



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

May 25, 2010

### **H.R. 5297** **Small Business Lending Fund Act of 2010**

*As ordered reported by the House Committee on Financial Services on May 19, 2010*

#### **SUMMARY**

H.R. 5297 would create the Small Business Lending Fund (SBLF) and authorize the appropriation of funds to the Treasury Department to make up to \$30 billion of capital investments in financial institutions with total assets of less than or equal to \$10 billion. Participating institutions would issue to the Treasury preferred stock or similar instruments with a dividend that would depend on the extent to which an institution increases lending to small businesses.

Under the bill, as approved by the Committee on Financial Services, the preferred stock would have to be redeemed within 10 years. Thus, the initial investments would be considered loans for federal budgetary purposes. In addition, consultations with federal regulators indicate that, for the committee-approved language, investments made through the SBLF would not be considered Tier 1 capital for the borrowing institutions, and hence would not satisfy certain regulatory capital requirements.

H.R. 5297 also would create a Small Business Credit Initiative and authorize the appropriation of \$2 billion to assist states with their efforts to increase the amount of capital made available by private lenders to small businesses.

CBO estimates that implementing H.R. 5297 would cost about \$3.3 billion over the 2011-2015 period, assuming appropriation of the necessary amounts. We estimate that enacting the bill would not affect direct spending or revenues; therefore, pay-as-you-go procedures would not apply.

H.R. 5297 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

## ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 5297 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

|   | By Fiscal Year, in Millions of Dollars |      |      |      |      | 2011-<br>2015 |
|---|--|------|------|------|------|---------------|
|   | 2011                                   | 2012 | 2013 | 2014 | 2015 |               |
| <b>CHANGES IN SPENDING SUBJECT TO APPROPRIATION</b> |  |      |      |      |      |               |
| <b>Small Business Lending Fund</b>                  |  |      |      |      |      |               |
| Estimated Authorization Level                       | 1,366                                  | 0    | 0    | 0    | 0    | 1,366         |
| Estimated Outlays                                   | 1,366                                  | 0    | 0    | 0    | 0    | 1,366         |
| <b>Small Business Credit Initiative</b>             |  |      |      |      |      |               |
| Authorization Level                                 | 2,000                                  | 0    | 0    | 0    | 0    | 2,000         |
| Estimated Outlays                                   | 335                                    | 335  | 495  | 655  | 75   | 1,895         |
| <b>Studies and Reports</b>                          |  |      |      |      |      |               |
| Estimated Authorization Level                       | 1                                      | 1    | 1    | 1    | 1    | 5             |
| Estimated Outlays                                   | 1                                      | 1    | 1    | 1    | 1    | 5             |
| <b>Total Changes</b>                                |  |      |      |      |      |               |
| Estimated Authorization Level                       | 3,367                                  | 1    | 1    | 1    | 1    | 3,371         |
| Estimated Outlays                                   | 1,702                                  | 336  | 496  | 656  | 76   | 3,266         |

## BASIS OF ESTIMATE

For the purposes of this estimate, CBO assumes that H.R. 5297 will be enacted by the end of fiscal year 2010 and that the amounts necessary to implement the bill will be appropriated for fiscal year 2011 (and subsequent years in the case of the required studies and reports).

### Small Business Lending Fund

H.R. 5297 would authorize the Treasury to purchase preferred stock and similar instruments in financial institutions, with dividend payments initially set at 5 percent. For the first four and one-half years from the date of disbursement, the dividend payable to the Treasury would be adjusted downward from 5 percent per annum to a rate that depends on the extent to which an institution increases lending to small businesses; for example, institutions that increase such lending by 10 percent or more would pay a dividend of just 1 percent per annum. However, institutions that do not increase their small business lending within the first two years would owe a 7 percent annual dividend after that time. At

the end of that initial four-and-a-half-year term, the annual dividend rate for all borrowers would be fixed at 9 percent.

Under the legislation, CBO expects that the Treasury would disburse about \$23 billion of the \$30 billion of available funds in fiscal year 2011, but would not disburse the remaining \$7 billion. Because the legislation specifies that the funds must be repaid within 10 years, the investments would not be classified as Tier 1 capital. From regulators' perspectives, Tier 1 capital is the core measure of a bank's financial strength; such capital consists primarily of common stock and retained earnings, but may also include preferred stocks. If the securities could qualify as Tier 1 capital, the demand for the funds would probably be higher. Still, the SBLF would provide relatively inexpensive financing for the eligible institutions, especially those that currently provide only moderate amounts of small business loans and could more easily reach thresholds for growth in lending and thereby achieve lower dividend rates.

CBO expects that early repayments would be small in the first few years, but become significant at the end of the four-and-a-half-year term when the dividend would reset to the higher rate. In particular, the increase in dividends to 9 percent would probably spur most borrowers to repay the loans much earlier than the 10-year limit on outstanding funds.

**Credit Reform Budget Treatment.** The budgetary accounting for loans from the SBLF is governed by the Federal Credit Reform Act of 1990 (FCRA), which requires an appropriation of the subsidy and administrative costs associated with federal loan guarantees and federal direct loans. Although the purchase of preferred stock requiring a dividend payment differs from a traditional loan requiring an interest payment, CBO believes the capital investments from the SBLF under this bill would meet the definition of a loan under FCRA because of the bill's specific requirement that those investments be repaid to the federal government within 10 years.

Under FCRA, the subsidy is the estimated lifetime cost to the government of a loan or loan guarantee, calculated on a net-present-value basis excluding administrative costs. FCRA further specifies that the present-value computation should be done by discounting the expected net cash flows from the government at interest rates on Treasury securities of comparable maturity. On that basis, CBO estimates that the subsidy cost for the SBLF would total \$1.4 billion over the 2010-2015 period (6 percent of the roughly \$23 billion in expected loans), resulting from a projected level of defaults and missed dividend payments.

**Fair-Value Evaluation.** Alternatively, the potential costs of the SBLF under H.R. 5297 can be measured using procedures similar to those specified by FCRA but adjusted for market risk—as is specified by law for estimating the costs of the Troubled Asset Relief Program.

Cost estimates made under FCRA do not provide a comprehensive measure of the cost to taxpayers primarily because the FCRA methodology does not include the costs that stem from certain risks involved in lending—risks that private investors would require compensation to bear. In particular, although the FCRA methodology accounts for average losses from defaults, it does not recognize a cost for the risk that losses from defaults will be higher during periods of market stress, when resources are scarce and hence most valuable. Such “market risk” is excluded from FCRA estimates because that methodology discounts expected cash flows at Treasury borrowing rates rather than at higher interest rates that incorporate the price of risk.

Estimates prepared on a “fair-value” basis include the cost of the risk that the government has assumed; as a result, they provide a more comprehensive measure of the cost of the financial commitments than estimates done on a FCRA basis or on a cash basis. CBO estimates that if the budgetary impact of the SBLF under H.R. 5297 was calculated on such a fair-value basis (that is, reflecting market risk), the cost would be approximately \$3.4 billion (15 percent of the roughly \$23 billion in expected loans).

### **Small Business Credit Initiative**

H.R. 5297 would also authorize the appropriation of \$2 billion to be allocated to states (or in some cases, municipalities) that have created programs to increase the amount of capital made available by private lenders to small businesses. The federal funds would be allocated among the states based on certain employment statistics; states would have nine months from the date of enactment of the bill to apply to participate in the program. The Department of the Treasury would release funds to participating states in three installments. The first installment would be released upon approval of a state’s application, and the second and third installments would be released after the Department of the Treasury completes an audit of the state’s spending of the previous installment. Assuming appropriation of the specified amount, CBO estimates that implementing this program would cost \$1.9 billion over the 2010-2015 period.

H.R. 5297 also would require the Department of the Treasury and the Government Accountability Office to prepare certain reports and to audit both the Small Business Lending Fund program and the Small Business Credit Initiative on a regular basis. Assuming appropriation of the necessary amounts, CBO estimates that implementing the bill’s reporting and auditing requirements would cost \$5 million over the 2010-2015 period.

**PAY-AS-YOU-GO CONSIDERATIONS:** None.

## **INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT**

H.R. 5297 contains no intergovernmental or private-sector mandates as defined in UMRA. The bill would benefit state and local governments by providing funding for lending to small businesses. Any costs to those entities participating in the program would be incurred voluntarily.

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