



Cost Report

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



June 2012

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**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 banks¹ 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 program as of March 31, 2012.

Investments made through the SBLF program are presently expected to generate a positive return of \$84 million in contrast to an originally projected cost of \$1.3 billion, excluding administrative costs. In addition, Treasury is currently projected to incur \$23.6 million in fiscal year 2012 operating expenses for the SBLF program, \$2 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. The initial SBLF funding occurred on June 21, 2011, with subsequent transactions completed thereafter until the program's September 27, 2011 statutory funding deadline.

As of December 31, 2011, 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 \$4.8 billion over a \$36.0 billion baseline², and by \$1.3 billion 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 \$84 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 2013.

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)

Treasury estimated the program’s budget cost in conformance with the Federal Credit Reform Act (FCRA) methodology using actual program data for fiscal year 2011. The fiscal year 2011 data, combined with the expected future cash flows, results in a subsidy rate of -2.08 percent compared to an original subsidy rate of 7.24 percent. The current estimate of projected lifetime savings incorporates a forecasted cumulative default rate (i.e., lost principal investments) of 4.29 percent.³

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.

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 2011, reported in the previous Cost Report published in February 2012, primarily reflected the costs of establishing the SBLF program office, conducting outreach to potential applicants, reviewing applications, and funding investment transactions. The projected 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.

The figures shown in the following table reflect operating expenses incurred as of March 31, 2012. Descriptions of operating expenses follow the table on the next page.

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.



SBLF Operating Expenses for Fiscal Year 2012

	[1]	[2]	[3]	[4]
	Expenditures fiscal year 2012 budgeted	Actual expenditures as of 3/31/12	Commitments, obligations, and expenditures as of 3/31/12	Expenditures fiscal year 2012 projected
Salaries and benefits	4,119,000	2,213,338	2,213,338	4,119,000
Travel	30,000	8,535	9,802	30,000
Contracts and other				
Legal support	n/a	0	98,000	147,000
Custodian and infrastructure provider	n/a	2,366,250	6,225,000	8,056,572
Asset managers	n/a	767,475	1,125,250	3,001,429
Internal controls	n/a	586,031	2,364,529	2,364,529
Office of the Treasury Inspector General	n/a	449,036	4,343,642	4,343,642
Other (equipment, supplies, rent)	n/a	110,579	1,525,950	1,540,950
Subtotal (contracts and other)	21,441,000	4,279,370	15,584,371	19,454,122
Total	25,590,000	6,501,243	17,807,511	23,603,122

[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 the start of fiscal year 2012 (10/1/11) through 3/31/12.

[3] Includes all financial commitments, obligations, and expenditures from the start of fiscal year 2012 (10/1/11) through 3/31/12.

[4] Includes all financial commitments, obligations, expenditures, and projections from the start of fiscal year 2012 through 3/31/12.

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 current projection of incurring \$23.6 million in operating expenditures represents a 57% reduction in annual expenditures from the program's fiscal year 2011 budget of \$54.6 million and a 29% 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. These costs are largely volume- and activity-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 March 31, 2012, a total of \$449,036 was spent on audit related activities. This cost is not volume-dependent.

