



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

August 1, 2003

S. 1375 **Small Business Administration 50th Anniversary** **Reauthorization Act of 2003**

*As ordered reported by the Senate Committee on Small Business and Entrepreneurship
on July 10, 2003*

SUMMARY

S. 1375 would authorize appropriations for fiscal years 2004 through 2006 for the Small Business Administration (SBA) and would make a number of changes to SBA loan programs, programs that support entrepreneurship, and programs that involve preferences for small businesses in government contracting.

Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 1375 would cost about \$3 billion over the 2004-2008 period. About \$1.6 billion of this amount is the estimated subsidy and administrative cost of continuing SBA credit programs, and \$1.3 billion would be for other SBA programs and activities. The remaining \$0.1 billion is for provisions related to federal procurement activities. Enacting this bill would not have a significant effect on direct spending or revenues.

S. 1375 contains no intergovernmental or private-sector mandates as defined by the Unfunded Mandates Reform Act (UMRA). Any costs incurred by state, local, or tribal governments would be the result of complying with conditions of federal grants. The bill would authorize \$2 million per year for pilot programs run by the Office of Native American Affairs (ONAA) over the 2004-2007 period.

MAJOR PROVISIONS

Title I would set the maximum amounts of small business loans that could be guaranteed by SBA in 2004, 2005, and 2006. It also would authorize the appropriation of funds for the Service Corps of Retired Executives (SCORE), for technical assistance grants to recipients of microloans, and for certain activities of the Small Business Development Centers (SBDCs). Title I would authorize the appropriation of such sums as may be necessary for

the disaster loan program and for administrative expenses to carry out the Small Business Act and the Small Business Investment Act.

Title II would make a number of changes to SBA's loan guarantee programs. It would require SBA to:

- Collect fees from business-lending companies sufficient to offset the cost of financial examinations by SBA;
- Reduce the initial and annual fees paid by prospective borrowers under the 7(a) loan program;
- Develop and implement a new subsidy model for the microloan program by 2005; and
- Establish a new pilot program at SBA to guarantee pools of conventional small business loans.

Title III would reauthorize the Program for Investment in Microentrepreneurs through 2006, reauthorize and amend several Women's Small Business Ownership Programs, create grant programs for Native American business development, and reauthorize SBA's Outreach Grants for Veterans.

Title IV would authorize appropriations for the HUBZone program for 2004 through 2006.

Title V would extend the authorization of appropriations for the Federal and State Technology Partnership and Rural Outreach Programs through 2006.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1375 is shown in Table 1. The costs of this legislation fall primarily within budget function 370 (commerce and housing credit).

TABLE 1. SPENDING SUBJECT TO APPROPRIATION UNDER S. 1375

	By Fiscal Year, in Millions of Dollars					
	2003	2004	2005	2006	2007	2008
SBA Spending Under Current Law						
Estimated Authorization Level ^a	765	0	0	0	0	0
Estimated Outlays	917	225	67	11	4	0
Changes to SBA Loan Programs						
Estimated Authorization Level	0	536	549	561	0	0
Estimated Outlays	0	322	505	539	210	27
Changes to Noncredit Programs						
Estimated Authorization Level	0	441	457	484	5	5
Estimated Outlays	0	190	307	411	241	141
Subtotal, Changes to SBA Spending						
Estimated Authorization Level	0	977	1,005	1,045	5	5
Estimated Outlays	0	512	812	951	452	168
SBA Spending Under S. 1375						
Estimated Authorization Level ^a	765	977	1,005	1,045	5	5
Estimated Outlays	917	737	879	962	456	168
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Changes to Federal Procurement Spending						
Estimated Authorization Level	0	23	23	23	23	23
Estimated Outlays	0	14	23	23	23	23
Total Changes to Spending Under S. 1375						
Estimated Authorization Level	0	1,000	1,028	1,068	28	28
Estimated Outlays	0	526	835	974	475	191

a. The 2003 level is the amount appropriated for SBA operations for that year.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted near the beginning of fiscal year 2004 and that the necessary amounts will be appropriated by the start of each fiscal year. Outlay estimates are based on historical spending rates for existing or similar programs.

Spending Subject to Appropriation

Most of the bill's budgetary effects would come from reauthorizing existing SBA programs and would consist primarily of the subsidy costs of direct and guaranteed loans. Provisions affecting government procurement also would add to the cost of implementing the legislation.

Small Business Administration. The bill would reauthorize most of the programs administered by SBA through 2006. Based on information from SBA and historical spending patterns for the agency's programs, CBO estimates that implementing those provisions would cost \$2.9 billion (including about \$1.6 billion for loan programs) over the 2004-2008 period.

Loan Programs. The bill would authorize SBA to guarantee loans and make direct loans to businesses worth up to \$29 billion in 2004, \$30 billion in 2005, and \$31 billion in 2006. By comparison, the authorized loan level for 2003 is \$29 billion, and in 2002, the agency's direct and guaranteed loans were worth about \$15 billion. S. 1375 would authorize the agency to make an indefinite amount of disaster loans over the 2004-2006 period. Table 2 shows the loan levels that would be authorized by the bill for SBA's guaranteed and direct business loans and CBO's estimate of the amounts of disaster loans, as well as the estimated subsidy cost and administrative expenses for those loans.

The Federal Credit Reform Act of 1990 requires an appropriation of the subsidy costs and administrative costs associated with loan guarantees and direct loan program operations. (The subsidy cost is the estimated long-term cost to the government of a direct loan or loan guarantee, calculated on a net present value basis, excluding administrative costs.) The bill does not specify an explicit authorization for either the subsidy or administrative costs for the guaranteed, direct, or disaster loans, and CBO estimated these amounts based on historical information about the operation of those programs.

The estimated subsidy rates for the different types of business loans and loan guarantees offered by SBA ranges from zero to about 9 percent. Based on historical data for those loan programs and incorporating minor program changes required by this bill, CBO estimates that the subsidy costs for the authorized levels of guaranteed and direct business loans would be \$189 million in 2004, \$195 million in 2005, and \$200 million in 2006.

Based on the current administrative costs for SBA's loan programs, CBO estimates that the administrative costs for the business loan programs would be \$132 million in fiscal year 2004, \$136 million in fiscal year 2005, and \$140 million in fiscal year 2006.

TABLE 2. ESTIMATED SBA LOAN LEVELS, SUBSIDY COSTS, AND ADMINISTRATIVE COSTS UNDER S. 1375

	By Fiscal Year, in Millions of Dollars				
	2004	2005	2006	2007	2008
Authorized Loan Levels					
Guaranteed and Direct Business Loans	28,650	29,905	31,160	0	0
Disaster Loans ^a	815	815	815	0	0
Loan Subsidy Costs					
Guaranteed and Direct Business Loans					
Estimated Authorization Level	189	195	200	0	0
Estimated Outlays	99	181	188	87	4
Disaster Loans					
Estimated Authorization Level	114	114	114	0	0
Estimated Outlays	57	103	114	57	11
Loan Administration Costs					
Guaranteed and Direct Business Loans					
Estimated Authorization Level	132	136	140	0	0
Estimated Outlays	94	126	135	38	7
Disaster Loans					
Estimated Authorization Level	101	104	107	0	0
Estimated Outlays	72	96	103	29	5

a. These are estimated loan levels, based on the historical experience of SBA's Disaster Loan Program.

For this estimate, CBO assumes that demand for SBA's disaster loans would be near the average historical rate for the past four years, excluding loans authorized to be made by the Small Business Investment Company Amendments Act of 2001 immediately following the terrorist attacks of September 11, 2001. We estimate that SBA would make disaster loans worth \$815 million a year over the 2004-2006 period. Over the last four years, loan volume for the regular disaster loan program has ranged from about \$760 million to \$870 million. CBO estimates that the administrative costs for the disaster loan program would be \$101 million in 2004, \$104 million in 2005, and \$107 million in 2006. The estimated

subsidy rate for disaster loans is about 14 percent, based on the historical performance of those loans.

Noncredit Programs. The bill would authorize the appropriation of funds for noncredit programs that support small businesses and other SBA activities, most of which the agency does under current law. CBO estimates that continuing those activities would require the appropriation of \$1.3 billion over the 2004-2008 period. Of that amount, the bill would specifically authorize the appropriation of \$763 million for SBDCs, SCORE, technical assistance for recipients of SBA microloans, the women's business council, the drug-free workplace program, the HUBZone program, and various other SBA programs designed to benefit businesses owned by Native Americans and veterans over the 2004-2006 period.

Fees for 7(a) Loans. Section 202 would permanently reduce the initial loan fee and the annual fees that borrowers pay under the 7(a) program. In 2001, the fees associated with loan guarantees under the 7(a) program were temporarily reduced by the Small Business Investment Company Amendments Act of 2001. Based on information provided by the Administration, CBO assumes for this estimate that the reduced fees would only apply to loans made in 2004 and after, and would not affect loans made before those fees were reduced in 2001. The estimated subsidy rate set by the Administration for fiscal year 2003 for the 7(a) program is about 1 percent. That subsidy estimate considers the lower fees that are temporarily in place. Thus, CBO estimates that permanently reducing the fees would not change the current subsidy rate for the 7(a) program.

By permanently lowering the 7(a) program fees, this provision would increase the subsidy rate from what it would otherwise be if the temporary reduction in fees were allowed to expire. Because the number of 7(a) loan guarantees that the SBA can issue in any year is limited by the amount of the subsidy appropriation, the agency would be able to guarantee fewer loans when the subsidy rate increases.

Interest Rate on Microloans. Under current law, SBA microloans of \$7,500 or less are eligible to receive an interest rate reduction of 75 basis points below the interest rate for direct loans in the microloan program. Section 211 would increase the maximum loan amount eligible for the interest rate reduction to \$10,000. Because more loans could receive a lower interest rate under the bill, CBO expects that this provision would lead to a minor increase in the subsidy rate for the microloan program. Because of the small volume of such loans, however, we estimate that the increased cost of this provision would be less than \$500,000 a year.

Examination Fees. Section 221 would require small business lending companies to pay the costs of financial examinations performed by SBA. Based on the amount SBA currently spends to examine small business lending companies, CBO estimates this provision would

increase collections, which are an offset to discretionary spending for those examinations, by \$3 million a year over the 2004-2008 period.

Pilot Program for Guarantees on Pools of Non-SBA Loans. A common financial practice among commercial lenders and firms that issue securities is to pool together large collections of individual conventional and government-guaranteed loans. Such loan pools are used to create asset-backed securities (ABSs). The sale of such ABSs give lenders access to capital from the secondary loan marketplace to fund new loans. Section 265 would authorize a three-year pilot program that would enable the SBA to guarantee pools of conventional small business loans (that is, loans not guaranteed by SBA). Under the bill, the SBA would guarantee a portion of the timely payments of scheduled principal and interest due on the pooled loans that back those securities in exchange for a fee paid by the issuers of those ABSs. CBO estimates that SBA would charge the lenders or issuers of the ABSs a fee of about 20 basis points to cover the estimated subsidy cost associated with the program. Without such a fee, SBA would require appropriations of about \$2 million over the next three years to cover the estimated subsidy cost of the program.

This legislation does not specify a particular structure for the new SBA pilot program. CBO consulted firms involved with small business credit to understand how this program might work. There are many ways to structure such a program, and for this estimate, CBO assumes that the lender or issuer of the ABSs would assume a first-loss position and SBA would assume a second-loss position. That is, the lenders or issuers of the securities would realize losses before SBA would be called upon to make good on its guarantee. (In contrast, a typical SBA loan guarantee would cover 75 percent of any loss associated with the underlying loan.) SBA has not decided how the risk shares would be allocated for this program. To estimate the subsidy cost associated with this program, CBO assumes that the first-loss position would cover the first 5 percent of the loss and that SBA would cover the next 20 percent of the loss. If SBA were to cover a smaller portion of the loss, estimated subsidy costs would be lower than this estimate. Alternatively, if SBA were to cover a greater portion of the loss, estimated subsidy costs would be greater than we have estimated here.

Over the past 10 years, there have been about 40 commercial issues involving the securitization of conventional small business loans, totaling about \$4 billion. (The largest offering by a single issuer was about \$590 million in 1999.) In contrast, the SBA reports that in 2001 the outstanding balance on all small business loans totaled \$460 billion. Industry analysts that CBO consulted anticipate that the demand for a secondary market for conventional small business loans would be relatively small. Small business loans are often profitable for lenders, and as a result, many lenders prefer to hold such loans in a portfolio rather than sell them. Moreover, such loans are not always the best candidates for pooling into securities because as a group they are not homogenous, and small business lenders do

not currently adhere to a standard set of underwriting guidelines, creating some additional underlying risk for the firm issuing an ABS consisting of small business loans.

This legislation would limit the number of entities that could participate in the program to no more than five lenders or issuers. Given this limitation on the number of participants and information that suggests only modest demand for ABSs backed by conventional small business loans, CBO estimates that over the next three years, SBA would provide guarantees for ABSs worth about \$1 billion.

Under credit reform procedures, funds must be appropriated in advance to cover the subsidy cost of loan guarantees, measured on a present-value basis. Under this legislation, SBA would be required to charge a fee that would cover—in whole or in part—the cost of the credit subsidy for SBA’s guarantee on the pools of small business loans. CBO estimates that the subsidy rate for this pilot program as outlined above would be about 0.2 percent if no fees were charged to lenders or the issuers of securities. Furthermore, CBO estimates that if SBA charged an up-front fee of about 20 basis points, this estimated subsidy cost would be offset and no additional appropriations would be required. If, however, the participants in the pilot program would not be willing to pay such a fee, CBO estimates that the SBA would require appropriations of about \$2 million over the next three years to cover its cost of expected losses under a \$1 billion guarantee program. Additionally, if SBA implements the risk share differently, the program could be more costly and appropriations greater than \$2 million would be required.

Small Business Intermediary Lending Pilot Program. Section 293 would authorize the SBA to make direct loans of up to \$20 million over the 2004-2006 period for the new Small Business Intermediary Lending (SBIL) program. The new program would be similar to the existing direct loans made under the microloan program but would feature lower interest rates, a longer loan duration, and a longer grace period. CBO estimates that the subsidy rate for the SBIL would be about 30 percent, or around three times the subsidy rate for direct loans under the microloan program. We estimate that the subsidy cost for the authorized amount of SBIL loans would be about \$6 million over the 2004-2006 period.

Procurement Center Representatives. Section 401 would expand the use of the federal procurement center representative (PCR) program. Under the bill, the program would operate at each major federal procurement center and in each state. The PCR program helps small businesses obtain federal contracts. According to SBA, there are 255 major federal procurement centers. The PCR program currently operates at 47 of those centers. CBO estimates that expanding the program to operate at each major procurement center and in each state would cost \$23 million a year.

Direct Spending and Revenues

Premier Certified Lenders Program. Certified Development Company (CDC) loans, also known as section 503 and 504 loans, provide small businesses with long-term, fixed-rate financing for the purchase of land, buildings, and equipment. The Premier Certified Lenders Program allows a participating CDC 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 (i.e., 1 percent of the total loan) in a reserve for the life of the loan.

Sections 242 and 243 would have two effects on the requirements for loss reserves under the PCL Program. First, the provisions would change the loss-reserve requirement from 1 percent of the total value of the loan to 1 percent of the total loan outstanding. PCLs would be allowed to withdraw any funds from their loss reserves in excess of this amount. Second, certain PCLs would have the option to maintain an alternate loss-reserve level based on risk rather than a fixed percentage. The amount of the reserve would be determined by an independent, SBA-approved auditor. Under the two provisions, if a PCL chooses this option, it must pay 15 percent of SBA's total loss on defaulted CDC loans.

Under current law, the Administrator of SBA must adjust an annual fee on CDC loans to produce an estimated subsidy rate of zero at the time the loans are guaranteed. Enacting sections 242 and 243 could affect the subsidy rates 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. However, increasing the required loss coverage to 15 percent for PCLs that opt to maintain a loss-reserve level based on risk would increase SBA's recoveries on defaulted CDC loans. It is unclear if, taken together, those two effects would increase or decrease the average subsidy costs for previous CDC loans. However, CBO estimates that the net result of those two effects would not have a significant impact on direct spending.

Civil Penalties. Sections 222 and 223 of the bill would authorize SBA to impose civil penalties on small business lending companies and SBA lenders that are not federally regulated. Such penalties are recorded in the budget as revenues. CBO expects that any increase in civil penalties resulting from the enactment of S. 1375 would be insignificant.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 1375 contains no intergovernmental or private-sector mandates as defined by UMRA. The intergovernmental impacts, primarily benefits, would be on tribal governments. Title III, the Native American Small Business Development Act, would establish ONAA within the Small Business Administration and authorize \$2 million for pilot programs. The ONAA would create and administer Native American Business Centers and provide grants and other assistance to tribal governments and businesses owned and operated by Native Americans.

PREVIOUS ESTIMATE

On June 5, 2003, CBO transmitted a cost estimate for H.R. 923, the Premier Certified Lenders Program Improvement Act of 2003, as ordered reported by the House Committee on Small business on May 22, 2003. Provisions of that bill are similar to sections 242 and 243 of S. 1375, and the estimated costs for those provisions are the same.

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