



# Introduction to Federal Credit Budgeting

OMB Annual Training

June 25, 2008



# Types of Federal Credit

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- Direct Loan
- Loan Guarantee
- Sale of Government Assets on Credit Terms

Critical Determinant:

- Non-Federal Borrower



# Types of Federal Credit

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## ❑ **Direct Loan:**

A disbursement of funds made by the Federal government to a non-Federal borrower under terms that require repayment with or without interest.

## ❑ **Loan Guarantee:**

Any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on a debt obligation of a non-Federal borrower to a non-Federal lender.

## ❑ **Sale of Government Assets on Credit Terms:**

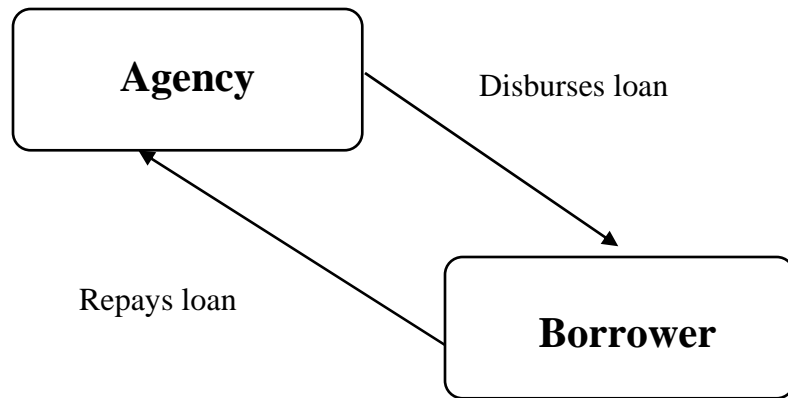
The sale of a Federal Government asset to a Non-Federal borrower on credit terms (payment of purchase price, with or without interest, over time).



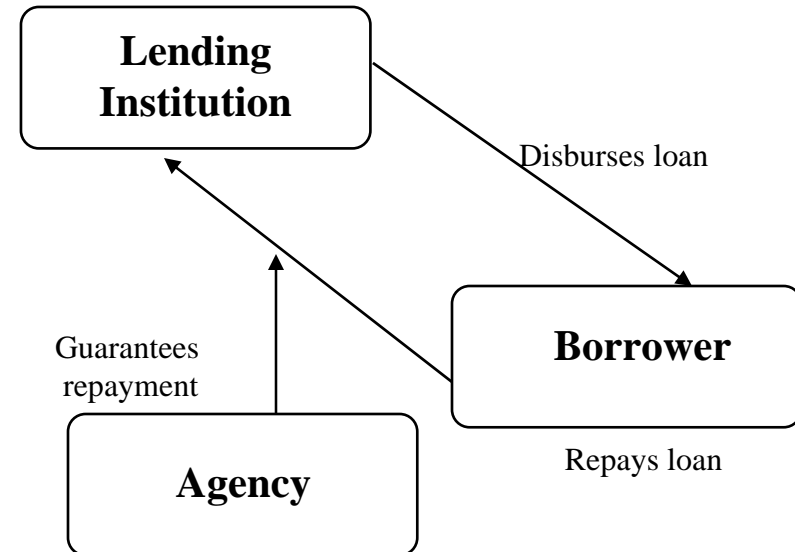
# Types of Federal Credit

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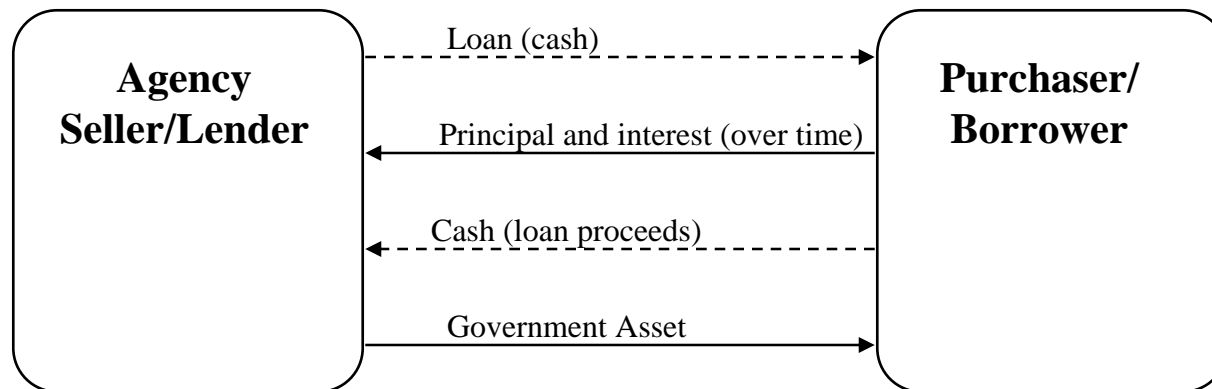
## Direct Loans



## Loan Guarantees



## Sale of Government Assets on Credit Terms





# The Federal Credit Reform Act of 1990

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- ❑ Established a system for budgeting and accounting for the cost of credit programs.
- ❑ Changed the budgetary basis from annual cash transactions to cash transactions over the life of the loan on a present value basis.
- ❑ Separated the accounting between on-budget and non-budgetary effects.



# Established a system for budgeting and accounting for the cost of credit programs

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## Cash basis:

- ❑ Outlays recorded when direct loans were disbursed or claims on loan guarantees were paid.
- ❑ Consequently, overstated cost of direct loans and understated cost of loan guarantees.
- ❑ No resources set aside for future defaults and claims.
- ❑ No budgetary control over loan guarantees.

## Credit reform basis:

- ❑ Recognizes the cost of future losses at time of obligation.
- ❑ Sets aside resources for future losses.
- ❑ More accurately measures cost of credit programs.
- ❑ Allows for cost comparison between credit programs and other forms of assistance.
- ❑ Encourages the most efficient form of assistance delivery for beneficiaries.



# Credit Subsidy Cost Estimation

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- The credit subsidy cost is the net present value of the expected cash inflows and outflows over the full life of the direct or guaranteed loan.
  - Agencies develop technical assumptions and models, subject to OMB approval, to estimate these expected cash inflows and outflows.
  - OMB provides discount rates (an economic assumption).
  - These inflows and outflows are discounted using the OMB Credit Subsidy Calculator (CSC) software to arrive at the subsidy estimate.



# Cohorts and Risk Categories

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**Agency:** Department of Agriculture

**Bureau:** Farm Service Agency

**Fund:** A. CCC Export Guarantees  
B. Agricultural Credit Insurance Fund

**Program:** B1. Farm Ownership Loans  
B2. Farm Operating Loans

**Cohort:** B2a. FY92 Farm Operating Loans  
B2b. FY93 Farm Operating Loans  
B2c. FY94 Farm Operating Loans

**Risk Category:** B2b1. FY93 Farm Operating Loan, Southwest  
B2b2. FY93 Farm Operating Loan, Northeast

**Loan:** B2b2i. FY93 Farm Operating Loan, Northeast, Farmer A  
B2b2ii. FY93 Farm Operating Loan, Northeast, Farmer B





# Types and Sources of Cash Flow Assumptions

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## Technical Assumptions:

- Contract terms (explicit)
  - Maturity
  - Borrower's interest rate
  - Fees
  - Grace periods
- Estimated factors (forecast)
  - Defaults
  - Recoveries
  - Prepayments
  - Workouts
- Methodology
  - Equations
  - Models

## Economic Assumptions:

- Discount rates
- Other

## Sources:

Technical assumptions are developed by the Agency, using:

- Historical cash reports and loan performance
- Actuarial studies
- Sensitivity analysis
- Legislation or regulations
- Loan contracts and guarantee agreements

Economic assumptions are provided by OMB in preparation of the budget and the mid-session review.



# Credit Subsidy Estimate Assumptions for Budget Execution

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## At the Time of Obligation:

- Update subsidy estimate for explicit assumptions
  - cash flows specified in loan contract
- Update subsidy estimate for changes in law
- Forecast assumptions remain the same
  - forecast assumptions must be same as the assumptions used to formulate the President's Budget

## At the Time of Disbursement:

- Update for changes in law, regulation or policy (modification)

## After Disbursement:

- Update for all forecast assumptions (reestimate)
- Update for changes in law, regulation or policy (modification)



# Example Subsidy Estimate for a Direct Loan and Loan Guarantee

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## Assumptions:

Principal.....	\$1,000	Technical assumption - Contract terms
Borrower's interest rate.....	7.0%	
Maturity.....	5	
Default year.....	5	Technical assumption - Estimated factors
Discount rate.....	7.0%	Economic assumption

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
<b>Direct Loan:</b>					
Loan disbursement.....	\$1,000				
Principal and interest payment.....	<u>-244</u>	<u>-244</u>	<u>-244</u>	<u>-244</u>	<u>0</u>
	756	-244	-244	-244	0
<b>Loan Guarantee:</b>					
Default claim payment.....	0	0	0	0	244
<b>Net Present Value of Cash Flows:</b>					
Direct Loan.....	174				
Loan Guarantee.....	174	Subsidy amount			



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# Discounting to the Present Value

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The future value of money invested in the present.

Compounding interest example - Savings account in a bank

Amount deposited    \$100                      Interest rate    5%

Year 1..... $(1+0.05) \times \$100 = \$105$   
Year 2..... $(1+0.05) \times \$105 = \$110.25$   
Year 3..... $(1+0.05) \times \$110.25 = \$115.76$   
Year 4..... $(1+0.05) \times \$115.76 = \$121.55$   
Year 5..... $(1+0.05) \times \$121.55 = \$127.63$

The present value of money to be received or paid in the future.

Discounting example - Buying a bond

Face value of bond    \$127.63                      Discount rate    5%

Year 5..... $\$127.63 / (1+0.05) = \$121.55$   
Year 4..... $\$121.55 / (1+0.05) = \$115.76$   
Year 3..... $\$115.76 / (1+0.05) = \$110.25$   
Year 2..... $\$110.25 / (1+0.05) = \$105$   
Year 1..... $\$105 / (1+0.05) = \$100$



# Budget Accounts for Credit Programs

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- Liquidating
- Program
- Financing
- Negative receipt





# Budget Accounts for Credit Programs

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Liquidating Account	Program Account	Financing Account(s)
For direct loans obligated or loan guarantees committed prior to FY 1992 (pre-1992)	For direct loans obligated or loan guarantees committed in FY 1992 and fiscal years thereafter (post-1991)	For direct loans obligated or loan guarantees committed in FY 1992 and fiscal years thereafter (post-1991)
Pre-1992 loan activity	Amounts for subsidy and administrative expenses for post-1991 loans	Cash flows from post-1991 loans
Recorded on a cash basis (on-budget)	Recorded on a credit reform basis (subsidy)	Recorded as a means-of-financing (non-budgetary)
<ul style="list-style-type: none"> <li>• Collects repayments, interest, fees, et al.</li> <li>• Repays any borrowing with interest</li> <li>• Pays default claims and interest subsidies</li> </ul>	<ul style="list-style-type: none"> <li>• Receives appropriation of subsidy and administrative expenses</li> <li>• Subsidy is transferred from the program account to the financing account(s)</li> </ul>	<p><u>Direct Loans:</u></p> <ul style="list-style-type: none"> <li>o Receives subsidy from program account</li> <li>o Borrows unsubsidized portion of loan from Treasury</li> <li>o Disburses new loans</li> <li>o Collects repayments, interest, fees, et al.</li> <li>o Repays borrowing to Treasury, plus interest</li> </ul> <p><u>Guaranteed Loans:</u></p> <ul style="list-style-type: none"> <li>o Receives subsidy from program account</li> <li>o Collects fees from borrowers</li> <li>o Acts as a reserve for default claims</li> <li>o Receives interest on reserves from Treasury</li> <li>o Pays default claims and interest subsidies</li> </ul>



# Budget Accounts for Credit Programs

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Negative subsidy and downward reestimate  
receipt accounts

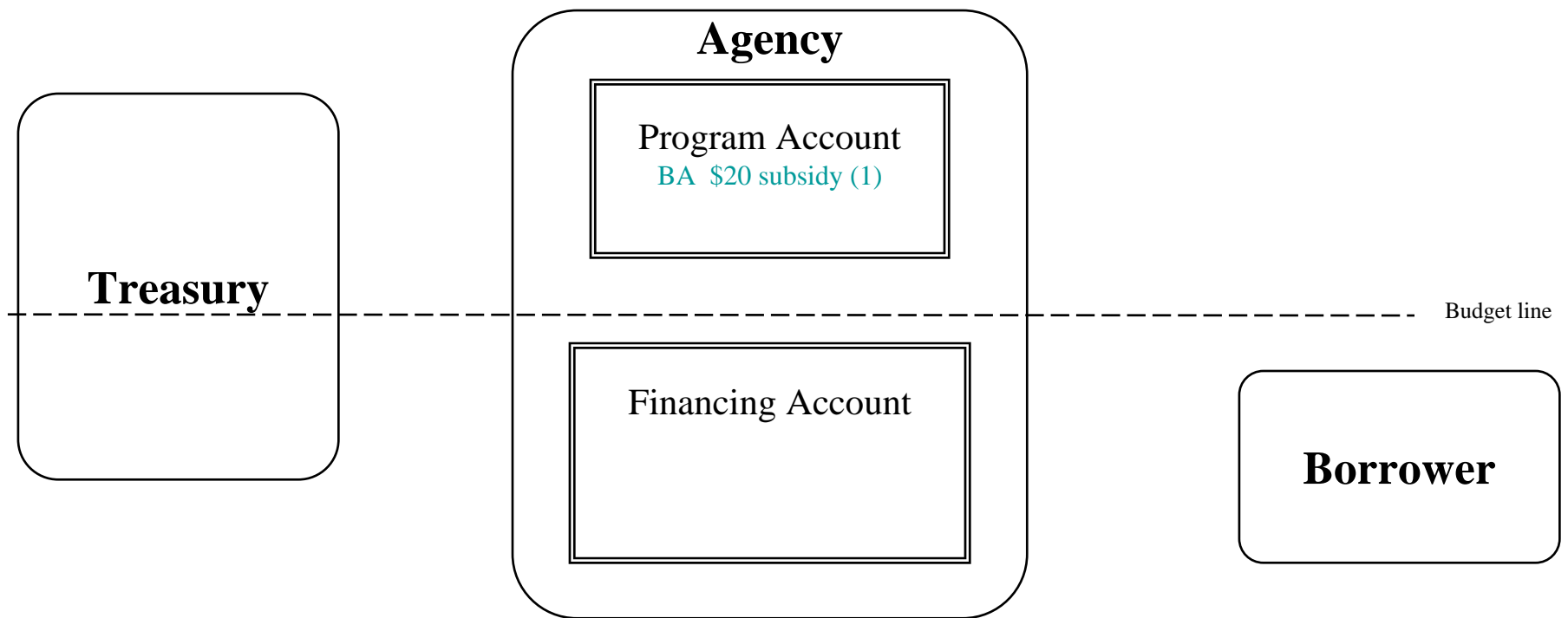
- For direct loans obligated or loan guarantees committed in FY 1992 and fiscal years thereafter (post-1991).
- Amounts of negative subsidy and downward reestimates from associated financing accounts.
- Recorded as on-budget.
- Available for appropriation.



# Budgetary Accounting: Cash Flows for Direct Loans

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EXAMPLE: \$100 loan, 20% subsidy rate, disburses in one year.



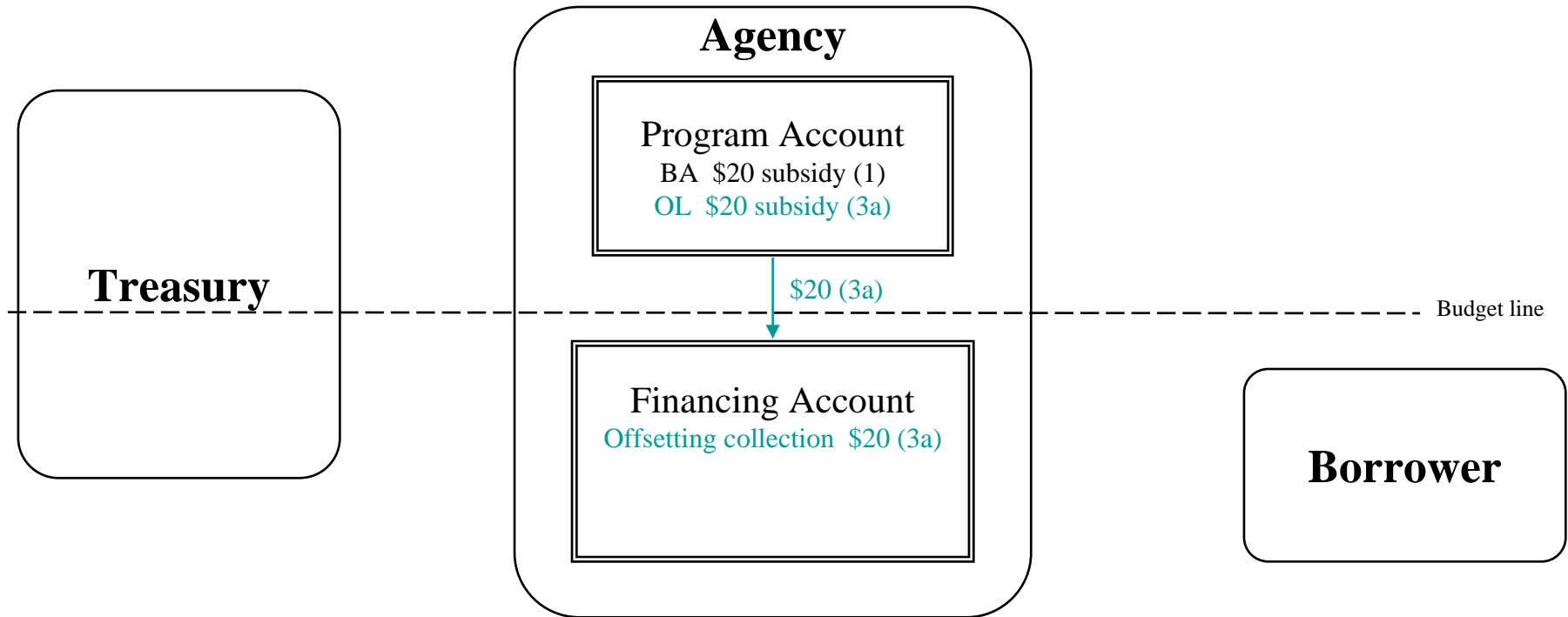
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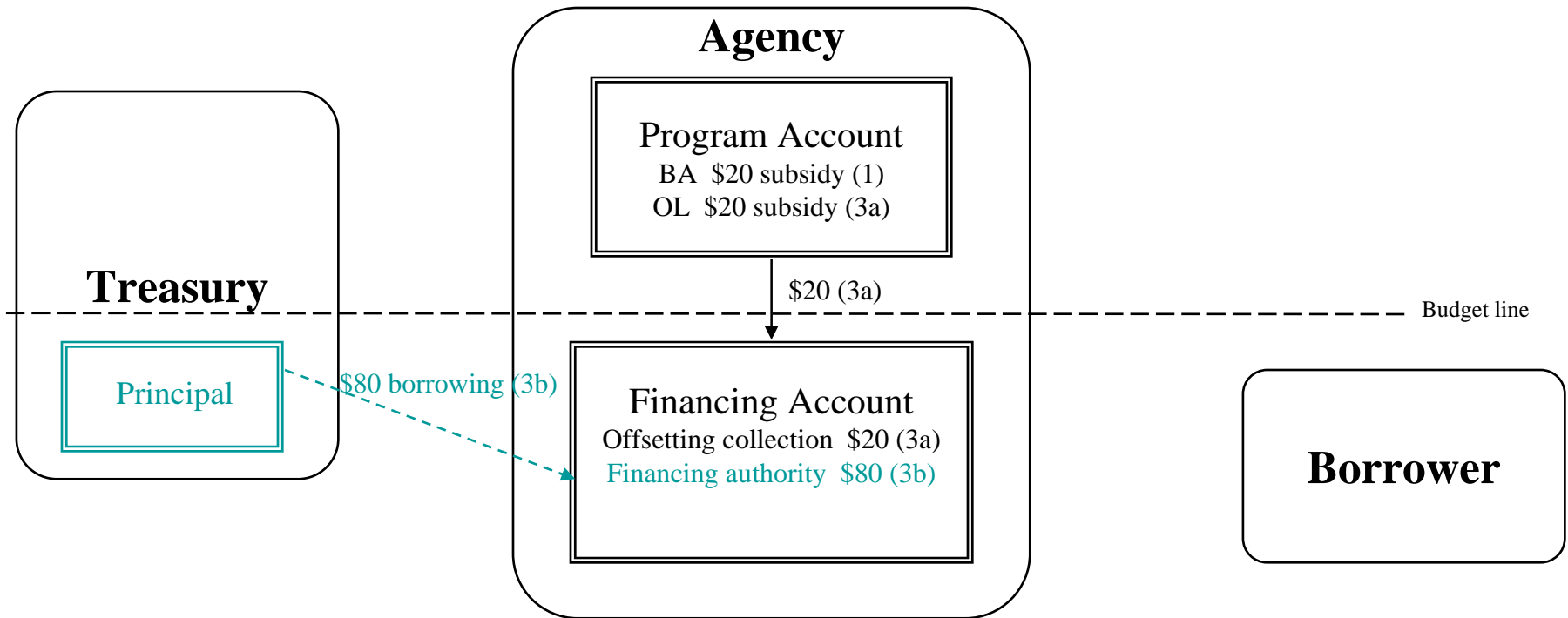
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  - a. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.



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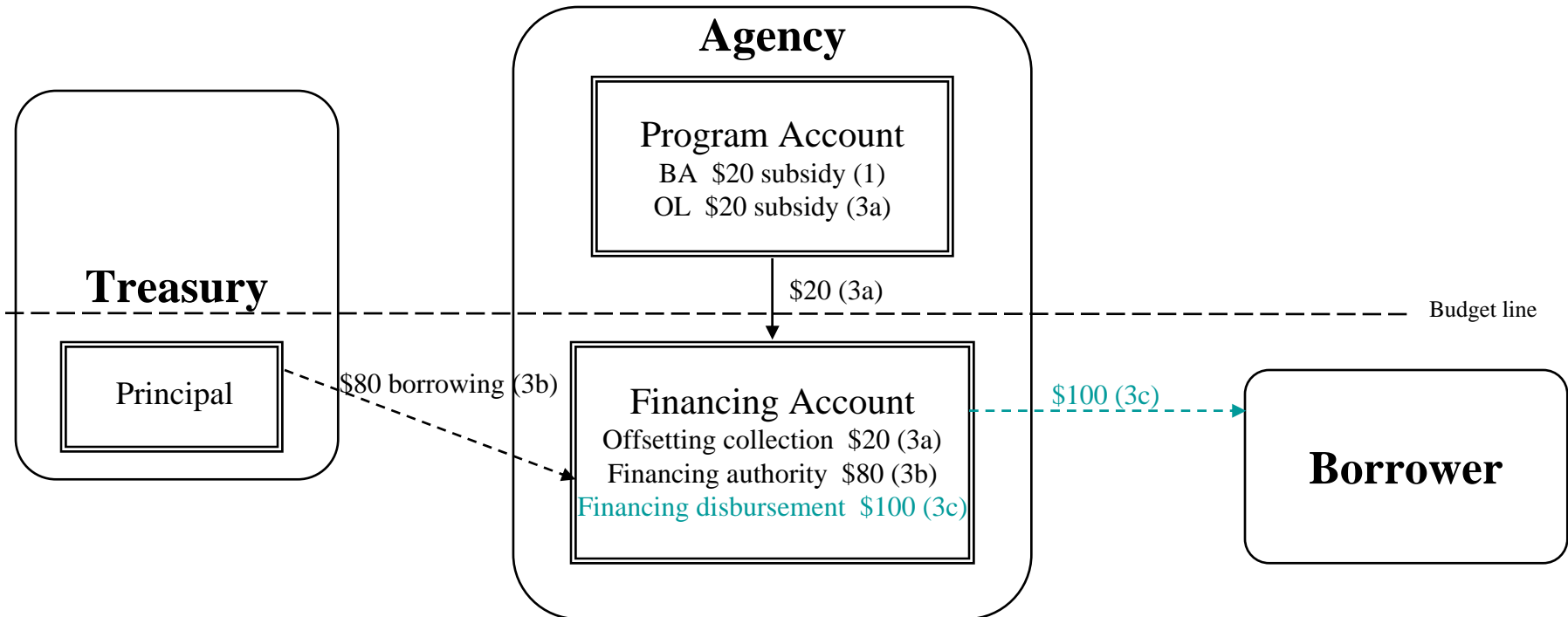
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  - b. The financing account borrows \$80 from Treasury.



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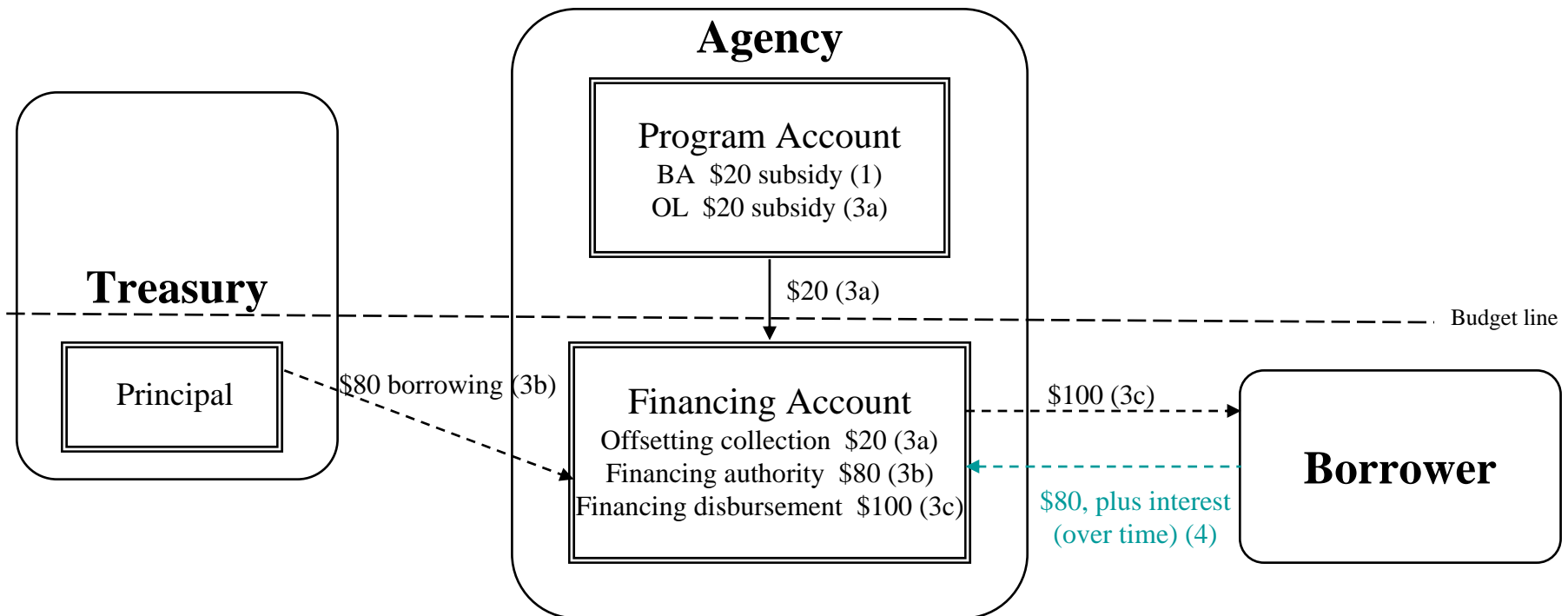
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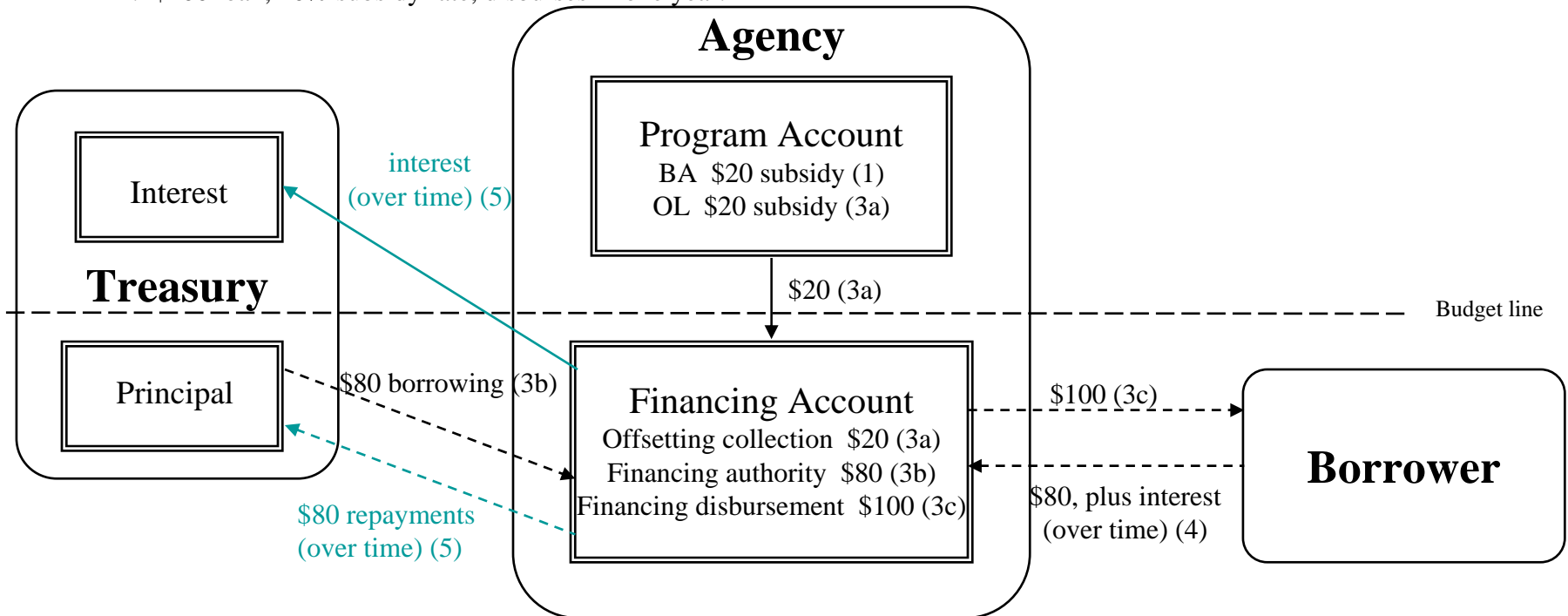
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  - b. The financing account borrows \$80 from Treasury.
  - c. The financing account disburses a \$100 loan to the Borrower.
4. The Borrower pays fees (if any), interest, and principal to the financing account, under the terms of the contract over time.



# Budgetary Accounting: Cash Flows for Direct Loans

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EXAMPLE: \$100 loan, 20% subsidy rate, disburses in one year.



- The Borrower pays fees (if any), interest, and principal to the financing account, under the terms of the contract over time.
- If the subsidy rate is accurate, the Borrower will make payments to the financing account exactly in the amount necessary to repay the original Treasury borrowing (\$80) plus interest. The financing account pays interest and principal to Treasury each year, which are a means of financing and do not affect the budget totals. The interest that Treasury receives from the financing account is an offsetting receipt from the public, reducing the deficit.
- If the subsidy is not accurate, a reestimate will be made and, as necessary, either (1) additional subsidy will be disbursed from the program account to the financing account to cover the amount of the reestimate or (2) excess funds will be moved from the financing account to a negative receipt account, where these funds are unavailable until appropriated.

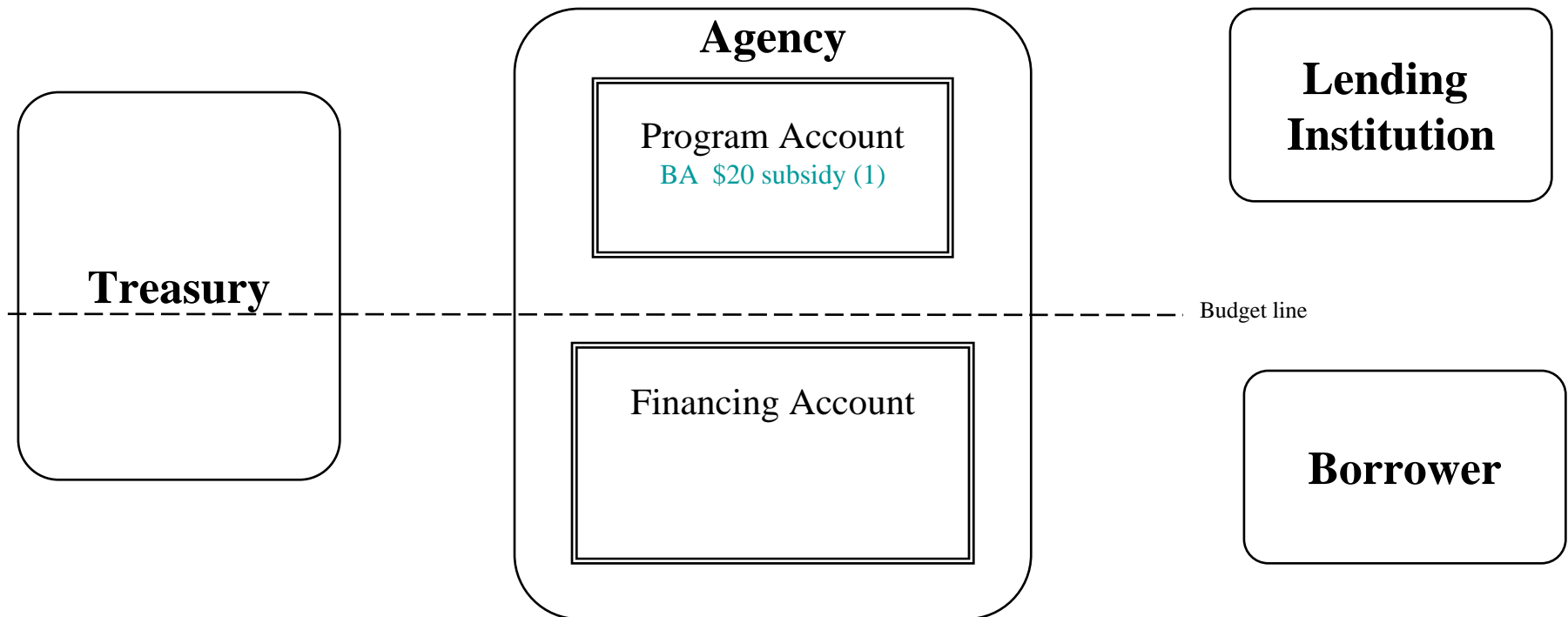




# Budgetary Accounting: Cash Flows for Loan Guarantees

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EXAMPLE: \$100 loan with 75% Federal guarantee on principal outstanding, 20% subsidy rate, disbursed in one year, upfront fee of 2%, and 40% default rate with no recoveries.



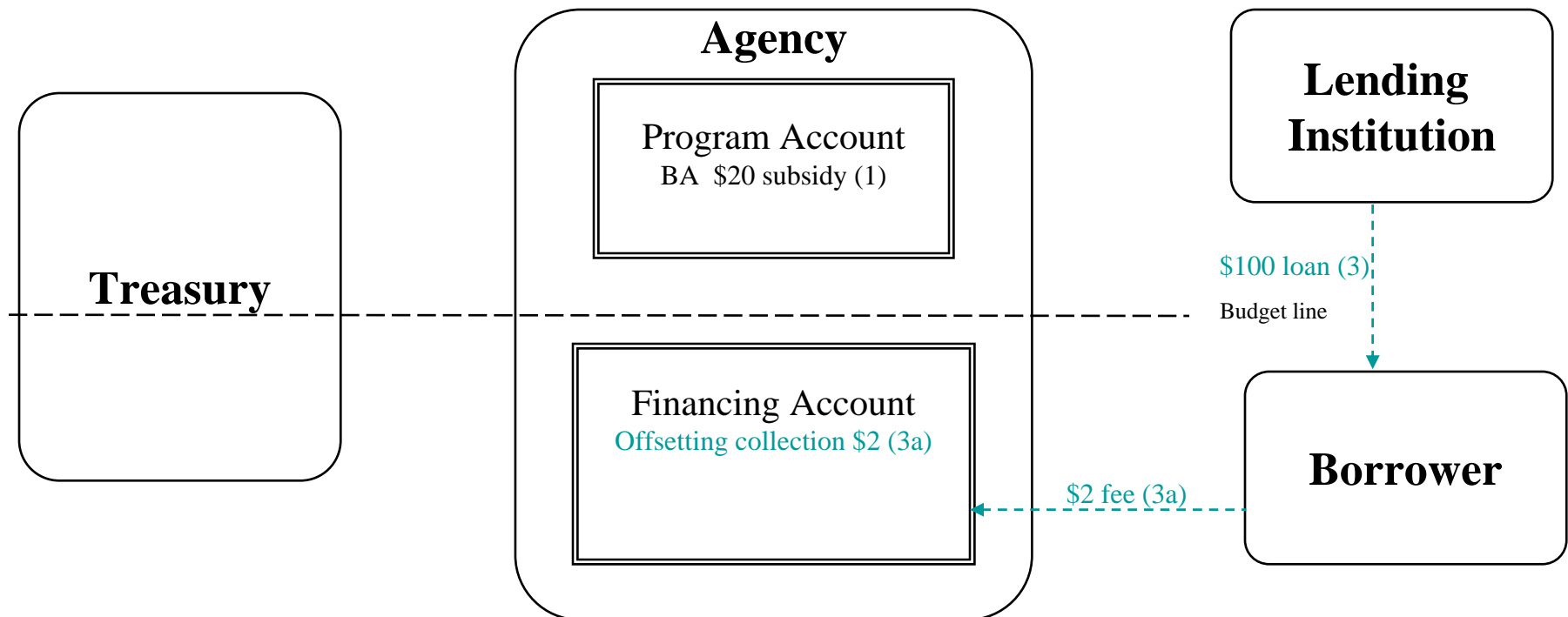
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2. Lending Institution and Borrower sign loan agreement for \$100 loan (commitment), obligating \$20 for subsidy in the program account.



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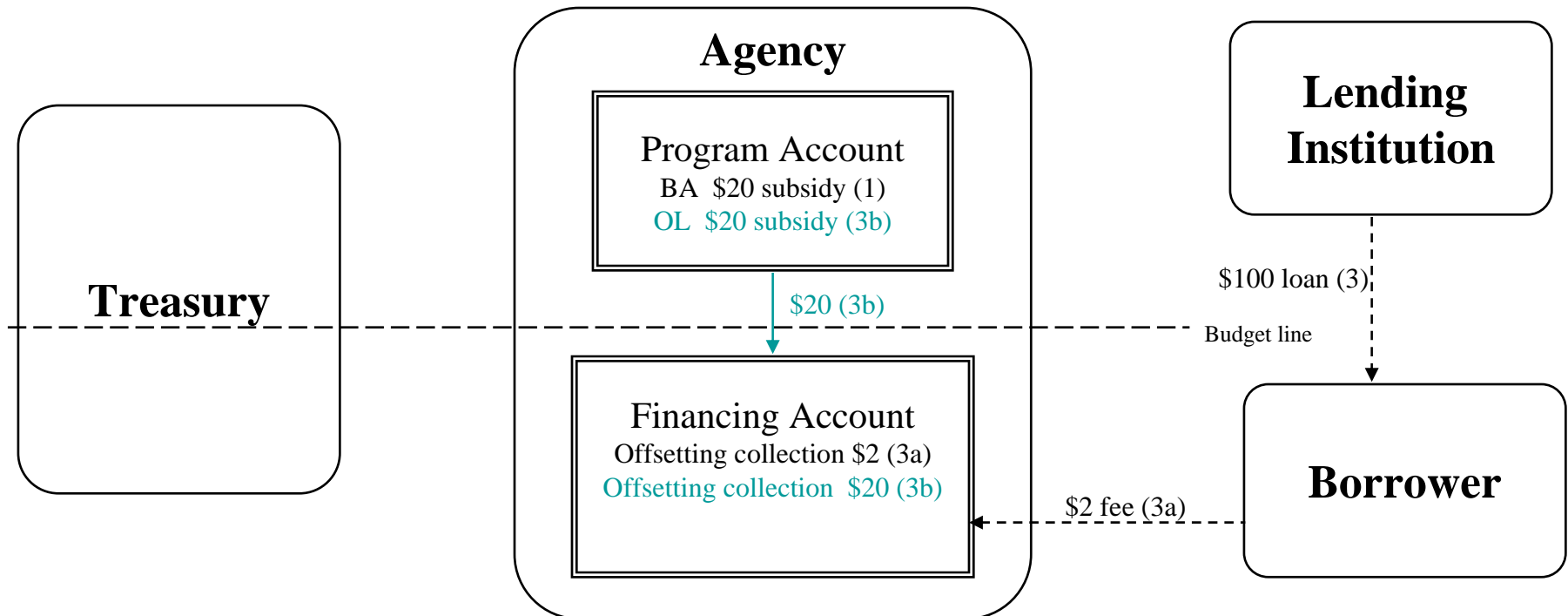
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3. When the Lending Institution disburses the loan to the Borrower:
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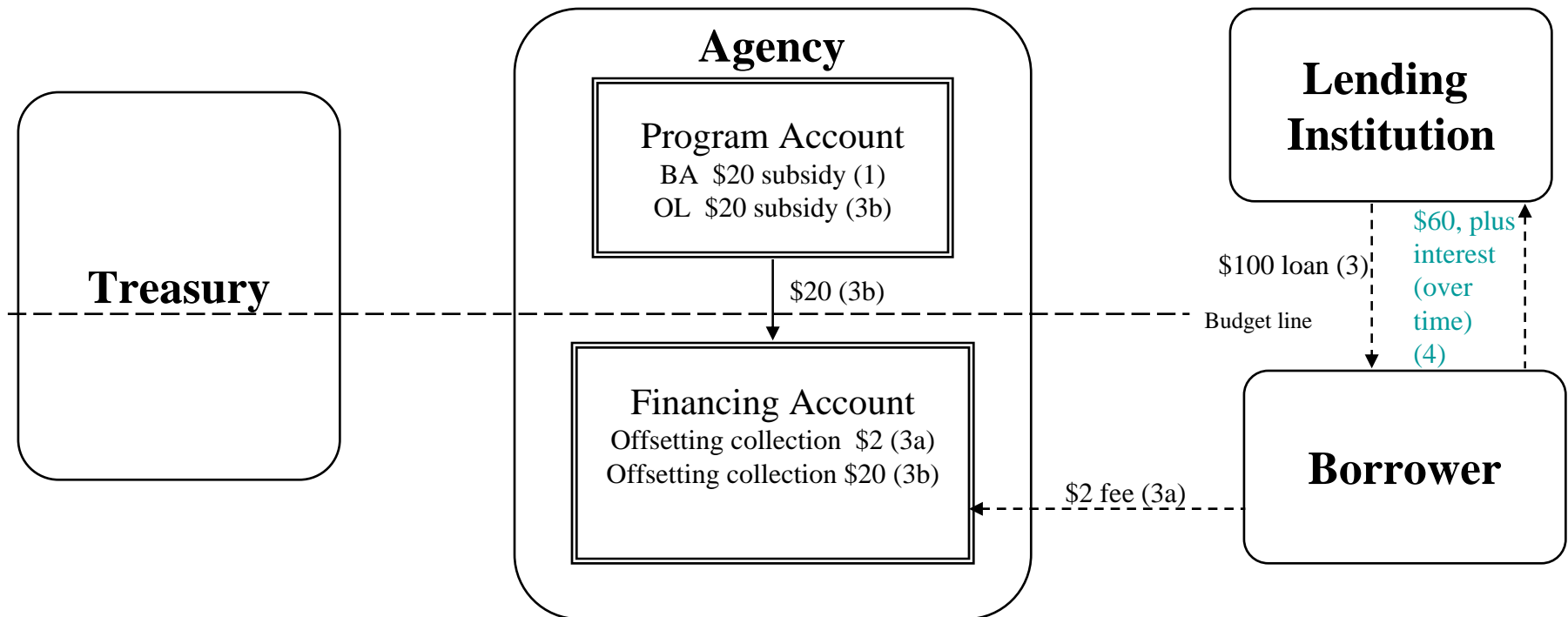
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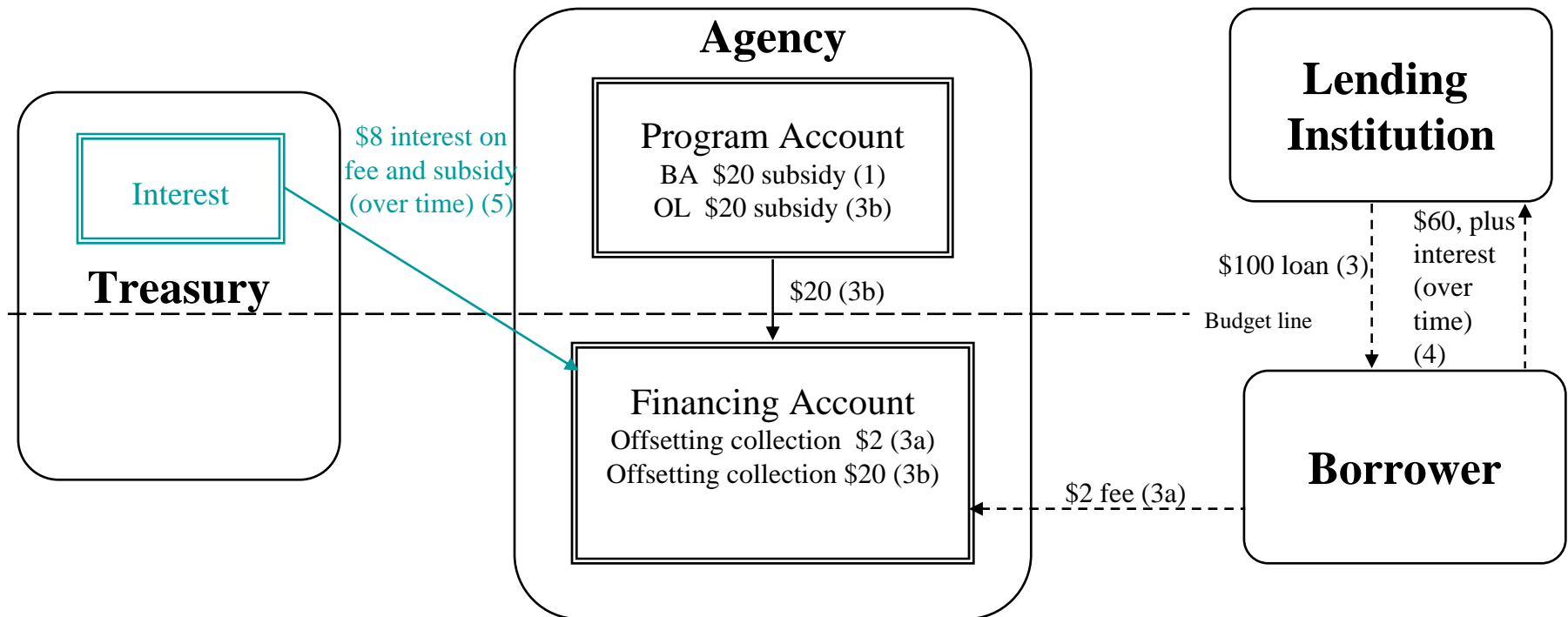
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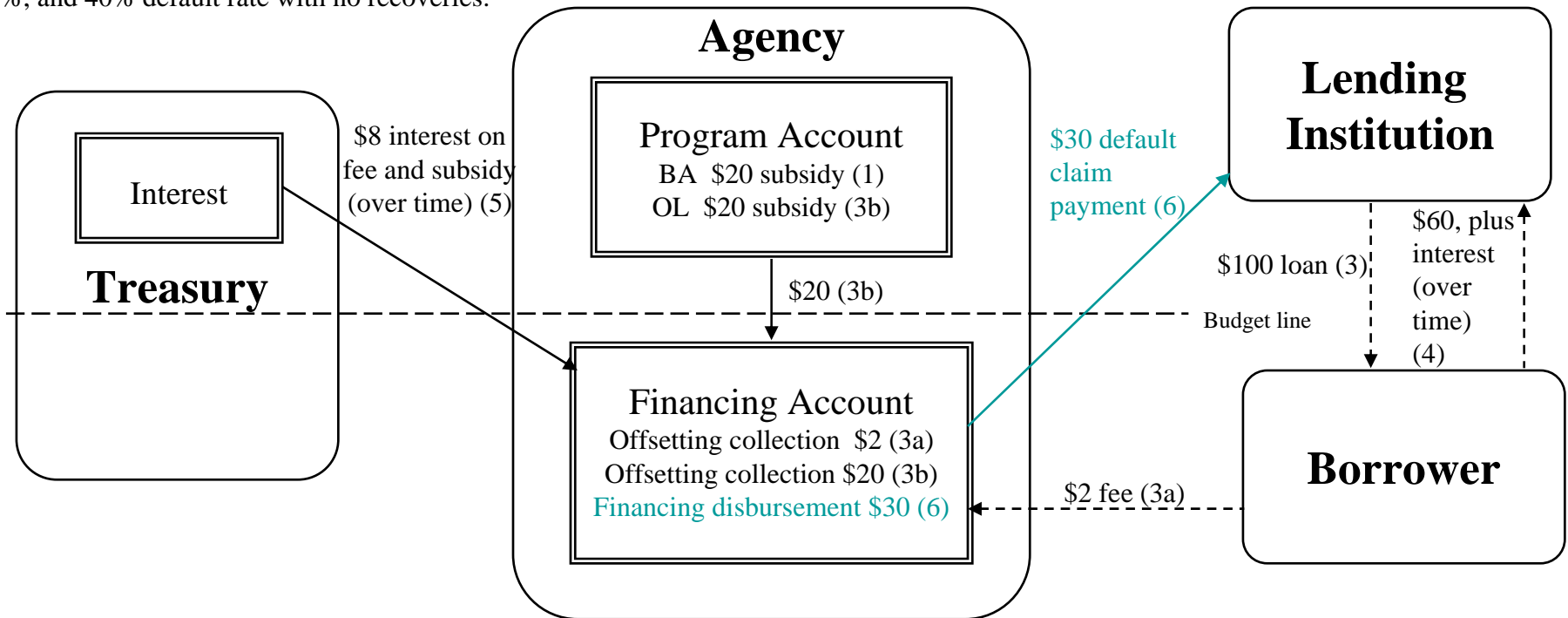
- The Borrower pays principal and interest to the Lending Institution under the terms of the contract over time.
- Reserves (uninvested funds) are held in the financing account and earn interest. The interest that Treasury pays to the financing account is an outlay, increasing the deficit, but the interest received by the financing account is a means of financing and does not affect the budget totals.



# Budgetary Accounting: Cash Flows for Loan Guarantees

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EXAMPLE: \$100 loan with 75% Federal guarantee on principal outstanding, 20% subsidy rate, disbursed in one year, upfront fee of 2%, and 40% default rate with no recoveries.



- The Borrower pays principal and interest to the Lending Institution under the terms of the contract over time.
- Reserves (uninvested funds) are held in the financing account and earn interest. The interest that Treasury pays to the financing account is an outlay, increasing the deficit, but the interest received by the financing account is a means of financing and does not affect the budget totals.
- If the Borrower defaults, the reserves held in the financing account (\$22 plus interest) are used to make claim payments to the Lending Institution. If the subsidy rate is accurate, the financing account will have exactly the reserves needed to cover all defaults and other subsidies for the cohort.
- If the subsidy is not accurate, a reestimate will be made and, as necessary, either (1) additional subsidy will be disbursed from the program account to the financing account to cover the amount of the reestimate or (2) excess funds will be moved from the financing account to a negative receipt account, where these funds are unavailable until appropriated.



# Subsidy Reestimate

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Annual comparison of:

- Estimated cash flows and actual cash flows, plus updated assumptions about future cash flows, or
- End-of-year financing account balances and present value of estimated future cash flows.

Types of reestimates:

- Interest rate reestimate.
- Technical reestimate.
- Plus an adjusting entry, interest on the reestimate.

Covered by permanent, indefinite authority.



# Subsidy Reestimate Cost

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- ❑ Upward or downward.
- ❑ **Upward** indicates a net increase in the subsidy cost.
  - Requires a transfer of funds between the program account and financing account.
- ❑ **Downward** indicates a net decrease in the subsidy cost.
  - Requires a transfer of funds from the financing account to the downward reestimate receipt account.





# Types of Subsidy Reestimates

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## Interest rate Reestimate:

- ❑ Difference between estimated discount rates and actual average annual rates (disbursement weighted average or single effective rate).
- ❑ At a minimum, required at 90% disbursement.

## Technical Reestimate:

- ❑ Difference between estimated cash flows and actual cash flows, plus changes in assumptions about future cash flows.
- ❑ First technical after 90% disbursement sets the final cohort interest rate for discounting and calculating financing account interest.
- ❑ Annual, unless otherwise approved by OMB examiner.



# Illustration of Technical Reestimate

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## Technical Reestimate: Direct Loan

Number of Loans	1,000	<b>Original Subsidy Rate</b>		<b>Reestimated Subsidy Rate</b>	
Loan Amount	\$1,000.00	Outstanding	\$1,000,000	Outstanding	\$1,000,000
Borrower interest rate	5%	PV of cashflows	(\$794,220)	PV of cashflows	(\$786,122)
Maturity	5 years	Subsidy Cost	\$205,780	Subsidy Cost	\$213,878
Borrower Payment	\$181.90	Subsidy Rate	20.58%	Subsidy Rate	21.39%
Discount rate	4%				

### Cashflows

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
	← actual data			→ estimated	
<b>Original:</b>					
Contractual P&I...	\$181,899	\$181,899	\$181,899	\$181,899	\$181,899
Default rate.....	0%	1%	2%	3%	4%
Less Defaults.....	\$0	(\$1,819)	(\$3,638)	(\$5,457)	(\$7,276)
Estimated.....	\$181,899	\$180,080	\$178,261	\$176,442	\$174,623
<b>Reestimate</b>					
Contractual P&I...	\$181,899	\$181,899	\$181,899	\$181,899	\$181,899
Default rate.....	1%	2%	3%	4%	5%
Less Defaults.....	(\$1,819)	(\$3,638)	(\$5,457)	(\$7,276)	(\$9,095)
Estimated.....	\$180,080	\$178,261	\$176,442	\$174,623	\$172,804



# Interest on the Reestimate

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- ❑ Interest on the reestimate represents interest that would have been earned or paid if the reestimate amount was included in the original estimate.
- ❑ When calculating the interest on the reestimate, use the disbursement weighted average rate (cohorts 1992-2000) or single effective rate (cohorts 2001-present).



# Modification

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- ❑ Occurs when a Government action:
  - Changes actions assumed in the baseline estimate of cash flows and changes the estimated subsidy cost
- ❑ Modification cost estimate:
  - The difference between the present value of the remaining cashflows before the modification, and after the modification
  - Plus an adjusting entry (modification adjustment transfer) for loans that have already disbursed
- ❑ Requires an appropriation in advance



# Modification Cost

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- ❑ Positive, negative, or zero.
- ❑ Positive indicates an additional subsidy cost.
  - Requires a transfer of funds between the program account and financing account.
- ❑ Negative indicates a savings is achieved.
  - Requires a transfer of funds from the financing account to the negative receipt account.



# Modification Adjustment Transfer

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- ❑ The current fiscal year discount rates are used to calculate the modification cost.
- ❑ To account for the difference between the current discount rate and cohort's interest rate, a modification adjustment transfer is made between the financing account and general fund.
- ❑ The effect of the modification adjustment transfer depends on whether a direct loan or loan guarantee was modified and whether the current discount rates are lower or higher relative to the cohort interest rate (DWADR or SER).



# Reestimate vs. Modification

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## Reestimate

- Uses permanent, indefinite authority
- Annual
- Adjusts subsidy estimate for difference between assumptions and actual experience
- Economic and technical assumptions

## Modification

- Requires an appropriation in advance of the action
- As needed basis
- Adjusts subsidy for decisions to relax or tighten terms
- Technical assumptions



# For More Information

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## ❑ Legislation

- The Federal Credit Reform Act of 1990

<http://www.fms.treas.gov/ussgl/creditreform/fcra.html#titleV>

## ❑ OMB Circulars

- OMB Circular A-11, Section 185 “Federal Credit Data”:

[http://www.whitehouse.gov/omb/circulars/a11/current\\_year/s185.pdf](http://www.whitehouse.gov/omb/circulars/a11/current_year/s185.pdf)

- OMB Circular A-129, “Policies for Federal Credit Programs and Non-Tax Receivables”:

<http://www.whitehouse.gov/omb/circulars/a129/a129rev.html>

## ❑ Budget Publications

- Federal Credit Supplement:

[http://origin.www.gpoaccess.gov/usbudget/fy09/cr\\_supp.html](http://origin.www.gpoaccess.gov/usbudget/fy09/cr_supp.html)





# For More Information (continued)

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## Other OMB

- Your Program Examiner
- Federal Credit Support Page:  
<http://www.whitehouse.gov/omb/credit>
  - OMB Credit Subsidy Calculator 2, Credit Discount Rates
- Credit Crew: [CSC2@omb.eop.gov](mailto:CSC2@omb.eop.gov)

## Other Sources

- U.S Treasury Financial Management Service websites
  - Credit reform accounting information:  
<http://www.fms.treas.gov/ussgl/creditreform/index.html>
  - Debt management information: <http://www.fms.treas.gov/debt>
  - Bureau of Public Debt—Federal Borrowings Program  
<http://www.treasurydirect.gov/govt/apps/tbp/tbp.htm>