



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

January 30, 2012

### H.R. 3581 Budget and Accounting Transparency Act of 2012

*As ordered reported by the House Committee on the Budget  
on January 24, 2012*

#### SUMMARY

H.R. 3581 would modify the budgetary treatment of federal credit programs. The bill would amend the Federal Credit Reform Act of 1990 (FCRA) to require that, beginning in 2014, the cost of direct loans or loan guarantees be recognized in the federal budget on a fair-value basis using guidelines set forth by the Financial Accounting Standards Board. A fair-value approach to accounting for the cost of federal loans and loan guarantees would produce estimates of costs that either correspond to or approximate the value of these loans or guarantees to buyers in the private market.

The bill also would require that the federal budget reflect the net impact of programs administered by Fannie Mae and Freddie Mac; federal agencies post budget justifications on public Web sites on the same day they are submitted to the Congress; and the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) prepare studies on the costs of federal insurance programs and the historical application of the budgetary terms revenue, offsetting collections, and offsetting receipts.

The proposed changes to the budgetary treatment of federal credit programs would increase the estimated costs of such programs compared to measures used under current law. (This legislation would not change the terms of such credit programs, but would change what is recorded in the budget as the cost of credit assistance.) CBO estimates that if fair-value procedures were used to estimate the cost of new credit activity in 2012, the total deficit for the year would be about \$55 billion greater than the deficit as measured under current estimating procedures. Because that increased cost would stem from a change in concepts and definitions used to prepare federal budget documents rather than a change in agencies' legal authority to operate credit programs, it would not be an additional cost attributed to H.R. 3581 for Congressional budget enforcement procedures.

CBO estimates that measuring the cost of federal credit programs on a fair-value basis as prescribed under H.R. 3581 would increase agencies' administrative costs to operate such programs. In addition, the requirements to post budget justifications on the Internet and produce studies would require additional resources. Assuming appropriation of the necessary amounts, CBO estimates such costs would total \$14 million over the 2012-2017 period. Pay-as-you-go procedures do not apply to this legislation because it would not affect direct spending or revenues.

H.R. 3581 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

The estimated budgetary impact of H.R. 3581 is shown in the following table. The costs of this legislation fall within all budget functions that include administrative costs associated with federal credit programs.

	By Fiscal Year, in Millions of Dollars						
	2012	2013	2014	2015	2016	2017	2012-2017
<b>CHANGES IN SPENDING SUBJECT TO APPROPRIATION</b>							
Estimated Authorization Level	1	5	5	1	1	1	14
Estimated Outlays	1	5	5	1	1	1	14

## **BASIS OF ESTIMATE**

Agencies would face various administrative challenges to develop and execute new requirements that would be imposed by a change in budgetary treatment for credit programs. CBO estimates that the procedures prescribed by the bill would require federal agencies that administer credit programs to update their accounting and budget preparation systems, procure advisory services, and hire additional staff with expertise in financial asset valuation. In addition, the bill's requirement that all agencies post uniform, searchable, and sortable budget justifications and that OMB and CBO produce two studies would increase administrative costs. Based on information about the cost of carrying out similar activities and information from some federal agencies that operate major credit

programs, CBO estimates that implementing H.R. 3581 would cost \$14 million over the next five years, assuming appropriation of the necessary amounts.

## **COMPARISON OF ALTERNATIVE BUDGETARY TREATMENTS OF CREDIT PROGRAMS**

The federal government provides credit assistance in the form of direct loans and guaranteed loans. Most of that assistance is offered through a few large programs; together, the Federal Housing Administration’s (FHA’s) mortgage guarantee programs and the Department of Education’s student loan programs account for about 60 percent of outstanding federally backed credit.<sup>1</sup> Other major credit programs include the Department of Veterans Affairs’ mortgage guarantee programs, the Department of Agriculture’s credit programs for rural utilities, and the Small Business Administration’s loan and loan guarantee programs. More than 150 smaller credit programs currently provide assistance for a variety of other activities including international trade and investments in new energy technologies.

H.R. 3581 would amend FCRA to modify procedures for calculating the budgetary cost of federally backed credit programs. As discussed below, such changes would increase the estimated cost of such programs for budget purposes, thereby increasing the estimates of future deficits.

### **FCRA Procedures**

FCRA specifies that the budgetary cost of federally backed credit programs are calculated and recorded on an accrual basis—unlike most items in the federal budget, which are shown on a cash basis. The main distinction between cash and accrual accounting is that, whereas under cash accounting expenditures are recorded in the years when cash payments are made, on an accrual basis the estimated lifetime cost of a direct loan or loan guarantee is recognized in the year when the loan is approved.

Under FCRA, the budgetary impact—or subsidy cost—of a direct loan or loan guarantee is calculated as the net present value of expected cash flows over the life of the loan. For a direct loan, net cash flows include payments of principal, interest, and any fees paid by the borrower less any amounts lost due to borrower default. For a loan guarantee, fees collected from the borrower and guarantor, and payments made to make the guarantor

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<sup>1</sup> The term federally backed credit is used to encompass all federal loan and loan guarantee programs. For this cost estimate, these programs do not include the credit assistance provided by Fannie Mae or Freddie Mac, or the Troubled Asset Relief Program.

whole if the borrower defaults would be included in the cash flows. The net present value is estimated by discounting the expected cash flows to the time of loan disbursement. FCRA specifies that discounting calculations use the interest rates on Treasury securities with maturities comparable to the terms of loans. For example, cash flows projected in the year following disbursement are discounted using the rate for one-year Treasury securities; those five years out are discounted using a five-year rate; and so on.

## **Cost of Credit Programs Under FCRA**

Over the 2000-2007 period, the face value of loans made or guaranteed by the federal government (known as the aggregate volume of credit activity) averaged \$310 billion and estimated subsidy costs under FCRA averaged \$6.4 billion annually—for a net, average subsidy rate of 2 percent of aggregate loan volume. In contrast, the aggregate subsidy rate for programs covered by FCRA was negative in each fiscal year over the 2008-2011 period; that is, the government’s lending activities generated an accounting profit which reduced measures of budget deficits in those years. That swing from positive to negative FCRA subsidies stemmed primarily from legislative and programmatic changes to student loans and FHA mortgage insurance. For 2011, CBO estimates that programs covered by FCRA reduced the deficit by \$22 billion.

## **Fair-Value Procedures**

H.R. 3581 would require that subsidy estimates for federal credit programs be calculated on a fair-value basis. The Financial Accounting Standards Board defines the fair value of a loan as the price that would be received if it were sold in a competitive market. Similarly, the fair value of a loan guarantee is the price that would have to be paid to induce a market participant to assume the guarantee commitment.

In practice, differences between FCRA estimates and fair-value estimates stem from differences in the effective discount rates used to calculate the present value of future cash flows. While FCRA requires that subsidy calculations use Treasury rates to discount future cash flows, fair-value estimates employ rates that also incorporate a premium for market risk. Private investors require additional compensation for market risk because investments exposed to such risk are more likely to have low returns when the economy as a whole is weak and resources are scarce and highly valued. By incorporating a market-based risk premium, fair-value estimates would recognize that the government’s assumption of financial risk involves costs that exceed the average amount of losses that would be expected from defaults.

## Cost of Credit Programs Under H.R. 3581

A consequence of switching to fair-value accounting is that the estimated budgetary cost of credit programs would appear higher than under FCRA. CBO has provided detailed supplementary information to the Congress about the fair-value cost of certain federal credit and insurance programs and how they compare to FCRA estimates.<sup>2</sup> To illustrate the change in measures of future deficits under the bill, CBO has also analyzed the cost of federal credit programs in 2012 on both a FCRA and fair-value basis.

CBO estimates that if fair-value procedures were used to estimate the cost of credit programs in 2012, the total deficit would be about \$55 billion greater than the deficit as measured using current estimating procedures. That increase would be split between the mandatory and discretionary portions of the budget:

- On a FCRA basis, CBO estimates net subsidies for mandatory credit programs would reduce the federal deficit by about \$30 billion in 2012. On a fair-value basis, the cost of those same programs would be roughly \$35 billion greater. Starting in 2014, the budget would record increased budget authority and outlays for those programs; however, because those programs are mandatory, fully funding them on a fair-value basis under H.R. 3581 would require no further Congressional action.<sup>3</sup> The estimated cost of legislative proposals for new mandatory credit programs or changes to existing programs (such as student loans) would be higher using fair-value procedures than they would be on a FCRA basis.
- Net receipts from discretionary credit programs reduced the estimated cost of appropriations in 2012 by about \$4 billion on a FCRA basis. On a fair-value basis, CBO estimates that those same programs would require additional appropriations of about \$20 billion. To account for the increased need for future appropriations to cover higher subsidy costs when measured on a fair-value basis, H.R. 3581 would allow the caps on discretionary appropriations set forth in the Budget Control Act of 2011 to be adjusted upward.

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<sup>2</sup> *Costs and Policy Options for Federal Student Loan Programs* (March 2010),  
<http://www.cbo.gov/ftpdocs/110xx/doc11043/03-25-StudentLoans.pdf>

*Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair value Basis* (May 18, 2011),  
[http://www.cbo.gov/ftpdocs/120xx/doc12054/05-18-FHA\\_Letter.pdf](http://www.cbo.gov/ftpdocs/120xx/doc12054/05-18-FHA_Letter.pdf)

*Federal Loan Guarantees for the Construction of Nuclear Power Plants* (August 2011),  
<http://www.cbo.gov/ftpdocs/122xx/doc12238/08-03-NuclearLoans.pdf>

<sup>3</sup> Mandatory spending refers to budget authority that is provided in laws other than appropriation acts and the outlays that result from such budget authority.

The Administration currently records transactions related to the Treasury's conservatorship of Fannie Mae and Freddie Mac on a cash basis in the federal budget. CBO estimates that the net impact of the activities of those entities would cost an average of about \$3 billion per year on a fair-value basis over the next 10 years.

**PAY-AS-YOU-GO CONSIDERATIONS:** None.

**INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT**

H.R. 3581 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local or tribal governments.

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