Government expects lending fund to turn taxpayers a profit

By Jose Pagliery @CNNMoney February 7, 2012: 5:49 AM ET

An Obama administration lending program set up to funnel cash to small banks was expected to cost taxpayers $1.3 billion. Instead, it will turn a profit of $80 million.

But the turnabout isn't all good news: The Treasury Department's Small Business Lending Fund helped far fewer banks than Congress intended.

The government program, one of President Obama's many attempts to pump capital into small firms, disbursed only $4 billion of the $30 billion it was allotted.

Of more than 7,000 community banks small enough to potentially qualify, only 933 applied. And a mere 332 community banks and organizations made the cut.

Treasury, explaining why the 2010 program is expected to cost less than expected, cited fewer banks healthy enough to qualify, weaker demand for small business loans and fewer bank failures.

But some small business leaders and banks bemoan the low participation rate. They say government officials were too stringent about which banks got the money or that banks had trouble navigating the application process.

Under the program, banks seeking an infusion spelled out how they would use taxpayer money to spur lending to small businesses. If Treasury accepted a bank's plan, it essentially became an investor in it -- turning over capital that would spur lending and getting dividend payments in return.

Treasury still holds stakes in most of the banks, and banks say they are continuing to make loans under the program. In fact, the $4 billion infusion could eventually spur $32 billion in lending, according to Independent Community Bankers of America chief economist Paul Merski.

Alma Bank in Astoria, N.Y., received $19 million and reported one of the largest increases in lending to small firms.

According to Treasury data, Alma Bank lent $91 million to small businesses in the 12 months ending in June 2010 and $235 million over the next 15 months.

"We did need this money," CEO Kirk Karabelas said. "It helped us dedicate more to small business lending, and God knows there are plenty of businesses right now that can use this."

Karabelas said much of the money went to nearby diners and restaurants, as well as

Italian foods producer Rienzi Foods.

New Jersey Community Bank President Bob O'Donnell had a different take on the lending fund.

O'Donnell said he avoided the program entirely because he feared the funds would allow the government to place restrictions on his bank like those that accompanied the 2008 Troubled Asset Relief Program.

Besides, O'Donnell said, small businesses weren't exactly breaking down his door for loans during the program's term, which ended last September.

But that wasn't the case for First Green Bank in Mt. Dora, Fla., where bank President Paul Rountree had several entrepreneurs asking for loans.

Rountree said his bank was capitalized enough to go without the funds but accepted $4.7 million anyway to bulk itself up. The funds let it lend more to doctors with private practices as well as to a steel fabricator. Rountree said it also allowed the young bank, which started in 2009, to avoid having to raise money from private investors.

"For once, there was a government program put in place that worked," Rountree said.

And the funds will help small business for several years to come, Treasury Secretary Tim Geithner told Congress last October.

But **Cato Institute** economist Mark Calabria questioned the program's effectiveness because it came on the heels of a deep decline in small business lending.

"They've used a very low baseline, which questions whether we actually had an increase in small business lending that wouldn't have happened otherwise," Calabria said.

Some experts said the billions allocated by Congress would have been more effective if directed toward the Small Business Administration's loan programs.

Even Merski of the community bankers group, one of the original proponents of the effort, said more should have been done with the Treasury fund.

"The program filled a niche that was needed: banks that had lending opportunities but needed additional capital," he said. "But more banks should have been included in the program."

Merski said several factors slowed down the process, such as lack of coordination between Treasury officials disbursing the funds and regulators that oversee the banks, and a short one-year window for banks to apply.

"A lot banks just ran out of time," Merski said.

Treasury spokesman Anthony Coley defended the program and noted the department worked closely with federal banking agencies to ensure a thorough review of each application.

"Early reports indicate [the program] is working well," he said. "More than 60% of participants have already increased their small business lending by 10% or more."