CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

October 12, 2011

Honorable Olympia J. Snowe
Ranking Member
Committee on Small Business
and Entrepreneurship
United States Senate
Washington, DC 20510

Dear Senator:

This letter responds to your request for information about the cost estimate the Congressional Budget Office (CBO) prepared for H.R. 5297 in the 111th Congress, which was ultimately enacted as Public Law 111-240, the Small Business Jobs Act of 2010. That act established the Small Business Lending Fund (SBLF) and through it, authorized the Treasury Department to make up to $30 billion of capital investments in certain financial institutions to encourage those institutions to increase lending to small businesses.

In its analysis of the effects of the legislation on direct spending that was prepared when H.R. 5297 was being considered in the Senate, CBO estimated that enactment of the provisions related to the SBLF would *reduce* net federal outlays by $1.1 billion over the 2010-2020 period.[1] (Other provisions of the act were estimated to increase direct spending and to increase revenues. On balance, CBO estimated that enacting the legislation would reduce deficits by $0.5 billion over the 2010-2020 period.)

The act authorized the Treasury Department 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

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1. See Congressional Budget Office pay-as-you-go estimate for Senate Amendment 4594 in the nature of a substitute to H.R. 5297, the Small Business Jobs and Credit Act of 2010 (August 9, 2010). For more background and analysis, see also the Congressional Budget Office cost estimate for H.R. 5297, the Small Business Lending Fund Act of 2010 (June 28, 2010).

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 increased lending to small businesses. At the end of that initial four-and-a-half-year term, the annual dividend rate would be fixed at 9 percent.

H.R. 5297 specified that the costs of the preferred stock purchases be determined as provided by the Federal Credit Reform Act of 1990 (FCRA). However, in preparing cost estimates while legislation is being considered, CBO generally makes its best judgment regarding the appropriate methodology for estimating the budgetary impact of a bill, regardless of such specifications. CBO concluded that the procedures indicated by FCRA did not apply to the transactions of the SBLF because FCRA only provides guidance for determining the cost of loans, which, by definition, require repayment to the government, or loan guarantees, which do not involve an upfront disbursement of government funds. The transactions of the SBLF would fall in neither of those categories. Financial institutions would not be required to redeem the shares of preferred stock authorized for purchase by the legislation. (That would enable the financial institutions to count the funds as Tier 1 capital, the core measure of a bank's financial strength.) Therefore, at the time that CBO prepared the estimate, the agency estimated the budgetary impact of the act on a cash basis, consistent with the principles published in OMB Circular A-11.[2] On that basis, CBO estimated that the SBLF would *increase* net outlays by $8.4 billion over the 2010-2015 period, and would *reduce* net outlays by $1.1 billion over the 2010-2020 period.[3]

In preparing that estimate, CBO anticipated that the funding provided by the SBLF would be fully disbursed, primarily because the program would provide capital to financial institutions at attractive dividend rates, well below what they would have to offer to private investors. Participants could further reduce their dividend payments to the Treasury by increasing their lending to small businesses; CBO estimated that this provision would enable those financial institutions to reduce their average annual dividend rate to between 3.0 percent and 3.5 percent. In total, CBO estimated that

2. In particular, Circular A-11 states that, except when superseded by statutory accounting requirements, "[t]he budget treats an investment in a non-Federal security (equity or debt security) as a purchase of an asset, recording an obligation and an outlay in an amount equal to the purchase price in the year of the purchase."

3. CBO also reviewed other versions of the legislation, and some of those versions would have had a different budgetary impact because of differences in how the SBLF would have operated. For example, one earlier version of the legislation would have required that the SBLF's disbursements be repaid to the government.

dividend payments to the government would total roughly $5 billion over the life of the program, much of which would be offset by nearly $4 billion in estimated defaults.

Since that estimate was published on August 9, 2010, CBO has revised its assessment of the program's budgetary impact in two ways and has incorporated those changes in its baseline projections. It reduced the projected participation by financial institutions in the SBLF and modified the program's budgetary treatment to be consistent with the way it is actually being treated in the budget by the Office of Management and Budget (that is, on a present-value basis).

First, at the time the August 9 estimate was published, CBO expected that the full $30 billion in available funding would be disbursed. However, the volume of applications and the rate of disbursement through July 2011 fell below those initial expectations. As a result, in its most recent baseline, CBO estimated that only $10 billion would be disbursed to financial institutions through the SBLF.[4]

Second, the act's direction regarding the budgetary treatment of the SBLF—that is, the requirement that the program's costs be estimated in accordance with FCRA—is now law, and the Administration is recording the costs of the program on a present-value basis, treating the SBLF's investments as loans. Present value is a single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The present value also depends on the rate of interest (known as the discount rate) that is used to translate future cash flows into current dollars. Under FCRA, the discount rate applied to present-value calculations corresponds to the rates on Treasury securities.

To reflect in the baseline the way the SBLF is actually being treated in the budget, CBO's current estimate of the cost of the SBLF was computed as the net present value of expected disbursements, repayments, and receipts from dividends over the life of the program and was recorded in its baseline as an outlay in 2011 (the year in which the loans were disbursed). CBO estimates that repayments of principal and dividend payments will exceed the amount disbursed. However, because those repayments and dividend payments will occur over the next several years (and a dollar in the future is

4. On September 6, 2011, the Treasury announced that more than 40 percent of applicants had failed to meet the minimum statutory or program requirements, and therefore, were not approved for participation; the final amount of disbursements will be $4.3 billion.

worth less than a dollar today), their present value is less than the amount disbursed this year. As a result, on a present-value basis, CBO's most recent baseline records a subsidy *cost* for the program of roughly $750 million.

I hope this information is helpful to you. Please let me know if you have any further questions. The staff contact for this analysis is Avi Lerner.

Sincerely,

Douglas W. Elmendorf

Douglas W. Elmendorf
Director

cc: Honorable Mary L. Landrieu
Chair