CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 10, 2007

S. 1256
Small Business Lending Reauthorization and Improvements Act of 2007

As ordered reported by the Senate Committee on Small Business and Entrepreneurship on May 16, 2007

SUMMARY

S. 1256 would reauthorize the business and disaster loan programs of the Small Business Administration (SBA) through 2010. The bill also would make technical changes to the SBA's business loan programs, authorize two pilot loan programs, and reauthorize a grant program to support minority entrepreneurs. Finally, the bill would authorize SBA to use appropriated funds, with limits, in lieu of charging fees to cover the cost of 7(a) loan guarantees.

Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 1256 would cost $487 million in 2008 and $3.4 billion over the 2008-2012 period. About $1.8 billion of this amount is the estimated subsidy and administrative cost of continuing SBA’s credit programs, and about $1.6 billion would be for SBA's noncredit programs and other activities authorized in the bill. CBO estimates that enacting the bill would not affect revenues and would have no significant effect on direct spending.

S. 1256 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). The bill would authorize grant funds that could benefit tribal governments. Any costs they might incur would result from complying with conditions of federal assistance.

MAJOR PROVISIONS

Title I would make technical changes to the microloan program, which provides funding to companies whose capital needs are too small to qualify for the larger SBA business loan programs. Title I also would reauthorize the Program for Investment in Microentrepreneurs (PRIME).

Title II would create an Intermediary Lending Pilot Program, modeled after the microloan program, to provide midsize loans to small businesses. Under the pilot program, loans made to small businesses would range between $35,000 and $200,000.

Title III would make a number of changes to the 7(a) loan guarantee program, including: creating a preferred lenders program, which would authorize certain lenders to make and service loans; increasing certain loan limits for 7(a) guarantees; and establishing a program to increase loans available in rural areas. This title also would authorize SBA to lower fees charged to borrowers and lenders for 7(a) loan guarantees under certain conditions and establish an Office of Minority Small Business Development.

Title IV would make changes to SBA's 504 loan program, which provides loans through Certified Development Companies (CDCs) for investments in major fixed assets. S. 1256 would change the name of the program to the Local Development Business Loan Program, allow CDCs to contract with third parties to foreclose and liquidate defaulted loans, and adjust eligibility requirements to encourage investment in low-income areas. This title also would establish a pilot program that would authorize CDCs to make loans to nonprofit child care businesses in a limited number of states.

S. 1256 also would set the maximum amount of loans and loan guarantees that could be funded by SBA for fiscal years 2008, 2009, and 2010. In addition, it would provide specific authorizations of appropriations for the PRIME program and technical assistance grants for microloan recipients. Finally, the bill would authorize appropriations of such sums as may be necessary for salaries and expenses of the SBA, administrative expenses and loan capital for the disaster loan program, and administrative expenses and subsidy costs to carry out the the Small Business Investment Act.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1256 is shown in the following table. The costs of this legislation fall within budget functions 370 (commerce and housing credit) and 450 (community and regional development).

TABLE 1. ESTIMATED BUDGETARY IMPACT OF S. 1256

	By Fiscal Year, in Millions of Dollars					
	2007	2008	2009	2010	2011	2012
SPENDING SUBJECT TO APPROPRIATION						
SBA Spending Under Current Law						
Budget Authority [a]	492	0	0	0	0	0
Estimated Outlays	357	95	23	5	0	0
Proposed Changes						
Loan Programs						
Estimated Authorization Level	0	434	435	441	268	275
Estimated Outlays	0	277	400	430	349	283
Noncredit Programs						
Estimated Authorization Level	0	386	394	402	310	318
Estimated Outlays	0	210	310	368	382	365
Total						
Estimated Authorization Level	0	820	829	843	578	593
Estimated Outlays	0	487	710	798	731	648
SBA Spending Under S. 1256						
Estimated Authorization Level [a]	492	820	829	843	578	593
Estimated Outlays	357	582	733	803	731	648

a. The 2007 level is the amount appropriated for that year.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted near the end of fiscal year 2007 and that the necessary amounts will be appropriated near the start of each year. We assume that spending will follow historical patterns for the various SBA loan and business assistance programs.

The budgetary accounting for SBA's direct loan and loan guarantee programs is governed by the Federal Credit Reform Act (FCRA) of 1990, which requires an appropriation of subsidy and administrative costs associated with loan guarantees and loan operations. The subsidy cost is the estimated long-term cost to the government of a loan or loan guarantee, calculated on a net-present-value basis, excluding administrative costs. Administrative costs, recorded on a cash basis, include activities related to making, servicing, and liquidating loans as well as overseeing the performance of lenders.

The effect of the changes S. 1256 would make to SBA's business and disaster loan programs is measured in terms of projected subsidy costs. The bill does not specify an authorization level for either the subsidy or administrative costs, if any, that could be incurred as a result of implementing the amendments in the bill. CBO has estimated those amounts based on information from SBA regarding the historical demand for and costs of the agency's business and disaster loan programs. We assume that administrative activities related to those loans would continue beyond the 2008-2010 period.

Spending Subject to Appropriation

S. 1256 would authorize SBA to continue its direct loan and loan guarantee programs as well as various technical assistance and support programs for fiscal years 2008 through 2010. Based on information from SBA and historical spending patterns for the agency's programs, CBO estimates that implementing those provisions would cost $3.4 billion over the 2008-2012 period, assuming appropriation of the necessary amounts.

Table 2 shows the loan levels that would be authorized by the bill, the estimated subsidy and administrative costs for those loans, and the cost to continue certain grant programs and other activities authorized by the bill.

Guaranteed and Direct Business Loan Programs. The following loan programs would be authorized by S. 1256:

- The 7(a) program, which provides limited guarantees on loans made by certain lending institutions to small businesses.

- The certified development company program (also known as section 504 loans), which provides guarantees on debentures issued by CDCs to provide funding to small businesses for major fixed assets such as land, structures, machinery, and equipment.

- The microloan program, which provides direct loans to nonprofit lenders which then offer loans to small businesses just starting up, whose capital needs are too small to qualify for the 7(a) program.

- The Small Business Investment Company (SBIC) debenture program, which provides funding to privately owned companies that provide venture capital to small businesses.

TABLE 2. ESTIMATED SUBSIDY, ADMINISTRATIVE, AND OTHER NONCREDIT COSTS UNDER S. 1256

	By Fiscal Year, in Millions of Dollars				
	2008	2009	2010	2011	2012
Guaranteed and Direct Business Loan Subsidy and Administration Costs					
Subsidy Costs					
Estimated Authorization Level	13	13	13	0	0
Estimated Outlays	7	12	12	6	0
Administration Costs					
Estimated Authorization Level	127	131	135	138	142
Estimated Outlays	90	121	129	134	138
Lower 7(a) Fees					
Subsidy Costs					
Estimated Authorization Level	8	2	0	0	0
Estimated Outlays	5	4	1	0	0
Small Business Intermediary Lending Program					
Estimated Authorization Level	3	3	3	0	0
Estimated Outlays	1	3	3	1	0
Disaster Loan Subsidy and Administration Costs					
Subsidy Costs					
Estimated Authorization Level	163	163	163	0	0
Estimated Outlays	82	146	163	82	16
Administration Costs					
Estimated Authorization Level	120	123	127	130	133
Estimated Outlays	92	114	122	126	129
Noncredit Programs and Costs					
PRIME Program					
Estimated Authorization Level	17	17	17	0	0
Estimated Outlays	1	6	13	15	10
Other Noncredit Programs and Costs					
Estimated Authorization Level	369	377	385	309	318
Estimated Outlays	209	304	355	367	355
Memorandum:					
Authorized Loan Levels					
Guaranteed and Direct Business Loans	31,167	32,667	34,167	0	0
Disaster Loans	1,000	1,000	1,000	0	0

The bill would authorize SBA to guarantee loans and to make direct loans to small businesses, with a total loan value up to $31 billion in 2008, $33 billion in 2009, and $34 billion in 2010. By comparison, the authorized loan level for 2007 is about $28 billion. In 2006, the agency's authorized loan level was about $28 billion, and it funded direct and guaranteed loans worth about $20 billion in that year.

The estimated subsidy rates for the business loan programs offered by SBA range from zero for 7(a) and section 504 programs to about 10 percent for the microloan program. Incorporating the program amendments in the bill and using historical demand and default rates for those loan programs, CBO estimates that the subsidy costs for the authorized levels of guaranteed and direct business loans would be $7 million in 2008 and about $37 million over the 2008-2012 period.

As specified in FCRA, subsidy rates do not reflect the administrative costs to service loan programs. CBO estimates the administrative costs for the business loans authorized in the bill would be $90 million in fiscal year 2008 and $612 million over the 2008-2012 period.

Lowering 7(a) fees. S. 1256 would authorize SBA to use appropriated funds, if available and within limits, to lower certain fees charged to cover the estimated cost of loans guaranteed through the 7(a) program. The maximum annual fee reduction set by the bill would equal the average amount, over the previous three fiscal years, that fee collections have exceeded the cost of the underlying loan guarantees.

Under current law, SBA develops a schedule of fees to be charged to both borrowers and lenders each fiscal year to produce an estimated subsidy rate of zero when the loans are guaranteed. In other words, each year SBA sets fees at the rate, in its estimation, that will generate collections equal to the estimated lifetime cost of providing the loan guarantees. Each year, SBA guarantees a growing number of 7(a) loans (over 90,000 in 2006); the net cost of those guarantees cannot be calculated until all the loans are closed out. At that point, SBA can determine if the fees charged were sufficient to cover the long-term cost of the guarantees—it is not until the loans are closed out that SBA can know whether fee collections were too high or too low.

The projected subsidy cost for the 7(a) program in 2008, in the absence of fees, would be about 3.4 percent of the loan principle guaranteed, or about $305 million. Over the 2004-2006 period, SBA reduced its estimate of the cost of 7(a) loan guarantees, indicating that in the early years of the loans, the cost of providing the guarantees was lower than SBA originally estimated. As those loans age, however, the guarantees could become more costly.

Assuming appropriation of the maximum amount authorized by S. 1256 for reducing fees on the 7(a) program, CBO estimates that implementing this provision would cost $5 million in

2008. That estimate is the average amount of fees collected above the amounts SBA estimates would be necessary to fully offset the cost of guarantees over the fiscal year 2005-2006 period. We assume that SBA will set fees in subsequent years equal to the program's costs, thereby lowering the maximum amount available to reduce fees in each year. We estimate that this provision would cost $10 million over the 2008-2012 period.

Small Business Intermediary Lending Program. The bill would authorize a three-year program to provide up to $20 million in loans, ranging in size from $35,000 to $200,000, to nonprofit lenders over the 2008-2010 period. The Small Business Intermediary Lending Pilot Program would make direct loans to nonprofit intermediaries that would, in turn, make loans to eligible small businesses. The program, modeled after the microloan program, would feature a 20-year loan term, an interest rate of 1 percent, and a two-year grace period before principal and interest payments would be first due. Based on information from the SBA, CBO estimates that the subsidy rate for the program would be about 38 percent, largely due to the difference between the government's borrowing rate and the rate SBA would charge the borrowers. We estimate that the subsidy cost for the authorized loan amounts would be $8 million over the 2008-2012 period.

Disaster Loan Program. S. 1256 would reauthorize SBA's disaster loan program through 2010. This program provides direct loans to businesses and households in areas affected by a disaster for the costs of economic injury and repair. CBO expects that the demand for SBA disaster loans over the next several years would average about $1 billion per year. This assumption is based on the historical average of approved disaster loans over the 2000-2005 period, including an additional amount reflecting the probability that a catastrophe similar to Hurricane Katrina could strike in a given year.

Based on historical experience, SBA estimates that the subsidy rate for those loans would be about 16 percent. Using that rate and assuming the appropriation of the necessary funds, CBO estimates that reauthorizing the disaster loan program through 2010 would cost $174 million in 2008 and about $1.1 billion over the 2008-2012 period. This estimate includes $489 million over the five-year period for the cost of subsidizing those loans and $583 million over the same period for loan service and administration.

PRIME Reauthorization. S. 1256 would authorize the Program for Investment in Microentrepreneurs (PRIME) through 2010. This program disburses grants to certain development organizations to provide very small businesses (microenterprises) with technical assistance, training, and capacity building services. Assuming appropriation of the specified amounts, CBO estimates that this provision would cost $45 million over the 2008-2012 period.

Other Noncredit Activites. S. 1256 would authorize specific amounts or such sums as necessary for the salaries and expenses of SBA and several programs to support certain types of small businesses. Based on information from SBA, CBO estimates that implementing those provisions of S. 1256 would cost $209 million in 2008 and about $1.6 billion over the 2008-2012 period, assuming appropriation of the specified or necessary amounts.

Specifically, the bill would authorize grants to nonprofit lenders participating in the microloan program to provide technical assistance to borrowers who receive loans under the program. Assuming appropriation of the specified amounts, CBO estimates this provision would cost $4 million in 2008 and $207 million over the 2008-2012 period.

The bill also would authorize $5 million per year over the 2008-2010 period to establish the Office of Minority Small Business Development to increase the proportion of SBA loans, investments, training, and contracting opportunities directed toward minorities. Assuming appropriation of the specified amounts, CBO estimates this provision would cost $15 million over the 2008-2012 period.

Salaries and expenses for SBA employees, other than those involved in the administration of direct loans and loan guarantees, make up the balance of the cost. CBO estimates that the cost to support grant administration, advocacy, and entrepreneurial programs would be about $200 million in 2008 and $1.4 billion over the 2008-2012 period.

Direct Spending

SBA's Premier Certified Lenders Program gives a CDC participating in the 504 program the authority to review and approve loan requests and to foreclose, litigate, and liquidate loans made under the program. Under current law, CDCs can qualify as Premier Certified Lenders (PCLs) if, among other requirements, they agree to pay 10 percent of SBA's potential loss on a defaulted 504 loan. A PCL must hold 10 percent of this potential loss (that is, 1 percent of the total loan) in a reserve for the life of the loan.

S. 1256 would reinstate a program that allows PCLs to maintain a lower loss reserve equal to 1 percent of the total loan outstanding. PCLs would be allowed to withdraw any funds from their loss reserve in excess of this amount. This lower loss reserve option was previously authorized for two years; it expired in 2006. S. 1256 would reinstate the option permanently, which could affect the subsidy rate for previous cohorts of CDC loans. Decreasing the loss reserve requirement for PCLs would cause SBA to collect a smaller amount of recoveries if a small business defaults on a loan and a PCL is unable to pay its portion of SBA's total loss. Based on information from SBA, CBO estimates that this provision would not have a significant effect on the subsidy cost of outstanding loans.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 1256 contains no intergovernmental or private-sector mandates as defined in UMRA. The bill would authorize grant funds that could benefit tribal governments. Any costs they might incur would result from complying with conditions of federal assistance.

PREVIOUS CBO ESTIMATE

On April 19, 2007, CBO transmitted a cost estimate for H.R. 1332, the Small Business Lending Improvements Act of 2007, as ordered reported by the House Committee on Small Business on March 15, 2007. That bill contained many of the same technical changes to SBA's 7(a) and 504 programs but did not provide maximum loan levels for the various business loan programs. H.R. 1332 also would authorize SBA to use appropriated funds rather than charging certain fees on loans guaranteed under the 7(a) program to cover the program's cost. CBO provided an estimate of the cost—$2.3 billion over the 2008-2012 period—to fully replace such fees with appropriated funds.

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