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FEMA's Community Disaster Loan Program: Action in the 110th Congress

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Summary

The emergency supplemental appropriations act for FY2007 (P.L. 110-28), enacted on May 25, 2007, included provisions permitting the cancellation of the $1.3 billion in special community disaster loans (CDLs) approved by the Federal Emergency Management Agency (FEMA) under two laws enacted during the 109th Congress in the aftermath of Hurricanes Katrina and Rita.

Areas struck by disaster often experience a destruction of property and decline in economic activity. Local revenue collections may fall substantially as a consequence. The federal Community Disaster Loan program, administered by FEMA, is intended to assist local governments that experience revenue losses as the result of a presidentially declared major disaster. The traditional 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. From the initiation of the program in August 1976 through September 30, 2005, 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 the cancelled principal. To restrain program costs, 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. The CDLA provided for "special" community disaster loans, up to an aggregate of $1 billion in principal amount, to local governments so they could continue to provide essential services in the aftermath of Hurricanes Katrina and Rita. For these special loans, the new law removed the $5 million per loan limit but prohibited their cancellation. Within two weeks of enactment, companion bills were introduced to remove the prohibition on cancellation, but they were not voted upon.

The Emergency Supplemental Appropriations Act of 2006 (P.L. 109-234), enacted on June 15, 2006, included an appropriation to support an additional $371.733 million in CDLs. These loans were available only to communities that had lost 25% or more of their tax revenues as the result of Hurricane Katrina or Rita. Again, the $5 million limit was removed but cancellation of the loans was prohibited.

Efforts to permit the cancellation of both groups of special CDLs authorized by the 109th Congress resumed early in the 110th Congress. Such provisions were included in H.R. 1591, the emergency supplemental appropriations bill for FY2007, vetoed by President Bush on May 2, 2007, and again in H.R. 2206, the emergency supplemental that was finally enacted as P.L. 110-28. The original appropriations for the loans had assumed a 75% default rate. The Congressional Budget Office (CBO) estimated the cost of permitting cancellation of the $1.27 billion in loans to be an additional $321 million. This report is the follow-up to CRS Report RL33174, *FEMA's Community Disaster Loan Program: Action in the 109th Congress*, by Nonna A. Noto and Steven Maguire. It will be updated if events warrant.

Contents

List of Tables

FEMA's Community Disaster Loan Program: Action in the 110th Congress

Overview

In addition to the heavy loss of lives and the dislocation of hundreds of thousands of families, Hurricane Katrina on August 29, 2005, 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 was concern in Congress and elsewhere, but particularly in the tax-exempt bond community, that the destruction of the underlying tax base would 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 faced 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]

The Community Disaster Loan (CDL) program, administered by the Federal Emergency Management Agency (FEMA), 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.

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 local budget conditions.

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

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

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.[3] The CDL program is intended specifically to permit a community to borrow to pay for operating expenses *after* its revenue base has been damaged by a disaster.

In the 109th Congress, on a single day — 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 (CDLA), P.L. 109-88. The act provided 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 made two important changes in the conditions governing these loans compared with traditional CDLs: it removed the $5 million per loan limit and prohibited the cancellation (forgiveness) of these loans. Nonetheless, the ratio of appropriations to loan limit was based on the assumption of a 75% default rate on the loans. Subsequently, FEMA approved loans totaling the full $1 billion permitted by the CDLA.

Efforts soon began to remove the prohibition on the cancellation of the special CDLs. Companion bills to that effect were introduced in late October 2005, but were never voted upon by the 109th Congress.

The Emergency Supplemental Appropriations Act of 2006 (P.L. 109-234), enacted on June 15, 2006, included an appropriation of $279.8 million to support an additional $371.733 million in direct loans to communities affected by hurricanes during the 2005 season. Once again, the ratio of appropriations to loan limit was based on the assumption of a 75% default rate on the loans. These supplemental loans were available to communities that lost 25% or more of their tax revenues as the result of Hurricanes Katrina or Rita. This law again removed the $5 million per loan limit and prohibited cancellation of these loans. It also raised the size limit for a loan from 25% to 50% of a community's operating budget. FEMA approved loans totaling $271 million to all eligible applicants; $101 million of the loan authorization was not used.

The SAFE Port Act (P.L. 109-347), enacted on October 13, 2006, raised the size limit for a traditional CDL from 25% to 50% of a local government's annual operating budget if that government lost 75% or more of its tax and other revenue as the result of a major disaster. The $5 million per loan limit and the cancellation option still apply to traditional CDLs.

Efforts began early in the 110th Congress to permit the cancellation of the two groups of community disaster loans specifically authorized by the 109th Congress. Several bills were introduced in the first three months of 2007. Provisions enabling cancellation of those loans were included in H.R. 1591, the initial emergency supplemental appropriations bill for FY2007 that was approved by Congress but

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[3] 44 C.F.R. 206.366 (a)(5).

vetoed by President George W. Bush on May 1, 2007, for reasons related to the war in Iraq. The same CDL provisions were included in H.R. 2206, the emergency supplemental for FY2007 that was enacted as P.L. 110-28 on May 25, 2007.

The original appropriations for the loans in 2005 and 2006 had already covered 75% of the principal amount. The Congressional Budget Office (CBO) estimated the cost of permitting cancellation of the principal and interest due on the $1.27 billion in loans to be an additional $321 million, measured in FY2007 dollars.[4]

Traditional Community Disaster Loans: Section 417 of the Stafford Act

This section describes the law and regulations which governed all community disaster loans before October 2005. These rules will continue to govern traditional community disaster loans made outside of the provisions for special CDLs. The rules not amended by the laws enacted in 2005 and 2006 will continue to apply to the special community disaster loans as well.

The Robert T. Stafford Disaster Relief and Emergency Assistance Act[5] 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.[6]

Of particular relevance to local governments is Section 417 of the Stafford Act.[7] Section 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.

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[4] U.S. Congressional Budget Office, *H.R. 1144, Hurricanes Katrina, Rita, and Wilma Federal Match Relief Act of 2007*, CBO Cost Estimate, March 13, 2007.

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

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

[7] 42 U.S.C. 5184, Community Disaster Loans.

A loan may be approved in either the fiscal year in which the disaster occurs or the fiscal year immediately following. Only one CDL may be approved for any one local government as the result of a single disaster.[8]

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. The SAFE Port Act (P.L. 109-347), enacted on October 13, 2006, raised the size limit for a traditional CDL from 25% to 50% of a local government's annual operating budget if that government lost 75% or more of its tax and other revenue as the result of a major disaster. In addition, as a result of an amendment made in 2000, the dollar amount of any loan is limited to $5 million.[9] 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.[10]

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 or anticipating a 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.[11] The funds are *not* to be used to finance capital

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[8] 44 C.F.R. 206.361(d).

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

[10] 44 C.F.R. 206.361(e) and 206.367(c).

[11] 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

(continued...)

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.[12]

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.[13]

Disaster-related expenses that are eligible for reimbursement under project applications or other federal programs are *not* eligible for loan cancellation.[14] 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; or 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

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[11] (...continued)
(10-1-04 Edition).

[12] 44 C.F.R. 206.361 (f).

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

[14] 44 C.F.R. 206.366 (b) (2).

> additional unreimbursed disaster-related expenses of a municipal operating character.[15]

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

Legislation Enacted 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 and allocated funding for $1 billion in special loans through the Community Disaster Loan Act of 2005 (P.L. 109-88), enacted on October 7, 2005. The Emergency Supplemental Appropriations Act for FY2006 (P.L. 109-234), enacted on June 15, 2006, provided funding for an additional $372 million in special loans to communities that lost tax revenues as a result of the 2005 hurricanes; this law included another change in the rules governing the size of these disaster loans. The SAFE Port Act (P.L. 109-347) raised the percent-of-budget limit on the size of a traditional CDL that will now be available to a local government that suffers a severe loss of tax and other revenue from a major disaster.

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.[16] The motivation for the expedited treatment was reportedly to have the money available to affected communities by Monday, October 10.[17]

P.L. 109-62, the second emergency supplemental appropriations act adopted following Hurricane Katrina, provided for $50 billion in "disaster relief."[18] The Community Disaster Loan Act of 2005 provided for up to $750 million of those funds to be transferred to FEMA's Disaster Assistance Direct Loan (DADL) Program. These funds, in turn, were to be used to make direct loans to local governments to assist them in providing "essential services," as authorized under

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[15] 44 C.F.R. 206.366. See also Section 206.361(g).

[16] S. 1858 was introduced by Sen. 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 October 7, 2005.

[17] Statement by Rep. Baker, *Congressional Record*, daily edition, vol. 151, no. 130, October 7, 2005, p. H8797.

[18] 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 September 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.

Section 417 of the Stafford Act.[19] The transfer of $750 million could subsidize gross obligations for the principal amount of direct loans not to exceed $1 billion.[20]

The CDLA also allowed 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.[21]

The new law made 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 applied.) Second, the cancellation (forgiveness) of such loans was prohibited. Third, the law directed 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.[22] Several Members made statements on the House and Senate floors objecting to the requirement that the loans be repaid.[23] Representative David Obey requested that a requirement be included to report to Congress about the size and use of the loans made.[24] There were assurances from Representative Richard Baker that Mr. Obey's concern would be addressed after the Columbus Day recess,[25] but it was not.

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[19] 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).

[20] 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.

[21] 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.

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

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

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

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

The interim rules implementing the Special Community Disaster Loans Program were published on October 18, 2005.[26] The standard interest rate on SCDLs is, again, the average rate on Treasury issues with five-year maturities. However, the rules provide that FEMA would 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.[27] A formula was 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 assumed that the borrower interest rate for the CDL program would be 2.70% during FY2006.[28]

The term of the SCDLs is to remain, as for traditional CDLs, at five years, with the option for the Associate Director of FEMA to extend 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.

Emergency Supplemental Appropriations Enacted in June 2006

The Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006 (H.R. 4939 as amended, P.L. 109-234) was enacted on June 15, 2006.[29] Among its many provisions, it appropriated an additional $279.8 million for the Disaster Assistance Direct Loan Program Account, of which $1 million was for administrative expenses. The remaining $278.8 million was to subsidize gross obligations for the principal amount of direct loans up to $371.733 million. As with the Special Community Disaster Loan (SCDL) program

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

[27] For businesses not able to obtain credit elsewhere, the law sets a maximum interest rate of 4% per year on federal physical disaster loans to small businesses. Explained on the SBA website at [http://www.sba.gov].

[28] 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.

[29] For detailed information about that act, see CRS Report RL33298, *FY2006 Supplemental Appropriations: Iraq and Other International Activities; Additional Hurricane Katrina Relief*, coordinated by Paul M. Irwin and Larry Nowels.

authorized under the CDLA of 2005, this numerical relationship was based on the assumption of a 75% credit subsidy rate for the loans.

The funds were to be used to assist local governments affected by Hurricane Katrina and other hurricanes of the 2005 season in providing essential services. As with the SCDLs, the loans made under this law may not be cancelled. Loans were available only to local governments that suffered a loss of 25% or more in *tax revenues* due to Hurricane Katrina or Hurricane Rita. This is in contrast to the reference in Section 417 of the Stafford Act to "a substantial loss of tax and other revenues." As was provided for the special CDLs, a loan could exceed the $5 million limit placed on traditional CDLs. In addition, the loan could equal not more than 50% of the annual operating budget of the local government. This is in contrast to the 25%-of-budget limit that applies to both traditional and special CDLs.

Because no specific language was included to indicate that the funds would be available until expended, it was interpreted by FEMA that the loans must be made by September 30, 2006, the end of FY2006, to take advantage of the supplemental appropriation. (The same time limit applied to the original SCDLs.) This placed time pressure on the loan application, approval, and dispersal process. Because the percent-of-budget limit was raised to 50%, communities that applied in the first round for SCDLs of up to 25% of their operating budget could apply for an additional 25% under the emergency supplemental loans. A variety of special districts that rely on revenues other than taxes (such as charges and fees) were *not* eligible to apply for the supplemental appropriations loans. This included, for example, hospital, port, airport, water, regional transit, and communications authorities.

Number of Loans Approved by State and Size of Loan

Tables 1 and **2** summarize the experience under the two special CDL programs combined, with separate tabulations for Louisiana and Mississippi. FEMA approved 96 loans for Louisiana communities, totaling $1 billion in principal amount. Fifty-six loans totaling $271 million were approved for communities in Mississippi (**Table 1**). All together, FEMA approved 152 loans totaling $1,271 million. The full $1 billion of loan authority under the CDLA of 2005 was used. Of the $372 million in loans authorized by the 2007 emergency supplemental, $271 million was used, but $101 million was not.

Table 1. Total Number and Dollar Amount of Combined 2005 Special and 2006 Supplemental CDLs Approved by FEMA, by State

State	Number of Loans	Amount ($ millions)
Louisiana	96	1,000
Mississippi	56	271
Total	152	1,271

Source: Data supplied by FEMA, June 18, 2007.

Approximately two-thirds of the 152 loans approved were for amounts under $5 million, the previous cap on the size of a community disaster loan. Fifty-three loans were for more than $5 million. Of those, 18 loans were for between $5 million and $10 million, 21 between $10 million and $20 million, and 14 over $20 million. Louisiana dominated in both the smallest and largest loan size categories. Louisiana communities received 33 loans for under $1 million, compared with 10 for Mississippi communities. All of the 14 loans for over $20 million went to Louisiana entities (**Table 2**).

Table 2. Size Distribution of Combined Special and Supplemental CDLs Approved by FEMA, by State

(number of loans)

Size of Loan (in $ millions)	Louisiana	Mississippi	Total
over 20	14	0	14
10-20	10	11	21
5-10	12	6	18
1-5	27	29	56
under 1	33	10	43
Total	96	56	152

Source: Tabulated by CRS from information on individual loans supplied by FEMA, June 18, 2007.

SAFE Port Act Enacted in October 2006

The Security and Accountability For Every Port Act of 2006, or SAFE Port Act (H.R. 4954, P.L. 109-347), was enacted on October 13, 2006. Section 608 of the act, added in the conference on the bill,[30] addresses community disaster loans. The act increased the size limit on a traditional CDL from 25% to 50% of the annual operating budget of the local government for the fiscal year in which the major disaster occurs, under the following condition: the local government's loss of tax and other revenues as a result of the major disaster must equal at least 75% of the annual operating budget of that local government for the fiscal year in which the major disaster occurs. The $5 million cap on the size of an individual loan and the option for FEMA to cancel the loan still apply. The conference report stated that this provision would primarily help small local governments with annual budgets of under $10 million.

[30] *SAFE Port Act*, conference report to accompany H.R. 4954, 109th Cong., 2nd sess., H.Rept. 109-711, printed in *Congressional Record*, daily edition, vol. 152, No. 125 — Book II, September 29, 2006, p.H8540.

Bills and Legislation in the 110th Congress

Soon after the bill creating the special CDLs was enacted on October 7, 2005, companion bills were introduced to remove the clause in the Community Disaster Loan Act of 2005 (P.L. 109-88) that prohibits the cancellation of those loans. Those bills — S. 1872 (Landrieu), introduced October 17, 2005, and H.R. 4117 (Melancon), introduced October 20, 2005 — were never voted upon in the 109th Congress.

The effort to permit cancellation of the CDLs authorized by the 109th Congress resumed early in the 110th Congress. Some bills addressed permitting cancellation of only the special CDLs authorized in October 2005. These included S. 87 (Vitter) introduced on January 4, H.R. 680 (Jefferson) introduced on January 24, and H.R. 1144 (Clyburn) introduced on February 16, 2007. S. 253 (Landrieu), introduced on January 10, 2007, was the first bill to permit cancellation of both the special CDLs provided under P.L. 109-88 and the emergency supplemental CDLs provided under P.L. 109-234.

Provisions permitting cancellation for both groups of loans were included in H.R. 1591, the massive emergency supplemental appropriations bill for FY2007, which was approved by both the House and the Senate, but vetoed by President Bush on May 1, 2007. The provisions were present in both H.R. 1591 as initially reported by the House Appropriations Committee and in the final conference report. The dual provisions were also included in S. 965, the Senate Appropriations Committee version of the emergency supplemental for FY2007, which was reported on March 22, 2007, but not voted upon. Subsequent to the veto of H.R. 1591, the chapter pertaining to Disaster Relief was included in H.R. 2187 (Alexander).[31] Identical language permitting cancellation of the CDLs was again included in H.R. 2206 (Obey), the second version of the emergency supplemental appropriations bill for FY2007, which was enacted as P.L. 110-28 on May 25, 2007.

The relevant language of the new law amends both Section 2(a) of the Community Disaster Loan Act of 2005 (P.L. 109-88) and Chapter 4 of Title II of the Emergency Supplemental Appropriations Act 2006 (P.L. 109-234) under FEMA's Disaster Assistance Direct Loan Program Account by striking "*Provided further*, That notwithstanding section 417(c)(1) of [the Stafford Act], such loans may not be canceled:" from both acts.[32] This change was made effective retroactively, as of the date of enactment of the respective law that authorized the particular group of loans.

House Bills

H.R. 680 (Jefferson). Introduced January 24, 2007; referred to the Committee on Transportation and Infrastructure. H.R. 680 would have permitted the cancellation of the special community disaster loans made under the auspices of the

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[31] In both H.R. 1591 and H.R. 2187, Chapter 5 addresses Department of Homeland Security, Federal Emergency Management Agency, Disaster Relief.

[32] "Stafford Act" was used in the case of the special CDLs, P.L. 109-88. In the case of the emergency supplemental CDLs, P.L. 109-234, the reference was to "such Act."

Community Disaster Loan Act of 2005 (P.L. 109-88). Nearly identical to S. 87 (Vitter). Essentially the same language was subsequently included as Section 3 of H.R. 1144 (Clyburn) and as Section 2502(a) of H.R. 1591 as agreed to by both the House and the Senate in April 2007.

H.R. 1144 (Clyburn). *Hurricanes Katrina and Rita Federal Match Relief Act of 2007*. Introduced February 16, 2007; referred to the Committee on Transportation and Infrastructure. Section 3 of this short bill would have removed the prohibition on the cancellation of the special CDLs made under the Community Disaster Loan Act of 2005 (P.L. 109-88). Section 3, the last section of H.R. 1144, was identical to H.R. 680 and very similar to S. 87. It was also included as Section 2502(a) of H.R. 1591. Section 2 of H.R. 1144 was amplified in Section 2501(a) of H.R. 1591 and subsequently included as Section 4501 of H.R. 2206, enacted as P.L. 110-28. It makes the federal share of assistance 100% for states affected by specific recent hurricanes. CBO issued a cost estimate of the bill. Their estimated cost of permitting cancellation of the special and emergency supplemental CDLs was $321 million.[33]

H.R. 1591 (Obey). *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*. An original measure from the House Appropriations Committee. Reported by Representative Obey on March 20, 2007, H.Rept. 110-60. Approved by the House on March 23. Approved by the Senate with an amendment on March 29. Conference Report 110-107 was filed on April 26. The conference report was agreed to in the House on April 25 and in the Senate on April 26. H.R. 1591 was vetoed by President Bush on May 1. The House failed to override the veto on May 2. This was the House version of the first attempt at an emergency supplemental appropriations bill for FY2007. It was the House counterpart to S. 965.

The relevant provisions of this massive bill are found in Title II (Katrina Recovery, Veterans' Care and Other Purposes), Chapter 5 (Department of Homeland Security, Federal Emergency Management Agency, Disaster Relief), General Provisions. Section 2502(a) would remove the prohibition on cancellation for the special community disaster loans provided by P.L. 109-88. This provision had previously appeared in H.R. 680, S. 87, and H.R. 1144. Section 2502(b) would remove the prohibition on cancellation for the CDLs provided by the FY2006 Emergency Supplemental Appropriations Act, P.L. 109-234. This provision was first included in S. 253 and was later included in S. 961. H.R. 1591 was the first bill to included a separate effective date for the provision addressing the emergency supplemental CDLs, in Section 2502(b)(2). The same provisions were subsequently included in H.R. 2187 and H.R. 2206, enacted as P.L. 110-28.

H.R. 2187 (Alexander). *To make emergency supplemental appropriations for Katrina recovery for the fiscal year ending September 30, 2007, and for other purposes*. Introduced May 7, 2007; referred to the Appropriations Committee and the Budget Committee. The language of Chapter 5, which addresses disaster relief,

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[33] U.S. Congressional Budget Office, *H.R. 1144, Hurricanes Katrina, Rita, and Wilma Federal Match Relief Act of 2007,* CBO Cost Estimate, March 13, 2007.

is identical to Chapter 5 of Title II of H.R. 1591, the bill vetoed by President Bush on May 1. Section 2502 of H.R. 2187 would have removed the prohibition on cancellation of both the special (Section 2502(a)) and emergency supplemental (Section 2502(b)) community disaster loans.

H.R. 2206 (Obey). *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*. Introduced May 8, 2007; referred to the Appropriations Committee and the Budget Committee. Enacted as P.L. 110-28 on May 25, 2007. 121 Stat. 112. This is the second version of the emergency supplemental appropriations bill for FY2007. It was introduced by Representative Obey, Chairman of the House Appropriations Committee, following President Bush's veto of H.R. 1591. Chapter 5 (Department of Homeland Security, Federal Emergency Management Agency, Disaster Relief) of Title IV (Additional Hurricane Relief and Recovery) of H.R. 2206 as enacted is identical to Chapter 5 of Title II of H.R. 1591 and chapter 5 of H.R. 2187, with the exception that the section numbers are 4501-4503, instead of 2501-2503. Section 4502(a) removes the prohibition on the cancellation of the special CDLs, and Section 4502(b) does the same for the emergency supplemental CDLs .

Senate Bills

S. 87 (Vitter). Introduced January 4, 2007; referred to the Committee on Homeland Security and Governmental Affairs. S. 87 is a short, single-purpose bill would have permitted the cancellation of the special community disaster loans authorized by the Community Disaster Loan Act of 2005 (P.L. 109-88). Nearly identical to H.R. 680 (Jefferson). Similar language was subsequently included as Section 2502(a) of H.R. 1591 as agreed to by both the House and the Senate in late April 2007 and Section 4502(a) of H.R. 2206, enacted as P.L. 110-28.

S. 253 (Landrieu). *Disaster Loan Fairness Act of 2007*. Introduced January 10, 2007; referred to the Committee on Homeland Security and Governmental Affairs. This short bill was the first to remove the prohibition on cancellation from the community disaster loans made under the FY2006 Emergency Supplemental Appropriations Act (P.L. 109-234), in addition to the special CDLs made under the CDLA of 2005 (P.L. 109-88). This language was included in both S. 965 and H.R. 1591, the first versions of the emergency supplemental appropriations bills for FY2007, and later in H.R. 2206, enacted as P.L. 110-28. S. 253 did not include a separate effective date for the provision addressing the emergency supplemental loans.

S. 965 (Byrd). *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007*. An original measure from the Senate Appropriations Committee. Reported by Senator Byrd, March 22, 2007, S.Rept. No. 110-37. This was the Senate version of the first attempt at an emergency supplemental appropriations bill for FY2007. It was the Senate counterpart to H.R. 1591. The relevant sections of this massive bill are contained in Chapter 5, Department of Homeland Security, Federal Emergency Management Agency, Disaster Relief, General Provisions — This Chapter, Sections 2502 (a) and (b). Section 2502(a) would have removed the prohibition on cancellation for special community disaster loans authorized by P.L. 109-88. Section 2502(a) would have removed the prohibition on cancellation for the FY2006 emergency supplemental CDLs authorized under P.L. 109-234. S. 965 did not include effective dates particular to these two sections. S. 965 was never voted upon. Instead, H.R. 1591 became the first legislative vehicle for emergency supplemental appropriations for FY2007.

Budget Treatment of the CDL Program

Governing Budget Rules

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). Typically there is supplemental appropriations legislation to meet the needs of catastrophic disasters, as occurred with Hurricane Katrina.[34] Funds appropriated to the DRF usually remain available until expended (termed a "no-year" account). But in the case of the two special CDL programs, FEMA understood that the appropriated funds would be available to make loans only through the end of FY2006.

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.[35]

The CDL program is subject to the Federal Credit Reform Act of 1990 (FCRA).[36] The FCRA changed the accounting method for measuring the cost of federal direct loans and loan guarantees from cash flow to accrual accounting, starting in FY1992. Under the 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.[37] These requirements of the FCRA explain the

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[34] For more information on the FY2005 emergency legislation, see CRS Report RS22239, *Emergency Supplemental Appropriations for Hurricane Katrina Relief*, by Keith Bea. For an historical overview, see CRS Report RL33226, *Emergency Supplemental Appropriations Legislation for Disaster Assistance: Summary Data, FY1989 to FY2007*, by Justin Murray and Keith Bea. For information on the most recent emergency supplemental, see CRS Report RL33900, *FY2007 Supplemental Appropriations for Defense, Foreign Affairs, and Other Purposes*, by Stephen Daggett et al.

[35] Title XIII of The Omnibus Budget Reconciliation Act of 1990, P.L. 101-508.

[36] 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.

[37] For further explanation, see CRS Report RL30346, *Federal Credit Reform:*
(continued...)

language used in the laws that provided for the special and emergency supplemental CDLs, detailed in the last two paragraphs of this section.

Historically, traditional 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.[38] Congress made these changes to help control CDL program costs.

Both the CDLA of 2005 and the Emergency Supplemental of 2006 took two other approaches to controlling the cost of the particular CDL programs that they created. While they lifted the $5 million cap on an individual loan,[39] both laws prohibited the cancellation of any loan made under their auspices. Both laws also specified an upper limit on the aggregate principal amount of loans that could be made, based upon the dollars of subsidy appropriated.

The Community Disaster Loan Act of 2005 (P.L. 109-88) provided that up to $750 million of amounts previously appropriated by P.L. 109-62 for disaster relief could be transferred to the Disaster Assistance Direct Loan Program for the cost of direct loans as authorized under Section 417 of the Stafford Act. The transfer was permitted to subsidize gross obligations for the principal amount of direct loans not to exceed $1 billion. An additional $1 million was allocated for administering the loans.

The Emergency Supplemental Appropriations Act of 2006 (P.L. 109-234) appropriated an additional $279.8 million for the Disaster Assistance Direct Loan Program Account, of which $1 million was for administrative expenses. The remaining $278.8 million was permitted to subsidize gross obligations for the principal amount of direct loans not to exceed $371.733 million.

Subsidy Rate

The aggregate loan amounts authorized under the two acts were based on the assumption of a 75% subsidy rate. Seventy-five percent was the number used to determine that $750 million in budget authority could support total loans of $1

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[37] (...continued)
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.

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

[39] The FY2007 budget assumed that the average loan size under the special CDL program in FY2006 would be $5.714 million. OMB, *FY2007 Budget, Federal Credit Supplement*, p. 2.

billion,[40] as provided in the language of the CDLA.[41] The 75% figure was again used to determine that $278.8 million in appropriations could support direct loans of up to $371.733 million, as set forth in the 2006 Emergency Supplemental.[42]

The 75% subsidy rate assumed for the special CDLs was lower than the subsidy rate ascribed to traditional CDLs. FEMA has estimated the credit subsidy rate of the traditional CDL program at just over 93% for each fiscal year from 2005 through 2008. This subsidy is made up of two components, an interest rate subsidy and "all other." The interest rate subsidy accounts for the borrower's interest rate being below the federal government's cost of borrowing funds. The all other category includes cancellation of principal and interest payments. No part of the subsidy for traditional CDLs is attributed to the other two explanatory categories of defaults net of recoveries or fees.

For FY2005, for example, the traditional CDL program had an estimated credit subsidy rate of 93.43%. Of this, 3.72% was attributed to the interest rate and 89.72% to "all other." From FY2005 to FY2008, the interest component was projected to rise slightly, to 5.01%, as interest rates rose.[43] Essentially offsetting this, the "all other" component fell slightly, to 88.29%. Net, in each of the four years, the total estimated subsidy rate remained in the very narrow band from 93.30% to 93.43%.

Roughly speaking, this means that for every $100 million of traditional community disaster loans made, the federal government is assumed to provide a subsidy of $93 million. Of that, $5 million subsidizes an interest rate for borrowers that is lower than the federal borrowing rate and $88 million covers principal and interest payments that are cancelled (forgiven) by FEMA.[44] This was by far the

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[40] $750,000,000 divided by .75 equals $1,000,000,000. Equivalently, $1 billion times .75 equals $750 million.

[41] The Administration's FY2007 budget reported a subsidy rate of 75% and obligations of $1 billion for FY2006, as enacted by the CDLA in October 2005. The emergency supplemental CDLs were not enacted until June 2006, well after the publication date for the FY2007 budget documents in February 2006. 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), Table 1, p. 2 and note 3 on p. 3.

[42] $278,799,750 / .75 = $371,733,000. Equivalently, $371,733,000 x .75 = $278,799,750.

[43] The average borrower 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.

[44] 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

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highest estimated subsidy rate among all of the federal government's direct loan and loan guarantee programs listed in the FY2006 Budget.[45] Even at 75% the special and emergency supplemental CDL programs had the second highest subsidy rate estimated for FY2006 among all of the federal direct loan and loan guarantee programs listed in the FY2007 Budget.[46]

All of the 75% subsidy rate for special CDLs for FY2006 was attributed to defaults net of recoveries and none to interest.[47] This was despite an explicit interest subsidy for the program. All of the Gulf-area jurisdictions received the discounted interest rate permitted under the interim rules implementing the Special Community Disaster Loans Program (explained below in the section on History of the CDL Program, Lowering the Interest Rate). The FY2007 Budget assumed a borrower interest rate of 2.70% for the special CDL program in FY2006.[48] This was half or less of the borrower rate reported for other federal direct loan programs.[49] Consequently, it seems that the interest component of the subsidy should be even higher under the special and emergency supplemental CDL programs than it is under the traditional CDL program.

The laws that authorized the special and emergency supplemental CDLs prohibited their cancellation by FEMA. (This was in direct contrast to the rules governing traditional CDLs.) At the same time, a 75% default rate was assumed for both groups of special CDLs. The subsidy appropriated was intended to cover potential defaults on both the principal amounts loaned and the interest due.

In response to the modification of the rules governing the special CDLs to permit their cancellation, the estimated subsidy rate may be raised from 75% to 92% (comparable to traditional CDLs) or even to 100%. Permitting the cancellation of the loans does not necessarily mean that all of the loans will be cancelled. There remains the possibility that some loans may be repaid.

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[44] (...continued)
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.

[45] OMB, *FY2006 Budget, Federal Credit Supplement*, Table 1 (Direct Loans: Subsidy Rates, Obligations, and Average Loan Size), pp. 1-3 and Table 2 (Loan Guarantees: Subsidy Rates, Commitments, and Average Loan Size), pp. 5-8.

[46] Only the Transitional Housing Program for Homeless Veterans, also a direct loan program, had a higher estimated subsidy rate for FY2006, 79.89%. OMB, *FY2007 Federal Credit Supplement*, Table 1, p. 2 for special CDLs (see note 3), p. 3 for veterans' programs.

[47] OMB, *FY2007 Budget, Federal Credit Supplement*, Table 3 (Direct Loans: Assumptions Underlying the FY2006 Subsidy Estimates), p. 10 and note 5 on p. 11..

[48] OMB, *FY2007 Budget, Federal Credit Supplement*, Table 3, p. 10.

[49] OMB, *FY2007 Budget, Federal Credit Supplement*, Table 3, p. 9-11.

Cost of Permitting Cancellation of the Post-Katrina CDLs

The initial assumption of a 75% default rate for the special CDLs made the additional cost of subsequently permitting the cancellation of these loans relatively low.

Seventy-five percent of the loan amounts disbursed under the two special CDL programs was already covered by the appropriations made for FY2006 in the same two laws that authorized the loans. The remaining 25% was borrowed from the U.S. Treasury by the Disaster Assistance Direct Loan Financing Account.[50]

The subsequent action by Congress in 2007 to modify the original rules governing the loans to permit their cancellation also required that Congress appropriate the funds needed to cover the remaining 25% of the loan principal amount and the interest payments likely to be forgiven. P.L. 110-28, the emergency supplemental for FY2007, appropriated $710 million for "Disaster Relief," encompassing several programs.[51] Presently, OMB is attempting to determine the specific amount needed to cover the cancellation provision. In its official cost estimate for H.R 1144, an earlier bill, the Congressional Budget Office estimated the cost of permitting the cancellation of the $1.27 billion in 2005 special and 2006 emergency supplemental community disaster loans to be an additional $321 million, measured in FY2007 dollars.[52]

History of the CDL Program

Loan or Grant Program?

In the 109th Congress there was considerable controversy 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 could be cancelled (forgiven). The effect of cancelling the loan repayment obligation is to convert the loan into a grant for the community.

Indeed, 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.[53] However, the loan program

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[50] Through the Disaster Assistance Direct Loan Financing Account, interest is paid to the Treasury on the amounts borrowed.

[51] P.L. 110-28, Title IV — Additional Hurricane Disaster Relief and Recovery), Chapter 5: Department of Homeland Security, Federal Emergency Management Agency, Disaster Relief.

[52] U.S. Congressional Budget Office, *H.R. 1144, Hurricanes Katrina, Rita, and Wilma Federal Match Relief Act of 2007*, CBO Cost Estimate, March 13, 2007.

[53] The evolution of the CDL program is explained in more detail at the end of this report, in (continued...)

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 or the 2006 Emergency Supplemental were to 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.[54] 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 terminate, to administer it as a grant program.[55]

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?[56]

With a grant program, immediate revenue relief could be provided to local jurisdictions in a disaster area without saddling them with additional debt. On the other hand, with no possibility of interest or principal repayments, a grant program would cost the federal government 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.

Further, 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.

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[53] (...continued)
the Legislative History section.

[54] 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.

[55] Op. cit.

[56] 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.

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 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, even though this period included the multiple Florida hurricanes of 2004.

The FEMA data summarized in **Table 3** (in millions of dollars) and **Table 4** (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 six 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 were 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 3. Community Disaster Loan Program from the First Loans in August 1976 through September 30, 2005

	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 was partially cancelled. Another outstanding loan was partially repaid. The dollar amounts are assigned to their respective categories.

Table 4. 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, 30, 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 5**). 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.

Table 5. 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.

Raising the Percentage-of-Budget Limit

Some argue that the other cap — 25% of the borrowing government's operating budget in the fiscal year of the disaster event — achieved the objective of capping the federal exposure, albeit at a higher level. That cap was raised to 50% for the loans made under the 2006 Emergency Supplemental Appropriations Act (P.L. 109-234), which also removed the $5 million per loan cap.

Section 608 of the SAFE Port Act (P.L. 109-347) raised the size limit for a traditional community disaster loan from 25% to 50% of the annual operating budget of the local government for the fiscal year in which the major disaster occurs — under a particular condition. The local government's loss of tax and other revenues as a result of the major disaster must equal at least 75% of the annual operating budget of that local government for the fiscal year in which the major disaster occurs. The $5 million per loan cap and the cancellation option still apply to traditional CDLs. This combination of rules would appear to offer substantial aid to small local governments in a geographic area devastated by a major disaster.

Lowering the Interest Rate

A consolation offered to those concerned about the non-cancellation provision for the special and emergency supplemental 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.[57] However, according to the interim regulations accompanying CDLA of 2005, the time period for repayment is the same for the special program as it is for the traditional program. This is typically five years, and not to exceed 10 years except in cases of exceptional financial hardship.[58]

The special CDL program provides 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 were eligible for the subsidized interest rate on the special and emergency supplemental CDLs. 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.[59]

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. 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

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[57] Statement of Rep. Baker, *Congressional Record*, daily edition, vol. 151, no. 130, October 7, 2005, p. H8796.

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

[59] 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]

under both the traditional and special CDL programs.[60] 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.

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. Section 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.

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.

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[60] 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.

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.[61]

Disaster Relief Act of 1974: The Robert T. Stafford Disaster Relief and Emergency Assistance Act[62]

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 (Section 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 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

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[61] 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.

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

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.[63] 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.[64]

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 Section 417 of the Stafford Act. Section 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 Section 417 if it is in arrears on payments for a previous loan.[65]

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 Section 417 of the Stafford Act and thereby eliminated the disaster loan program. It was Section 207 of H.R. 707 as passed by the Senate which contained the amendments to Section 417 that were adopted in the enacted bill.

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[63] 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.

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

[65] CRS (archived) 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, available from author upon request.