U.S. Senate Committee on Homeland Security and Governmental Affairs

Subcommittee on Federal Spending Oversight

Senator Rand Paul, M.D. (Kentucky), Chairman

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Small Business Administration's Disastrous Loans

Subprime, liar loans, no-doc, income unverified… these sound like terms used to describe the 2007 mortgage crisis. Unfortunately, they can also be used to describe the Small Business Administration's disaster assistance loans following Hurricane Sandy, which resulted in as much as $4.3 million of lost taxpayer money.[1] In most instances, these loans were made either because SBA guidelines were ignored, or loopholes were exploited.[2]

Part of federal disaster relief includes the availability of low-interest loans to persons in the affected area via the Small Business Administration (SBA), even though these loans are not necessarily for business purposes.[3] **According to the SBA's Inspector General, approximately 500 of SBA's Sandy loans went into default within 18 months of issuance, though even that number is misleading, as two thirds of these loan recipients made fewer than three payments, and more than half of those made no payment at all.[4]**

While these defaults represent just 2.6 percent of all SBA Sandy loans, they tell a troubling story of lax lending practices eerily similar to the 2007 subprime crisis, where persons that never should have gotten loans did. However, unlike with private lenders, in this case loans were made using taxpayer dollars.

The IG estimates that loan approvals totaled nearly $3 million for persons with unsatisfactory credit.[5] Like all lenders, SBA has a minimum creditworthiness standard for a loan approval. However, loans can be approved if a borrower can explain minor or isolated credit blemishes,[6] a loophole you could drive a Mack truck through.

In one instance, **SBA approved an over $200k loan, despite the borrower having multiple past-due and charge-off accounts. The explanation that satisfied SBA? The borrower was unaware of one, yes one, of their many delinquent debts**. After receiving an initial $14k disbursement, the borrower failed to make even their first payment, and, thankfully, the remainder of the loan was canceled.[7]

More troubling, the IG estimates that $1.46 million in loans went to persons who could not demonstrate an ability to repay.[8] Sound familiar? **One borrower never made a payment on their $12k loan. This is probably because, when taking into account their existing obligations, "the borrower's cash available [to pay the loan] was negative."[9]** Another borrower claimed nearly 30 percent of their income came from rental properties they could not document and did not report on their tax returns. In other words, they either were dodging taxes or lying to SBA. Nonetheless, they received more than $8k on a loan they defaulted on after only four payments.[10]

In another case, one loan was approved for a person who was not a U.S. citizen, which is permissible for some legal residents who provide additional documentation demonstrating their eligibility. Unfortunately, in this case, **such documentation was not obtained or even requested, and the borrower defaulted.[11]**

Of course, disaster lending might call for some more flexibility than traditional loan making, but such flexibility must be limited, standards (even looser ones) need to be adhered to, and taxpayers' interests cannot be ignored.

[1] https://www.sba.gov/sites/default/files/oig/16-18_-_Sandy_Early_Default_Final_Report.pdf?utm_medium=email&utm_source=govdelivery
[2] Ibid., page 1
[3] Ibid.
[4] Ibid., pp. 1-2
[5] Ibid., page 4
[6] Ibid., page 5
[7] Ibid.
[8] Ibid., page 9
[9] Ibid.
[10] Ibid.
[11] Ibid., page 11