

applying to include that county in its proposed area of operations. In addition, the regulations currently do not permit a new CDC, or a CDC applying to expand its area of operations, to apply for a particular county if that county has become part of another CDC's area of operations within the previous 24 months. Eliminating this standard will encourage new CDC applications and expansion applications from existing CDCs. SBA is proposing to allow the marketplace to determine the maximum number of CDCs that can co-exist within a State. With these changes SBA anticipates that small businesses, as well as lenders, will have greater choice in and access to capital.

To facilitate these changes, SBA is proposing to streamline a CDC's organizational structure by modifying the CDCs' general membership requirements. Currently, a CDC is required to have a general membership that covers the CDC's entire area of operations. In the proposed rule, SBA would no longer require that a CDC's membership cover the entire area of operations, but rather would require that the CDC's members each actively support economic development within all or some portion of the CDC's area of operations. The CDC's board of directors would make the decision on how widely disbursed the CDC's general membership needs to be to meet the objective of local economic development. SBA also is proposing to modify the regulations governing contracting for staff to facilitate a CDC's contracting for "back office" work with a contractor located outside of the CDC's area of operations. SBA believes that this will permit certain economies of scale by providing additional sources of expertise in 504 packaging, processing, servicing and liquidation.

For CDCs that apply to cross State lines as a multi-state CDC, the CDC also will be able to determine the maximum geographic coverage its general membership in the new State needs to be. Also for multi-state CDCs, SBA is proposing to relax the requirements for board representation from the new State by eliminating the current requirement that at least three of the CDC's board members must come from the new State. In addition, SBA is proposing to allow a CDC that currently has ALP or PCLP authority in its State of incorporation to use that authority in its expanded area. To ensure that only those CDCs with demonstrated strong underwriting are permitted to expand beyond their State of incorporation, SBA is clarifying the requirement that the expanding CDC must meet SBA's portfolio performance benchmarks. Taken together, SBA

believes that these changes in a CDC's area of operations, elimination of the concept of "adequately served," elimination of the requirement that a CDC's membership cover the entire area of operations, the clarification regarding contracting, and the changes in the expansion requirements for CDCs will result in the 504 Program becoming more relevant in today's dynamic financial services marketplace.

SBA agrees with the opinion of the majority of writers that the 504 Program should remain separate from the 7(a) Program. The proposed rule introduces a new regulation that prohibits a CDC from investing in or being affiliated with a 7(a) lender.

The concept of permitting a CDC to invest in a Small Business Investment Company ("SBIC") generally was supported by the commenters. Many writers viewed such an investment as economic development as long as the SBIC and the CDC were not affiliates. However, SBA's current regulations prohibit a CDC from owning an equity interest in a business that has received or is applying to receive SBA financing (§ 120.140). Since SBICs typically have an ownership interest in the businesses that they assist, a CDC that has invested in an SBIC also would have an ownership interest in the small business receiving financing from the SBIC and could potentially violate this regulation by providing financing directly to that small business. In addition, SBA's regulations state that a CDC must operate in its Area of Operations. SBA interprets this requirement to apply to all CDC activities that use funds generated from the 504 Program. In light of these concerns, at this time SBA proposes to prohibit a CDC from investing in an SBIC. The proposed rule would not require a CDC with an existing investment in an SBIC to liquidate such investment.

Section-by-Section Analysis

SBA proposes to add a definition of "SOP" to § 120.102, the definitions section applicable to the entire part 120.

SBA proposes to amend § 120.140 to delete references to Associate Development Companies ("ADC") (see discussion of § 120.850).

SBA proposed to change the headings for § 120.800 and § 120.801 to make their format consistent with the other section headings in subpart H.

SBA proposed some changes to the definitions in § 120.802. The definition of "Area of Operations" would be modified to add that the minimum area of operations for a CDC is the State in which the CDC is incorporated. This change would permit more access to

capital as well as choices for small businesses. In response to the ANPRM, several commentors suggested that a CDC's area of operations be SBA district-wide. However, SBA agrees with the reasoning of one commentor regarding the district-wide proposal:

(The district-wide proposal) presents two problems. First, it would not eliminate some current monopolies. * * * Secondly, it produces something of a double standard. In some 41 states, all CDCs would be statewide by virtue of the fact that there is only one district office in each of those states. That leaves 9 states requiring special regulations and monitoring by the SBA. The statewide CDC proposal eliminates these problems and provides a single, national standard and is therefore preferable.

The definition of "Local Economic Area" would be revised slightly to make it consistent with the revised, statewide "Area of Operations" definition. In addition, the definition for "Associate Development Company" would be deleted. This change is discussed in the analysis of revisions proposed for § 120.850. Other regulations in subpart H of part 120 use the terms "Designated Attorney," "Lead SBA Office" and "Priority CDC." For clarification, this proposed rule would add definitions for those terms.

In § 120.810, application for certification as a CDC, SBA is proposing changes to the policies governing new CDC applications to reflect the change in the definition of a CDC's "Area of Operations" to a minimum of statewide. Additionally, it deletes the current restrictions that permit existing CDCs to exclude geographic areas from being considered for a new CDC. SBA is permitting the marketplace to determine the optimum number of CDCs that may be supported.

Because of these changes and in order to streamline the application process, SBA would delete § 120.811, public notice of CDC certification application, which requires public notice as well as direct notice to existing CDCs. SBA believes the application process, SBA oversight, and the marketplace will be enough to ensure that the process will lead to improved economic development. This proposed rule would add a clarification that an applicant CDC must demonstrate financial capability to meet the upfront costs of the program until the CDC's operations meet the breakeven point. This is to ensure that the CDC will be staffed sufficiently to meet the requirements of marketing, processing, closing, and servicing 504 Loans.

Section 120.812, probationary period for newly certified CDCs, proposes revisions that would clarify how SBA