Small Business Administration (SBA) Physical Disaster Loan Performance Before and After the Recovery Improvements for Small Entities After Disaster Act of 2015

Briefing to Senate Committee on Small Business and Entrepreneurship on June 24, 2021

Briefing to House Committee on Small Business on June 25, 2021

Note: This enclosure was updated in August 2021 for the dates the audit was conducted and for copyediting.

Introduction: GAO's Mandate

- The Small Business Act authorizes SBA to make available direct physical disaster loans to help entities recover from both presidentially declared and SBA-declared disasters. [1]
- On November 25, 2015, Congress and the President enacted the Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act), Pub. L. No. 114-88, section 2102 of which amended certain collateral requirements for physical disaster loans issued under SBA-declared disasters.
  - SBA previously amended the collateral requirements for physical disaster loans from presidentially declared disasters.
- The Rebuilding Small Businesses After Disasters Act, Pub. L. No. 116-70, § 3 (2019), includes a requirement for GAO to submit a report comparing the performance, including the default rate, of SBA physical disaster loans made from January 1, 2000, through the date on which SBA began making loans in accordance with the amendment made by the RISE Act to those made in accordance with that amendment.
- This briefing provides information collected for GAO's report in response to the mandate.

[1] 15 U.S.C. § 636(b)(1).

Objective

- Compare the default and charge-off rates of physical disaster loans, with and without collateral, issued under SBA disaster declarations since the RISE Act was enacted to physical disaster loans issued prior to the act.

Scope and Methodology

- Focused on physical disaster loans issued under SBA disaster declarations from January 1, 2000, through September 30, 2020.
- Reviewed relevant federal laws and regulations, as well as SBA policies and guidance.
- Interviewed SBA officials to develop an understanding of the physical disaster loan program and physical disaster loan data and the associated information systems.

Scope and Methodology

- Obtained and analyzed SBA physical disaster loan data for disasters declared from January 1, 2000, through September 30, 2020.
- Calculated and compared default and charge-off rates for pre-RISE Act and post-RISE Act loans that were made under SBA disaster declarations.
  - Default rates are based on the number of loans that have ever gone into default and that SBA has placed into liquidation status, which occurs when loans are 90 days delinquent. Borrowers can catch up on payments to bring their loans out of liquidation and back to a current status.
  - Charge-off rates are based on the number of loans that SBA has determined to be uncollectible—after exhausting all reasonable efforts—and moved from liquidation to charge-off status.

Scope and Methodology

- We conducted this performance audit from February 2020 to August 2021 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.
- We provided a draft of this briefing to SBA for comment. SBA did not have any comments.

Background

- SBA physical disaster loans provide for the permanent rebuilding and replacement of uninsured or underinsured property damaged in a declared disaster area. They are available to homeowners, renters, businesses of all sizes, and private nonprofit organizations.

Background

Physical Disaster Loans

- Provide loan terms up to 30 years.
- Lending limits:
  - $200,000 for homeowners to repair or replace primary residence; $40,000 for homeowners/renters to repair or replace personal property damaged or destroyed by the disaster.
  - $2 million for businesses or nonprofits and their affiliates for each disaster, although SBA may waive this limit in certain circumstances.
- Effective March 30, 2020, SBA provided an automatic deferment of payments until March 31, 2022, for existing borrowers of physical disaster loans that were in regular servicing status on March 1, 2020 because of the COVID-19 public health emergency.

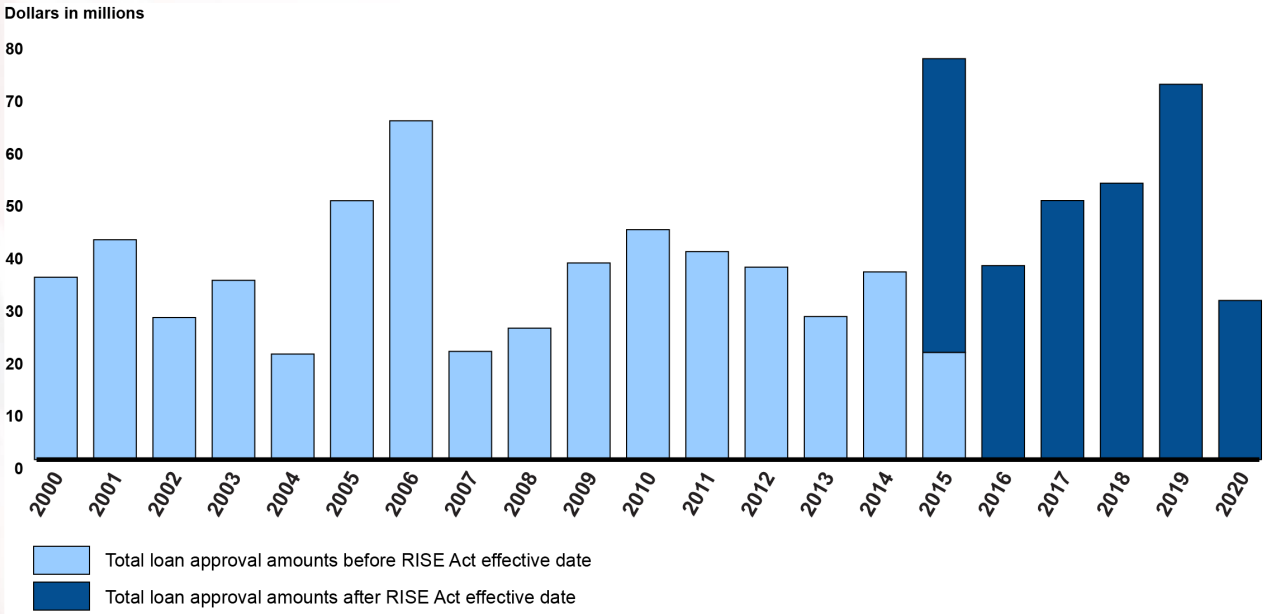
Background

Disaster Declaration Types and Limits

- The SBA Administrator can declare a physical disaster for an event that does not rise to the level of a presidential disaster declaration in response to a timely request by a state governor.
- Limits for loans without collateral from presidential disaster declarations were increased from $14,000 to $25,000 in 2014.
- The RISE Act temporarily provided the same increase for loans without collateral from SBA disaster declarations. The increase expires on November 25, 2022, when, absent further revision of the statute, the amount will revert back to $14,000.
- Of the $28 billion in approved SBA physical disaster loans for years 2000 through 2020, $855 million were issued under SBA disaster declarations.

Background

Figure 1: Physical Disaster Loan Approval Totals from SBA Disaster Declarations from 2000 through 2020 as of September 30, 2020



Source: GAO analysis of Small Business Administration data. | GAO-21-581R

Notes: Figure represents the dollar value of Small Business Administration (SBA) loans approved by calendar year for SBA disaster declarations from January 1, 2000, through September 30, 2020. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

Over the past 21 years, annual loan approval totals varied from the lowest total of $20 million in 2004 to the highest of $76 million in 2015.

The RISE Act gave SBA authority to make additional disaster loans for Hurricane Sandy, which made landfall in 2012, for a period of 1 year. On December 2, 2015, SBA reopened disaster loan filing for Hurricane Sandy survivors, which resulted in a large volume of loan approvals in December 2015. Although there were presidential disaster declarations for Hurricane Sandy, the loans from this reopening were processed under SBA disaster declarations.

Physical Disaster Loan Performance

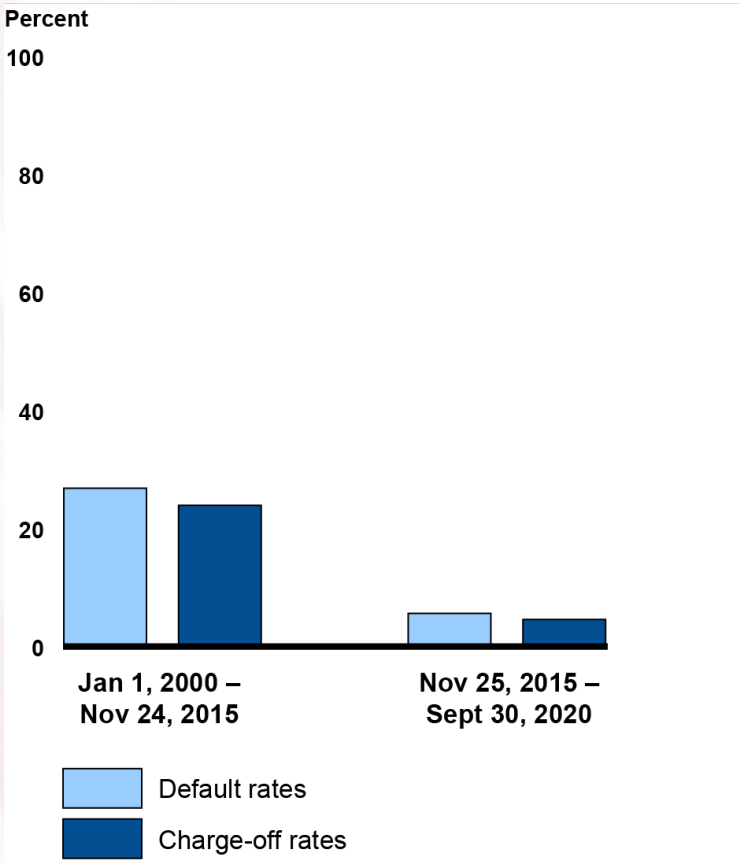
Performance of Physical Disaster Loans Issued under SBA Disaster Declarations

- Pre-RISE Act default and charge-off rates are higher than post-RISE Act rates; however, as post-RISE Act loans reach a maturity level similar to that of pre-RISE Act loans, their default and charge-off rates may increase. [2]
- Pre-RISE Act loans had approximately 5 to 20 years to perform; post-RISE Act loans all had less than 5 years.
- For the pre-RISE Act loans that defaulted, an average of 53 months elapsed from the disbursement date to default date.
  - Only 12.3 percent of post-RISE Act loans had this long to perform.

[2]We cannot isolate the contribution of the RISE Act to the loan performance because there are confounding factors, such as differences in loan maturity and the state of the economy.

Physical Disaster Loan Performance

Figure 2: Performance of Physical Disaster Loans Issued under SBA Disaster Declarations as of September 30, 2020



Source: GAO analysis of Small Business Administration data. | GAO-21-581R

- Pre-RISE Act loans had a default rate of 26.8 percent and a charge-off rate of 23.9 percent.
- Post-RISE Act loans had a default rate of 5.6 percent and a charge-off rate of 4.6 percent

Note: Figure represents Small Business Administration (SBA) loans approved for SBA disaster declarations from January 1, 2000, through September 30, 2020. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

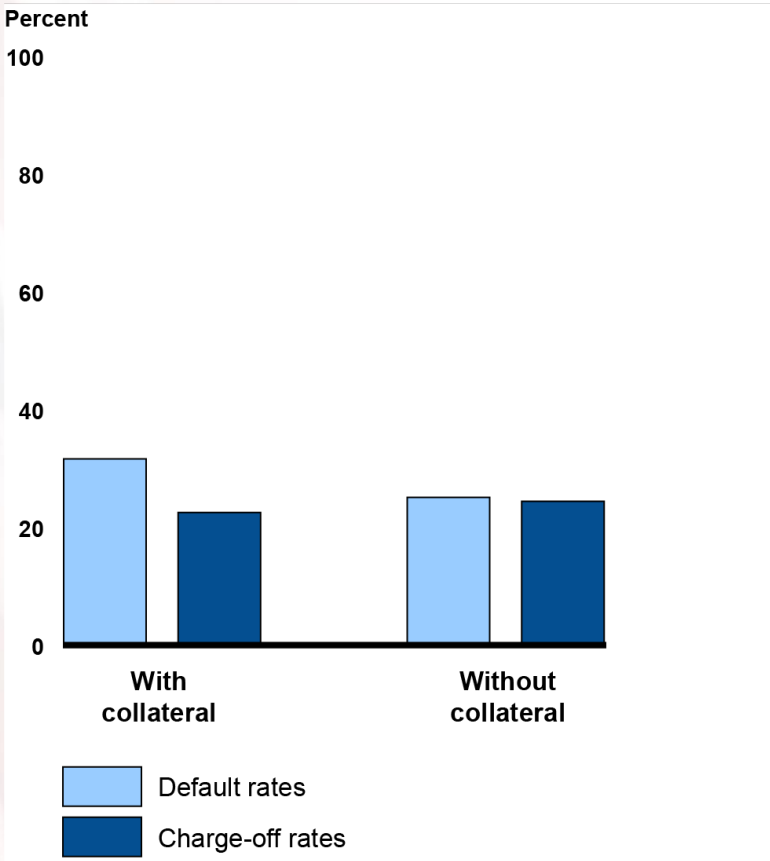
Physical Disaster Loan Performance

Performance of Physical Disaster Loans Issued under SBA Disaster Declarations—Uncollateralized Compared to Collateralized

- Loans with collateral did not necessarily perform better than loans without collateral.
- Since post-RISE Act loans had less than 5 years to perform, default and charge-off rates may increase for these loans regardless of whether they have collateral.

Physical Disaster Loan Performance

Figure 3: Performance of Physical Disaster Loans Issued under SBA Disaster Declarations Before the RISE Act as of September 30, 2020



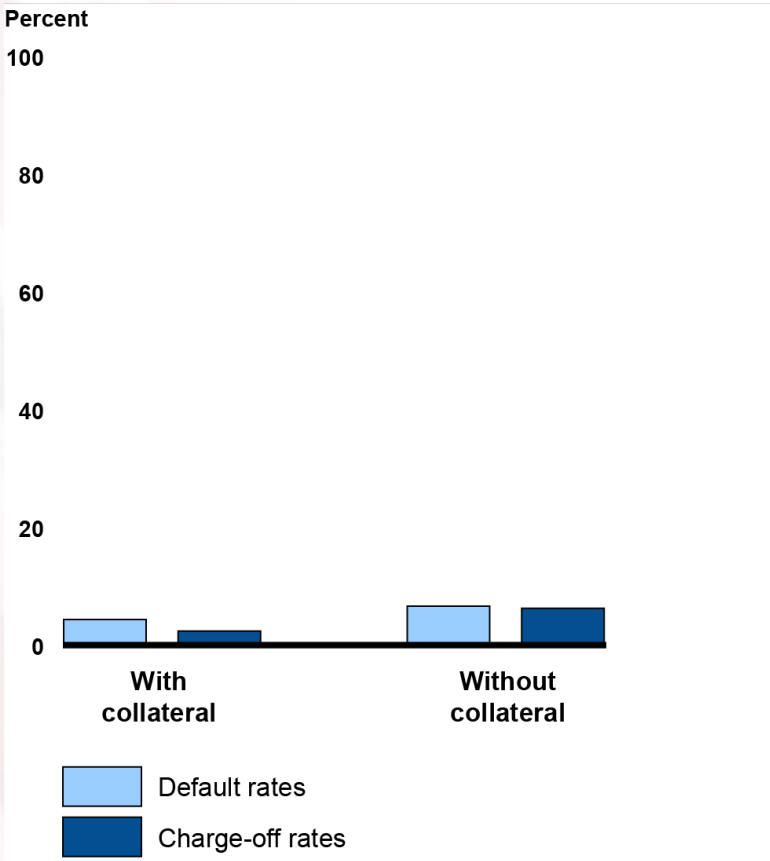
Source: GAO analysis of Small Business Administration data. | GAO-21-581R

- Loans with collateral had a default rate of 31.6 percent and a charge-off rate of 22.5 percent.
- Loans without collateral had a default rate of 25.1 percent and a charge-off rate of 24.4 percent.

Note: Figure represents Small Business Administration (SBA) loans approved for SBA disaster declarations from January 1, 2000, through November 24, 2015. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

Physical Disaster Loan Performance

Figure 4: Performance of Physical Disaster Loans Issued under SBA Disaster Declarations After the RISE Act as of September 30, 2020



Source: GAO analysis of Small Business Administration data. | GAO-21-581R

- Loans with collateral had a default rate of 4.4 percent and a charge-off rate of 2.4 percent.
- Loans without collateral had a default rate of 6.6 percent and a charge-off rate of 6.2 percent.

Note: Figure represents Small Business Administration (SBA) loans approved for SBA disaster declarations from November 25, 2015 through September, 30, 2020. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

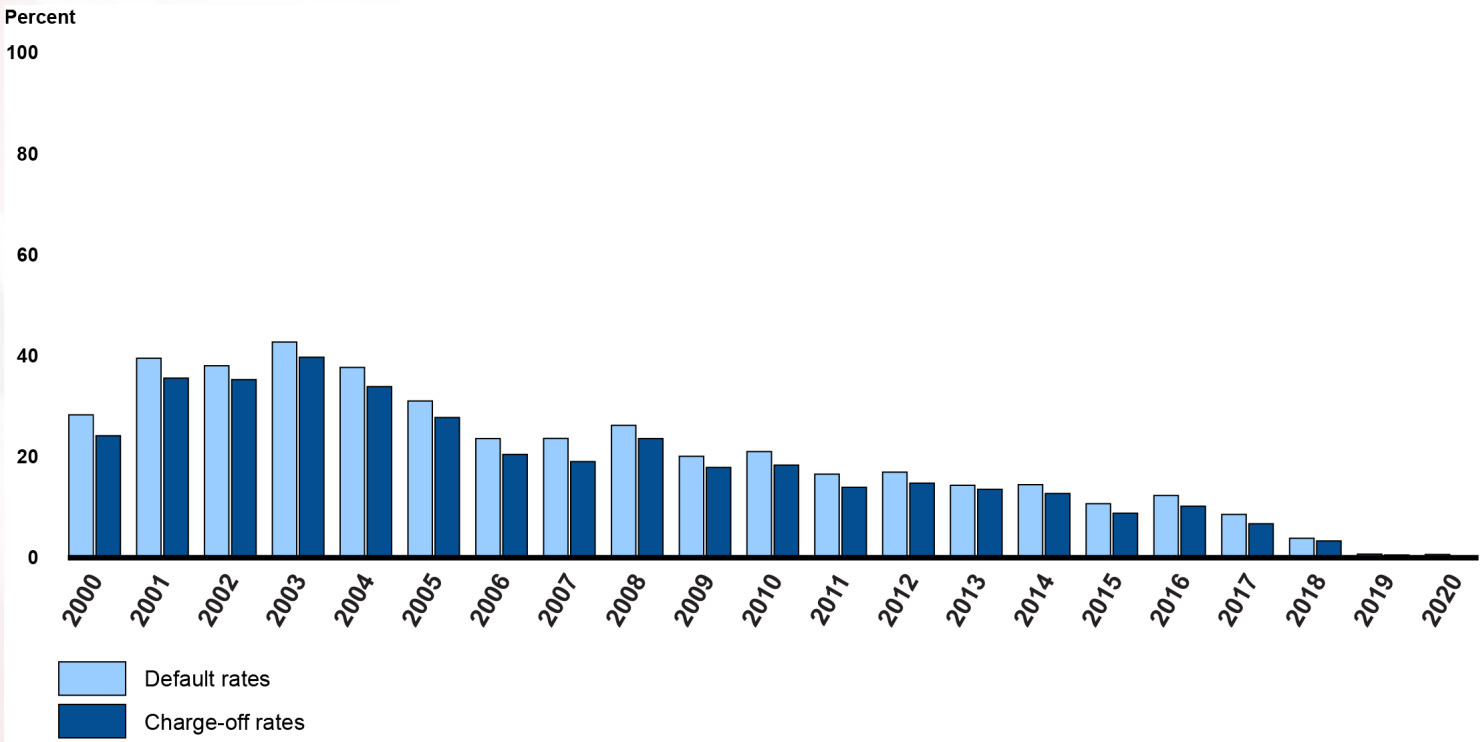
Physical Disaster Loan Performance

Performance of Physical Disaster Loans Issued under SBA Disaster Declarations—Other Factors

- Other factors that may also affect performance, include:
  - Changes in SBA's lending practices, such as a change in 2014 to consider applicants credit scores and credit history.
  - Economic conditions in a given disaster area.
  - Payment deferrals beginning in March 2020 because of the COVID-19 public health emergency.

Physical Disaster Loan Performance

Figure 5: Performance of Physical Disaster Loans Issued under SBA Disaster Declarations as of September 30, 2020



Source: GAO analysis of Small Business Administration data. | GAO-21-581R

Notes: Figure represents Small Business Administration (SBA) loans approved by calendar year for SBA disaster declarations from January 1, 2000, through September 30, 2020. SBA lending policies have varied over the 20 year period.
Older loans have had more time to perform and as a result generally have higher default and charge-off rates.

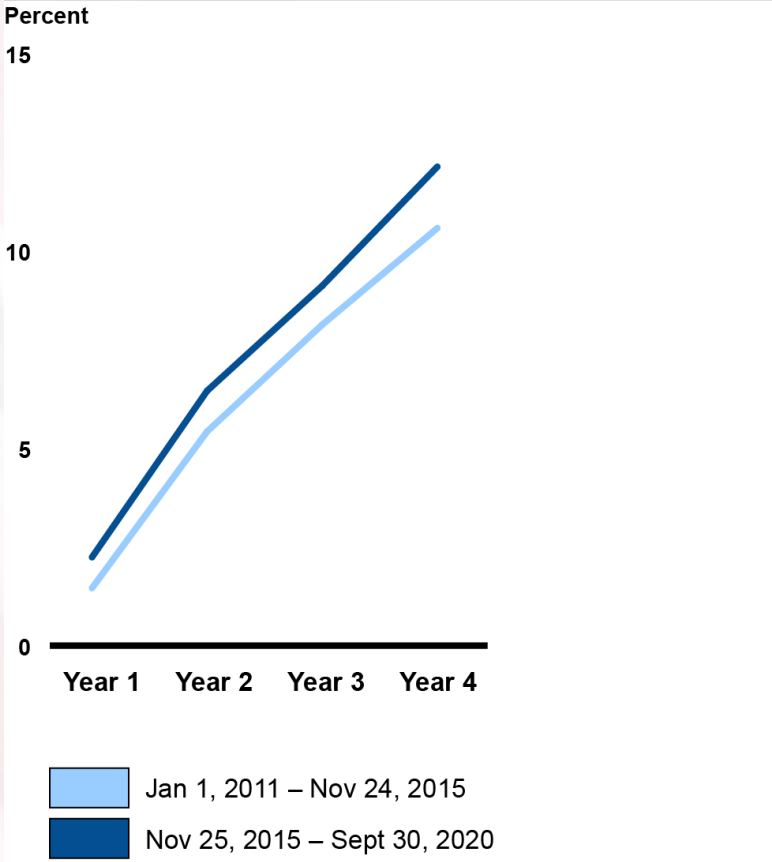
Physical Disaster Loan Performance

Performance of Physical Disaster Loans Issued under SBA Disaster Declarations over 4 Years

- To minimize the effects of having large differences in the age of loans, we compared default and charge-off rates during the first 4 years of the following:
  - Pre-RISE Act loans disbursed from January 1, 2011, through November 24, 2015
  - Post-RISE Act loans disbursed from November 25, 2015, through September 30, 2020
- The default and charge-off rates for each year varied by less than one percentage point.
- Consistent with the overall 20 year trend previously shown, default and charge-off rates will likely increase as the loans mature.

Physical Disaster Loan Performance

Figure 6: Default Rates of Physical Disaster Loans Issued under SBA Disaster Declarations over 4 Years as of September 30, 2020



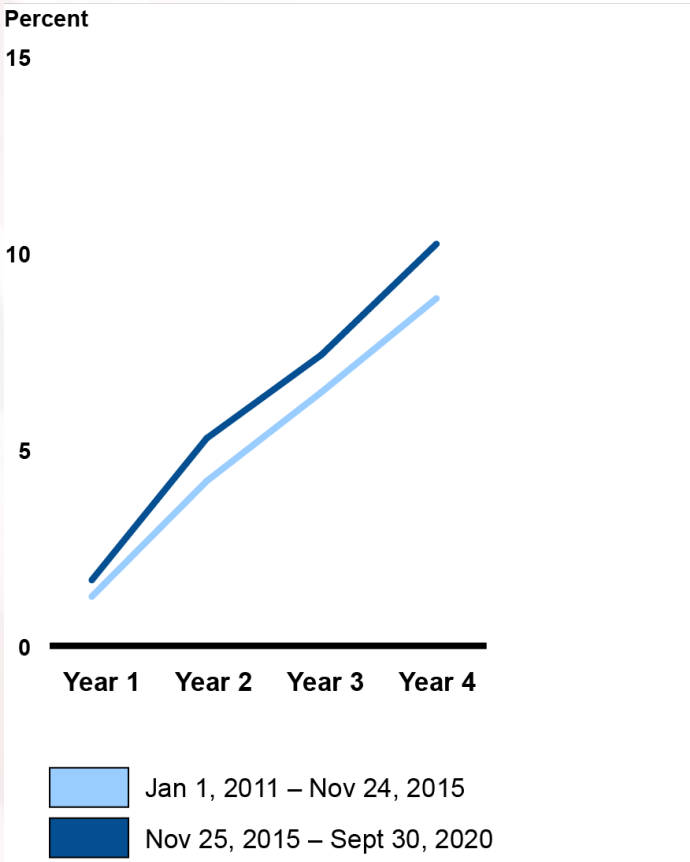
Source: GAO analysis of Small Business Administration data. | GAO-21-581R

- The default rates varied by less than one percentage point for each year and less than two percentage points cumulatively.

Note: Figure represents Small Business Administration (SBA) loans approved for SBA disaster declarations from January 1, 2011, through November 24, 2015 and from November 25, 2015, through September 30,2020. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

Physical Disaster Loan Performance

Figure 7: Charge-off Rates of Physical Disaster Loans Issued under SBA Disaster Declarations over 4 Years as of September 30, 2020



Source: GAO analysis of Small Business Administration data. | GAO-21-581R

- The charge-off rates varied by less than one percentage point for each year and less than two percentage points cumulatively.

Note: Figure represents Small Business Administration (SBA) loans approved for SBA disaster declarations from January 1, 2011, through November 24, 2015 and from November 25, 2015, through September 30, 2020. The Recovery Improvements for Small Entities After Disaster Act of 2015 (RISE Act) was enacted on November 25, 2015.

Physical Disaster Loan Performance

Summary

- For loans approved under SBA disaster declarations, pre-RISE Act default and charge-off rates are higher than post-RISE Act rates; however, as post-RISE Act loans reach a maturity level similar to that of pre-RISE Act loans, their default and charge-off rates may increase. [3]
- Pre-RISE Act loans had approximately 5 to 20 years to perform; post-RISE Act loans all had less than 5 years.
- An analysis of the first 4 years of both pre-RISE Act and post-RISE Act loans showed that the default and charge-off rates varied by less than one percentage point for each of the years.
- Loans with collateral did not necessarily perform better than loans without collateral.
- Other factors, such as changes in SBA's lending policies and the COVID-19 payment deferral, could also affect loan performance.

[3]We cannot isolate the contribution of the RISE Act to the loan performance because there are confounding factors such as differences in loan maturity and the state of the economy.