



Introduction to Federal Credit Budgeting

OMB Annual Training

June 27, 2012

CSC2@omb.eop.gov



What we'll cover

Executive Office of the President • Office of Management and Budget

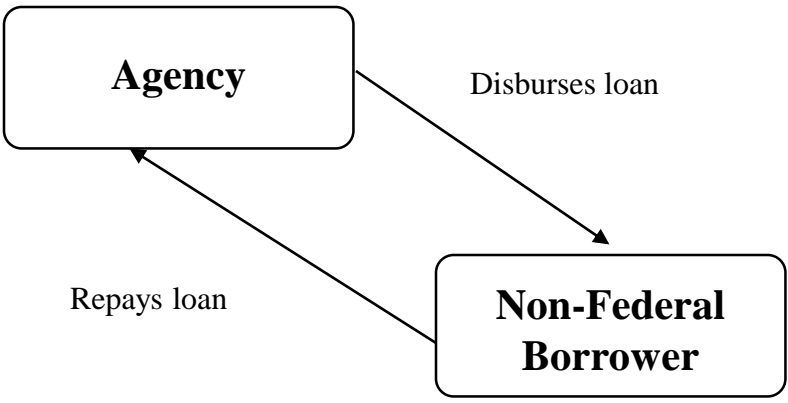
- Federal Credit Reform Act and key concepts
- Federal credit policies in OMB Circular A-129
- Credit subsidy cost estimates
- Budgetary accounting for credit programs
- Reestimates and modifications
- Resources for learning more



Types of Federal Credit

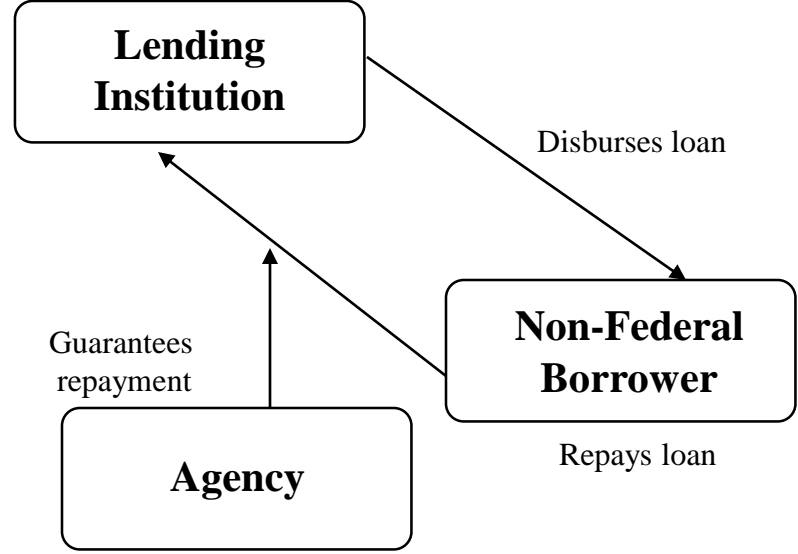
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Direct Loans*

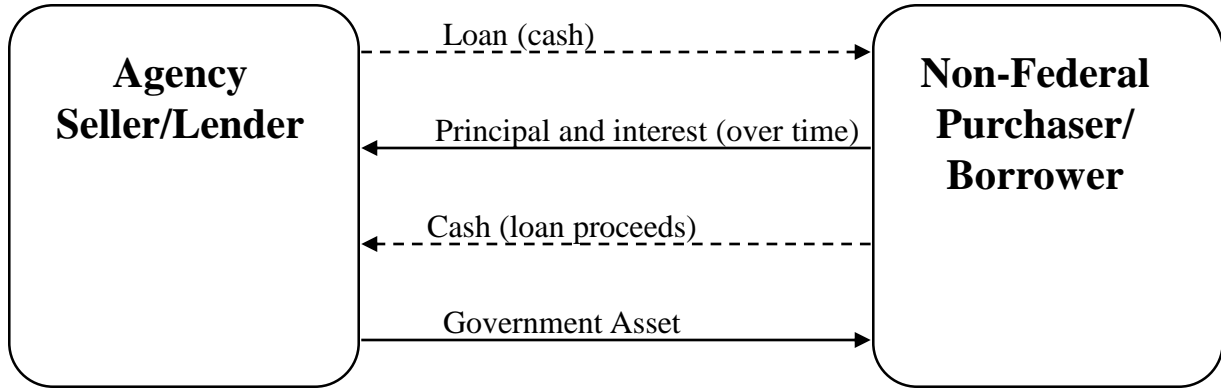


*Includes 100% guarantees financed through the Federal Financing Bank.

Loan Guarantees



Sale of Government Assets on Credit Terms





The Federal Credit Reform Act of 1990

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- ❑ FCRA established a system for budgeting and accounting for the cost of credit programs on a present value basis.
 - Establishes what falls under credit reform (direct loans, loan guarantees), and what does not (Federal borrowing, deposit insurance)
 - Defines the cost of credit programs
 - Provides authority for all the necessary accounts and transactions to support present value accounting – costs (deficit effects) vs. means of financing (non-budgetary effects)
 - Appropriation requirements – New loans, guarantees, and modifications
 - Provides permanent indefinite authority for reestimates

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



Cash Basis vs. Credit Reform

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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 expected lifetime cost at 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.



Federal Credit Policies: A-129

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- ❑ Federal credit policies for efficient, effective use of credit assistance
- ❑ Includes guidance from a program's inception through execution
- ❑ Program evaluation requirement: key questions
 - What is the policy goal(s)?
 - Who are the target borrowers, and what degree of subsidy is needed?
 - What is the right level of overall Federal participation/support?
 - What are the costs and benefits of the program?
- ❑ A-129 outlines incentives and practices to mitigate risk, and more effectively target limited Federal assistance
 - Does not mean that there should be no risk or cost of the program
 - Does not mean that there are not policy objectives and circumstances that suggest a deeper subsidy is warranted



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 (economic assumption)
 - These inflows and outflows are discounted using the OMB Credit Subsidy Calculator 2 (CSC2) software to arrive at the subsidy estimate



Cohorts and Risk Categories

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- ❑ Costs are estimated by cohort and risk category
 - Cohorts are defined by the year of obligation/commitment
 - Risk categories are groups of loans/guarantees that are relatively homogenous in cost

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



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

Direct Loan:

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
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

Loan Guarantee:

Default claim payment.....	0	0	0	0	244
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Net Present Value of Cash Flows:

Direct Loan.....	174
Loan Guarantee.....	174 Subsidy amount

In each case, there are \$244 in nominal losses in year 5—discounted to disbursement at 7%, this equals \$174.



Budget Accounts for Credit Programs

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Pre-credit reform activity (pre-1992 loans and guarantees)

- Liquidating – on budget

Credit reform (post-1991 loans and guarantees)

- Program – on budget
- Financing – means of financing
- Negative subsidy receipt account – on budget
- Downward reestimate receipt account – on budget



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 (on-budget)	Recorded as a means-of-financing (non-budgetary)
<ul style="list-style-type: none"> • Collects repayments, interest, fees, et al. • Repays any borrowing with interest • Pays default claims and interest subsidies 	<ul style="list-style-type: none"> • Receives appropriation of subsidy and administrative expenses • Subsidy is transferred from the program account to the financing account(s) 	<p><u>Direct Loans:</u></p> <ul style="list-style-type: none"> o Receives subsidy from program account o Borrows unsubsidized portion of loan from Treasury o Disburses new loans o Collects repayments, interest, fees, et al. o Repays borrowing to Treasury, plus interest <p><u>Guaranteed Loans:</u></p> <ul style="list-style-type: none"> o Receives subsidy from program account o Collects fees from borrowers o Acts as a reserve for default claims o Receives interest on reserves from Treasury o Pays default claims and interest subsidies



Budget Accounts for Credit Programs

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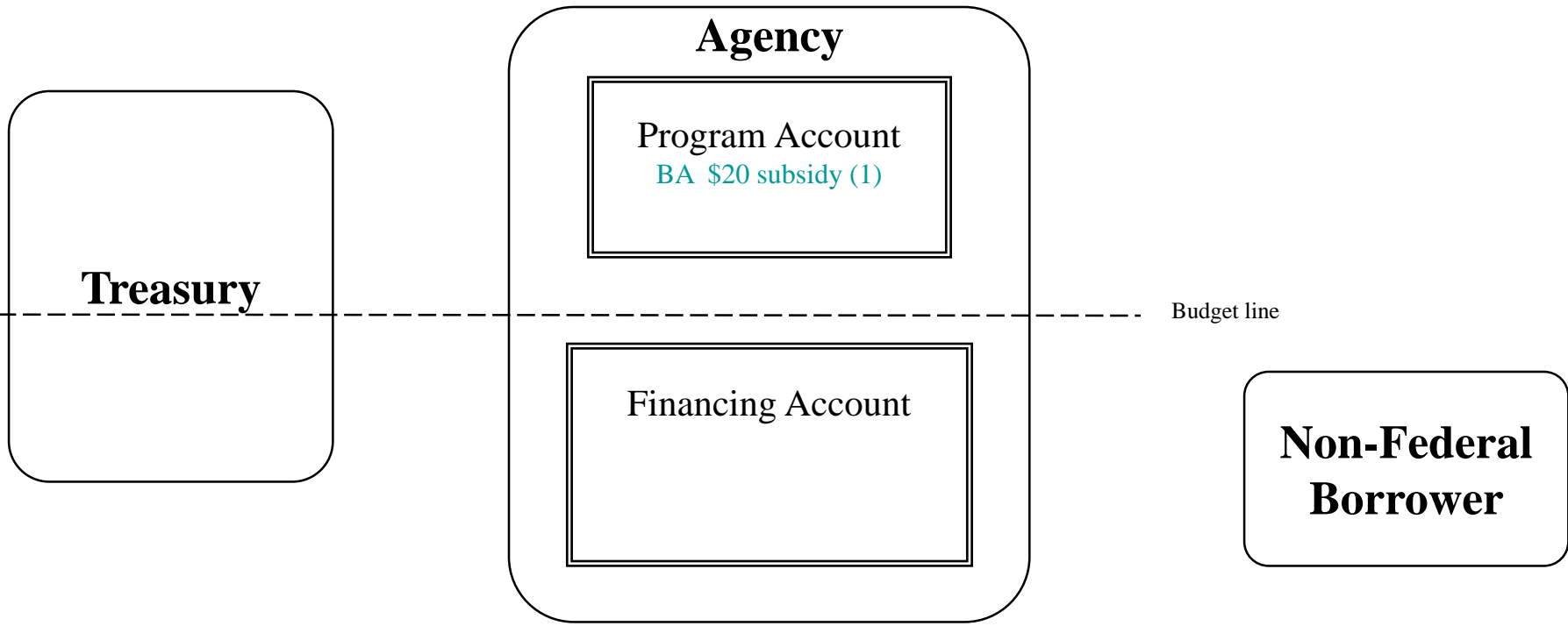
- ❑ Negative subsidy receipt and downward reestimate receipt accounts return excess funds to the general fund
- ❑ Negative subsidy receipts: When the present value of collections from the public exceeds losses, or when there is a modification that results in savings
- ❑ Downward reestimate receipts: Reflects the return of excess subsidy to the general fund
- ❑ Available for appropriation when realized



Budgetary Accounting: Cash Flows for Direct Loans

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



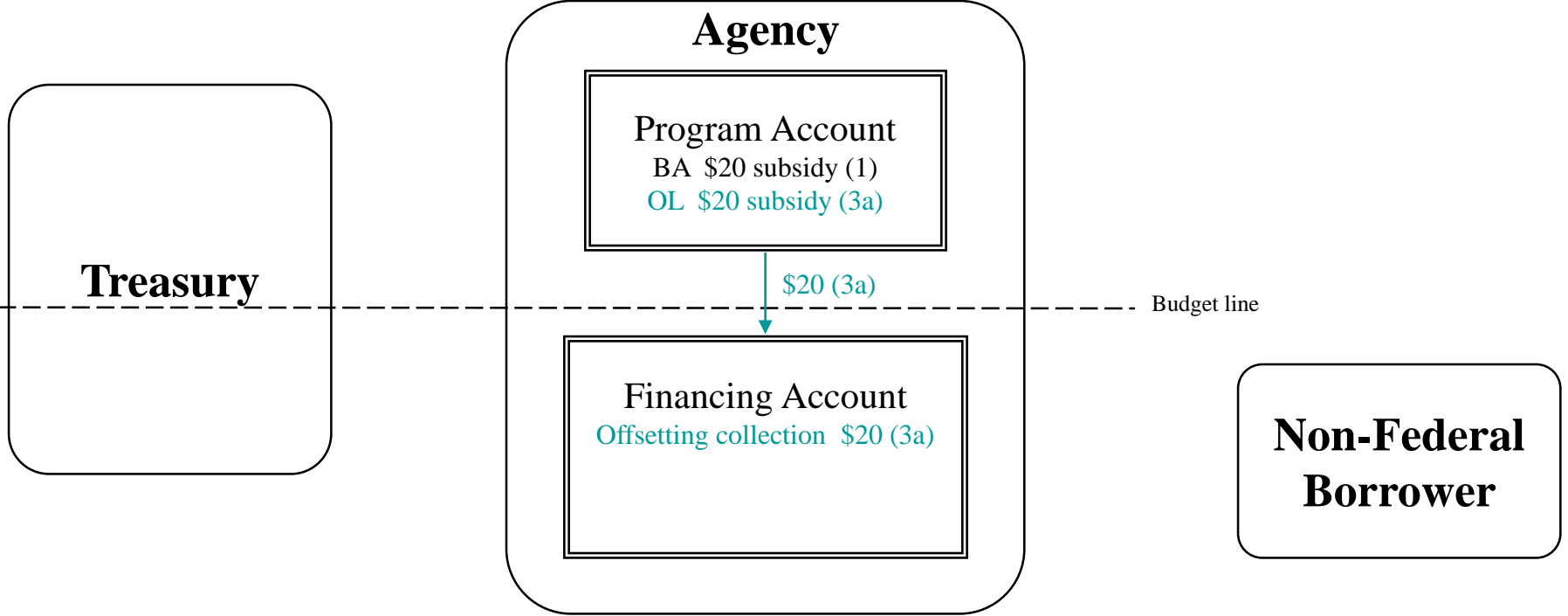
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Agency and Borrower sign loan agreement for a \$100 loan, obligating \$20 for subsidy in the program account and \$100 for the loan in the financing account.



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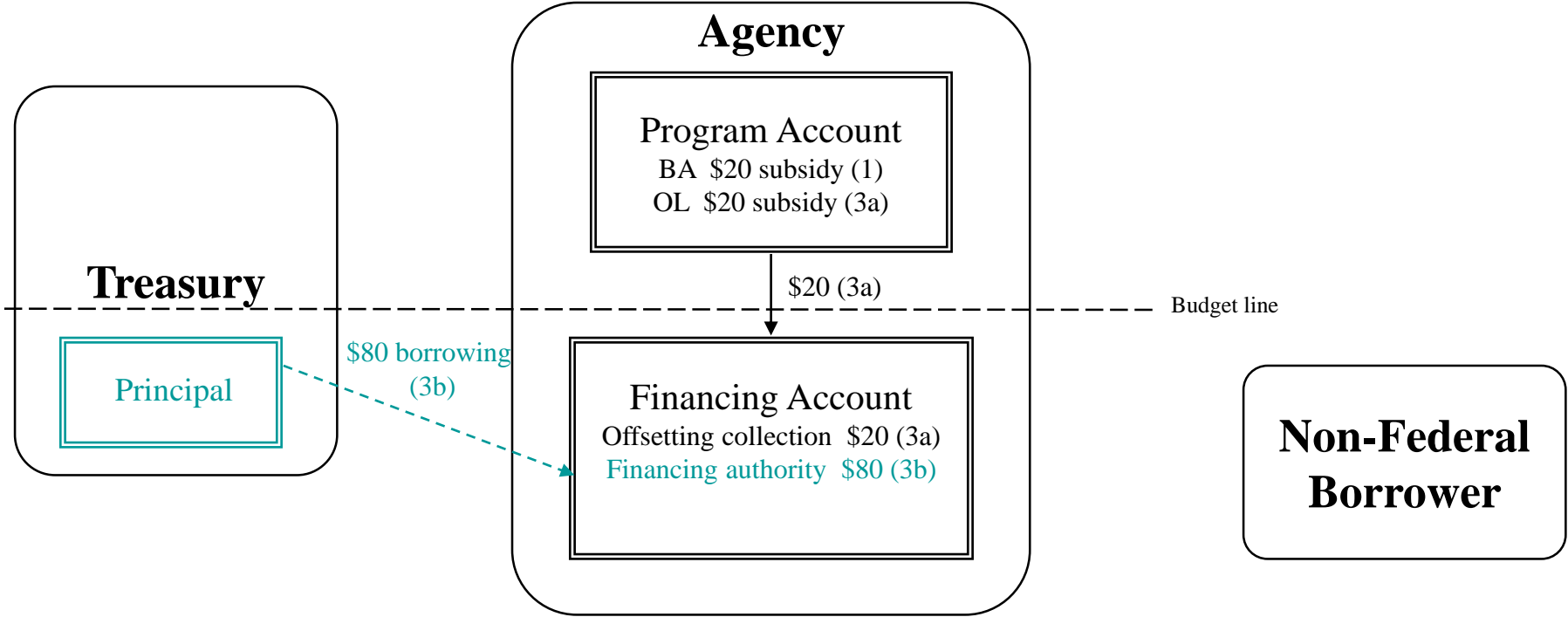
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Agency and Borrower sign loan agreement for a \$100 loan, obligating \$20 for subsidy in the program account and \$100 for the loan in the financing account.
3. When the Agency disburses the loan to the Borrower:
 - a. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.



Budgetary Accounting: Cash Flows for Direct Loans

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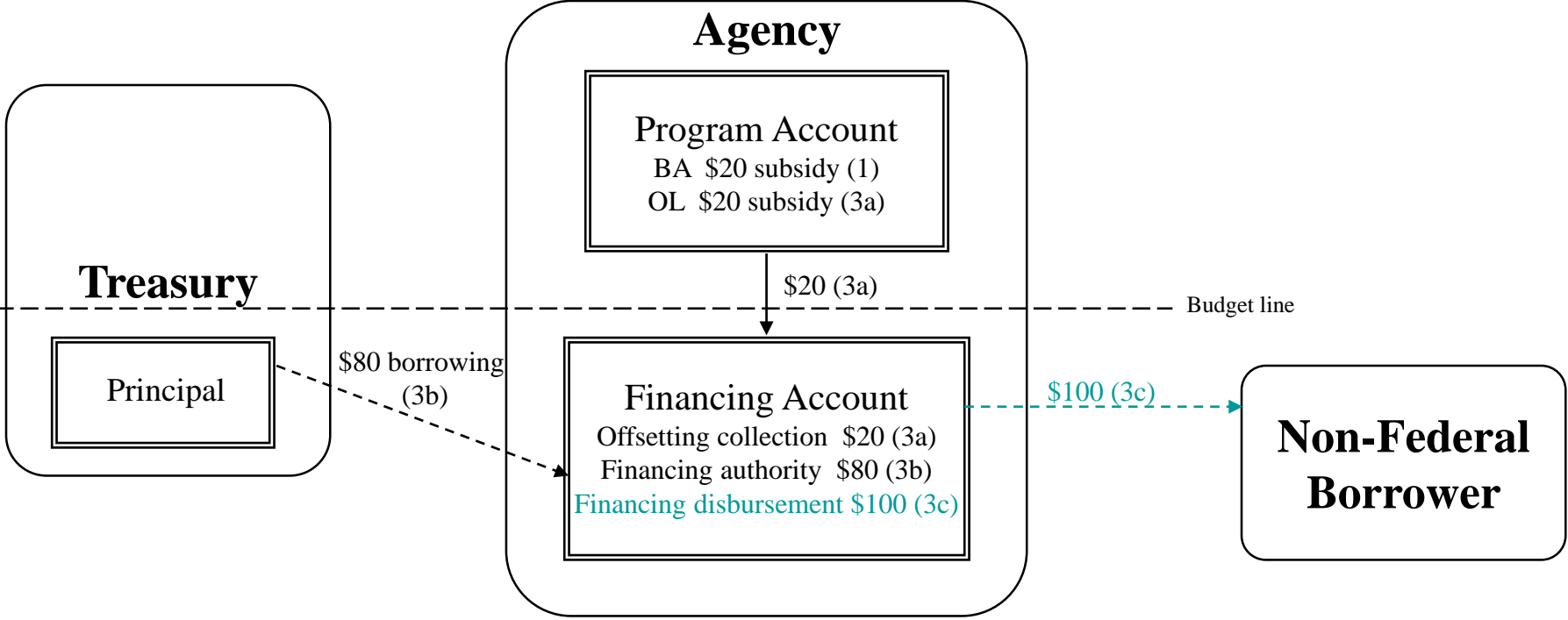
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Agency and Borrower sign loan agreement for a \$100 loan, obligating \$20 for subsidy in the program account and \$100 for the loan in the financing account.
3. When the Agency disburses the loan to the Borrower:
 - a. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.
 - b. The financing account borrows \$80 from Treasury.



Budgetary Accounting: Cash Flows for Direct Loans

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



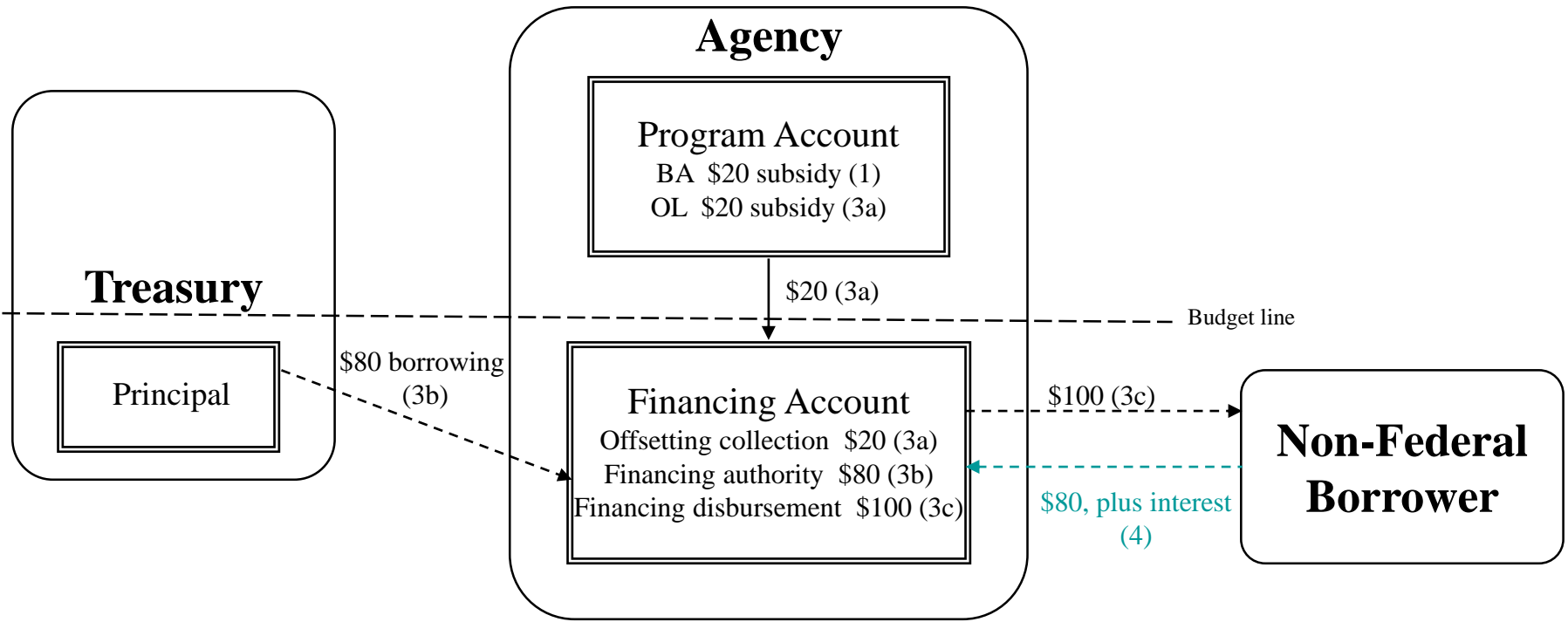
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Agency and Borrower sign loan agreement for a \$100 loan, obligating \$20 for subsidy in the program account and \$100 for the loan in the financing account.
3. When the Agency disburses the loan to the Borrower:
 - a. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.
 - b. The financing account borrows \$80 from Treasury.
 - c. The financing account disburses a \$100 loan to the Borrower.



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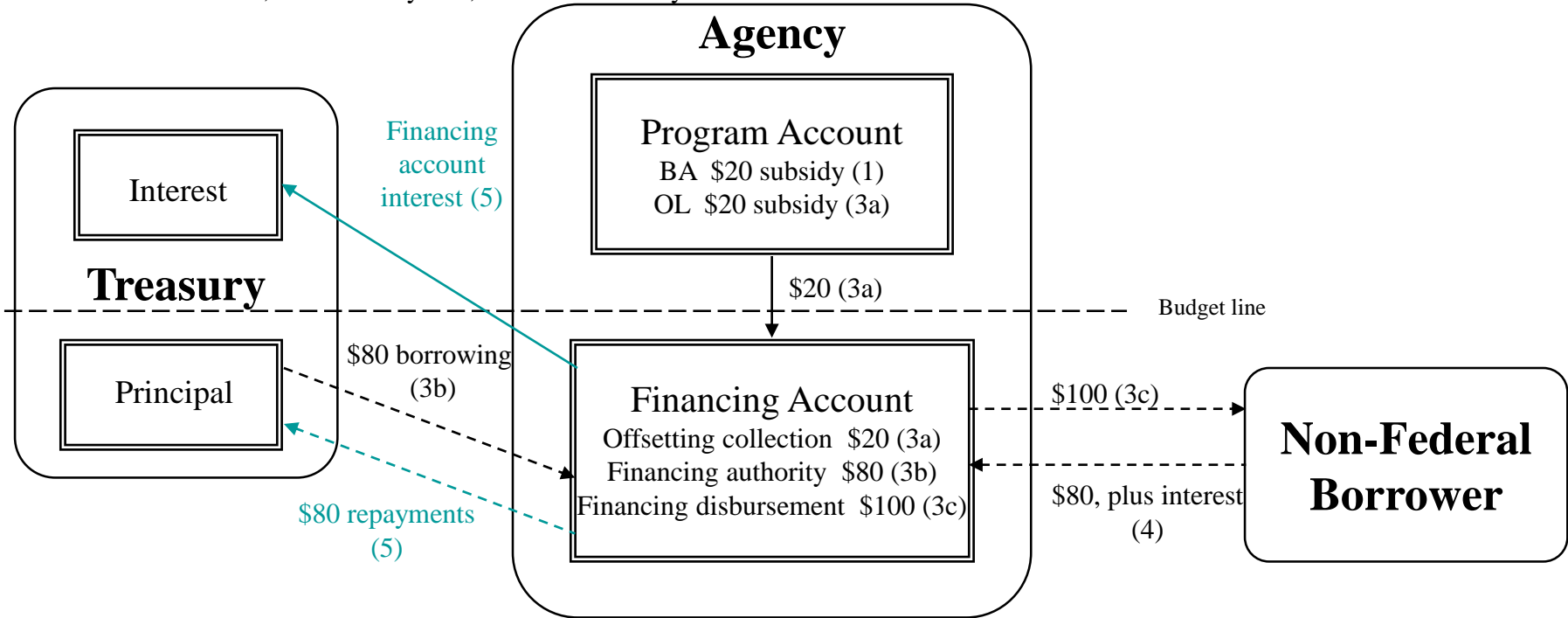
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Agency and Borrower sign loan agreement for a \$100 loan, obligating \$20 for subsidy in the program account and \$100 for the loan in the financing account.
3. When the Agency disburses the loan to the Borrower:
 - a. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.
 - 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.



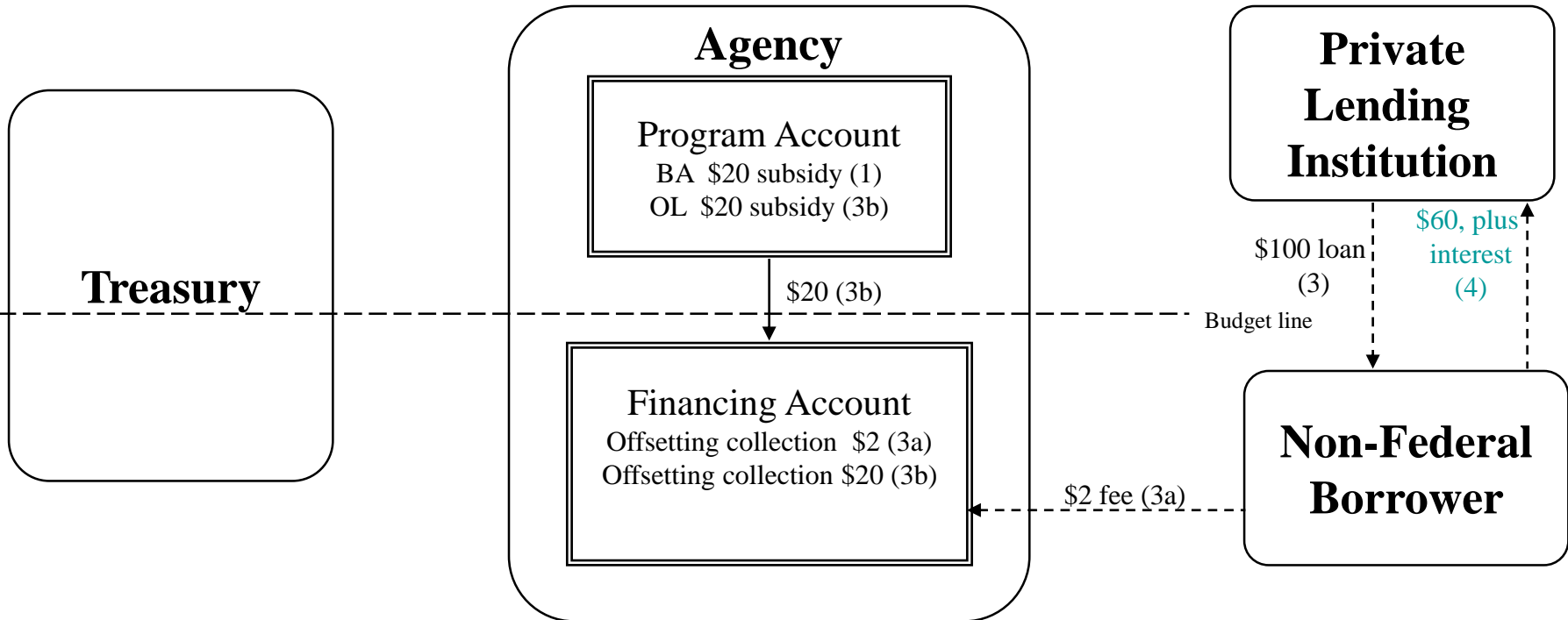
- The Borrower pays fees (if any), interest, and principal to the financing account, under the terms of the contract over time.
- If the subsidy rate is accurate, the Borrower will make payments to the financing account exactly in the amount necessary to repay the original Treasury borrowing (\$80) plus 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 a 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 are returned to the general fund via the



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.



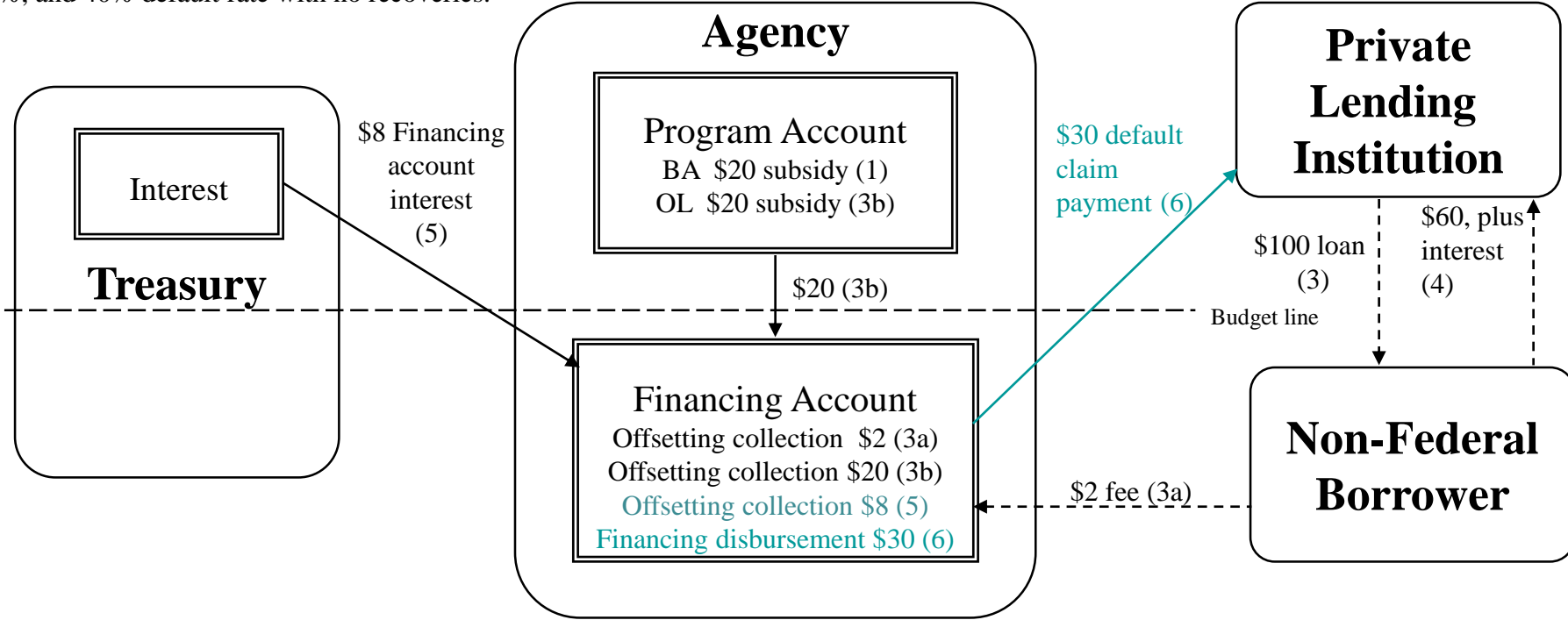
1. Congress appropriates \$20 in subsidy budget authority (BA) to the program account.
2. Lending Institution and Borrower sign loan agreement for \$100 loan (commitment), obligating \$20 for subsidy in the program account.
3. When the Lending Institution disburses the loan to the Borrower:
 - a. The Borrower pays a 2% upfront fee to the Agency, which is deposited in the financing account.
 - b. The program account outlays \$20 in subsidy to the financing account, which records an equal amount of offsetting collections.
4. The Borrower pays principal and interest to the Lending Institution under the terms of the contract over time.



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 obligations.
- If the subsidy is not accurate, a reestimate will be made as necessary: (1) additional subsidy is provided via the program account to the financing account to cover the amount of the reestimate or (2) excess funds are returned to the general fund via downward reestimate receipt account



Subsidy Reestimate

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Annual update of the subsidy cost of outstanding loans and guarantees

- Reflects actual and updated estimates of future cashflows
- Assets and Liabilities true-up: End-of-year financing account net balance, compared to present value of future cashflows

Types of reestimates:

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

Covered by permanent, indefinite authority.



Types of Subsidy Reestimates

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Interest Rate Reestimate:

- ❑ Difference between estimated discount rates and actual Treasury 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	Original Subsidy Rate		Reestimated Subsidy Rate	
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
Original:					
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
Reestimate					
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 subsidy estimate.
- ❑ Interest on the reestimate is calculated using the cohort interest rate: 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
- ❑ If a modification results in an increase in cost, it requires an appropriation in advance



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”

http://www.whitehouse.gov/sites/default/files/omb/assets/a11_current_year/s185.pdf

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

http://www.whitehouse.gov/omb/circulars_a129rev/

Budget Publications

- Federal Credit Supplement (PDF and Excel):

<http://www.whitehouse.gov/omb/budget/Supplemental>



For More Information (continued)

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Other OMB

- Your Program Examiner

- Federal Credit Support Page:

 - <https://max.omb.gov/community/x/6gLuFQ>

 - OMB Credit Subsidy Calculator 2, Credit Discount Rates

- Credit Crew: CSC2@omb.eop.gov

U.S Treasury Financial Management Service

- 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>