sblf | small business lending fund

# Cost Report

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

THE DEPARTMENT OF THE TREASURY 1789

**March 2019**

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## 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 that was designed to provide capital to qualified community banks[1] and community development loan funds to encourage small business lending. The purpose of the SBLF was to encourage Main Street banks and small businesses to work together, help create jobs, and promote economic growth in communities across the nation. 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.

This report is submitted as a requirement of 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 all transactions made for the SBLF program. This report reflects the estimated lifetime returns on the program's investments and the outlays and obligations for the period ending September 30, 2018.

Investments made through the SBLF program are currently expected to generate a positive return of $31 million, excluding administrative costs. In addition, by September 30, 2018, Treasury incurred $3.36 million in outlays for the SBLF program.

## Estimated Cost of SBLF Investments

Treasury invested more than $4 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 community development loan funds. Collectively, these institutions operate in more than 3,000 locations across 48 states. Initial disbursement of SBLF funding occurred on June 21, 2011, with subsequent transactions occurring until the program's September 27, 2011 statutory funding deadline.

As of September 30, 2018, 277 institutions with aggregate investments of $3.8 billion have fully redeemed Treasury's investment and exited the program (compared with 274 institutions representing aggregate investments of $3.73 in the previous reporting period) and 5 institutions have partially redeemed $14.4 million (or 60 percent) of Treasury's investment while continuing to participate in the program.[2]

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

[2] Only redemptions through fiscal year 2017 are included in the calculation of the lifetime subsidy.

As of September 30, 2018, the total increase in small business lending reported by current and former SBLF participants is $19.1 billion over the baseline[3].

Treasury currently estimates that investments made through the SBLF program will generate a lifetime positive return of $31 million for the Treasury General Fund. The figures in the following table reflect Treasury's calculation of the estimated cost of SBLF investments, as presented in the President's Budget for fiscal year (FY) 2019.

**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 |
| President's Budget for fiscal year 2015 | -0.63% | 4,028 | -25 |
| President's Budget for fiscal year 2016 | -0.26% | 4,028 | -10 |
| President's Budget for fiscal year 2017 | -1.27% | 4,028 | -51 |
| President's Budget for fiscal year 2018 | -1.82% | 4,028 | -73 |
| President's Budget for fiscal year 2019 | -0.76% | 4,028 | -31 |

Treasury estimated the budgetary cost of investments made through the program in conformance with the Federal Credit Reform Act methodology using actual program data for FYs 2011 - 2017. This data, combined with the expected future cash flows, results in a subsidy rate of -0.76 percent compared to an original subsidy rate of 7.24 percent.

As required by the Credit Reform Act, Treasury estimated the lifetime cost and subsidy rate of the SBLF program on a present value basis. Assumptions used to estimate future cash flows included: (1) the forecasted cumulative default rate for program participants; (2) the actual and projected cash flows received by Treasury from the participants' dividend, interest, and other payments; and (3) Treasury's cost of raising funds to make the SBLF investments.

The current estimate of the program's projected lifetime savings incorporates a forecasted cumulative default rate (i.e., lost principal, interest, and dividends) of 1.57 percent compared to 0.42 percent in the previous year's estimate.  This higher rate is due to two SBLF institutions, with outstanding investment amounts totaling approximately $44 million, failing during FY 2017.  Currently these institutions are valued at $0, with chances of any recoveries considered to be unlikely or minimal.  As the SBLF model uses historical data to predict future incidence of default, these two failures resulted in a higher forecasted cumulative default rate. The realized cost associated with the two defaults and the increase

[3] 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. The aggregate baseline lending decreases as participants redeem and those participants' baseline lending is removed from the aggregate baseline. The default rate is estimated based on the financial condition of program participants relative to the historical performance of institutions rated by the major ratings agencies.

in the forecasted cumulative default rate for the remaining active institutions resulted in the program's projected lifetime positive return decreasing to $31 million.

## Outlays and Obligations for 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 outlays for fiscal year 2018 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. In total, as of September 30, 2018, outlays for fiscal year 2018 totaled $3.36 million.

The figures shown in the following table reflect outlays and obligations for operating expenses incurred as of September 30, 2018. Descriptions of the expense categories follow the Outlays and Obligations table.

**SBLF Outlays and Obligations through September 30, 2018**

| | Budget for Fiscal Year 2018[a] | Outlays as of September 30, 2018[b] | Obligations as of September 30, 2018[c] | Total Obligations and Outlays as of September 30, 2018[c] |
|---|---|---|---|---|
| **Salaries and benefits** | 1,392,000 | 1,040,332 | 0 | 1,040,332 |
| **Travel** | 20,000 | 2,070 | | 2,070 |
| **Contracts and Other** | | | | |
| **Legal support** | n/a | 0 | 0 | 0 |
| **Custodian and infrastructure provider** | n/a | 187,500 | 0 | 187,500 |
| **Asset management** | n/a | 538,742 | 96,758 | 635,500 |
| **Internal controls** | n/a | 27,741 | 264,633 | 292,375 |
| **Office of the Treasury Inspector General** | n/a | 201,889 | 173,111 | 375,000 |
| **Other (equipment, supplies, rent)** | 6,238,000 | 1,364,734 | 481,521 | 1,846,255 |
| **Subtotal (contracts and other)** | 6,238,000 | 2,320,605 | 1,016,024 | 3,336,630 |
| **$ Total** | 7,650,000 | 3,363,007 | 1,016,024 | 4,379,032 |

[a] Represents the total budget for the Small Business Lending Fund program for fiscal year (FY) 2018, according to the 2018 President's Budget estimate.

[b] Includes outlays from Oct. 1, 2017, to September 30, 2018 against FY2018 obligations.

[c] Includes all FY 2018 obligations from Oct. 1, 2017, to September 30, 2018. This column does not reflect de-obligations.

Contract and other expenses are reported in the period obligated. Descriptions of costs related to legal support, financial agents, internal controls, and the Treasury's Office of the Inspector General (OIG) follow:

- **Legal Support:** These expenses are for legal services for legal support related to the management of the investments.
- **Custodian and Infrastructure Provider:** These expenses relate to bank custodial services for SBLF securities and documents and payments processing for SBLF participants.
- **Asset Management:** These expenses are for financial analysis and monitoring of SBLF participants and applicable market research regarding the community banking sector.
- **Internal Controls:** These expenses relate principally to the design and implementation of processes and internal controls associated with the program's asset management, operating, reporting, and compliance functions. This activity includes work performed by consultants to develop procedures, systems, information databases, and other documentation for monitoring and managing program activities.
- **Office of the Treasury Inspector General:** These expenses reflect reimbursements to the Treasury's OIG for audits of the SBLF program. The OIG is required to issue reports on the SBLF no less than two times each year. The FY 2018 revised budgeted amount for audit related activities is $375,000.