CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 29, 2007

H.R. 1361
RECOVER Act

As ordered reported by the House Committee on Small Business on March 15, 2007

SUMMARY

H.R. 1361 would make various changes to existing and future loans made by the Small Business Administration (SBA) in response to a disaster. Those changes would increase the cost of assistance that SBA will provide after future disasters, and also would increase the cost of certain loans SBA has already made or obligated. In addition, the bill would: increase the maximum loan that can be made for certain categories of individuals and businesses for hazard mitigation purposes; authorize SBA to guarantee disaster bridge loans to businesses; establish a program to authorize certain types of private lenders to process, approve, disburse, and service SBA disaster loans; and create a grant program for small businesses affected by the 2005 Gulf Coast hurricanes. Moreover, the bill would expand the Economic Injury Disaster Loan (EIDL) program to include private, nonprofit organizations.

One provision of the bill would increase direct spending. Section 211 would grant SBA the discretion to partially or fully waive the requirement that borrowers prepay disaster loans upon receipt of other funds that are considered to be a duplication of the benefits provided by the SBA disaster loan. This provision would apply to borrowers in areas affected by Hurricanes Katrina, Rita, and Wilma. Based on information from SBA, CBO estimates that authorizing SBA to waive the duplication of benefits requirement would increase the subsidy rate for outstanding disaster loans by about 2 percentage points, at an estimated cost of $215 million over the 2007-2009 period. That cost would be incurred without enactment of any subsequent legislation.

In addition, CBO estimates that implementing other provisions of H.R. 1361 would cost $347 million over the 2008-2012 period, subject to the appropriation of the necessary funds.

H.R. 1361 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the bill is shown in the following table. The budgetary impact of this legislation falls within budget function 450 (community and regional development).

	By Fiscal Year, In Millions of Dollars					
	2007	2008	2009	2010	2011	2012
CHANGES IN DIRECT SPENDING						
Elimination of Prohibition on Duplication of Benefits						
Estimated Authorization Level	215	0	0	0	0	0
Estimated Outlays	140	45	30	0	0	0
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Changes to Future SBA Disaster Loans						
Estimated Authorization Level	0	28	29	29	30	30
Estimated Outlays	0	14	25	29	29	30
Grants to Disaster-Affected Small Businesses						
Estimated Authorization Level	0	180	0	0	0	0
Estimated Outlays	0	72	72	36	0	0
Economic Injury Disaster Loans to Private Nonprofit Organizations						
Estimated Authorization Level	0	3	3	3	3	3
Estimated Outlays	0	2	3	3	3	3
Other Provisions Affecting SBA						
Estimated Authorization Level	0	6	6	6	6	6
Estimated Outlays	0	4	5	5	6	6
Total Proposed Changes - Subject to Appropriation						
Estimated Authorization Level	0	217	38	38	39	39
Estimated Outlays	0	92	105	73	38	39

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted before the end of fiscal year 2007, that the amounts authorized by the bill will be appropriated for each year, and that spending will follow historical patterns for current and similar programs.

The Federal Credit Reform Act (FCRA) of 1990 requires an appropriation of the estimated subsidy costs and administrative costs associated with loan guarantee and direct loan program operations. The subsidy cost is the estimated long-term cost to the government of a direct loan or a loan guarantee, calculated on a net-present-value basis, excluding administrative costs. Administrative costs, calculated on a cash basis, include activities related to making, servicing and liquidating loans, as well as overseeing the performance of lenders.

The budgetary impact of the bill's modifications to SBA's credit programs is measured in terms of projected subsidy costs. H.R. 1361 does not specify an explicit authorization level for either the subsidy or the administrative costs for the amendments it would make to SBA's disaster loan program or for the new direct loan and loan guarantee programs authorized by the bill; CBO estimated those amounts using historical information about the operation of SBA's disaster loan program.

Direct Spending

Section 211 would grant SBA the discretion to partially or fully waive the requirement that borrowers prepay disaster loans upon receipt of other funds (for example, grants or insurance payments) that are considered to be a duplication of the benefits provided by the loan. This provision would apply to loans made to areas of Texas, Louisiana, Mississippi, Alabama, and Florida affected by Hurricanes Katrina, Rita, and Wilma.

Under procedures specified in the Federal Credit Reform Act for recording the cost of direct federal loans, the Administration now estimates that the subsidy rate is about 20 percent for disaster loans made in fiscal year 2006 and 18 percent for loans made in fiscal year 2007. As of March 2007, SBA had approved about $5.4 billion in disaster loans to individuals and businesses affected by the 2005 Gulf Coast hurricanes. CBO estimates that loan disbursements will reach about $7 billion by the end of fiscal year 2007 and close to $11 billion through 2009. Under current law, the expected subsidy cost to the federal government of those disaster loans made through fiscal year 2009 is about $1.9 billion. Based on information from SBA, CBO estimates that eliminating the prohibition on the duplication of benefits would increase the subsidy rate by about 2 percentage points, at an estimated cost of $215 million over the 2007-2009 period, largely because the loans would remain outstanding for longer periods of time.

Under FCRA, the budgetary cost of legislative modifications to existing loans is recorded on the budget in the same year that the legislation making the modification is enacted. Thus, for the $7 billion in loans expected to be disbursed by the end of fiscal year 2007, CBO estimates that this provision would cost $140 million in 2007. As approved loans continue to be disbursed through 2009, the additional costs of those loans would be recorded in the federal budget upon disbursement. As a result, CBO estimates that enacting H.R. 1361 will increase direct spending by $215 million over the 2007-2009 period. Enacting H.R. 1361 would affect direct spending because that cost would be incurred without enactment of subsequent legislation.

Spending Subject to Appropriation

CBO estimates that the costs of implementing H.R. 1361 that are subject to appropriation action would total $347 million over the 2008-2012 period, assuming appropriation of the necessary amounts.

Disaster Mitigation Loans. Section 201 would authorize SBA to make or guarantee loans for disaster mitigation up to a maximum of 20 percent of the assessed damage to a home or business. Currently, SBA offers direct loans for such purposes up to a maximum of 20 percent of the approved disaster loan. In some cases, SBA will make a disaster loan for less than the assessed damage due to factors such as reimbursements from other sources. Thus, H.R. 1361 would increase the maximum amount of a disaster mitigation loan by 20 percent of the difference between assessed damages and the approved loan amount. The bill would apply this increase to loans made to small businesses and private, nonprofit organizations in the areas of Texas, Louisiana, Mississippi, Alabama and Florida affected by Hurricanes Katrina, Rita, and Wilma, as well as to all future mitigation loans. The demand for such loans tends to be relatively small, and CBO estimates that implementing this provision would have a negligible effect on the federal budget over the next five years.

Immediate Disaster Assistance Program. Section 203 would establish an Immediate Disaster Assistance Program. Under the program, SBA would guarantee 85 percent of private loans, up to $25,000, made to businesses following a disaster. Once an application is received, SBA would be required to approve or disapprove such a loan guarantee within 36 hours. Upon approval of a traditional disaster loan for a business borrower, any amount guaranteed under the proposed Immediate Disaster Assistance Program would be immediately repaid. Such a program to “bridge” the time period between the need for a loan and the availability of a traditional disaster loan would be similar to one already operated by

SBA for certain nondisaster loans. Based on information from the agency, CBO expects that demand for SBA loans would not be significantly altered under such new authority, although additional risk would be incurred for borrowers that receive loan guarantees and are later denied a traditional disaster loan. Because that is not likely to occur often, CBO estimates that this program would have a negligible cost over the next five years.

Changes to Future SBA Disaster Loans. Section 205 would require SBA to lengthen the time period during which borrowers may defer repayment of disaster loans to a minimum of 12 months after final loan disbursement. Furthermore, the bill would require that repayment calculations be based solely upon the disbursed amount of the loan. Currently, SBA grants a minimum deferment period of five months following loan approval and calculates repayment based on the approved amount of the loan. Based on information from SBA, CBO expects that the deferment period for most disaster loans would increase to about 18 months under the bill and that the revised repayment calculation would extend the total repayment period for a small number of loans. CBO estimates that implementing these provisions of H.R. 1361 would increase the future subsidy cost of disaster loans by about 3 percentage points. For this estimate, CBO assumed that the demand for SBA disaster loans over the next five years would average about $1 billion per year. On that basis, we estimate that implementing this provision would cost $14 million in 2008 and $127 million over the 2008-2012 period. Such costs would be subject to appropriation action.

Section 207 would prohibit SBA from requiring a borrower to use his or her home as collateral for a business disaster loan of less than or equal to $100,000. Current law prohibits the collateral requirement for loans that are less than $10,000. For loans above this threshold, SBA prefers (but does not require) the use of a borrower's home as collateral. As such, CBO expects that this provision would not increase the number of loans approved by SBA, but that it could affect the recovery rates on any future loans that go into default. SBA does not consider the value of a home as collateral when estimating the subsidy rate for business disaster loans. Therefore, CBO expects that this provision would have a minor impact on the subsidy cost of such loans.

Enhanced Lending Authority for Private Lenders. Section 208 would direct SBA to establish a program whereby certain private lenders would be permitted to process, approve, close, and service disaster loans. This program could be implemented at any time at the discretion of the SBA, but would be required when a disaster of national significance occurs or when the average approval period for disaster loans exceeds 30 days. For this work, SBA would pay participating private lenders a servicing fee of up to two percent of the total loan amount approved by the private lenders.

CBO expects that such a program would be used infrequently following rare catastrophic events. The existence of the Disaster Reserve Corps that would be authorized by this bill would lessen the need to use private lenders. Assuming minimal differences in the default rates and administrative expenses of loans made by private lenders and those made by SBA, CBO estimates that implementing this provision would have a negligible effect on the federal budget. It is possible, however, that having private lenders approve, disburse, close, and service direct federal loans could change—perhaps significantly—the subsidy rate for future disaster loans. There is no precedent for this type of private-sector involvement in issuing federal loans, and CBO has no basis for judging whether and how subsidy rates would change as a result of this provision.

Grants to Disaster-Affected Small Businesses. Section 210 would establish a grant program for small businesses in certain areas of Texas, Louisiana, Mississippi, Alabama, and Florida affected by Hurricanes Katrina, Rita, and Wilma. Eligible small businesses include those that were denied traditional disaster loans and are determined to have long-term economic viability. The maximum amount of such grants would be $100,000, and they would be awarded upon the condition that the business be reestablished in the disaster-affected region. As of March 2007, about 18,000 businesses were rejected for traditional disaster loans in the applicable regions. Because they did not receive loans, CBO expects few businesses could be considered viable. Assuming 10 percent of those applicants met the eligibility criteria specified in the bill and were awarded the full grant value, CBO estimates that implementing this provision would cost $72 million in 2008 and $180 million over the 2008-2012 period, assuming appropriation of the necessary funds.

Disaster Loans to Private Nonprofit Organizations. Section 214 would expand SBA's Economic Injury Disaster Loans (EIDL) program to include private, nonprofit organizations**.** Under current law, the EIDL program makes direct loans to small businesses and small agricultural cooperatives that have suffered a substantial loss in business revenue as a result of a disaster. Based on the historical volume of physical disaster loans made to nonprofits and of EIDLs made to small businesses, CBO estimates that implementing this provision would cost $2 million in 2008 and $14 million over the 2008-2012 period for the subsidy and administrative cost of making additional loans.

Other Provisions. Based on information from SBA, CBO estimates that implementing other provisions of H.R. 1361 would require appropriations totaling $30 million over the next five years. That amount includes:

- $15 million to maintain a Disaster Reserve Corps of 1,000 individuals, including training and an annual simulation exercise;

- $10 million to ensure that a backup loan-processing facility could become operational within 2 days of a primary facility becoming unavailable; and

- $5 million to create separate Directors of Disaster Assistance and Planning, including additional support staff.

Those estimates are based on information from SBA regarding costs of existing or similar programs. Based on historical spending patterns, CBO estimates that fully funding those activities would cost $4 million in 2008 and $26 million over the next five years, assuming appropriation of the necessary amounts.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 1361 contains no intergovernmental or private-sector mandates, as defined in UMRA, and would impose no costs on state, local, or tribal governments.

ESTIMATE PREPARED BY:

Federal Costs: Daniel Hoople
Impact on State, Local, and Tribal Governments: Melissa Merrell
Impact on the Private Sector: Craig Cammarata

ESTIMATE APPROVED BY:

Robert A. Sunshine
Assistant Director for Budget Analysis