February 2012

Cost Report

Report to Congress submitted pursuant to Section 4106(2) of the Small Business Jobs Act of 2010

Introduction

Small businesses are a vital part of the American economy, and their success is a critical component of the economic recovery. Established by the Small Business Jobs Act of 2010 (the Act), the Small Business Lending Fund (SBLF) is a dedicated fund designed to provide capital to qualified community banks and community development loan funds (CDLFs) in order to encourage small business lending. The purpose of the SBLF is to encourage Main Street banks and small businesses to work together, help create jobs, and promote economic growth in communities across the Nation.

This report is submitted pursuant to Section 4106(2) of the Act, which directs the Secretary of the Treasury to provide a semiannual written report to Congress on all projected costs and liabilities, all operating expenses, including compensation for financial agents, and all transactions made with respect to the SBLF program. This report reflects the estimated cost of the program's investments and the actual operating expenses for the fiscal year ending September 30, 2011.

Treasury is pleased to report that it expects that expenditures associated with SBLF investments and operations will be significantly less than initial estimates presented in the President's 2012 Budget.

Investments made through the SBLF program are presently expected to generate a profit (or budget savings) of $80 million in contrast to an initially-projected cost of $1.3 billion. The savings between the initial and current cost estimates is due to a reduction in the projected default rates estimated for participating institutions as their financial condition is stronger than initially forecast, coupled with fewer actual investments than initially forecast. The cost savings is also due to a decrease in Treasury's cost of raising funds, which is the result of lower interest rates than expected at the time the SBLF investments were made and lower projected market rates over the life of the program.

In addition, Treasury incurred $33 million in fiscal year 2011 operating expenses for the SBLF program, versus an operating expense budget of $55 million. These realized expenses represent a further reduction from the July 2011 estimate of $40 million.

Estimated Cost of SBLF Investments

Treasury invested over $4.0 billion in 332 institutions through the SBLF program. These amounts include investments of $3.9 billion in 281 community banks and $104 million in 51 CDLFs. Collectively, these institutions operate in over 3,000 locations across 48 states. The initial SBLF funding occurred on June 21, 2011, with subsequent transactions completed thereafter until the program's September 27, 2011 statutory funding deadline.

Treasury currently estimates[1] that the investments made through SBLF will generate a budget savings to be returned to the Treasury General Fund of $80 million over the life of the program. This estimate, which was prepared for inclusion in Treasury's fiscal year 2011 financial statements, represents a decrease in projected budget cost from the $1.3 billion estimate contained in the President's 2012 Budget. The figures in the following table reflect the originally estimated cost of the SBLF investments and the reestimate as of November 2011.

Estimated Cost of SBLF Investments
(Dollars in millions)

	Subsidy Rate	Projected Investment Amount	Projected Lifetime Cost (Savings)
Original estimate	7.24%	17,399	1,260
Reestimate as of November 2011	-1.98%	4,028	(80)

Treasury estimated the program's budget cost in conformance with the Federal Credit Reform Act (FCRA) methodology using actual program data for fiscal year 2011. This data, combined with the expected future cash flows, results in a subsidy rate of -1.98 percent compared to an original subsidy rate of 7.24 percent. The current estimate incorporates a forecasted cumulative default rate (i.e., lost principal investments) of 4.29 percent.

As applied to the SBLF program, the FCRA methodology includes: (1) an estimate of the cumulative default rate for program participants, (2) the estimated cash flow received by Treasury from the participants' dividend, interest, and other payments, and (3) Treasury's cost of raising funds to make SBLF investments. Using this information, Treasury calculated the subsidy rate for SBLF based on the present value of the program's expected cash flow.

Operating Expenses

Treasury is committed to implementing the SBLF in a cost-effective manner to protect taxpayers while achieving the program's objectives. The operating expenses reflect the costs of establishing the SBLF program office, conducting outreach to potential applicants, reviewing applications, and funding investment transactions. Going forward, expenses for the SBLF program will relate primarily to monitoring the performance and compliance of participating institutions, reporting on program performance and costs, maintaining program accounts, and managing the portfolio and the disposition of securities purchased.

The figures shown in the following table reflect operating expenses incurred as of September 30, 2011, which covers the first year of the program. These figures reflect $22 million in savings versus budgeted amounts, and $7 million in savings versus July 2011 estimates, driven by Treasury's ability to build upon existing resources and employ contract specialists for certain temporary and volume-dependent tasks, among other efficiencies. Certain accounting obligations for the program's operating expenses in fiscal

[1] Treasury prepares subsidy rate reestimates for all of its credit reform programs for inclusion in its annual financial statements. Treasury's financial statements for fiscal year 2011 were released in November 2011.

year 2011 will be de-obligated and returned to the Treasury General Fund. These obligations are shown in the third column of the table. Budgeted expenditures for fiscal year 2012 are $26 million. Descriptions of operating expenses follow the table below.

SBLF Operating Expenses for Fiscal Year 2011

	[1] Expenditures FY 2011 Budgeted	[2] Actual Expenditures as of 9/30/11	[3] Commitments, Obligations, and Expenditures as of 9/30/11
Salaries and benefits	7,025,000	3,551,843	3,551,843
Travel	187,000	29,110	38,475
Contracts and other			
Legal support	n/a	4,694,349	9,518,806
Custodian and infrastructure provider	n/a	10,517,454	12,163,493
Asset managers	n/a	8,345,000	9,869,125
Internal controls	n/a	4,427,859	5,262,364
Office of the Treasury Inspector General	n/a	696,194	987,000
Other (equipment, supplies, rent)	n/a	1,000,286	1,148,314
Subtotal (contracts and other)	47,437,000	29,681,142	38,949,102
Total	54,649,000	33,262,095	42,539,420

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[1] As presented in the President's Budget for Fiscal Year 2012, the SBLF program—which was established on September 27, 2010—did not include a detailed line item budget beyond "Salaries and benefits," "Travel," and "Contracts and other."

[2] Includes actual expenditures from the beginning of the program (9/27/10) through 9/30/11.

[3] Includes all financial commitments, obligations and expenditures as of 9/30/11.

As of September 27, 2011, the SBLF program's core investment activities have been completed. SBLF is now staffed primarily to monitor, manage, and report on these investments and related participant lending and program activities. Because many employees joined the SBLF program over the course of the 2011 fiscal year, actual salary expenses incurred through September 30, 2011 are substantially lower than the budgeted amount. SBLF is utilizing administrative infrastructure available through the Treasury Departmental Offices to further minimize expenses.

Throughout the implementation of the SBLF program, Treasury engaged in extensive outreach with potential applicants, participating in over 50 industry events, teleconferences, and webinars as well as initiating more than 4,600 outbound calls directly to institutions. Travel expenses to date relate primarily to outreach activities to build awareness of the program and to provide education to eligible institutions regarding the SBLF program.

The cost of legal services and financial agents (including custody of securities, payments, credit analysis, and market research) is largely proportionate to the volume of applications (933 applications) and the number of investments (332 investments):

- **Legal Support:** These expenses are for legal services for investment-related documentation and closing transactions with the 332 institutions participating in the SBLF. Going forward, legal expenses are expected to be incurred in connection with repurchases of SBLF securities and other transactions related to the management of the investments. These costs are volume-dependent.

- **Financial Agents (Custodian and Infrastructure Provider, Asset Managers):** These expenses are related to (i) bank custodial services with respect to SBLF securities and documents, outreach to eligible institutions, and payments processing for SBLF participants, (ii) financial analysis of SBLF applicants, and (iii) market research of the community banking sector. These costs were largely volume- and activity-dependent. Going forward, the program will incur costs from financial agents that manage investment accounts and perform financial analyses on Treasury's investments.

- **Internal Controls:** These expenses relate principally to the design of processes and internal controls associated with setting up the program, reviewing applications and making investment decisions. This activity includes work performed by consultants regarding the development of procedures, information databases, and other documentation for the processing of applications. These contractual expenses will be significantly reduced in future years, as the program's operational processes and controls are established. This cost is not volume-dependent.

- **Office of the Treasury Inspector General:** These expenses reflect reimbursements to the Treasury Office of the Inspector General (OIG) for audits of the SBLF program. Per the Act, Treasury's OIG is required to issue reports on the SBLF not less than two times each year. Through September 30, 2011, a total of $696,194 had been spent on audit related activities. This cost is not volume-dependent.