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Before the Committee on Small Business and Entrepreneurship, U.S. Senate

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SMALL BUSINESS ADMINISTRATION

Continued Attention Needed to Address Reforms to the Disaster Loan Program

Statement of William B. Shear, Director Financial Markets and Community Investment





Highlights of GAO-10-735T, a testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

Why GAO Did This Study

After the Small Business
Administration (SBA) was widely criticized for its performance following the 2005 Gulf Coast hurricanes, the agency took steps to reform its Disaster Loan Program. Congress also enacted the Small Business Disaster Response and Loan Improvements Act of 2008 (Act), which places new requirements on SBA to ensure it is prepared for catastrophic disasters.

This testimony discusses (1) the extent to which SBA has addressed the Act's requirements, and (2) how SBA's response to major disasters in 2008 aligned with key components of its June 2007 Disaster Recovery Plan (DRP).

In completing this statement, GAO reviewed and updated, as appropriate, the July 2009 report, Small Business Administration: Additional Steps Should Be Taken to Address Reforms to the Disaster Loan Program and Improve the Application Process for Future Disasters (GAO-09-755). In that report, GAO recommended that SBA should fulfill the Act's regionspecific marketing and outreach requirements; complete its annual report to Congress; issue an updated DRP; develop an implementation plan for remaining requirements; and develop procedures to further improve the application process for the Disaster Loan Program.

View GAO-10-735T or key components. For more information, contact William Shear at (202) 512-8678 or shearw@gao.gov.

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Continued Attention Needed to Address Reforms to the Disaster Loan Program

What GAO Found

SBA has made some progress since GAO's July 2009 report in addressing provisions of the Act and continued attention to certain provisions will be important for sustained progress. As of May 2010, SBA met requirements for 15 of 26 provisions of the Act and partially addressed 6. Five provisions do not require any action at this time. Since July 2009 SBA has taken a number of actions. For example, SBA issued an updated DRP in November 2009. In addition, SBA issued regulations on coordinating with the Federal Emergency Management Agency on timely submission of disaster assistance applications. SBA also has taken steps to address the Act's requirements for region-specific marketing and outreach. For example, SBA has begun a dialogue with the Small Business Development Center state directors in the Gulf Coast about disseminating disaster planning information in the five most hurricane-prone states before the hurricane season. However, these steps have not been discussed in public documents or venues, such as in the DRP or on the SBA Web site, which would make the information more transparent and easily accessible to the public and Congress. SBA officials told GAO the agency has not yet completely addressed some provisions because the agency must make extensive changes to current programs or implement new programs. In particular, for two requirements that will involve private lenders, SBA plans to implement pilots before finalizing regulations. SBA officials recently said that they had formed a cross-functional work group and began reaching out to lenders about the planned pilots. SBA has not yet developed an implementation plan with milestone dates for addressing the remaining requirements, but recently said it would provide a plan or report that included milestone dates for addressing the Act's requirements.

SBA's initial response after the 2008 Midwest floods and Hurricane Ike aligned with certain components of its initial DRP, such as using technology and outreach efforts to better ensure timely assistance. The individuals GAO interviewed and results from SBA's 2008 Disaster Loan Program Customer Satisfaction Survey provided somewhat positive feedback about SBA's performance following the disasters. However, interviewees and survey results indicated areas for improvement; in particular, both indicated that application paperwork was burdensome and that the application process needed improvement. The agency did not appear to have a formal process for identifying problems in the application process and making needed improvements. SBA officials told GAO that they have been taking steps to improve the application process. However, SBA has not provided information to GAO on how it would implement a formal process to address identified problem areas in the disaster loan application process.

Madam Chair and Members of the Committee:

I am pleased to be here today to discuss our work on reforms made to the Small Business Administration's (SBA) Disaster Loan Program. As you know, SBA plays a critical role in assisting the victims of natural and other declared disasters. SBA provides financial assistance through its Disaster Loan Program to help homeowners, renters, businesses of all sizes, and nonprofits recover from disasters such as earthquakes, hurricanes, and terrorist attacks. Since the agency's inception in 1953, SBA has approved more than \$47 billion in disaster loans for homeowners, businesses, and nonprofits.

After the 2005 Gulf Coast hurricanes (Katrina, Rita, and Wilma), SBA faced an unprecedented demand for disaster loans, while also being confronted with a significant backlog of applications; therefore, hundreds of thousands of loans were not disbursed in a timely way. Many criticized SBA for what was perceived to be a slow and confusing response to the disasters and one that exposed many deficiencies in the agency's Disaster Loan Program and demonstrated the need for reform. As a result, Congress and SBA agreed that the program needed significant improvements. Since then, SBA has taken several steps to reform its Disaster Loan Program including creating an online loan application, increasing the capacity of its Disaster Credit Management System (DCMS), and developing a Disaster Recovery Plan (DRP). In June 2008, Congress enacted the Small Business Disaster Response and Loan Improvements Act (Act) which places new requirements on SBA to ensure that it is prepared for future catastrophic disasters.

My statement today is based on our 2009 report and updated information on SBA's progress in addressing the Act's requirements and our report's recommendations.³ Specifically, this statement focuses on (1) SBA's progress in addressing certain requirements of the Act, and (2) how SBA's

¹ SBA's use of the term "disaster recovery plan" differs from how it is generally used in referring to an information technology-focused plan designed to restore operability of a system, application, or computer facility following an emergency.

² Pub. L. No. 110-246, subtitle B, 122 Stat. 2168 (2008).

³ GAO, Small Business Administration: Additional Steps Should Be Taken to Address Reforms to the Disaster Loan Program and Improve the Application Process for Future Disasters, GAO-09-755 (Washington, D.C.: Jul 29, 2009).

response, following the major disasters of 2008, aligned with key components of its June 2007 DRP.

For our 2009 report, we identified and analyzed the requirements of the Act and related statutory deadlines; obtained information about SBA's completed, current, and planned reform efforts; reviewed documents and progress reports to determine if requirements had been addressed and deadlines were met; interviewed officials and obtained information on what, if any, challenges exist that may affect SBA's ability to meet certain requirements; and interviewed officials to obtain information about next steps and resources that the agency identified as needed to address any remaining requirements. We visited Iowa and Texas, and obtained information on SBA's performance in the aftermath of the 2008 Midwest floods and Hurricane Ike. We interviewed SBA and Small Business Development Center (SBDC) officials, state and local officials, and representatives of local Chambers of Commerce, economic development organizations, and affected small business owners about what worked well and what improvements to SBA's disaster loan processes they would suggest. Finally, we reviewed results from a survey of SBA loan applicants on their satisfaction with SBA's Disaster Loan Program in 2008. To update this information, we interviewed SBA officials and reviewed documents related to the disaster reform provisions and actions taken to implement our recommendations.

We conducted our work for the July 2009 report between October 2008 and July 2009 and updated information between March 2010 and May 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

SBA's Office of Disaster Assistance (ODA) responds to disasters and administers the Disaster Loan Program. A Presidential disaster declaration puts into motion long-term federal recovery programs, such as the Disaster Loan Program, but SBA is not a "first responder" after a disaster. Rather, local government emergency services assume that role with help from state and volunteer agencies. For catastrophic disasters, and if a governor requests it, federal resources can be mobilized through the U.S. Department of Homeland Security's Federal Emergency Management Agency (FEMA). SBA typically responds to a disaster within 3 days by

sending ODA field staff to the affected area to begin providing public information about SBA's services.

Once a disaster is declared, SBA by law is authorized to make two types of disaster loans: (1) physical disaster loans, and (2) economic injury disaster loans. Physical disaster loans are for the permanent rebuilding and replacement of uninsured or underinsured disaster-damaged property, including personal residences and businesses of any size. That is, SBA provides loans to cover repair costs that FEMA or other insurance has not already fully compensated or covered.⁴ Economic injury disaster loans provide small businesses, including agricultural cooperatives and private nonprofit organizations, with necessary working capital until normal operations can resume.

The Act comprises 26 provisions with substantive requirements for SBA; some with specific deadlines and some needing appropriations, and includes requirements that SBA must meet for disaster planning and response, disaster lending, and reporting. For instance, the Act includes provisions to improve SBA's coordination with FEMA, require that the agency conduct biennial disaster simulations, create a comprehensive disaster response plan, and improve communication with the public when disaster assistance is made available. It includes requirements to improve ODA's infrastructure, appoint an official to oversee the disaster planning and responsibilities of the agency, and establish reporting requirements for various reports to Congress. The Act also creates new programs, such as the Immediate Disaster Assistance Program that would provide small

⁴ SBA can lend individuals amounts up to \$200,000 for their primary residence and \$40,000 for household goods and personal effects and can lend businesses up to an aggregated \$2 million for physical and economic injury disaster loans, before the individuals receive their insurance recovery. In these cases, the loan recipient must use the insurance recovery funds to reduce the balance of the SBA disaster loan. Even individuals or business owners who believe they have full insurance coverage are encouraged to apply for an SBA loan because their insurance recovery may turn out to be only partial, or their damage may exceed insurance policy limits.

⁵ In June 2008, as part of the Food, Conservation, and Energy Act (also commonly known as the Farm Bill), Pub. L. No. 110-246, 122 Stat. 1651, Congress enacted the Small Business Disaster Response and Loan Improvements Act of 2008. This law repealed and replaced a duplicative enactment, which had been enacted on May 22, 2008. However, the Farm Bill contains a provision that generally preserved the prior act's date of enactment if it would provide an earlier effective date than the date of enactment of the Farm Bill. Although the Act became law on June 18, 2008, the enactment date for purposes of determining the effective date is May 22, 2008. Therefore, all statutory deadlines presented in our July 2009 report were calculated from May 22, 2008.

dollar loans immediately following a disaster and the Expedited Disaster Assistance Loan Program that would provide expedited disaster assistance to businesses.

SBA Continues to Make Progress in Addressing the Act's Provisions, but Has Not Yet Established Milestones for Implementing Remaining Requirements As of May 2010, SBA fully addressed requirements for 15 of 26 provisions of the Act; partially addressed 6; and took no action on 5 that are not applicable at this time (see fig. 1). For the 15 provisions SBA fully addressed, the agency's actions included putting in place a secondary facility in Sacramento, California to process loans when the main facility in Fort Worth, Texas is unavailable, making improvements to DCMS to track and follow up with applicants, and expanding its disaster reserve staff from about 300 to more than 2,000 individuals. According to SBA and our review, 5 provisions require no action at this time because they are discretionary or additional appropriations are needed before SBA can satisfy the Act's requirements.

Figure 1: SBA's Status in Addressing Requirements of the 2008 Small Business Disaster Response and Loan Improvements Act, as of May 2010

Section	Description of requirement	Status (May '10)	Deadline
12061	SBA permitted to make economic injury disaster loans to nonprofits.		
12062 ^a	SBA must ensure its disaster assistance programs are coordinated to the maximum extent practicable with FEMA programs.		0
12063	Better public awareness of disaster declaration, application periods, and creation of a marketing and outreach plan.	•	0
12064	SBA must conduct a study looking at the consistency between standard operating procedures and regulations of the Disaster Loan Program.		0
12065	SBA increased loan amounts from \$10,000 to \$14,000 without requiring collateral.		
12066	SBA authorizes private contractors to process disaster loans and coordinate efforts with IRS to expedite loan processing.	•	
12067	SBA must develop, implement, or maintain a centralized information system to track and follow up with disaster loan applicants.		
12068	SBA is authorized to increase the deferment period of loans, but the deferment may not exceed 4 years.	N/A	
12069	SBA must put in a place a secondary facility for processing disaster loans in case the primary facility is unavailable.		
12070	SBA can not require the borrower to pay any non-amortized amount for the first 5 years after repayment begins.		
12071	SBA is authorized to make economic injury disaster loans in cases of ice storms and blizzards.		
12072	SBA must develop and implement a major disaster response plan and conduct a disaster simulation exercise at least once every 2 years.	•	
12073	SBA must assign an individual the disaster planning responsibilities and report to Congress.		
12074	SBA should ensure that the number of full-time equivalent ODA employees is not fewer than 800 and in the disaster cadre not fewer than 1,000.		
12075	SBA must develop, implement, or maintain a comprehensive written disaster response plan and update the plan annually.		● p
12076	SBA must develop long-term plans to secure sufficient office space to accommodate an increased workforce in times of disaster.		
12077	SBA may not rely solely on the loan applicant's status as a major source of employment prior to the disaster to qualify for disaster loans beyond the current statutory limit.		
12078	Maximum disaster loan amount increased from \$1.5 to \$2 million.		
12079	SBA may guarantee any surety against loss on a bid, payment, performance, or ancillary bond on any work order or contract that at the time of the bond execution does not exceed \$5 million.	N/A	
12081	If the President declares a major disaster, SBA may declare eligibility for additional disaster assistance.	N/A	
12082	SBA permitted to make economic injury disaster loans to eligible small business concerns located anywhere in the US (including outside the disaster area) when the SBA declares eligibility for additional disaster assistance.	N/A	
12083 ^a	SBA must establish and implement a Private Disaster Assistance Program. SBA may guarantee timely payment of principal and interest on private disaster loans issued to eliqible small businesses and homeowners within an eliqible disaster area.	•	0
12084	SBA must establish an Immediate Disaster Assistance Program to provide immediate small dollar loans through private lenders.	•	
12085 ^a	SBA must establish an Expedited Disaster Assistance Business Loan Program.	•	0
12086	SBA is allowed to institute a program to refinance Gulf Coast disaster loans resulting form Hurricanes Katrina, Rita, or Wilma up to an amount no greater than the original loan.	N/A	
12091 ^c	SBA must submit reports to Congress on disaster assistance.	•	

Addressed (initial or ongoing)

N/A Not applicable because no action is needed to be taken by SBA at this time, due to provisions' discretionary nature. Source: GAO analysis of the Act and SBA documents.

Partially addressed

O Missed deadline

^aThe Act requires SBA to issue regulations for these provisions.

^bSBA provided the first updated DRP on November 15, 2009, several months past the expected update in June 2009.

°12091(f) includes requirements for a loan approval rate report, which is to provide a "detailing of how [SBA] can improve the processing of applications under the disaster loan program." SBA officials told us that they had covered the requirement in the 2007 DRP. However, it is not clear to us whether information in the 2007 DRP meets the congressional intent of the requirement.

When we issued our report in July 2009, SBA had fully addressed 13 of the 26 provisions. Since then, SBA has fully addressed two additional provisions. As we recommended and the Act requires, SBA issued an updated DRP. SBA also issued regulations on coordinating with FEMA to ensure that disaster assistance applications are submitted in a timely manner. In addition, SBA must revise the regulations annually and report on the revisions when submitting its annual report to Congress. The annual requirements associated with the provision on FEMA coordination will help SBA, FEMA, and Congress to determine whether the regulations are effective.

SBA still has to take additional steps to completely address 6 provisions. For example, SBA officials told us that the agency has taken additional steps to address the marketing and outreach provision, including that they (1) began an ongoing dialogue with the SBDC state directors in the Gulf Coast about disseminating disaster planning and preparation information in the five most hurricane-prone states before the hurricane season, (2) detailed an SBA employee who works with the SBDCs to the Office of Entrepreneurial Development to help the agency develop a strategic approach for its disaster role, and (3) issued some public service announcements tailored to specific regions. In our 2009 report, we recommended that SBA should fulfill the region-specific marketing and outreach requirement, including making this information readily available to regional entities prior to the likely occurrence of a disaster. However, the steps recently taken by SBA have not been discussed in public documents or venues, such as in the DRP or on the SBA Web site, which would make the information more transparent and easily accessible to the public and Congress. As we reported in 2009, we consistently heard from regional entities, such as SBDCs and emergency management groups, about the need for more up-front information on SBA's Disaster Loan Program and their expected roles and responsibilities in disaster response efforts.

According to SBA officials, the agency has not yet completely addressed some provisions because to do so, the agency would have to make extensive changes to current programs or implement new programs—such as the Immediate and Expedited Disaster Assistance Programs—to satisfy

requirements of the Act. These programs, which require participation of private lenders, would be designed to provide businesses with access to short-term loans while they are waiting for long-term assistance. As we reported in 2009, SBA plans to conduct pilots of these programs before fully implementing them. SBA officials recently told us they have established a cross-functional work group jointly chaired by officials from ODA and the Office of Capital Access to address these requirements and develop the pilots. ODA officials said they drafted regulations and received subsidy and administrative cost funding in the 2010 budget to allow them to pilot test about 600 loans under the Immediate Disaster Assistance Program (section 12084). Additionally, SBA officials told us that they performed initial outreach to lenders—such as those who have participated in their Gulf Opportunity Pilot Loan Program—to obtain their reaction to and interest in the programs. They believe such outreach will help SBA identify and address any issues that may arise and determine the viability of the loan programs. SBA officials told us that their goal is to have the pilot for the Immediate Disaster Assistance Program in place by September 2010.

The Act establishes multiple new reporting requirements and while SBA has addressed most of these, the agency has not met some statutory deadlines. For example, as required by the Act and as we recommended, the agency issued its first annual report on disaster assistance in November 2009 but the report was due in November 2008. Specifically, the Act requires that SBA report annually on the total number of SBA disaster staff, major changes to the Disaster Loan Program (such as changes to technology or staff responsibilities), a description of the number and dollar amount of disaster loans made during the year, and SBA's plans for preparing and responding to possible future disasters. In 2009, we reported that failure to produce annual reports on schedule can lead to a lack of transparency about the agency's progress in reforming the program. The agency has had limited success in meeting nine additional

⁶ The Act also states the annual report must include information on some requirements under certain provisions, such as (a) the regulations on coordination with FEMA to assure that applications for disaster assistance are submitted as quickly as practicable as required under section 12062; (b) disaster simulation exercises conducted by the agency under section 12072; (c) updates to the comprehensive DRP required under section 12075; and (d) updates to SBA's plans for securing office space to accommodate an expanded workforce required under section 12076.

provisions in the Act that have deadlines associated with them.⁷ The agency also has not developed a plan with expected time frames for addressing the remaining requirements. Not having an implementation plan in place for addressing the remaining requirements can lead to a lack of transparency about the agency's Disaster Loan Program, capacity to reform the program and program improvements, as well as its ability to adequately prepare for and respond to disasters. In our 2009 report, we recommended that SBA develop an implementation plan and include milestone dates for completing implementation and any major program, resource, or other challenges the agency faces as it continues efforts to address requirements of the Act. Recently, SBA officials told us that they would provide a plan or report that included milestone dates for addressing the Act's requirements.

SBA's Response Following 2008 Disasters Aligned with Some DRP Components, but Its Responses to Disaster Victims' Feedback on the Application Process Could Be Improved SBA's initial response following the 2008 Midwest floods and Hurricane Ike aligned with major components of its DRP, such as infrastructure, human capital, information technology, and communications. For example, according to SBA, following both disasters the agency used its organizational infrastructure and key staff in each of its core functions to provide disaster assistance. ODA also utilized available operational and technological support, and communications and outreach, to help ensure that the agency would be able to provide timely financial assistance to the disaster victims. Additionally, individuals affected by both disasters with whom we spoke considered the agency's overall performance somewhat positive, but believed the disaster loan process could be improved.

In May 2008, floods devastated 85 counties in Iowa (one of several states affected) and in September 2008, Hurricane Ike devastated 50 counties in Texas. SBA and SBDC officials, state and local representatives, private-entity officials, and business owners in Iowa and Texas told us that in the days immediately following the disasters, ODA staff reported to the affected areas and began providing needed disaster assistance. These individuals also said that SBA staff provided outreach and public information about the Disaster Loan Program; distributed application information; assigned knowledgeable customer service representatives to various Disaster and Business Recovery Centers; and helped applicants by

 $^{^7}$ In July 2009 we reported that SBA had met some deadlines for four provisions, missed one deadline by 27 days, and missed deadlines for four remaining provisions by many months.

answering questions, providing guidance, and offering one-on-one help—as outlined in SBA's DRP. In addition, our review of SBA's 2008 Disaster Loan Program Customer Satisfaction Survey also showed that respondents were somewhat satisfied with the assistance SBA provided during other recent disasters.

However, both the individuals we interviewed and survey results indicated areas for improvement and opportunities to increase satisfaction. For example, individuals we interviewed and survey responses pointed to concerns about the amount of paperwork required to complete SBA's disaster loan application and the timeliness of loan disbursements. Also, some business owners said they had to provide copies of 3 years of federal income tax returns, although they had signed an Internal Revenue Service (IRS) form 8821—Tax Information Authorization—which allows SBA to get tax return information directly from IRS. To address these concerns, the individuals we interviewed suggested several changes to the program, such as eliminating the requirement that business loan applicants provide copies of IRS tax records; providing partial disbursements earlier in the process; using bridge loans to help ensure disaster victims receive timely assistance; and involving SBA, SBDCs, and state and local officials in joint pre-planning and disaster preparedness efforts.

Although SBA officials told us they have been improving the application process, they had not documented the improvement efforts. In addition, we found that while SBA conducts an annual customer satisfaction survey, the agency does not appear to incorporate this feedback mechanism into its formal efforts to continually improve the application process. Furthermore, SBA does not appear to have a formal process for addressing identified problem areas and using the information gained to improve the experience of future applicants. By establishing such a process to address identified problem areas, SBA could better demonstrate its commitment to improving the Disaster Loan Program. Because the agency has missed opportunities to further improve its Disaster Loan Program, and in particular improve the application process for future applicants, we recommended in our July 2009 report that SBA develop and implement a process to address identified problems in the disaster loan application process. In response to our recommendation, SBA cited ongoing efforts since 2005, such as the electronic loan application, and said the agency has plans to continue its improvement efforts and make them an ongoing priority. However, SBA has not provided information to us on how it would implement a formal process to address identified problem areas in the disaster loan application process.

As you know, we have reported on a variety of issues related to the federal government's response to the 2005 Gulf Coast hurricanes. As part of this committee's efforts to assess the level and success of federal efforts to help Gulf Coast small businesses recover from the 2005 hurricanes, we are conducting work at your request that focuses on small business recovery efforts in four states impacted by Hurricanes Katrina and Rita: Alabama, Louisiana, Mississippi, and Texas. This summer, we will report to this committee on: (1) assistance small businesses in the Gulf Coast received from the SBA, the Department of Housing and Urban Development, and the Economic Development Administration; (2) federal contract funds received by small businesses; and (3) the small business economy in the Gulf Coast region.

Madam Chair, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the Committee may have.

GAO Contacts and Acknowledgments

For further information on this testimony, please contact William B. Shear at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Kay Kuhlman, Assistant Director; Beth Faraguna, Alexandra Martin-Arseneau, Marc Molino, Linda Rego and Barbara Roesmann.

⁸ For example, GAO, Small Business Administration: Actions Needed to Provide More Timely Disaster Assistance, GAO-06-860 (Washington, D.C.: Jul 28, 2006); Catastrophic Disasters: Enhanced Leadership, Capabilities, and Accountability Controls Will Improve the Effectiveness of the Nation's Preparedness, Response, and Recovery System, GAO-06-618 (Washington, D.C.: Sep. 6, 2006); and Small Business Administration: Additional Steps Needed to Enhance Agency Preparedness for Future Disasters, GAO-07-114 (Washington, D.C.: Feb. 14, 2007).

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