CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 21, 2003

H.R. 2802
Small Business Reauthorization and Manufacturing Revitalization Act of 2003

As ordered reported by the House Committee on Small Business on July 24, 2003

SUMMARY

H.R. 2802 would authorize appropriations for fiscal year 2004 and subsequent years for operations of the Small Business Administration (SBA) and would make a number of amendments to SBA loan programs that support entrepreneurship.

Assuming appropriation of the necessary amounts, CBO estimates that implementing H.R. 2802 would cost about $4.8 billion over the 2004-2008 period. About $2.9 billion of this amount is the estimated subsidy and administrative cost of continuing SBA credit programs, and $1.9 billion would be for noncredit SBA programs and activities. In addition, CBO estimates that enacting this bill would increase direct spending by $310 million in 2004 for the cost of modifying existing loans and loan guarantees. Enacting the bill would have no significant effect on revenues.

H.R. 2802 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 federal grant conditions. The bill would authorize $7 million per year for 2004 through 2006 for temporary assistance to Indian tribe members, Native Alaskans, and Native Hawaiians.

MAJOR PROVISIONS

Title I would reduce the amounts authorized to be appropriated for the New Markets Venture Capital program over the 2004-2006 period, amend the loss-reserve requirement under the Premier Certified Lenders Program, and make other changes to the Small Business Investment Act. This title also would amend the terms of existing and future loan guarantees issued under the Small Business Investment Company program.

Title II would set the maximum amounts of small business loans that could be guaranteed by SBA in 2004 and 2005 and would authorize the appropriation of funds for the Service Corps of Retired Executives (SCORE) and the Active Corps of Manufacturing Executives (ACME), the Paul D. Coverdell drug-free workplace program, the women's business center program, the HUBZone program, and grants under the microloan program. Title II also 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. In addition, title II would authorize such sums as may be necessary to carry out the Small Business Act and the Small Business Investment Act for all fiscal years beyond 2005. Finally, it would require SBA to reduce the initial fees paid by prospective borrowers under the 7(a) loan program starting in 2005.

Title III would call for a plan to reorganize SBA and would authorize appropriations for small business development centers for temporary assistance to Indian tribe members, Native Alaskans, and Native Hawaiians. It also would authorize funding for vocational and technical entrepreneurship development and grants for the National Small Business Incubator Program. Finally, title III would amend the terms of existing direct loans made to certain small businesses after September 11, 2001.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2802 is shown in Table 1. The costs of this legislation fall primarily within budget function 370 (commerce and housing credit).

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted in the fall of 2003 and that the necessary amounts will be appropriated near the start of each fiscal year. Outlay estimates are based on historical spending rates for existing or similar programs. CBO estimates that implementing H.R. 2802 would cost $4.8 billion over the 2004-2008 period. We also estimate that enacting the bill would increase direct spending by $310 million in 2004.

Spending Subject to Appropriation

The bill would reauthorize most of the programs administered by SBA for 2004 and subsequent years. Based on information from SBA and historical spending patterns for the agency's programs, CBO estimates that implementing those provisions would cost $4.8 billion (including about $2.9 billion for loan programs) over the 2004-2008 period.

TABLE 1. BUDGETARY IMPACT OF H.R. 2802

	By Fiscal Year, in Millions of Dollars					
	2003	2004	2005	2006	2007	2008
SPENDING SUBJECT TO APPROPRIATION						
SBA Spending Under Current Law						
Budget Authority[a]	765	0	0	0	0	0
Estimated Outlays	917	225	67	11	4	0
Changes to SBA Loan Programs						
Estimated Authorization Level	0	739	669	685	707	765
Estimated Outlays	0	363	578	608	661	708
Changes to Noncredit Programs						
Estimated Authorization Level	0	494	515	527	541	555
Estimated Outlays	0	172	310	439	484	519
Total Changes						
Estimated Authorization Level	0	1,233	1,184	1,212	1,248	1,320
Estimated Outlays	0	535	889	1,046	1,145	1,227
SBA Spending Under H.R. 2802						
Estimated Authorization Level[a]	765	1,233	1,184	1,212	1,248	1,320
Estimated Outlays	917	760	956	1,057	1,149	1,227
CHANGES IN DIRECT SPENDING						
Estimated Budget Authority	0	310	0	0	0	0
Estimated Outlays	0	310	0	0	0	0

a. The 2003 level is the amount appropriated for SBA operations for that year. A full-year appropriation for 2004 has not yet been provided.

Authorizations to Continue Loan Programs. The bill would authorize SBA to guarantee loans and make direct loans to businesses worth up to $28 billion in 2004, $30 billion in 2005, $31 billion in 2006, $31 billion in 2007, and $32 billion in 2008. 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. H.R. 2802 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.

TABLE 2. ESTIMATED SBA LOAN LEVELS, SUBSIDY COSTS, AND ADMINISTRATIVE COSTS UNDER H.R. 2802

	By Fiscal Year, in Millions of Dollars				
	2004	2005	2006	2007	2008
Authorized Loan Levels					
Guaranteed and Direct Business Loans	27,938	29,843	30,589	31,353	32,137
Disaster Loans[a]	815	815	815	815	815
Loan Subsidy Costs					
Guaranteed and Direct Business Loans					
Estimated Authorization Level	392	315	323	331	339
Estimated Outlays	140	254	255	295	323
Disaster Loans					
Estimated Authorization Level	114	114	114	114	114
Estimated Outlays	57	103	114	114	114
Loan Administration Costs					
Guaranteed and Direct Business Loans					
Estimated Authorization Level	132	136	141	145	150
Estimated Outlays	94	126	135	141	145
Disaster Loans					
Estimated Authorization Level	101	104	107	117	132
Estimated Outlays	72	96	103	112	125

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

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 program changes required by this bill, CBO estimates that the subsidy costs for the authorized levels of guaranteed and direct business loans would be $100 million in 2004 and $514 million over the 2004-2008 period.

Based on the current administrative costs for SBA's loan programs, CBO estimates that the administrative costs for the business loan programs would be $94 million in fiscal year 2004 and $641 million over the 2004-2008 period.

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 aby the Small Business Investment Company Amendments Act of 2001 immediately following the terrorist attacks of September 11, 2001. Over the last four years, loan volume for the regular disaster loan program has ranged from about $760 million to $870 million. We estimate that SBA would make disaster loans worth $815 million a year over the 2004-2008 period. The estimated subsidy rate for disaster loans is about 14 percent, based on the historical performance of those loans. At that rate, the subsidy cost for the anticipated volume of disaster loans would $114 million a year. CBO estimates that the administrative costs for the disaster loan program would be $72 million in 2004 and $508 million over the 2004-2008 period.

Cost of 7(a) Loans. Two provisions in H.R. 2802 would affect the subsidy rate for loan guarantees under SBA's 7(a) program. First, the bill would change the fee rate for 7(a) loans starting in 2005. Second, it would increase the percentage of these loans that SBA guarantees for small businesses located in rural areas. In total, the bill would authorize loan guarantees for SBA's 7(a) program of $16 billion in 2004 and $84.5 billion over the 2004-2008 period. These amounts are included in the total authorizations for guaranteed and direct business loans discussed in the previous section. CBO estimates that implementing H.R. 2802 would result in subsidy costs for the 7(a) program of $166 million in 2004 and $451 million over the 2004-2008 period.

Changes in Fees for 7(a) Loans. In 2003, the subsidy rate for SBA's 7(a) program was about 1 percent. Based on information provided by SBA, CBO estimates that the subsidy rate for 2004 also would be 1 percent and that, beginning in 2005, the subsidy rate would be 0.4 percent. The estimated change for the 2005 subsidy rate reflects changes in the fee rates for the 7(a) program included in section 207 of the bill. Under current law, both the initial upfront and annual fees that borrowers pay to obtain these loans are set to increase beginning in 2005. H.R. 2802 would maintain the upfront fee rate at the 2004 level. Based on information provided by the Administration, CBO assumes that the changes in fee rates would only apply to loans made in 2005 and subsequent years.

7(a) Loans to Rural Small Businesses. Under the current 7(a) program, SBA guarantees 85 percent of loans under $150,000 and 75 percent of loans over $150,000. Section 207 would increase the guarantee to 90 percent for certain small businesses located in rural areas. Based on information provided by SBA's Office of Advocacy, CBO estimates that 20 percent of 7(a) loans are made to small businesses in rural areas. Under H.R. 2802, that amount would be $2.3 billion in 2004 and about $17 billion over the 2004-2008 period—out of the total authorized loan level ($84.5 billion) for the 7(a) program. Based on information provided by SBA, CBO estimates that the subsidy rate for loans made to small businesses located in rural areas would be about 1.2 percent in 2004 and about 0.5 percent starting in 2005. The change in the subsidy rate between 2004 and 2005 is attributable to the proposed change in 7(a) fees that would begin in 2005 under the bill.

Cost of Small Business Investment Company (SBIC) Loan Guarantees. SBA guarantees 10-year loans made to venture capital firms, or Small Business Investment Companies. Under current law, if an SBIC exhibits certain financial conditions, SBA can intervene into the operations of the SBIC. One condition that merits intervention is "capital impairment," which SBA defines using a numerical measure of financial viability. If an SBIC becomes capitally impaired, SBA can prevent the SBIC from making further investments and stop the SBIC from making further draw downs of leverage. According to SBA, these actions provide the agency a means to limit its exposure to risk.

Under section 107 of the bill, SBA would no longer have the ability to intervene in the operations of an SBIC because of capital impairment. SBA currently estimates that the SBIC program operates at no net cost. CBO expects that the bill's prohibition of intervention for capital impairment would lead to fewer recoveries on defaulted loans relative to current law. Furthermore, we expect that SBA would receive most loan recoveries at the end of the loan term because they would not be permitted to intervene with SBICs earlier as they do under current law.

Based on information provided by SBA, CBO estimates that the subsidy rate associated with the SBIC program would increase to about 4 percent for loans made after enactment of the bill. Of the total amount authorized for loans under H.R. 2802, $5 billion in 2004 and about $28 billion over the 2004-2008 period would be for the participating securities portion of SBA's SBIC program. CBO estimates that the subsidy cost for these loans would be $40 million in 2004 and $750 million over the 2004-2008 period. (We also estimate that this provision would affect existing loan guarantees. The cost of that loan modification is discussed below under the "Direct Spending and Revenues" section.)

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 207 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.

National Small Business Incubator Program (NSBIP) Loans. Section 315 would authorize guaranteed loans to small businesses that receive grants under NSBIP. These loans would be guaranteed following the structure of SBA's 7(a) program but would have lower initial fees and annual fees. Also, interest rates on NSBIP loans would be capped at 4 percent while interest rates on 7(a) loans are capped at the prime rate plus a certain fixed percentage, depending on the size and length of maturity of the loan.

CBO estimates that the total program level for NSBIP guaranteed loans would be no larger than $10 million over the 2004-2008 period. The estimated subsidy rate for fiscal year 2003 for the 7(a) program is about 1 percent. CBO expects that the lower fees and lower interest rate cap for loans guaranteed under the NSBIP would result in a larger subsidy rate compared to the 7(a) subsidy rate. However, because loans under this new program would be limited to $10 million in total over the 2004-2008 period, CBO expects that subsidy costs associated with the new loans would be less than $500,000 a year over that period.

Compensation for the Fiscal Transfer Agent in the 7(a) Secondary Market. Under current law, SBA contracts with a Fiscal Transfer Agent (FTA) to operate a secondary market for guaranteed portions of 7(a) loans. As part of its services, the FTA collects fees on behalf of SBA from borrowers and lenders participating in the 7(a) program and also collects principle and interest from borrowers and holds it in the Master Reserve Fund until payments are due to investors.

Two provisions of section 207 would give SBA specific authority to compensate the FTA by allowing it to retain the float (short-term) interest on those fees and on transfers in and out of the Master Reserve Fund. While current law does not give SBA specific authority to do so, SBA's existing contract with the FTA allows for compensation to the FTA in this manner. According to a January 2003 report issued by SBA's Office of the Inspector General, the FTA earned revenues of about $250,000 each year of float interest on fees due to SBA and about $4 million each year of float interest on fund transfers with the Master Reserve Fund during 2000 and 2001.

Although SBA could opt to change the terms of the contract with the FTA in the future, the SBA's mechanism for compensating the FTA under H.R. 2802 would be identical to its current operation. Because section 207 would codify how SBA currently compensates the FTA, CBO estimates this provision would have no effect on federal spending.

SBA's Noncredit Programs. The bill also would authorize the appropriation of funds for noncredit programs that support small businesses and other SBA activities. Most of those activities are conducted under current law. CBO estimates that continuing those activities would cost $1.9 billion over the 2004-2008 period.

CBO estimates that $944 million of that cost would be for SBDCs, SCORE, ACME, NCBIP, technical assistance for recipients of SBA microloans, the women's business center program, the drug-free workplace program, the HUBZone program, the Business Learning Information Networking Collaboration (BusinessLINC) program, government contract and business development assistance, and temporary assistance to Indian tribe members, Native Alaskans, and Native Hawaiians, along with vocational and technical entrepreneurship development for 2004-2008.

The bill also would authorize the appropriation of such sums as may be necessary for other activities that SBA conducts for 2004 and beyond. To estimate those amounts, CBO adjusted spending provided in 2003 for anticipated inflation over the next five years. We estimate the total cost of continuing those programs would be $1 billion over the 2004-2008 period.

Direct Spending Revenues

CBO estimates that enacting H.R. 2802 would increase direct spending by $310 million in 2004 for modifications to certain loans made after September 11, 2001, and for outstanding loans to SBICs. The bill also would affect direct spending by modifying Certified Development Company (CDC) loans, but CBO estimates that these costs would not be significant. Finally, the bill would affect revenues by authorizing SBA to collect civil penalties for certain activities, but those effects would also be insignificant.

Modification of SBIC Loan Guarantees. By restricting the ability of SBA to control the operations of SBICs with capital impairment, the bill would postpone anticipated defaults until the end of the 10-year loan term and would reduce expected recoveries on such defaults. Under section 107, SBA would no longer have the ability to intervene in the operations of an SBIC because of capital impairment of the SBIC. Within the SBIC program, there are currently $3.8 billion in participating securities and $1.6 billion in debentures outstanding. SBA estimates that the SBIC program currently operates at no cost because program costs are currently offset by fees collected by SBA. Based on information from SBA, CBO expects that the value of recoveries on defaulted loans would decrease by about one-half.

Because section 107 would affect previous loan cohorts, enacting H.R. 2802 would necessitate a loan modification under the Federal Credit Reform Act. The cost of a loan modification is the change in the subsidy cost of the loan (on a present-value basis) because of the modified loan terms. Based on information provided by SBA, CBO estimates that the modification of SBIC loan guarantees would increase direct spending by about $300 million in 2004, when we assume the legislation will be enacted. That estimate is only for the cost of modifying the loan terms for the participating securities un the SBIC program. CBO has insufficient information at this time to estimate the added cost of modifying the terms of debentures under this program.

Loan Modification for Disaster Loans. Following the terrorist attacks of September 11, 2001, Public Law 107-117 authorized SBA to make disaster loans to small businesses located in designated disaster areas near northern Virginia and New York City. Payments of principal and interest on these loans were deferred for two years, and during that time, interest did not accrue on the loans. According to SBA, the total value of these loans is about $580 million.

Section 317 of the bill would authorize SBA to defer payments of principal and interest on certain qualified loan recipients for an additional two to five years. Interest would accrue during this time period, and the life of the loan would be extended. Qualified applicants would have to show that making principal and interest payments would cause economic injury to the small business. Based on information provided by SBA, CBO estimates that about one-third of loan volume would be modified under section 317.

Under the Federal Credit Reform Act, the cost of a loan modification is the change in the subsidy cost of the loan (on a present-value basis) because of the modified loan terms. Based on information provided by SBA, CBO assumes that the average interest rate on these loans is about 3.6 percent. Because CBO projects interest rates for Treasury borrowing (on debt of comparable maturity) higher than 3.6 percent, the provision would have a cost on a present-value basis. CBO estimates that this provision would cost $10 million, which would be recorded in 2004, when we assume the legislation will be enacted.

Premier Certified Lenders Program. 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.

Section 126 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 section 126 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 those two effects would not have a significant net impact on direct spending.

Civil Penalties. Section 214 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 H.R. 2802 would be insignificant.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 2802 contains no intergovernmental or private-sector mandates as defined by UMRA. Implementing the bill would benefit tribal governments. Title III would authorize $7 million per year for 2004 through 2006 for temporary assistance to Indian tribe members, Native Alaskans, and Native Hawaiians.

PREVIOUS CBO ESTIMATES

On August 1, 2003, CBO transmitted a cost estimate for S. 1375, the Small Business Administration 50th Anniversary Reauthorization Act of 2003, as ordered reported by the Senate Committee on Small Business on July 10, 2003. H.R. 2802 and S. 1375 have different authorization levels and different authorization periods. Our cost estimates reflect those differences.

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 and Entrepreneurship on May 22, 2003. Provisions of that bill are similar to section 126 of H.R. 2802, and the estimated costs for those provisions are the same.

ESTIMATE PREPARED BY:

Federal Costs: Melissa E. Zimmerman, Julie Middleton, and Matthew Pickford
Impact on State, Local, and Tribal Governments: Sarah Puro
Impact on the Private Sector: Cecil McPherson

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis