. Key contributors to this letter were Marcia Carlsen, Ruth Sessions, and Bill Shear.



Linda M. Calbom
Director
Financial Management and Assurance

Enclosure

**Briefing Before the Staffs of the Senate and House
Committees on Small Business**



Briefing to Staff of the Senate and House
Committees on Small Business

Small Business Administration
Section 7(a) General Business Loans Credit Subsidy
Estimates

July 30, 2001



- Objectives
- Scope and Methodology
- Background
- Process and Data Used to Estimate 7(a) Subsidy Costs
- Reestimates of the 7(a) Program Subsidy Costs
- Comparison of Originally Estimated Defaults and Recoveries to Actual Data
- Effect of Overestimating the 7(a) Program's Subsidy Cost
- Causes of Differences
- Implications of Proposed Changes
- Agency Comments



Our objectives for the Section 7(a) General Business Loans (the 7(a) program) review were to

- identify the types of data and process used to estimate the subsidy cost, including the incorporation of program changes,
- compare originally estimated defaults and recoveries from the 1992 through 2000 subsidy cost estimates to actual data recorded in the accounting system,
- determine the causes of differences between original estimates and actual defaults and recoveries,
- assess the implications of proposed changes to SBA's approach to estimate defaults.



- To achieve our objectives, we
 - discussed SBA's process and types of data used to prepare subsidy cost estimates with agency staff,
 - compared SBA's current process to prepare subsidy cost estimates to existing guidance from the Office of Management and Budget (OMB),
 - reconciled actual data used as a basis to estimate defaults and recoveries with data from the accounting system,¹
 - analyzed trends in the actual defaults, recoveries and guaranteed percentages,

¹ We were not able to reconcile to the actual data prior to fiscal year 1992 because the current accounting system was implemented in 1992 and does not include data prior to that time.



- compared the original estimated default and recovery amounts for the 1992 through 2000 cohorts² to actual loan performance data recorded in the accounting system,
 - discussed the causes of differences and proposed changes with SBA staff and OMB officials, and
 - determined the potential impact of various alternative approaches on subsidy cost estimates.
-
- Our audit work was conducted in Washington, D.C., from May 2001 through July 2001 in accordance with generally accepted government auditing standards.

² A cohort includes those direct loans or loan guarantees of a program for which a subsidy appropriation is provided for in a given fiscal year even if the loans are not disbursed until subsequent years.



- The 7(a) program guarantees loans made to small businesses that are unable to obtain financing on similar terms in the private credit market but can demonstrate the ability to repay the loan.
 - SBA reported that its share of outstanding 7(a) loan guarantees totaled nearly \$22.9 billion as of September 30, 2000. This represents about 65 percent of SBA's total loan guarantees outstanding.
 - From 1995 to 1996, SBA undertook a significant data gathering effort to capture historical loan performance for the 7(a) loan program and began using this data in 1996 to estimate the subsidy cost of the 1998 cohort.



- Since the inception of credit reform, the 7(a) program has had net downward reestimates of nearly \$1 billion.³
 - In March 2001, SBA submitted a proposal to OMB, which is discussed later in more detail, to adjust its approach to estimating the subsidy cost of the 7(a) program.
 - OMB is in the process of reviewing the recent SBA proposal.

³ A downward reestimate indicates a cohort of loans or loan guarantees is expected to cost the federal government less than previously anticipated. This amount does not include the portion of the reestimate attributable to interest.



- Prior to the Federal Credit Reform Act (FCRA) of 1990, credit programs--like most other federal programs--were reported in the budget on a cash basis.
 - Loan guarantees appeared to be free in the budget year while direct loans appeared to be as expensive as grants.
 - This cash basis distorted costs and, thus, the comparison of credit program costs with other programs and each other.



- FCRA was, among other reasons, enacted to more accurately measure the government's costs of federal loan programs and to permit better comparisons both among credit programs and between credit and noncredit programs.
- Under FCRA, agencies are required to estimate the cost of extending or guaranteeing credit over the life of the loan, called the subsidy cost.
 - This cost is the estimated long-term cost to the government of direct loans or loan guarantees calculated on a net present value⁴ basis, excluding administrative costs.

⁴ The net present value expresses expected future cash inflows and outflows in today's dollars. In calculating the present value, prevailing interest rates provide the basis for converting future amounts into today's dollar equivalents.



- In the subsidy cost calculation, agencies estimate the cash flows for a program, including (but not limited to) estimated defaults, recoveries, and fees, and the effects of prepayments, on a cohort basis, for the life of the loans.
- Generally, agencies are required to annually update the subsidy cost - referred to as reestimates - of each cohort based on information about the actual performance and/or estimated changes in future loan performance.
- FCRA recognized that agencies' ability to make subsidy cost estimates that mirrored actual loan performance could be impeded by various factors and provided permanent indefinite budget authority for reestimates that reflect increased credit program costs.



- Section 503 of FCRA states that OMB is responsible for, among other things,
 - coordinating subsidy cost estimates for executive branch agencies and
 - reviewing historical data and developing the best possible credit subsidy estimates.

- The Accounting and Auditing Policy Committee's⁵ (AAPC) Technical Release 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*, identifies specific practices that, if fully implemented by credit agencies, will enhance their ability to reasonably estimate loan program costs.

⁵ The AAPC is sponsored by the Federal Accounting Standards Advisory Board.



- When calculating the subsidy cost of the 7(a) program, SBA considers, for the life of the loans guaranteed
 - (1) fees that will be received,
 - (2) the percent of total loan amounts guaranteed, which currently can not exceed 75 or 85 percent depending on the loan amount,
 - (3) the volume and mix of loan guarantees,⁶ and
 - (4) the amount and timing of defaults and recoveries.
- To estimate defaults and recoveries, SBA averages its historical loan performance since 1986.⁷

⁶ The volume and mix of loan guarantees refers to the total amount of loans SBA expects to guarantee and the various loan sizes based upon different fee and guaranteed percentages.

⁷ SBA began using this historical database in 1996 to calculate the subsidy cost of the 1998 cohort.



- According to SBA staff, when there is a change in the 7(a) program's design, SBA staff
 - determine if the change affects existing assumptions or adds a new assumption to the subsidy cost calculation,
 - determine if there is any historical data that could be used to assess the impact of the change on the subsidy cost estimates, and
 - use informed opinion⁸ to estimate the impact on the subsidy cost if no applicable historical experience exists.

⁸ Informed opinion refers to the judgment of agency staff who make subsidy estimates based on their programmatic knowledge and/or experience. According to Technical Release 3, informed opinion is an acceptable approach in situations where historical data does not exist.



- SBA generally uses the same process and types of data as explained on the prior two slides to calculate reestimates of subsidy costs. In addition, as part of the reestimate process,
 - as actual loan performance becomes available, it replaces estimated cash flows and
 - expectations of future loan performance are updated based on information about actual performance and/or estimated changes in future loan performance.
- In summary, the process and types of data SBA uses to estimate the subsidy cost of the 7(a) program are generally reasonable and comply with existing OMB guidance.



- Since the inception of credit reform, SBA has overestimated the original subsidy cost of the 7(a) program by nearly \$1 billion, as evidenced by the net downward reestimate shown on the following slide.
- Because reestimate data were not separately available for interest, defaults, fees and other cash flows, we were unable to determine the net overestimate attributable to each of these factors.
- However, based on our comparisons of originally estimated defaults and recoveries to actual loan performance, a significant portion of the 7(a) program's total \$1 billion net reestimate is attributed to the overestimate of defaults.



Reestimates of the 7(a) Program Subsidy Costs

Reestimate History of the 7(a) Program
(Dollars in millions)

Cohort	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget	Cummulative
1992	\$5	(\$55)	(\$30)	(\$74)	(\$5)	(\$4)	(\$163)
1993	(14)	(77)	(50)	(80)	(21)	(16)	(259)
1994	53	(14)	(63)	(60)	(12)	(4)	(100)
1995	11	49	(68)	(60)	(1)	(4)	(73)
1996		32	37	(101)	(16)	(9)	(57)
1997			(24)	(86)	(39)	(0)	(149)
1998				(52)	(39)	(39)	(130)
1999					(13)	(11)	(24)
2000						(3)	(3)
Totals	\$54	(\$65)	(\$198)	(\$513)	(\$145)	(\$91)	(\$958)

Source: Small Business Administration

Note: For each annual reestimate, net amounts were either received from Treasury (1997 Budget) or returned to Treasury (1998 - 2002 Budget).



Comparison of Originally Estimated
Defaults and Recoveries to Actual Data

- SBA originally overestimated defaults⁹ for 1992 through 2000 by over \$2 billion, or about 87 percent, when compared to actual loan performance.
- Since estimated recoveries are based on a percent of estimated defaults, SBA also originally overestimated recoveries for 1992 through 2000 by nearly \$450 million, or about 62 percent, when compared to actual loan performance.
- According to SBA staff, overestimating fees also contributed to the 7(a) program total net reestimate. However, we did not attempt to quantify the effect of fees.¹⁰

⁹ The amount defaulted is based on the portion SBA guarantees.

¹⁰ In addition to the differences between actuals and estimates to date, the net reestimate would also be impacted by the present value of these differences and changes in the estimates for expected future loan performance.



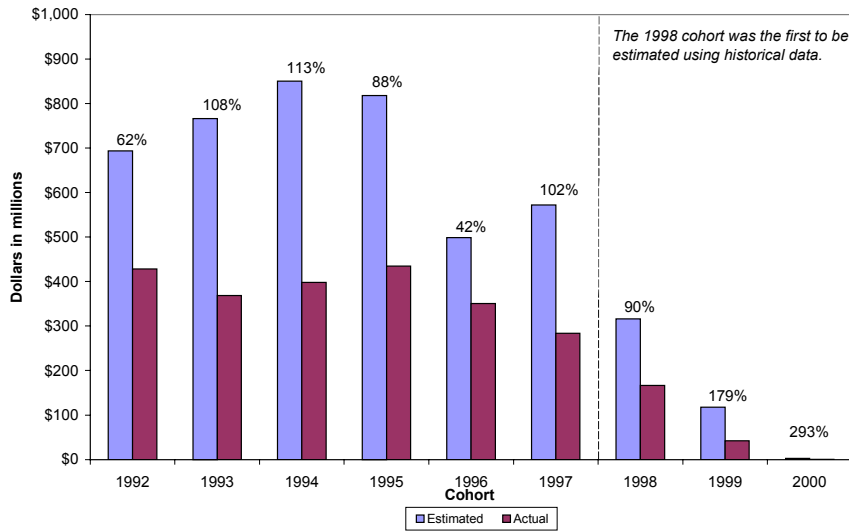
Comparison of Originally Estimated
Defaults and Recoveries to Actual Data

- The following 4 slides summarize the results of our comparison of original estimates of defaults and recoveries to actual defaults and recoveries for the 1992 through 2000 cohorts.
- The original estimates of defaults and recoveries for each cohort are based on expectations of future loan performance from the time of origination through fiscal year 2000. Actual defaults and recoveries for each cohort are based on actual loan performance through fiscal year 2000.



Comparison of Originally Estimated Defaults and Recoveries to Actual Data

Percentage by which Originally Estimated Defaults were more than Actual Defaults for Fiscal Years 1992 through 2000 (Cumulatively by Cohort)

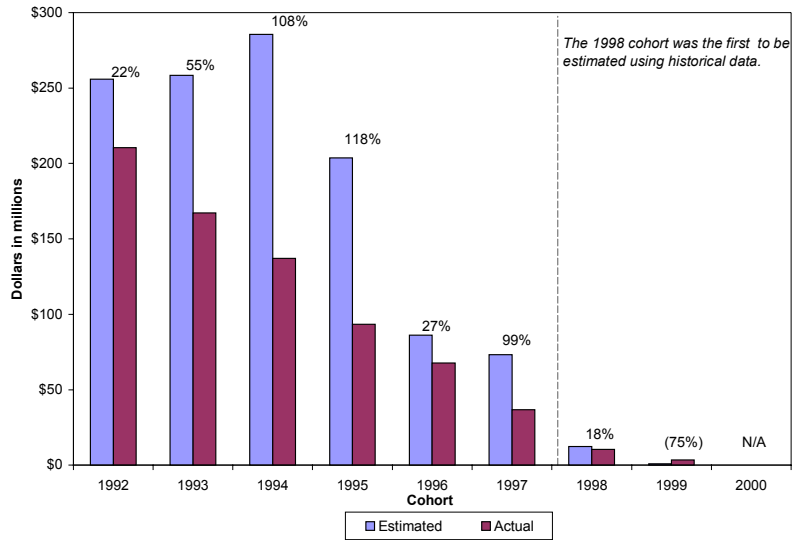


Source: GAO analysis based on SBA data.
 Note: By the end of fiscal year 2000, only the 1992 through 1996 cohorts had reached the typical peak default years, which historically have been years 3 through 5 after approval.



Comparison of Originally Estimated Defaults and Recoveries to Actual Data

Percentage by which Originally Estimated Recoveries were more (less) than Actual Recoveries for Fiscal Years 1992 through 2000 (Cumulatively by Cohort)



Source: GAO analysis based on SBA data

Note: N/A indicates that there were no actual recoveries as expected for a cohort in its first year.



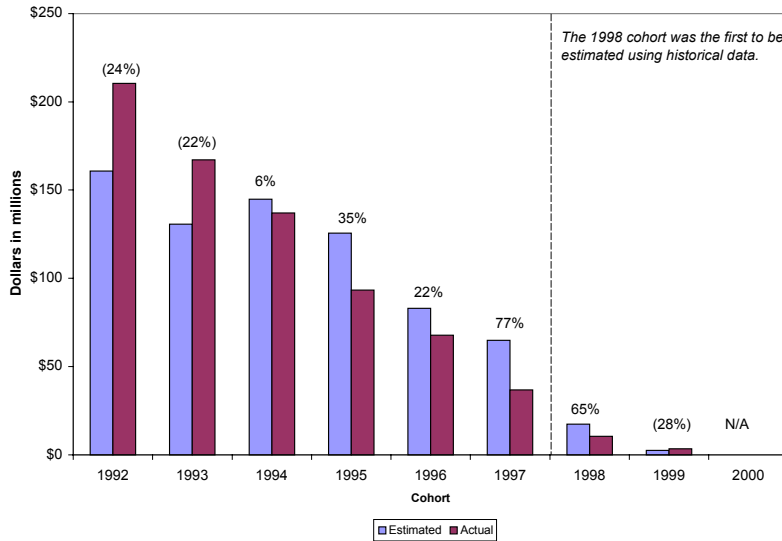
Comparison of Originally Estimated
Defaults and Recoveries to Actual Data

- In order to assess estimated recoveries independently from the effect of overestimating defaults, we compared estimated recoveries based on actual defaults to actual recoveries.
- This comparison, summarized on the next slide, showed that adjusting for the effect of originally overestimating defaults, estimated recoveries have more closely matched actual loan performance over time.
 - The cumulative difference between the adjusted estimate of recoveries and actual recoveries was about \$3 million, or about 1 percent of actual recoveries.



Comparison of Originally Estimated Defaults and Recoveries to Actual Data

Percentage by which Adjusted Estimated Recoveries were more (less) than Actual Recoveries for Fiscal Years 1992 through 2000 (Cumulatively by Cohort)



Source: GAO analysis based on SBA data.

Note: Estimated recoveries were adjusted to be based upon actual defaults in order to remove the effect of overestimating defaults. N/A indicates that there were no actual recoveries for the cohort, as expected for a cohort in its first year.



- Because the 7(a) program is a discretionary credit program, overestimating the cost can affect the number or size of loans guaranteed, if the program runs out of budget authority.
- However, according to SBA and OMB, the 7(a) program has typically not depleted its allocated budget authority and has generally met its demand for loan guarantees.
 - According to SBA, the 7(a) program did run out of budget authority a few days before the end of fiscal year 1995, preventing SBA from issuing some loan guarantees. However, SBA issued loan guarantees for those loans the following fiscal year. Further, for a part of 1997, SBA established a temporary cap on the size of loans it guaranteed, which limited the amount of subsidy available per loan.



- Appropriations for the original 7(a) program subsidy cost, like other discretionary credit programs, are counted under the discretionary spending caps and must compete with other discretionary programs for the funding available under these limits.
- The cumulative result of the overestimates of the subsidy cost of the 7(a) program is that \$958 million of budget authority was not available for other discretionary programs for fiscal years 1992 through 2000.



- For the 1992 through 1997 cohorts,¹¹ the specific reason for the differences between originally estimated and actual defaults is unclear because the basis of the estimate is unknown.
 - SBA did not begin to use its historical data until 1996, when it calculated the original subsidy cost estimate for the 1998 cohort.
 - According to SBA officials, prior to 1996, subsidy cost estimates were prepared based on direct consultation with OMB and the basis used for the default estimates was not documented.
 - However, SBA believes one of the reasons for the differences was an unexpected good economy.

¹¹ Reestimates of the 1992 through 1997 cohorts have accounted for 84 percent of the 7(a) program's total downward reestimate.



- The reason for the differences between originally estimated and actual defaults for the 1998 through 2000 cohorts is that the historical average default rate used as the basis for the default estimate was greater than recent loan performance.
 - The historical average default rate was higher because loans guaranteed in fiscal years 1986 through 1990 defaulted at a significantly higher rate than those for later years.
 - SBA attributes the high default rates in fiscal years 1986 through 1990 generally to differences in (1) economic conditions, (2) guarantee percentages, and (3) underwriting standards.
 - The loans in the 1998 through 2000 cohorts are still relatively new and have not yet reached the typical peak default years, which historically have been years 3 through 5 after approval.



- In March 2001, SBA submitted a proposal to OMB¹² that discusses using 5 years or 3 years of the most recent actual loan performance - referred to as the lookback period¹³ - as the basis for the 7(a) program default estimate in order to more closely track with actual loan performance in the future. SBA recommends the 5 year lookback period.
- This proposal is based on SBA's analysis that showed that the most recent years of actuals are more predictive of near-term future loan performance, notwithstanding a sudden shift in the economy.

¹² In the past, SBA has proposed other methods to refine its default estimates to OMB. According to OMB, SBA has not provided acceptable support that the alternatives would provide better estimates.

¹³ For example, under the 5 year lookback period, the 2002 cohort estimate of year one default activity would be based on the average actual first year defaults that occurred for the 1996 through 2000 cohorts and the second year default activity would be based on actual second year defaults that occurred for the 1995 through 1999 cohorts.



- Because the lookback period is shorter, original subsidy cost estimates, as well as annual reestimates of outstanding cohorts, would be more sensitive to fluctuations in economic conditions or changes in program delivery and design.
- The benefit of this approach is that in a continuing stable economy, the original subsidy cost estimate would be expected to more closely match actual loan performance and reestimates would therefore be smaller.



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- However, the risk of this approach is that a sudden downturn in the economy would be much more likely to result in actual loan performance being different than estimated and thus could result in larger reestimates.
- If SBA were to implement a shorter lookback period approach, its next reestimate would likely be large because expectations of future loan performance of outstanding cohorts would also be impacted by the change.



- Under SBA’s current approach, initial estimates of the subsidy rate are fairly stable because of the longer lookback period, which smoothes out fluctuations in economic conditions from year to year.
 - This approach is based on the concept that, averaging “good” and “bad” years is the best way to estimate the effect of uncertain future economic conditions.
 - The benefit of this approach is that it provides a “cushion” in the event of an unexpected downturn in the economy.



- The consequence of this approach is that the “cushion” ties up appropriations that could have been available to other discretionary programs.
- This approach is also more likely to result in continuing annual downward reestimates in a strong economic environment.
- However, in a less favorable economy, the current approach may result in original subsidy cost estimates that are closer to actual loan performance than the proposed 5 year lookback approach.



- The following table contrasts the impact of using the current approach, a 5 year lookback, and a 3 year lookback to estimate the subsidy cost of the fiscal year 2002 cohort.

Estimation Alternatives' Effect on Subsidy Rate and Appropriation for the Fiscal Year 2002 Cohort

	Default Rate	Subsidy Rate	Appropriation
Current Approach	13.87%	1.07%	\$114,490,000
5 Year Lookback	9.74%	-0.40%	-\$42,800,000
3 Year Lookback	8.97%	-0.61%	-\$65,270,000

Source: GAO analysis based on SBA data.

Note: Estimated appropriation assumes that all other assumptions remain unchanged.



- For both the 5 year and 3 year lookback approach, we estimated a negative subsidy, meaning that the program is estimated to “make money” for the federal government.
 - We estimated that the 5 year and 3 year lookback would project a negative subsidy of \$43 million and \$65 million, respectively, versus a subsidy cost of \$114 million under the current approach.



- SBA generally agreed with the information presented in this briefing. SBA officials added that they view the proposed change in the default estimation methodology to be an interim solution. SBA views the long-term solution as a sophisticated econometric modeling approach.
 - Econometric modeling is meant to include any estimated quantitative method of analysis. It defines key relationships between loan performance and economic and other indicators.
 - SBA has already started work on this type of methodology.

Appendix E

*Letter from the Chair and Ranking Member of the Senate
Committee on Small Business and Entrepreneurship to
the Director of the Office of Management and Budget;
September 7, 2001*

JOHN F. KERRY, MASSACHUSETTS, CHAIRMAN
CHRISTOPHER S. BOND, MISSOURI, RANKING MEMBER

CARL LEVIN, MICHIGAN
TOM HARKIN, IOWA
JOSEPH I. LIEBERMAN, CONNECTICUT
PAUL D. WELLSTONE, MINNESOTA
MAX CLELAND, GEORGIA
MARY LANDRIEU, LOUISIANA
JOHN EDWARDS, NORTH CAROLINA
MARIA CANTWELL, WASHINGTON
JEAN CARRAHAN, MISSOURI

CLYDE R. BURNS, MONTANA
ROBERT F. BENNETT, UTAH
OLYMPIA J. SNOWE, MAINE
MICHAEL ENZI, WYOMING
PETER G. FITZGERALD, ILLINOIS
MIKE CRAPO, IDAHO
GEORGE ALLEN, VIRGINIA
JOHN ENSIGN, NEVADA

PATRICIA R. FORBES, MAJORITY STAFF DIRECTOR AND CHIEF COUNSEL
EMILIA DISANTO, REPUBLICAN STAFF DIRECTOR

United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510-6350

September 7, 2001

The Honorable Mitchell E. Daniels, Jr.
Director
Office of Management and Budget
Executive Office of the President
17th Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Dear Mitch:

On Wednesday, September 5, 2001, the Committee on Small Business and Entrepreneurship conducted a Roundtable on the credit subsidy rates for the Small Business Administration's (SBA) 7(a) guaranteed business loan program. The purpose of the Roundtable was to review a recent report from the General Accounting Office (GAO), which concluded that the SBA and the Office of Management and Budget (OMB) had overestimated the credit subsidy cost of the 7(a) program by \$958 million since Fiscal Year 1992. GAO further concluded that the overestimate of defaults was the prime reason for the inaccurate credit subsidy rates.

A large portion of the \$958 million overcharge is made up of fees paid to the SBA by the small business borrowers and the lenders who deliver the SBA 7(a) guaranteed loan program. As you know, under the Federal Credit Reform Act of 1990, excess fees paid as part of the credit subsidy cost of Federal loan program are sent to the general fund of the Treasury rather than being returned to the program or to the persons who made the payments.

As was discussed before yesterday's hearing at the Budget Committee, Dr. Lloyd Blanchard represented the OMB at this Roundtable. Indeed, we are very appreciative of his participation in this session which lasted over two hours. For your review and future reference, a list of the Roundtable participants is enclosed.

It is imperative that this matter be resolved before October 1, 2001, the beginning of FY 2002. Consistent with this deadline, Dr. Blanchard agreed to undertake a complete review of the information provided at the Roundtable and to work with the staffs from the GAO, the SBA, the Committee, and representatives from the lending industry in arriving at a possible and expedited solution and to report back to Committee in not more than three weeks. The Committee expects that OMB will also report on what adjustments can be made to the credit subsidy rate to make it more accurate for FY 2002.

The Honorable Mitchell E. Daniels, Jr.

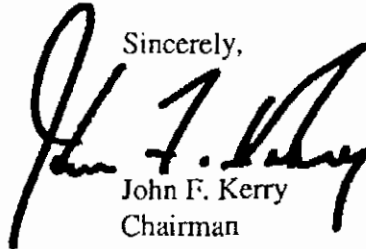
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Your assistance in insuring a prompt solution to this important matter will be greatly appreciated. Small business borrowers and the lenders who deliver the 7(a) program should not enter the next fiscal year knowing that the fees they are paying are well in excess of the needs of the program. As the GAO report emphasized, this situation has persisted since 1992, and we on the Committee urge you to initiate action that is fair and equitable to our Nation's small businesses. It is vital to ensure adequate funding for small businesses to help them lead us out of the current economic doldrums.



Christopher S. Bond
Ranking Member

Sincerely,



John F. Kerry
Chairman

Appendix F

Excerpts from the Congressional Record

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THE AMERICAN SMALL BUSINESS EMERGENCY RELIEF AND RECOVERY ACT OF 2001 -- (Senate - January 23, 2002)

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Mr. KERRY. Madam President, I rise today to speak on the behalf of thousands of small business owners across this country who are still struggling to keep their businesses open in the aftermath of the terrorist attacks. They're having a tremendously tough time paying their bills and making payroll, and they need access to affordable loans so that they have sufficient working capital as they adjust to the market or until business returns to normal.

Senator *Bond* and I put forth a comprehensive bill in the last session, shortly after terrorist attacks, that addressed not only disaster assistance and the worsening credit crunch that has compounded the financial problems of small businesses, but also the need for business counseling and protection in recovering lost revenue from frozen federal contracting jobs. I am talking specifically about S . 1499 , the American Small Business Emergency Relief and Recovery Act of 2001.

For the sake of small business owners and their employees, I wish I could say that I was here to speak about implementation of this legislation. But I cannot. S . 1499 , was blocked by the Administration and a few Republican Senators. So here I am, at the beginning of another session, a new year, and four months after the bill was introduced, talking about the Senate acting on emergency legislation as small businesses wait for us to do something to help them. I really do not know how anyone in this body could stand to go home after Congress adjourned and explain to their constituents how we could provide billions in loans and grants to airlines, but we could not provide a modicum of that assistance to small businesses.

Republicans holding the bill in the Senate tell me and the press that they blocked the bill and still have holds on the bill because the Administration has problems with it. The Administration says they have problems with the bill because they do not believe there is a credit crunch making it harder and more expensive for small businesses to get loans. They do not believe we need to provide incentives to stimulate borrowing or to encourage banks to make loans to small businesses.

How can there be no credit crunch when survey results by the Federal Reserve reveal that as many as 51 percent of banks have reduced lending to small businesses? How can there be no credit crunch when established giants like the airlines could not get loans in the post-September 11th economy?

Please tell me how the Administration's priority is an economic stimulus package, but the Administration wants us to drop the stimulus provisions in S . 1499 ? What better way to stimulate the economy than through business investment and job creation? What is homeland security without economic security? They want us to drop the protection for small businesses doing business with the Federal Government. And they want us to drop incentives making the Small Business Administration's loans more affordable for borrowers and lenders.

Senator *Bond* and I asked them to meet us halfway, and they said no. We asked them to give us alternative language, and they didn't give us any. We spent more than 20 hours negotiating on this bill and it appears as if the Administration never had any intention of finding common ground. It appears as if it was an exercise in delay.

Let me describe briefly where I disagree with the Administration about how to help small businesses battling bankruptcy and employee layoffs triggered by the terrorist attacks and economic downturn. The Administration believes that all assistance should be

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delivered through the SBA's disaster loans, which are administered through only four regional offices. From talking to small businesses and SBA lenders, Senator *Bond* and I have concluded that small businesses would be better served through a combination of disaster loans and government guaranteed loans. Government guaranteed loans are almost five times cheaper than what the Administration has proposed, have less risk for the taxpayer, and can reach more small business owners because they are delivered through more than 5,000 private sector lenders who know their communities and have experience making SBA guaranteed loans. Our proposal combines public and private sector approaches to ensure small businesses nationwide receive the maximum amount of assistance.

The economy was fizzling before September 11th, and small businesses were already feeling the pain. To stay financially healthy, they were doing their part by cutting back on spending, investing and hiring, and the Federal Reserve was cutting interest rates in an attempt to keep inflation in check. After September 11th, small business owners across this country put on black arm bands. The plug was pulled on their business. It didn't matter what state they were in; they weren't immune to the ripple effect of grounded transportation, closed financial markets, a volatile economy, and lay-offs announced by the tens of thousands. Let's start this session off right by passing S . 1499 . Let's demonstrate that we understand the significance of small businesses to the American economy and that we will help them like we have helped other industries.

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**AMERICAN SMALL BUSINESS EMERGENCY RELIEF ACT OF 2001 -- (Senate -
March 22, 2002)**

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Mr. DODD. Mr. President, I ask unanimous consent that the Senate proceed to the immediate consideration of Calendar No. 186, S . 1499 .

The PRESIDING OFFICER. The clerk will report the bill by title.

The legislative clerk read as follows:

A bill (S . 1499) to provide assistance to small business concerns adversely impacted by the terrorist attacks perpetrated against the United States on September 11, 2001, and for other purposes.

There being no objection, the Senate proceeded to consider the bill.

AMENDMENT NO. 3076

Mr. DODD. Mr. President, I understand Senators **KERRY** and **BOND** have a substitute amendment at the desk. I ask unanimous consent that the Senate proceed to its immediate consideration, that the amendment be agreed to, and that the motion to reconsider be laid upon the table.

The PRESIDING OFFICER. Without objection, it is so ordered.

The amendment (No. 3076) was agreed to.

(The text of the amendment is printed in today's **RECORD** under ``Text of Amendments.'')

- [Begin Insert]

Mr. KERRY. Mr. President, I would urge that there be no further delay, no further

obstruction, and that the Senate act--at long last--to pass a bill that is very important to so many small businesses in this country crippled by the economic fall-out of September 11, including businesses that were already struggling before September 11 during the recession and are now faced with even more difficult prospects.

For months, tens of thousands of small businesses have been asking for help--an immediate helping hand--just to keep their businesses going--particularly working capital to meet payroll and pay the bills--but they have been forced to make ends meet by using credit cards and depleting personal savings because small businesses doesn't have the same access as big

[Page: S2336] GPO's PDF

business--to credit or otherwise. Left in the lurch by congressional inaction and delay, these businesses and their employees paid the price.

Now it is time that the Senate delivers the relief the vast majority of us were prepared to deliver in the first weeks after September 11, urgent relief delayed by partisan gamesmanship.

My American Small Business Emergency Relief and Recovery Act has gotten a lot of attention over the past 5 months. It has been blocked from even a meaningful debate on the Senate floor. What makes this week different?

What makes it different is that we have reached final agreement with the White House on a compromise, thanks to our last resort--hardball tactics of our own--and the bill has at long last been cleared to pass the Senate by unanimous consent.

I thank the 63 cosponsors of this bill. I thank the numerous small businesses and small business advocates who have worked so hard and used so much of their limited resources to free this bill for passage. This diverse coalition of business leaders and Democratic and Republican policy makers have stood by us from day one--their support should have been enough to guarantee passage way back then, but it wasn't enough to stop some from playing partisan games with even bipartisan legislation. Now, at long last, the good faith efforts of our supporters are being rewarded.

It is my hope that having worked out our differences with the White House, we have cleared the way for passage not just through the Senate but also through the House. Once this help is enacted, small businesses will finally be able to receive desperately needed economic relief.

I am pleased with the compromise. It preserves provisions that are really important for those small businesses that have needed help over the past few months but fell through the cracks in SBA's disaster loan program, or fell through the cracks in the private sector where lenders have cut back on loans to small businesses over the past year.

It simply was not enough, not efficient, and not cost-effective to use only one of SBA's many lending programs to serve all the small businesses throughout this country that were hurt by the terrorist attacks or that have been struggling with the credit crunch. All of the SBA's tools should be used to help the affected small businesses, and this bill does just that. Because this bill was blocked from consideration, Senator *Bond* and I were

forced to enact some of these provisions through a defense bill. I very much thank Senators **BYRD** and **HOLLINGS** for including them. Specifically, we made it possible for small businesses to get working capital loans through the SBA's 7(a) loan program. SBA is calling these "STAR loans," and compared to the economic injury disaster loans, borrowers are accessing capital faster. In just seven weeks, since the loans were made available, nearly \$38 million has been loaned to 129 small

businesses. It reminds us that being able to go sit in the office of a lender in the same town is far more efficient and effective than requiring a small business in West Virginia or Puerto Rico to call a 1-800 number in Niagara Falls for emergency assistance.

One needs only to look at the record by comparison for economic injury disaster loans outside New York and Virginia to see the need for these STAR loans. After 22 weeks (nearly 6 months), only 2,600 loans have been approved, adding up to a denial rate of almost 50 percent. That doesn't even include the small businesses that were turned away before they even filled out an application because of outdated size standards. That has left a lot of small businesses across this country without assistance. A lot of small business owners turning are in their keys to the bank. As one small business advocate said today, in reference to the thousands of tour bus companies that went out of business, "I understand the banks now own a wonderful fleet of tour buses."

Well, for those small tour bus owners who have been waiting for this bill to pass and still need a working capital loan to ramp back up in the upcoming tour season, the compromise preserves the refinancing of business debt under a disaster loan. They need this so that they can restructure debt to survive this business slump. We fought very hard to keep this assistance in the bill.

For the owners of travel agencies--the majority of which are small businesses--we have increased the size standards for your industry so that more of your companies qualify for disaster loans and 7(a) emergency loans. Please spread the word to travel agencies that were turned away earlier in the year because they were considered too large. They might need working capital more than ever now that the airlines have completely eliminated commissions.

For small businesses that need access to credit and can't get it because of the credit crunch, Senator *Bond* and I were able make SBA's programs more affordable by reducing the fees borrowers pay through September 2004. In both the Senate and the House, we have had hearing after hearing trying to get fairer fees for the borrowers who need capital and the lenders who make loans, but until now we haven't gotten any cooperation. This bill will make a difference. Whether you need working capital through SBA's 7(a) loan program or credit to buy a building or equipment through SBA's 504 loan program, it will now be less expensive. Stimulating lending and borrowing is good for the economy because it creates jobs and saves jobs. By law, small businesses that borrow money through the SBA 504 loan program have to hire or retain an employee for each \$35,000 borrowed. This is a win-win situation for our economy.

The overall purpose of this emergency legislation is to provide access to the full complement of SBA loans and business counseling in order to help small businesses hurt by the terrorist attacks of September 11th and their aftermath.

This legislation will help mitigate bankruptcies, business closures, and lay-offs and

address the shrinking availability of credit. However, small businesses doing business with the Federal Government have also felt the impact of the terrorist attacks.

Small business contractors, because of very real and legitimate security concerns, have experienced a dramatic increase in costs for work in and around Federal Government facilities. We have heard reports of small businesses being denied access to their equipment on military bases, waiting for hours each day to enter government facilities and being limited in the hours they can work on their projects.

Let me cite the situation faced by Dave Krueger, President of AS Horner Construction, Inc. out of Albuquerque, NM. Dave was currently doing work on a Federal contract at an Air Force facility pouring concrete parking aprons. Immediately after the attack, his company was locked out of the facility for nearly 2 weeks and currently has limited hours to access the construction site. Dave estimates that this will result in cost increases of at least 10 percent, meaning he will take a loss on this contract.

Such situations cannot go unresolved. Small businesses are far too important, not just to our national economy, but to our national defense as well. Small business is a vital component of our national supply chain and essential to our national security interests. To address this, S . 1499 establishes an expedited procedure whereby Federal small business contractors can apply for an equitable adjustment to their contract if costs have been incurred due to security or other measures resulting from the terrorist attacks. In the interest of compromise, Senator *Bond* and I agreed to reduce the funding available for these provisions from \$100 million to \$50 million.

The Kerry-Bond approach has always been cost-effective--about five times cheaper than the administration's approach. CBO estimated that providing this assistance to small businesses would cost \$860 million. The final compromise, based on CBO's estimates, is down from \$860 million to \$300 million.

This is a good compromise. It will help small businesses in every State. It is a reasonable approach that maximizes existing resources and private sector help. I strongly and respectfully urge my colleagues to let this legislation pass. Small businesses in your State will thank you.

I ask that a list of supporters of S . 1499 be printed in the **RECORD**.

The list follows:

S . 1499 Supporters: Airport Ground Transportation Association; American Bus Asso-

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ciation; American Subcontractors Association; Associated General Contractors of America; Association of Women's Business Centers; CDC Small Business Finance; Chicago Association of Neighborhood Development Organizations; Citizens Financial Group, RI; Clovis Community Bank, CA; Coastal Enterprises, ME; County of San Diego; Delaware Community Reinvestment Act Council; Fairness in Rural Lending; Florida Atlantic University Small Business Development Center; Helicopter Association; HUBZone Contractors National Council; National Association of Government Guaranteed Lenders; National Community Reinvestment Coalition; National League of Cities; National

Limousine Association; National Restaurant Association; National Small Business United; National Tour Association; New Jersey Citizen Action; Rural Housing Institute; Rural Opportunities; Self Help Credit Union; Small Business Legislative Council; U.S. Conference of Mayors; United Motorcoach Association; United States Air Tour Association; United States Chamber of Commerce; United States Tour Operator Association; Women's Business Development Center.

- [Begin Insert]

Mr. BOND. Mr. President, I urge my colleagues in the Senate to vote in favor of S . 1499 , the American Small Business Emergency Relief and Recovery Act. I thank my colleague from Massachusetts, Senator **KERRY**, for introducing the bill, and I am pleased to be its principal cosponsor. Since S . 1499 was introduced on October 4, 2001, 62 of our Senate colleagues have joined us as cosponsors.

The measure before the Senate today is a comprehensive managers' substitute amendment to S . 1499 , which incorporates significant changes that have been agreed to following lengthy negotiations with the staffs from the White House and the Office of Management and Budget, OMB. In particular, I thank Andy Card, the President's Chief of Staff, Dr. Lawrence Lindsey, Director of the National Economic Advisors, and Steve McMillin, Assistant Director at OMB, for their personal involvement in the negotiations.

The managers' substitute amendment modifies S . 1499 to recognize changes in the disaster relief and credit programs at the Small Business Administration, SBA, that were enacted on January 10, 2002, in section 203 of the Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorists Attacks on the United States, P.L. 107-117 Emergency Disaster Supplemental.

Enactment of S . 1499 , as amended, will insure that valuable credit and management assistance will flow to small businesses that were harmed by the September 11 terrorist attacks on the World Trade Centers and the Pentagon. It is my understanding the House of Representatives is prepared to act quickly on the bill soon after the 2-week recess, so that it can be sent to President Bush for his signature in the near future. Fast action by Congress is critical. Small businesses from across the United States are continuing to struggle under the dual pressures from the economy and the aftermath of the terrorist attacks.

As the ranking member of the Committee on Small Business and Entrepreneurship, I have received pleas for help from small business in Missouri and across the nation: small restaurants that have lost much of their business due to the fall off in business travel; local flight schools that have been grounded as a result of the recent terrorist attacks; and Main Street retailers who are struggling to survive. The American Small Business Emergency Relief and Recovery Act contains sound initiatives to help our nation's small businesses and their employees. We in Congress must act and act soon to help our Nation's small businesses.

In response to the urgent calls for strong and effective Federal Government action to reverse the

decline in the economy and stimulate a business rebound, last October I introduced the Small Business Emergency Relief and Recovery Act of 2001, S . 1499, which was designed

to provide effective economic stimulus in three distinct but complementary ways: increasing access to capital for the nation's small enterprises; providing tax relief and investment incentives for our small firms and the self-employed; and directing one of the Nation's largest consumers--the Federal Government--to shop with small business in America.

Historically, when our economy slows or turns into a recession, the strength of the small business sector helps to right our economic ship, with small businesses leading the Nation to economic recovery. Small businesses employ over one-half of the U.S. workforce and create 75 percent of the net new jobs. Clearly, we cannot afford to ignore America's small businesses as we consider measures to stimulate our economy.

S . 1499 goes to the heart of a major problem confronting thousands of small businesses today by taking on access to capital barriers. This bill is a bipartisan collaboration between Senator **KERRY**, and me and our staffs of the Committee on Small Business and Entrepreneurship. We have worked together to devise one-time modifications to the SBA Disaster Relief, 7(a) and 504 Loan Programs because the traditional approach to disaster relief will not address the critical needs of thousands of small businesses located at or around the World Trade Center, the Pentagon and in strategic locations throughout the United States.

In New York City, it could be a year and more before many of the small businesses destroyed or shut down by the terrorist attacks can reopen their doors for business. Small firms near the Pentagon, such as those at the Reagan National Airport or Crystal City, VA, are also shut down or struggling. And there are small businesses throughout the United States that were shut down for national security concerns and continue to struggle to regain lost customers.

Small enterprises located in the Presidentially declared disaster areas surrounding the World Trade Center and the Pentagon are not the only businesses experiencing extreme hardship as a direct result of the terrorist attacks of September 11. Nationwide, thousands of small businesses are unable to conduct business or are operating at a bare-minimum level. Tens of thousands of jobs are at risk of being lost as small businesses weather the fall out from the September 11 attacks.

Regular small business disaster loans fall short of providing effective disaster relief to help these small businesses. The Emergency Disaster Supplemental included a provision from S . 1499 as introduced that allows small businesses to defer for up to 2 years repayment of principal and interest on their SBA disaster relief loans. Interest that would otherwise accrue during the deferment period would be forgiven. The thrust of this essential ingredient is to allow the small businesses to get back on their feet without jeopardizing their credit or driving them into bankruptcy. The managers' substitute amendment restates this key provision.

The managers' substitute amendment also retains the provision permitting small businesses located in the Presidentially declared disaster areas and those small businesses directly affected by the terrorist attack to refinance existing business debt. Repayment of principal shall be deferred for disaster loans to refinance existing business debt, however, interest would accrue during the deferment period.

S . 1499 would provide a special financial tool to assist small businesses as they deal

with these significant business disruption. Small businesses in need of working capital would be able to obtain SBA-guaranteed "Emergency Relief Loans" from their banks to help them during this period. Fees normally paid by the borrower to the SBA would be eliminated, and the SBA would guarantee 85 percent of the loan. A key feature of the bill is the authorization for banks to defer repayment of principal for up to one year. This section would remain in effect for 9 months after the date of enactment of the act.

My colleagues and I have heard from thousands of small businesses since the terrorist attacks that small businesses are experiencing significant hardship. The downturn in business activity, however, was clearly underway prior to September 11. The downturn was further exacerbated by the terrorist attacks.

S . 1499 would provide for changes in the SBA 7(a) Guaranteed Business Loan Program and the 504 Certified Development Company Loan Program to

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stimulate lending to small businesses that are most likely to grow and add new employees. The managers' substitute amendment incorporates the provision from the emergency supplemental that reduces the annual fee paid by lenders from 50 basis points, 0.50 percent, to 25 basis points, 0.25 percent. In addition, the up front origination fee paid by small business borrowers would be reduced. These enhancements to the SBA's 7(a) program, and comparable reductions in 504 loan program fees, are to continue through September 30, 2004. They are designed to make the programs operate more effectively and efficiently during the period when the economy is weak and banks have tightened their underwriting requirements for small business loans.

Specifically, when the economy is slowing, it is normal for banks to raise the bar for obtaining commercial loans. However, making it harder for small businesses to survive is the wrong reaction to a slowing economy. By making these adjustments to the 7(a) and 504 loans to make them more affordable to borrowers and lenders, we will be working against history's rules governing a slowing economy, thereby adding a stimulus for small businesses. Essentially, we will be providing a counter-cyclical action in the face of a slow economy with the express purpose of accelerating the recovery.

The SBA has a very effective infrastructure for providing management assistance to small businesses located nationwide. The Small Business Development Center, SBDC, SCORE, Women's Business Center and Microloan programs provide much needed counseling to small businesses that are struggling or facing problems in their start-up phase. With the U.S. economy under unusual stress, many segments of the small business community are today unable to cope with daily management issues.

S . 1499 would authorize expansions in these programs so that the SBDCs, the SCORE chapters and the Women's Business Centers are positioned to address the needs of a large influx of small businesses looking for help. Our bill would create special authorization for each program to provide assistance tailored to the needs of small businesses following the September 11 terrorist attacks. In addition, the bill would increase the authorization levels by the following amounts: SBDC program, \$25 million, SCORE \$2 million, Women's Business Centers \$2 million, and Microloan technical assistance, \$5 million.

For small businesses that are doing business with the Federal Government section 9 of the managers' substitute amendment to S . 1499 would authorize a fund of \$50 million to compensate small businesses when Federal action as the result of the terrorist attacks, has caused the costs to increase for small businesses to meet the terms of their contracts. The fund would be administered by the Department of the Treasury. The Office of Federal Procurement Policy would establish guidelines for administering the program, and the contracting agencies would consult with the SBA when determining whether an award should be made.

The American Small Businesses Emergency Relief and Recovery Act is important legislation that is needed to help the many struggling small businesses. Swift passage will be very helpful to the long-term survival of many of American's small businesses, and I urge each of my colleagues to vote in favor of the bill.

Mr. DODD. Mr. President, I ask unanimous consent that the bill, as amended, be read the third time and passed; that the motion to reconsider be laid upon the table, with no intervening action or debate; and that any statements relating to the bill be printed in the **RECORD**.

The PRESIDING OFFICER. Without objection, it is so ordered.

The bill (S . 1499), as amended, was read the third time and passed.

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SMALL BUSINESS RELIEF -- (Senate - December 11, 2001)

Mr. BOND. Madam President, I concur wholeheartedly with my colleague from Massachusetts. The needs of small business are great. Not only the small businesses directly impacted in New York and in Virginia by the tragic terrorist actions, but many other small businesses throughout this country are suffering. I think every Member of this body can tell you about general aviation companies in their States who

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were shut down, put out of business for up to a month, some even longer because of the FAA restrictions. The bill we have sponsored is very modest, \$851 million. We are talking about the need.

We just passed \$40 billion in relief. We passed another \$20 billion on Friday night, an allocation of \$20 billion for antiterrorism. We are talking about a stimulus that could be anywhere from \$40 to \$80 billion.

The beauty of 1499 is that it only spends money if the small businesses that have been crippled as a result of this terrorist action will borrow the money and put it to work hiring people, buying goods, getting the economy moving again. It is absolutely critical. I ask my colleagues to let us debate the bill. Let us bring out the problems on the floor.

If the administration were ultimately to decide we have not made the case, then they still have the right to veto it. We cannot get into the details of this legislation. My last count was we had 64 Members--at least we have over 60 Members supporting the bill. It is something we need to do this month because small businesses may be out of business, if they are not already, by the time we get back next year. I urge my colleagues to let us debate the bill.

I also join with my colleague from Arizona in saying that it is absolutely unconscionable that we not act on the nomination of Eugene Scalia, ultimately qualified to be the lawyer for the Secretary of Labor. If people have objections to him, let them bring them to the floor. I don't think they will withstand the scrutiny of the light of day. We have just a few days remaining. It is very important that we act on the Secretary of Labor nomination, the lawyer the President selected, who is adequately qualified and deeply committed to this cause.

This is absolutely essential that we act now to provide small business the stimulus it

Interest rate reductions alone are not enough to jump-start this economy. We need to make sure that cheaper credit reaches the companies that need it..... . The Fed is cutting interest rates--but the money isn't reaching capital-starved small businesses because Treasury regulators are cracking down on bank loans. Credit rationing, not interest rates, is the real problem with the economy..... .

That is exactly the same problem we faced in 1989, 1990, and 1991 when we had failures in the savings and loan and the banking industry, and we had an entity called Recall Management come in to try to process some of the small loan portfolios. What happened is a whole lot of viable businesses got lumped into the bad loans so that the viable businesses were, in effect, put into a category where they could not get the credit they needed simply to tide them over. We lost thousands of jobs. Viable business was liquidated because of bad judgment. That is precisely the situation in which we are now putting people. People who have a viable business, who simply need to ride out this momentary downturn, which all of us know was exacerbated by the events of September 11, need small amounts of working capital in order to be able to tide over their workers, to be able to pay the various legal obligations they have to stay in business.

If you don't want to create a cycle of self-fulfilling prophecy, where you drag your economy down as a consequence of not helping all of these small businesses to be able to sustain those jobs, this is the way to do it. If you provide emergency small business lending in a way that is in keeping with the emergency efforts in the past, the standards of the SBA will still be met. These are not throw-away loans. These are loans that can leverage some \$25 billion of economic activity in the country. That is why this legislation has 62 cosponsors in the Senate.

Madam President, I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The assistant legislative clerk proceeded to call the roll.

Mr. REID. Madam President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

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EMERGENCY SMALL BUSINESS LOAN ASSISTANCE -- (Senate - December 19, 2001)

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Mr. KYL. Mr. President, I rise today to share concerns raised by the Bush administration and some of my colleagues regarding S . 1499 , authored by my colleague from Massachusetts, Mr. **KERRY**.

I strongly believe that we must come to the aid of small businesses hurt hard by the September 11 attacks. That is why I have enthusiastically endorsed the Bush administration's ongoing, active, and aggressive efforts to provide emergency small-business loan assistance.

Unfortunately, S . 1499 came to the Senate floor without debate, without committee hearings, and without an opportunity for concerns about the bill to be raised and addressed. No CBO score was released, depriving those who are fiscally-responsible of a cost estimate of this legislation. Yet the Senate leadership attempted to pass this bill without affording us any opportunity to offer amendments.

Scarcely any explanation of this bill's provisions was ever offered before it was moved to the Senate floor--and that is extremely troubling.

We do know now that the costs of this bill--as much as \$815 million--would actually exceed the entire 2002 budget for the Small Business Administration, nearly doubling it, at a time of a economic slowdown.

Additionally, the agency responsible for carrying out this legislation--the Small Business Administration (SBA)--has raised a number of concerns about this bill that have not been adequately addressed.

First, some of the provisions of the Kerry bill duplicate efforts already underway by the Bush administration. After the terrorist attacks, the SBA established the September 11 Emergency Injury Disaster Loan, EIDL, assistance program to make loans available to small businesses throughout the United States, who could demonstrate economic injury as a result of the terrorist attacks.

This was an appropriate and necessary response. I emphasize, Mr. President: these loans already are being made available.

In addition to duplication of ongoing efforts, the SBA also expressed the concern that provisions of the Kerry bill would actually increase the number of small-business loan defaults, at the expense of the American taxpayer.

As the SBA wrote in a letter to the sponsors of this measure:

By relaxing credit requirements, reducing interest rates, eliminating fees, increasing the government guarantee, deferring principal payments, forgiving interest and increasing government liability, S . 1499 could make government-guaranteed small business loans more attractive than conventional loans, potentially displacing private sector options. In addition, S . 1499 significantly reduces lender and borrower stakes in a loan, thereby increasing the likelihood of default.

Certainly the sponsors of this measure do not want to promote defaults. After all, the goal of small-business assistance is to help entrepreneurs build, sustain and grow small businesses, with sound and fiscally-responsible loan assistance programs.

The existing EIDL assistance program provides a reasonable mechanism for needed aid by offering up to \$1.5 million in emergency loans to small businesses at four percent interest over 30 years. Loans are not intended purely as a means of disaster relief.

Additionally, S . 1499 's language is so broad that loan assistance could be provided to any small business that have ``been, or, that (are) likely to be directly or indirectly adversely affected'' by the terrorist attacks. Obviously, such language is ripe for abuse and could lead to exorbitant costs for the American taxpayer. Surely, this is not what the bill sponsors intended from this provision.

Lastly, the Small Business Administration expresses concerns regarding S . 1499 's provisions providing emergency relief for Federal contractors. The provisions would allow an increase in the price of a federal contract that is performed by a small business in order to offset losses resulting from increased security measures taken by the Federal government at Federal facilities. As the SBA points out: ``providing equitable relief through SBA acting as a central clearing house would prove inefficient, costly, and burdensome on the Federal acquisition process."

All of us want to come to the aid of small businesses adversely affected by the September 11 attacks and their aftermath. But we can do so in a cost-effective and responsible way, instead of a rushed, haphazard process designed to thwart compromise.

I am confident that a bipartisan compromise on this issue can be found in the near-term, so that the concerns raised by the administration can be taken into account, and we can pass something the President will support.

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Appendix G

*Coleman Report, June 2002. “SBA Vows Not to Play
‘Gotcha’ for STAR Loans”*

COLEMAN REPORT—JUNE 1, 2002

The economic advantage to lenders is substantial. The annual SBA servicing fee for STAR loans is 25 basis points, half of the current 50 basis points—\$2,500 savings for every \$1 million of STAR loans in a lender's portfolio.

Retroactive Classification

Importantly, lenders may also retroactively recode any previously approved SBA 7(a) loan approved after January 10, 2002 as a STAR loan by providing the SBA servicing office with a 327 action with justification for reclassification.

The lender must also provide a memorandum for the loan file describing how the business was adversely affected by the events of September 11, 2001.

STAR Program

Here are some quick facts about the Supplemental Terrorist Relief loan program (STAR)

- STAR has \$4.5 billion available for 7(a) lenders.
- The loan is available for businesses adversely affected by September 11.
- Lender determines that business has been adversely affected.
- The loan may be used for any business purpose.
- Annual fee is 25 basis points for the entire repayment period.
- Maximum loan amount is \$2 million.
- Minimum loan amount is \$1 million.

Following is an excerpt of Butler's remarks about the STAR program:

"I don't think there's a person or business in this country that was not impacted to a greater or lesser degree by the horrible events that took place in September.

"What this program attempts to do is to supplement -- not to replace, but to supplement -- the disaster assistance that's available from SBA and from other federal programs to individuals and to borrowers around the country.

"Many of you know SBA expanded our economic injury disaster program (EIDL) so we could help additional businesses. However, there are still very specific guidelines under which those loans can be made. You have to be able to quantify the amount of loss that you suffered as a result of the disaster -- in this case the September 11 attacks -- and SBA can only lend on the value of the lost cash flow.

"STAR is a huge step beyond the EIDL program because it allows any business that was adversely affected by the September 11 terrorist attacks to be eligible for loans under the same terms and conditions as any other 7(a) loans-- except you get a reduction in the annual fee, making it more cost effective for you.

"What we're seeing in practice from the lenders making these loans is that the lenders are passing along the savings to the borrowers.

"Obviously there is a competitive issue there -- you have to remain competitive in your marketplace.

"I think everyone who works in this industry has long since acknowledged that as goes the way of small business so goes the way of the American economy. I think it's up to us to keep that segment of the economy as viable as possible.

COLEMAN REPORT—JUNE 1, 2002

STAR Eligibility

“An adversely affected business is any business that has suffered economic harm or disruption of its business operations as a direct or indirect result of the September 11, 2001 terrorist attacks.

Examples of Economic Harm

“Following is a list of items that can demonstrate economic harm:

- 1) Difficulty in making loan payments on existing debt
- 2) Difficulty in paying employees or vendors
- 3) Difficulty in purchasing materials, supplies, or inventory
- 4) Difficulty in paying rents, mortgages, or other operating expenses
- 5) Difficulty in securing financing

Butler continued:

“This is not an exhaustive list. That is the beginning of the list.

“SBA has taken a stand that is very inclusive. We have an expansive definition of economic disadvantage.

“As a matter of fact, we believe that every business can probably demonstrate some degree of economic disadvantage as a result of the terrorist attacks.

“We so strongly believe this -- we have a lunch meeting every Tuesday -- we've offered any lender who has a loan that can't find any basis for it to be a STAR loan to e-mail us the facts of the

situation and we'll spend our lunch hour looking at it for you [to make it eligible].

“I know many of you have not used the program because you are worried about post-lending review by SBA.

Lender Determines STAR Classification

For PLP reviews and post-purchase reviews on any loan that defaults, SBA will only be looking for one thing [for STAR loan classification].

They will be looking for a document that you have put in the file where you discuss how the business was adversely affected. It is not enough to say “This business was adversely affected.” It is enough to say “This business was adversely affected because...”

Jane Butler
SBA Associate Administrator

“First of all, I want to tell you that by the terms under which we have implemented the program, we delegate to you, the lender, the authority to determine that a business was adversely affected.

“It is your determination, not SBA's determination.

“It is not our intent to substitute our judgment for your judgment in these cases.

“The second factor for PLP reviews and for post-purchase reviews on any loan that defaults is that SBA will only be looking for one thing [for STAR loan classification].

“They will be looking for a document that you have put in the file where you discuss how the business was adversely affected. It is not enough to say ‘This business was adversely affected.’ It is enough to say ‘This business was adversely affected because...’

“And we believe that the ‘because’s’ can be very inclusive.

“For example, one of our lenders on the East Coast sent in a whole series of examples where they were asking us to make judgments so they could get benchmarks for what was considered eligible for STAR and what wasn't.

COLEMAN REPORT—JUNE 1, 2002

"In fact, every single example they sent in we determined would have been eligible for STAR.

"One example was a bakery in downtown Washington, DC.

"First of all, the events shut down Washington for about a day, so that effectively the business was out of business for a little bit -- a day, maybe two.

"Secondly, there were some disruptions to the bakery's ability to deliver products and its ability to get raw materials.

"For those that weren't in Washington, traffic patterns in the city were changed immediately and many remain changed.

"There are a lot of streets that are no longer open to traffic on a daily basis, so there was some disruption of traffic patterns.

"The borrower wanted to buy his building.

"On first blush you might say that buying the building has very little to do with anything related to the attacks. It doesn't have to. The business was adversely affected, and because it was adversely affected, it is eligible for STAR no matter what purpose the loan is to be used for.

"There will be lots of examples that will come to mind automatically.

"The travel agent who not only had a number of cancellations because the planes stopped flying but also had cancellations because people were reluctant to travel. Those things are clear.

"But you also need to think about the printer who provides the materials for the brochures for the travel agent who doesn't have any business right now.

"One of our lenders actually said he has instructed his staff if he has a loan that is not a STAR loan, the lender has to justify that as well as justify the

ones that are STAR loans. I think that's a great practice.

"We want to encourage these loans to be made, and we want you to understand that we do not intend to play 'gotcha..'

"I have talked with the Office of Lender Oversight head. I have talked with the Inspector General. We have talked with the Office of the General Counsel.

"SBA's intention for STAR is that we make maximum use of the program to provide maximum assistance to the small businesses around the country that were adversely affected by September 11.

"Note that this program has a very short window of opportunity. With the fee reduction that takes effect October 1, fees will actually be lower than this one-time reduction under STAR. Loans under STAR that are not made by October 1 will not be made.

"At this point in time, I cannot guarantee that money will be available for regular 7(a) loans. That would take legislation.

"If you have questions, talk to your local staff. They'll get in touch with us. And as I said, I will offer my lunchtime group to help you find eligibility under STAR for any borrower that you think might have been adversely impacted!"

2003 Budget

The June 15 *Coleman Report* will address the 2003 budget for SBA in depth.

However, Butler candidly said SBA's budget for next year would probably be sufficient to meet 7(a) lender demand for FY 2003.

"It always works out and everything will probably be OK," she said.

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She also said she would not support a shift of traditional 7(a) loans into the 504 program on her watch.

“You may have heard some people say that we’re going to shift 7(a) loans to 504. You’ll never hear me say that. That isn’t what I think SBA needs to do. What SBA intends to do is to make maximum use of all small business lending authority that’s available to us.

“That includes determining ways that we can expand the 504 program and its accessibility to small businesses in order to increase the amount of small business lending that we’re capable of doing.”

7(a) Purchase Review

SBA Field Office Overreaction

Butler acknowledged SBA has exercised an inappropriate level of scrutiny for lender purchase reviews and hinted at future changes for the purchase review process

Here are her comments:

“When SBA started looking at the purchase reviews one of the things that happened was a certain amount of overreaction.

“If I tell you I’m going to audit your tax return—if you know that—on April 12, the tax return that you submit on April 15 is going to be much more conservative in terms of deductions and so forth than if you didn’t know. I think there’s been a certain amount of that [mentality at SBA] and some field offices believe that they are under closer scrutiny. They’ve seen some cases returned.

There’s a certain amount of second guessing going on. They’re a little uncomfortable with it. I do believe there may be some small percentage of overreaction to the idea of having these loans reviewed.

When SBA started looking at the purchase reviews, one of the things that happened was a certain amount of overreaction. . .

To the extent that it’s due to SBA’s internal policies in looking at loans, we are trying to make sure that we correct for that.

Jane Butler
SBA Associate Administrator

Focus Upon PLP Loans

“Someone told me in the past that SBA would only deny a guaranty if someone was going to jail.

“In truth, that was true at the time because every single loan SBA guaran-

teed, SBA touched. It’s awfully hard to blame your partner for a bad act if you participated in it, if you were in effect in the conspiracy to do whatever you did wrong.

“However, as we delegate more and more authority I think it is reasonable that there might be greater instances of mistakes on the part of lenders or problems on the part of lenders because SBA is not seeing every loan.

“The way we take care of that is having better training, better oversight, and having resources available to you so if you have a question, instead of guessing what the right answer might be, you can come to us.

“For example, we’re talking about delegating to PLP lenders the authority to make eligibility determinations. We believe that’s just the logical next step. However, in order to do that, we need to set up an office where you can send an e-mail request with the facts, and we can respond in writing and so you can rely on it if the loan is purchased.

“I do think that there probably has been an increase in denials, repairs, and requests that purchases be withdrawn by the lender.

COLEMAN REPORT—JUNE 1, 2002

"I really believe the bigger percentage of it is because lenders are getting more and more authority so that you're out there on your own more often.

"To the extent that it's due to SBA's internal policies in looking at loans, we are trying to make sure that we correct for that."

Statute of Limitations?

Further evidence that Butler believes current SBA purchase policies are draconian is her admission that a statute of limitations of one year would be appropriate for guaranty purchases. After the lender receives SBA's guaranty payment SBA would only have one year to challenge the guaranty. She comments on this as follows:

"That is my personal opinion, but based on our conversations everyone seems to think that's fair and appropriate.

"We haven't worked it out, but in my mind it's something like a year.

"SBA would have a year to re-look at the guaranty — and I'm including the IG and anyone else who might look at the purchase. If we didn't do anything in that year, we couldn't do anything.

"We can tell you not to do it again, we can slap your hand, we could put your name on our list of lenders that had problems that we had missed in purchase, but we wouldn't go back to you for the money.

"I think it's important for you to be able to rely on your guaranty. It's a cash flow tool for you—knowing what interest you have. If anyone starts to perceive the SBA guaranty as contingent, then that's going to be a problem."

SBA Statistics — Guaranty Repairs and Denials

A question was raised about the actual number of guaranty repairs and denials.

A concern was also raised about how a loan that was reviewed by the PLP review team and found to not contain any errors later became the target of a guaranty repair.

"Under the existing system, we cannot track repairs," answered Butler.

"Currently, someone physically goes into the system and changes the SBA guaranty percentage.

"Under the new system, which has kind of gotten stalled because everybody in the world, including Congress, GAO, the Inspector General, and, I am pretty sure, the Mormon Tabernacle Choir, have weighed in on how SBA should do its systems modernization!

"We keep track of denials of liability because only the Administrator can issue a denial of liability.

"I will tell you that the vast majority that are forwarded to us we do go forward with as denials because the district has already done its work.

"I'd like to reiterate the point. Training is the key. I've always believed lenders do the right thing to the extent that they understand it. Every once in while you get somebody who has bad intentions, but that is rare.

"We need to make sure that our SOP is clear, and that means eliminating some of the extraneous parts and getting to the heart of things.

"We need to reconsider what policies we have been too selective on from the lender's viewpoint. We need to take away some of the 'gotcha' syndrome.

"We need to make sure we have uniform training across the country so that a lender in Des Moines and a lender in San Francisco understand the policy the same way.

(Continued on page 8)

COLEMAN REPORT-JUNE 1, 2002

Secondary Market Quotes as of June 1, 2002

Guaranteed Loan Amount	Term	Rate	Cap	Premium	Coupon Sold	Servicing
\$1,000,000 or less	25 years	P + 2.75	No	110	P + 1.00	1.75
\$1,000,000 or less	25 years	P + 2.00	No	108.50	P + 1.00	1.00
\$1,000,000 or less	25 years	P + 2.00	No	Par	P - 1.80	3.80
\$1,000,000 or less	25 years	P + 1.00	No	105.75	Prime	1.00
\$1,000,000 or less	25 years	P + 1.00	No	Par	P - 1.80	2.80
\$1,000,000 or less	25 years	P + 2.00	Yes	105	P + 1.00	1.00
\$1,000,000 or less	25 years	P + 2.00	Yes	Par	P -1.25	3.25
\$1,000,000 or less	20 years	P + 2.00	No	108.50	P + 1.00	1.00
\$1,000,000 or less	20 years	P + 2.00	No	Par	P - 1.80	3.80
\$1,000,000 or less	10 years	P + 2.75	No	110	P +1.75	1.00
\$1,000,000 or less	7 years	P + 2.75	No	108.625	P +1.75	1.00
\$1,000,000 or less	7 years	P + 2.50	No	107.75	P + 1.50	1.00
\$50,000	7 years	P + 2.75	No	108.625	P + 1.75	1.00

The current bid for fixed rate notes @ par for 20 and 25 years and over is 7.75%

504 Loan 20 year Debenture Rate May 2002

Rate	Debenture Rate	CDC Fee	Borrower Subsidy Fee	CSA Fee
7.24%	5.83%	0.625%	0.41%	0.10%

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(Continued from page 6)

“We are working on all that. In the meantime, I will tell you that Lender Oversight is very mindful of this issue.

“They are looking at ways to make the reviews more valuable with the understanding that we use the contract to help make the bean counting easier.”

Future Changes to SBAExpress

Butler also included comments about proposed changes to the SBAExpress loan program:

“Our intention is to increase the number of SBAExpress loans—particularly loans of \$50,000 or less. We are trying to make the program more attractive to small business lenders.

“Under the existing program, in order to qualify to be a SBAExpress lender, you had to be a PLP lender and you had to meet certain criteria with regard to volume and currency rates.

“We are expanding the SBAExpress loan program and allowing lenders that do not currently qualify for SBAExpress to participate with us.

“One group [that will now be able to participate] will be lenders that were not PLP eligible or did not meet the volume requirements even though they were already SBA lenders. These lenders will automatically be eligible to participate with us.

“We expect that lenders who could not make our volume requirements and could not qualify for PLP will now be eligible to participate with SBA and to start their participation with the SBAExpress program.”

Predicated changes to SBAExpress are:

1) Maximum loan amount increased from \$150,000 to \$250,000.

2) Lenders will be allowed to charge up to Prime + 6.5% for loans \$50,000 and less and up to 4.5% for loans between \$50,000 and \$250,000.

3) SBA will purchase SBAExpress loans under \$50,000 when requested after default rather than after liquidation.

4) SBA will continue to review and revise all SBAExpress forms, procedures, certifications, etc. to further streamline, consolidate, and reduce the program’s complexity and documentation to make the program more seamless with lender practices.

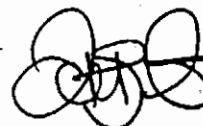
“I know most of you are aware that many of the requirements that you consider very burdensome are not just SBA requirements.

“They are federal government lending program-wide requirements. For example, having an individual say whether the business is on an historical property, whether it is in a flood-plain area, whether the individual is in the country legally—these are SBA legislative requirements.

“We are trying to put those certifications in a single place and make them more clearly available to you. They will no longer be part of the application phase, but will be part of the loan closing or loan disbursement phase. Hopefully all these changes will help make the program more attractive to you and by making it more attractive to you also make it more attractive to our small business borrowers.”

Our intention is to increase the number of SBAExpress loans—particularly loans of \$50,000 or less. We are trying to make the program more attractive to small business lenders.

Jane Butler
SBA Associate Administrator



SBA Lender's Marketplace

June 1, 2002

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Seeking Vice Presidents – Small Business Lending for a leading non-bank institution, which specializes in providing small business loans to a variety of industries across the United States. Vice Presidents will be responsible for developing regional territory for SBA lending, with opportunities in Massachusetts, New York, Florida, Ohio, Kentucky and Indiana.

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Qualified candidates should submit their resumes in confidence by email to info@travillianguard.com or by fax to (434) 951-0701. The Travillian Group is an executive search firm providing expert recruiting services to the financial services industry. For more information, please visit us on the Web at www.travillianguard.com.

Underwriter, Closing, Servicing East Coast

East Coast lender has several key positions opening shortly and is interested in pre-qualifying potential candidates.

Senior positions will be available in: underwriting, closing, and servicing.

Knowledge of SBA policies and procedures is important.

This process is being managed by JRC Consulting, LLC.

Please e mail: resumes, comments, or questions to MJDOWD1000@AOL.COM



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(Continued on next page)

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Robert J. Coleman

Publisher & Editor

SBA Vows Not to Play "Gotcha" for STAR Loans

Butler Says Every Small Business in America Affected by 9/11

SAN FRANCISCO, May 30--Against the imposing Power Point title, "7(a) Program in Jeopardy?" SBA Associate Administrator for Financial Assistance **Jane Butler** addressed the **Bay Area Association of Government Guaranteed Lenders' (BAAGGL's)** annual conference before 125 Northern California SBA lenders.

Also in This Issue . . .

Secondary Market Quotes, 7

Her remarks sought to alleviate SBA lending industry fears of budget concerns and SBA's increasing level of guaranty purchase reviews resulting in greater lender guaranty repairs and denials.

She also promised the agency would not second guess lenders who make Supplemental Terrorist Relief (STAR) 7(a) loan program loans.

SBA Stance on Lender STAR Designation

"It is not our intent to substitute our judgment for your judgment in these cases," **Butler** told an initially skeptical audience.

"As a matter of fact, we believe that every business can probably demonstrate some degree of economic disadvantage as a result of the terrorist attacks of September 11."

Promising lenders that the agency would not play "gotcha" and attempt to undermine any lender's SBA guaranty at a later date, **Butler** said 7(a) PLP lenders must simply provide a memorandum to the file supporting the STAR designation. CLP and GP loans must also include the memorandum in the loan file. Specific examples lenders may utilize follow in this report.

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SBA Lender's Marketplace

June 1, 2002

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Appendix H

SBA Procedural Notice 5000-775



SBA Procedural Notice

TO: All SBA Employees

CONTROL NO.: 5000-775

SUBJECT: Reduced Fee for New 7(a)
Loans Made to Businesses
Adversely Affected by
September 11th Terrorist
Attacks

EFFECTIVE: 1-17-2002

The Defense Appropriations Act, signed by President Bush on January 10, 2002, reduces the on-going fee charged to the lender on new 7(a) loans made to small businesses that were “adversely affected” by the September 11, 2001, terrorist attacks and their aftermath. The legislation makes no other changes to 7(a) program fees, or to the 504 loan program.

Under the new law, the on-going fee for eligible 7(a) loans is reduced from 0.5 percent (50 basis points) of the outstanding balance of the guaranteed portion of the loan to 0.25 percent (25 basis points). This fee reduction is effective for the full term of eligible loans approved by SBA during the 1 year period beginning January 11, 2002 and ending January 10, 2003, or until the funds available for this purpose are expended, whichever occurs first.

SBA has received an appropriation that will allow the Agency to fund up to approximately \$4.5 billion in eligible loans. Since the fee income received by SBA on loans made under this provision will be different from that received on regular 7(a) loans, these loans will have a different subsidy rate and will be tracked separately for subsidy rate purposes.

Eligibility

For purposes of implementation of this legislative provision, the term “adversely affected small business” means a small business that has suffered economic harm or disruption of its business operations as a direct or indirect result of the terrorist attacks perpetrated against the United States on September 11, 2001. Some examples of economic harm are: difficulty in making loan payments on existing debt; difficulty in paying employees or vendors; difficulty in purchasing materials, supplies, or inventory; difficulty in paying rents, mortgages, or other operating expenses; and, difficulty in securing financing. SBA does not intend that this list be considered all-inclusive. The Agency anticipates that other circumstances can illustrate that a business has suffered economic harm or a disruption of its business operations.

Special Requirements

Each lender making a reduced fee 7(a) loan under the provisions of the new law is responsible for determining that the loan is being made to a small business that was adversely affected by the terrorist attacks of September 11, 2001. For each such loan, the lender must prepare, place, and keep in its loan file, a short written statement documenting the basis for its conclusion that the loan is eligible for inclusion under this provision.

All other existing SBA 7(a) loan requirements, including credit requirements, apply to loans made under the provisions of the new law.

Loans made under this statutory provision must be identified with a special code that will alert SBA and the SBA Fiscal and Transfer Agent (Colson Services Corp.) to calculate the appropriate on-going fee.

A follow-up Procedural Notice will be issued shortly with additional guidance for implementation of these special requirements.

Additional Information

Field offices should provide this notice to all participating lenders immediately.

Lenders and other interested parties should contact their local SBA field offices for more information. SBA field staff should contact James Hammersley, Director, Loan Programs Division, at (202) 205-7505.

Jeanne M. Sclater
Acting Associate Deputy Administrator
for Capital Access

Expires: 01-01-2003