CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 28, 2010

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

As passed by the House of Representatives on June 17, 2010

SUMMARY

CBO estimates that enacting H.R. 5297 would increase direct spending by $2.1 billion over the 2010-2020 period. In addition, H.R. 5297 would make several changes to tax law. The staff of the Joint Committee on Taxation (JCT) estimates that the tax provisions, on net, would increase revenues by about $3.6 billion over the 2010-2020 period. In sum, CBO estimates that the direct spending and revenue effects of the legislation would decrease budget deficits by $1.5 billion over the 2010-2020 period. In addition, we estimate that implementing H.R. 5297 would increase spending subject to appropriation by $290 million over the 2010-2015 period and by $305 million over the 2011-2020 period.

H.R. 5297 would create the Small Business Lending Fund (SBLF) and provide funding 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 preferred stock or similar instruments to the Treasury with a dividend that would depend on the extent to which a participating institution increases its lending to small businesses.

The act also would appropriate $3 billion to create two programs to support investments in small businesses. The Small Business Credit Initiative (SBCI) would provide grants to states to provide capital to increase the amount of capital made available by private lenders to small businesses. The Early Stage Investment Program would make grants to certain participating lenders to invest in eligible small businesses. In addition, the act would allow certain banks to temporarily change how they report credit losses (referred to as temporary amortization authority) to federal regulators if they maintain or increase lending to small businesses. CBO estimates that this provision would increase the federal cost of resolving failed institutions through the Federal Deposit Insurance Corporation (FDIC) by about $0.2 billion over the next 10 years.

Finally, the act would authorize the appropriation of $300 million to establish a program at the Small Business Administration (SBA) to create a fund that could be tapped by certain borrowers for payments of principal and interest on loans guaranteed by the agency.

CBO has determined that the nontax provisions of H.R. 5297 contain 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 Billions of Dollars												
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2010-2015	2010-2020
CHANGES IN DIRECT SPENDING													
Small Business Lending Fund													
Estimated Budget Authority	10.0	19.1	-1.5	-1.9	-2.2	-20.1	-2.7	-0.8	-0.5	-0.3	-0.2	3.3	-1.1
Estimated Outlays	10.0	19.1	-1.5	-1.9	-2.2	-20.1	-2.7	-0.8	-0.5	-0.3	-0.2	3.3	-1.1
Small Business Credit Initiative													
Budget Authority	2.0	0	0	0	0	0	0	0	0	0	0	2.0	2.0
Estimated Outlays	0	0.3	0.3	0.5	0.7	0.1	0.1	*	0	0	0	1.9	2.0
Early-Stage Investment Program													
Budget Authority	1.0	0	0	0	0	0	0	0	0	0	0	1.0	1.0
Estimated Outlays	0	*	0.2	0.3	0.2	0.1	*	0	0	0	0	1.0	1.0
Temporary Amortization Authority													
Estimated Budget Authority	0	0	-0.1	-0.1	-0.1	-0.1	0.1	0.1	0.1	0.1	0.2	-0.3	0.2
Estimated Outlays	0	0	-0.1	-0.1	-0.1	-0.1	0.1	0.1	0.1	0.1	0.2	-0.3	0.2
Total Changes in Direct Spending													
Estimated Budget Authority	13.0	19.1	-1.6	-2.0	-2.3	-20.2	-2.6	-0.7	-0.4	-0.2	*	6.0	2.1
Estimated Outlays	10.0	19.5	-1.0	-1.2	-1.4	-20.0	-2.5	-0.7	-0.4	-0.2	*	5.9	2.1
CHANGES IN REVENUES													
Estimated Revenues	-0.1	0.1	0.2	0.5	0.6	5.3	-5.4	0.2	0.6	0.7	0.8	6.6	3.6
NET INCREASE OR DECREASE (-) IN THE BUDGET DEFICIT FROM CHANGES IN DIRECT SPENDING AND RECEIPTS													
Net Impact on Deficit [a]	10.1	19.4	-1.3	-1.7	-2.0	-25.2	2.8	-0.9	-1.0	-0.9	-0.8	-0.7	-1.5
CHANGES IN SPENDING SUBJECT TO APPROPRIATION													
Estimated Authorization Level	0.3	*	*	*	*	*	0	0	0	0	0	0.3	0.3
Estimated Outlays	0	*	0.1	0.1	*	*	*	*	0	0	0	0.3	0.3

Sources: Congressional Budget Office and staff of the Joint Committee on Taxation.

Note: * = between -$50 million and $50 million. Components may not sum to totals because of rounding.

a. Positive numbers indicate increases in deficits; negative numbers indicate decreases in deficits.

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 5297 will be enacted by early in August 2010.

Direct Spending

Small Business Lending Fund. H.R. 5297 would authorize the Treasury to purchase preferred stock and similar instruments in financial institutions. Dividend payments on those instruments would initially be set at 5 percent. During the first four and one-half years of the program, the dividend would be adjusted by an amount that would depend 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 full $30 billion in available funds would be disbursed within a year following enactment. Repayments would probably 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, we estimate that about $20 billion of the stock purchases would be repaid to the Treasury in fiscal year 2015.

Cash-Based Estimate. H.R. 5297 would direct that the costs of preferred stock purchases made under the legislation be determined as provided by the Federal Credit Reform Act of 1990 (FCRA). However, FCRA only provides guidance for determining the cost of loans or loan guarantees; FCRA defines a loan as “a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds with or without interest.” The investments of preferred stock authorized in H.R. 5297 have no such requirement to repay the funds, thus enabling the financial institutions to count the funds as Tier 1 capital (the core measure of a bank’s financial strength). Therefore, CBO has estimated the budgetary impact of H.R. 5297 using the principles provided in OMB Circular No. A-11. Under that guidance, the investments in equity or debt securities authorized in the act, as well as earnings and redemptions, should be recorded in the federal budget on a cash basis in the year that the transactions would occur. On that basis, CBO estimates that the SBLF would result in net outlays of $3.3 billion over the 2010-2015 period, and would reduce outlays by $1.1 billion over the 2010-2020 period.

Fair–Value Estimate. 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. In CBO’s view, 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 the 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 the cost of the SBLF on such a fair-value basis (that is, reflecting market risk) would be $6.2 billion.

Small Business Credit Initiative. H.R. 5297 would appropriate $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 act 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. CBO estimates that enacting this program would cost $2.0 billion over the 2010-2020 period, with most of the funding spent over the next five years.

Early-Stage Investment Program. H.R. 5297 would appropriate $1 billion to establish an SBA program to make equity investments in eligible investment companies, including small business investment corporations (SBICs) licensed by SBA. Investment companies that receive funds under the program would be required to invest a portion of the funds in small businesses that meet certain annual revenue requirements. Further, participating investment companies would be required to provide SBA with a financial interest that would entitle the agency to a share of any distributions made to investors.

CBO expects that investments made through this program would take several years to generate distributions from participating investment companies; therefore, we expect a negligible amount of distributions would be received over the 2010-2020 period. Under the act, spending of any distributions received through the program would be subject to future appropriation action.

Based on information from SBA, CBO estimates that enacting the early-stage investment program would cost $1.0 billion over the 2011-2020 period, with nearly all of that spending falling in the next five years.

Temporary Amortization Authority. Section 113 would modify financial regulatory practices by allowing certain financial institutions to record losses over a multiyear period, subject to certain conditions. CBO estimates that enacting this provision would increase net direct spending by about $200 million over the 2011-2020 period.

Under current regulatory guidelines, such losses are recorded as an expense in the year in which the write-down or loss is recognized by the lender. Higher expenses reduce the firm’s available capital, which reduces the amount of lending allowed under financial regulatory guidelines. The legislation would provide temporary authority for institutions with assets equal to or less than $10 billion to report any losses from certain real estate loans over a period of six to 10 years, depending on the extent to which the institution increases lending to small business. Institutions using the new authority also would be required to disclose to federal regulators their expenses and available capital on the same basis that would have been required in the absence of this legislation.

Enacting those provisions would affect the cash flows of the FDIC over the next 10 years but would have a negligible net impact on the budget in the long run because any change in the agency’s expenses related to the closing of failed institutions would ultimately be offset by changes in the amounts collected from deposit insurance premiums. The budgetary impact of this provision through 2020 is uncertain because it would depend on various market and regulatory factors. Considering the outcome of similar accounting measures adopted in the past, CBO expects that allowing institutions to amortize losses could delay the closure of some financially weak institutions in the first few years after enactment and would increase the FDIC’s losses for such institutions that fail. CBO expects that the extent of those losses would be much smaller than in the past, because federal regulators would have reports on the institutions’ capital levels and expenses under both the new and existing accounting methods.

On balance, we estimate that this provision would postpone the failure of some financial institutions, thus reducing net FDIC spending through 2015. However, increased FDIC costs would probably occur over the 2016-2020 period, as shown in the above table.

Revenues

H.R. 5297 would make several changes to tax law. JCT estimates that the tax provisions, on net, would increase revenues by about $3.6 billion over the 2010-2020 period.

Exclusion of Gain on Small Business Stock. The act would temporarily increase—from 75 percent to 100 percent—the amount of gains on sales of small business stock that is excluded from taxable income, for stock newly acquired, through December 31, 2011. JCT estimates that the change would reduce revenues by $2.0 billion over the 2010-2020 period.

Deductions for Expenses Financed by Nonrecourse SBA Loans. H.R. 5297 would provide an exception to the normal rules that prohibit tax deductions for firms' expenses that are financed by nonrecourse loans. (Such loans provide lenders with access to collateral, but not to other assets of the borrower, in the event of default.) The act would allow tax deductions if the nonrecourse loans are guaranteed by the Small Business Administration. JCT estimates that the provision would reduce revenues by $0.9 billion over the 2010-2020 period.

Minimum Term for Certain Trusts. The legislation would require that grantor-retained annuity trusts have a minimum 10-year term to qualify for a reduced valuation upon transfer for purposes of gift taxation. JCT estimates that the provision would increase revenues by $5.3 billion over the 2010-2020 period.

Biofuel Credits for Crude Tall Oil. H.R. 5297 would make crude tall oil (a co-product of wood pulp manufacturing) ineligible for the cellulosic biofuel producer credit, which is worth $1.01 per gallon of fuel produced. The change would expand on provisions enacted in the Health Care and Education Affordability Reconciliation Act of 2010 (Public Law 111-152) that restricted other byproducts of the process of producing paper from qualifying for the credit. JCT estimates that the restrictions would increase revenues by $1.8 billion over the 2010-2020 period.

Other Provisions. The act also would provide additional deductions for start-up expenditures of businesses and limit the penalties for failure to disclose to the Internal Revenue Service certain transactions potentially related to tax shelters. JCT estimates that those provisions would reduce revenues by about $0.7 billion over the 2010-2020 period. In addition, the legislation would shift about $5.0 billion in revenues from 2016 to 2015 by temporarily changing the required amounts of quarterly estimated tax payments of large corporations.

Spending Subject to Appropriation

Small Business Borrower Assistance Program. H.R. 5297 would establish a program to make principal and interest payments on certain small business loans. The act would authorize SBA to set aside 6 percent of the principal disbursed on qualifying loans made under the agency's 7(a) loan-guarantee program during the one-year period following the date that final regulations for the program are issued. From those funds, SBA would be authorized to make principal and interest payments to lenders upon the request of borrowers participating in the program.

Based on information from SBA, CBO estimates that enacting the borrower assistance program would cost $290 million over the 2010-2015 period and $300 million over the 2010-2020 period, assuming appropriation of the specified amount.

Reports and Audits. H.R. 5297 also would require the Department of the Treasury and the Government Accountability Office to prepare certain reports for the Congress 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 act's reporting and auditing requirements would cost $5 million over the 2010-2015 period.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 5297, as passed by the House of Representatives on June 17, 2010

	By Fiscal Year, in Millions of Dollars												
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2010-2015	2010-2020
NET INCREASE OR DECREASE (-) IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	10,137	19,368	-1,282	-1,664	-2,002	-25,239	2,841	-875	-1,019	-919	-816	-685	-1,473

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

CBO has determined that the nontax provisions of H.R. 5297 contain no intergovernmental mandates as defined in UMRA. The act would benefit state and local governments by providing funding for lending to small businesses. Any costs to those entities of participating in the program would be incurred voluntarily.

PREVIOUS CBO ESTIMATE

On May 25, 2010, CBO transmitted a cost estimate for H.R. 5297, the Small Business Lending Fund Act of 2010, as ordered reported by the House Committee on Financial Services on May 19, 2010. That version of the legislation established the Small Business Lending Fund and the Small Business Credit Initiative and authorized the appropriations for both programs. The version of H.R. 5297 passed by the House provided funding for the SBLF and SBCI as well as a third program, the Early Stage Investment Program; further, the House-passed version changed the budgetary treatment of the SBLF, and made several changes to tax law. The cost estimates for the two versions of the act reflect those differences.

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