

SMALL BUSINESS CREDIT EFFICIENCY ACT OF 1995

SEPTEMBER 6, 1995.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mrs. MEYERS, from the Committee on Small Business,
submitted the following

REPORT

[To accompany H.R. 2150]

[Including cost estimate of the Congressional Budget Office]

The Committee on Small Business, to whom was referred the bill (H.R. 2150) to amend the Small Business Act and the Small Business Investment Act of 1958 to reduce the cost to the Federal Government of guaranteeing certain loans and debentures, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment (stated in terms of the page and line numbers of the introduced bill) is as follows:

Page 4, line 5, strike "The" and insert the following: "For any loan or financing made under this subsection other than a loan repayable in a period of one year or less, the".

PURPOSE

The primary purpose of the bill is to adjust the fees and guarantee levels of the loan programs found in Section 7(a) of the Small Business Act, P.L. 83-163, 15 U.S.C. § 631, et seq. and Section 503 of the Small Business Investment Act of 1958, P.L. 85-699, 15 U.S.C. § 661, et seq. thereby lowering the credit subsidy rate of both programs.

SUMMARY

In brief, H.R. 2150 is intended to do four basic things:

A. Fees for loans sold on the secondary market

Section 2 would amend Section 634(g)(4)(A) of Title 15 to increase the annual fee charged to lenders who sell the guaranteed portion of their loans on the secondary market. The fee would increase from 0.4 percent of the outstanding principal balance of the guaranteed portion to 0.5 percent.

In addition, Section 3(b) will establish a 0.4 percent annual fee on the outstanding principal of all guaranteed loans that are not sold into the secondary market.

B. Reduced level of participation in guaranteed loans

Section 3(a) of H.R. 2150 will reduce and simplify the level of guarantee offered through the 7(a) program. Section 636(a)(2) of Title 15 is amended to change the guarantee percentage to no more than 80 percent of the total amount of loans up to \$100,000 and no more than 75 percent of all loans above \$100,000. This will alter the current system where loans under \$155,000 are guaranteed up to 90 percent; loans over \$155,000 are guaranteed up to 85 percent; and loans from Preferred Lenders are guaranteed at 70 percent.

C. Increase in guarantee fees

Section 3(b) of H.R. 2150 increases the guarantee fees charged on guaranteed loans. The current fee is two percent of the guaranteed portion of all loans. Under H.R. 2150 the fees would increase to two percent of the gross amount of any loan below \$250,000; 2.5 percent of any loan between \$250,000 and \$500,000; and three percent of any loan above \$500,000.

Section 3(c) of H.R. 2150 also ends the practice of allowing lenders to keep one half of the guarantee fees on loans under 50,000 dollars or loans under 75,000 dollars made in rural areas.

D. Increased fee and loan limit on development company loans

Section 4(a) of H.R. 2150 amends Section 502(2) of The Small Business Investment Act of 1958 (15 U.S.C. § 696(2)) by increasing the total loan amount available from \$750,000 to \$1,250,000.

Section 4(b) of H.R. 2150 amends Section 697(b)(3) of Title 15 by adding a one-eighth of one percent fee to cost of any loans made by a Certified Development Company under the 504 loan program. This fee is to be passed on directly to the Small Business Administration and is to be used solely to offset the cost of the program.

NEED FOR LEGISLATION

What is the Section 7(a) Loan Program?

The 7(a) General Business Loan Program was originally enacted as several categorical loan programs designed to aid small businesses in different economic sectors in gaining access to capital. In 1981 the program was entirely rewritten by Title XIX, Section 1902, of P.L. 97-35. This new 7(a) program consolidated the old program in order to harmonize the interest rates and terms of the loans under Section 7(a).

The 7(a) program helps provide financing to small businesses that are unable to secure financing in the private sector on reasonable terms. Through the 7(a) program the Small Business Administration guarantees to pay part of any loss sustained by a bank or other financial institution on a qualified small business loan.

These loans may be for a broad variety of purposes including the purchase of buildings or equipment, working capital, or the financing of commercial construction or rehabilitation. However, proceeds may not be used primarily for the acquisition of land.

Section 7(a) general business loans cannot be made unless the financing sought is unavailable on reasonable terms from non-Federal sources. An SBA Section 7(a) general business loan must be of such sound value or so secured as to reasonably assure repayment.

Currently SBA may guarantee up to \$750,000 of a commercial loan. For loans under \$155,000 in value the SBA guarantees up to 90 percent of the loan. For loans exceeding \$155,000 the guarantee is limited to 85 percent unless the lender is a participant in the Preferred Lender program. The lenders in the Preferred Lender Program are granted expedited consideration of their loans in return for a lesser guarantee of 70 percent. The SBA guarantees loans up to 25 years in term; however, the average term for a working loan is usually 5–7 years.

During the 103d Congress legislation was passed and signed into law that significantly lowered the credit subsidy rate of the 7(a) general business loan program. This legislation, P.L. 103–81 was designed to reduce the subsidy rate from 5.73 percent to 2.73 percent by the imposition of a 0.4 percent fee on all loans whose guaranteed portion was sold into the secondary market, a modification of the guarantee percentages on most loans, and a formula requiring lenders to give one-half of all premiums above 110 percent on loans sold into the secondary market to the Small Business Administration.

What is the 504 Loan Program?

The Small Business Investment Act of 1958 allows The Small Business Administration, through financial intermediary local and state development companies, to finance the growth and expansion of small businesses through the purchase of plants and equipment.

Originally, these development companies obtained small business financing funds directly from the Small Business Administration, or through SBA guarantees of their loans. Today, however, the majority of their lending is financed through SBA guaranteed debentures.

Under Sections 503 and 504 of the Small Business Investment Act of 1958, development companies may obtain a charter from SBA designating them as “certified” development companies. These certified development companies may then issue debentures or long term debt instruments. These debentures or debt instruments are now sold to private investors backed by a 100 percent SBA guarantee. Previously these debentures were sold to the Federal Financing Bank at the Department of the Treasury.

The proceeds of the debenture or debt sales are used to finance the acquisition of equipment, building sites, and plant construction

or renovation. The development company must show that the project to be funded is directed toward one of the following objectives:

Job creation, preservation or retention within two years of completion of the project;

Stimulating, stabilizing or diversifying the local economy; and

Certain public policy goals including: business district revitalization, export expansion, rural development, enhancing competitiveness, defense conversion, and restructuring due to federal mandates.

The financing packages usually consist of 10 percent funding from the small business, 50 percent from a commercial lender backed by a first mortgage lien and 40 percent from the certified development company backed by a second mortgage lien.

The interest rate on these financings is based on the rate set by the debenture or debt sales plus some servicing fees of between 0.5 and 1.5 percent and a 0.1 percent fee to the fiscal agent. In addition, there are 2.875 percent loan origination fees including a 0.5 percent fee for the SBA guarantee costs.

The maximum financing available through the debentures is 750,000 dollars, or 1 million dollars if it serves one of the enumerated public policy goals. The financing is also limited to no more than 50 percent of the total cost of the project. Furthermore, no financing may be made if financing is available elsewhere.

Why must the Section 7(a) and 504 Loan Programs be amended?

The following charts show the growth in demand for small business credit assistance through the SBA's Section 7(a) general business loan and Section 504 development company loan programs since 1992.

7(a) LOAN PROGRAM

[Dollars in thousands]

Year	Appropriation	Subsidy rate (in percent)	Loans guaranteed
1995 (est.)	215,081 (20,531)	2.74	7,849,000
1994	168,420 (38,950)	2.15	7,833,472
1993	333,956 (20,124)	5.21	6,409,913
1992	272,779	4.85	5,624,313

Amounts in parentheses are carried over from prior year.

504 LOAN PROGRAM

[Dollars in thousands]

Year	Appropriation	Subsidy rate (in percent)	Loans guaranteed
1995 (est.)	8,030	0.57	1,408,772
1994	6,584	0.51	1,290,942
1993	4,395	0.54	813,846
1992	3,052	0.49	622,822

As the number of persons who enter our Nation's economy as small business owners increases the availability of small business credit continues to fall short of demand. Committee hearings have regularly pinpointed overregulation of the banking community as

one of the root causes of this shortage. However, despite the Administration's attempts at reducing and easing banking regulation the demand for the services of the SBA's loan programs continue to rise.¹

Over the years there have been numerous supplemental appropriations for the 7(a) and 504 business loan programs. The most recent occurred in 1993 when the SBA received an additional 175 million dollar appropriation under P.L. 103-50. This resulted in the near doubling of the fiscal year 1993 appropriation for the 7(a) loan program.

Despite these supplemental funds, and realizing the difficulty that chronic shortfalls have caused in the administration of the 7(a) program, the Committee on Small Business acted to reduce the credit subsidy rate of the 7(a) program from 5.21 percent to 2.15 percent. As a result of P.L. 103-81, the Small Business Administration gained the ability to provide credit assistance to the small business community at a substantially lower rate. However, these savings proved ephemeral. The fee income obtained through requiring lenders who sold loans into the secondary market to share all premium income above 110 percent did not materialize. Consequently the credit subsidy rate for the 7(a) program rose to the current 2.74 percent.

Recent developments which led to the current legislation

As stated above, the credit subsidy rate of the Section 7(a) loan program is now 2.74 percent. This allows the Small Business Administration to offer a total of 7.8 billion dollars of loan guarantees with appropriated funds of 215.1 million dollars. However, even before the 104th Congress convened the Committee on Small Business became aware that overwhelming demand was forcing the SBA to shift quarterly allocations forward in order to meet demand.

In addition, the Administration drastically reduced the size of the loans it could guarantee, from 750,000 dollars to 500,000 dollars, and imposed other administrative restrictions in order to continue to offer credit assistance to the small business community.

On January 11, 1995 the Committee received the following letter from SBA Administrator Philip Lader explaining the rising demand and the administrative steps taken to deal with the situation:

U.S. SMALL BUSINESS ADMINISTRATION,
Washington, DC, January 11, 1995.

Hon. JAN MEYERS,
Chairwoman, Committee on Small Business,
House of Representatives, Washington, DC.

DEAR MADAM CHAIRWOMAN: Unprecedented demand for Small Business Administration (SBA) guaranteed loans under the 7(a) program recently persuaded us to adopt an administrative change which will allow SBA to keep the program running for the balance of FY 1995. I am writing to convey some background on our deci-

¹Hearing Before the Committee on Small Business on the Administration's Program to Enhance Credit Availability, 103d Cong., 1st Sess. (1993). Serial No. 103-45 and Hearing Before the Committee on Small Business on the Status of the Administration's Credit Availability Proposal, 103d Cong., 2d Sess. (1994) Serial No. 103-71.

sion and to ask your support in exploring possible legislative changes which would improve our subsidy rate and help us meet growing small business credit needs.

As you know, SBA's statutory ceiling for guaranties under the 7(a) program is \$750,000, as provided in Section 7(a)(3)(A) of the Small Business Act. Given limited resources, we decided to use our administrative authority under the Small Business Act to "cap" 7(a) guaranteed loans at \$500,000. We made this decision for three reasons: to "stretch" our authorization so that it would last the full fiscal year; to assist the greatest number of small businesses possible; and to focus on smaller businesses, which have the greatest difficulty obtaining capital and which are creating the preponderance of new jobs.

Absent prompt administrative action, the demand for SBA loans this year would have exhausted our appropriation by July, 1995. Indeed, our 1st quarter funds would have been depleted on December 16, 1994, had OMB not approved our request to transfer funds from our 4th quarter allocation. OMB's approval was conditioned on our presenting a plan to manage loan demand. The \$500,000 cap became the central feature of that plan.

In the 1st quarter, SBA's 7(a) loan approvals averaged \$38 million per day (\$8.8 billion annualized), compared with \$30 million per day in the last fiscal year. This reflects, among other factors, SBA's reaching a greatly underserved segment of the small business community through the "Low Doc" simplified application introduced last June for loans under \$100,000. Since demand traditionally increases in the second half of each year, applications for FY 1995 were likely to exceed \$9.3 billion, while our appropriation would support only \$7.8 billion in loans.

SBA's reduction of the loan limit should make \$900 million available for smaller loans, permitting us to serve nearly six times as many small businesses as we could have with the same money without the \$500,000 cap. A relatively small percentage of SBA's customers will be affected; last year, only 10 percent of 7(a) borrowers received loans exceeding \$500,000. Moreover, a cap reduction was the only administrative solution with a significant budgetary impact which could be accomplished in a timely manner, before the funds were depleted.

Among the alternatives we examined were:

- Allocating funds by category or geography (though this might be arbitrary);

- Limiting the refinancing of debt (though this has little budgetary impact); and

- Reducing the maximum maturity on 7(a) loans (though longer-term maturities are very valuable to small-business owners).

As I suspect you would agree, the best course of action for our small business customers would be legislative action to improve our subsidy rate. This would enable us to meet demand which otherwise will not be satisfied by the private sector. We would greatly appreciate your guidance and support in this regard, and I welcome the opportunity to discuss this matter further with you at your earliest convenience.

Best personal regards.
Sincerely,

PHILIP LADER, *Administrator.*

On January 25, 1995 the Committee on Small Business held a hearing on the 7(a) loan program in order to clarify the reasons for the shortfall in program funds.² SBA Administrator Philip Lader testified before the Committee and explained that an increase in demand at the end of fiscal year 1994 had dramatically reduced the anticipated carry over for fiscal year 1995, and that therefore the fiscal year 1995 appropriation would prove inadequate.

To compound the problem the Office of Management and Budget projected an increase in the credit subsidy rate of the 7(a) program from 2.74 to 2.76 percent. This increase would, of course, further reduce the cost effectiveness of the 7(a) program.

On March 9, 1995 the Committee held a hearing regarding the Section 504 loan program.³ While the witnesses praised the program and its exemplary loss rate of 0.9 percent, concerns were raised regarding the funding of the program. Witnesses informed the Committee that they anticipated the need for either a supplemental appropriation or reprogramming of funds before the end of fiscal year 1995.

The Committee recognizes that supplemental appropriations and liberal use of the taxpayer's dollars is a thing of the past. Fiscal responsibility dictates that the Committee further reduce the credit subsidy rate of the Section 7(a) program and the Section 504 program in order to enable the Small Business Administration to meet demand and operate at a minimal cost to the taxpayer.

The President's 1996 Budget, released on February 1995, proposed changes in the 8(a) program consisting of a 0.3 percent annualized fee on loans not sold into the secondary market, and the elimination of the fee split on small and rural loans. These changes would have lowered the credit subsidy rate to 2.01 percent. Combined with the requested funding level of 189.8 million dollars, this would have provided a total of 9.4 billion dollars in guaranteed loan availability.

Later, on March 27, 1995, the Administration offered another legislative proposal known as REGO II. This proposal suggested among other things, reducing the credit subsidy rate of both the 7(a) and 504 loan programs to a zero credit subsidy rate. In the case of the 7(a) program this would have been accomplished by:

Increasing the interest rate cap by one-half of one percent and passing the increase through to the agency;

Changing the guarantee fee to two percent of the gross of the amount of the loan;

A 0.3 percent annualized fee on all loans under 100,000 dollars or any loans made by Preferred Lenders;

A 0.4 percent annualized fee on loans over 100,000 dollars;

and

²Hearing Before the Committee on Small Business on the SBA's 7(a) loan program, 104th Cong., 1st Sess. (1995). Serial No. 104-6.

³Hearing Before the Committee on Small Business on the SBA's Section 504 Development Company Loan Program, 104th Cong., 1st Sess. (1995). Serial No. 104-17.

Changing the guarantee percentage to 85 percent on loans under 100,000 dollars, 75 percent on loans from 100,000 to 500,000 dollars and 50 percent for loans from 500,000 dollars to one million dollars.

For the 504 loan program the Administration proposed a one-eighth of one percent fee. This would lower that program's 0.57 percent credit subsidy rate to zero.

There has been an increasing awareness in the Congress that the spending patterns of the past can no longer continue without jeopardizing the Nation's future. In that spirit the Committee on Small Business is working to identify areas where the SBA's programs can be improved and their costs significantly reduced. Working with the Committee on Appropriations, the Committee on Small Business has proposed these changes as a beginning step in our effort to identify savings while continuing to meet the needs of the small business community.

The changes proposed in H.R. 2150, as reported from the Committee, are estimated to lower the credit subsidy rate to 1.06 percent. At the House passed 1996 appropriations level of 104,500,000 dollars, the new subsidy rate will allow the Small Business Administration to guarantee 9.858 billion dollars in small business loans. This is an additional 2 billion dollars in loans guarantees for 110.6 million fewer dollars than fiscal year 1995, and 85.2 million dollars below the President's budget request.

These changes represent a solution to the problem that recognizes that the Administration's proposals went either too far (the REGO II proposal) or not far enough (the President's 1996 budget). In considering the REGO II proposal the Committee took into account the SBA Administrator's testimony on January 25, 1995.

Testifying before the Committee on Small Business Mr. Lader said:

Care must be taken to assure that the fees charged to borrowers do not make the program too expensive to be financially practical and that the fees charged to the lenders or reductions in the guaranty percentages are not so great as to make use of the program commercially impractical."⁴

The Committee shares that view and also some concern over the mechanism inherent in a zero subsidy rate.

Programs like the 7(a) and 504 loan programs that have a significant potential impact on the economy should not lie outside the normal checks and balances of our system of government. The Administration's REGO II proposal suggests eliminating not only the appropriation levels but also the authorization levels. The 7(a) program would then be limited only by the number of agency employees needed to monitor the loans. With the increasing use of Preferred Lenders (a situation encouraged by REGO II) fewer employees would be needed and the program could expand essentially unchecked.

The Committee believes that this expanded government role would be detrimental. Small business lending would become increasingly dependent on government guarantees and lenders less

⁴Hearing Before the Committee on Small Business on the SBA's 7(a) Loan Program, 104th Cong., 1st Sess. (1995). Serial No. 104-6.

likely to carry small business loans unguaranteed. In addition, regulators would have little incentive to ease their overly harsh assessment of the small business loans in lender's portfolios.

The Committee is willing to lower the subsidy rate on the smaller 504 program while continuing to maintain its control over the authorization levels. This program already functions in a nearly privatized state and the Committee is ready to observe the effect this will have.

COMMITTEE ACTION

In response to a looming shortfall, on January 25, 1995, the Committee on Small Business held a hearing concerning the Small Business Administration's Section 7(a) general business loan program.⁵

During the hearing the Committee received testimony regarding the efficacy and success of the 7(a) program. The Committee also heard testimony from Philip Lader, Administrator of the Small Business Administration, explaining the growing demand for the program's services. In his testimony, Administrator Lader suggested the need for changes in the 7(a) program in order to reduce the credit subsidy rate.

On March 9, 1995 the Committee held a hearing on the Section 504 development company loan program.⁶ During this hearing, testimony was heard regarding the economic development potential of the program and its extremely low loss rate. At the hearing, representatives of the development companies that participate in the program expressed their support for changes in fees that would make the 504 program an essentially self-funding program.

During the months following the Committee's hearings involved much work by members and staff. Prior to the passage of the Budget Resolution and receipt of the Administration's original budget and later REGO II proposal the Committee had considered numerous changes in both the 7(a) and 504 programs in the interests of meeting budget targets.

As a result of this work, H.R. 2150 was introduced on August 1, 1995 by Chairman Meyers. The bill contains the revisions and improvements explained elsewhere in this report, taking into consideration comments offered by witnesses at the hearings and suggestions proposed by other Members. As originally introduced the bill would have lowered the credit subsidy rate of the Section 7(a) loan program to 1.04 percent.

On August 4, 1995, the Committee on Small Business reported H.R. 2150 by voice vote, after having adopted one amendment, also by voice vote. The amendment offered by Mr. LaFalce reinserted language allowing the Administration to reduce guarantee fees for loans of one year's duration or less. These loans of short duration are made for the purposes of financing small business export activities, and are generally known as Export Working Capital Loans. According to SBA and CBO estimates this amendment will result

⁵Hearing Before the Committee on Small Business on the SBA's 7(a) Loan Program, 104th Cong., 1st Sess. (1995). Serial No. 104-6.

⁶Hearing Before the Committee on Small Business on the SBA's Section 504 Development Company Loan Program, 104th Cong., 1st Sess. (1995). Serial No. 104-17.

in an 0.02 percent increase in the credit subsidy rate for the Section 7(a) general business loan program.

A second amendment was offered by Mr. LaFalce and later withdrawn. The amendment proposed leaving the guarantee percentage on loans of one year's duration or less at its current 90 percent, rather than lowering it to either 75 or 80 percent as proposed. During discussion of the amendment, Mr. Torkildsen and Mr. Manzullo, respectively Chairmen of the Government Programs Subcommittee and the Procurement and Exports Subcommittee, volunteered to hold a joint hearing on the export loans that were the subject of the amendment.

The Chairwoman also stated, in response to an inquiry from Mr. Skelton, that if a consensus of Committee members developed after the hearing, an amendment could be offered on the floor to retain the guarantee at the current percentage. After this discussion, Mr. LaFalce sought and obtained unanimous consent to withdraw the amendment.

In addition, at the outset of the hearing, Mr. Talent voiced some concerns regarding the 0.1 percent difference between the annual fee charged to lenders for loans sold into the secondary market as compared to loans not sold into the secondary market. His concern centered on the possible inequity of any difference in these fees.

SECTION-BY-SECTION ANALYSIS

SECTION 1—SHORT TITLE

Section 1 provides that this bill be known as "The Small Business Credit Efficiency Act of 1995".

SECTION 2—FEE FOR LOANS SOLD ON SECONDARY MARKET.

Section 2 amends Section 5(g)(4)(A) of the Small Business Act (15 U.S.C. § 634(g)(4)(A)) by striking "4/10 of one percent" and inserting "one-half of one percent". This effectively increases the fee on the sales of the guaranteed portion of SBA guaranteed general business loans by one-tenth of one percent.

SECTION 3—GENERAL BUSINESS LOANS

Section 3(a) amends the language of Section 7 of the Small Business Act (15 U.S.C. § 636) by striking paragraph (a)(2) and inserting a new paragraph in its place. The new paragraph (a)(2) changes the guarantee percentages on general business loans to 80 percent for loans 100,000 dollars and under and 75 percent for loans above 100,000 dollars. The new paragraph also separates and clarifies the definitions of the Preferred Lenders program and the language allowing lenders to seek lower guarantee percentages.

Section 3(b) amends the language of Section 7 of the Small Business Act (15 U.S.C. § 636) by striking paragraph (a)(18) and inserting a new paragraph (a)(18). The proposed new paragraph, in subparagraph (A) authorizes the Administration to charge a guarantee fee of two percent of the gross amount of any general business loan under 250,000 dollars. For loans of 250,000 dollars or more but less than 500,000 dollars the fee guarantee fee shall be 2.5 percent of the gross amount of the loan. For all loans above 500,000 dollars the guarantee fee will be three percent of the gross amount of the

loan. The guarantee fees will not apply to loans repayable in one year or less.

The new subparagraph (B) of paragraph (a)(18) proposes establishing a new annual fee of 0.4 percent of the outstanding principal balance of the guaranteed portion of any general business loan not sold into the secondary market. This fee is to be used solely to offset the cost of the program as defined by the Congressional Budget Act of 1974 and is to be paid by the lender and not charged to the borrower.

Section 3(c) amends Section 7(a)(19) of the Small Business Act of (15 U.S.C. § 636(a)(19)) by striking subparagraph (B)(ii) and (C). This eliminates the ability of lenders to retain one-half of the guarantee fee under Section 7(a)(18) when making loans under 50,000 dollars or loans under 75,000 in rural areas.

SECTION 4—MODIFICATIONS TO DEVELOPMENT COMPANY DEBENTURE PROGRAM

Section 4(a) amends Section 502(2) of the Small Business Investment Act of 1958 (15 U.S.C. § 696(2)) by striking the existing paragraph and inserting a new paragraph which increases the limit for loans from 750,000 dollars, or 1,000,000 dollars for loans meeting the policy goals of Section 501(d)(3), to 1,250,000 dollars for all loans.

Section 4(b) amends Section 503(b)(3) of the Small Business Investment Act of 1958 (15 U.S.C. § 697(b)(3)) by inserting a sentence authorizing the Small Business Administration to charge an additional one-eighth of 1 percent fee on all financings to solely to offset the costs of the program.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 2(l)(3)(c) of rule XI of the House of Representatives, the Committee sets forth, with respect to H.R. 2150, the following statement received by the Director of the Congressional Budget Office under section 403 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, August 18, 1995.

Hon. JAN MEYERS,
*Chairman, Committee on Small Business,
House of Representatives, Washington, DC.*

DEAR MADAM CHAIR: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2150, the Small Business Credit Efficiency Act of 1995.

Enacting H.R. 2150 would not affect direct spending or receipts. Therefore, pay-as-you-go procedures would not apply to the bill.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

JUNE E. O'NEILL, *Director.*

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: H.R. 2150.
2. Bill title: Small Business Credit Efficiency Act of 1995.
3. Bill status: As ordered reported by the House Committee on Small Business on August 4, 1995.

4. Bill purpose: H.R. 2150 would amend the section 7(a) general business loan guaranty program administered by the Small Business Administration (SBA) to reduce the percentage of loans that the government guarantees. Lenders of guaranteed business loans would be able to request a further reduction in the level of SBA participation.

H.R. 2150 also would provide for new fees and increases in fees on loans guaranteed by SBA under sections 7(a) and 504 of the Small Business Act. The bill would authorize SBA to raise existing guarantee fees for the loans made under the section 7(a) program, and to establish an annual fee charged to the lenders. The guarantee fees would be payable by the lenders but could be charged to the borrowers, but the new annual fee would not be passed on to the borrowers. The bill would authorize SBA to assess and collect an annual fee for the section 504 loan program; that fee would be charged to the borrowers and would be based on outstanding loan balances. The proceeds from the fees would be used to offset the cost of making the guarantees.

5. Estimated cost to the Federal Government: This estimate assumes that H.R. 2150 would be enacted by the beginning of fiscal year 1996, and that the estimated authorization amounts would be appropriated for fiscal years 1996 and 1997. Based on information from the SBA, CBO estimates that enacting H.R. 2150 would reduce authorization levels by \$253 million for loans to be guaranteed in 1996 and 1997. The following table summarizes the estimated budgetary impact of H.R. 2150.

[By fiscal years, in millions of dollars]

	1995	1996	1997	1998	1999	2000
Spending under current law:						
Authorization level ¹	202	225	280	0	0	0
Estimated outlays	208	212	255	100	15	0
Proposed Changes:						
Estimated authorization level	0	-113	-140	0	0	0
Estimated outlays	0	-68	-121	-58	-8	0
Projected spending under H.R. 2150:						
Authorization level ¹	202	112	140	0	0	0
Estimated outlays	208	144	134	42	7	0

¹The 1995 level is the amount appropriated for that year.

The costs of this bill fall within budget function 370.

6. Basis of estimate: Under current law SBA is authorized to guarantee \$13 billion in loans for 1996 and \$16.1 billion in 1997 for both the section 7(a) program and the section 504 program. (Fiscal year 1995 appropriations provide for \$11.4 billion in guaranteed loans.) CBO estimates that reducing the percentage of SBA participation in guaranteed loans would have no significant budgetary impact because the bill would not change the amount of loans SBA is authorized to guarantee and the percentage of SBA participation in guaranteed loans would not change significantly. Based

on information from SBA, we expect that the reduction in SBA participation would enable SBA to increase slightly the number of loans guaranteed but would not significantly increase administrative costs.

Enacting H.R. 2150, however, would reduce the average subsidy for loans guaranteed by SBA because the bill would result in additional fees paid to the federal government. CBO estimates that the increased fees on new loan guarantees would reduce the average subsidy rate from approximately 2 percent to 1.1 percent for the section 7(a) program, and from approximately 0.6 percent to zero for the section 504 program. Assuming that appropriations acts grant authority for SBA to guarantee the authorized level of loans, the reduction in subsidy rates would reduce the amount of appropriations needed to subsidize SBA loan guarantees from an estimated \$225 million to \$112 million in 1996, and from \$280 million to \$140 million in 1997. The programs have not been authorized beyond 1997.

7. Pay-as-you-go considerations: None.

8. Estimated cost to State and local governments: None.

9. Estimate comparison: None.

10. Previous CBO estimate: On August 3, 1995, CBO provided a cost estimate for S. 895, the Small Business Lending Enhancement Act of 1995, as ordered reported by the Senate Committee on Small Business on July 13, 1995. The two bills are similar, as are the two cost estimates. H.R. 3150 would reduce the need for subsidy appropriations by a slightly larger amount by reducing the estimated subsidy rate for section 504 loans to zero from 0.6 percent while S. 895 would reduce that subsidy rate to 0.2 percent. (We estimate that the two bills would have the same budgetary effect on section 7(a) loans.)

11. Estimate prepared by: Rachel Forward.

12. Estimate approved by: Paul N. Van de Water, Assistant Director for Budget Analysis.

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l) (4) of rule XI of the House of Representatives, the Committee estimates that H.R. 2150 will have no inflationary impact on prices and costs in the operation of the national economy.

OVERSIGHT FINDINGS

In accordance with clause (l)(3)(D) of rule XI of the House of Representatives, the Committee states that no oversight findings or recommendations have been made by the Committee on Government Reform and Oversight with respect to the subject matter contained in H.R. 2150.

In accordance with clause 2(l)(3)(A) of rule XI and clause 2(b)(1) of rule X of the House of Representatives, the oversight findings and recommendations of the Committee on Small Business with respect to the subject matter contained in H.R. 2150 are incorporated into the descriptive portions of this report.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SMALL BUSINESS ACT

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 SEC. 5. (a) * * * * *
 * * * * *
 (g)(1) * * * * *
 * * * * *

(4)(A) The Administration may collect the following fees for loan guarantees sold into the secondary market pursuant to the provisions of subsection (f): an amount equal to (A) not more than ~~4/10 of one percent~~ *one-half of 1 percent* per year of the outstanding principal amount of the portion of such loan guaranteed by the Administration, and (B) not more than 50 percent of the portion of the sale price which is in excess of 110 percent of the outstanding principal amount of the portion of such loan guaranteed by the Administration. Any such fees imposed by the Administration shall be collected by the Administration or by the agent which carries out on behalf of the Administration the central registration functions required by subsection (h) of this section and shall be paid to the Administration and used solely to reduce the subsidy on loans guaranteed under section 7(a) of this Act: *Provided*, That such fees shall not be charged to the borrower whose loan is guaranteed; and, *Provided further*, That nothing herein shall preclude any agent of the Administration from collecting a fee approved by the Administration for the functions described in subsection (h)(2).

* * * * *
 SEC. 7. (a) The Administration is empowered to the extent and in such amounts as provided in advance in appropriation Acts to make loans for plant acquisition, construction, conversion, or expansion, including the acquisition of land, material, supplies, equipment, and working capital, and to make loans to any qualified small business concern, including those owned by qualified Indian tribes, for purposes of this Act. Such financings may be made either directly or in cooperation with banks or other financial institutions through agreements to participate on an immediate or deferred (guaranteed) basis. These powers shall be subject, however, to the following restrictions, limitations, and provisions:

- (1) * * * * *
- (2) In agreements to participate in loans on a deferred basis under this subsection, such participation by the Administration, except as provided in paragraph (6), shall be—
 - (A) not less than 90 percent of the balance of the financing outstanding at the time of disbursement if such financing does not exceed \$155,000: *Provided*, That the percentage of partici-

pation by the Administration may be reduced below 90 percent upon request of the participating lender; and

[(B) subject to the limitation in paragraph (3)—

[(i) not less than 70 percent nor more than 85 percent of the financing outstanding at the time of disbursement if such financing exceeds \$155,000: *Provided*, That the participation by the Administration may be reduced below 70 percent upon request of the participating lender;

[(ii) not less than 75 percent of the financing outstanding at the time of disbursement, if such financing is more than \$155,000 and the period of maturity of such financing is more than 10 years, except that the participation by the Administration may be reduced below 75 percent upon request of the participating lender;

[(iii) not less than 85 percent of the financing outstanding at the time of disbursement, if such financing is more than \$155,000 and the period of maturity of such financing is 10 years or less, except that the participation by the Administration may be reduced below 85 percent upon request of the participating lender; and

[(iv) not less than 85 percent nor more than 90 percent of the financing outstanding at the time of disbursement if such financing is a loan under paragraph (14) or (16).

The Administration shall not use the percent of guarantee requested as a criterion for establishing priorities in approving guarantee requests nor shall the Administration reduce the percent guaranteed to less than the above specified percentums other than by determination made on each application. Notwithstanding subparagraphs (A) and (B), the Administration's participation under the Preferred Lenders Program or any successor thereto shall be not less than 80 percent, except upon request of the participating lender. The maximum interest rate for a loan guaranteed under the Preferred Lenders Program shall not exceed the maximum interest rate, as determined by the Administration, which is made applicable to other loan guarantees under section 7(a). As used in this subsection, the term "Preferred Lenders Program" means a program under which a written agreement between the lender and the Administration delegates to the lender (I) complete authority to make and close loans with a guarantee from the Administration without obtaining the prior specific approval of the Administration, and (II) authority to service and liquidate such loans.】

(2) *LEVEL OF PARTICIPATION IN GUARANTEED LOANS.*—

(A) *IN GENERAL.*—*In agreements to participate in loans on a deferred basis under this subsection, such participation by the Administration shall be—*

(i) equal to 80 percent of the balance of the financing outstanding at the time of disbursement if such financing is less than or equal to \$100,000; and

(ii) equal to 75 percent of the balance of the financing outstanding at the time of disbursement if such financing is greater than \$100,000.

(B) *REDUCED PARTICIPATION.*—*The guarantee percentage specified by subparagraph (A) for any loan may be reduced upon the request of the participating lender. The Adminis-*

tration shall not use the percent of guarantee requested as a criterion for establishing priorities in approving guarantee requests.

(C) *INTEREST RATE UNDER PREFERRED LENDERS PROGRAM.*—The maximum interest rate for a loan guaranteed under the Preferred Lenders Program shall not exceed the maximum interest rate, as determined by the Administration, which is made applicable to other loan guarantees under this subsection.

(D) *PREFERRED LENDERS PROGRAM DEFINED.*—In this paragraph, the term “Preferred Lenders Program” means a program under which a written agreement between the lender and the Administration delegates to the lender—

- (i) complete authority to make and close loans with a guarantee from the Administration without obtaining the prior specific approval of the Administration; and
- (ii) authority to service and liquidate such loans.

* * * * *

[(18) The Administration shall collect a guarantee fee equal to two percent of the amount of the deferred participation share of any loan under this subsection other than a loan repayable in one year or less. The fee shall be payable by the participating lending institution and may be charged to the borrower.]

(18) GUARANTEE FEES.—

(A) *GENERAL FEE.*—For any loan or financing made under this subsection other than a loan repayable in a period of one year or less, the Administration shall collect a guarantee fee equal to—

- (i) 2 percent of the gross amount of any loan guaranteed under this subsection of an amount less than \$250,000;
- (ii) 2.5 percent of the gross amount of any loan guaranteed under this subsection of an amount equal to or greater than \$250,000 and less than \$500,000; or
- (iii) 3 percent of the gross amount of any loan guaranteed under this subsection of an amount equal to or greater than \$500,000.

Such fee shall be payable by the participating lending institution and may be charged to the borrower.

(B) *ADDITIONAL FEE TO OFFSET COST.*—

(i) *IN GENERAL.*—In addition to the guarantee fee to be collected under subparagraph (A), the Administration shall collect a fee for loans guaranteed under this subsection (other than loans for which a guarantee fee may be collected under section 5(g)(4)(A)) in an amount equal to not more than four-tenths of 1 percent per year of the outstanding principal portion of such loan guaranteed by the Administration.

(ii) *USE.*—Fees collected under clause (i) shall be used solely to offset the cost (as defined by section 502(5) of the Congressional Budget Act of 1974) of guaranteeing loans under this subsection.

(iii) *PAYMENT.*—Fees collected under clause (i) shall be payable by the participating lending institution and shall not be charged to the borrower.

(19)(A) * * *

(B) In order to encourage all lending institutions and other entities making loans authorized under this subsection to provide loans of \$50,000 or less in guarantees to eligible small business loan applicants, the Administration [shall (i) develop] *shall develop* and allow participating lenders to solely utilize a uniform and simplified loan form for such loans[, and (ii) allow such lenders to retain one-half of the fee collected pursuant to section (7)(a)(18) on such loans. A participating lender may not retain any fee pursuant to this paragraph if the amount committed and outstanding to the applicant would exceed \$50,000 unless the amount in excess of \$50,000 is an amount not approved under the provisions of this paragraph].

[(C) In order to encourage lending institutions and other entities making loans authorized under this subsection to provide loans to small business loan applicants located in rural areas, such lenders shall be permitted to retain one-half of the fee collected pursuant to paragraph (18) on loans of less than \$75,000. A participating lender may not retain any fee pursuant to this subparagraph if the amount committed and outstanding to the applicant would exceed \$75,000 unless the amount in excess of \$75,000 is an amount not approved under the provisions of this subparagraph. This subparagraph shall cease to be effective on October 1, 1995.]

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SMALL BUSINESS INVESTMENT ACT OF 1958

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TITLE V—LOANS TO STATE AND LOCAL DEVELOPMENT COMPANIES

* * * * *

SEC. 502. The Administration may, in addition to its authority under section 501, make loans for plant acquisition, construction, conversion or expansion, including the acquisition of land, to State and local development companies, and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis: *Provided, however,* That the foregoing powers shall be subject to the following restrictions and limitations:

(1) * * *

[(2) Loans made by the Administration under this section shall be limited to \$750,000 for each such identifiable small-business concern, except loans meeting the criteria specified in section 501(d)(3) shall be limited to \$1,000,000 for each such identifiable small business concern.]

(2) Loans made by the Administration under this section shall be limited to \$1,250,000 for each such identifiable small business concern.

* * * * *

DEVELOPMENT COMPANY DEBENTURES

SEC. 503. (a) * * *

(b) No guarantee may be made with respect to any debenture under subsection (a) unless—

(1) * * *

* * * * *

(3) the interest rate on such debentures is not less than the rate of interest determined by the Secretary of the Treasury for purposes of section 303(b) and includes a one-eighth of 1 percent fee which shall be paid to the Administration and which shall be used solely to offset the cost (as defined by section 502(5) of the Congressional Budget Act of 1974) of guaranteeing the debenture.;

* * * * *

