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### ***Revitalizing the SBA Bond Guarantee Program***

The SBA Bond Guarantee Program (Program) was created to ensure that small and emerging contractors have the opportunity to bid on public construction work, grow their businesses and remain a viable part of the U.S. economy. Surety bonds are a vital mechanism to protect taxpayers and workers on public construction projects from the danger of contractor default. Small businesses must have access to these bonds to obtain federal construction contracts, and the SBA program assists them in obtaining these bonds. The Program has been serving small businesses for decades and continues to be a necessary federal program. In recent years, the SBA has undertaken incremental efforts to improve the functioning and the appeal of the Program, such as improving its application process and procedures, its response time to claims and expanding the Program's reach to include design-build contracts. Just recently the SBA proposed a rule to fast track bonding applications for \$250,000 or less. However, much more needs to be done so the Program can fully realize its potential to assist small businesses.

As the SBA Bond Guarantee Program has evolved, there are two plans under which sureties can participate in the Program. The Prior Approval Program (Plan A) was the original SBA bond guaranty program. In this program, the surety must obtain SBA approval for each bond prior to writing the SBA guaranteed bond. The SBA indemnification of the surety's loss as a result of a bond claim in Plan A is 80%, and 90% for bonds written for socially and economically disadvantaged contractors and bonds written for contracts under \$100,000. The second program is the Preferred Surety Bond Program (Plan B). Under this plan, sureties apply to participate, submitting information up front on their underwriting practices and financial strength. Once a surety becomes a participant in Plan B, it is given an aggregate limit of bonds that it can write within the Program. As long as the surety complies with all of the requirements of Plan B, all bonds written within the Program qualify for reimbursement of losses. The SBA does not review

or approve each individual bond before it is written and the guarantee attaches. In Plan B the surety receives a 70% indemnification. Both plans should be revised to gain further efficiencies.

*In order to guarantee more bonds and to provide better assistance to small and emerging contractors, the structure of the SBA Surety Bond Guarantee Program must be changed. There are several reforms necessary to achieve this:*

- Require the SBA to track the contractors that participate in the Program. The surety industry believes that legislation is needed to revitalize the SBA program so that it is attractive to sureties and agents and assists small and emerging contractors in obtaining their first bonds, increasing the size bonds they can obtain and graduating from the Program into the traditional surety market. Although these contractors may continue to obtain some bonds through the Program, there should be a common understanding between the surety industry, the SBA and Congress about what constitutes success for the Program.
- Ensure that the SBA Bond Guarantee Program regulations keep pace with changes in law and practice in the construction and surety industries. Current SBA regulations, for example, require notice to the SBA of change orders exceeding a certain amount, but most construction contracts and bonds now require the surety to waive notice of such changes.
- Create a system of due process in connection with the SBA Bond Guarantee Program so that sureties receive notice, a hearing and right to appeal if: 1) the SBA denies a surety's request to participate in the Program or eliminates a surety from the Program, or 2) denies a claim under a bond that the SBA has guaranteed. Such a process currently exists for the SBA loan programs but is absent from the SBA Bond Guarantee Program.
- Review the current fee structure of the Bond Program and establish reporting mechanisms concerning why fees continue to increase. The focus of the Bond Guarantee Program should be to provide increased contracting opportunities for emerging contractors and not to recoup administrative costs to fund the Program.
- Ensure that the Program has adequate resources to market itself to small construction businesses and to state and local agencies assisting such businesses.
- Recognize that the SBA Bond Guarantee Program serves a useful public policy function and that it may not be self-sufficient each year. There always are competing interests in any federal budget. Congress, however, has never required the SBA Bond Guarantee Program to be self-sufficient. The Congressional declaration of policy for all the SBA programs in the Small Business Investment Act of 1958 was to stimulate and improve the economy by establishing assistance programs for small businesses, which are to be "carried out in such a manner as to insure maximum participation of private financing sources." (15 USC Section 661). If the purpose of the Program is to help small and emerging contractors that may not otherwise qualify for bonds in the marketplace, it stands to reason that there will be losses. The most recent direction from the Office of

Management and Budget (OMB) was for the SBA to increase its fees to cover SBA losses, which represents a major shift in philosophy and direction for the SBA Program and is in conflict with the spirit of the law. The public policy of helping small and emerging contractors is a sound one, and it needs to be supported in the funding structure and reauthorization of the SBA.

### **Learn from other SBA Successes**

In the 111<sup>th</sup> Congress, the SBA's appropriations bill included \$125 million to continue enhancements made to the SBA's 7(a) and 504 loan programs in February 2009. The SBA was allowed to eliminate fees on 7(a) and 504 loans, the maximum government guarantee to banks that make these loans was increased to 95% and the maximum loan that could be guaranteed was increased from \$2 million to \$5 million. These enhancements to the loan program led to an immediate nationwide increase in lending.

In June 2010, The SBA reported that its weekly dollar volume of SBA-backed loans had risen 90% in its 7(a) and 504 loan programs during the period of February 17, 2009, until April 23, 2010. In October 2011, SBA reported that in fiscal year 2011, the SBA supported \$30.5 billion (61,689 loans), a return to pre-recession levels.

It is clear that an increase in the guarantee amount and the reduction or waiver of fees increases participation in government guarantee programs. Such reforms should be implemented in the SBA Bond Guarantee Program to provide a boost to the bonding program.

*In order to increase access to bond guarantees by small and emerging contractors, the following changes should be considered:*

- Establish the SBA guarantees to sureties for all bonds written through both programs at 90% of the bond amount, and 95% for guarantees on bonds for socially and economically disadvantaged contractors and bonds written for contracts under \$100,000. This should help stimulate greater surety company participation, similar to the response experienced in the SBA Loan Program.
- Allow the Administrator to reduce or waive fees paid by contractors and sureties in the Bond Guarantee Program. The construction industry currently has a significantly higher percentage of unemployment than the country as a whole. The current fees to small contractors may put them at a competitive disadvantage in the bidding process, which hurts them rather than helps them obtain public projects. The existing fee structure makes the Program economically less attractive for many sureties and could affect the continued viability of the Program.
- To maximize the number of contracts available to small businesses under the bond guaranty program, increase the size of the contracts that can be guaranteed through the Program to \$6.5 million; the current contract size is \$2 million.

- Provide statutory discretion to the Administrator to determine the Program's liabilities, so that a denial of a guarantee can be partial, reflecting the amount of prejudice suffered by the SBA, and not a complete denial of the entire guarantee in every instance.

### **A Coordinated Approach and Vision is Needed to Put All Available Federal Resources to Work for the Benefit of Small and Emerging Contractors**

"Small businesses are the backbone of the American economy," Administrator Mills and Treasury Secretary Timothy F. Geithner wrote in their Small Business Financing Forum Report to the President. The construction industry serves as the catalyst for the emergence of many new small businesses. Construction is a challenging and competitive business environment that demands business owners, especially those of small and emerging businesses, have specialized knowledge and skill sets. Therefore, it is essential that the SBA provides the necessary skills needed for these small and emerging businesses to compete and survive in the marketplace. Moreover, it is important that these businesses receive the necessary educational training on business and risk management topics so they graduate out of the SBA Bond Guarantee Program with the goal of qualifying for standard surety credit.

*In order to establish a holistic business approach model, the SBA Bond Guarantee Program should consider the following reforms:*

- Establish better internal coordination and communications between the SBA Bond Guarantee Program and other SBA small business programs, such as those relating to loan guarantees and business assistance. When a small business applies to any of the SBA programs in any of the SBA offices, a case file should be opened and communications should be facilitated among all SBA programs that can provide assistance to the contractor. The needs of the small business should be reviewed so that it can be connected to the proper SBA program, i.e. loan, bond or other programs administered by the SBA. This should not delay any SBA program from providing the small business the specific assistance sought. If the business is a small and emerging contractor, for example, the SBA Bond Guarantee Program should proceed to provide a bond guarantee while other SBA programs review the contractor for collateral or other assistance.

### **Education and Access to Necessary Professional Services are Essential**

Congress should consider funding grants and establishing freestanding educational programs to assist veteran-, minority- and women-owned small businesses to improve their ability to compete in the construction industry.

- Provide assistance to small construction firms, particularly to women-, minority- and veteran-owned construction firms for the purpose of providing them financial means/incentives to access professional services such as legal, accounting and other advisers.

- Create a second grant component, which establishes a freestanding educational program to provide grant funds to colleges, universities, vocational/technical schools, community colleges and business leagues or not-for-profit entities to develop and administer a small business construction executive business and risk management curriculum in conjunction with local professionals, such as accountants, attorneys, risk management experts, financial experts/bankers, surety bond producers and local professional and trade associations.