

operations within the previous 24 months. Eliminating this standard will encourage new CDC applications and existing CDCs to expand their operations within their state of incorporation without first having to go through a lengthy expansion application process. SBA is allowing 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 streamlining CDC 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 final rule, SBA will no longer require that a CDC's membership cover the entire area of operations, but rather will 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. The result of this change and others will be that CDCs will be empowered to determine in which areas within their state of incorporation they wish to engage in 504 Program activities; they will not be required to serve the entire state but may do so if they choose. SBA also is modifying 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 geographic coverage of its general membership in the new State. Also for multi-state CDCs, SBA is relaxing 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 allowing 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 proficiency in the 504 Program are permitted to expand beyond their State of incorporation, SBA is requiring applicants for multi-state CDC and local

economic area expansion to be ALP-qualified, among other things. 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 of contracting requirements, 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.

The final rule prohibits a CDC from investing in or being affiliated with a 7(a) lender. This rule was developed after reviewing the comments on this issue received in response to the ANPRM. The majority of those commenting on this issue, as well as those that commented on the proposed rule, stated that the 504 Program should remain separate from the 7(a) Program.

The concept of permitting a CDC to invest in a Small Business Investment Company ("SBIC") generally was supported by the commenters to the ANPRM. 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 is prohibiting a CDC from investing in an SBIC.

#### Section-by-Section Analysis

SBA is adding a definition of "SOP" to § 120.102, the definitions section applicable to the entire part 120. SBA's SOPs are available at any SBA office (see 13 CFR 102.2 and are generally available in SBA's reading room on its Web site (<http://www.SBA.GOV>).

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

SBA is changing the headings for § 120.800 and § 120.801 to make them

consistent with the other section headings in Subpart H.

In § 120.802 the definition of "Area of Operations" is modified to define the minimum area of operations for a CDC as the State in which the CDC is incorporated. As stated in the proposed rule, SBA has decided to take steps to increase the availability of the long-term, fixed-rate financing offered by the 504 Program that is vital for our nation's small business community. Currently, each CDC is assigned a specific, local area, typically several counties. Only one CDC per State is permitted to be a statewide CDC. In some cases, there are geographic areas that do not have CDC coverage. Although CDCs' areas of operations often overlap, SBA believes that establishing statewide areas of operations for all CDCs will increase the availability of 504 Program assistance to small businesses. Most of the comments SBA received concerned the proposed change to the CDC's minimum area of operations. Several comments were opposed to the proposed change based on concerns that the changes would dilute a CDC's role in community and economic development as well as a concern that rural areas would be neglected. Some commenters also were concerned that a CDC could not provide adequate servicing to much larger geographic areas. SBA also received several comments supporting the change as proposed. One such comment explained that it would eliminate monopolies that some CDCs currently have. Another stated that competition will result in the CDC working harder to distinguish itself by attempting to provide better service at the lowest possible cost. Other commenters supported expansion of a CDC's minimum area of operations but wanted the SBA district offices' geographic jurisdiction to define the minimum area, not the State.

With regard to the concern about whether CDCs will be able to adequately provide 504 Program service to the much larger geographic area of the State in which it is incorporated, SBA did not propose to require that a CDC must serve the entire State in which it is incorporated when it proposed to change the "area of operations" definition to provide for a minimum of the State in which the CDC is incorporated. A CDC will continue to be free to concentrate its 504 Program activities in whatever portions of its State it believes it can operate effectively as a CDC.

As to the issue of the specific geographic limit of the area of operations (*i.e.*, Statewide, as proposed; district-wide, as favored by several