Cost Report

Report to Congress submitted pursuant to Section 4106(2) of the Small Business Jobs Act

April 2013

Cost Report

Report to Congress submitted pursuant to Section 4106(2) of the Small Business Jobs Act of 2010

Introduction

Small businesses are a vital part of the American economy, and their success is a critical component of the economic recovery. Established by the Small Business Jobs Act of 2010 (the Act), the Small Business Lending Fund (SBLF) is a dedicated fund designed to provide capital to qualified community banks[1] and community development loan funds (CDLFs) in order to encourage small business lending. The purpose of the SBLF is to encourage Main Street banks and small businesses to work together, help create jobs, and promote economic growth in communities across the nation.

This report is submitted pursuant to Section 4106(2) of the Act, which directs the Secretary of the Treasury to provide a semiannual written report to Congress on all projected costs and liabilities, all operating expenses, including compensation for financial agents and contractors, and all transactions made with respect to the SBLF program. This report reflects the estimated cost of the program's investments and the actual operating expenses for the fiscal year ending September 30, 2012.

Investments made through the SBLF program are presently expected to generate a positive return of $50 million in contrast to an originally projected cost of $1.3 billion, excluding administrative costs. In addition, Treasury incurred $15.5 million in actual fiscal year 2012 operating expenses for the SBLF program, $10.1 million less than the operating expense budget of $25.6 million as presented in the President's Budget for fiscal year 2013.

Estimated Cost of SBLF Investments

Treasury invested over $4.0 billion in 332 institutions through the SBLF program. These amounts include investments of $3.9 billion in 281 community banks and $104 million in 51 CDLFs. Collectively, these institutions operate in over 3,000 locations across 48 states. As of September 30, 2012, 328 institutions continue to participate in the program, including 277 community banks and 51 CDLFs. In total, four bank participants have fully repaid their SBLF investments. The initial disbursement of SBLF funding occurred on June 21, 2011, with subsequent transactions completed thereafter until the program's September 27, 2011 statutory funding deadline.

As of September 30, 2012, institutions participating in SBLF had made important progress in increasing their small business lending, helping to support small businesses and local economies across the nation. In total, SBLF participants increased their small business lending by $7.4 billion over a $36.5 billion baseline[2], and by $740 million over the prior quarter.

---

[1] In this report, the terms "banks" and "community banks" encompass banks, thrifts, and bank and thrift holding companies with consolidated assets of less than $10 billion as of December 31, 2010.

[2] As established in the Act, the baseline for measuring the change in small business lending is the average of the amounts that were reported for each of the four calendar quarters ended June 30, 2010.

Treasury currently estimates that the investments made through SBLF will generate a lifetime positive return of $50 million for the Treasury General Fund. The figures in the following table reflect Treasury's calculation of the estimated cost of SBLF investments in the President's Budget for fiscal year 2014.

Estimated Cost of SBLF Investments
(Dollars in millions)

	Subsidy Rate	Projected/Actual Investment Amount	Projected Lifetime Cost (Savings)
Original estimate	7.24%	17,399	1,260
President's Budget for fiscal year 2013	-2.08%	4,028	-84
President's Budget for fiscal year 2014	-1.26%	4,028	-50

Treasury estimated the program's budget cost in conformance with the Federal Credit Reform Act (FCRA) methodology using actual program data for fiscal years 2011 and 2012. This data, combined with the expected future cash flows, results in a subsidy rate of -1.26 percent compared to an original subsidy rate of 7.24 percent.

Per FCRA requirements, the lifetime cost and subsidy rate of the SBLF program is estimated on a present value basis. Assumptions used to estimate future cash flows include, but are not limited to: (1) the cumulative default rate for program participants, (2) the cash flows received by Treasury from the participants' dividend, interest, and other payments, and (3) Treasury's cost of raising funds to make SBLF investments.

The current estimate of the program's projected lifetime savings incorporates a forecasted cumulative default rate (i.e., lost principal investments) of 3.78 percent compared to a 4.29 percent rate in the prior year's estimate.[3] This lower rate reflects an overall improvement in the financial condition of program participants and, independent of other factors, would result in greater projected lifetime savings for the program. The current year estimate also incorporates, however, a reduction in expected lifetime dividend and interest payments to Treasury as a result of higher-than-projected increases in small business lending by program participants, in accordance with the lending incentives provided for by the Act. Changes in economic projections also contributed to the decrease in program cost. Inclusive of these changes, the projected program lifetime savings is $50 million.

Operating Expenses

Treasury is committed to implementing the SBLF in a cost-effective manner to protect taxpayer interests while achieving the program's objectives of encouraging small business lending. The operating expenses for fiscal year 2012, reported herein, primarily reflect the costs of monitoring the performance and compliance of participating institutions, reporting on program performance and expenses, maintaining program accounts, and managing the portfolio and the disposition of securities purchased.

[3] The forecasted cumulative default rate represents the projected investment amounts not repaid by program participants as a percentage of all SBLF investments. The rate is estimated based on the financial condition of program participants relative to the historical performance of institutions rated by the major ratings agencies.

The figures shown in the following table reflect operating expenses incurred as of September 30, 2012. Descriptions of operating expenses follow the table.

SBLF Operating Expenses for Fiscal Year 2012

	[1] Expenditures fiscal year 2012 budgeted	[2] Actual expenditures as of 9/30/12	[3] Commitments, obligations, and expenditures as of 9/30/12
Salaries and benefits	4,119,000	3,887,486	3,887,486
Travel	30,000	18,477	19,635
Contracts and other			
Legal support	n/a	0	0
Custodian and infrastructure provider	n/a	6,625,250	6,625,250
Asset managers	n/a	767,475	1,125,250
Internal controls	n/a	1,628,598	4,771,044
Office of the Treasury Inspector General	n/a	1,300,159	4,343,642
Other (equipment, supplies, rent)	n/a	1,226,864	1,813,971
Subtotal (contracts and other)	21,441,000	11,548,346	18,679,157
Total	25,590,000	15,454,309	22,586,278

[1] Represents the total budgeted expenditures for the SBLF program in fiscal year 2012 per the 2013 President's Budget. Note: The 2013 President's Budget did not break out expenditures by some of these line items.

[2] Includes actual expenditures from 10/1/11 to 9/30/12.

[3] Includes all financial commitments, obligations, and expenditures as of 9/30/12. For Internal Controls, this includes commitments and obligations made in fiscal year 2012 for fiscal year 2013.

On September 27, 2011, the SBLF program's core investment activities were completed. SBLF is now staffed primarily to monitor, manage, and report on these investments and related participant lending and program activities. Treasury's actual fiscal year 2012 operating expenditures of $15.5 million represent a 72% reduction in annual expenditures from the program's fiscal year 2011 budget of $54.6 million and a 53% reduction from the program's fiscal year 2011 actual expenditures of $33.3 million.

Travel expenses in fiscal year 2012 relate primarily to asset management, internal controls, and monitoring the compliance of the SBLF participants with the program terms.

Descriptions of costs related to legal support, financial agents, internal controls, and the Treasury's Office of the Inspector General (OIG) are included here:

- **Legal Support:** These expenses are for legal services incurred in connection with repurchases of SBLF securities and other transactions related to the management of the investments. These costs are volume-dependent.

- **Custodian and Infrastructure Provider:** These expenses relate to bank custodial services with respect to SBLF securities and documents, outreach to participating institutions, and payments processing for SBLF participants. Following the conclusion of the program's initial investment period, this cost is no longer volume-dependent.

- **Asset Managers:** These expenses relate to financial analysis and monitoring of SBLF participants and applicable market research regarding the community banking sector. These costs are largely volume- and activity-dependent.

- **Internal Controls:** These expenses relate principally to the design of processes and internal controls associated with setting up the asset management structure for the SBLF. This activity includes work performed by consultants regarding the development of procedures, information databases, and other documentation for monitoring and managing SBLF investments. This cost is not volume-dependent.

- **Office of the Treasury Inspector General:** These expenses reflect reimbursements to the Treasury's OIG for audits of the SBLF program. Per the Act, OIG is required to issue reports on the SBLF no less than two times each year. From October 1, 2011 through September 30, 2012, a total of $1,300,159 was spent on audit related activities. This cost is not volume-dependent.