CUNA
Credit Union National Association
601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | PHONE: 202-638-5777 | FAX: 202-638-7734
cuna.org

TESTIMONY
OF
BRETT MARTINEZ
PRESIDENT AND CHIEF EXECUTIVE OFFICER
REDWOOD CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING
ON
SMALL BUSINESS LENDING:
PERSPECTIVES FROM THE PRIVATE SECTOR

JUNE 21, 2012

Testimony of
Brett Martinez
President and Chief Executive Officer
Redwood Credit Union
On behalf of the
Credit Union National Association
Before the
Subcommittee on Investigations, Oversight and Regulations
Committee on Small Business
United States House of Representatives
Hearing on
Small Business Lending:
Perspectives from the Private Sector

June 21, 2012

Chairman Coffman, Ranking Member Schrader, Members of the Subcommittee:

Thank you very much for the opportunity to testify today on behalf of the Credit Union National Association (CUNA).[1] My name is Brett Martinez, and I am President and Chief Executive Officer of Redwood Credit Union, a $2 billion state chartered credit union, serving 220,000 members, located in Santa Rosa, California. I am also a member of CUNA's Board of Directors.

Credit unions share the Small Business Committee's goal of increasing small business access to capital through the reduction of statutory and regulatory impediments. My testimony will describe the current state of credit union business lending with a particular focus on Small Business Administration (SBA) guaranteed lending and conventional business lending at Redwood Credit Union; discuss areas where improvements at the SBA could benefit lenders and borrowers alike; and discuss the impediments to credit union business lending and additional participation in SBA lending programs.

[1] CUNA is the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,200 state and federally chartered and their 95 million members.

As you may know, since their inception in the United States more than 100 years ago, credit unions have been offering business loans to their members. Since 1998, credit unions have operated under a statutory cap on business lending, which limits business lending at most credit unions to 12.25% of assets. Despite this cap, at the end of 2011, credit unions had $40 billion in business loans outstanding, representing approximately 6% of the depository institution market. While it is not the primary book of business for most credit unions, it has been the fastest growing type of credit union lending over the last several years.

There are a small number of exceptions to the cap, including an exemption for the guaranteed portion of a government-guaranteed loan. Many business lending-credit unions also participate in Small Business Administration (SBA) guaranteed lending programs. At the end of 2011, there were 331 credit union SBA lenders – collectively they reported $805 million in SBA loans outstanding in 8,091 individual loans (the average SBA loan size is thus roughly $100,000.) In dollar terms, SBA loans are equal to about 2% of total MBLs at credit unions. Since December 2007, SBA loans have grown by 89% at credit unions throughout the nation.

Redwood credit union is the largest credit union SBA lender in the country by loan volume in fiscal year 2012. We currently have about $190 million in outstanding member business loans and $68 million in SBA loans, including $37 million in 7(a) loans and $31 million in 504 loans. At present, we have 118 SBA loans outstanding.

The Importance of SBA-Guaranteed Lending In a Fragile Economic Recovery

SBA guaranteed loans are important for borrowers who otherwise would not be able to get a conventional business loan, but they are complicated to make. They require staff with a special kind of expertise; they cost the borrower and the lender more to make than conventional loans; and, they take longer to complete. Nevertheless, as a leading SBA lender in the San Francisco North Bay, we believe that the SBA is providing programs that help meet the current needs of small businesses. We have been a leader in our markets providing credit to businesses by effectively utilizing SBA loan programs. Please allow me to share three recent examples of how Redwood Credit Union has assisted our members through SBA lending.

In April 2010, we assisted an electrical contractor with a $900,000 SBA 7(a) loan to restructure business debt. The company has been in business since 1968 and, at the time of submission, employed 44 people. In the mid-2000s, the company was a typical electrical contractor with annual revenue of approximately $12 million. The business' primary source of revenue prior to the recession was typical residential subdivisions and commercial construction projects throughout the North Bay Area of San Francisco. In the wake of the downturn, revenues fell approximately 40% due to lack of construction projects.

Prior to the recession, the business owner began focusing more on solar installations and home remodels to diversify income streams. The recession and subsequent lack of construction did not completely decimate the company because of this diversity in revenues. We were able to assist the company in restructuring business debt to allow the company to grow by positively impacting cash flow. Today, that company is once again in a growth mode. Revenues have recovered greatly, and the company now employs approximately 60 people. We recently assisted the company with a $500,000 SBA Working Capital CAPLine loan to continue to assist in that growth.

In June 2010, we assisted a trucking company with a $975,000 SBA 7(a) loan to restructure equipment debt. Prior to the recession, this company built up a new trucking fleet to respond to the demand for its services. Financing for this new fleet came in the form of relatively short-term loans and leases. The onset of the recession caused the company's revenues to fall by nearly 25% over a three year period. The company was well-managed and performing well, but the short-term nature of the debt that made sense prior to the recession was impacting cash flow dramatically. We were able to restructure the equipment debt by lengthening out the term to be more in-line with the useful life of the equipment with the assistance of the SBA 7(a) loan, thus making the debt manageable for the company on a monthly basis. Today, that company is prospering. Revenues have been increasing steadily. In 2012, the company was awarded a contract for a large transportation project, so they are once again growing the fleet and hiring more people to keep up with demand.

In February 2012, we assisted a vineyard management company and winery with restructuring some business debt and providing working capital with an SBA 504 refinance loan. The total project of approximately $3.8 million allowed the company to refinance its vineyard and winery property, as well as pay-off all business debt and payables to improve cash flow and allow the company to grow and take on more vineyard management opportunities. The vineyard management company has a very unique way of farming, and its services are in high demand. Prior to the recession, the company spent a great deal of its working capital hiring people and buying equipment to take on a large vineyard development. After the onset of the recession, the financing for the vineyard development was suddenly cut-off by the vineyard owner's lender.

The borrower worked to scale back its vineyard management company and put the winery on the back-burner to get through the recession. While the services of the vineyard management company were in high demand, the company did not have the working capital to grow the company because of the monthly debt service requirements of the existing debt. With the help of the 504 refinance program, the business owner was able to restructure all debt into manageable payments. The financing also included some working capital, which allowed the company to immediately grow by taking on new contracts. Also, the owners are once again able to focus on growing the winery, which has developed quite a following.

While we continue to use SBA programs to help meet the credit needs of our small businesses members, there may be ways to improve the process to enhance access to capital for small businesses, and credit unions want to work with the Subcommittee to this end.

Expiring Programs Should Be Reauthorized

Business owners who survived the recession have largely done so by right sizing their businesses as they follow a path of declining revenues and profits. Many have shown losses for several years, but as a result of their ongoing restructuring efforts and a return to increasing revenues, they are beginning to once again show profits. Ultimately, they are left with a need to restructure their balance sheets, consolidate debt and free up cash to grow their businesses. At Redwood Credit Union, we have helped a number of businesses accomplish this by utilizing the SBA 7(a) program. As conventional commercial lenders are largely short term historical cash flow lenders, typical lending standards would not have allowed approval of these types of loans.

Lower commercial real estate values are one of the few upsides for many small businesses today. Add historically low interest rates to that and a once in a lifetime opportunity has presented itself for business people to acquire commercial real estate. Redwood Credit Union has worked closely with its members to help them take advantage of this opportunity using the SBA 504 program. Additionally, we have helped many members refinance their existing properties utilizing the 504 refinance program. This is an example of the right product at the right time providing business owners what they need exactly when they need it the most. While low real estate values are good if you are buying, they work against you if you are refinancing. This is why the 504 refinance program is important.

To that end, it is important that Congress reauthorize the SBA 504 refinance loan program and the SBA 504 First Mortgage Lien Pool (FMLP) program. These programs were put in place by the *American Recovery and Reinvestment Act* (ARRA) and are set to expire in September. Allowing refinancing under the SBA 504 loan program should be extended and consideration should be given to making them permanent. In some instances, it is the only vehicle by which a business owner with a maturing commercial real estate loan may be able to deal with a declining real estate market and stay in their building, thereby preserving jobs rather than losing the building, having to move, and likely shuttering a business, thereby losing valuable jobs. If the FMLP is allowed to end, it will adversely impact credit unions and banks managing to capital and liquidity constraints, thereby ruling out the 504 loan program as a source of capital for small businesses looking to grow their businesses and create much-needed jobs.

Suggestions to Improve SBA Programs through Reduced Regulatory Burden, Increased Transparency, Efficient Lender Oversight and a Streamlined Application Process

Last year, CUNA supported the SBA's efforts to finalize the single electronic lender application and the development of an automated credit decision model for 7(a) loan applications. The single electronic lender application will reduce the paperwork burden at credit unions and should result in increased lender participation among credit unions. We also hope that the electronic lender application will bring efficiencies to the approval process which will reduce the amount of time it takes to complete the loan process.

CUNA has also supported SBA's consideration of developing an optional credit scoring methodology to be used by SBA lender partners in the underwriting process in an effort to lower lenders' costs of delivering capital to borrowers. We are hopeful that such a methodology will expand the interest of credit union lenders in making low dollar loans as a result of this initiative. We also hope to increase the number of credit unions that choose to participate in SBA lending going forward in an effort to increase credit availability for small businesses.

We have also supported the SBA's review of regulations to reduce lender burden by eliminating outdated, duplicative or overlapping regulations. Objectives of this review are to reduce paperwork through the elimination of duplication, allow electronic submission, standardize forms, exempt small entities, and incorporate industry consensus standards into regulations, as appropriate. We encouraged the SBA to simplify and clarify the language of its regulations, and eliminate conflicts and inconsistencies that make rules more complex and confusing.

We are aware that in recent hearings members of the Committee have expressed concerns regarding transparency, lender oversight and streamlining. I would like to offer observations from Redwood Credit Union's perspective as well as from the perspective of the broader credit union system.

In the past, when the relationship between the SBA and its participating lenders were more constrained, there was not enough transparency in the creation of policy notices, which served as amendments to the Standard Operating Procedures (SOP). As it stands now, we feel there is a sufficient level of transparency in the SBA's revisions of its SOP. In addition to our affiliation with CUNA, Redwood Credit Union is also a member of the National Association of Government Guaranteed Lenders (NAGGL), the trade association for SBA lenders. NAGGL has an open dialogue with the SBA in its amendment process of SOPs. If Redwood Credit Union has an issue with the verbiage in the SOP, we can voice our issue with the SBA, CUNA and NAGGL, and these trade groups will work on our behalf to find resolution to an identified issue. Some have suggested that SBA should institute a public hearing process for amendments to its SOPs, but we feel this would add a layer of bureaucracy that would likely only add unnecessary delays to the implementation of the changes we, as SBA lenders, needed in the first place.

With respect to lender oversight, we have observed a significant amount of work in this area, specifically in the areas of risk-based reviews, risk analytics and higher intensity oversight and enforcement. We understand that SBA expects to complete its first comprehensive risk plan before the beginning of the next fiscal year. Lenders have asked for greater clarity, consistency and transparency in a number of lender oversight areas. Lender feedback is ostensibly being incorporated into a new lender oversight program.

Having said that, I will elaborate a bit on what lenders have been seeing. For years, we asked for access to the Portal and loan specific data, and the SBA has finally implemented this request. Other requests remain pending, such as our own request for the composition of the data used to develop the Small Business Portfolio Solution (SBPS) credit scores and the lender ratings. Furthermore, there appears to be no logic as to when Preferred Lender Program (PLP) reviews will happen. Also, it has taken up to a year in some instances to get the final report back. Many lenders have reported that there were findings in the final report that were never addressed in the wrap up meeting.

We have asked SBA to provide to us the information about the SBPS credit scores and if they are doing any analysis of those scores to see if they actually have any predictive value.

When SBA started using a review sheet that had not been distributed to lenders and that actual reviewers would not provide, we asked SBA to provide us with a copy and asked about the logic of not sharing it with lenders.

There appears to be an ongoing dialogue between lenders and SBA on these issues. I am aware that NAGGL and a representative group of 8 lenders traveled to Washington, DC in May and attended a four hour meeting with the SBA to brainstorm about those and other issues around lender oversight. The general consensus was that those discussions went very well. Further feedback from their visit was that the current regime is cooperative, responsive, and supports greater consistency and transparency. We hope the subcommittee will encourage the SBA to give these issues priority consideration.

Streamlining is an area that directly affects credit unions and their members. As members of the Small Business Committee know, SBA lending is very specialized and requires an enhanced level of training in order for lenders to originate and service loans effectively. As a result, higher volume and larger SBA lenders likely find that the process is working for their institutions and borrowers. Indeed, existing policy and procedures seem to be working for both Redwood Credit Union and our members. However, this may not be the case for all credit union SBA lenders. The application process requires more information than is required for a conventional loan. Overall, there is a greater amount of paperwork as compared to a conventional loan. We focus on setting expectations and managing the application process so that is not a burden to our members. We are granted wide unilateral authority under our PLP agreement and view the process as generally reasonable given the SBA's responsibilities regarding risk management and oversight.

Impediments to Additional Credit Union Business Lending and Increased Participation in SBA Loan Programs

Job creation is one of the most important drivers of an economic recovery. Consumer spending accounts for 70% of US economic activity, so strong labor markets and healthy job creation are essential components of any sustainable economic recovery. Small businesses employ half of all private sector employees and generated two-thirds of net new jobs over the past 17 years. Enhancing access to credit for small businesses is an important part of promoting job creation and economic recovery.

We believe there is significant demand for credit from small businesses. In fact, during the economic crisis, credit unions experienced a 57% increase in business loans, and as noted an 89% increase in SBA loans; at the same time, bank small business lending contracted by -14%. The credit unions that contributed to the vast majority of this growth are now becoming increasingly constrained by the statutory cap on credit union business lending. Redwood Credit Union is one of these credit unions; we are at over 75% of our capacity, which means we will probably only be able to continue to lend to business members for the next 18 months. From our perspective, a natural way to increase access to capital for small businesses would be to increase the statutory cap on credit union business lending.

While this is not within the jurisdiction of the Subcommittee, increasing the cap on credit union business lending would almost certainly lead to an increase in SBA guaranteed lending, as explained below. This would mean more small businesses – both those who qualify for a conventional loan and those which require a government guarantee – would have access to credit to start or grow their business, and create jobs.

Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY) have introduced H.R. 1418, the Small Business Lending Enhancement Act (also known as the Credit Union Small Business Lending Jobs Act). This legislation would allow well capitalized credit unions with a substantial history of business lending that have been operating near the statutory cap for at least a year to apply to the National Credit Union Administration (NCUA) for authority to lend up to 27.5% of assets to small businesses. Credit unions which receive NCUA approval would be subject to a portfolio growth limit of 30% per year. We estimate that this legislation would allow credit unions to lend up to an additional $13 billion in the first year after enactment, helping small business to create 140,000 new jobs. Most importantly, this legislation would not require an outlay of taxpayer funds.

The banking trade associations strongly oppose this legislation. They suggest that the bill is unnecessary because the guaranteed portion of a credit union SBA loan does not count against the cap; however, SBA loans clearly are not a substitute for conventional business loans. Given the complexity of SBA lending and the resources required for a credit union to engage in these programs, not to mention the fact that only borrowers who would not qualify for a conventional loan can receive an SBA-guaranteed loan, additional credit union SBA lending does not begin to solve the credit union business lending problem. However, if experienced credit unions operating near the cap were given the ability to offer expanded lending, it is very likely they may invest more resources in their business lending programs, including the possibility of adding an SBA program. Consider the following: approximately 2,000 credit unions engage in business lending. Of these, approximately 500 are close enough to the cap for it to be limiting their lending, and roughly 300 are SBA lenders. There is considerable potential for increased SBA lending if the credit unions managing the cap are given the ability to lend more.

We understand that this legislation is not subject to the jurisdiction of this subcommittee or the full committee, but we encourage you to support the legislation and encourage its enactment.

Conclusion

On behalf of America's credit unions and their 95 million members, thank you for holding this oversight hearing on small business lending and giving credit unions the opportunity to testify. I am pleased to answer any questions the members of the Subcommittee may have.