Calculating Reestimates: Concepts

OMB Annual Training
June 25, 2008

Agenda

❑ The requirements for calculating reestimates

❑ Why are reestimates needed

❑ Concepts and data underlying reestimates

■ Interest rate reestimate

■ Technical reestimates

❑ Balances Approach Reestimates

❑ Traditional Approach Reestimates

❑ Reestimates with the CSC2 (concepts)

Subsidy estimate:

❑ Cost to the Government on a net present value (NPV) basis of direct loans or loan guarantees

❑ Subsidy rate = subsidy cost/total disbursements

❑ Subsidy estimates by cohort and risk category

Review: Subsidy Estimation

Subsidy estimate:

❑ Rate is expressed in terms of percentage

  ◼ Program X has a 20% subsidy estimate

❑ Applied to the estimated face value of direct loans or loan guarantees

  ◼ 20% subsidy rate

  ◼ $10 million in loan volume

  ◼ $2 million of subsidy budget authority required

❑ Agency develops models to generate expected program cash inflows and outflows between the Government and the public

❑ Agency formats cash flows to be read by the OMB Credit Subsidy Calculator 2 (CSC2)

❑ CSC2 discounts cash flows to disbursement and generates the subsidy rate

  ■ Interest rates for discounting are provided by OMB in the CSC2

❑ Reestimate—a revision of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes.

❑ Comparison **for each cohort** of:

- prior subsidy estimates for each disbursed loan/guarantee cohort

  - to -

- actual loan/guarantee cash flows and updated assumptions about expected performance

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Two types of reestimates are required for each cohort/risk category

❑ **Interest rate reestimate**
- ■ Update for change in the discount rate between time of loan obligation (or guarantee commitment) and disbursement.
- ■ Performed at substantial disbursement (i.e. 90 percent)

❑ **Technical reestimate**
- ■ Update for actual cash flows and changes in technical/default assumptions (e.g., forecast technical assumptions)
- ■ Performed annually

❑ Trues up the financing account for the difference between estimated and actual discount rates

■ Replace OMB-issued economic assumption Treasury rates with actual Treasury rates

■ Recalculate the subsidy estimate using the actual Treasury interest rates

■ Some agencies update borrower's interest rate

■ Interest rate reestimate output is a subsidy rate

■ Federal credit supplement shows the percent change due to interest

❑ Once after a cohort becomes at least 90% disbursed ("use 90 percent" method).

❑ Some agencies are required by auditors to calculate each year during disbursement unless the interest rate reestimate is not material to the financial statements ("use all" method).

❑ OMB does not require "use all" method for budget formulation and execution

Interest rate reestimate example

❑ Direct loan with a Budget subsidy rate of 6.23% using the 2005 budget assumption discount rates.

- Using the original budget cashflow (updated for interest) generates an interest rate reestimated subsidy rate of 6.99% using the <u>actual</u> Treasury rates.

- Percent change due to interest = interest rate reestimated subsidy rate – original subsidy rate. 6.99% - 6.23% = 0.76%.

- Interest rate reestimate = percent change due to interest * disbursements to date. For example, if there were $100M in disbursements, interest rate reestimate = $760K

- To derive the additional interest rate subsidy reestimate for the current year—deduct previous interest rate reestimate (if any).

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❑ Corrects for changes in actual loan performance from the latest subsidy estimate.

❑ Example:

- ■ A loan guarantee program fully guarantees a $10 million loan.

- ■ Original subsidy estimate is 20%, based on the default risk of the borrower. Agency sets aside $2 million in a financing account in anticipation of future default.

- ■ Loan defaults on first payment. Bank places a claim of $10 million.

- ■ The reestimate gives the agency permanent indefinite authority to cover the $8 million shortfall between the claim and the balance of the financing account.

❑ Required to be calculated and executed annually, unless one of the following four conditions is met:

- ■ A different periodic schedule has been established with OMB;

- ■ a major change in actual versus projected activity is detected,

- ■ a material difference is detected through monitoring "triggers" developed in coordination with OMB, or

- ■ a cohort is being closed out.

Agency

NPV of actual and updated future cashflows / Disbursements

Treasury

Interest

Interest repayment

Principal

Agency Borrowing

Principal repayment

Program Account

Subsidy + Reestimates

Financing Account

Budget line

Loan

Loan repayment (P & I)

Borrower/ Public
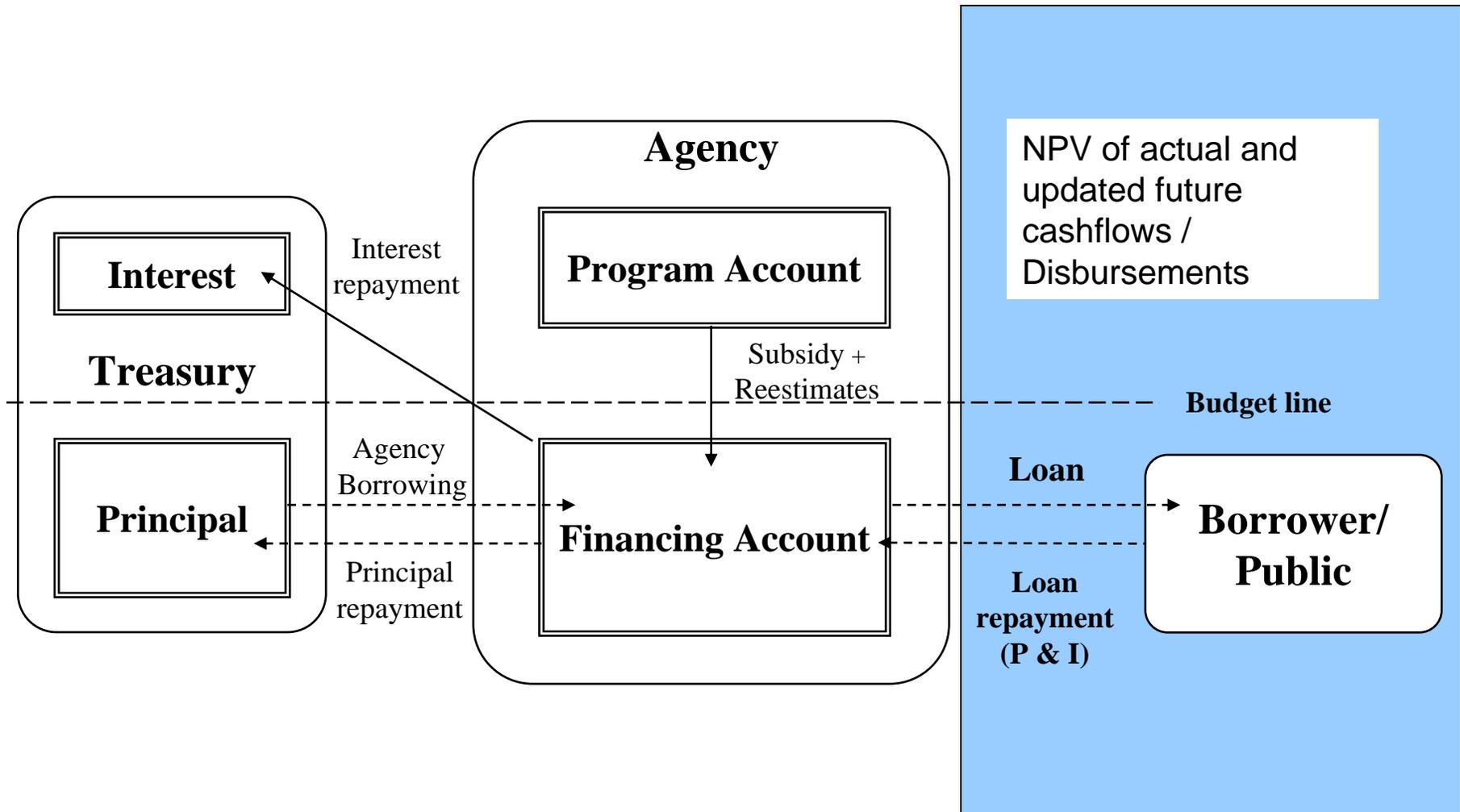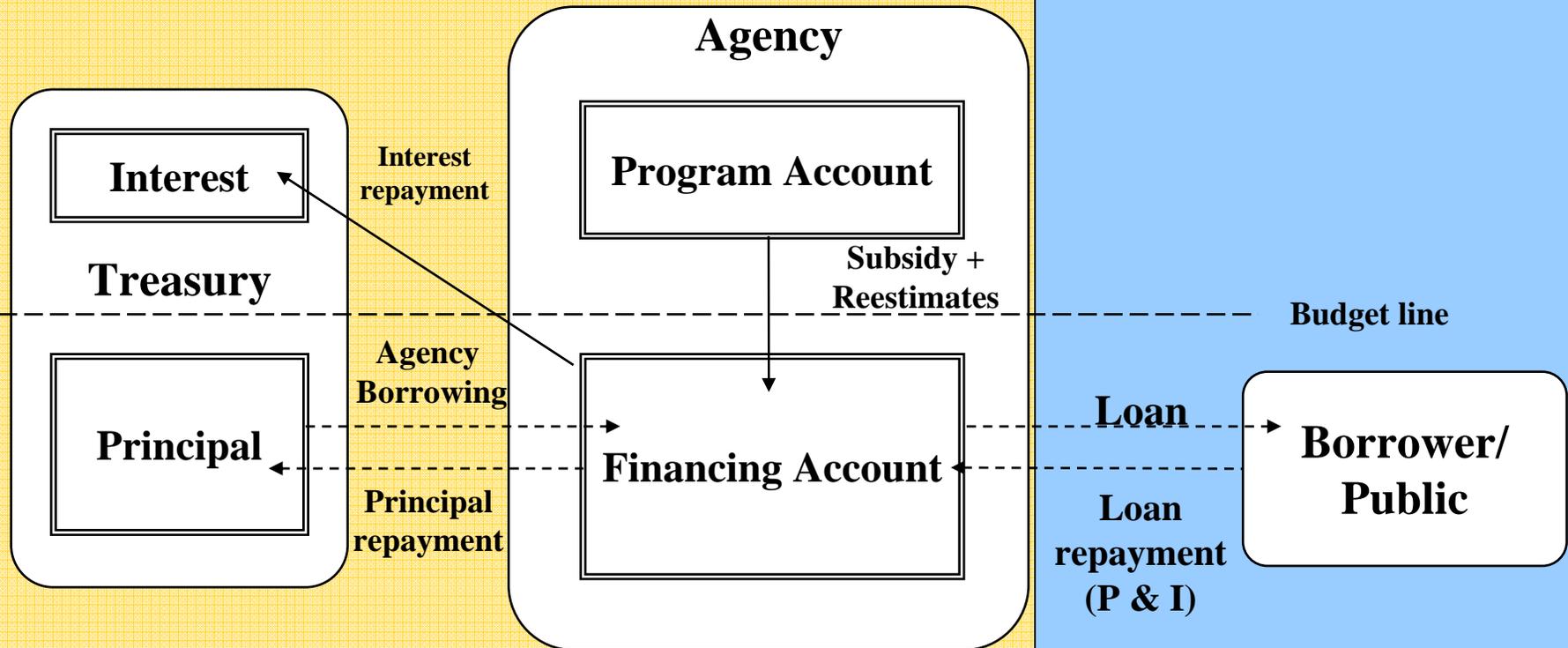
Transactions with Treasury exactly match transactions with the public.

Or: Liabilities (debt to Treasury) equal assets (loan to public)

Or: Net position is zero

Or: The financing account has no debt or cash at the end of the life of the loan.

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Assets

- Direct loans—present value of remaining cash flows from the public
- Balance of funds on deposit with Treasury

Liabilities

- Balances owed to Treasury
- For loan guarantees, the present value of remaining cash flows, including undisbursed loans

- ❑ Traditional approach reestimates:
  - ◼ Reestimate based on cashflows with the public
  - ◼ Traditional approach had no check on accounting errors
  - ◼ Unexplained balances in financing accounts

- ❑ Balances approach reestimates:
  - ◼ Took the end of year financing account balance as given
  - ◼ Could not distinguish between reestimates resulting from borrower performance and accounting errors—subsidy rates that did not reflect borrower performance

- ❑ Financing account interest:
  - ◼ Simplified interest and no method for correcting interest earned at budget assumptions

- ❑ Balances approach reestimates
  - ■ Calculated financing account balance with interest
  - ■ Agencies reconcile calculated vs. reported balance
  - ■ Future cashflows discounted to the end of the fiscal year
- ❑ Traditional approach reestimate
  - ■ Check against Balances approach reestimated rate
- ❑ Financing account interest adjustment
- ❑ Historical cohort data is required for Traditional approach reestimate check and financing account interest adjustment

❑ Consistent data for credit calculations

❑ Disconnects in financing account balances are transparent

❑ Accounting differences are transparent

❑ Cost accurately reflects long term cost to government

■ Transactions to and from public + Intragovernmental transactions = Financing account balance

To perform technical reestimates using the CSC2:

DATA

❑ Update borrower cashflows (to or from the public) for actual performance

❑ Updated estimated future borrower cashflows

❑ Financing account balances

 ▪ End of year Debt/Cash balance in the financing account

❑ Intragovernmental transactions

 ▪ Includes borrowing, repayments, subsidy, financing account interest, modifications, and prior reestimates

ANALYSIS

❑ Source of any differences between what should be in the financing account (sum of transactions) and what was reported.

❑ Why are costs changing?

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Reestimate Requirements

- Required to be calculated at the close of each fiscal year

- With OMB approval, agencies may use actual data through either March 31 or June 30 and estimate remainder of year

- Discount rates for calculating the cohort interest rate are released about 10 days before the end of the fiscal year.

Reestimate execution

- ❑ Upward reestimate
  - Liabilities exceed assets
  - The subsidy cost is higher than previously estimated
  - Permanent indefinite authority cover the upward reestimate

- ❑ Downward reestimate
  - Assets exceed liabilities
  - The subsidy cost is lower than previously estimated
  - The downward reestimate must be returned to the general fund via the downward reestimate receipt account

❑ The amount of interest that would have been paid or earned by the financing account if loan had originally been executed at the reestimated subsidy rate

❑ Interest on the reestimate is calculated at the disbursement-weighted average discount rate or single effective rate

❑ Financing account interest adjustment is executed as interest on reestimate.

- ❑ For basket of zeros cohorts (cohorts 2001 and forward), only two single effective rates will be calculated.
  - ■ Budget formulation single effective rate
  - ■ Final single effective rate

- ❑ For technical reestimates, enter the numeric single effective rate as the "reestimate discount rate" in CSC2 input cashflows for each cohort

- ❑ Exceptions:
  - ■ Interest rate reestimate
  - ■ First technical reestimate after 90% disbursement

- Guidance on Reestimates:
- OMB Circular A-11, Ch. 185, especially Section 185.6
- Federal Credit Support Page:
  - http://www.whitehouse.gov/omb/credit
  - OMB Credit Subsidy Calculator 2 User guide