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# FEMA's Community Disaster Loan Program

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## Summary

Areas struck by disasters, both natural and man-made, often experience a destruction of property and decline in economic activity. Tax collections for affected local governments may fall substantially as a consequence. At the same time, the financial and public service obligations of local governments persist and may actually increase. The unexpected loss of revenue coupled with the increased financial needs for responding to a natural disaster or terrorist act may lead local governments to seek assistance from the federal government.

This report examines the federal Community Disaster Loan (CDL) program, authorized by Section 417 of the Stafford Act and administered by the Federal Emergency Management Agency (FEMA). The CDL program is intended to assist local governments that experience revenue losses and/or increased municipal operating expenses as the result of a presidentially declared major disaster.

The CDL program provides for loan forgiveness (cancellation) when it is determined for three fiscal years following a disaster that the affected government will not be able to repay the loan. A total of 55 CDLs were made from the initiation of the program in August 1976 through September 30, 2005, a period of 29 years. No new loans were made from FY1999 through FY2005. Of the 55 loans made, 36, or 65%, were paid back in part or in full. However, because many of these repaid loans were for small amounts, they accounted for only 2% of the principal amount advanced. Of the total of $233.5 million in principal advanced, $225.7 million, or 97%, was for loan amounts that were cancelled. Five loans in excess of $5 million accounted for 90% of cancelled principal. In 2000, a $5 million limit was placed on a loan that any one jurisdiction can receive through the traditional CDL program for a single disaster.

On October 7, 2005, both houses of Congress approved and President Bush signed the Community Disaster Loan Act of 2005 (CDLA), P.L. 109-88. Previously, P.L. 109-62, the second emergency supplemental bill enacted following Hurricane Katrina, had appropriated $50 billion in disaster assistance. CDLA provides for up to $750 million of those funds to be used to support "special" community disaster loans, up to a total of $1 billion in principal amount, to local governments so that they can continue to provide essential services. For purposes of these special loans, the new law removes the $5 million per loan limit but prohibits their cancellation. As of February 21, 2006, FEMA had approved 55 special CDL applications for local governments in Louisiana and 39 for those in Mississippi, for a total of 94 loans. These loans summed to $602 million for Louisiana communities, including $120 million for New Orleans, and $144 million for Mississippi communities, for a total of $746 million. FEMA continues to process loan applications which are expected to reach the $1 billion limit.

Congress may be called upon to revisit the issues of whether these loans could be cancelled and whether there should be requirements to report to Congress on the use of these loans. This report will be updated when legislative events warrant or when new information about use of the CDL program becomes available.

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## Overview

In addition to the heavy loss of lives and the dislocation of hundreds of thousands of families, Hurricane Katrina on August 29 and Hurricane Rita on September 24, 2005, caused devastating damage to property and seriously disrupted the economic activity that normally provided the tax and revenue base of the affected areas, especially in Louisiana and Mississippi. There is concern in Congress and elsewhere, but particularly in the tax-exempt bond community, that the destruction of the underlying tax base will impair the ability of Gulf Coast communities to make the payments on their outstanding debt, let alone their ability to issue new debt.[1] These communities also face the loss of revenues needed to finance normal operating expenses (beyond debt servicing) and possibly additional operating expenses engendered by the hurricane disasters. This point was brought home when New Orleans Mayor C. Ray Nagin announced on October 4, 2005, that he would have to lay off 3,000 municipal employees — 50% of the city's work force — due to lack of revenue.[2]

This report focuses on the Federal Emergency Management Agency's (FEMA's) Community Disaster Loan (CDL) program. This is a program of federal aid available to local governments specifically to replace revenues lost as the result of a natural or man-made disaster. These are the revenues needed to pay for normal operating expenses, such as fire and police services, public schools, and debt servicing. This aid is available in addition to the federal disaster aid provided to replace damaged public infrastructure and to address special storm-related expenses such as debris removal.

On October 7, 2005, both the Senate and the House of Representatives approved, and President Bush signed into law, the Community Disaster Loan Act of 2005, P.L. 109-88. The act provides for up to $750 million of the $50 billion previously appropriated for disaster assistance following Hurricane Katrina to be available to support up to $1 billion in special CDLs to local governments affected by the hurricanes. In addition, it makes two important changes in the conditions governing these loans compared with traditional CDLs: it removes the $5 million per

[1] Leslie Wayne, "Tax Bases Shattered, Gulf Region Faces Debt Crisis," *New York Times*, Sept. 13, 2005, pp. C1, C4. Frank Shafroth, "Meteorological Taxes — Taxing Issues in Katrina's Wake," *State Tax Notes* by Tax Analysts, Sept. 26, 2005, pp. 955-960. Frank Shafroth, "The Big Easy — The Taxing Aftermath of Katrina," *State Tax Notes*, Oct. 3, 2005, pp. 149-153.

[2] Christine Hauser, "Mayor Announces Layoffs of City Workers, *New York Times*, Oct. 5, 2005, p. A24.

loan limit and prohibits the cancellation (forgiveness) of these loans. Congress may be called upon to revisit the issues of whether the option to cancel should apply to these loans and whether there should be requirements to report to Congress on the use of these loans.

## Traditional Community Disaster Loans: Section 417 of the Stafford Act

This section describes the law and regulations which governed all community disaster loans *before the enactment of P.L. 109-88 in October 2005*. These rules will continue to govern traditional community disaster loans (CDLs) made outside of the special provisions of the new law. The rules not amended by the new law will continue to apply to the special loans made under the new program.

The Robert T. Stafford Disaster Relief and Emergency Assistance Act[3] is popularly known as the Stafford Act. The Stafford Act

> ...authorizes the President to issue major disaster declarations that authorize federal agencies to provide assistance to states overwhelmed by disasters. Through executive orders, the President has delegated to the Federal Emergency Management Agency (FEMA), within the Department of Homeland Security (DHS), responsibility for administering the major provisions of the Stafford Act. Assistance authorized by the statute is available to individuals, families, state and local governments, and certain nonprofit organizations.[4]

Of particular relevance to local governments is Section 417 of the Stafford Act.[5] Sec. 417 authorizes the President

> ...to make loans to any local government which may suffer a substantial loss of tax and other revenues as a result of a major disaster, and has demonstrated a need for financial assistance in order to perform its governmental functions.

A loan may be approved in either the fiscal year in which the disaster occurs or the immediately following fiscal year. Only one CDL may be approved for any one local government as the result of a single disaster.[6]

The amount of a loan is based on need and is not to exceed 25% of the annual operating budget of the local government for the (local government's) fiscal year in which the major disaster occurs. In addition, as a result of an amendment made in

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[3] P.L. 93-288, as amended; 42 U.S.C. 5121 et seq..

[4] CRS Report RL33053, *Federal Stafford Act Disaster Assistance: Presidential Declarations, Eligible Activities, and Funding*, by Keith Bea.

[5] 42 U.S.C. 5184, Community Disaster Loans.

[6] 44 C.F.R. 206.361 (d).

2000, the dollar amount of any loan is limited to $5 million.[7] The obligation to repay the loan is to be cancelled if the locality's revenues in the three fiscal years following the disaster are deemed insufficient by FEMA or its outside auditors.

The normal term of a CDL is five years. The loan typically takes the form of a five-year balloon. That is, the full principal and accumulated interest are due all together at the end of the five-year term. The Associate Director of FEMA may consider requests for an extension, based on the local government's financial condition. However, the total term of a loan normally may not exceed 10 years, except under extenuating circumstances.[8]

The interest rate on CDLs is based on the average rate, on the date of the loan approval, for U.S. Treasury obligations with maturities of five years. The interest rate on CDLs is higher than the average rate on municipal (state and local) bonds of similar maturity. This is because the federal tax exemption of interest on state and local government bonds enables those governments to sell bonds at lower interest rates than comparable federal bonds. The relatively higher CDL rate implies that localities with strong credit ratings would be better off borrowing from the private credit market, if they were permitted to borrow to cover operating expenses. Only communities with a weak credit rating — or those hoping for loan cancellation — would be attracted to traditional CDLs.

A locality that is in arrears on its repayment of a CDL is not eligible to receive any additional loans under Section 417. Receiving loans under Section 417 does not reduce or otherwise affect any grants or other assistance available to a locality under other parts of the Stafford Act.

A local government may use the borrowed funds to carry on existing local government functions of a municipal operation character or to expand such functions to meet disaster-related needs.[9] The funds are *not* to be used to finance capital improvements or the repair or restoration of damaged public facilities. Neither the loans nor any cancelled portion of the loans may be used as the non-federal share of any federal program, including those under the Stafford Act.[10]

For loan cancellation purposes, unreimbursed expenses of a municipal operating character are those incurred for general government purposes, such as police and fire protection, trash collection, revenue collection, maintenance of public facilities, and other expenses normally budgeted for the general fund.[11]

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[7] Section 207(5) of P.L. 106-390, the Disaster Mitigation Act of 2000.

[8] 44 C.F.R. 206.361(e) and 206.367(c).

[9] The Code of Federal Regulations sets forth the policies and procedures concerning the Community Disaster Loan program in 44 C.F.R. Ch. 1, Subpart K, Secs. 206.361-206.367 (10-1-04 Edition).

[10] 44 C.F.R. 206.361 (f).

[11] General fund as defined by the Municipal Finance Officers Association. See 44 C.F.R. 206.366 (b) (1).

Disaster-related expenses that are eligible for reimbursement under project applications or other federal programs are *not* eligible for loan cancellation.[12] In addition, expenditures associated with debt service, any major repairs, rebuilding, replacement, or reconstruction of public facilities or other capital projects, intragovernmental services, special assessments, and trust and agency fund operations are not eligible for loan cancellation.

The state must co-sign the promissory note or else the local government must pledge collateral security to cover the principal amount of the note. In the event of default, FEMA may request administrative offset against other federal funds due the borrower and/or referral to the Department of Justice for judicial enforcement and collection.

CDLs are not available to states or non-profit organizations.

A community must submit an application to FEMA either to receive a CDL or to have a loan cancelled. Typically, FEMA hires an outside auditing firm to perform the required analysis of the community's operating budget. This outside analysis is combined with data and information that the jurisdiction provides to FEMA in support of its loan application or cancellation application.

The Code of Federal Regulations (CFR) assigns the primary responsibility for both making and canceling CDLs to the Associate Director of FEMA for State and Local Programs and Support. However, according to FEMA's Office of General Counsel, these functions are currently performed by the Director of the Recovery Division. The regulations provide that FEMA shall

> ...cancel repayment of all or part of a Community Disaster Loan to the extent that the Associate Director determines that revenues of the local government during the full three fiscal year period following the disaster are insufficient, as a result of the disaster, to meet the operating budget for the local government, including additional unreimbursed disaster-related expenses of a municipal operating character.[13]

Accordingly, a community cannot seek to, and FEMA cannot, cancel a loan until at least three years following a disaster.

## Legislative Activity in the 109th Congress

To address the immediate needs of the local governments affected by Hurricanes Katrina and Rita, the 109th Congress modified the CDL program through the Community Disaster Loan Act of 2005 (CDLA), S. 1858/P.L. 109-88, enacted on October 7, 2005. Several other bills introduced at that time (discussed below) would have made other changes to the rules governing the CDL program. Since the CDLA was enacted, two bills have been introduced to repeal the provision that prohibits

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[12] 44 C.F.R. 206.366 (b) (2).

[13] 44 C.F.R. 206.366. See also Sec. 206.361(g).

cancellation of the special CDLs (H.R. 4117 and S. 1872). Another would raise the percentage-of-budget limit on the size of a CDL from 25% to 50% (H.R. 4438).

## Special Community Disaster Loans Enacted in October 2005

The Community Disaster Loan Act of 2005 (CDLA), S. 1858 (Vitter), was passed by Congress and signed by President Bush as P.L. 109-88, on Friday, October 7, 2005, the eve of the week-long Columbus Day recess.[14] The motivation for the expedited treatment was reportedly to have the money available to affected communities by Monday, October 10.[15]

P.L. 109-62, the second emergency supplemental appropriations act adopted following Hurricane Katrina, provided for $50 billion in "disaster relief."[16] The Community Disaster Loan Act of 2005 provides for up to $750 million of those funds to be transferred to FEMA's Disaster Assistance Direct Loan (DADL) Program. These funds, in turn, are to be used to make direct loans to local governments to assist them in providing "essential services," as authorized under Section 417 of the Stafford Act.[17] The transfer of $750 million may subsidize gross obligations for the principal amount of direct loans not to exceed $1 billion.[18]

The CDLA also allows for an additional $1 million of the disaster relief funds provided by P.L. 109-62 to be transferred to the Disaster Assistance Direct Loan Program for administrative expenses to carry out the direct loan program.[19]

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[14] S. 1858 was introduced by Senator Vitter, passed without amendment by unanimous consent in the Senate, then agreed to in the House and passed without objection, and signed by President Bush, all on Oct. 7, 2005.

[15] Statement by Representative Baker, *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, p. H8797.

[16] P.L. 109-62 (H.R. 3673) Second Emergency Supplemental Appropriations Act to Meet Immediate Needs Arising from the Consequences of Hurricane Katrina. Passed by both the House and Senate and enacted on Sept. 8, 2005. For more information on the two emergency supplemental laws enacted, see CRS Report RS22239, *Emergency Supplemental Appropriations for Hurricane Katrina Relief*, by Keith Bea.

[17] The CDLA does not define the term "essential services." The Stafford Act does include the term within its definition of "private nonprofit facility." 42 U.S.C. 5122(9).

[18] The $1 billion amount is based on the assumption by the Office of Management and Budget that the new loan program will have a credit subsidy rate of 75%. This is explained in greater detail in the section on Budgetary Treatment later in this report.

[19] For comparison, FEMA's budget request for FY2006 was for $567,000 to administer the entire Disaster Assistance Direct Loan Program which includes "state share" loans in addition to CDLs. Under the state share program, FEMA may lend to a state or other eligible applicant the amount it is responsible for under cost-sharing provisions of the Stafford Act. U.S. Department of Homeland Security, Emergency Preparedness and Response Directorate, Federal Emergency Management Agency, *Fiscal Year 2006 Congressional Justification*, 2005, pp. FEMA 156-157.

The new law makes three changes to the CDL program law with respect to the Special Community Disaster Loans (SCDLs) to be made under this section. First, an SCDL may exceed the $5 million limit placed on traditional loans made under Section 417. (The limit of 25% of the locality's operating budget still applies.) Second, the cancellation of such loans is prohibited. Third, the law directs that the loans be used to assist local governments in providing *essential* services.

The provision eliminating the possibility of loan cancellation was reportedly insisted upon by the Bush Administration (Office of Management and Budget) and the Republican leadership in the House as a condition for providing the loan assistance.[20] Several Members made statements on the House and Senate floors objecting to the requirement that the loans be repaid.[21] Representative Obey requested that a requirement be included to report to Congress about the size and use of the loans made.[22] There were assurances from Representative Baker that this concern would be addressed after the Columbus Day recess.[23]

The interim rules implementing the Special Community Disaster Loans Program were published on October 18, 2005.[24] The standard interest rate on SCDLs is, again, the average rate on Treasury issues with five-year maturities. However, the rules provide that FEMA will have the discretion to allow localities facing unique economic hardships to receive discounted interest rates, at levels consistent with the lowest rate offered by the Small Business Administration's disaster loan program.[25] A formula is provided for determining the discounted interest rate. The subsidized rate would be the U.S. Treasury's five-year maturity rate plus one percentum, adjusted to the nearest 1/8 %, and reduced by one-half. For example, assume that the yield on five-year Treasury bonds were 4.32%, as it was on October 21, 2005. Adding one percentum would give 5.32%. Rounding that to the nearest 1/8% would give 5-3/8%. Reducing that by one-half would give 2-11/16% (2.69%) as the subsidized interest rate on SCDLs. The federal budget for FY2007 assumes that the borrower interest rate for the CDL program will be 2.70% during FY2006.[26]

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[20] Statements by Senator Clinton on Relief for the Gulf Coast and by Senator Frist, *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, on p. S11280 and p. S11282, respectively.

[21] Statements regarding the Community Disaster Loan Act of 2005, *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, pp. S11279-S11285 and H8794-H8796.

[22] *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, pp. H8797-H8798.

[23] *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, p. H8798.

[24] Department of Homeland Security, Emergency Preparedness and Response Directorate, Federal Emergency Management Agency, "Special Community Disaster Loans Program," 70 *Federal Register* 60443, Oct. 18, 2005; 44 C.F.R. 206.370-206.377.

[25] For businesses not able to obtain credit elsewhere, the law sets a maximum interest rate of four percent per year on federal physical disaster loans to small businesses. Explained on the SBA website at [http://www.sba.gov], visited Oct. 18, 2005.

[26] U.S. Executive Office of the President, Office of Management and Budget, *Budget of the United States Government Fiscal Year 2007, Federal Credit Supplement* (Washington: February 2006), p. 10.

The term of the SCDLs is to remain, as for traditional CDLs, at five years, with the option of the Associate Director of FEMA extending the term to up to 10 years. Only under extenuating circumstances may the repayment period exceed 10 years. Also as with traditional CDLs, the state must co-sign the promissory note or else the local government must pledge collateral security to cover the principal amount of the note. In the event of default, FEMA may request administrative offset against other federal funds due the borrower and/or referral to the Department of Justice for judicial enforcement and collection.

## Other Bills in the 109th Congress

Several other bills introduced on or around October 7, 2005, would have made other changes to the rules governing the CDL program. Three of the comprehensive Katrina relief bills — H.R. 3958, S. 1765, and S. 1766 — contained identical CDL provisions. These would have lifted limits on the size of a loan and allocated specific dollar amounts to five named parishes in Louisiana. Senator Landrieu introduced four other bills at that time that addressed CDLs: S. 1846, S. 1855, S. 1856, and S. 1857. The last three — which allocated $750 million in disaster relief funds to support $1 billion in loans — were superceded by the bill enacted, S. 1858. Two would have lifted the $5 million per loan limit but imposed the condition of approval by either Congress (S. 1857) or OMB (S. 1856) for loans to be cancelled. H.R. 4024 would have removed the $5 million cap and the automatic cancellation provision for all CDLs, not just the special new loan program.

Since the CDLA was enacted, two companion bills have been introduced specifically to repeal the provision that prohibits cancellation of the special CDLs (H.R. 4117 and S. 1872). Part of a more comprehensive Gulf Coast recovery bill would raise the percentage-of-budget limit on a CDL from 25% to 50% (H.R. 4438).

Representative Maloney of New York City has introduced three bills that would make CDLs available to state as well as local governments, remove size limits on loans, and turn the loans into grants from the outset by not requiring any payment of interest or principal in the case of a major disaster. The first bill (H.R. 1795) addresses the revenue losses experienced by the city and state of New York after the terrorist disaster of September 11, 2001. The other two bills respond to the effects of the hurricanes (H.R. 4012 and H.R. 4090).

Short descriptions of the individual bills addressing CDLs follow.

**H.R. 1795 (Maloney).** *The Whatever It Takes To Rebuild Act of 2005*. Introduced April 21, 2005; referred to the Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings and Emergency Management, on April 22. H.R. 1795 was introduced with the intention of increasing federal aid to the governments of New York City and the state of New York to help compensate them for the losses of tax and other revenues related to the terrorist attacks of September 11, 2001. H.R. 1795 would amend the Stafford Act to make community disaster loans available to states as well as local governments. It would retain the restriction that the loan not exceed 25% of the annual operating budget of the (state or local) governmental entity. But it would remove the limit of $5 million on the size of the loan that could be made to an individual government.

The bill would effectively turn into grants loans made as a result of a major disaster caused by terrorist attacks occurring on or after October 30, 2000. The bill provides that

> The President shall not require the payment of any interest or principal on a loan made under this section to a State or local government which may suffer a substantial loss of tax and other revenues as a result of a major disaster caused by a terrorist attack.[27]

Finally, Section 4 of H.R. 1795 would specifically authorize the President to make loans to New York City and the state of New York for losses of tax and other revenues as a result of the terrorist attacks of September 11, 2001. The total amount of the loans would be set at $8.8 billion, or a greater amount if determined by the President to be necessary to cover the losses, subject to the availability of appropriations. The President would not require the payment of any interest or principal on these loans.

Representative Maloney introduced identical legislation in the 108th Congress (H.R. 1542) and nearly identical legislation in the 107th Congress (H.R. 5523) (without Section 4, the explicit funding for New York City and New York State).

**H.R. 3958 (Melancon).** *Louisiana Katrina Reconstruction Act*. Introduced September 29, 2005; referred to numerous committees and subcommittees. The CDL provisions are identical to those in S. 1765 and S. 1766. Section 114 of the general provisions of this comprehensive bill addresses CDLs. Sec. 114(a) prohibits any dollar or percentage limit on a CDL made to assist a local government in which a major disaster relating to Hurricane Katrina was declared to exist. Of the funds appropriated for CDLs in FY2006, Sec. 114(b) of H.R. 3958 lists specific dollar amounts to be used for loans to five named parishes in Louisiana, totaling just over $1 billion.

**H.R. 4012 (Maloney).** *Community Disaster Loan Equity Act of 2005*. Introduced October 7, 2005; referred to the Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings and Emergency Management. H.R. 4012 would amend Section 417 of the Stafford Act to make CDLs available to states as well as local governments. It would remove the limit of $5 million per loan. In addition, two special conditions are provided for a loan made to a state or local government which has suffered a substantial loss of tax and other revenues as a result of a major disaster that the President determines to be an "incident of national significance." First, the loan is not subject to the limit of 25% of the government's operating budget. Second, the President shall not require the payment of any interest or principal on the loan. (This would effectively make the loan a grant from the outset.) The amendments would apply to any major disaster occurring after August 24, 2005. The findings section nonetheless refers to revenue losses experienced by the city and state of New York following the terrorist attack of September 11, 2001, as well as the effects of Hurricane Katrina (which occurred on August 29, 2005).

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[27] Section 3(c) of H.R. 1795 in the 109th Congress.

**H.R. 4024 (Baker).** *Community Disaster Loan Act of 2005*. Introduced October 7, 2005; referred to the Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings and Emergency Management. Of the funds appropriated for disaster relief by P.L. 109-62, H.R. 4024 would allocate $300 million to subsidize loan amounts not to exceed $400 million, and another $1 million for loan administration. Like the bill enacted, it would remove the limit of $5 million per loan and prohibit the cancellation of the special loans made from these funds. But it would also remove the $5 million cap and the requirement that loans be cancelled if the local government is in poor fiscal condition *for all loans made under the traditional CDL program*.

**H.R. 4090 (Maloney).** *Whatever It Takes to Rebuild Act of 2005, Part II*. Introduced October 20, 2005; referred to the Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings and Emergency Management. H.R. 4090 builds upon H.R. 4012. H.R. 4090 would repeal the recently passed Community Disaster Loan Act of 2005, P.L. 109-88. Like H.R. 4012, H.R. 4090 would make state as well as local governments eligible for CDLs. It would remove the $5 million cap on a CDL. In the case of a loan made as a result of a major disaster that the President determines to be an "incident of national significance," the loan limit of 25% of the community's operating budget would not apply; also, the President shall not require payment of any interest or principal on the loan. In addition to the provisions of H.R. 4012, H.R. 4090 would authorize the appropriation of $1 billion *and such additional sums as may be necessary* for CDLs to state and local governments which suffer a substantial loss of tax and other revenues as a result of Hurricane Katrina *or Hurricane Rita*.

**H.R. 4117 (Melancon).** Introduced October 20, 2005; referred to the Committee on Transportation and Infrastructure, Subcommittee on Economic Development, Public Buildings and Emergency Management. Companion to S. 1872. H.R. 4117 would repeal the provision in the CDLA of 2005 that disallows cancellation of the loans.

**H.R. 4438 (Shuster).** *Gulf Coast Recovery Act of 2005*. Introduced December 6, 2005; referred to the Committee on Transportation and Infrastructure; ordered to be reported by voice vote, December 7, 2005. H.R. 4438 would govern the distribution of money already appropriated for the Federal Disaster Relief Fund by the two emergency supplemental appropriations acts enacted following Hurricane Katrina, P.L. 109-61 and P.L. 106-62. It would amend the CDLA of 2005 to raise the limit on the size of CDLs to 50% (rather than 25%) of the community's operating budget for the fiscal year in which the disaster occurs.

In addition, H.R. 4438 would authorize the President, under the Stafford Act, to reimburse expenses incurred by an eligible state or local government for the base pay and overtime expenses of employees who provide essential governmental services for response and recovery operations with respect to disaster declarations made for Hurricane Katrina and Hurricane Rita on or after August 29, 2005. This would apply to expenses incurred during the six-month period from January 1, 2006, through June 30, 2006. The rate of reimbursement would be 75% of the expenses incurred. (As a general rule, straight- or regular-time salaries for force account labor are not eligible for reimbursement. See 44 C.F.R. 206.228(a)(4).) The assistance would be available to state and local governments that have experienced a loss of 25% or more of their annual operating revenues as a result of the disaster(s).

Again with respect to disaster declarations made for Hurricanes Katrina and Rita on or after August 29, 2005, H.R. 4438 would provide that the federal share of assistance for debris removal under the Stafford Act be 100% (rather than not less than 75%). The federal share for the hazard mitigation program would be not less than 75% (rather than up to 75%) for measures approved during the one-year period following enactment. The limit on hazard mitigation grants for a major disaster would be 15% of the estimated aggregate amount of grants made for relief with respect to the major disaster. Unemployment assistance would be available for 52 weeks (rather than no longer than 26 weeks) after the date of the disaster declaration. The amount of assistance would be not less than 50% of the national average weekly unemployment benefit provided to an individual on the date of the disaster declaration (rather than not to exceed the maximum weekly amount authorized under the unemployment compensation law of the state in which the disaster occurred).

Finally, H.R. 4438 would authorize appropriations of $200 million for each of the three fiscal years 2006, 2007, and 2008, for grants to states and local governments throughout the country to purchase interoperable communications equipment and mobile equipment for the generation of emergency power, and to train first responders and emergency personnel in the use of that equipment.

**S. 1765 (Landrieu).** *Louisiana Katrina Reconstruction Act*. Introduced September 22, 2005; referred to the Committee on Finance. The CDL provisions are identical to those in S. 1766 and H.R. 3958. Section 114 of the general provisions of this comprehensive bill addresses CDLs. Sec. 114(a) prohibits any dollar or percentage limit on a CDL made to assist a local government in which a major disaster relating to Hurricane Katrina was declared to exist. Of the funds appropriated for CDLs in FY2006, Sec. 114(b) of S. 1765 lists specific dollar amounts to be used for loans to five named parishes in Louisiana, totaling just over $1 billion.

**S. 1766 (Vitter).** *Louisiana Katrina Reconstruction Act*. S. 1766 was introduced September 22, 2005; referred to the Committee on Finance. The CDL provisions in Sec. 114 are identical to those in S. 1765 and H.R. 3958.

**S. 1846 (Landrieu).** Introduced October 6, 2005; referred to the Committee on Homeland Security and Governmental Affairs. S. 1846 prohibits any dollar or percentage limit on a CDL made to assist a local government dealing with a major disaster area related to Hurricane Katrina or Hurricane Rita. It treats a sheriff department in the state of Louisiana as a local government. It provides that there will be no prohibition or limitation on the reimbursement of straight and regular-time salaries of public personnel that provide essential public services in the state of Louisiana on behalf of that state, on or after August 29, 2005. It would authorize the appropriation of $1.5 billion of the funds provided for disaster relief by P.L. 109-62 to be made available to the appropriate federal agencies to carry out the programs and activities authorized under this act, with the funds to remain available until expended.

**S. 1855 (Landrieu).** *Community Disaster Loan Act of 200*5. Introduced October 7 (legislative day, October 6, 2005); referred to the Committee on Homeland Security and Governmental Affairs. S. 1855 would allocate $750 million of the disaster relief funds provided in P.L. 109-62 to support up to $1 billion in loans to help local communities provide essential services, plus $1 million for administrative expenses. For further action, see the description of S. 1858, which became P.L. 109-88 on October 7.

**S. 1856 (Landrieu).** *Community Disaster Loan Act of 200*5. Introduced October 7 (legislative day, October 6, 2005); referred to the Committee on Homeland Security and Governmental Affairs. S. 1856 would allocate $750 million of the disaster relief funds provided in P.L. 109-62 to support up to $1 billion in loans to help local communities provide essential services, plus $1 million for administrative expenses. In addition, it permits a loan made from these funds to exceed $5 million and provides that such loans may only be cancelled with the approval of the Office of Management and Budget (OMB). For further action, see the description of S. 1858, which became P.L. 109-88 on October 7.

**S. 1857 (Landrieu).** *Community Disaster Loan Act of 200*5. Introduced October 7 (legislative day, October 6, 2005); referred to the Committee on Homeland Security and Governmental Affairs. S. 1857 would allocate $750 million of the disaster relief funds provided in P.L. 109-62 to support up to $1 billion in loans to help local communities provide essential services, plus $1 million for administrative expenses. In addition, it permits a loan made from these funds to exceed $5 million and provides that such loans may only be cancelled with the approval of Congress. For further action, see the description of S. 1858, which became P.L. 109-88 on October 7.

**S. 1872 (Landrieu)**. Introduced October 17, 2005; referred to the Committee on Homeland Security and Governmental Affairs. Companion to H.R. 4117. S. 1872 would repeal the provision in the CDLA of 2005 that disallows cancellation of the loans.

## Analysis of the CDL Program

The federal role in aiding particular local governments in budgetary distress has typically been to subsidize borrowing costs. This has taken the form of providing a federal guarantee of loans made to the local government — as in the case of the loan guarantee enacted for New York City in 1978 in the midst of its fiscal crisis. It has also taken the form of permitting a locality to issue federally tax-exempt bonds for private activities in order to augment its tax base over the long run — as in the case of Liberty Zone bonds issued by New York City after the terrorist attack of September 11, 2001.

The Community Disaster Loan program is unique in permitting local governments struck by disasters to borrow directly from the federal government. It has also been unique in giving the federal administrators of the loan program the authority to cancel the borrower's obligation to repay the loan under specified budgetary conditions.

State and local governments are generally prohibited by state constitutions or laws from issuing municipal debt to finance deficits in their operating budgets. Indeed, the regulations governing traditional CDLs prohibit loan cancellation to finance a budget deficit that was anticipated *before* the disaster.[28] In contrast, the CDL program is intended specifically to permit a community to borrow to pay for operating expenses when its revenue base has been damaged by a disaster.

## Budgetary Treatment

Financing for the activities authorized by the Stafford Act is provided through funds appropriated to the Disaster Relief Fund (DRF), which is administered by the Department of Homeland Security (DHS) through the Federal Emergency Management Agency (FEMA). Funds appropriated to the DRF remain available until expended (termed a "no-year" account). Typically there is supplemental appropriations legislation every fiscal year to meet the needs of especially catastrophic disasters, as occurred with Hurricane Katrina.[29] Accordingly, FEMA's budget request for FY2007 includes only routine administrative expenses of $569,000 for the Disaster Assistance Direct Loan Program Account.[30] In FY2006, however, FEMA expects to spend an additional $2.5 million for "advisory and assistance services" to help process the $1 billion in special CDLs.[31] CDLA (P.L. 109-88) provided $1 million from disaster relief funds to help administer the special CDLs.

The CDL program is a direct loan program of the federal government (in contrast to a loan guarantee program). The CDL program is classified as a discretionary program (in contrast to a mandatory program) under the Budget Enforcement Act of 1990.

The CDL program is subject to the Federal Credit Reform Act of 1990 (FCRA).[32] The FCRA changed the accounting method for measuring the cost of federal direct loans and loan guarantees from cash flow to accrual accounting,

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[28] 44 C.F.R. 206.366 (a)(5).

[29] For more information on the FY2005 emergency legislation, see CRS Report RS22239, *Emergency Supplemental Appropriations for Hurricane Katrina Relief*, by Keith Bea.

[30] The DADL program oversees State Share Loans as well as Community Disaster Loans. The FY2007 administrative expense request for $569,000 covers three FTE positions, the same number of positions as in FY2005 and FY2006. U.S. Department of Homeland Security, Federal Emergency Management Agency, Disaster Assistance Direct Loan Program Account, *Fiscal Year 2007 Congressional Justification* (Washington, February 2006), pp. FEMA-1 - FEMA-2.

[31] FEMA, DADL Program Account, *Fiscal Year 2007 Congressional Justification*, pp. FEMA-5 and FEMA-11.

[32] The Omnibus Budget Reconciliation Act of 1990, P.L. 101-508, added Title V to the Congressional Budget Act. Title V is also known as the Federal Credit Reform Act of 1990.

starting in FY1992. Under FCRA, discretionary programs providing new direct loan obligations or new loan guarantee commitments require appropriations of budget authority equal to their estimated subsidy costs. Furthermore, the appropriations bill must include an estimate of the dollar amount of the new direct loan obligations that are supportable by the subsidy budget authority appropriated to the agency for its credit program.[33] These requirements of the FCRA explain the language used in the CDLA of 2005.

In February 2005 the Office of Management and Budget (OMB) estimated the credit subsidy rate of the traditional CDL program at 93% for FY2005 and FY2006.[34] Roughly speaking, this means that for every $100 million of loans made and interest due, $93 million in principal or interest was cancelled or forgiven.[35] This was by far the highest subsidy rate among all of the federal government's direct loan and loan guarantee programs.

In contrast, a subsidy rate of 75% was used in the calculations for the CDLA of 2005. This lower rate was based on the assumption that the special CDLs could not be cancelled. The 75% subsidy rate was used to determine that $750 million in budget authority could support total loans of $1 billion, as provided in the language of P.L. 109-88. This language conforms to the requirements of the FCRA. In February 2006 the Administration's FY2007 budget reported a subsidy rate of 75% and obligations limit of $1 billion for FY2006 as enacted by the CDLA; the budget

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[33] For further explanation, see CRS Report RL30346, *Federal Credit Reform: Implementation of the Changed Budgetary Treatment of Direct Loans and Loan Guarantees*, by James M. Bickley, especially Appendix B, Budgetary Treatment of a Hypothetical Direct Loan.

[34] For FY2005, the traditional CDL program had an estimated credit subsidy rate of 93.43%. This subsidy rate was attributed 3.72 to the interest rate and 89.72 to all other. The interest rate subsidy accounts for the borrower's interest rate being below the federal government's cost of borrowed funds. "All other" reflects cancellations of interest and principal payments. (No part of the subsidy was attributed to defaults net of recoveries or to fees.) The average borrower's interest rate assumed for the purpose of calculating the subsidy rate for the CDL program during FY2005 was 4.30%. This was lower than the borrower interest rates that applied to most of the other federal direct loan and loan guarantee programs. In early 2005, the subsidy rate of the traditional CDL program for FY2006 was estimated just slightly lower at 93.30%, assuming a borrower interest rate of 4.66%, and attributing 3.75 of the subsidy to the interest rate, and 89.55 to all other. U.S. Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2006, Federal Credit Supplement* (Washington: GPO, 2005), pp. 2, 10, 16.

[35] More precisely, the credit subsidy rate is equal to 1.00 minus the ratio of the present value of expected cash inflows to the government, relative to the present value of cash outflows. In essence, it reflects the extent of nonpayment by the borrowers. The estimate is based on both actual and projected repayments by borrowers. U.S. General Accounting Office (now named the Government Accountability Office), Letter to The Honorable Christopher S. Bond, Chairman, Subcommittee on VA, HUD and Independent Agencies, Committee on Appropriations, U.S. Senate, June 5, 1996, GAO/RCED-96-148R Community Disaster Loans, p. 5.

contained no CDL subsidy or obligation entries for FY2007.[36] Even at 75% the special CDL program has the second highest subsidy rate assumed for FY2006 among all of the federal direct loan and loan guarantee programs.[37]

The interest rate component of the subsidy should be higher than under the traditional CDL program because all of the Gulf-area jurisdictions will get the discounted interest rate.[38] The FY2007 budget assumes a borrower interest rate of 2.70% for the CDL program in FY2006. This is half or less of the borrower rate reported for other federal direct loan programs. Despite this apparent interest subsidy, the FY2007 budget attributes all of the 75% subsidy rate to defaults (net of recoveries) and none to interest.[39] The actual subsidy outcome will not be known for five or 10 years, depending upon the maturity period set for the special CDLs.

Historically, CDLs have been made on an "as-needed" basis, without a pre-specified aggregate limit. Furthermore, from 1974 until 2000 there was no dollar limit on the size of a loan that could be made to an individual local government through the traditional CDL program. The 2000 amendment limited the loan to any individual local government to $5 million and provided that no additional loan would be made to a community that is in arrears on payments under a previous loan.[40] Congress made these changes to help control program costs.

The 2005 CDLA took another approach to controlling the cost of the special CDL program that it created. While it lifts the $5 million cap on an individual loan, the new law prohibits the cancellation of any loan made under its auspices. It also sets an aggregate limit of $1 billion on the principal amount of loans that can be made, based upon a set-aside of $750 million from funds already appropriated for disaster relief. The FY2007 budget assumes that the average loan size under the CDL program in FY2006 will be $5.714 million.[41]

## Loan or Grant Program?

There is considerable controversy in Congress over whether the CDL monies to be advanced to the local governments affected by Hurricanes Katrina and Rita should be treated as loans that must be repaid or as loans that may be cancelled.

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[36] U.S. Executive Office of the President, Office of Management and Budget, *Budget of the United States Government Fiscal Year 2007, Federal Credit Supplement* (Washington: February 2006), pp. 2-3.

[37] Only the Transitional Housing Program for Homeless Veterans had a higher subsidy rate, 79.89%. OMB, *FY2007 Federal Credit Supplement*, p. 11.

[38] Credit analysts at OMB suggested that roughly five percentage points of the total estimated credit subsidy of 75% is attributable to the interest rate subsidy and 70 percentage points to the expected default on principal and interest payments.

[39] OMB, *FY2007 Budget, Federal Credit Supplement*, p. 10.

[40] Disaster Mitigation Act of 2000, P.L. 106-390, 114 Stat. 1571.

[41] OMB, *FY2007 Budget, Federal Credit Supplement*, p. 2.

Cancellation of loan repayment obligation in effect results in a grant to the community.

The community disaster program for local governments began in 1970 as a program of community disaster grants. In 1974, Congress replaced the grant program with a program of community disaster loans.[42] However, the loan program was accompanied by a provision requiring mandatory cancellation of the obligation to repay all or part of the loan under specified local budget conditions. In contrast, the funds advanced under the 2005 CDLA would be treated strictly as repayable loans.

A 1995 report by FEMA's Office of Inspector General recommended considering the conversion of the community disaster loan program into a grant program because so few of the loans were expected to be repaid and because it requires much less time, effort, and expense to administer a grant program than a loan program.[43] In 1996, FEMA's Director of the Office of Policy and Regional Operations noted that the subsidy rate for the CDL program was close to 90% for FY1996 and close to 100% for FY1997. He said that FEMA's goal was to terminate the loan program or, if not terminated, to administer it as a grant program.[44]

In 1997 congressional testimony, then FEMA director James Lee Witt asked rhetorically

> ... then let it be a grant program if they can't pay the money back. Why spend all the money we are having to spend administratively to support these loans and to have accounting firms go in and do audits of the cities or governments that are getting the loans if they are not being repaid?[45]

With a grant program, immediate revenue relief could be provided to local jurisdictions in a disaster area without saddling them with additional debt. With no possibility of interest or principal repayments, a grant program would cost more per dollar of aid delivered than a loan program. In addition, a grant program would likely be used by more jurisdictions than a loan program and could thus be considerably more expensive for federal taxpayers. A larger program would redistribute more resources from non-affected areas to areas affected by disaster.

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[42] The evolution of the CDL program is explained in more detail at the end of this report, in the Legislative History section.

[43] Federal Emergency Management Agency (FEMA), Office of Inspector General, *Audit of FEMA's Disaster Relief Fund*, H-16-95 (July 27, 1995). Cited in U.S. General Accounting Office (now named the Government Accountability Office), Letter to The Honorable Christopher S. Bond, Chairman, Subcommittee on VA, HUD and Independent Agencies, Committee on Appropriations, U.S. Senate, June 5, 1996, GAO/RCED-96-148R Community Disaster Loans, p. 5.

[44] Op. cit.

[45] U.S. Congress, House Committee on Appropriations, Subcommittee on VA, HUD, and Independent Agencies, hearings, part 4, 105th Cong., 1st sess., 1997 (Washington: GPO, 1997), pp. 64-65.

However, even though administrative accounting costs may be lower with grants than loans, grants may require more federal control and oversight of the use of funds. Monitoring compliance could increase the cost of administering a grant program.

## Experience with Traditional Loans and Their Cancellation

The traditional CDL program has been used infrequently relative to the number of declared disasters. From the first loans made in August 1976 through September 30, 2005, a period of 29 years, FEMA received 64 loan applications related to 21 separate disasters. Of those 64 applications, four were withdrawn by the community and five were suspended because another federal aid program was then available to school districts through the Department of Education. FEMA approved the remaining 55 loan requests and disbursed funds. In contrast, over the same time period there were 1,104 declared major disasters, many of which affected more than one local jurisdiction. No community disaster loans were made from FY1999 through FY2005.

The FEMA data summarized in **Table 1** (in millions of dollars) and **Table 2** (as a percentage of total for loans disbursed) suggest that the traditional CDL program is more accurately described as a grant program with a small loan component. This is because the CDL program has experienced a high rate of loan cancellation, measured in dollar terms. Of the $233.5 million in total loan principal disbursed, $168.7 million, or 72.2%, went to 16 loans that were fully cancelled. Another $57.0 million, or 24.4%, was the amount of principal cancelled for the 6 loans that were partially cancelled. Adding these two categories together indicates that $225.7 million, or 96.6%, of the total loan principal disbursed was cancelled.

The repayment experience looks better when measured simply by the number of loans. Thirty-six, or two-thirds, of the 55 individual loans made have been paid back in part or in full. However, many of these loans were for amounts as small as $500 or $1,000. Altogether, these loans repaid only $5.5 million, or 2.3%, of the total principal amount loaned by the CDL program.

When the loan principal was cancelled, generally so was the interest due. In addition to the $225.7 million in loan principal that was cancelled, so was $95.3 million in interest owed. In contrast, loans that were paid back in part or in full paid only $10.1 million in interest.

## Table 1. Community Disaster Loan Program from the First Loans in August 1976 through September 30, 2005
(in $ millions)

| | Number of Loans | Amounts in $ millions: Principal | Interest | Principal and Interest |
|---|---|---|---|---|
| Loans applied for | 64 | — | — | — |
| Applications withdrawn or suspended | - 9 | — | — | — |
| Loans approved | 55 | $279.7 | — | — |
| Loans disbursed | 55 | 233.5 | $106.8 | $340.3 |
| Loans cancelled in full | 16 | 168.7 | 74.4 | 243.1 |
| Loans cancelled in part | 6[a] | 57.0 | 20.9 | 77.9 |
| Loans paid back in part | 6[a] | 2.2 | 8.3 | 10.5 |
| Loans paid back in full | 30 | 3.3 | 1.8 | 5.1 |
| Loans outstanding | 4[a] | 2.3 | 1.4 | 3.7 |

**Source:** Tabulated by CRS from data on individual loans, as of Sept. 30, 2005, provided by Gerry Miederhoff, FEMA program specialist.

a. Five loans were counted as both cancelled in part and paid back in part. One outstanding loan has also been partially cancelled. Another outstanding loan has been partially repaid. The dollar amounts are assigned to their respective categories.

## Table 2. Community Disaster Loan Program from the First Loans in August 1976 through September 30, 2005
(as a percentage of total for loans disbursed)

| | Number of Loans | Principal | Interest | Principal and Interest |
|---|---|---|---|---|
| Loans disbursed | 100.0% | 100.0% | 100.0% | 100.0% |
| Loans cancelled in full | 29.1 | 72.2 | 69.9 | 71.4 |
| Loans cancelled in part | 10.9 | 24.4 | 19.6 | 22.9 |
| Loans paid back in part | 10.9 | 0.9 | 7.8 | 3.0 |
| Loans paid back in full | 54.5 | 1.4 | 1.7 | 1.5 |
| Loans outstanding | 7.3 | 1.0 | 1.3 | 1.1 |

**Note:** Percentages may not sum to 100.0 due to rounding and, for number of loans, some double counting. See note a to Table 1.

**Source:** Tabulated by CRS from data on individual loans, as of Sept, 39, 2005, provided by Gerry Miederhoff, FEMA program specialist.

## Eliminating the $5 Million Per Loan Cap

Many large local governments in the Gulf region, including New Orleans, could not benefit significantly from the traditional CDL program because of the loan limit of $5 million per jurisdiction, per disaster. Removing the $5 million limit is likely to deliver more federal aid to large jurisdictions than would be allowed under traditional program rules.

The primary argument against eliminating the $5 million cap is the greater potential cost to the federal government. A total of five of the 55 CDLs approved through September 2005 under the traditional CDL program exceeded the $5 million cap. Together they accounted for 90% of the cancelled principal and 93% of the cancelled principal and interest (see **Table 3**). This suggests that removal of the $5 million cap is likely to increase the federal cost of the program if there are defaults on large loans. Some argue that the other cap — 25% of the borrowing government's operating budget in the fiscal year of the disaster event — achieves the objective of capping the federal exposure, albeit at a higher level.

### Table 3. CDLs Greater than $5 Million and Amount Cancelled
(in $ millions)

| Disaster Event | Date of Event | Amount Disbursed | Principal Amount Cancelled | Principal and Interest Cancelled |
|---|---|---|---|---|
| Hurricane Hugo, U.S.V.I. | 9/20/89 | $50.1 | $48.2 | $65.7 |
| Hurricane Val, American Samoa | 12/13/91 | $10.2 | $8.6 | $12.0 |
| Hurricane Andrew, Homestead, FL | 8/24/92 | $10.3 | $10.3 | $13.5 |
| Hurricane Iniki, Kauai, HI | 9/12/92 | $15.0 | $15.0 | $19.1 |
| Hurricane Marilyn, U.S.V.I. | 9/16/95 | $127.2 | $127.2 | $189.0 |
| Total for CDLs over $5 million (5 loan approvals) | __ | $212.8 | $209.3 | $299.3 |
| Total for all CDLs (55 loan approvals) | __ | $233.5 | $233.5 | $321.0 |

**Source:** Data as of Sept. 30, 2005, from Gerry Miederhoff, FEMA program specialist.

## Lowering the Interest Rate

A consolation offered to those concerned about the non-cancellation provision for the special CDLs was that the administrators of the loan program would have considerable latitude in setting the terms of repayment for the loans which include both the interest rate and the time period of the loan.[46] However, according to the interim regulations accompanying CDLA of 2005, the time period for repayment is

[46] Statement of Representative Baker, *Congressional Record*, daily edition, vol. 151, no. 130, Oct. 7, 2005, p. H8796.

the same for the special program as it is for the traditional program — typically five years, and not to exceed 10 years except in cases of exceptional financial hardship.[47]

The new CDL program does, however, offer FEMA administrators the option of offering a lower interest rate to communities judged to be in more serious financial distress. According to FEMA, all Gulf jurisdictions will be eligible for the subsidized interest rate. Lowering the interest rate is intended to reduce the burden of repaying the loan. This is counter to the usual practice in credit markets, where borrowers judged more financially risky typically face a higher interest rate than those judged more likely to repay. However, it does parallel the treatment of physical disaster business loans offered by the Small Business Administration (SBA) to businesses that have not been able to obtain credit elsewhere.[48]

A lower interest rate would, by design, increase the attractiveness of the CDL program to more governments. The likely increased demand for the loans would increase the federal cost of the program. The larger interest subsidy alone would add to the cost of the program even if the loans were repaid. But attracting less creditworthy borrowers is likely to raise the risk of default on the loans, further increasing the cost of the program.

In contrast, a policy of linking the CDL interest rate to the underlying credit rating of the borrowing government could reduce the adverse selection that may exist under both the traditional and special CDL programs.[49] For example, setting the interest rate at a fixed amount (number of basis points) or percentage below the local government's current five-year bond rate is a method that could be easily implemented by FEMA yet would still reduce the burden on the borrowing government.

## Experience with the Special CDL Program

With the authority to make up to $1 billion in loans, the special CDL program has the potential to be nearly four times as large as the traditional CDL program to date ($233.5 billion loaned). As of February 21, 2006, FEMA had approved 55 special community disaster loans for local governments in Louisiana and 39 for Mississippi, for a total of 94 loans. The loan amounts summed to $602 million for

[47] Department of Homeland Security, Emergency Preparedness and Response Directorate, Federal Emergency Management Agency, "Special Community Disaster Loans Program," 70 *Federal Register* 60443, Oct. 18, 2005.

[48] The SBA sets a maximum interest rate of 4% per year and a maximum maturity of 30 years on loans to borrowers judged unable to obtain credit elsewhere. For businesses that SBA determines can obtain credit elsewhere, the interest rate charged by SBA cannot exceed what is being charged in the private market at the time of the disaster, or 8%, whichever is less, and the maturity period cannot exceed three years. [http://www.sba.gov] visited Oct. 18, 2005.

[49] The term "adverse selection" refers to the concept in insurance markets whereby only those who will likely need insurance are most likely to purchase policies. In the context of CDLs, it suggests that jurisdictions with serious budget troubles will be more likely to use the federal loan program.

Louisiana communities, including $120 million for New Orleans, and $144 million for Mississippi communities, for a total of $746 million in loans.[50]

State and FEMA officials continue to process loan applications. Concerned that applications were approaching the $1 billion limit, on November 16, 2005, FEMA officials placed a cap of $700 million on the aggregate amount of loans that could be approved for communities in Louisiana, with the remaining $300 million reserved for Mississippi communities. To stay within its limit, the state of Louisiana reduced by 30% every request for a loan of more than $2 million that was received after November 16. As of February 21, 2006, 14 communities in Louisiana had had a total of $126 million cut from their loan requests. If additional funds become available later on, FEMA will loan the remaining 30% originally requested. Applications approved as of November 16 were approved for the full amount requested. Nineteen applications totaling $250.8 million in loans had been approved for Louisiana communities as of that cutoff date.[51]

# Legislative History

Over its history, the community disaster program has taken the form of both a grant program and a loan program. Several approaches have been used to limit the cost of the program. In addition, changes were made in the definitions of revenues to be replaced and expenses to be supported by the program.

## Disaster Relief Act of 1970

The CDL program originated as a grant program. Sec. 261 of the Disaster Relief Act of 1970 (P.L. 91-606) provided for community disaster grants. The grant provisions originated in a House amendment to S. 3619. The President was authorized to make grants to any local government which, as the result of a major disaster, had suffered a substantial loss of property tax revenue (both real and personal). A grant could be made for the year of the disaster and the following two tax years.

The grants were intended to replace lost property tax revenue. The locality was expected to maintain its tax rate and assessed value factors at their pre-disaster levels. Specifically, the grant for any tax year could not exceed the difference between the annual average of property tax revenues received by the local government during the three tax years preceding the disaster and the actual property tax revenue received by the local government for the tax year of the disaster, and similarly for the next two tax years. However, if the government had reduced its tax rates or tax assessment valuation factors subsequent to the disaster, an adjustment would be made to remove the effect when measuring the shortfall in revenues.

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[50] Information from Gerald Connolly at FEMA, Feb. 21, 2006.

[51] Michelle Krupa, "Loan cuts threaten official agencies," *The Times-Picayune*, Dec. 6, 2005, p. 1. Available at [http://www.nola.com/news/t-p/frontpage/index.ssf?/base/news-4/1133854216307140.xml], visited Dec. 13, 2005.

**Alternative Senate Proposal for a Loan Program Not Adopted.** The conference committee on S. 3619 did not adopt the provisions of the bill passed by the Senate which proposed a loan program instead of the grant program. The Senate-passed bill would have authorized $100 million to establish a Community Disaster Loan Fund in the Treasury. The Fund would have provided loans to local governments for three purposes: (1) meeting interest and principal payments on outstanding bonded indebtedness; (2) paying the local share of federal grant-in-aid programs necessary to restore the disaster area; and (3) providing and maintaining essential public services, such as fire and police protection.

To qualify for a loan, a local government would have to have suffered a loss of more than 25% of its tax base or such a substantial amount that it could not otherwise meet payments on its debt obligations, its matching shares, or its essential public services. The size of the loan was linked to the loss of property tax revenues, in the same way as the grant program that was adopted. The loans would be interest-free for the first two years. The term of the loan could not exceed 20 years. The interest rate on the loans would be determined by the Secretary of the Treasury, based on the current average market yield on 10- to 12-year U.S. Treasury obligations less an adjustment not to exceed 2% per year. The President would be authorized to defer the initial payments on the loans for five years or half the term of the loan, whichever was less. Such sums as the President might determine necessary could be transferred to the Fund from disaster relief appropriations. In turn, the President could transfer excess monies in the Fund to the general fund of the Treasury or to disaster relief appropriations.[52]

## Disaster Relief Act of 1974: The Robert T. Stafford Disaster Relief and Emergency Assistance Act[53]

The Disaster Relief Act of 1974 (P.L. 93-288, 42 U.S.C. 5121 et seq.) replaced the program of community disaster *grants* with a program of community disaster *loans*. However, the loan program was given a mandatory cancellation provision. This eliminated the locality's obligation to repay the loan, under specified budgetary conditions (Sec. 414(a)). The 1974 amendments broadened the consideration of revenues to be replaced from property taxes to "tax and other revenues." The amount of, and limit on, the loan was linked, not to lost revenues, but to the size of the operating budget. The budget could include additional disaster-related expenses if they were of a municipal operation nature.

Specifically, the 1974 Act authorized the President to make loans to any local government which suffers a substantial loss of tax and other revenues (which the conferees intended to include utility revenues) as a result of a major disaster, and has demonstrated a need for financial assistance in order to perform its governmental functions. (The legislative history of the act gives as examples of municipal services

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[52] Legislative History of P.L. 91-606, Disaster Relief Act of 1970, *United States Code, Congressional and Administrative News*, 91st Cong., 2nd Sess., 1970, vol. 3 (St. Paul, Minn.: West Publishing Co., 1971), pp. 5513-5514.

[53] The 1974 Act was renamed the Stafford Act by the Disaster Relief and Emergency Assistance Amendments of 1988, P.L. 100-707, Sec. 102.

the protection of public health and safety and the operation of the public school system.) The amount of the loan is to be based on need but may not exceed 25% of the annual operating budget of the local government for the fiscal year in which the major disaster occurs.

Repayment of all or any part of the loan is to be cancelled to the extent that revenues of the local government during the three full fiscal years following the major disaster are insufficient to meet the operating budget of the local government. This budget may include additional disaster-related expenses of a municipal operation character. The 1974 Act also provided that any loans made under this section would not reduce or otherwise affect any grants or other assistance under the Stafford Act.

The enacted provisions regarding CDLs originated in S. 3062, the Disaster Relief Act Amendments of 1974, as approved by the Senate. There was no counterpart in the House amendment to S. 3062. The conference substitute amendment made the cancellation of community disaster loans mandatory under the specified conditions. The Senate-passed bill had authorized the President to cancel all or part of the CDLs under the specified conditions.[54] The Senate Report to accompany S. 3062 stated that the loan or any cancelled portion could not be used as the non-federal share of any federal program, including those programs under the act.[55]

## Disaster Mitigation Act of 2000

Before 2000, there was no dollar limit on the amount of the loan that could be made to a local government under Sec. 417 of the Stafford Act. Sec. 207(5) of the Disaster Mitigation Act of 2000 (P.L. 106-390) placed a limit of $5 million on the size of the loan that could be made to a local government. (This dollar limit was in addition to the limit of 25% of the operating budget.) The 2000 amendments also provided that a local government cannot receive additional assistance under Sec. 417 if it is in arrears on payments for a previous loan.[56]

In placing these limits, Congress was reportedly reacting to two very large loans that had been made to the Virgin Islands in the aftermath of Hurricane Hugo in 1989 and Hurricane Marilyn in 1995, for which repayment was cancelled. See **Table 3** earlier in this report.

Section 204(a) of H.R. 707 as passed by the House would have repealed Sec. 417 of the Stafford Act and thereby eliminated the disaster loan program. It was Sec.

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[54] Legislative History of P.L. 93-288, Disaster Relief Act of 1974, *United States Code, Congressional and Administrative News*, 93rd Cong., 2nd Sess., 1974, vol. 2 (St. Paul, Minn.: West Publishing Co., 1975), pp. 3077, 3086, and 3110.

[55] Op. cit., p. 3077. Senate Report (Public Works Committee) No. 93-778, Apr. 9, 1974, 12. Community Disaster Grants (Sec. 414).

[56] CRS Report RS20736, *Disaster Mitigation Act of 2000 (P.L. 106-390): Summary of New and Amended Provisions of the Stafford Disaster Relief Act*, by Keith Bea..

207 of H.R. 707 as passed by the Senate which contained the amendments to Sec. 417 that were adopted in the enacted bill.