Calculating Traditional Reestimates

OMB Annual Training

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What I want you to get out of this session

- An understanding of the requirements for calculating traditional approach reestimates
- Why are reestimates needed
- **Bottom line: concepts and data, not process**

Review: Subsidy Estimation

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

Review: Subsidy Estimation

Subsidy estimate:

- Rate is expressed in terms of percentage
  - e.g. Program X has a 15% subsidy estimate
- Applied to the estimated face value of direct loans or loan guarantees
  - e.g. 15% of $10,000,000 in loans = $1.5 million of subsidy budget authority required

Review: Subsidy Estimation

- Agency develops models and spreadsheets presenting program cash inflows and outflows between the Government and the public
- Agency uses OMB Credit Subsidy Calculator (CSC) to discount cash flows to date(s) of disbursement
  - Interest rates used for discounting are provided by OMB through CSC

Credit Subsidy Reestimate

Annual comparison of:

- prior subsidy estimates for each previously disbursed loan/guarantee cohort

  - to -

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

Two-part calculation:

- update for change in discount rate between time of loan obligation (guarantee commitment) and disbursement ("interest rate reestimate")
- update for changes in technical/default assumptions (e.g., forecast technical assumptions) ("technical reestimate")

Important note about reestimates under the new CSC

- Some of the underlying mechnical processes for calculating reestimates will change.
- The data described in the following slides will still be needed.
- Additional data already being collected by agencies for internal purposes (and not previously requested by OMB for reestimates) will also be needed.

Interest Rate Reestimate

- 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
  - Some agencies update borrower’s interest rate

When should agencies perform interest rate reestimates?

- Required to be calculated...
  - 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

Technical Reestimate

- Corrects for changes in actual loan performance from the latest subsidy estimate.
- Example:
  - A loan guarantee program fully guarantees a $10,000,000 loan.
  - Original subsidy estimate is 15%, based on the default risk of the borrower. Agency sets aside $1.5 million in a financing account in anticipation of future default.
  - Loan defaults on first payment. Bank places a claim of $10,000,000. The reestimate gives the agency permanent indefinite authority to cover the $8.5 million shortfall between the claim and the balance of the financing account.

Calculating a Technical Reestimate

- Replace estimated cash flows with actual cash received or paid by financing account to or from the public
  - direct loans: repayments of principal and interest, defaults, recoveries, fees, prepayments, etc.
  - loan guarantees: default claim payments, recoveries, fees, interest subsidies, etc.
- Update estimates of future cash flows based upon recent historical performance (must be supported by analysis)
  - why is performance different from expected?

When should agencies perform technical reestimates?

- Required to be calculated and executed annually, unless one of the following four conditions is met:
  - based upon periodic schedules 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.

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 cohort interest rate are released 10 days before the end of the fiscal year.

Reestimate Execution

- Upward reestimate
  - The subsidy cost is higher than previously estimated
  - Permanent indefinite authority is available to cover the upward reestimate
- Downward reestimate
  - The subsidy cost is lower than previously estimated
  - The downward reestimate must be returned to the general fund via the downward reestimate receipt account

Interest on the Reestimate

- 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

What rate should agencies use to discount reestimate cashflows?

- 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
- Enter a numeric single effective rate as the “reestimate discount rate” in CSC cashflows
- Exceptions:
  - Interest rate reestimate
  - First technical reestimate after 90% disbursement

What fixing the SER means to agencies

- For agencies which calculate discount rate reestimates using the “Use 90” rule, only cohorts which become 90% disbursed in the current fiscal year require the Treasury rates released 10 days before the end of the fiscal year.
- Accountants preparing financing account interest should use these rates for calculating interest earned or paid on financing account balances.

Performing Traditional Reestimates

- Interest Rate Reestimate
  - Discount the original cash flows using the actual Treasury yield curve using the OMB CSC.
- Technical Reestimate
  - Update the cash flows for actual data and updated projections.
  - Discount the revised cash flows using the budget formulation or actual cohort interest rate using the CSC.

Balances Approach

- Alternative method for calculating reestimates
- Compares the NPV of projected future cash flows to the balance in the financing account

For More Information

- 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 (CSC page)
- Reference tools for previous software
  - Consolidated Credit Tool instructions (Utilities page)
  - Working Paper, “Performing reestimates with the revised credit subsidy calculator” (CSC page)